

About IREF

IREF is a private institute founded in 2002 by representatives of the civil society coming from the academic as well as business worlds. It is designed to be an efficient platform for the investigation of fiscal and taxation policies. Taxation is a many-faceted issue and existing studies are mostly incomplete if not biased. It is the aim of IREF to explore systematically and completely questions related to taxation and public finance.

IREF has a strong European dimension. Tax studies can no longer ignore the process of globalisation and its consequences in terms of tax competition. In particular, tax authorities are currently under the strain of two opposing forces: centralisation and harmonization on one hand, devolution and competition on the other. It is IREF's intention to reintroduce in this debate the essential links between tax competition and individual freedom.

In order to achieve its goals, IREF relies on a network of specialists. Today, a team of over 25 scholars or professionals--economists and lawyers--report regularly on the quantitative as well as qualitative evolution of the fiscal systems of their respective countries or regions.

Besides its Yearbook on Taxation in Europe, IREF is editing books, reports, briefs and academic studies on topics related to taxation and public finance. Those studies together with general information on taxation in Europe can be found on IREF website at: <http://www.irefeurope.org>



Taxation in Europe 2010

Institute for Research on Economic and Fiscal Issues

The yearly report on the evolution of European tax systems

**presented by
IREF with contributions from 22 countries**

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Taxation in Europe 2009: a year of transition. Towards what...



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A financial crisis or the crisis of the modern State?

Prior to the 2008 crisis, the overall tax ratio in the EU-zone had been increasing for three years in a row and was back to the record level of 1999. Then came the crisis and with it the perspective of a drop in gross domestic product and, consequently, of tax revenues. The table below confirms that, with the exception of Poland, production has been decreasing everywhere in 2009. Where data on tax revenues are available, we also get confirmation that tax revenues in many cases went down; they represent a lower share of a lower GDP (again with some exceptions such as Bulgaria, Lithuania or Switzerland).

Clearly, most—may be all—of the fall in the overall tax ratio that we observed in 2009 had little to do with the desire to reduce public expenditures. If it has certainly something to do with the desire to boost

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consumption, with more generous tax allowances for instance, the truth is that it was *imposed* on government. It was, indeed, an instance of a fiscal constraint tying the hands of governments in their attempts to react to the crisis. And the constraint was reinforced by the fact that many European countries were, even before the crisis occurred, already struggling to maintain public debt at a reasonable level.

What did governments do in such a tight financial situation? Again, the data speak clearly: governments did their best to maintain public expenditures. As a matter of fact, the share of public expenditures to GDP increased almost everywhere (see table). This increase has two causes. First, governments have attempted to boost their economy with new expenditures such as incentive schemes to replace old cars with new ones. But more importantly many governments were stuck with mandatory spending that automatically generated an increase of the share of government spending to GDP when GDP fell off.

Whatever may be our appreciation of the success of these fiscal and budgetary policies, a pressing question remains: what comes next? Again, looking at the table we clearly see that public debt and public deficit have both soared literally everywhere. Will the various governments be able to reduce public spending and public debt in the future, and if not, what will happen? Some may point out the alleged virtue of so-called automatic stabilizers and argue that when growth returns, tax revenues will automatically increase and absorb the debt; and indeed many budget laws passed in 2010 are based on this kind of scenario. There are good reasons, however, to question such optimistic predictions. For what 2009 teaches us is precisely that most governments have few degrees of freedom. Deficits are structural and debts are not here to promote investment but mandatory expenditures; there is therefore little hope that things will go back to normal when growth reappears. Could it be then that Nation States have just grown too large?

One escape route for 2010 could be to tax personal incomes a bit more (we must remember that, as we will see later and contrarily to what is often claimed, the implicit rate on capital income has increased). But isn't this route

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a dead end? Up to what point will people be ready to work and invest to pay for benefits clearly accruing to others?

Global economic and public finance outlook

| | Public deficit as % GDP | Public debt as % GDP | Public Spending (% GDP) | Total tax revenues /GDP | SS contrib. (% GDP) | Growth of Real GDP (%) | GDP per capita (USD) |
|-------------|-------------------------|----------------------|-------------------------|-------------------------|---------------------|------------------------|----------------------|
| Austria | 4.3 | 79.1 | 51.9 | 42.9 | 15.9 | -3.6 | 37858 |
| Belgium | 5.89 | 100 | 50.1 | 44.3 | 16.1 | -3.1 | 35289 |
| Bulgaria | 1.0 | 14.7 | 40.7 | 33.0 | 8.4 | -5.0 | 11800 |
| Croatia | 2.9 | 29.3 | 40.8 | 38.8 | 12 | -5.8 | 18600 |
| Czech Rep. | 6.6 | 35.5 | 42.1 | 36.6 | 5.6 | -4.8 | 24631 |
| Denmark | 2.0 | 38.3 | 51.5 | 47.4 | 1.3 | -4.9 | 36808 |
| France | 7.9 | 77.4 | 55.6 | 41.0 | 17.9 | -2.2 | 33090 |
| Germany | 3.9 | 73.4 | 48.2 | 36.4 | 15.4 | -5.0 | 35432 |
| Greece | 12.7 | 113.3 | 48.3 | 31.3 | 11.7 | -2.0 | 28896 |
| Ireland | 12.0 | 65.8 | 42.0 | 28.3 | 4.4 | -7.5 | 41493 |
| Italy | 5.3 | 115.1 | 49.3 | 42.8 | 13.4 | -5.0 | 31253 |
| Lithuania | 9.5 | 15.6 | 37.4 | 32.9 | 14.7 | -15.0 | 18000 |
| Luxembourg | 2.3 | 13.5 | 37.7 | 38.3 | 9.9 | -3.4 | 84713 |
| Netherlands | 3.4 | 60.0 | 48.3 | 37.5* | 14.5 | -4.0 | 41063 |
| Norway | 9.6 (+) | 56 | 40.0 | 39.8 | 8.9 | -1.5 | 58717 |
| Poland | 6.4 | 51.7 | 38.6 | 39.6 | 11.4 | 1.7 | 17294 |
| Portugal | 9.3 | 75.4 | 46.0 | 36.5 | 11.8 | -2.7 | 23283 |
| Romania | 7.8 | 21.8 | 38.2* | 28.6* | 9.5 | -7.1 | 11100 |
| Slovakia | 6.34 | 37.1 | 42.0 | 29.3 | 11.8 | -4.7 | 22141 |
| Spain | 9.6 | 59.3 | 41.1 | 33.0 | 12 | -3.6 | 31455 |
| Sweden | 2.1 | 42.0 | 54.1 | 46.6 | 5.6 | -4.9 | 36938 |
| Switzerland | 0.0 | 41.4 | 31.5 | 23.5 | 7.6 | -1.5 | 42783 |
| UK | 12.6 | 69.1 | 47.5 | 35.7 | 8.4 | -4.9 | 35631 |
| USA | 11.2 | 83.9 | 38.8 | 26.9 | - | -2.4 | 47186 |

***Red** = increase from 2008 to 2009 ***Blue**=decrease from 2008 to 2009

***Yellow**=2008 data (2009 data not available)

When not from IREF's reports, data are from the sources below: For Social Security: Eurostat. (tec00019); For Croatia: "Annual report of the Ministry of Finance 2008"; For Total tax revenues: OECD-Stat; For Romania: Minister of finance Romania; For Public spending: OECD Economic Outlook, General government. total outlays, table 25; For GDP/capita: OECD-Stat 2008 data (except for Croatia, Bulgaria, Romania, Lithuania: CIA world fact book)

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Another solution could be to borrow more on the financial market. This is relatively easy; so easy that it is apparently hard for some governments to resist the temptation. But this route, as is well known, is also full of unpleasant surprises. First, there is the cost for the coming generations who will have to make the efforts that their parents kept postponing. Second, because the money lent to governments for mandatory expenditures is missing for private investment. And finally because, as the experience of Greece reminds us, actors on the financial market traditionally become reluctant at some point to finance social benefits and inefficiencies that do not create wealth.

The misnamed “financial crisis” of 2008 reveals the urgency to reflect on the role of the State for the coming years. Unfortunately, little was done in 2009 in that direction.

Various reactions to the crisis

Still, it would be a dangerous simplification to put all European governments in the same basket. The reports included in this volume allow us to single out three key parameters to understand the situation facing each country.

The first one is of course the state and structure of public finance prior to the crisis. To make it short, some were relatively fit when the crisis broke (for instance, Norway, Luxembourg, Bulgaria and Switzerland), while others were “fat” (France, Germany, Italy, UK, Greece, etc.) Countries in the latter group

“Fiscal stimuli based upon tax cuts are more likely to increase growth than those based upon spending increases. As for fiscal adjustments, those based upon spending cuts and no tax increases are more likely to reduce deficits and debt over GDP ratios than those based upon tax increases. In addition, adjustments on the spending side rather than on the tax side are less likely to create recessions.”

Alesina and Ardagna, *NBER working paper 15438*, October 2009

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were of course in a delicate position: they were reluctant to opt for a genuine fiscal stimulus (tax cuts), and they were also reluctant to focus on fiscal adjustment (spending cuts). Short-term considerations, such as the desire to avoid a further increase of unemployment, were therefore bound to prevail, and a “pragmatic” stance was adopted which in practice translated into incoherent economic policies.

Secondly, the crisis hit differently small economies relying heavily on exports (Slovakia, Croatia, Lithuania, Switzerland) and large countries such as Germany, Italy or France; especially those with a highly developed public sector. If small, open economies were hit badly (Slovakia: -4.7% of GDP, Lithuania: -15%, compared to France, -2.2%), they are also more likely to recover quickly as growth takes off again in the global economy.

Finally, countries diverge in their degrees of political stability. Hence, 2009 was election year for Bulgaria, Germany and Romania. It was also a year of political instability in the UK, Czech Republic and in Croatia. In most of those countries no fundamental changes were introduced in economic policies. This was good news where economic policy was globally sound, like in Bulgaria. It was bad news when the country needed reforms.

Evolution of Tax Mix

Fundamental in the design of a fiscal policy is the choice of the tax mix, that is, how should the fiscal burden be allocated. This choice does (or, at least, should) take into account the long-term economic impact of the tax mix (whether it will bring more or less growth). It is also influenced by political considerations such as the desire to redistribute income. Hence, a mix of high direct taxation and low indirect taxation typically allows for more redistributive policies. On this issue, the reports shade some light but also underline the complexity of the issue.

A first observation is that little happened in 2009 as far as tax rates are concerned. In the table below, the green—which is here the colour signalling

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“no change”—prevails. Some rates were cut, but these were only marginal (with the possible exception of Lithuania) and concerned personal as well as corporate income taxes. Also, excise duties tended to increase in new members countries, but this is largely due to EU regulation.

But it is not enough to look at tax rates; tax bases are just as important if one wishes to assess the fiscal policy and in particular the tax mix of a country. For instance, although Romania kept its income tax flat in 2009, new, regressive tax allowances were granted that reintroduce through the back door part of the progressiveness of taxation that had been previously kicked out through the front door. In the same way, while indeed corporate income tax rates have been decreasing in the past decade and the rates remained mostly unchanged in 2009, the overall taxation of capital has been increasing, partly because the tax base of the corporate income tax has been enlarged and partly because changes have been introduced in capital stock and wealth taxation (France, for instance, gets more revenues from business tax and wealth tax than from corporate income tax). As pointed out in the 2009 report from the European commission’s Taxation and Customs Unit (Main results, page 12): “despite significantly lower corporate tax rates, partly influenced by cyclical factors, the revenues from taxes on capital have been growing again in importance during the years 2003–07, both in terms of GDP and as a share of total taxation”.

If looking at the evolution of tax bases, as we do in these reports, does not provide us with a clear view on the tax-mix trend, it nonetheless protects us against hasty conclusions drawn from the simple observation of tax rates.

Finally, let us note what did not happen in 2009. In particular there was no major reform in health insurance and pension schemes. The trend there remains towards tax-financed pensions. Also, the enthusiasm for environmental taxes is somehow eroded, despite the political discourse that suggests the contrary.

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Main tax rates in 2009

| | Personal Income* | Corporate Inc. | VAT* | Excise | Wealth tax |
|-------------|--------------------|----------------|------------------------|--------|------------|
| Austria | 0/36.5/43.21/50 | 25 | 10/20 | | no |
| Belgium | 25/30/40/45/50 | 24.25/31/34.5 | 6/12/21 | | no |
| Bulgaria | 10 | 10 | 7/20 | UP | no |
| Croatia | .../45 | 20 | 0/10/23 | | |
| Czech Rep. | 15 | 20 | 9/19 | UP | no |
| Denmark | 8/43.5/56.1 (2010) | 25 | 25 | | no |
| France | 5.5/14/30/40 | 15/33.33/36.6 | 2.1/5.5/19.6 | | Yes |
| Germany | 14/42/45 | 29.83 | 7/19 | | no |
| Greece | 0/15/25/35/40 | 25 (max) | 4.5/9/19 | UP | no |
| Ireland | 20/41 | 12.5 | 13.5/21.5 | | no |
| Italy | 23/27/38/41/43 | 31.4 | 4/10/20 | Down | no |
| Lithuania | 15 | 20 | 19 | UP | no |
| Luxembourg | 0/8/10/.../38 | 20/21 | 15 | UP | Yes * |
| Netherlands | 33.6/.../52 | 20/25.5 | 6/19 | | no |
| Norway | 28/.../47.8 | 28 | 8/14/25 | | Yes |
| Poland | 18/32 | 19 | 0/3/7/22 | | no |
| Portugal | 10.5/.../42 | 12.5/25 | 5/12/20 | | no |
| Romania | 16 | 16 | 5/9/19 | UP | no |
| Slovakia | 19 | 19 | 10/19 | UP | no |
| Spain | 24/28/37/43 | 25/30 | 4/7/16 | | Yes * |
| Sweden | 29/.../50 | 26.3 | 0/6/12/25 | | no |
| Switzerland | 21.7 (avg.) | 21.2 (avg.) | 8 | | |
| UK | 20/.../50 | 21/28 | 17.5 (15 temporarily) | UP | no |
| USA | 10/.../35 | 15/.../39 | 0/.../6.87 (sales tax) | | no |

Green=no change in 2009; **Blue**=decreased rate; **Red**=Increase rate

Sources: IREF country reports and Eurostat: "Taxation Trends in the European Union, 2009" (*) PIT: some countries there have tax bases Only changes in *rates* lead to change from green to blue or red). (*) VAT: Many countries have preferential rates for some specific goods. Only changes in *rates* lead to change from green. (*) Some countries have wealth tax only for corporations or with 100% rebate.

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Tax competition, bank secrecy and individual freedom

Clearly, governments choose their fiscal policies aware of the competitive environment that surrounds them. Tax competition is an avoidable reality and has often been assessed in terms of tax burden; a fundamental teaching of economics being that individuals take tax burden into account in their choice of residency and activity. If we observe no fierce competition on tax rates in 2009, there was however a debate (at times violent) between governments of various European countries and the European Commission regarding rights to be entrusted to tax authorities. We can get a flavour of these debates in the reports on Luxembourg, Switzerland, Italy, Belgium or France.

To start with we observe a clear and understandable desire to create incentives for individuals to repatriate their funds to their country of origin and more generally to increase the level of tax residency in the country. This is a form of competition for the tax base.

But what is taking place at present is not the ordinary competition between jurisdictions to offer the best quality/price alternative. What is different here is that tools used by some of the protagonists often border violation of fundamental rights and are used with the approval of the European Commission and the OECD. What is at stake in this debate is therefore essential to the future development of Europe and to individual freedom.

“The Swiss government also stated that it “fully endorses” banking secrecy and “resolutely rejects” any form of automatic exchange of information. The implementation of such an automatic exchange of information remains the official policy of the European Union’s Commission, with Austria and Luxembourg as the last two remaining EU member countries refusing to implement it as long as Switzerland holds on to its own banking secrecy laws.”

Pierre Bessard, *IREF 2010
Yearbook on Taxation.*

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It is vital for the preservation of individual freedom to limit the power of tax authorities to investigate individuals' private lives. Surely, the mere existence of tax evasion, tax fraud, money laundering and terrorist organizations—four phenomena that should not be confused and cannot be bundled without danger—is not sufficient to give unlimited power to the tax man. But the heavy trend in Europe (and in the USA for that matter) is nonetheless to expand these limits ever further. If our basic, fundamental rights are thus endangered this could direct investments away from Europe in the future. Tax competition knows no border. Let us hope that it is not too late for European governments and European citizens to reflect on this crucial dimension of the problem.

Main results to be found in the reports

Austria

Austria is typically a high-tax country in Europe and we have to go back at least to the years 2004-2005 to observe a substantive fiscal reform (e.g., Corporate Income Tax rate reduced from 34 to 25 %) with the exception of the death and gift taxes in 2008. The changes brought in 2009 concern a reduction of tax rates on salaries and income and further tax exemption and tax credit for family with children. More will have to be done, especially to tackle a worrying public debt (some 70% of GDP).

Belgium

A substantial range of measures was enacted to respond to the crisis. Besides this, if taxation is characterized by the heavy burden of direct taxation (CIT at 33.99% and top PIT marginal rate at 50%), we also clearly observe the desire to attract businesses. To this must be opposed, however, the recent decline in bank secrecy (Belgium was for a while on the OECD grey list).

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Bulgaria

Certainly the most interesting fact is that, despite the economic crisis and despite elections, Bulgaria sticks to a flat-low tax policy, with PIT and CIT at 10%. The possibility to get rid of the dividend tax was discussed but no agreement was reached. Even the balanced budget policy was maintained and the new government seems committed to the same, sound, fiscal and budgetary policy. Good news for Bulgaria.

Croatia

The situation is rather gloomy: Croatia maintains very high rates on income tax, value added tax, and social contributions. To support the economy throughout the crisis a “special-crisis tax” was established which was the object of bitter political fight. Still, there was a substantial drop in tax revenues and GDP contracted by 5.7%. On the positive side one can notice efforts to modernize the tax administration thereby reducing its cost.

Czech Republic

In March 2009, the government had to resign and the country’s economic policy has since been then designed by the “National Economic Council”. This transitory government has done little but, still, it opted for a supply side response to the crisis (cut in CIT and social contributions). Will this last? Probably not. Tax increases and higher public expenditures are on the menu of the coming budget and public deficit is calling for attention. The Civic Democratic Party proposed that, whenever MPs approve a budget deficit, they should be punished by a wage decrease and vice versa!

Denmark

Things should be moving soon in Denmark. After more than a decade without substantial reform, top marginal income tax rates are scheduled to decrease in 2010 (from 63 to 56.1%). There will also be higher transfers to low-income families and individuals. The tax burden will be shifted from individuals to corporations and further green taxes are to be introduced. The global “tax freeze” (no new tax without some tax cuts elsewhere so that tax burden remains unchanged) in place since 2001 is likely to vanish soon. Things are not necessarily moving in the right direction.

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France

As was the case with most European countries, France chose to respond to the crisis with increased government spending at the cost of larger debt and larger deficits; a response much in line with the “voluntarism” of the current President. The results so far have been predictable: increases in the public deficit and public debt, reaching respectively nearly 8% and 80% of GDP. Meanwhile, the social security account broke a new record with a € 20 billion deficit for the year. According to the official government line, things will soon be back on track thanks to a new € 30 billion loan contracted by the government in 2010 to be invested in the “technology of tomorrow” and in education... On purely fiscal grounds, 2009 saw a new attempt to reform the (heavy) local business tax. If this was partly successful, the government had to backtrack on a much promised carbon tax.

Germany

Small steps and piecemeal reforms have characterized German tax policy during the last year. There have not been any fundamental reform measures. A “Law for accelerating economic growth” was passed that contained mainly pragmatic short-term measures (reduced PIT, increase of tax-free allowances for children and of direct transfers for children, some reduction in inheritance tax, enlargement of the possibility to deduct interest payment from tax base, etc.). The new liberal coalition (September 2009) was supposed to introduce a sharp reduction in PIT and suppress the local business tax. But the state of public finances is not healthy and the new constitutional limit on public debt might push the government to postpone announced changes. Fundamental reforms will unfortunately have to wait.

Greece

The public finance crisis of Greece, with a deficit of 12.7% of GDP, was at the centre of all debates in 2009. What is at stake, besides the level of indebtedness, is the ability of Greece to pay back its debt. The inefficiency and corruption of the public sector and of tax authorities is obvious. At most 70% of imposed taxes are collected and the grey economy is the most developed in OECD countries. In 2009, after a short period of lower taxes

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(e.g., lighter inheritance tax, more favourable regime for property grants from parents to children), the newly elected socialist party will move towards more progressive PIT, higher excise taxes, higher taxes on dividends, capital gains, less favourable regime for parental gifts, and a new “emergency contribution”. But if tax evasion remains what it is, the crisis is far from over.

Italy

Tax changes during 2009 have been a combination of tax rebates to sustain family incomes and economic activities and of tax increases made necessary to avoid excessive overshooting of net public sector borrowing with respect to the 3% threshold imposed by the Maastricht criteria. Hence, some “oxygen” was given to firms (e.g., tax credit for investment in—preferably Italian—machinery) and consumers (VAT reduction on newly acquired—and preferably Italian!—cars, incentives to refurbishment of dwelling). There was also a new tax amnesty for those who repatriated their assets. As for local tax autonomy, a new law on local finances threatens it and no one seems to care.

Lithuania

Late 2008, elections brought to power a right-wing coalition with promises of lower taxes. Instead, the coalition came up with a sweeping reform (amending 106 articles) that meant a higher tax burden... CIT, VAT and excise duties had their rates lifted. Personal income tax remained flat, however, and its rate was even lowered from 18 to 15% (but this “flatness” is blurred with progressive exemptions). Later on in the year, CIT rate was brought back to its initial level (15%) but VAT rate was further increased to 21%. What saved Lithuania could be that neighboring countries’ performances are even worst.

Luxembourg

Due to its reasonable level of indebtedness, Luxembourg was in fairly good position to confront the economic crisis. No major change was enacted, but few extra tax incentives were introduced, such as a tax relief for company hiring young people. Amendment to the Luxembourg VAT legislation was introduced to transpose the new EU “VAT package”. The future is highly dependent on the ability of Luxembourg to maintain its leading position in financial services. Competition from neighbouring countries is fierce. Many

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double taxation treaties have been negotiated in 2009 that do not, however, imply automatic transfer of information. The competitive position, as of today, stays strong.

Netherlands

Decision was made to boost entrepreneurship by fiscal means. Profits will be less taxed thanks to a broadening of the “patent box” system (income derived from R&D is taxed at reduced rate), new tax exemptions for SMEs, more tax credit for small scale investments, easier transfer of ownership of small business, etc. Besides those measures, there was a small fiscal push for consumption (e.g., targeted VAT reduction) and continued effort to improve tax administration and intensified war against tax evaders (a new fine is set at 300% of concealed income).

Norway

Life is sometimes easier when you get oil and gas! Throughout the crisis, consumer demand remained stable and industry was little affected. Nonetheless, expansionary and fiscal measures were taken in 2009. The approved 2009 Fiscal Budget was indeed the most expansionary in more than 30 years. Overall fiscal stimulus in 2009 is estimated at 3% of non-oil GDP. The Central Bank’s key policy rate hit its lowest level (1.25%) in June 2009. Apart from this, no major change in tax rates took place and the target was to maintain a constant overall tax level. What comes next is likely to be lower rates (back to their 2004 levels) and broader bases; and of course green taxes (carbon tax introduced April 1st 2010). The wealth tax remains with an increased threshold, however.

Poland

An impressive 1.2% GDP growth in the midst of a recession looks like promising sign. But one must not ignore many alarming signals: budget deficit is at 6.4% and the debt is increasing rapidly. Even the overall tax burden is not that encouraging: if it is below EU average, it is much above what you observe in countries with similar level of economic development. In 2009,

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PIT has been lowered (two brackets instead of three and lower rates). CIT and VAT rates remained unchanged while their bases were somewhat broadened. Also revealing is the fact that entrepreneurs perceive the tax administration and tax laws to be very costly and cumbersome and, indeed, impediment number one to entrepreneurship! May be one could start by fixing this. But that will not be enough.

Portugal

We will probably have to wait still a few years before we see the long waited take-off of the Portuguese economy. Government's reaction to the crisis was the all too familiar one: no major fiscal reform but the distribution of tax exemptions and tax credits to boost demand and support targeted sectors (e.g., housing and green energy) or employment. The introduction of a lower rate for CIT is one of the rare exceptions. Meanwhile public deficit rose to an impressive 9% of GDP, which makes an increase of VAT rate likely.

In 2009 a major report on the fiscal apparatus of the country was produced that identifies the main problems and respective solutions. What is needed now is a real political will to move things in the right direction.

Romania

The economic downturn combined with two successive electoral years had a deep negative impact on Romania's public finances and put in jeopardy the architecture of the fiscal system. Romania preserved the rates of main taxes (personal income tax, 16%, corporate income tax, 16%, and VAT, 19%). Remarkable enough, flat tax on personal income survived after a change in political majority (although allowances are numerous and changing). However, a devastating "minimum corporate income tax" was introduced that strongly penalizes micro-enterprises, and social contributions increased again by 3.55%. Total labor based taxes are now situated between 44.50 and 55.70% of gross salary. Administrative burden (reporting frequency, number of fiscal payments, compliancy costs, quasi-taxes,...) is till very high, despite some improvements.

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Slovakia

Being a very open economy that relies heavily on exports, and although its finance sector had kept itself away from toxic products, Slovakia was badly hurt (GDP dropped by 5.7%) when a large chunk of her trading partners were hit by the economic crisis. The situation was not made easier by the switch to the Euro that occurred January 1st 2009 at a rather too advantageous rate for the Slovakian currency. To deal with the situation the government did little—putting aside usual pragmatic measures—but maintained the level of public expenditures planned before the crisis. Because tax revenue dropped sharply, this implied high deficit (€ 1.5 billion) and higher debt. PIT remains at a 16% flat rate (the government playing around with the level of allowances), some CIT deductions have disappeared and a large project to reduce cost of paying and collecting taxes is on its way. The state of the social security accounts becomes alarming.

Sweden

Since the center-right coalition came to power in 2006, the tax burden for Swedes is somehow lighter: no inheritance tax, no gift tax, no wealth tax. Still, economic calculation leads many to stay off the labor market. To bring them back in, the fourth and last step of a earned income tax credit has been implemented in 2009 and 97% of full time workers can now benefit from it. Whether the scheme will have a long run effect on the supply of labor remains to be seen. In the meantime, CIT and social contributions have been brought slightly down. 2010 will be an election year: some suggest reintroducing wealth tax and inheritance tax; many would like to do more to support entrepreneurship.

Switzerland

Swiss financial privacy policy took a dramatic turn in 2009. The Swiss government accepted to adopt the OECD standards for exchanging information in individual cases for non-resident clients of Swiss banks. As a result, Switzerland was removed from OECD's "grey list". The Swiss government still hopes to reach a win-win deal in its negotiation with the EU. In particular, a better access for Swiss financial entities to the EU market is being sought. But, the French, German and Italian governments continued to

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question Swiss privacy rules and limit access to their markets. Internally, amid mild tax reductions, the Swiss government put forward a proposal to abolish the taxation of rental value for property owners and pursued the reform of VAT.

United Kingdom

2009/2010 has been a period of phoney fiscalism in the United Kingdom. The period is sandwiched between the economic crisis, which put fiscal policy onto an emergency, and an election (May 6th 2010). Economic crisis has been marked in the UK as in most other countries by a severe worsening of the fiscal balance which has been supported for now by government borrowing and straightforward money-creation (“quantitative easing”). The political constraint of election has led to a more than usually cosmetic approach to changes in the structure of taxation. One interesting move, however, was the preparation of the “Fiscal Responsibility Act (2010)” drafted to restrain the borrowing capacity of future governments (and send positive signals to sovereign bond markets). Also worth of attention is a revitalized desire to tax the rich (or to try to) while being friendly to some targeted businesses. More significant changes in fiscal policy are expected after this May elections

Austria



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General background

While some legislative efforts were undertaken in 2009 to reduce it, Austria has still one of the highest tax burdens in Europe.

The average Austrian worker has a tax burden that is nearly fifty percent of his income; this includes social contributions, as every employee is required to fall under the social security program. According to statistics published by the OECD (Revenue Statistics, 2009 Edition), total tax revenue as percentage of GDP was for Austria at 42.9% in 2008; far above the OECD average for that year which was 35.7%.

This burden results from different forms of taxation. There are four different brackets for personal income tax. On income up to € 11,000 a year, there is no tax levied. For income between € 11,000 and € 25,000, there is an effective tax rate of 20.44% and a marginal tax rate of 36.5%. The next bracket is between € 25,000 and 60,000, and has an effective rate of 33.74% and marginal rate of 43.21%. The highest tax bracket applies to income above €

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60,000. The effective rate on such income is 33.73%, and the marginal rate is 50%. It is important to note that the marginal tax rate is the important number; this is the amount taxed on your next dollar of income. In effect, it shows you how much of the money you are about to earn that you will keep. Revenues from personal income tax make up approximately 35.84% of total tax receipts.

Corporate income tax rate stands at 25%. Collection of corporate tax makes up 9.3% of fiscal revenues in 2007 (all data from Taxation Trend in the EU, 2009 edition). A value added tax (VAT) makes up a large amount of revenue as well. There is a 20% tax on normal goods, and a reduced rate of 10% that applies to basic foodstuffs, books and newspapers, public transport and renting of residential immovable property. Revenues from the VAT tax make up 27.6% of total fiscal revenues. The property tax rate in Austria is 1%. There are also several other taxes that piece together a portion of this burden, such as a 25% tax on dividends and other taxes on various insurance and pension policies.

Public debt accounts in 2009 for an astounding 69.1% of GDP, and public spending for the same year was at 51.9% of GDP. Social security contributions come in at 16.52% of GDP. Total tax receipts number at 28.6% of GDP (sources: www.statistik.at and OECD's Economic Outlook)

Some History of Tax Policy

Efforts to improve the state of government finances in the run-up to EMU led to an increase in the overall tax-to-GDP ratio between 1995 and 1997 (from 41.3 % to 44.0 %), achieved mainly through the broadening of the base for corporate and personal income tax. Tax levels remained stable at this level until the cut in income taxation in 2000 led to a dip to 42,8 % while a rise to 44.7 % in 2001 resulted from base-broadening measure, reductions in tax credits and significantly increased tax pre-payments, stimulated by the introduction of interest charges on tax arrears. Additional reforms enacted since then have resulted in a decline of the tax-to GDP ratio to 41.8 %

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(2006). In particular the two steps of the Tax reform 2004/2005 lead to an annual tax relief of about € 3 billion (1.2 % of GDP).

Between 1988 and 2000 income tax rates were slashed and the base was broadened. The consolidation package of 2001 included the reduction of tax credits and other tax increasing measures. In 2004, Step 1 of a far-reaching tax reform focused on the reduction of the income and wage tax of low and middle-income earners. Under Step 2 a new system with four brackets came into force in 2005 replacing the old five brackets system. Further changes referred to, inter alia, the introduction of an additional children's tax credit for single parents and sole earners.

In 2005 the corporate tax rate was lowered from 34 % to 25 %, partly financed by broadening the tax base and abolishing the 10 % subsidy for the increment in investment in machinery and equipment, which had existed since 2002. A further consequence is that the deductibility of notional interest payments on additional own-capital (introduced in 2001) is rendered redundant as, while profits after deduction had been subject to the standard rate, notional interest was subject to a 25 % rate. Since 2001, tax arrears have been subject to an interest charge. This led to a jump in corporate tax receipts in that year. As part of the base broadening measures undertaken, depreciation rates for buildings have been cut, and now stand at 2 %. In recent years R&D allowances and tax credits have been increased. There is an R&D allowance of 25 % with an option for an 8 % tax credit. The training allowance is 20 % of the qualifying expenses with an optional tax credit of 6 %.

The Tax Amendment Act 2007, inter alia, focused on the environment. It contained an increase in the mineral oil tax on gasoline by three cents and on the tax on diesel by five cents as of 1 July 2007. At the same time commuter support was increased by 10 % and a negative income tax for commuters with low income was introduced. Moreover, the act aimed at strengthening tax compliance by reducing the scope for fraud. The „Ecologisation“ Act 2007 (Ökologiesierungs-gesetz 2007) contains further measures to combat climate change. As of 1 July 2008 a bonus-malus system based on carbon

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dioxide emissions is introduced into the motor vehicles tax and a split tax rate based on the sulphur content into the mineral oil tax. The Tax Securing Act 2007 in particular contained further measures to increase tax compliance. Also in recent changes, the death and gift taxes were abolished in Austria in 2008. This shows that there have been some positive changes, however few.

Recent Changes

In March of 2009 the *Tax Reform 2009* was enacted. The tax rates on salaries and income were reduced, retroactively as of 1 January 2009. In addition, a four-steps program was enacted to support families with children. For entrepreneurs, from 2010 onwards, a tax-free amount for profits of 13 % is going to replace the hitherto existing equity capital stimulation mechanism. Moreover, the tax deductibility of donations for humanitarian purposes, for development cooperation, and emergency aid has been enacted as from 2009 (source: Austrian Federal Ministry of Finance).

This is a list provided by the Federal Ministry of Finance that goes into more detail on the legislation:

- Reduction of tax rates on salaries and income
- Increase of the exemption limit and changes concerning the reduced tax rate of other receipts.
- Increase of the child tax credit from €50.90 to €58.40/month
- Analogue adjustment of the single-parent tax credit
- Introduction of a child tax-free amount of €220/child/year
- Deductibility of child care costs up to €2,300/child/year for children up to an age of 10
- Tax exemption for employers' subsidies for child care up to € 500/child/year
- Change from the tax-free amount for profits invested by entrepreneurs subject to accounting to a tax-free amount for profits as from 2010: the tax-free amount will be increased from 10 % to 13 % and the requirement for investing profits will be abolished up to € 30,000

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- Abolishment of the preferential taxation for retained profits as from 2010
- Abolishment of the preferential tax treatment of stock options as from 1 April 2009
- Tax deductibility of donations for humanitarian purposes, for development cooperation and emergency aid up to 10 % of the profits or income of the previous year
- Increase of the maximum deductible amount of contributions to churches to € 200 as from 2009.

Some of the tax reductions are an encouraging sign, but it is simply not enough. More reductions would go a long way to turn the troubling economy around. Strong rate reductions on all kinds of tax would not only help Austrian citizens, but also make Austrian businesses more competitive in Europe and worldwide.

What Next?

This can be a troubling question, especially those days. In the wake of the global economic downturn, nearly all governments call for higher taxes and more regulation. Spending is skyrocketing with various bailouts and stimulus packages, creating an unstable economic environment. There are a few tax policy changes that could reasonably be put in effect that would greatly help Austria.

A top marginal tax rate of 25% on income should be implemented in addition to the corporate tax rate of 25%. This would not be a flat tax in the most basic sense. The possible exemptions prevent it from being a true flat tax. An annual exemption of € 12.000,00 per family member could indeed guarantee that no disadvantage be inflicted to individuals with less income. Tax relief for middle-income families creates growth, and incentives for top executives to stay/return to Austria would increase Austria's tax revenues. Austria's ratio of public debt to GDP should be reduced in order to remain competitive. This can be achieved by reforming parts of the public sector (e.g.

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administration, the pension and the health care systems) as well as through tax cuts.

Below is a chart from the Heritage Foundation's *2010 Index of Economic Freedom*. This shows how competitive Austria is with the rest of the world based on several economic factors. Obviously, the most appalling ones are "Fiscal Freedom" and "Government Size". These two factors measure levels of taxation and government spending. Austria ranks far below average in both of these categories, leading to a distinct economic disadvantage for citizens and businesses. In order to diminish this disadvantage, taxes must be lowered to promote economic growth.

Austria's ranking in the Index of Economic Freedom 2010

| | Austria's score* | World average |
|----------------------|------------------|---------------|
| Business freedom | 73.6 | 64.6 |
| Trade freedom | 87.5 | 74.2 |
| Fiscal freedom | 51.2 | 75.4 |
| Government size | 28.8 | 65 |
| Monetary freedom | 79.3 | 70.6 |
| Investment freedom | 75 | 49 |
| Financila freedom | 70 | 48.5 |
| Property rights | 90 | 43.8 |
| Fdm. from corruption | 81 | 40.5 |
| Labor freedom | 79.1 | 62.1 |

* high scores are associated with high degree of freedom

Source: Heritage's 2010 Index of Economic Freedom

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Introduction

With a 33.99% corporate taxation rate and up to 50% of tax on individual income, Belgium has, once more, the sad privilege of being one of the world leaders as far as tax burden is concerned (third actually on the corporate field, and second in Europe after Malta – Source: Corporate and Indirect Tax Rate Survey 2009 by KPMG).

As for the Tax Freedom Day, in 2009, it was the 8th of June (in 2008: 10 June – for comparison sake, these are the dates for the neighbouring countries: UK 14 May, France 11 June); paradoxically, the “gain” of 2 days is due to the crisis.

A number of measures have been adopted these last years in order to improve the country’s image to the outside world: notional interest deduction,

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exemption of dividends from pre-levies, deduction of patent revenues and, of course, the OFP ("Organisation for Financing of Pensions"), which is a vehicle presenting important advantages and being used today by an important number of multinational companies in order to structure their pension funds.

These measures, combined with better communication and promotion of the existing tax advantages for investors on both federal and regional level, aim at attracting foreign investors, especially when Belgian economy has always been highly dependent on imports and international trade.

Nevertheless, last year was poor in interesting measures (especially given the necessity born from the crisis to attract more foreign investors). The world crisis also stroke Belgium in the year 2009 which was described as an "*annus horribilis*" in the Government Declaration related to its General Policy of October 13, 2009.

If before 2009 the government had announced an economic growth of 1.2%, Belgium finally ended up with a regression of 3% and a loss of 35,000 jobs. Furthermore, cases such as the FORTIS BANK case have not made things easier, the state being forced to spend more than what had been planed...

Recent forecasts predict a decrease in domestic demand and exports, despite the rise of public consumption and investments; unfortunately, no recovery is expected before the second semester of 2010; an economic growth of 0.4% is foreseen for 2010 but it still has to be verified in the facts.

When a state needs money and cannot count on economic development, especially in times of crisis, there aren't many solutions: heavier taxation or enlargement of the tax base--driving out new taxpayers or undeclared funds. Below, some interesting measures or facts are presented with the goal to understand the origins and trends of the current taxation policy in Belgium.

Recent developments

Rate of the notional interest

As already explained last year, companies and other organizations established in Belgium can reduce their tax base by claiming a notional tax deduction, when making investment from their own resources. The deductible amount equals the fictitious interest cost on the adjusted equity capital. It is also possible to carry forward any unused amount of the deduction

The notional interest rate for tax year 2010 is fixed at 4.473% and may be increased by 0.5% for small and medium sized companies.

On 19 February 2009, the European Commission opened an infringement procedure against Belgium alleging a possible violation of the liberties of capital circulation or establishment. Nevertheless, the institution itself is not challenged.

VAT Package

A series of changes occur in VAT matters from the 1st of January 2010, additional changes being predicated before 2015.

Briefly: a distinction has to be made between business-to-business (B2B) and business-to-consumer (B2C) transactions as far as supply of services is concerned.

Hence:

- B2B transactions: these transactions will be taxable in the country where the recipient is established (default rule). Therefore the application of local VAT at the rate of the supplier in case of cross-border B2B transactions will become actually the exception.
- B2C transactions: the cross-border services will be taxable in the country where the supplier is established.

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Furthermore, non-resident's refund applications will be addressed electronically to their own country with new periodicity-related thresholds statement.

DRD (Dividend received deduction)

Belgian courts of appeal have addressed preliminary rulings requests to the European Court of Justice in the *Cobelfret* case (C-138/07). The question asked was whether Belgium's dividends received deduction (DRD) regime complies with Article 4(1) of the EU Parent-Subsidiary Directive; on the 12th of February 2009, the Court gave a negative answer and ruled in favour of *Cobelfret*.

It is to be remembered that the purpose of this deduction, and of the EU Directive, is to soften the consequences of triple taxation (the company paying the dividend does so with after-tax money and the receiving company is subject to income tax on the dividends). Following the Belgian system, any dividends received by a Belgian parent company are included in its income; a deduction is then granted that can't exceed 95% of qualifying dividends received. The DRD amount is limited to the net operating profit of the parent company: as a result of the limitation of the DRD, the net operating losses of the parent company cannot be offset against future taxable income (other than qualifying dividends received).

On May 15, 2009, Belgium agreed to comply with the decision of the Court and decided that "excess" DRD that relates to dividends from companies resident in Belgium or another EU/EEA Member State may be claimed, under the condition that, at the time the dividends were received, the requirements for the DRD are met; excess DRD may be carried forward.

Signature of additional agreements and tax treaties

a. Belgium and France have signed, on July 7, 2009, an additional agreement under which a party has to transmit to the other information even if this information is not necessary for her own tax purposes. Similar agreements

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have been signed with the United States, Australia, Luxembourg, Austria and The Netherlands.

b. The renegotiated treaty with Singapore (into force on 6 November 2008) contains interesting provisions concerning income derived after 1 January 2009. For instance, withholding tax rate on interest payments have been reduced from 10% to 5% and royalty withholding tax from 5% to 3%. Furthermore, no withholding tax shall apply on dividends for corporate shareholders holding at least 25% of the share capital for a period of no less than 12 months.

Savings guideline and Bank secrecy

The Guideline provided that every country should automatically share data in order to allow the optimal taxation of savings income.

Belgium (as Austria and Luxembourg) applied instead another system: the identity of the foreign deposit holders is not disclosed but a withholding tax is levied (currently 20% and 35% as from July 2011), 75% of which is transferred to the foreign saver home country.

Willing to comply with EU regulation and also, let's be honest, to avoid to apply a 35% withholding tax after July 2011 (which could lead to a flight of capital towards other countries), Belgium has decided to abandon this system and, from January 1st, 2009 on, will participate to the automatic exchange information system of the Guideline.

In April 2009, Belgium has been included in the “grey list” of the OECD, among countries who did not meet OECD's criteria or international standards on the sharing of tax information... and was not removed from this list until July 2009.

Henceforth, Belgium, which adopted/will adopt new *Information exchange* clauses in the different treaties signed, will transmit to other countries information on revenue collected by non-Belgian tax residents on Belgian

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territory, without having the possibility to oppose to such a demand its bank secrecy; and it will also receive such information under the same conditions.

From the combination of the two systems, Guideline and Treaties' "information" clauses, results a double attack on bank secrecy:

- On one hand, the banks transmit the lists of their non-resident clients for the purpose of the automatic exchange of information in the frame of the European Guideline, and
- On the other hand, bank secrecy will be lifted upon request: the *fishing* is nevertheless still forbidden (the question must concern specific taxpayers and banks) and article 318 Code of the Tax on revenue remains applicable in all other cases.

All the above contributes to the decline of bank secrecy in Belgium.

Withholding tax

By a Royal decree of 31 July 2009 (Official Gazette 21 August 2009- into force: 31 August 2009), and following two injunctions of the European Commission of 18 October 2006, Belgium has decided to renounce to the collection of a withholding tax in the following cases:

- a. On the dividends paid to any Belgian establishment of a company established in another state of the EEA, and
- b. On the premiums on options to buy shares related to financial instruments issued by entities established in another member state of the EEA (modification of articles 106, §1st and 102, §2, 1^o AR/CIR'92).

Business restructurings

In order to align Belgian tax law to the Council's Guideline 90/434/EEC of 23 July 1990 (amended by C. dir. 2005/19/EC of 17th of February 2005), the parliament has voted the law of 11 December 2008 (into force: 12 January 2009).

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The new law has modified domestic restructuring rules and regulated the consequences of the application of Belgian tax law on outbound or inbound cross-border mergers.

The principle is that the operation, whereby a Belgian company is absorbed or (partially) divided, is carried out in strict tax neutrality as long as it is scheduled and carried out for valid commercial reasons (the tax administration bears the burden of proof), that is, not exclusively/principally for tax evasion/tax avoidance purposes and under the condition that the relevant company law provisions of the concerned countries are followed and that the assets transferred to the intra-European absorbing or acquiring company constitute a Belgian establishment of this company.

The already existing limitation of tax loss carry-forward is extended to cross-border reorganizations.

The new rules also apply if a foreign company should transfer its seat of effective management to Belgium. Finally, the new law mentions the “exchange of shares” topic and provides, under certain conditions, the application of an exemption if such gains are realised in a share exchange operation.

Capital gains tax

The law of December 11, 2008, by which Belgium transposed the Council Directive 2005/19/EC, has been published and entered into force on January 12, 2009. Following the provisions of this bill, the eventual capital gain resulting from the difference between the price of the original purchase and the one of the sale of shares (article 90,9° Code of Tax on Revenue) is taxable at a rate of 33% as a “miscellaneous” revenue, unless the transfer is related to a normal management of one’s private assets, therefore in absence of any speculation (the tax administration bears the burden of proof).

Rumours say that the tax administration is paying special attention to the role of the tax payer in the company and his potential power to create capital gain;

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rumours that the Minister of Finances denies (Parl. Question N° 609, 4 August 2009, Bull., 2008-2009, p. 40).

Report of payments to tax havens

A “Programme Bill” of December 23, 2009 modified article 198, 1, 10° of the Belgian Code of Tax on revenues and provides that Belgian companies (and Belgian branches) would need to report direct and indirect payments over € 100,000 made as from 1 January 2010 to “legal entities” established in tax havens.

The tax havens aimed by this bill are either black or grey OECD list countries (<http://www.oecd.org/dataoecd/50/0/43606256.pdf>) or countries mentioned in a list to be established by the tax administration and mentioning countries without taxation, or almost; European countries cannot be mentioned on this list (Exposé des Motifs, Doc Chambre 52 2278/001 p. 71).

If these payments are not reported in the special tax return to fill in the future, they will be *de plano* considered as disallowed expenses, at least for the part related to these expenses.

These payments must relate to "genuine business expenses" and cannot be the result of an "artificial arrangement" (a concept derived from ECJ ruling in the *Cadbury-Schweppes* case, C-196/04 – ECJ).

Inheritance of family businesses in the Flemish Region: elimination of the employment condition

*Since 1999, family businesses establish in the Flemish region can transmit free of estate taxes to the heirs (not necessarily family members), if a number of conditions have been met (Article 60bis of the Flemish Region Estate Tax Law). The “employment condition”, will probably disappear shortly (*Policy Memorandum Finance and Budget 2009-2014*).*

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VAT for restaurants and construction

The reduced rate for restaurant and catering services (except beverages) of 12% has entered into force on the 1st of January 2010 (Royal Decree 9 December 2009, O.G. 14 December 2009); this measure will be evaluated in 2010 and there will be, eventually further reductions.

On the construction field, the decree provides that the operations of demolition and reconstruction of dwellings located in Belgium will carry a VAT at a 6% rate; this measure will be in force till January 1, 2011.

Other measures are provided concerning the construction or supply of housing and will be in force until the 31st of December 2010.

Various non-tax news

a. Negative indexation for January 2010

In Belgium, salaries are indexed on the evolution of the price of consumer goods. For the first time since many years, almost 50 sectors will experience a negative salary indexation during the first weeks of 2010. The employers have the possibility not to reduce the salaries but in case of positive indexation for 2011, the new salaries would be calculated on the current, non-reduced, salary; this would generate additional expenses for the employers.

b. The extension of stock plans

Following the Stock market crisis, the majority of stock options have virtually lost most or all of their value. The Economic recovery Bill of 27 March 2009 (M.B. 9 April 2009) allows the beneficiaries of such stock options to extend, under certain conditions, the exercise periods foreseen by the option plans and this for a period of 5 years.

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c. Work permit exemptions

Belgium has decided to lift its restrictions on workers from the new Members States (Czech Republic, Estonia, Hungary, Latvia, Lithuania, Slovakia and Slovenia - but not Bulgarian and Romanian nationals who still need one) as from May 1, 2009; therefore, they also benefit from the system applicable to self-employed since 2004.

Conclusions

OECD's *Economic Survey of Belgium 2009-How to reform the tax system to enhance economic growth* states: "In terms of structure, the tax system relies too heavily on relatively distorting taxes,... Thus, to promote growth, a tax reform should aim at shifting the tax burden from labour and business to consumption and immovable property."

Once more, *reform* is the cornerstone of change and the OECD's idea is clear: one should privilege consumption rather than direct taxation, which has the disadvantage of depriving the taxpayer of the motivation to produce, and to spend.

Nevertheless, in Belgium as elsewhere, heavier taxation seems to be the only mean governments found in order to improve the public treasury, especially in the middle of the current economic crisis. This "short term" policy, although quickly effective, does not allow the economy to develop as the companies give almost every extra cent to the state instead of investing and individuals pay taxes instead of spending... As a result, the economy is virtually on hold and, subsequently, so is the improvement of public finances.

In the same time, projects for reduction in corporate taxation have been put aside although the global economical crises convinced the Belgian lawmakers

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of the necessity to attract foreign investors. It is for this reason that, on the occasion of the presentation of the draft of the 2010-2011 budget, the government has announced its intention to increase the 'participation exemption' threshold for dividends, and to cap the reference rate for the 'notional interest deduction'; one should maybe have grabbed the occasion to propose the total exemption of taxes of the dividends collected by companies; actually, Belgium should try to adopt the European standard, that is the total exemption of taxes on dividend collection by a holding company.

Furthermore, and this is not a surprise, new measures will be taken in order to reduce tax avoidance and tax fraud; in this way, instead of levying heavier taxes, which would not be an investor-friendly initiative, the State takes every possible step in order to enlarge the taxation base.

To our days, in order to achieve this target, states claim transparency... and transparency excludes secrets. Therefore, all these measures are closely related to the bank secrecy, an institution which is progressively fading away. For the taxpayer, this is a quite annoying situation.

Without surprise, the decline of bank secrecy is perceived differently by government officials : "We don' have any problem with that. To our best knowledge we don't have bank secrecy in Belgium," Minister of Finances D. REYNDERS said. This is a strange position considering that the same person would state, a few months later, that the (non-existing?) bank secrecy should only disappear in case of fraud...

(<http://www.reuters.com/article/idUSLO7815120090224>);

The reasons put forward are social equity and a need for social justice, the "honest" taxpayers being allegedly wronged by those who avoid paying taxes. These noble reasons are supposed to justify the current Belgian policy of the progressive destruction of the bank secrecy, whether by applying the European guideline on savings revenue or whether by collaborating with other countries in the frame of double taxation avoidance treaties. Nevertheless, it is obvious that the new measures will only affect small

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taxpayers, as the important savers will move ahead under more sun-bathed skies.

We live today in a world full of paradoxes:

- the competition protecting European Union is, in reality, eliminating tax competition on the prejudice of the taxpayers ... whose sphere of privacy is constantly invaded
- the most powerful and heavily taxing countries impose their law to the more liberal ones; in a free Europe, this attitude, frequently institutionalized, is a new, and certainly original, form of “intra-european” imperialism against which we ought to stand up.
- China (Honk Kong) appears as the last shelter of the wealthy, and this is indisputably an unexpected situation!

And all the above in the name of common wealth and prosperity.

Let's only hope that the additional measures and the subsequent sacrifices, including the loss of bank secrecy, which are supposed to generate additional resources for the State, will lead in the future to a reduction of the actual tax burden. If not, all this would only have allowed the State to increase its resources, its knowledge of taxpayer's private life and fortune, and, at the EU level, its influence on the alienated countries' tax policies...

Bulgaria



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Top Priority: Balanced Budget

At a first sight the fiscal year 2010 look pretty much the same as the previous year: No cardinal change in the major taxes and unchanged policy of preferable balanced budget. Nevertheless, a closer look gives a different picture – problems with the balanced budget and pressure on the tax rates. The only way to understand what actually changed in 2010 is to look back at the events of 2009 – both before and after the elections that took place in the middle of the year. Going through these moments again, one could easily understand the logic that lies behind the current fiscal policy. Higher excise duties and reduction of social contributions by 2 percentage points are just part of the changes that took place. Other important changes are the improved collection of taxes, the measures towards fiscal frauds and contraband goods and the elimination of tax preferences. All these combined are supposed to strengthen the budget, without touching the major taxes in the country – income tax, corporate tax, VAT. Still, just a few months in 2010 and the VAT rate is put in question.

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Elections and Government Spending

2009 was a tough year for Bulgarian fiscal policy. First it was the crisis that hit the economy and consequently government revenues. With projections of a budget of around € 15 billion (plus € 1 billion surplus), the year ended with a budget down to around € 13 billion (and a minor deficit). These figures may not differ much from the previous year (namely 2008), but they are obviously far from what was expected by the government and what was written in the budget law. Lack of expected revenues led to some severe problems at the end of the year, but they were not the only reason for what happened. At the beginning was the crisis, but then came ... the elections.

Governments react to a crisis in different ways – some decide to spend more (running budget deficits) and some decide to tighten the belt (balanced budget or even surplus) and introduce reforms. As Bulgaria is a small country, with a currency board, the decision comes naturally – no deficits and no raising taxes. Such policy was strongly supported by the positive experience of recent years – low taxes and surpluses, combined with the bad memories of government spending and hyperinflation in the mid 90s.

But even though the government was officially declaring the balanced budget as their primary goal, the forthcoming parliamentary elections in the middle of the year pushed reason aside. The data from the last decade clearly shows that when elections come in Bulgaria, government spending climbs high. Whether a message sent to the people (voters) or simply corruption (last days in office); the result is always the same: the government expenditures went higher just before the elections, the signed contracts and the given promises also went higher, but at the end the voters elected a fresh new government.

Balanced Budget?

The elections took place July 5th of 2009 and the shift of powers happened on 27th of July. Funny enough, the budget officially run into deficit also in July, with a bizarre public debate on what was the exact date of the ‘event’ (budget running from surplus into deficit) – was it with the old or with the new government?!

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Few months later, the official data made it clear – June and July were one of the worst fiscal months in recent years (another terrible time being when, at the end of the previous years, the government spent the accumulated surpluses). The pre-election expenditures, combined with delayed payments and last minute government contracts, threw the country into a fiscal crisis – the balanced budget was threatened.

Right from the beginning, the newly elected government committed itself to full fiscal transparency and no budget deficit. The balanced budget was once again a top priority, with measures in both directions – cut government spending and push on revenues. Until the end of the year, government's expenditures were put in order (but not as drastically as expected) and several revenue-oriented measures did take place – those were administrative measures, mainly towards fiscal fraud and contraband goods. Putting all this together, the goal was almost fulfilled, but not entirely – the budget deficit for 2009 will be around € 250 million, which is less than 1% of GDP.

The fiscal year of 2009 was tough, but the experience gained and the lessons learned shaped the fiscal policy for 2010. With the intention to balance the budget, but not to cut expenditures, the government main task was to find a source of higher revenues. Raising the main taxes (such as income tax, corporate tax and VAT) was not an option, as the pre-election promises were towards lower taxes (actually no party argued for higher taxes). Thus, the government looked somewhere else – elimination of tax preferences, better collection of taxes and, as usual, higher excise duties.

Just a few months in 2010 and now the picture look entirely different. The balanced budget is once again threatened with revenues far from expected. The debate is still open, but obviously the expenditures are going to be cut one way or another and the pressure to increase taxes is also visible.

Direct Taxation (Corporate Tax & Income Tax)

Since the beginning of 2007 the corporate tax rate has been reduced from 15% to 10%. To the great surprise of State's authorities, revenues from corporate taxes went straight up, both in 2007 and in 2008. If we compare the budget revenues before the reform (2006) and two years later (2008), we can

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see that in 2008 the government had collected almost twice more money from corporate taxation than in 2006. These favourable results are, among other things, due to the positive effects of lower taxes – companies coming out from the grey economy, more foreign investments and economic growth due to increased incentives for entrepreneurship.

The recent crisis had, however, a severe impact on corporate tax revenues. In 2009, these revenues declined by about 20% (on a year basis), but still were far above their 2006 level. Nevertheless, the corporate tax for 2010 will be again 10%, with a projection to stay at that level for the next 3-4 years. As was already the case last year, at the end of 2009 there were wide discussions in the country towards abolishing the dividend tax – mainly as a reaction to the financial crisis. Again, nothing changed, and in 2009 the tax rate for dividend income and income from sale of shares will be 5% for individuals.

The success story of the corporate tax cut gave wings to the flat tax proposal that was passed the year after. Bulgaria introduced the lowest flat tax in Europe at the beginning of 2008, replacing the progressive scale (20%, 22% and 24%) with one single rate – namely, 10%. The flat tax was welcomed by the people for its simplicity and fairness, and also for being two times lower than the lowest marginal rate of the previous progressive scale. The fiscal revenues from the income tax also went straight up after the reform. Surprisingly, even in 2009, despite the crisis, the government will collect more money from income tax than in previous years.

The flat tax stays the same in 2010 and seems untouchable for the forthcoming years. The only changes in income taxation will come through the removal of some tax exemptions. For instance, farmers didn't pay any income taxes in the recent years, but in 2010 they will have to. The income of the farmers is estimated at about € 500 million per year, which from now on will be taxed at a 10% flat rate (after some deductions). The bad news for the budget is that the removal of the tax exemptions for farmers will be partly replaced by direct payments (subsidies). Nevertheless, the elimination of tax preferences will probably continue in 2011.

Indirect Taxation (VAT & Excise Duties)

Indirect taxes include VAT and excise duties on special goods such as cigarettes and alcohol beverages. Bulgaria has to harmonize its tax regime with that of the European Union by introducing the minimum excise duties of the European Community on tobacco, alcoholic beverages, and fuels. Started in 2002, the harmonization process is scheduled to be completed by the end of 2013. In 2010 excise duties on kerosene, electricity for industrial purposes and cigarettes will increase, while on gasoline and diesel, as well as on liquor there will be no price adjustment.

The fiscal effect of the higher excise duties on the budget is expected to be above € 100 million. It should be also mentioned that, to the extent that excises are part of the taxable base for VAT, the additional excises lead to additional revenues from VAT. As a whole, indirect taxes continue to be the largest source of tax revenues, accounting for more than 40% of the consolidated public revenues or in other words for more than € 5 billion.

Once again one of the most debated tax issues in 2009 was the implementation of VAT differentiation. Despite all the pressure put upon the politicians by all kinds of groups of special interest, the rule stayed unchanged and in 2009 there will be a single VAT rate for all commodities and services, namely 20 percent (there has been only one exception in the recent years – a 7 percent VAT on tourist services). The official projection is that the VAT rate will stay at 20% for the next 3-4 years, although recently the prime minister mentioned the possibility to increase the rate to 22% in the forthcoming years (possibly 2011).

Social Security Contributions

Social contributions are still the most disputable tax in Bulgaria. In 2005 they were above 40% of the gross wage, but with the 6 percentage points cut in

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2006 and a 3 percentage points cut in late 2007, they fell to 33.5% of the gross wage. At the start of 2009 a further reduction of 2.4 percentage points was enacted, bringing the contributions to 31.1% of the gross wage. Also from the beginning of 2009, along with social contributions paid by the employee and the employer (as in most European countries), the State itself started to pay social contributions for every worker – 12% of the gross wage. Those “new” State contributions are more of an accountant’s trick than a real reform. Actually, the State has always made payment from the budget to the Pension Fund; the difference is that those payments were called transfers (or subsidies) and now they are called contributions. Even with these State contributions, the State pension fund is far from balanced and needs further government subsidies (transfers).

In 2010, social contributions will be cut again by another 2 percentage points. More precisely, the cut will be coming from the pension contributions (1.1 percentage points reduction for the employer and 0.9 percentage points reduction for the employee). Thus, the social contributions as a whole will fall below 30% of the gross wage for the first time (at average 29.1% of gross wage). Still, the employer’s contributions are higher than the employee’s, but that is not so important as both of these payments lay, one way or another, on the shoulders of the employee (as they are taxes on labour).

Further changes in social security contributions are to be expected in the forthcoming year. The pre-election promise was a 5 percentage points reduction of the contributions, so now it is expected that they will be reduced by at least 1 percentage point per year (next 3 years). Nevertheless, it is not so clear how this will happen as the health contributions are expected to reach 10% of the gross wage in 2011. Also interesting is that the mandatory contributions to the private pension fund, which will be again 5% of the gross wage in 2010, are expected to go up in the forthcoming years.

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Social Security Contributions in Bulgaria (% of the gross wage)

| Social Contributions (2010) | Total | State Fund | | Private Fund | |
|--|---------------|---------------|--------------|--------------|--------------|
| | | Employer | Employee | Employer | Employee |
| Pension | 16.00% | 6.10% | 4.90% | 2.80% | 2.20% |
| Illness & Maternity | 3.50% | 2.10% | 1.40% | X | X |
| Unemployment | 1.00% | 0.60% | 0.40% | X | X |
| Labor Accidents & Professional Illness* | 0.50% | 0.50% | 0.00% | X | X |
| Salary Guarantee Fund | 0.10% | 0.10% | 0.00% | X | X |
| Health | 8.00% | 4.80% | 3.20% | X | X |
| OVERALL | 29.10% | 14.20% | 9.90% | 2.80% | 2.20% |

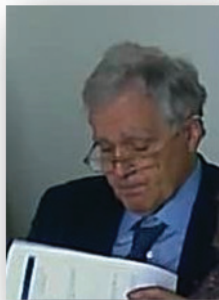
Note:* The rate for Labor Accidents and Professional Illness is averaged – there are several rates depending on the labor category – vary from 0.4 to 1.1 percent

Conclusions

Fiscal policy in Bulgaria has played a crucial role for the development of the economy in the recent years. Balanced budgets and low taxes proved to be a success and even after the tough year of 2009 the economy is still in relatively good shape. Such policies are most likely to prevail in the years to come, together with greater fiscal transparency, better and more effective revenue services and probably less tax preferences. The 10% flat income tax and the 10% corporate tax seem to be untouchable, while the 20% VAT may face some changes (up to 22%) in forthcoming years. Social contributions will once again drag attention, as the reforms in pension system and healthcare are inevitable.

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Croatia



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Introduction

As many others, Croatia has been severely affected, last year, by the global economic crisis. GDP contracted on an annual basis by 5.7 percent, due to a severe drop of personal consumption and, particularly, to a drop of exports of goods and services (consisting mainly of tourism). According to government estimates (Central Bank of Croatia, *Economic Bulletin*, N. 155, January 2010), the drop of exports was close to 20 percent. As expected, fixed investment showed also a negative trend during the year.

The downturn of economic activity has had a huge impact on tax revenues. Consolidated government revenue dropped in the first 10 months by 6.9 percent compared with the same period of the previous year. The decrease was primarily due to a fall in collections of VAT and excises. This trend resulted, in turn, from a sharp drop in personal consumption and imports.

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Furthermore, the growing number of companies with problems of liquidity due to the deterioration of their business brought up a decrease in the collection of the profit tax, and also had a smaller and negative impact on social security contributions.

On the expenditure side there was a substantial increase of consolidated government expenditure, + 5.6 per cent over the same period, spurred mainly by social security benefits including pensions and health care. There was also, until May 2009, a marked increase in public servants' salaries. This huge public expenditure growth was largely intended to absorb the social impact of the crisis.

New tax measures

The combined effect of dropping revenues and of increasing expenditures brought the public sector deficit to an unsustainable level and forced the government to intervene to increase taxation. Tax measures exacerbated political conflicts that had been already fueled by the call for local elections in the spring of 2009 and for presidential election (the first round of which took place in December 2009).

The most conflict-generating measure was the introduction in July – with the Law on Special Tax on Salaries, Pensions and Other Income - of a special crisis tax. This is a temporary levy – it will be applied until 31 December 2010 - on salaries, pensions and other income with a tax rate of 2 percent on incomes exceeding HRK 3,000 (the equivalent of € 409 per month) and with a tax rate of 4 percent on incomes exceeding HRK 6,000 (€ 818 per month).

This levy is rather substantial and sits on top of an existing personal income tax that, while not particularly productive, has the top statutory tax rates among Eastern European countries. (The same applies also to the corporation income tax). Of course, high statutory tax rates do not translate

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immediately in high burden because of the existence of allowances, deductions and other loopholes in the tax base that will determine the real burden of taxation. However, the quite high nominal high tax pressure is a hot issue in Croatia. The debate was also spurred during the year by the publication of a comparative tax report by Kpmg (Kpmg, *Individual Income Tax and Social Security Rate Survey*, 2009) that showed that Croatia had the second highest marginal combined income tax and social security contributions tax rate in the world.

The increase of the tax burden in the midst of a deep economic slowdown was strongly resented and created a political conflict at the top of political institutions. More precisely, the President of Croatia, who is popularly elected although endowed with mainly formal responsibilities and who, more importantly, comes from a political party that seats in the opposition in the National Parliament, decided to take the special tax to the Constitutional Court on the grounds that “it did not respect the constitutional principles of justice, equality and proportionality”. In particular, the President maintained that the “new tax particularly affects the poorest in the society, which means the majority of citizens”.

The Constitutional Court rejected the appeal by the President in November. The Court ruled that the new tax was not discriminatory and thus did not violate the constitution. The judges did however recommend that the cabinet considers repealing the tax ahead of its planned lifting.

The special tax on income and pensions was accompanied by the increase of the VAT standard rate from 22 to 23 percent. Croatia has, also in this sector, one of the highest tax rates. It can be mentioned that within the OECD the average VAT standard rate is 17.8 per cent, while in the EU the average standard rate is 19,8 per cent. If it was member of the EU, Croatia would rank third amongst the EU countries in terms of VAT standard tax rate with only two countries ranked higher than Croatia: Denmark (25%) and Sweden (25%). Croatia has the highest VAT in the South East Europe region, which is considered the area of reference. Fears have been expressed that Croatia’s attractiveness for tourism could be imperiled.

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The set of tax increasing measures has been completed with the introduction of a 6 per cent levy on gross revenue of mobile phone operators and with some amendments on the vehicle tax that adjust the burden according to the value of the vehicle and thus to the economic capacity of the owner.

Finally, in the framework of the alignment of Croatian tax legislation to EU, the government decided to end the preferential treatment for the country's sole tobacco manufacturer, which angered the European Union, and tax local and foreign cigarettes equally. Although the explicit, and forced, aim is to lift protection on the domestic tobacco sector, the measure will contribute to increase revenues and to raise the fiscal burden on consumers.

The budget for 2010 excludes any further measure on the revenue side and puts the burden of the adjustment on the expenditure side, calling for reduction of subsidies to protected sectors, such as shipbuilding, and for containment of public servants' salaries.

Tax administration remains in Croatia a factor of weakness that deters improvements in tax collection. An important step towards better administration of taxes was taken with the adoption, starting from January 2009, of the Personal Identification Number for individual and corporate taxpayers. It is expected to facilitate flowing of information with crosschecks among all official records and to ease the burden of tax compliance.

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Structure and recent evolution of tax revenue in Croatia 2007-2009 (million Kuna)

| | 2007 | % on total | 2008 | % of total | 2009 | % of total |
|------------------------------|---------|------------|---------|------------|----------|------------|
| Personal income Tax | 1772.7 | 2.9 | 1687 | 2.5 | 1555 | 2.5 |
| Profit tax | 8816.3 | 14.5 | 10564.7 | 15.9 | 9550.1 | 15.9 |
| Taxes on Property | 578.6 | 1.0 | 635.9 | 0.9 | 596.4 | 0.9 |
| VAT | 37747.9 | 62.0 | 41308.0 | 62.2 | 36818.81 | 62.2 |
| Sales tax | 168.5 | 0.3 | 166.5 | 0.25 | 142.219 | 0.2 |
| Excises | 9096.9 | 15.0 | 588.6 | 0.9 | 634.218 | 0.8 |
| Taxes on games and gambling | 505.1 | 0.8 | 543.8 | 0.82 | 531.413 | 0.8 |
| Taxes on international trade | 1641.5 | 2.7 | 1.900.8 | 2.8 | 1784.632 | 2.8 |
| Other taxes | 509.6 | 0.8 | 0 | 0 | 0 | 0 |
| Total tax revenue | 60837.1 | 100.0 | 66344.9 | 100.0 | 60346.7 | 100.0 |

Source: Ministry of Finance of Croatia

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Czech Republic



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Overview

Main topic in fiscal debates was the economic crisis that was imported into the Czech Republic at the end of 2008. However, no deep reform was possible due to the political situation – the vote of no confidence led to the fall of the government in March 2009

and, since May 2009, the Czech Republic has been managed by a sort of technical government without political mandate. The government during 2009 prepared two different packages of laws. First there was an anti-crisis package with a goal of stimulating the economy; and second a package aiming at a reduction of deficit mainly by increasing tax burden. To sum up, starting from 2010, the Czechs will have to pay more for everything, due to the

Figure of the year

90 percent of all government revenues are used to pay for mandatory and quasi-mandatory expenditures

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increase of VAT rates. This is especially true for alcoholic beverages, cigarettes, and fuel. Social insurance contribution ceiling increases and the very much-needed pension and health care reforms were again postponed to some later time. No discussion about tax system simplification took place.

The anti-crisis package

End of 2008 the economic crisis entered the Czech Republic. It is, therefore, not surprising that the crisis was – directly or indirectly – the main topic of all fiscal debates. Unfortunately, last year's political development made any radical fiscal reforms practically impossible.

Czech fiscal system was not in a very good situation already in 2007. That is even before the recession arrived. The extraordinary high tax revenues in 2008 temporarily pushed the deficit below the 3 % of GDP level prescribed by the Maastricht criteria. However, it became clear right at the beginning of 2009 that the upcoming recession will, again, cause the revenues to drop and put pressure on the expenditures to rise. The severity of problems stemming from the financial crisis in the US and other countries later on indicated that the Czech Republic won't be spared from its consequences, even though Czech banks were not in precarious conditions. To identify and address the most burning issues of the Czech economy, the prime minister set up an apolitical expert advisory and consultative body – the Government's National Economic Council. Its foremost task was to analyze the risks and potential impacts of the global financial crisis on the Czech Republic, and propose measures and tools that could be used to mitigate or completely eliminate these impacts.

But maybe its most important role was to act as a wall against populist measures that could be helpful in the short term but would harm the economy in a long-term perspective. The government, therefore, postponed any active steps until the beginning of February when the Council presented its plan to respond to the economic crisis. Contrary to what most politicians would have done, the Council focused mainly on the supply side of the

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economy. A number of measures had been already introduced in the state budget approved in the second half of 2008 and were effective since the beginning of 2009. First, social insurance contribution payable by the employee was decreased by 1.5 percentage points to 6.5%. As a consequence, workers were allowed to keep in 2009 approx. CZK 18.4 billion more in their pockets. Another 6 billion stayed in the firms due to a reduction of corporate income tax rate from 21 % to 20 %. Together with other already existing fiscal measures on expenditure side, they were expected to cost CZK 32.2 billion (about 0.8 percent of GDP) in terms of tax revenues, but thanks to multiplication effects, they brought about an economic impulse of 1.3 % of GDP.

To complement and further develop these measures, the Council put forward on the revenue side a proposal for a cut to the social insurance paid by an employer when the employee receives up to 1.15 times the average salary. The amount of the cuts will decrease with the height of the employees' salary. Second, in order to support business and private investment, it was proposed to increase the speed of depreciation. And third, the Council proposed to expand the use of VAT write-offs for automobiles. These three measures were expected to leave additional CZK 29.8 billion in the private hands of employers and entrepreneurs. Coupled with other measures on the expenditure side of the budget, the proposed costs of the stimulus package were CZK 41.5 billion (1.1 % of GDP) with an expected impact on the economy of 1.6 % of GDP.

Fall of the government

The government approved the stimulus package but the opposition Social Democrats had another plan to support the economy that focused primarily on the demand side of the economy. On the one hand, the Socialists proposed to reduce the personal income tax and the reduced VAT rate (from 9 % to 6 % in 2010) but, on the other hand, to increase the corporate income tax (from 19 % to 21 % in 2010) and reintroduce tax progression in order to

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get the necessary funds for their expenditure programs. Subsequent political discussions about the final form of the anti-crisis package led to a vote of no confidence and the fall of the government. Against the government voted, not only Socialists and Communists MPs from the opposition, but also four MPs from the coalition parties. From the end of March until May 8, 2009, the Czech Republic was practically without functioning government. As of May 8, a sort of technical government, whose members were nominated by Civic Democrats, Socialists and Greens, was supposed to lead the Czech Republic to early general election in October.

However, changed political climate made it impossible for the former government's anti-crisis package to be approved by the legislation. A compromise between Social and Civic Democrats led to a mix of supply- and demand-side measures. The above-mentioned measures were complemented by an increase in a yearly tax deduction for children (from CZK 10,680 to CZK 11,604), higher child and unemployment benefits, and scrappage incentive scheme. Especially scrappage has been widely criticized as a populist measure that would unnecessarily increase the already high deficit.

Severe problems with deficit

The state budget for 2009 was unrealistic from the very beginning as it was built on an assumption of 4.8 % GDP growth in 2009. The planned deficit was CZK 38.1 billion. However, mainly due to the economic slowdown, revenues plummeted and social benefits went somewhat up. Most importantly, the corporate income tax revenue fell to 65.5 % of the previous year's revenue, and together with revenues from the social insurance (90.3 % compared to 2008) generated additional debt of almost CZK 100 billion. The Socialists repeatedly tried to ascribe the losses to a lower corporate income tax rate (that went down by 1 pp. in 2009). But in reality, the impact of the lower tax rate explained probably only about 13 % of the corporate income tax revenue drop. By the end of 2009, the state budget deficit climbed up to 192 billion. The whole government deficit, which is important for the

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Maastricht criteria, reached about CZK 240 billion. This is more than 6 percent of GDP.

If deficit in the time of economic recession is nothing to be extremely worried about, what is, however, alarming is the structure of this deficit. Out of the total expenditure, 37 percent are used for social benefits (29 % just for pensions). Overall, mandatory and quasi-mandatory expenditures constitute about 75-80 percent of expenditures and approximately 90 percent of all government revenues. This is not a new phenomenon -- since 1995 mandatory expenditures in the Czech Republic grow faster than its GDP, which means that the ability to pursue anti-cyclical fiscal policy lowers each year. Without profound changes, the Czech Republic is doomed to growing structural deficits.

Needless to say, deficits are these days a big issue almost everywhere. In a recent study, Alesina and Ardagna show that “fiscal stimuli based upon tax cuts are more likely to increase growth than those based upon spending increases. As for fiscal adjustments, those based upon spending cuts and no tax increases are more likely to reduce deficits and debt over GDP ratios than those based upon tax increases. In addition, adjustments on the spending side rather than on the tax side are less likely to create recessions” (NBER 15438, October 2009).

There can, of course, be some self-selection bias, but the message is clear. On average, countries that cut spending were more successful in dealing with deficits than countries increasing taxes. Unfortunately, politicians are not benevolent dictators who maximize utility of the whole society, as was again proven by the final form of anti-crisis package described above. The president Václav Klaus vetoed the whole package arguing that the scrappage scheme was highly discriminatory and un-systemic measure with uncertain outcome. However, his veto has been overridden by the Parliament in September.

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Preparation of the state budget for 2010

At that time, the planned state budget for the year 2010 was already in severe situation and the Czech Republic was heading towards a CZK 230 billion deficit which would, together with the rest of the government sector, constitute a deficit of almost 8 % of GDP. It has been calculated that measures introduced into the package by the Socialists would increase the deficit by additional CZK 6.5 billion. Moreover, the early general elections were first postponed and later cancelled altogether and the technical government was all of a sudden forced to lead the country until regular elections in May 2010. One of the implications was that the technical government had to prepare the state budget for 2010. The minister of finance made it clear that he would not allow deficit higher than CZK 160 billion as the situation was no longer tolerable. The government, therefore, prepared another package of laws that would make it possible to reach this goal.

The package contained changes on both revenue and expenditure sides. However, in order to get support from both Socialists and Civic Democrats, the resulting combination of measures wasn't one that would gain support of most economists. Contrary to the examples of successful fiscal adjustments described by Alesina and Ardagna, the goal of the government package was to implement legislative changes that would increase revenues by 50 billion (approx. 1.5 % of GDP) and reduce government spending by mere CZK 25 billion. Starting from the beginning of 2010, both VAT rates (reduced and normal) rise by one percentage point (to respectively, 10 and 20 %), which will increase the tax yield by 10 billion. Revoking the social insurance cuts introduced by the anti-crisis package in September, together with an increase of social insurance contribution ceiling is expected to bring another CZK 19.6 billion to the government. Raise of excise tax rates levied on fuels, alcohol, beer, and tobacco should increase the revenues by another 10.5 billion.

During the process of approval of the package in Parliament, the Socialists enforced significant reductions of planned saving measures by approximately

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CZK 7 billion. In the end, the reform package consisted mainly of different tax increases. The only larger spending cuts were in parental leave and sickness benefits and the final package was supposed to be the basis for the 2010 state budget. But the Socialists with the help of some of the Christian Democratic and Green MPs changed the proposed budget during its approval in December by adding another 12 billion of social expenditure. This means that for 2010 there is a planned deficit of CZK 163 billion (5.7 % of GDP).

How to deal with the deficits

The inability to reach a more balanced budget raised a public discussion about the possible ways of motivating the legislators to restore fiscal discipline. Civic Democrats proposed a system of automatic adjustment of MPs' wages. Whenever they allow approval of a deficit budget, they should be punished by a wage decrease and vice versa. On the other hand, a member of the Czech National Bank Board suggested enacting a constitutional law that would enforce balanced budget over a long term by allowing for cyclical deficits.

In order to be able to prepare a budget with lower deficit for 2011, the minister of finance already projected another package of laws to enable him to reduce the deficit. No fundamental reforms can, however, be implemented given the political setting. Among his plans to reduce the deficit by additional 40 billion are reintroduction of income tax progression (now flat at 15%), another increase of the reduced VAT rate, and higher excise and real estate taxes. But as the above-mentioned study of Alesina and Ardagna suggests, such fiscal policy is not likely to be successful. Moreover, according to the Doing Business 2010 survey, the Czech Republic ranks, as far as taxation is concerned, at the 171st place out of 183 countries. In order to be more business-friendly, politicians should simplify the tax system and cut the red tape. But there is practically no progress in this area and the only thing politicians care about is tax revenues.

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Conclusion

To sum up, starting from 2010, the Czechs will have to pay more for everything, due to the increase of VAT rates, and new duties for alcoholic beverages, cigarettes, and fuel. An increase of social insurance contribution ceiling will have the biggest impact on people who earn CZK 142,000 (about € 5,500) as they will have to pay CZK 91,000 per year more (7.1 % of their net income). The very much-needed pension and health care reforms were again postponed to some later time and no discussion about tax system simplification took place. We can only hope that it is just a temporary consequence of the economic crisis and the politicians would turn to more important topics in the coming year.

Denmark



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Overview

2009 saw the implementation of the second half of a minor tax package, originally passed in 2007 (first half was implemented in 2008). The change was aimed at lowering the marginal tax for middle-income earners. Together with the 2004 changes, the 2008-9 changes have effectively transformed the Danish three-tier tax system into a two-tier system; with a relatively low marginal tax rate applying to most taxpayers. The top marginal tax, however, remain at 63 pct.

Due to the economic crisis, some temporary tax measures were implemented in 2009 to improve the liquidity of corporation (extension of tax credits). Originally designed to be phased out in 2009, part of these measures have been extended till the end of 2010.

Denmark

The biggest news of the year was the agreement on the largest tax reform to be implemented since the middle of the 1990's. The reform allocates more than DKK 25 billion to the lowering of marginal taxes on income, including the lowering of the top marginal tax rate for the first time in ten years. As of 2010 the top marginal tax rate will be 56.1 pct. – the lowest in at least 40 years.

Due to the current economic crisis, most tax cuts will take effect immediately (2010), while the increases will follow gradually, thus making the tax reform under-financed the first years. In the long run, however, the tax reform is fully financed.

Tax changes in 2009

As mentioned in last year's report, 2009 saw the implementation of the second half of a minor tax reform agreed upon in 2007, the first half of which took effect in 2008. The 2008-9 changes are best seen in the context of the earlier 2004 changes, which instituted an earned income tax credit (applying exclusively to labor income), and raised the threshold for the middle income tax substantially.

The 2009-changes were:

- The basic personal allowance was raised by DKK 500 to a total of DKK 46,600 (€100 is approximately DKK 750 and DKK 100 is approximately € 13.5).
- The earned income tax credit was increased from 4.0 to 4.25 pct. of earned income with a maximum credit of DKK 13,600. The credit only applies to municipal tax, church tax and the health contribution, thus making the maximum after tax value DKK 4,556 [33.5 pct. of DKK 13,600].
- The basic allowance for the middle income tax bracket was increased by almost DKK 60,000 to DKK 377,400, which is identical to the basic allowance for the top income tax bracket (the exact tax base for the two taxes remain slightly different from each other).

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To offset an increase in the average municipal income tax from 2007 to 2008, the low income tax bracket was extraordinarily lowered in 2009 from 5.48 pct. to 5.04 pct. and to 5.26 pct. from 2010 onwards. The extraordinary lowering in 2009 meant that the top marginal tax fell slightly – from 63 to 62.8 pct. – in 2009.

Seen in conjunction with the earlier 2004-changes, the 2008-9 changes have in effect transformed the Danish tax system from a three-tier system (low, middle and top income tax brackets) to a two-tier system (with the middle and top income tax bracket being virtually identical). Thanks to the two reforms, the middle income tax bracket affects approximately 1.3 million fewer taxpayers than would have been the case without these reforms (the total number of taxpayers is 4.7 million).

As a consequence of the abovementioned changes, the 2009 marginal tax rates for wage income are (using average municipal and church tax):

- 8% of income below DKK 46,600
- 43.5% of income between DKK 46,600 and 377,400. For incomes below DKK 320,000 the earned income tax credit lowers the marginal tax to 42.1%
- 62.8% of income above DKK 377,400

As mentioned the middle and top income tax brackets now have the same threshold.

Positive capital income (net) is added to wage income, but not subject to the 8 pct, labor market contribution. The tax rates are thus 0, 38.6 pct. and 59.6 pct. respectively. Net negative capital income is only deductible against the municipal tax, church tax and health tax (33.5 pct average). Net income from shares (capital gains and dividends) is taxed separately at a progressive rate: Income below DKK 48,300 is taxed at 28 pct; Income between DKK 48,300 and 106,100 is taxed at 43 pct.; and income above DKK 106,100 is taxed at 45 pct.

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It is worth noticing that the relatively low threshold for the top income tax bracket means that the tax affects almost 900,000 taxpayers – 19 pct. of all taxpayers and almost half the full time employed. However, due to the slightly different tax bases for the middle and top income tax brackets one third of the top income tax payers do not pay the middle income tax. This is mainly because the basic allowance for the middle income tax bracket is shared between spouses. This is not the case with the basic allowance for the top income tax bracket. For the almost 300,000 taxpayers who pay the top tax, but not the middle tax, the marginal tax is 57.3 pct.

Crisis management

The worsening economic crisis prompted parliament to agree on a temporary extension of the credit time for payment of withholding taxes and VAT. In March 2009, the credit periods were extended by 30 days, beginning with the February 2009 payments – originally for a total of six months, ending August 2009. To prevent a sudden double-payment in September, parliament later (May, 2009) agreed on a gradual return to the regular credit periods lasting from August to December 2009.

Finally, in November 2009 – as part of the 2010 budget – it was decided to temporarily halt the gradual reduction of the extension of the credit for withholding taxes for one year. The credit period for withholding taxes will thus be 12 days longer than normal until November 2010, at which point it will be reduced to six extra days and then finally zero days for the December 2010 payments. There was no further extension of the extended VAT credit period, which will be phased out by the end of 2009.

Further tax cuts from 2010

The biggest tax news of 2009 came in the form of the largest tax reform to be implemented since the middle of the 1990's. The reform, due to be

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implemented from 2010 to 2019, allocates some DKK 25 billion to the lowering of marginal taxes on income, including the lowering of the top marginal tax rate for the first time in ten years – to its lowest level in at least 40 years. As of 2010 the top marginal tax rate will be 56.1 pct.

Due to the current economic crisis, most tax cuts will take effect immediately (2010), while the increases will follow gradually, thus making the tax reform under-financed the first years. In the long run, however, the tax reform will be fully financed through a general widening of the tax base, increases in a number of other taxes, especially on energy consumption, as well as through (other) taxes on corporations. All in all, the reform shifts some DKK 32 billion in tax revenue. The main features of the reform are presented below.

Lower tax on income:

- The middle income tax (6 pct.) is abolished (2010).
- The threshold for the top income tax is increased from DKK 377,400 to DKK 444,700 (2010 and 2011)
- The low income tax is reduced by 1.5 percentage points (2010). This also lowers the tax on transfer incomes such as unemployment benefits, etc.
- The first DKK 40,000 in capital income (net positive) will not be subject to top income tax, regardless of total income (transferable between spouses) (2010).
- The tax rates on income from shares (capital gains and dividends) will be lowered to 27 pct. of income below DKK 48,300 (2012) and 42 pct. above this level (2010).

Increased transfers and subsidies towards low-income families and individuals:

- A nominally fixed (not inflation adjusted) DKK 1,300 / year “green check” (plus DKK 300 per child; maximum DKK 600 per mother). The green check is income adjusted, adding 6.9 pct. to the marginal tax at income levels between approximately DKK 395,000 and DKK 413,000-422,000, depending on the number of children (2010).
- A DKK 2,000 / year increase to the income adjusted part of the public pension (2010).

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- A DKK 50,000 / year increase in the household income threshold for free daycare (2010).

Stronger public finances:

- The nominal “tax freeze” of the property tax on owner occupied property and some duties will be financed by the reform for the years 2016-19, rather than from the public purse.
- The permanent inflation adjustment of energy taxes from 2016 will not be used to finance lower taxes, rather the revenue will be allocated to the public purse.
- The increased tax revenue from the supply side effects of the reform (lower marginal tax will increase employment and thus the revenue from income taxes and consumption taxes) will not be allocated to lowering taxes, but rather to the public purse.

Broader tax base:

- The tax value of most deductions is reduced gradually (beginning 2012) by 8 percentage points. By 2019, most tax deductions will only be allowed against municipal tax and church tax (25.5 pct. average). Some standard deductions are raised to (partly) offset the effect, and the first DKK 50,000 in net negative capital income will still be deductible at 25.5 pct. + 8 pct.
- Maximum levels for some tax deductions, such as a DKK 100,000 / year maximum deduction for contributions to certain pension schemes (2010) [contributions to pension schemes are generally deductible against all income taxes except the labor market contribution. Consequently, pension payments are taxed as income, except that there is no labor market contribution].
- A DKK 3,000 / year add-on to taxable income for employees with (partly or fully) employer-paid telephone, PC or Internet available for private use outside the workplace (2010). This corresponds to a tax of DKK 1,200-1,700 / year depending on income. Likewise there will be an add-on to taxable income for employees with company car available for private use. The size of the add-on will depend on the mileage of the car and comes on top of the regular taxation of company cars.

Denmark

- A one-year (2010) freeze of the automatic adjustment of all thresholds in the tax system. Normally, all thresholds in the tax system are adjusted upwards yearly to take account of the increase in wages.

Higher taxes on tobacco, sugar and fat:

- A 25 pct. increase of the tax on ice cream, chocolate and candy (sugar free candy exempt) (2010)
- An increase in the tax on soft drinks containing sugar (and lower tax on sugar free soft drinks) (2010)
- A tax on saturated fat in oil and dairy products (except milk). The tax is postponed till 2011 and will probably be at some DKK 20-25 / kilogram fat.
- Increased taxes on cigarettes and tobacco (2010)

Higher taxes on energy consumption and pollution:

- A 15 pct. increase of the tax on fossil energy consumption and electricity (2010)
- Continued yearly inflation-adjustment of all energy taxes (already agreed for 2008-2015 as part of the 2007-tax adjustment; now the inflation adjustment will be indefinite).
- Introduction of a tax on energy used in the processing industry. Hitherto, energy consumed in the manufacturing process has been exempt from energy tax (but not CO₂-tax). As of 2010 this “process energy” is taxed at DKK 4.5 / GJ, rising to DKK 15-17 / GJ (fossil fuel and electricity, respectively) from 2013. A study of the effect on the competitiveness of Danish companies has been promised in 2012 at the latest.
- Reintroduction of tax on lubricating oil (2010). The tax will be DKK 60 / GJ.
- Gradual reduction of the tax exempt CO₂-emissions granted to heavy industry not part of the European Trading System, ETS (planned to mirror the reduction in free CO₂-quotas in the ETS from 2013)
- Introduction of tax on other green house gasses used for energy consumption at DKK 150 / ton CO₂-equivalent (2010).
- Higher taxes on pollutants in sewage (2011).

Denmark

- Increased taxes on waste for landfills (from DKK 375 / ton to DKK 475 / ton in 2010), including the introduction of a tax on toxic waste; prior exempt from tax to prevent illegal dumping (DKK 160 / ton from 2012, increasing to DKK 475 / ton in 2015.). Beginning 2013, toxic waste will – if used for energy – be taxed at DKK 19.6 / GJ.
- Reform of the registration fee for taxis; effectively lowering the registration fee on cheaper cars and increasing the registration fee on more expensive cars.
- The basis for the yearly tax on vans (cars not fitted for passengers) is changed from weight to mileage – and increased (2010). Existing vans are exempt.
- A DKK 1,000 / year surcharge for diesel powered cars without particle filter. Existing vans – but not passenger cars – are exempt.
- Road pricing on lorries / trucks from 2011.

Further costs on companies:

- Reduction of the (very low) number of VAT-exempt services (real estate and travel agencies) (2010 and 2011)
- Reform of the taxation of financial assets held by companies (2010).
- Nominal freeze on funds allocated as state aid (2010-15)

End of the tax freeze?

As should be clear, the reform is quite extensive; especially in terms of the number of taxes that are increased or introduced to finance the relatively targeted tax cuts and increased subsidies. As should also be noted, the tax cuts and subsidies are targeted at individuals, while roughly a third (in terms of revenue) of the tax increases is targeted at corporations. This shifting of the tax burden has generally been accepted by the major Danish employer's organizations as a sine qua non for the lower marginal taxes – especially on high-income earners – they have been advocating for years.

More controversial, however, is the reforms impact on the so called “tax freeze” which has been the economic backbone of the current centre-right

Denmark

government ever since it took office in November 2001. The original tax freeze was quite rigid, ensuring that no tax or duty could be raised above its 2001-level, except in a limited number of circumstances, e.g. if there was environmental reasons to do so. And in those limited cases, the revenue from the tax increase must be used to finance tax cuts elsewhere. Since being implemented, the tax freeze has kept taxes in check, and in only a limited number of cases can it be argued that the freeze has been broken. In those cases, however, the revenue from the increased taxes has always been returned to the taxpayers through tax cuts.

Upon presenting the ambition of a comprehensive tax reform, shortly after the November 2007 election, the government also announced that the original tax freeze would be temporarily suspended with the reform and be re-implemented immediately afterwards. The reform itself would be guided by a less rigid tax freeze, where *any* tax or duty could be raised, as long as the revenue was used to lower the tax on labor income. In reality, however, the tax reform unfortunately fails to live up to this “tax freeze light”.

Firstly, some of the tax cuts and subsidies are directed more or less specifically at non-labor incomes including transfer incomes. This may be – and has been – explained as part of the ambition to make the tax system “greener”, while at the same time ensuring equitability. These transfers, such as the green check should then be seen as compensation to low income families (who do not benefit particularly from the lower income taxes) for higher taxes on energy consumption. Also in this lighter category of transgresses towards the tax freeze should be mentioned the decision not to let the expected supply side effects of the reform be used to lower the needed tax increases. Instead it was agreed to let this expected revenue bolster the public finances which might not be against the letter of the tax freeze, but which is arguably against the spirit of the tax freeze.

Secondly – and more alarmingly – the tax reform will in a number of other ways strengthen the public finances in a matter that runs counter to the letter of even the tax freeze light that was supposed to govern the reform. This is the case, when some 3.3 billion of the increased tax revenue is used to pay for

Denmark

the nominal tax freeze of the property tax on owner occupied property and some duties in the years 2016-19. This is effectively feeding the dog with its own tail. A tax freeze is not really a tax freeze if it is paid through increased taxation elsewhere. And it is certainly the case with the decision to permanently adjust energy taxes with inflation, beginning in 2016, while not allocating the revenue to tax cuts.

The government has argued that it has always been the assumption behind the government's long term economic forecasts that the nominal tax freeze ends with the end of the current mid-term plan for the economy (at the moment 2015). This is true. Before 2007, when the 2015-plan replaced the 2010-plan, all long-term economic forecasts assumed that the tax freeze would end by 2010. This fact does, however, not change the fact that the tax reform as adopted effectively puts and end date to the tax freeze which has been at the heart of the current government's contract-policy with voters. Unless further tax cuts are agreed upon before December 31st, 2015, the tax freeze ends on this date.

France



Vesselina Spassova, PhD
IREF

Precarious state of public finance

2009 has not been a good year for the French public finances and chances are that 2010 will be even worse. France has deepened its budget deficit and public debt; this was the price to pay for allowing, among other things, the government to engage in some short term measures supposed to speed up the recovery of the French economy - measures included loans for the automobile industry (some € 6.5 billion) or to the banking sector (€ 21 billion). The social security debt also increased; while the pension's reform, desperately needed, was postponed after the 2010 regional elections. The government has announced that, in 2010, it will borrow € 35 billion. This huge loan is to be used for investment projects that should--hence the story goes--stimulate the long-term growth of the French economy. What is sure is that the return to balanced public finance is no longer on the table. The prime minister is timidly speaking about a possible return to the 3% deficit threshold for 2013.

France

Budget deficit

In 2009, while tax revenues represented 41% of GDP, the budget deficit increased to € 138 billion, which is € 80 billion above the 2008 deficit. This number is also more than three times the expected deficit and constitutes an absolute record, even for France. This deficit represents almost two thirds of the net fiscal revenues for the year (see the table below). According to the government's explanations, € 39 billion can be imputed to the "recovery plan", € 57 billion - to the fall in tax revenues and the remaining € 45 billion to the "normal" deficit. In GDP percentage points, the budget deficit thus goes from 3.4 in 2008 to 7.9 in 2009 (161.8 billion €).

Fiscal revenues in 2009 (billions of €)

| | |
|-----------------------|-------|
| Net fiscal revenues | 214.4 |
| Income tax | 46.7 |
| Business tax | 20.9 |
| Petrol products tax | 14.9 |
| VAT | 118.4 |
| Other fiscal revenues | 13.5 |

Source: Projet de loi de finances rectificative 2010

The tendency will not be reversed in 2010. 2010 deficit is expected to be around € 149.2 billion, that is to say, 8.2 % of the GDP. But, for reasons given below, this forecast is overoptimistic. The decrease of State's revenue is likely to last, since no spectacular economic growth is expected for 2010. As a matter of fact, the budget for 2010 is based on the forecast of 1.4% economic growth, instead of the initial 0.75%.

Social security deficit

The social security deficit is also breaking a new record this year, moving beyond the hulking amount of € 20 billion. In France, the social security

France

system unifies the healthcare system, the pensions fund and family state aids. Those deficits have been continuously growing for several years and, unfortunately, nothing leads us to foresee a change in the near future. The government has obviously abandoned the idea of introducing radical changes in the pensions system (although a “reform” is to be voted by the end of 2010, the government has already announced that the pillars of the actual system will stay unchanged); the healthcare system is remaining unchanged; the family aids budget is constantly growing because of the depression on the job market.

In this gloomy context it was for the least strange to observe how the French government found a way to waste hundreds of millions of euros during the vaccination campaign against the H1N1 flu.

Increase of the public debt

The public debt-to-GDP ratio, which was at 67.4% in 2008, is going to reach 77.4% in 2009 and increase again to some 83.2% in 2010. Government spending is also quickly growing – 52.7% in 2008, 55.6% in 2009 and 55.4% expected in 2010. This maintains France to one of the leading places in the ranking of government spending in OECD countries. More precisely, France was second only to Iceland in 2008 and just behind Iceland, Denmark, Finland and Sweden in 2009, the first rank accruing to Denmark with 57.7% (OECD *Economic Outlook* Table 25)

French Public Debt (% of GDP)

| | |
|-----------------|------|
| 2007 | 63.8 |
| 2008 | 67.4 |
| 2009 | 77.4 |
| 2010 (forecast) | 83.2 |

Source: Projet de loi de finances rectificative 2010

France

Recovery plan and “Grand Emprunt” (Massive Borrowing)

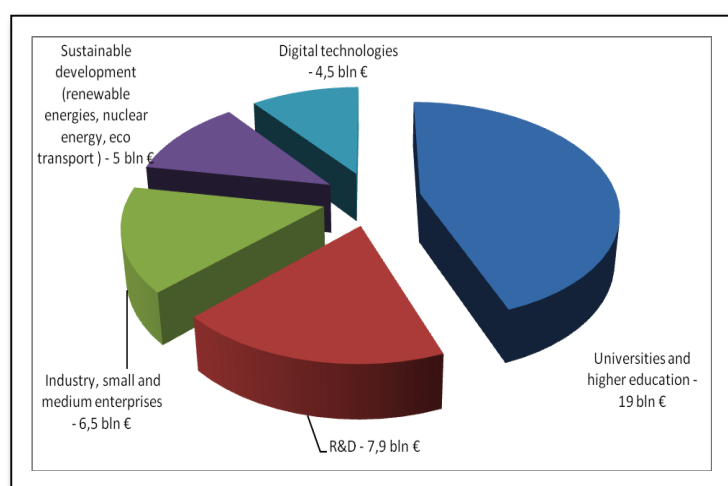
« France is among the countries which are dealing very well with the crisis” – is proudly claiming President Sarkozy. According to him, this good performance would be due to the recovery plan implemented by the (his) government. This plan has already led to the spending of € 29 billion and another € 6 billion should be spent in 2010. To this amount must be added the generous loans granted by the government to rescue the banking sector or the car industry.

Next to come to complete its ambitious recovery plan, is a massive borrowing by the government of about € 35 billion; the so-called “Grand Emprunt”. As a matter of fact, “only” € 22 billion will be borrowed on the international financial markets in 2010; the rest will be coming from the banking sector paying back its debt. In order to escape the Maastricht restrictions on government debt, the borrowed money will be transformed in “assets” by granting loans or taking shares in the capital of some companies. This maneuver is supposed to preserve the image of France on the international financial markets and avoid a downgrading of its notation.

With the borrowed money, the government is eager to invest in the capital of some universities and research unites in order to stimulate R&D expenses, which are in France, just below the average level for OECD countries. In the purest interventionist tradition, the French government is considering that R&D investments have to be realized and commanded by the State, not the private sector. This is why, to supervise those investments, the government just created a *Commissariat général à l'investissement* ; a kind of National Investment Planning Unit.

France

The Graph below presents how the government intends to spend the money to be borrowed.



Source: Projet de loi de finances rectificative 2010

Abolition of the Business Tax in France

France's 2010 Finance Bill provides for the abolition of the Business Tax, which is collected by local communities and currently accounts for 10% of their revenue. Named by François Mitterrand "the stupid tax", the Business Tax is the main local tax, paid every year by nearly 2.9 million firms. It is based on the investment in equipment done by firms (the basis of the tax is the rental value of a company's tangible fixed assets) plus 1.5% tax on the value added for companies with a turnover exceeding € 7.5 million. The tax had been for a long time the object of many criticisms, from the left as well as from the right side of the political spectrum, for hampering economic activity; penalizing those who innovate and invest the most (the tax is due even when the investments are not profitable). The abolition of the Business Tax is therefore expected to reduce incentives for outsourcing.

France

Moreover, throughout the years the State (central government) had become in a way the main payer of the Business Tax, since it had to compensate local communities for the dozens of business tax reductions and exemptions introduced by successive central governments.

The Business tax gone, new sources of revenue must be found for local communities. The government proposes a new Territorial Economic Contribution (TEC). The main difference between the Business Tax and the TEC is that the latter will be based only on the rental value of real estate assets of the company – machinery and equipment being no longer in the tax base (they represented 80% of the former Business Tax base). Besides the TEC, an Additional Contribution is set for companies with turnover exceeding € 500,000 - they will have to pay a percentage of their value-added, at a rate between 0.5 and 1.5%.

The abolition of the Business Tax is highly controversial – according to local representatives, it will compromise their budget balance if not compensated by other revenues, especially in the current economic context. Another side of the problem is that, if the State fills the gap in local finances, the reform will threaten local communities' autonomy, since they will more heavily dependent on central government. It might even be considered as unconstitutional, since article 72(2) is recognizing a fiscal and financial autonomy of local collectivities (See G. Bramoullé's contribution to IREF study on local finance in France).

Carbon Tax

As late as last January, the 2010 Financial Bill was still counting on the revenues from a new carbon tax at the rate of € 17 per tone. Some € 4 billion thus figure in the government budget for 2010. The problem, however, is that by the end of 2009 (and few days before the official publication of the financial bill), the French Constitutional Council pronounced a negative opinion on the carbon tax project cherished by President Sarkozy and his government.

France

The carbon tax was meant to bear on activities related to high CO₂ emissions, like petrol, gas, coal, fuel oil, LPG (liquefied petroleum gas) when used as combustible. It was supposed to be imposed to every physical or moral person, except those already subject to the European Emission Trading Scheme (ETS). Obviously, such a tax would represent an additional cost for French manufacturers and make it more difficult for them to compete abroad. This is why the government has decided to smooth the disposals for many sectors such as agriculture, fishing, road transportation, etc.

Those exceptions are precisely the reason for the Constitutional Council's rejection of the project – the tax is in contradiction with the principle of equality of all citizens before the tax.

From there, the French government was apparently facing two options - to renounce to its green ambitions or to find a compromise, reducing the tax exemptions without too much disappointing the previously exonerated groups. It finally decided in March to abandon temporarily the project, claiming that the discussion should be moved at the EU level.

The introduction of an “ad hoc” tax on bonuses

The government, considering that without its precious help the banks would not have realized benefits in 2009, has judged fair to tax bonuses exceeding € 27,500 at the rate of 50%. The expected revenue from this tax is € 360 million. Most of those revenues will be allocated to the *Fond de garantie des dépôts* (a national fund aimed at securing people's savings in case of bank crisis).

Tax avoidance scandal

In the context of the global financial crisis, the French government decided to intensify its war against tax avoidance and tax evasion. The war loot so far

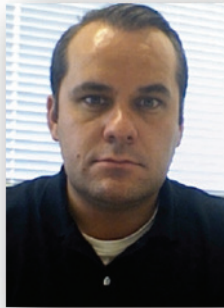
France

would amount, according to the Minister of Budget, to some € 700 million. But the tools used to win this war are questionable. Last August, the French finance minister, Eric Woerth, announced to be in possession of a list of 3000 bank accounts open by French citizens in Swiss banks. Many individuals on the list would have allegedly hidden their revenues in Swiss banks to avoid paying taxes in France. The government invited them to denounce themselves “spontaneously” before the end of 2009. In the meantime, however, the media revealed that a former employee of HSBC had stolen the list from the bank’s database. The use—or planned use—by the French authority of material stolen from the Swiss branch of HSBC made the bank furious, and led the Swiss government to suspend the ratification process of the renegotiated double taxation treaty with France until further notice.

Conclusion

As was the case with most European countries, France chose to respond to the crisis with increased government spending at the cost of larger debt and larger deficits. The French government is rather happy with the results at that point, since the economic growth is back (+0.6% for the fourth quarter of 2009). The future will tell us whether this Keynesian policy provides long-term benefits. One thing is certain, however: France is going on the road towards more public spending and greater deficits, and none of the much-needed reforms have been done.

Germany



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German tax policy changes for the year 2010

(i) Accelerating growth?

At the core of the tax changes for 2010 lies the “*Wachstumsbeschleunigungsgesetz*”, i.e. the *law for accelerating economic growth*. It has found a majority in the upper chamber of parliament, the Bundesrat, just before the Christmas break and comes into effect in January 2010. The title of this law is, however, somewhat misleading. Its goal is not so much to improve long-run growth, but rather to provide a short-run stimulus to the ailing economy. It does so in particular by reducing the tax burden for individual taxpayers in the personal income tax. A reduction of the tax burden is achieved through a number of different measures, and each by itself is not too spectacular quantitatively.

Germany

The most popular policy is the increase of the tax-free allowance for children in the personal income tax. This allowance consists of (a) the child allowance in the narrower sense, which is increased from € 3,864 to € 4,368 per child and family, and (b) an additional allowance for child attendance and education, which is raised from € 2,160 to € 2,640. The entire tax-free allowance therefore now stands at € 7,008. There has been some confusion in the initial stages of the political debate, when some pundits perceived the plans such that only (a) would be raised to €7,008, which obviously would have resulted in a much heftier reduction of the tax burden. The combined tax-free allowance for children now stands € 996 below that of an adult. In other words, a couple with two children is never taxed at all if its annual market income is below € 30,024 – social security contributions are, however, enforced.

It is necessary to point out that the German system of supporting families with children is a bit more complicated: Parallel to the tax-free allowance, there is also a direct transfer to families with children, the *Kindergeld*, which has also been increased, by € 20 per child and month. It now stands as € 184 for each of the first two children, and it increases to € 190 for the third, and € 215 for the fourth (and every further) child. For families who file taxes, the tax administration automatically checks which of the two options is more beneficial given their income situation. The dual system is meant to ensure that low-income families, who do not benefit from tax allowances to any large extent, also receive public support for their children. Also, note that for an average family with two parents and two children, an annual family income of above € 60,000 is necessary in order to make the tax-allowance option more beneficial than the *Kindergeld*. The larger fraction of the population will therefore not benefit from the change in the tax-free allowance, but from the increase of transfers.

Another adjustment is made to the only recently reformed inheritance tax. This tax is characterized by different progressive tax schedules, depending on the family relations between the bequeather and the heir. From 2010 onwards, the tax rates for siblings, nieces and nephews are reduced. So far, they were spread from 30 percent on tax bases below € 75,000 to 50 percent

Germany

on tax bases above € 26 million. After the reform, they will raise from 15 to 43 percent over the same range. Here, it is important to note that the tax base varies considerably from the actual value of the inheritance (some details on this can be found in last year's article on the German tax system). Another change with regard to the inheritance tax is that the qualifications for tax exemptions in the inheritance of businesses have been loosened. A business can qualify for these exemptions if it keeps the sum of its wages above a threshold level for a certain time after the actual inheritance took place (again, for details the reader is kindly referred to last year's article). From 2010 onwards, the required time has been generally shortened from seven to five years, and the wage thresholds have also been reduced, in some cases by more than 40 percent.

The latter measures reflect a certain kind of pragmatism in times of economic crisis. It is obviously difficult for businesses to stabilize their overall sum of wages paid during a recession. Their inability to meet the requirements of the inheritance tax code would, however, force recently inherited businesses into paying substantial inheritance taxes. This, in turn, might pose a problem for businesses with tight liquidity, especially in times of a (perceived or real) credit crunch. Unfortunately, these reforms do only scratch at the surface of the problem. The tax incentives that aim at preserving given structures instead of facilitating structural change remain in place, although in weakened form.

Some adjustments made with regard to the interest deduction ceiling (*Zinsschranke*) have a similar motivation. Interest payments are in general deductible only up to the amount on interest earnings in the same year; additional interest payments are only allowed to be deducted up to 30 percent of EBITDA (Earnings before interest, taxes, depreciation and amortization). Any further interest payments can be carried forward and, provided there is sufficient space under ceiling in the future, deducted later. Generally, businesses whose positive difference between interest payments and earnings was below € 1 million were exempt from this rule. The old government had extended this limit to € 3 million for 2008 and 2009. Now, this extended limit is kept in place for 2010 and beyond, without time limit.

Germany

In addition to this, businesses are now also allowed to carry forward an EBITDA not used (i.e., unused space under the interest deduction ceiling) for five years. This is intended to reduce an unwanted side effect of business cycle fluctuations: In a recession, typically characterized by a low EBITDA, businesses suffer from a reduced space under the interest deduction ceiling and thus from higher tax burdens. Allowing them to carry forward unused space from boom years reduces the cyclical effects of the interest deduction ceiling on tax burdens.

Again, these are certainly measures that, from the perspective of many entrepreneurs, are most welcome. It has to be noted however, that again the deeper structural problems of the tax system are not addressed. In particular, for businesses that are just below the 3-million limit, marginal decisions can have huge consequences in taxation. The difference between being subjected to the interest deduction ceiling regime or not being subjected to it can, after all, be very substantial. We can therefore expect this rule in general to have highly distortive effects, at least for some businesses.

There are also several changes in the tax code that aim at facilitating business restructuring. Already enacted by the old government but again limited for 2008 and 2009, an allowance was made to carry forward losses from purchased businesses, if there was an ongoing concern in them. The time limit for this allowance has also been removed. Furthermore, restructurings among companies within a holding are now exempt from the land purchase tax.

In the local business tax, the calculation of the tax base requires a number of additions to the profits determined via standard accounting rules. In particular, a fraction of rent and leasing payments on immobile assets is to be added. So far, this fraction has been set at 65 percent, and it is now reduced to 50 percent.

Finally, there are also a number of rather odd provisions in the newly approved tax law. For example, the VAT rate on hotel accommodation is reduced from 19 to 7 percent. And small assets worth up to € 410 can now be

Germany

deducted immediately in the year of purchase. The growth effects of these measures do, however, remain obscure.

(ii) Other changes in the German tax law

Not quite voluntarily, but following a decision from the constitutional court, the German government now also allows for a full deduction of the costs of private health insurance from the tax base. The only limit is that the deducted level of private insurance must not exceed that of a standard, public health insurance plan. To complicate matters, there is still a cap of € 2,800 in the tax law. If the costs for private health insurance are below this cap, then the remaining space can be used to deduct costs for other private insurances, e.g. against unemployment, or against incapacity to work. If, on the other hand, the costs for health insurance are equal to or greater than the cap, then only health insurance can be deducted – but to the full extent, even if the relevant amount exceeds the cap.

(iii) An outlook

Small steps and piecemeal reforms have characterized German tax policy during the last year. There have not been any fundamental reform measures. More radical changes in German tax policy might, however, follow in the near future. The coalition parties of the new centre-right government have in principle agreed on a number of more far-reaching tax reforms in their coalition accord, which has been negotiated shortly after the September 2009 elections. In short, the two most striking passages on tax policy in the agreement concern:

- A reform of the personal income tax. The coalition is planning to implement an income tax schedule with stepwise increasing marginal tax rates. In contrast, in today's system the marginal tax rate is continuously increasing until the top rate of 42 percent is reached at an annual income just above € 50,000 (for incomes over € 250,000, there is then another jump to 45 percent). The ambitious plan of the liberal coalition party is to have a schedule with only three marginal tax rates: 10, 25 and 35 percent. The very

Germany

significant advantage of such a reformed schedule would be that a huge incentive problem of the current system – steeply increasing marginal tax rates for low incomes – would simply disappear. The problem from a budgetary perspective, on the other hand, is that such an ambitious tax reform would also be costly in terms of lost tax revenue. At present, it is very doubtful that any such plan will indeed be realized. A tax reform is promised to be decided upon in 2010 and to come into effect in 2011, but the eventual outcome is likely to be much more modest.

- The coalition considers abolishing the local business tax (the *Gewerbesteuer*). Prima facie, abolishing this tax appears to be a reasonable idea. Transaction costs of paying and administering the tax are relatively high, since the tax base is different from that of the federal corporate income tax (the *Körperschaftsteuer*). Thus, some extra effort has to be put into the tax declaration for the local business tax. However, the key question emerges: How should local jurisdictions be financed instead? One proposal is to substitute the local business tax by assigning the local government level additional shares in the VAT revenue. This would imply a spectacular increase in government centralization, however. Local jurisdictions are relatively autonomous in setting tax rates for the local business tax, but the VAT is administered at the central level. It would certainly be a more elegant, federalism-preserving solution to allow the local governments to levy surcharges on the corporate income tax.

As so often, there are fiscal restrictions that political documents like the coalition accord do not always account for. The Council of Economic Advisors estimates a negative GDP growth of five percent in 2009 for Germany, and expects positive growth of 1.6 percent in 2010. With tax revenues lagging behind and government spending growing, the Council predicts a deficit to GDP ratio of 3 percent in 2009, and 5.1 percent in 2010. In addition to this, Germany now has a new constitutional limit on public debt, which is much more difficult to circumvent than the old rule. The new constitutional debt brake demands that, in general, the federal government is allowed to run a deficit to GDP ratio of only 0.35 percent from 2016. Budget consolidations towards this goal already have to start in the 2011 budget.

Germany

On the other hand, the current *Wachstumsbeschleunigungsgesetz* is already expected to be quite costly in fiscal terms. Relative to the status quo ante in tax laws, the government expects revenue losses of € 6.1 billion in 2010, € 9 billion in 2012 and still € 8.1 billion in 2014. Given this institutional and fiscal environment, it is at present very unlikely that a large-scale tax reform along the lines proposed by the liberal coalition partner should indeed find a majority. In fact, the Council of Economic Advisors is also strongly opposed to any further tax cuts. Instead, the Council proposes ambitious spending cuts in order to consolidate the budget without having to *increase* taxes.

There are also substantial uncertainties with regard to additional spending requirements in the coming years. The constitutional court, for instance, is to decide a case on the level of social transfers to children of unemployed parents in the near future. If the court decides that the level of transfers is unconstitutionally low, then tax increases are probably unavoidable. In short, the prospects for a fundamental tax reform that further decreases the tax burden of German citizens and corporations are not too good in the foreseeable future. This is reflected in political struggles within the newly formed coalition, where proponents of the conservative parties are already displaying a profound unwillingness to discuss further tax cuts.

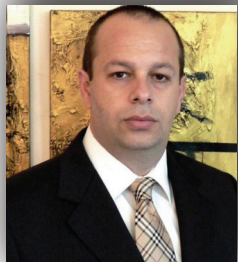
Germany

Greece



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Introduction

Year 2009 turned out to be a tempestuous one for Greece, especially regarding fiscal matters. It was the time when Greece figured in the front pages of prestigious European newspapers accompanied with titles such as “Greek tragedy” (Der Spiegel), or the “Greek Patient”, and comments such as that “Greece should never have joined the Eurozone” (Frankfurter Allgemeine Zeitung).

Greece

In the midst of this financial storm, the new socialist government elected in October 2009 looks like another Odysseus between Scylla and Charybdis, namely on the one hand the reactions of Greek citizens to whom a raise of income had been promised during the pre-election period and, on the other hand, the pressures of international markets and of the European Union to take tough measures, as Ireland did, mostly in the public sector.

Today (end of December 2009), the discussion regarding the clampdown tax measures is at the centre of a debate and it is clear that tough measures will be taken. On a daily basis, new ideas and new measures are added, and the government has already mooted a series of measures in the framework of a public debate.

As we will see below, in the last two years, the previous government has attempted to reduce taxation decreasing the tax rates on income, inheritance, and so-called “parental gifts”, and substituting to the tax on great real estate a much lighter new levy. Unfortunately, this attempt to rationalize the tax system was not associated with equivalent measures to restrict tax evasion, resulting in a deep fall of State’s income, and forcing the government to impose a new charge (named “emergency contribution”) on incomes above € 60,000.

Some numbers suffice to show the volume of the tax evasion. According to data from the Ministry of Finance, the amount of non-collected taxes reaches € 31 billion. It is also worth noting that the Greek State collects on time less than 70% of the taxes imposed every year, with, as a consequence, the continuous growth of the fiscal deficit and the public debt.

Regarding persons, 94% of the tax revenues stems from incomes below € 30,000. 33% of the Greek families submit a tax return of a yearly income between € 12,000 and € 30,000. The average of this income class is € 19,000 per year, meaning that the average monthly income is below € 1,600 Euros, and corresponds with a tax equal to €1,140 per year. Only 3,000 Greek households declare an income over € 200,000.

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Seven out of ten freelancers submit a tax return which is below the threshold of taxable income, and, as a consequence, do not pay any tax to the Greek State, whilst only 2,557 freelancers (0.6%) report an income above € 100,000.

If we trust the data coming from the tax returns of 2008, pensioners in Greece are richer than dealers, traders and freelancers, given that pensioners submit on average a taxable income of € 11,873 per year, whilst dealers and practical tradesmen report an income of € 10,440, and the freelancers, € 9,057!

Recent surveys of the European Commission show that 30% of VAT revenues, namely, € 6.6 billion per year, is not collected due to tax evasion and tax avoidance--compared to the average loss of VAT revenues in the European Union which is no more than 12%.

A special survey of the OECD estimates that, in Greece, for every 100 Euros of tax revenue, € 1.69 must be spent in tax-collecting mechanism and related red tape. In the other European States and OECD member countries, the equivalent cost is below 1 Euro (except for Slovakia). Hence, the total yearly cost of tax collection reaches a staggering € 900 million.

These calculations are indicative of the inefficiency of the tax-collecting mechanism and more generally of the Public Sector. It could explain the extent of tax evasion and of the grey-economy which is the highest among OECD countries. It could also explain why the Public Sector does not collect taxes below €27 (as, for instance, in the case of the Single Charge on Real Estate (ETAK)) -- the collection of debts below €27 is very likely to cost more than it collects.

It is obvious that any change in tax policy that would not be coupled with a crack on tax evasion and the creation of a rapid and effective tax collection mechanism, is condemned to fail.

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Below, we are going to see concisely, firstly, the major changes in the Greek tax system that have taken place in the last two years and, secondly, the changes that the new government has already announced for 2010.

Most significant changes in the tax system during the last two years

Income Tax:

Personal Income Tax generally is progressive (five brackets) with the highest marginal rate at 40%, whilst Corporate income tax is flat with a rate that varies according to the legal statute of the company and can reach 25%. Preferential taxation is granted to various classes of income without any justification (income of members of Parliament, judges, footballers etc.)!

With the Law 3758/2009 a new tax levy called “emergency economic contribution” was imposed on individuals’ 2007 income. More precisely, it concerns those who, in 2008, had reported an income above € 60,000. This emergency contribution caused a lot of reactions and many tax payers resorted to Administrative Courts considering that the law was anti-constitutional since it imposed retroactively a tax on previous years’ income; something in violation of the Greek Constitution. The Court of First Instance, in its first decision so far, has abrogated the emergency contribution considering it illegal. The Supreme Court will now judge the case and, if the latter confirm the decision of the Court of First Instance, the State will have to return the amounts collected, a situation that will worsen the problematic state of public finance.

Inheritance tax:

In 2008 (Law 3634/2008) the government took a series of measures to lighten the inheritance tax. Specifically:

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- Exemption from inheritance tax for the spouse or children of the legatee for the acquisition of a residence of at most 200 square meters as long as the heir do not have a residence fulfilling their housing needs.
- Reduction of the tax rates for the closest relatives of the legatee. Specifically, it was provided that for first-degree relatives of the legatee (based on the criterion of closeness as defined in the Law) the first € 95,000 are tax free (the first € 20,000 for so-called B-relatives), the remaining value of the inherited real estate being taxed at a rate of 1%.

Tax on “parental gifts”:

“Parental gifts” (goniki parohi) is the name given to property grants from parents to children having all the characteristics of a donation. With the Law of 3634/2008, the tax regime for parental gifts was reformed. Thus, in this case as well, a tax allowance of € 95,000 has been granted. For the remaining value of the transferred real estates from parents to children, a stable tax rate of 1% applies.

Pursuant to the same law, full tax exemption is granted when the parental gift transfers what is to become the first residence of the beneficiary. This tax exemption is conditional on the size of the real estate. The parental gift of movable property are taxed with a rate of 10%, whilst regarding the parental gift of participation in businesses, shares and other movable property, an independent taxation is imposed with rates from 0.6% to 1.2%.

It must be noted that those new tax rates and tax allowances are judged as particularly favorable in relation to what applied previously. As explained below, however, the new government already plans to increase those rates.

Real estate tax – Imposition of a single tax levy on real estate:

Pursuant to the law 3634/2008 a Single Charge on Real Estate was imposed on the value of the house and other real estate rights as of the 1st of January of the taxation year. After deduction of the value of the taxpayer’s main residence, the total value of the individual’s real estate is subject to a single

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charge with a proportional rate of 1%. The real estate value of legal entities is taxed with a rate of 0.6%. (In most cases the value is calculated on the basis of the pricing defined by a Law specific for each region). Individual's main residence with area not exceeding 200 square meters is not subject to any charge if its value is below € 300,000.

It must be noted that this single charge on real estate replaces a previous tax that was much more severe for owners of large real estate. If the change is therefore favorable to large owners, it is however penalizing owners of small real estate who until then had not paid any and are now subject to the same single charge on real estate.

Consumption tax:

In addition, the Greek government introduced the following changes:

- Increase of the excise tax on fuel
- Increase of the charge imposed on mobile telephony subscribers
- Imposition of an emergency contribution on the owners of pleasure craft from 10 meters on and sailing boats from 15 meters on.

Changes in the taxation promoted by the Greek government in 2010

A series of measures have already been mooted in the framework of a public debate; measures that the new government, elected in October 2009, intends to pass. The framework remains, however, rather flexible and new ideas are added on a daily basis. The main measures under discussion are the following:

Income tax:

- a. A single progressive tax scale is going to apply to all incomes notwithstanding their sources. It is also very likely that the tax rate for the lowest bracket will be reduced so as to relieve the lower-income class, while

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upper rates will be increased from today's 40% to 45%. Income tax will therefore become more progressive.

- b. Enhancement of the measure concerning the deduction of consumption expenses based on receipts. In an effort to increase incentives for taxpayers to ask for receipts from merchants and businesses that usually evade taxation, the government considers granting tax credit for such expenses.
- c. Distributing earnings and dividends. Today, dividends are taxed as a corporate income and not as an income for the shareholder. It is considered as certain that in 2010 dividends will be taxed as personal income. This means that the taxation of the dividends may arise up to 45%.
- d. Abolition of specific tax regimes and of many tax exemptions is predicted for special classes of taxpayers and benefits
- e. Stock Exchange Transactions. The Government intends to apply a tax to any net profits from the sales of stocks, that is, after deducting any eventual losses.
- f. Introduction of new objective criteria for the calculation of taxable income (probably through the introduction of presumptions), so as to put an end to tax evasion.
- g. Higher taxation on offshore companies having real estate in Greece.
- h. Taxation of the incomes of Monasteries, Church and other public welfare institutions that until today enjoy a special status of tax exemption.
- i. Taxation of the bonuses of bankers with a rate of 90%.
- j. Imposition of an "emergency contribution" on the 2008 profits, with a rate ranging from 5 to 10%, depending on the level of the company's gains. Specifically, the rates of this contribution will be:
 - 5% for the businesses with 2008 gains from € 5 million to € 10 million.
 - 7% for the businesses with gains from € 10 million to € 25 million.
 - 10% for the businesses with gains over € 25 million.

Inheritance tax – Parental gifts:

There should be a reintroduction of high rates for the inheritance tax, parental gifts and donations. As a result of this rumored change, there has

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been a great increase of real estate transfers through parental gifts in the last days so as to benefit from the favourable taxation regime while it is still in place.

Real estate taxation:

There should be a reintroduction of the Tax on Large Real Estate. The abolition of the single charge on real estate and the reintroduction of the Tax on large real estate are considered as certain, aiming at taxing as much as possible owners of large real estate.

Consumption tax:

There is going to be an increase of excise duties on fuels, drinks and cigarettes.

Measures to reduce tax evasion:

- i. A system requiring each taxpayer to justify the origin of the money spent for living is to be implemented largely. Its prevalence is proposed among the entire population and especially among employees of the Tax administration. When filling up their tax return forms in 2010, all the financial assets and the living expenses of the tax payers will be detailed as best as possible in order to control for the way their financial assets were obtained and to check whether the money spent to acquire property is derived from legal sources. Specifically, bank accounts, bonds, mutual funds, shares, dividends, even transactions with credit cards, real estate, pools, cars must be reported on the new tax return document. It is worth noting that this regulation will not have a retrospective effect, that is, in the 2011 tax returns (where the bank accounts are going to be recorded till the end of 2010) there will not be any retrospective check.
- ii. Commercial – professional transactions above a threshold value will be carried out exclusively through special bank accounts and will be open to the tax auditors.

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- iii. All incomes that freelancers and businesses understate through their tax returns will be published on the Internet.

Conclusion

It is widely known that in Greece there is too much black money circulating in the market which investigating authorities cannot or do not dare to tax. Indicative of that is the fact that the Prime Minister himself admitted to the European Union that, in Greece, corruption is widespread.

The new government elected in October 2009 inherited a huge deficit amounting to 12.7% of GDP. In order to reduce it, a series of measures have been prepared which suppress a substantial amount of tax preferences and loopholes introduced by the previous government and increase the taxation of the highest incomes.

However, this over-taxation cannot in itself solve the huge fiscal problems facing the country. Unless tax evasion and corruption of the tax controlling mechanism are eradicated, this heavier tax burden will have as only result a lower rate of development, and leave open the possibility to hide incomes.

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Italy



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Introduction

As in every country worldwide, the evolution of Italian tax policy has been, during 2009, completely dominated by the global economic and financial crisis. The general downturn in economic activity has had a huge impact on tax revenues protracting the fall that had begun at the end of 2008. Central government tax revenue on a cash basis decreased, in 2009, by 2.6 per cent or € 10.6 billion, against increases of 9.6, 4.8 and 0.7 per cent respectively in the three previous years.

Revenue from corporate income tax and self-assessed personal income tax fell by 20.3% or € 15 billion. The amount of self-assessed personal income tax collections was influenced by the reduction, introduced towards the end of the year, of the size of the payment on account. VAT receipts fell by 6.6 per cent, or € 7.8 billion, and receipts from the withholding tax on financial assets dropped by 7.3 per cent, or € 1 billion. The amounts withheld on payroll workers' earnings remained basically unchanged. Revenue in 2009 benefited, instead, from the temporary increase in receipts from excise duties on methane (€ 1.6 billion) and lotteries (€ 1.4 billion). Social security

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contributions also contracted in 2009. In the first nine months they were 1.3 per cent lower than in the year-earlier period.

Turning to local government revenue, the figures published by the Ministry for the Economy and Finance for the first eleven months of 2009 show a reduction of 10.9%, or € 3.9 billion, in receipts of the regional tax on productive activities (IRAP) and virtually no change in those of the regional and municipal personal income surtaxes.

The government had intervened to sustain the economic activity, which it did (although to a lower extent than most other industrial countries) with a combination of tax rebates and expenditure increases that were dictated by the worsening of the general economic situation and of the state of the public finances.

Tax changes during 2009 have been a combination of tax rebates to sustain family incomes and economic activities and of tax increases made necessary by the need of avoiding excessive overshooting of net public sector borrowing with respect of the 3% threshold imposed by the Maastricht criteria. By necessity, tax changes have been in general piecemeal and they have further distorted the structure of the Italian tax system. The government has also been forced to postpone to better times the implementation of the repeated promise of eliminating IRAP (see 2008 IREF report on Italy). The government has now promised that it will proceed in 2010 to an extensive tax reform that will align the Italian tax system to the most evolved models of revenue raising systems.

There have been three important rounds of policy measures during the year. They are reported in the next table along with the set of measures taken in November 2008 whose impact has been displayed in 2009. The table distinguishes between tax measures that reduce collections and those that increase them.