

Italy: summary of recent tax policy measures

Reference	Tax rebates	Tax changes leading to revenue increases
November 2008 Decree Law 185	<ul style="list-style-type: none"> • Partial deductibility of IRAP from corporate income tax • Deferral of VAT payments 	<ul style="list-style-type: none"> ▪ VAT tax rate on PAY TV services raised to 20% (from previous 10%) ▪ Surtax on pornography ▪ One-off substitute tax on voluntary revaluations of company assets
February's Anti-crisis decree	<ul style="list-style-type: none"> • Tax credits on purchase of furniture, high-tech domestic appliances, TV sets, personal computers. • VAT reduction on environmentally friendly vehicles 	
The law in favor of the population hit by the earthquake in Abruzzo, – Law 77/2009		Broadening of the range of gaming activities offered to the public (introduction of new lotteries and opening of tobacconists on public holidays).
The end-of-June anti-crisis decree – At the end of December the Government issued Decree Law 78/2009	Provision of tax incentives for new investments in machinery and equipment	Procedures for issuing gaming licenses revised
Law 102/2009		Extraordinary tax on repatriation of financial and real assets held illegally abroad (5% of repatriated sums)
Finance bill for 2010	Extension of personal tax relief for building refurbishments	

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Tax changes can be sorted out into three distinct sets: those referring to the taxation of firms, those oriented to sustain household consumption and an amnesty for repatriation of assets illegally held abroad.

Taxation of firms

Two important measures were taken with the Finance Law for 2010. The first one was the deductibility from the taxable income of the corporate income tax (IRES) and of personal income tax (IRPEF) of 10 per cent of the IRAP (regional tax on productive activities) due. This represents a substantial reduction of the tax burden on firms the cost of which has been totally assumed by the central government, since the regional governments that own this tax have no reduction in their collections. It is also partly in line with the intended elimination of IRAP. The second measure is a once for all payment, referred to corporate income tax, of the additional profits emerging: a) from extraordinary operations, such as mergers and fusions, b) from reevaluation of assets held by firms and c), from the reevaluation of assets connected with extraordinary operations (point a). The tax rate of this once for all payment varies from 1.5 to 10 percent. The measure is estimated to provide substantial revenue to the public treasury, by allowing firms to anticipate at a discount their future tax payments.

The most general anti-crisis measure is the provision, taken in June 2009, of tax incentives for investments in machinery. The measure provides for the exclusion from firms' income of half of the cost of machinery and equipment purchased in the following twelve months; the consequent loss of revenue is expected to occur over the next two years (it will amount to about € 2 billion per year). There have been antecedents of this measure in 1994 and 2001, although in those cases only investments exceeding the average of the previous five years could be excluded from revenue. The aim is very clear: to sustain investment activities by all categories of firms, and more particularly investment in machinery and equipment. For example, the purchase of computers is excluded from the provision. The reason is to focus the impact

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of the tax relief on purchase of machine tools and other equipment for which there is an important domestic supply in Italy.

Tax measures oriented to sustain household consumption (and indirectly industrial production)

There are here two subsets of measures. The most important one is the one on vehicles. As in most other car producing countries, Italy has tried to sustain domestic production through a set of measures stimulating: a) the replacement of old and heavily polluting vehicles with new and less polluting vehicles, (predominantly small cars) and, b) the purchase, without necessarily the replacement, of vehicles that feature fuel-saving innovative technologies, such as cars fueled with GPL. The incentive consists both of lump sum price rebates through the reduction of VAT due, and of temporary (up to 2 years) exemption from the vehicle tax (a regional tax on ownership of vehicles). As in other countries the measure has had a strong impact on car sales that have jumped despite the crisis. The impact on revenue has also been positive: the increase in the number of cars sold has more than compensated the reduction of VAT on each unit sold. In this case households have anticipated purchases and the fiscal authorities has anticipated its collections.

The second set refers to domestic appliances and consists in the possibility given to households to deduct from their taxable income a share (20 per cent) of the price of domestic appliances purchased during a process of refurbishment of their dwelling. In other words, no ordinary purchase of domestic appliances will benefit from the deduction, but only those purchases made in the framework of renovation/refurbishment of dwellings for which the government is also providing tax relief for construction and other structural work. To some extent the measure complements and parallels the incentives for vehicles, providing support to the producers of domestic appliances that constitute an important component of the Italian industrial sector. The incentive to refurbishment of dwelling, but not for purchases of domestic appliances, has been extended by the Finance Bill for 2010.

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The tax amnesty on repatriation of assets

In terms of revenue the biggest policy change has been the extraordinary tax on repatriation of assets illegally held abroad: the so called “tax shield”. This is a recurrent policy measure in Italy. Individual and firms export capital assets to avoid taxation and red tape and are lured back periodically by a tax amnesty requiring declaration of assets and payment of a once for all tax payment. In 2009 the tax rate has been 5 per cent on the gross amount of declared assets. The revenue collected has been quite substantial amounting to approximately € 5 billion on a total of € 98 billion of assets declared. It has to be specified that most of the assets will not be physically repatriated, but that the amnesty will have longstanding impact on tax revenue, because a large illegally hidden tax base has now fallen into the net of the Italian tax authorities.

To complete the illustration one has to mention that the other miscellaneous measures taken by the Italian government in the tax sector include some widening of the fiscal exploitation of gambling. This has been done mostly by extending the range of legal gambling activities and the number of lotteries organized by the public sector, and by extending the opening hours of tobacconists (the selling points of legal gambles).

Finally, mention has to be made of Parliament approval of Law 42 in June 2009. The law authorizes the government to issue decrees to determine the revenue system of regional and local governments implementing the constitutional reform of 2001. The law is quite detailed on equalization grants, but is rather vague about local tax autonomy. It mentions, however, that IRAP will be eliminated as soon as the macro- financial equilibrium will allow it. Thus, decentralized government tax autonomy will have to be rebuilt almost from scratch. It has to be pointed out, however, that a large consensus among political parties has been built around Law 42. This shows the broadly shared consensus around a skeptical view of the merits of local tax autonomy.

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Kaetana Leontjeva
Policy Analyst
Lithuanian Free Market Institute
Kaetana@lrinka.lt

Overview

In late 2008, a right-wing coalition government came to power in Lithuania and within a month it produced what would become a dramatic tax reform. Some areas of the Lithuanian tax system, such as personal income tax and healthcare security contributions, were indeed reformed. However, poorly disguised under the name of a reform was a sudden and sharp increase in tax burden. A relatively stable and predictable tax system was changed overnight – a total of 106 law articles were amended, in many cases changing the tax base which did not produce a fiscal effect. These rapidly produced changes contained a considerable number of mistakes. Yet the government refused to call tax increases a “mistake” and during the year corrected only the most obvious errors. Nonetheless the year 2009 could not be described as being entirely gloomy, since two popular ideas among the politicians – progressive income taxation and property tax on individual property – were not introduced.

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Tax Increases

In their electoral programs, two of the four right-wing parties that came to form a coalition government in November 2008 promised lower taxes, a zero-tax rate on reinvested profits, and the introduction of a so-called “cap” on social security contributions. Conservatives, the party with the most votes won in the election, pledged lower personal income tax if the economy were to shrink sharply, and talked of introducing property tax on individual property within 2 or 3 years. However, most of the electoral promises were forgotten as soon as government came to power. The government discovered a growing deficit and had to deal with a record-breaking budget expenditure plan. In less than a month, they produced and implemented an anti-recessionary plan that included dramatic tax increases for most taxpayers: corporate profit tax was increased from 15 to 20 percent; VAT was “temporarily” increased from 18 to 19 percent; reduced VAT rates were abolished; excise duties on alcohol and energy products were increased; royalty recipients were included into the state social security system; personal income tax and social security contributions increased for individual business owners.

The government planned that tax increases would boost budget revenue by more than LTL 2 billion (€ 580 million) and counteract the falling revenues caused by the economic recession. As economists predicted, tax increases did not bring about the desired results. Instead they deepened the recession and caused a surge in the gray economy, as taxpayers sought to avoid higher taxes. Consequently, state budget expenditure and revenue forecasts had to be reduced twice in 2009 in light of falling fiscal revenues.

Personal Income Tax

Until 2009, personal income tax rate was 24 percent (a flat tax rate since 1996). 30 percent of personal income tax revenue used to be transferred to the Mandatory Healthcare Insurance Fund. As of 2009, personal income tax

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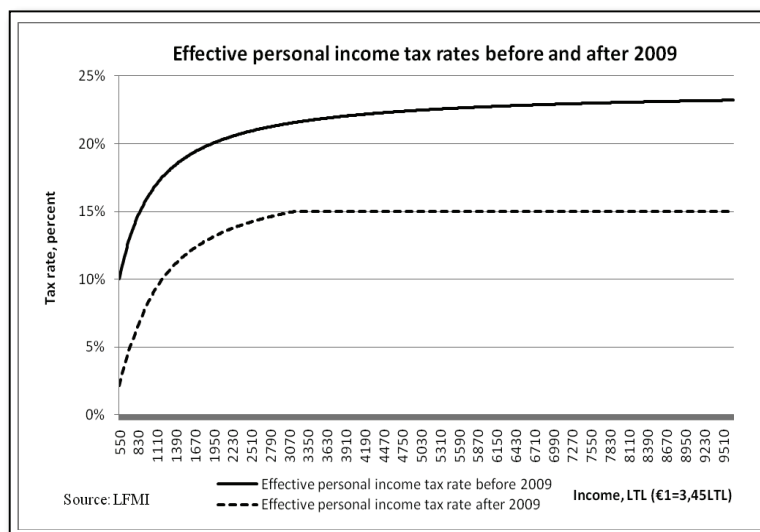
and healthcare insurance contributions were separated: healthcare insurance contributions were established at a rate of 6 percent, and there was a reduction of personal income tax from 18 to a flat 15 percent. However, the effective tax rates on income are lower because of tax-exempt income. Tax burden on income from distributed profits increased, as the rate rose from 15 to 20 percent.

Until 2009, taxpayers could choose whether to pay a rate of 24 percent on income from individual business activities and deduct expenses or pay a rate of 15 percent without deduction. As of 2009, expense deduction became mandatory and the overall rate was reduced to 15 percent. The minimum cost of business certificates (where personal income tax is paid in lump-sum, regardless of earnings) rose from LTL 1,392 (€ 403) to LTL 1,440 (€ 417).

Prior to the reform of 2009, a fixed amount of monthly tax-exempt income was applied on income of all individuals. Seeking to make income taxation more progressive, the size of the monthly tax-exempt income was made dependent on a taxpayer's monthly income: bigger amounts became tax-exempt for taxpayers with smaller income, and for taxpayers receiving more than LTL 3,150 (€ 912) all their income became taxable. Furthermore, at the end of the year all taxpayers benefiting from tax-exempt income are obliged to calculate their full yearly earnings (not just their salary, to which the amount of tax-exempt income is applied) and if they had any earnings other than their salary, the amount of tax-exempt income is reduced.

As of 2009, personal income tax deductions on mortgages and computers were abolished. Individuals can still deduct mortgage interest rate expenses and computer leasing expenses on contracts that came into effect prior to January 1, 2009.

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Healthcare Insurance Contributions

Healthcare insurance contributions rate for employees was set at 6 percent. On top of that, healthcare insurance contributions are included in social insurance contributions paid by employers (3 percentage points of social insurance contributions are transferred from the State Social Security Fund to the Mandatory Healthcare Insurance Fund). Before the reform, healthcare insurance contributions were paid on all income. The separation of healthcare insurance contribution from personal income tax was done mechanically, without changing the tax base or moving towards insurance principles. So the newly enacted Law on Healthcare Insurance Contributions regulated that these contributions should continue to be paid on all income, including from inactive individuals or even irregular income such as dividends, rent, etc. This meant that overall taxation of dividends jumped from 15 to 26 percent, making them highly unattractive option.

Although it is called “healthcare insurance”, these contributions do not buy an insured person a definite set of products. Therefore, despite different

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contributions, all individuals gain access to exactly the same services. This made taxation of inactive individuals' income even more questionable. After long public debates, a decision was made in the state-ordered Sunrise Commission to improve business conditions – healthcare security contributions should not be paid on income from inactive individuals. The Parliament agreed to this proposal and voted to change the law in August, with the changes coming into effect on January 1, 2010.

Income from individual business activities became taxed at a rate of 9 percent. Taxpayers have to pay a minimum amount of healthcare insurance (calculated as 9 percent of the minimum wage). After the end of the year they have to pay the difference between 9 percent of their income and healthcare contributions they had already paid. Taxpayers who besides their individual business also receive salaries or whose healthcare insurance is paid for by the state do not have to pay these contributions throughout the year, but are still obliged to pay them after the end of the year. Holders of business certificates originally became obliged to pay a rate of 9 percent, meaning taxes on business certificates were no longer fully paid in lump-sum but became dependent on income. This mistake was corrected early on and holders of business certificates now have to pay monthly healthcare insurance contributions set at 9 percent of the minimum wage, which comes to LTL 72 (€21). Recipients of royalties, performers and sportspeople have to pay healthcare insurance contributions at a rate of 9 percent.

Corporate Profit Tax

As of January 1, 2009 corporate profit tax rate was increased from 15 to 20 percent. Among other changes to the Law on Corporate Profit Tax, entities could reduce taxable profit if they were carrying out an investment project, cooperative entities working in agriculture became taxed with corporate profit tax, and investment income of investment entities was no longer treated as tax-exempt income.

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Corporate profit tax advance payments had to be paid at this new, higher rate, yet this was not the only problem with the advance payments. According to the Law on Corporate Profit Tax, these payments can either be made according to past results or based on predictions of future results. Once a company chooses one of these methods, it has to stick with it during the year. Advance payments for the first three quarters of 2009 had to be calculated using corporate profit of 2007, which was one of the most profitable years in Lithuanian history since the independence. The above mentioned Sunrise Commission recommended that taxpayers should have the possibility to switch between the two methods of calculating advance payments during the year and the Parliament amended the law to include this proposal.

Throughout 2009, public debates ensued whether tax increases should have been done by the coalition and eventually the idea of reducing corporate profit tax gained support. Together with the state budget, a law amending the current Law on Corporate Profit Tax was passed which mandated a decrease of corporate profit tax from 20 back to 15 percent. Tax on profit of small business was reduced from 13 to 5 percent. This law also included other important provisions: group taxation of corporate profit; deduction of expenses on employees, if those expenses are an object of personal income tax; investment income of investment entities will once again be treated as tax-exempt income. The implementation of group taxation of corporate profit will provide an opportunity to balance profits and losses within a group, whereby losses can be transferred among different entities of a group if the controlling entity holds at least 2/3 of the shares of the controlled entity.

Value Added Tax

VAT was “temporarily” increased from 18 to 19 percent as of January 1, 2009. Reduced VAT rates were abolished on the following goods and services: transport of passenger, pharmaceutical products, hotel accommodation, newspapers and periodicals, foodstuffs, admission to cultural services and sporting events, services of writers and composers,

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renovation and repairing of private dwellings. Reduced VAT rates are still applied on books, district heating and hot water, as well as pharmaceutical products compensated by the state.

Struggling with drastically decreasing budget revenues, the coalition government forgot (or maybe – fulfilled?) its promise that 19 percent VAT would only be temporary and proposed a further VAT rate increase by 2 more percentage points. The Parliament voted in favor of this decision and a new rate of 21 percent came into effect on September 1, 2009.

Excise Duties

As of January 1, 2009 excise duties were increased on alcohol and energy products. These increases were not made to comply with EU regulation – their sole motivation was more budget revenue. However, revenues from excise duties began to fall sharply as customers began buying products abroad or illegally. The coalition government decided to reduce excise duty on diesel fuel as an “experiment” from August 1, 2009, yet it remains unclear whether excise duties on other products will also be reduced. As of 2010, reduced rate of excise duty on energy product of bio-origin will be abolished.

Excise duties on tobacco rose twice in 2009, in order to reach the minimum level mandated by the EU. From 2010 onwards, excise duties will be levied on electricity in order to comply with EU regulation.

Social Security Contributions

Beginning 2009, the coalition government brought in more people into the state social security system: recipients of royalties, performers, sportspeople, as well as farmers became obliged to pay social security contributions. Although voluntary social security was always available to them, the government decided to establish mandatory participation in the state system. A 3-year transitional period was envisioned, with rates almost doubling each

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year, For example, recipients of royalties who receive royalties from their employer have to pay a social contributions rate of 8 percent in 2009, in 2010 it rises to 16 percent and in 2011 it will reach 31 percent. Recipients of royalties who are not employed by the company paying the royalties were envisioned to pay slightly lower rates (going up to 29.7 percent in 2011), as they would not be covered by unemployment and workplace accident insurance. Social security contributions also increased sharply on income from individual business activities.

Some changes were made to these provisions during 2009. The tax base for social security contributions was reduced for royalty recipients not employed by the company paying the royalties; from 2010 onwards, contributions will have to be paid on 50 percent of royalties.

In the second half of 2009, dealing with falling State Social Security Fund revenues, the coalition government proposed a 2 percentage point increase in the social security contributions rate. This proposal encountered a strong opposition both among the general public as well as other political parties. Subsequently, the coalition withdrew its proposal and the general social security contributions rate remains at 33.98 – 34.7 (depending on a company's rate of workplace accident insurance, which fluctuates from 0.28 to 1 percent).

Future Prospects

The coalition government has promised to hold a moratorium on any tax changes in 2010, which means there should not be any tax increase next year. Politicians and the public at large are still debating introducing progressive personal income taxation and property tax on individual property, yet it is not clear how realistic is the implementation of these ideas. In 2009, Lithuania became unattractive to foreign investors because of high taxation of dividends and it seems the only reason it is still keeping its competitiveness regionally is because the neighboring countries have recently also been raising taxes.

Luxembourg (The Grand Duchy of)



Serge Tabery
Lawyer - Avocat à la Cour
Tabery & Wauthier
Luxembourg

Introduction

The overall economic background of the Grand Duchy of Luxembourg is not fundamentally different from the one prevailing in most European countries. The crisis is hitting worldwide. The distinct advantage of Luxembourg is that it has for many years been in a budget surplus position and could therefore keep public debt at a fairly reasonable level. Most of the European citizens will envy the individual Luxemburger who has a debt of only € 6,549.14 on his shoulders.

The future does not however necessarily look bright as several threats may materialise and severely impact the Luxembourg economy.

As a matter of fact, the financial sector is under attack, in particular from its neighbours: France clearly aims at becoming an important financial centre even if this has to happen to the detriment of Luxembourg. Belgium and

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Germany, which desperately need tax income to finance their own abyssal public deficits, fiercely tracks monies held and managed by Luxembourg investment managers. No doubt that the pressure that these countries exercise will increase as they will have no other option than to levy new taxes after having increased all other tax rates they possibly can.

The industrial sector is not doing so well either and its performance is considered among the worse of the European countries.

The State budget provides that no tax increase and no tax reduction will take place in 2010 although a drop of about 15 % is expected in corporate income tax and VAT revenues.

Tax highlights

Personal income tax

The increase of tax brackets introduced in 2008 will continue to be applicable in 2010. This means that income up to € 11,265 remains tax-exempt whereas in the last tax bracket, income amounting to or exceeding € 39,885 will be taxed at a rate of 38 %.

The method of classification of taxing individuals according to their marital status, whether or not they have children, whether or not they are residents in the country and the calculation of children allowances allocated to single parents, remains unchanged (see “Taxation in Europe 2009”, IREF, p 97 ff)

The regime of tax credits that was introduced in order to simplify the various benefits schemes is maintained as well. This is geared towards retired taxpayers, monthly children allowances, etc.

A law was passed on the 11th of November 2009 the aim of which is to facilitate the jobless younger people to find a job. Via an amendment to the existing types of employment contracts, wages paid to people of less than 30

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years of age are partly reimbursed to the employer by the State in a proportion of 30 % (and above in certain exceptional cases).

Corporate taxes

The minimum tax rate remains set at 20 % applicable to income up to € 15,000. For taxable **income** above € 15,000, the tax rate is set at 21 %.

It is not anticipated that the municipal business tax be abolished in a reasonably near future although a certain pressure exists to obtain such a change. It does represent an important source of income for those municipalities (communes) that have made it attractive for businesses to settle on their territory, whether because they are ideally located nearby highways or train stations or because well equipped industrial or business zones are available to them.

The calculation of the municipal business tax is a complex formula based on the fiscal taxable income increased by certain payments (to partners of general partnerships or private companies - sàrl) reduced by some other income or expenses (income from participations of persons' companies- income not qualifying under the dividend tax exemption from general or limited partnerships – social security contributions –recoverable operating losses etc) times 3 % multiplied by a factor provided by law ranging from 200 to 400 varying from municipality to municipality.

The rate applicable in Luxembourg City, which is one of the highest of the country, was reduced to 6.75 %.

VAT

The so called VAT (the implementation of several EC Directive 2008/8. 9 and 117. EC regulation 143/2008 package) has come into force on the 1st of January 2010. Its aim is purportedly to minimise administrative burden for companies engaged in cross-border transactions and to prevent distortions

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between EU Member States but clearly it is designed to fight against fraud and extend control over service suppliers.

The major changes are as follows.

- The place of supply of a service determines the country where VAT should be charged: it no longer necessarily is the country of the provider of the supply in business to business transactions but the country where the customer purchasing the service is established. The beneficiary will apply the reverse charge principle under which he claims for the refund of the VAT it has charged to itself.
- In business to client transactions, they will continue to be taxed where the supplier is located.
- New parties will become liable to VAT (a 43 and 44 VAT tax book). For instance, Luxembourg passive holding companies receiving a fee note from a EU resident VAT registered adviser will become taxable in Luxembourg. It will also probably be the case for financial investment companies (SOPARFI) involved in the granting of loans to their subsidiaries (no VAT liability on the taking of a participation; VAT liability on the financing activity).

Exceptions will continue to prevail, with respect to properties (*rei sitae*), with respect to international transportation of goods or persons activities (differentiate B to B, B to C...), with respect to cultural, artistic, scientific, educational or sports services, with respect to catering services (place of where the service is rendered), etc.

It is already provided that certain measures are temporary and that practice will differ in several cases in 2011 (with respect to organisation of cultural, artistic, scientific and other services - place where they are actually organised), in 2013 (with respect to rental of means of transportation - differentiate short/long term) and 2015 (with respect to electronic services rendered by telecom, radio and TV providers - place of beneficiary of service).

On a daily basis the difficulties will initially not be small for the locally VAT registered actors. It will not necessarily be easy to determine if a service is to be charged with VAT of his country of establishment or not, if his client is

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really a EU registered VAT agent, or obtain a confirmation that his client is subject to a regime similar to the EU VAT system if he is not a EU counterpart.

International relations

Luxembourg has entered into double tax treaties with a large number of countries (57).

An important number of double tax agreements have recently been ratified or signed (Albania, Argentina, Armenia, Bahrain, Barbados, Cyprus, Kazakhstan, Kuwait, Kyrgyzstan, Macedonia, Qatar, Ukraine), are under current negotiation (Lebanon, Pakistan, Serbia, Syria) or are about to be completely renegotiated (UK).

Since March 2009, 18 double tax agreements are in full conformity with the OECD convention model out of which 12 with EU countries. Article 26§5 of the OECD convention 2005 model has been included which provides for an exchange of information including information and data held by banks.

Likewise a second amendment to the double tax treaty with Belgium with respect to “...other questions relating to taxes ...” was signed on the 16th of July 2009. This amendment has not been passed in law.

The new bill will confirm the principle of an exchange of “foreseeable relevant information” upon request by the tax authorities of one member state to the other with respect to all taxes. The concept of foreseeable, i.e., probable, relevant information must be understood as the acceptance of a full provision of information provided that they are in direct relation to a particular tax payer and that therefore fishing expeditions are excluded. In addition, this does absolutely not mean an automatic transfer of information. A requiring State looking for some information or data must indeed provide to the requested State specific evidence as to the relevance of the information.

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This must be satisfied under the form of the provision of the precise identity of a payer, the legal and tax objective grounds according to which it feels that an offence was committed, the reasonable but exhaustive actions (but not disproportionate) that it has itself undertaken to obtain the confirmation of its suspicion, the precise person residing in the requested State possessing the information.

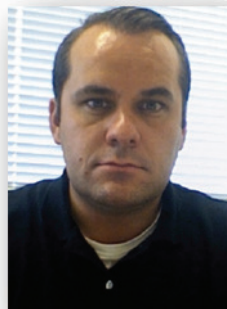
In 2010 new developments will certainly take place in this field.

Conclusion

In a changing world and even under a heavy pressure from circumstances as well as from competitors, Luxembourg continues to believe in its strengths and to offer significant assets. In the financial and tax domain, Luxembourg continues to offer a particularly strong stability in every respect, a deep respect for individual private rights, and a high degree of professionalism. It relies on the abolition of the wealth tax and on favourable tax regime -- as for instance the regime of intellectual property rights--, to maintain its competitiveness.

Specialised investment funds (SIF), Financial Investment companies (SOPARFI), Risk Capital Investment Companies (SICAR), or funds /UCITS (SICAV or other) or Securitization companies (Titrisation): all of them satisfy all tests that tax havens cannot meet.

Netherlands



PD Dr. Jan Schnellenbach
Ruprecht-Karls-Universität Heidelberg
Alfred-Weber-Institut für
Wirtschaftswissenschaften

Tax Policy in the Netherlands: recent developments

On December 22, 2009 the Netherlands' Senate has voted in favour of the 2010 tax plan proposed by the Secretary of Finance. This vote allows the policy bundle to come into effect, as planned, with the start of 2010. The 2010 tax plan has been given the motto "More enterprise, and fewer barriers to enterprise", and indeed, the most significant measures taken there aim at reforming corporate taxation.

Looking first at the supply-side

A first measure is the reform of the so-called patent box in corporate income taxation. Thus far, the patent box works as follows: Taxpaying corporations can declare those profits that stem from the use of immaterial assets (in particular patents) as belonging into the patent box. As a consequence, these profits are taxed at a reduced statutory rate of 10 percent. The patent box is, however, capped at 400 percent of the costs that the business has earlier

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incurred in developing the immaterial assets. Furthermore, the corporation needs to demonstrate that at least 30 percent of the profits transferred into the patent box can be directly linked to the underlying patent. From 2010 onwards, the patent box will be relabelled as “innovation box”. Materially, the change implies that any corporate income derived from research and development is taxed at the reduced rate, regardless if a patent is involved or not. In addition to this, the rate applied to income in the innovation box is reduced to 5 percent and the cap of 400 percent is suspended entirely.

Since 2007, the Netherlands also has a tax exemption for small and medium-sized enterprises. These have so far been allowed to deduct 10.5 percent of their taxable profits from the tax base. This deduction is now increased to 12 percent. Furthermore, a qualifying condition stating that small business owners have to spend at least 1225 hours per year on their business to qualify has now been dropped entirely, which implies a substantial reduction of bureaucratic effort in the administration of the tax. The expressed aim of this measure is to encourage individuals to start small businesses as a part-time activity and earn profit incomes in addition to wage incomes.

The Netherlands also attempts to use tax policy to provide their corporations with some additional liquidity, which is probably intended as a short-term expansionary policy during the current crisis. It is now allowed to offset losses from the years 2009 and 2010 against profits from the years 2006 to 2008. This is in contrast to a regime where losses can only be carried forward, and counted against future profits, thus allowing for future reimbursements only. The new rule allows Dutch companies with profits in the years 2006 to 2008 to opt for an immediate cash flow instead. There are other measures which aim at similar goals: The small-scale investment tax credit (the KIA) is raised to 29 percent (from 25 percent) of eligible investment expenditures, and an option for accelerated depreciation of assets is extended to 2010. This implies that any assets acquired in 2010 can be fully written off over the years 2010 and 2011.

Another change in the Netherlands' business taxation has been made to facilitate changes of ownership, predominantly of smaller businesses.

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Entrepreneurs who are directors of a business in which they are also major shareholders can now transfer their shares to co-entrepreneurs without any income tax liability resulting from this transfer.

On the demand side

Aiming at providing an additional, small stimulus in times of crisis, there will also be a number of VAT reductions on home services (painting, plastering, domestic cleaning etc.) and also tax reductions on ecologically efficient cars.

Better tax administration

There are also a number of smaller changes, which mainly serve the purpose of simplifying tax administration and reducing tax-related transaction costs. For example:

- 29 small and scattered tax-free allowances and exemptions on wage taxes are now substituted by a general, 1.5 percent tax exemption on the wage bill.
- Employers no longer need to deduct social and health insurance contributions from wages paid to workers who are under 23 years of age and earn less than a small threshold income.
- And finally, a uniform definition of wages is now used in different tax bases and to calculate health and social insurance contributions.

The Ministry of Finance boasts that this alone will save Dutch employers an overall amount of € 380 million.

Tax evasion

A strong focus of Dutch tax-policy in the near future turns out to be on an attempt to increase tax compliance. The Netherlands have reached or revised information exchange agreements with a number of countries, among them low-tax countries such as Andorra and Liechtenstein. The finance State

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Secretary De Jager has also announced plans to increase the fine for tax evaders from 100 percent of concealed income to at least 300 percent. This threat appears to have some effects, especially since it coincides with a reduced reliability of bank secrecy in countries like Switzerland. The Ministry of Finance did report a wave of voluntarily surrendering tax evaders in the spring of 2009.

Preparing for long-term reforms

All these changes to the Dutch tax system are apparently rather minor changes. There have been no large-scale reforms enacted for the coming tax year. However, the Ministry of Finance has appointed a Tax System Study Committee, composed mainly of academic economists and tax lawyers, who will look into necessities and opportunities for more fundamental, long-term reform measures. But given that this is only labelled as a preliminary study, substantial results that will also translate into actual policy can probably not be expected in the near future.

A look at the overall fiscal situation of the Netherlands shows that the ratio of public debt to GDP, according to EMU definitions, is expected to increase to 66% in 2010, up from 60% at the end of 2009.

Norway



Jan I. Frydenlund,
Attorney at Law
Advokatfirma Frydenlund

General outlook

The oil and gas activity in the North Sea puts Norway in a rather enviable position. In recent years we have seen that more than 25% of the general government revenues has been generated from this activity. These revenues are deposited in the “Government Pension Fund – Global” and the return from the Fund is used to finance public expenditures.

Yet, revenues from the oil and gas activity and the Pension Fund could not save the Norwegian economy from being affected by the global recession. The downturn seems, however, to be less severe in Norway than in several other countries. A range of expansionary fiscal and monetary measures implemented by the majority coalition Government (social democratic/left wing) and the Central Bank of Norway (Norges Bank), as well as the fact that the manufacturing and service industries were still benefiting from the

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displayed activity in the oil and gas sector, seem to have stabilised the Norwegian economy, which through 2009 has performed better than expected.

Norwegian industry is less concentrated on ICT-products, cars and other products that have been most severely hit by the downturn. Furthermore, households' debt ratio is high and since most borrowers have floating rate loans, the speed and extent of the reduction in the interest rates have kept households' demands on a high level during the crisis. These, plus a large public sector, have contributed to stabilise the Norwegian economy.

Petroleum activities continue to be of great importance for the Norwegian economy. The money allocated to the Government Pension Fund (approx. NOK 2,280 billion or some 90% of GDP by the end of 2008) is invested abroad. In 2009, the Fund has more or less recovered from the losses incurred during the worst period of the financial crisis.

The approved 2009 Fiscal Budget was the most expansionary in Norway 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. Since then, the rate went up to 1.75% by the end of December 2009. The increase in the key policy rate is expected to continue in 2010 and the banks are expected to follow suit, causing increased costs for households and businesses in the private sector. Hopefully this will not cause the economy to suffer a relapse.

Some of the main features of the budgetary policy for 2010 are:

- A structural, non-oil budget deficit not to exceed NOK 148.5 billion.
- An increase in the structural non-oil deficit below NOK 14.6 billion in real terms from 2009 to 2010. Measured as a share of Mainland trend-GDP the structural, non-oil deficit increases by 0.5%.
- A constant overall tax level.
- A real, underlying growth in the Fiscal Budget expenditure of around 1.75% from 2009 to 2010.

Employment

The turnaround of the Norwegian economy has, as predicted, resulted in a somewhat weaker labour market. The unemployment rate is expected to average 3.2% in 2009, with an increase to 3.7% average in 2010 -- which is fairly modest compared with quite a few other countries within the EEA (European Economic Area). The Government has expressed its intentions to keep focus on this matter in order to reduce unemployment during its period in office. In the 2010 budget, the Government states that:

“Employment policy is intended to facilitate an increased supply of labour and low unemployment over time, enabling most people to participate in the labour market.”

We must, however, face the fact that, compared with the OECD average, sick leave and the percentage of individuals on disability and other social security benefits are high in Norway. One out of five individuals in the working age of the population is currently receiving benefits from health-related schemes. No doubt some unemployment is hidden in these figures.

The Government now wishes to encourage older workers to stay in the labour force past normal retirement age (67 years) and has repealed the rules on income testing of pensions for 67 to 69 year olds as the icing on the cake. Under the earlier regime, those who continued working beyond their 67th birthday and received working income above a certain amount per year had their pension benefits from NIS reduced by a certain percentage until their 70th birthday. For instance, in 2008, a 69 year old had his/her pension benefits from NIS reduced by 40% of earned income above 2 G; “G” has a value of NOK 72,881 per year by the time the income testing rule for 69 year olds were done away with.

Taxation – General

Tax revenues in 2009 are expected to reach approx. NOK 932 billion in total, which is close to 39.8% of GDP.

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The Norwegian tax system is characterised by high indirect taxes by international standards. VAT (value added tax) and excise duties amount to approx. 28% of total tax revenue. Personal income tax and the tax on net wealth levied on individuals represent about 37% of the total tax revenues. Corporate tax (including employers' part of social security contribution) amounts to approx. 19% and tax levied on petroleum activities approx. 13% of total tax revenues.

In the 2010 budget, the Government says it will take further steps to strengthen the tax system's contribution to a "fair income distribution and to a better environment" ("green" taxes), including to ensure revenue for common endeavours, including reduced unemployment.

The Government's expressed aim still is to bring total tax revenues back to the 2004 level and thereby "create opportunities to improve welfare programmes and build up public benefits". Experience so far with our current Government indicates that by referring to the 2004 level of taxes it seems to mean the tax rates' levels, while it will continue to broaden the basis on which the taxes are calculated. This kind of lurking increase of taxes seems to elude a lot of the taxpayers' attention and the victory for the social democrats/left wingers at the polls last September indicates that the strategy works.

In the 2010 budget the Government claims that the 2004-2006 tax reform has been a success and that

"By continuing the systematic changes in the tax reform within a stable tax level, the Government is ensuring predictability in the tax system, making it attractive to invest and do business in Norway. In 2010, the redistributive aspect of the tax on net wealth will be enhanced further, environmental taxes will be strengthened and important measures will be taken to combat tax evasion".

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In relation to tax evasion, it is worth mentioning that, in cooperation with the other Nordic countries, Norwegian Tax Authorities have reached since 2006 agreements with a number of countries to exchange information in tax matters in order to avoid tax evasion. Jersey, Guernsey, Isle of Man, Cayman Islands, Bermuda, British Virgin Islands, Aruba and the Netherlands Antilles have all signed such agreements in 2009. As for Switzerland and Luxembourg, information exchange clauses have been included in the existing tax treaties between these countries and the Nordic Countries. Furthermore, information exchange agreements have been negotiated and expected to be signed in the near future between the Nordic countries and Gibraltar, Samoa, Cook Islands, Turks & Caicos Islands, Anguilla, San Marino and Andorra.

Besides fighting tax evasion, the 2010 budget tells us that the Government will introduce what they call “a new and more accurate system for determining assessed valuations of residential and commercial property, based on market value”. The changes is expected to have redistributive effects and benefit rural regions. But it is also an example that shows the Government’s strategy to broaden the basis for calculating taxes and hence also increase overall tax revenues.

Furthermore, the government states in the 2010 budget that the tax system should also, by lowered taxes, promote “environment-friendly behaviour” and encourage the consumers to choose the “greener” (i.e. the more environmental friendly and less polluting) alternative, for instance when buying a car. In addition to this, as of April 1st 2010, the Government will impose a “carbon tax” on domestic use of gas for heating in buildings.

Statements in the 2010 budget also confirm that the Government intend to follow up on recommendations by a committee appointed by the Government to broaden the VAT basis, for instance by introducing a 8% VAT rate for cultural and sporting services.

Norway

Taxation – Social security contributions – Allowances – rates & amounts

The figures below show tax rates for 2009 and proposals for 2010. Change in per cent in the far right column. The abbreviation “EEA” stands for “European Economic Area”.

Direct taxation

Companies/corporations	2009	Proposition for 2010
Ordinary income, incl. capital income and capital gains	28%	28%

Dividends distributed from a Norwegian resident (for tax purposes) limited liability company to another Norwegian resident company or to a comparable company resident within the EEA, are normally tax exempt under current Norwegian rules. The same normally applies for dividends received by a shareholding company resident (for tax purposes) in Norway distributed by another Norwegian resident company or by a comparable company resident within the EEA.

A company unable to prove to be comparable with a Norwegian limited liability company will normally be hit by Norwegian CFC-rules (“NOKUS”), meaning the above mentioned tax-exempt rules on dividends do not apply. Dividends received by a Norwegian resident (for tax purposes) limited liability company on shareholding in a comparable company domiciled outside the EEA are normally taxed in Norway as ordinary income, but with a right for the receiving company under tax treaty rules or Norwegian domestic tax rules, to deduct (“credit”) taxes withheld in the country of residence (for tax purposes) of the distributing company. Dividends distributed by a Norwegian resident (for tax purposes) limited liability company to a comparable shareholding company resident outside the EEA, is

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subject to withholding tax in Norway (normally 25%), unless protected by tax treaty rules in force between the two companies' countries of residence.

In tax treaty cases the "participation privilege" normally applies, meaning reduced tax rates are conditional upon a certain extent of shareholding, normally minimum 10% of the share capital in the distributing company.

Individuals	2009	Proposition for 2010
Ordinary income	28%	28%
Capital income	28%	28%

Dividends received by a Norwegian resident (for tax purposes) on a shareholding in a Norwegian resident limited liability company or as shareholder in a comparable company resident (for tax purposes) abroad, are subject to ordinary income tax. Withholding tax paid to the distributing company's country of residence is normally deductible in the Norwegian taxes levied on the dividends.

Surtax on wage income and income from self-employment	2009	Proposition 2010	% change
From (threshold)	NOK 441,000	NOK 456,000	+3.5%
Rate	9.0%	9.0%	
From (threshold)	NOK 716,000	NOK 741,700	+3.5%
Rate	12.0%	12.0%	

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Social security contribution

	2009	Proposition 2010
Lower threshold for payment of employee's contribution	NOK 39 600	NOK 39 600
Wage income	7.8%	7.8%
Income from self-employment primary sector (forestry, farming, fishing)	7.8%	7.8%
Other income from self-employment	11.0%	11.0%
Pension income	3.0%	3.0%

Employer's social security contribution

	2009	Proposition 2010
Depending on where the activity is taking place geographically	0.0% - 14.1%	0.0% - 14.1%

Maximum effective marginal tax rates

	2009	Proposition 2010
Wage income excl. employers' social security contribution	47.8%	47.8%
Self-employment, primary sector	47.8%	47.8%
Other self-employment	51.0%	51.0%
Dividends and withdrawals, including 28% corporate tax	48.2%	48.2%

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Special rules apply for calculating the basis for tax on dividends; in some cases also on interest income.

Allowances

	2009	Proposition for 2010
Pension income	43.0%	43.0%

- Personal allowance in Class 1 (single) is NOK 40,800 for 2009. Proposed increased to NOK 42,210 in 2010, i.e. + 3.5%.
- Personal allowance in Class 2 (supporting/single parent) is NOK 81,600 for 2009. Proposed increased to NOK 84,420 in 2010. i.e. + 3.5%.
- Basic allowance in wage income. The 2009 rate, 36%, is proposed unchanged for 2010. Lower limit is NOK 4,000 in 2009 and proposed unchanged in 2010. Upper limit is NOK 70,350 for 2009, proposed NOK 72,800 in 2010, i.e. + 3.5%.
- Basic allowance in pension income. The rate is 26.0% in 2009, proposed unchanged in 2010. Lower limit NOK 4,000 in 2009, also proposed unchanged for 2010. Upper limit for 2009 is NOK 58,900. Proposed NOK 60,950 for 2010, i.e. + 3.5%.

The sum of basic allowance in wage income and the basic allowance in pension income is limited upwards to the maximum basic allowance in wage income.

Special wage income allowance is NOK 31,800 for 2009 and proposed unchanged for 2010. Taxpayers who only have wage income shall have the highest of the basic allowance in wage income and the special wage income allowance.

There are special allowances limitations rules for: Age, disability etc., Taxpayers living in the northernmost areas of Norway (Finnmark and Nord-Troms), Seamen, Fishermen, Self-employed within farming/agriculture, High expenses due to illness, Payments to individual pension schemes, Travel

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between home and work site, Union fees, Saving schemes for young individuals under 34 years of age, Documented expenses for childminding and child care.

Tax on net wealth

	2009	Proposition 2010	% change
Threshold, municipal	NOK 470,000	NOK 700,000	+48.9%
Rate, municipal	0.7%	0.7%	
Threshold, state	NOK 470,000	NOK 700,000	+48.9%
Rate, state	0.4%	0.4%	

Inheritance tax

	2009	Proposition for 2010
Threshold Level 1	NOK 470,000	NOK 470,000
Threshold Level 2	NOK 800,000	NOK 800,000
Children/parents, level (1)	6.0%	6.0%
Children/parents, level (2)	10.0%	10.0%
Others, level (1)	8.0%	8.0%
Others, level (2)	15.0%	15.0%

Discount on non-listed shares: 40%. The discount applies to non-listed shares and shares in general partnerships. The discount is limited to an inheritance tax basis amounting to NOK 10 million for shares as mentioned.

Depreciations rates

Depreciation rates for tax purposes varies from 2% (business buildings) to 30% (office equipment etc.) per annum calculated on a declining basis and depending on type of asset.

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Value Added Tax

The Ordinary rate is 25%. Reduced rate (14%) or Low rate (8%) applies in some cases.

Stamp duty

Stamp duty on sale of real estate is 2.5% of the sales price.

Other topics

Gross Domestic Product (GDP) totalled NOK 2,543 billion in 2008; a 1.8% increase (in constant prices) compared with 2007. GDP per capita in 2008 amounted to NOK 533,363 (second only to Luxembourg among the European countries).

In 2008 Norwegian exports totalled (in constant 2006 prices) approx. NOK 1,225 billion and imports approx. NOK 732 billion, i.e. creating a surplus of approx. NOK 493 billion (19% of GDP). The final figures for 2009 are expected to show a reduction in exports as well as imports (6.5% and 4.9% respectively). The predictions for 2010 are a minor (0.1%) increase in exports and a somewhat higher increase (2.4%) in imports.

In 2008, gross public debt (according to EU's definition) totalled NOK 1,269 billion, i.e. 49.9% of GDP (compared to 52.4% in 2007).

Private consumption in 2008 totalled approx. NOK 992 billion compared to a public consumption of NOK 490 billion. For 2009, the figures so far indicate 0.3% increase in private consumption and 5.6% increase in public consumption. Predictions for 2010 are + 4% (private consumption) and + 2.1% (public consumption).

Norway

Summing up

Thanks to a rather sound economy at the time the financial crises hit and the constant, if somewhat reduced, revenues from the oil and gas sector, Norway seems to have been able to fight off the worst of the crisis during 2009. Yes, the price on oil has gone down and yes, the Governmental Pension Fund took a hit, but it seems that the Government's first aid to the banks and some other players in the private sector were sufficient and on time to gain control over the consequences of the recession. Unemployment has increased in 2009 and this is expected to continue in 2010; and the wage growth is expected to slow down. Nevertheless, housing prices are going up and the household demand seems to pick up more quickly than previously expected. An increase in private consumption of 0.3% is now forecast for 2009 and 4.0% for 2010.

The remaining question is: How will the Norwegian economy react when the Government ask for repayment of the NOK 350 billion in first aid granted in the early days of the financial crisis? The jury is still out on that one ...

Sources: Publications of Finansdepartementet (Ministry of Finance) and Statistisk Sentralbyrå (Statistics of Norway)



Poland

**Piotr Augustyniak,
Counsel, K&L Gates
&**

**Jaroslaw Kantorowicz,
Research Assistant,
Civil Development Forum
Foundation**



General macroeconomic performance

In 2009, Poland was among the few countries that experienced economic growth. Whereas the rest of Europe faced a downturn in GDP of more than 4%, the European Commission GDP prediction for Poland was 1.2%. It was less than in 2008 when GDP growth reached 5.0%; however, in view of the recent economic turbulence it should be stressed that Poland is doing relatively well in terms of economic performance.

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Nevertheless, some alarming signals have emerged in connection with trends in the structural budget balance and general government debt. In 2008, the budget deficit amounted to 4.7% of GDP. That was 1.8 percentage points higher than in 2007. The expected budget deficit for 2009 is 6.4% - much more than the targeted 3.0%. The same tendency is observed in public debt. There is a constant increase in general government gross debt from 45.0% in 2007 to an anticipated 51.7% in 2009 and 57.0% in 2010. This is above the cautious threshold of 55.0% and close to the constitutional limit of 60%.

According to *Eurostat* data, the tax burden was equal to 39.6% of GDP in 2008. The rate was lower when compared to data from 2006 and 2007 when the government revenue in relation to GDP was above 40%. It should be mentioned that the tax burden in Poland is 5 percentage points lower than in the EU27 on average. However, the Polish tax burden is relatively high when compared with countries such as the so-called Asian Tigers, Poland's regional neighbours or other developed countries, all with a similar per capita income. When referring to the period of time when these countries' level of development was comparable to our present level, the Polish tax burden is rather high – e.g. in Slovakia the tax burden amounts to 32.5% of GDP.

Structure of Polish taxes

According to the 2009 Budget Act, indirect taxes constitute more than 70% of all tax income. By itself, VAT provides nearly half of all tax income. It is more than the income from PIT and CIT together, which account for 16.7% and 11.7% respectively. About a quarter of income originates from excise. Detailed information is presented in the table below.

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Structure of tax income according to the 2009 Budget Act

Type of tax	Particular tax's share of overall tax income
PIT	16.7%
CIT	11.7%
Tonnage Tax	marginal
VAT	45.7%
Excise	25.2%
Gambling Tax	0.8%

Perception of taxes in Poland

Structural problems with the budget deficit and public debt in connection with relatively high taxes could lead to economic turbulence in the coming years.

According to Polish entrepreneurs, taxes are the main barrier to business development. One entrepreneur out of two lists taxes as the most significant constraint to entrepreneurship in Poland. Moreover, in their opinion, relations with the public administration, i.e. the tax authorities, is the second major barrier to doing business in Poland. Among other important obstacles listed were inconsistencies in laws and regulations, lack of financial resources and shortcoming in the law. High and complicated taxes as well as long settlement periods result in lower competitiveness and weaker development potential for a country.

On a macroeconomic level, the scope of the tax burden is crucial for the investment process and economic growth. When taxes are high and corresponding gains are low, incentives to operate in the grey economy increase. Research conducted by Djankov et al. (2000) reveals that higher taxes are associated with a drop in private investment and formal business. For example, an effective corporate tax rate increase of 10 percentage points will result in a 2 percentage points drop in the ratio of investment to GDP. New business entries will decrease by about 1 percentage point.

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In “Paying Taxes 2010” – the cyclical report conducted under the auspices of the World Bank Group looking at the ease of paying taxes – Poland was ranked 151. It means that only in 32 countries does the tax system have more burdens for entrepreneurs than in Poland. It turns out that the Polish taxation system is the least effective of all other European Union countries (the report does not include Malta). Additionally, the tax system in Poland is less competitive than in “exotic” countries such as Brunei Darussalam, Antigua and Barbuda.

There are three main components measured when paying taxes, namely the number of tax payments, time dedicated to prepare, file or pay taxes and tax costs expressed as a percentage of commercial profits. It turns out that a Polish entrepreneur devotes 170 hours more to pay his/her taxes than the “average entrepreneur” in all EU countries. Furthermore, a Polish taxpayer faces 40 tax payments a year, whilst in the EU there are on average only 17 payments. Tax costs are nearly 6 percentage points higher in Poland than in the EU. It should be noted that *Doing Business* reports on the ease of paying taxes for limited liability companies; however, the study provides us with a good approximation of the global performance of the Polish taxation system (one advantage of this report lies in the fact that it measures perceptions of entrepreneurs; it is not solely based on statistical evidence).

Direct taxation - Personal income tax

Despite the announcements of the government elected in 2007 regarding the introduction of a flat tax, taxpayers in Poland still have to pay personal income taxes with progressive rates. From the beginning of 2009 on, new personal income tax rates of 18% and 32% were introduced with the personal allowance equalling PLN 3,019 (PLN 1 is approx. € 0.257). They were significantly reduced as compared to the previous rates of 2008. Before, individuals were facing three tax brackets with rates of 19, 30 and 40% respectively. Detailed information regarding personal income tax in 2008 and 2009 are presented in the tables below.

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Income brackets and corresponding tax rates in 2008

Personal income	Tax rate
< PLN 44,490	19% tax base minus PLN 586.85
PLN 44,490 – PLN 85,528	PLN 7,866.25 plus 30% from surplus over PLN 44,490
> PLN 85,528	PLN 20,177.65 plus 40% from surplus over PLN 85,528

Income brackets and corresponding tax rates in 2009

Personal income	Tax rate
< PLN 85,528	18% minus PLN 556.02
> PLN 85,528	PLN 14,839.02 plus 32% from surplus over PLN 85,528

Beyond their fiscal purposes, taxes perform many other functions, e.g. a social function. Tax relieves are the most common tools by which these functions are fulfilled. In Poland, the relieves are applied in three ways. First of all, they reduce the tax base (e.g. social contributions, rehabilitation expenses, repayments of benefits wrongly calculated which increased the taxable income in the previous period, internet expenditures, charity donations and expenditures on interest payments on loans granted to finance residential investments). Secondly, they lower the due taxes (e.g. deduction of health insurance contributions, transmission of 1% tax to a charity, deductions connected with the number of children – in 2009 the exemption was PLN 1,112.04 per child). Thirdly, in some cases it is possible to implement reduced tax rates (e.g. reduced tax rates for prizes).

In response to the financial crisis, the amendment to The Natural Person Income Tax Act enacted in June 2009 introduced exemptions from taxation for allowances paid by trade unions and tangible benefits in the form of vouchers, coupons etc., and reimbursable expenses for social purposes. Earlier in 2008, entrepreneurs were allowed to credit expenses incurred for

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investments that were cancelled as a result of the deterioration of the company's financial situation.

Corporate income tax

The corporate income tax rate in Poland is fixed at 19%. The last changes in CIT rates took place in 2003 and 2004, when the rates were successively reduced – from 28% to 27% in 2003 and from 27% to 19% in 2004. It is possible to reduce the tax base in certain ways. Deductions are made for donations to charity and religious institutions (not exceeding 10% of income), credit cancellations related to the introduction of restructuring programs (not exceeding 20% of cancelled loans).

The amendment in The Legal Persons Income Tax Act and The Natural Persons Income Tax Act enacted in March 2009 changes the definition of a “small” taxpayer (“small” taxable person – small entrepreneur). The maximum revenue was increased from € 800,000 to € 1.2 million. There are many advantages to being a “small” taxpayer, such as quarterly advance payments on income tax or the ability to carry out a one-time depreciation (the previous limit of € 50,000 for one-time depreciations was increased to € 100,000 in 2009 and 2010). Moreover, the amendment provided deductions for expenses of expenditure on development, which is extremely beneficial for firms prospering in the R&D sector. The amendments were enacted in response to the financial crisis. Their basic purpose was to stimulate the private sector.

Indirect taxation- Value-added tax

The basic VAT rate amounts to 22%. There are two reduced VAT rates of 7% and 3%, as well as a 0% rate. The reduced level of 7% applies to books, toys, food and medicines whereas the 3% rate applies to unprocessed agriculture products. A total VAT exemption (0% VAT rate) is applied to

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export goods and intra-European Union supply of goods and is coherent with EU Directives.

According to an amendment in The Goods and Services Tax Act of December 2009, the annual turnover limit allowing for a VAT exemption will be increased from PLN 50,000 to PLN 100,000 in 2010 and PLN 150,000 in 2011. The higher limit results in a reduction of the VAT burden for small companies being subject to VAT settlement. A previous amendment from 2008 eliminated the obligation of new entrepreneurs to pay a VAT deposit.

Excise

Some rules regarding excise are harmonized at Community level. The main taxable products are: electricity, products used to produce energy, alcoholic beverages and tobacco. However, Poland, like all member states, is allowed to issue regulations concerning other products. For example, in Poland excise is imposed on cosmetics as well as cars before their first registration. In Poland an exception to the rule applies regarding excise imposed on cars, where tax is paid for every sale of a vehicle (in other EU countries excise is paid only once).

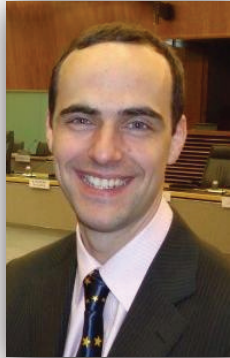
In 2009, some amendments to the Excise Act were introduced. The amendment enacted in June suspends excise on imported LPG, and to some extent would exempt from excise tobacco products bearing the old and new excise marks. The latter was issued in order to mitigate the consequences of the financial crisis for tobacco companies. The second amendment from December assumes an adjustment in the excise rate in accordance with EU law.

Conclusion

Due to inefficient tax regulations, Polish international competitiveness is undermined. All global reports providing objective measures of business

Poland

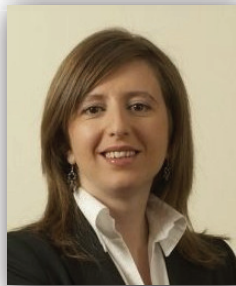
regulations warn against the ineffective tax system in Poland. In the Paying Taxes 2010 report, which is a part of the Doing Business project, Poland was ranked 151 amongst 183 countries. It follows that Poland is able to significantly improve its position. To this end, Poland should halve the number of tax payments (from 40 to 20) and time dedicated to prepare, file or pay taxes (from 395 to 198). Under the assumption that only Poland undertakes reforms, the country can advance in the Paying Taxes pool from 151 to 74 (the simulation is based on the Simulate Reform calculation sheet available on the Doing Business web page). The Polish government is aware of the problems related to taxes. Fixing and simplification of the tax law seem to be crucial for Poland's development in 2010.



Portugal

**Ricardo Campelo de Magalhães,
Financial Advisor at Banco Best**

&



**Andreia Junior, Lawyer at Gonçalo
Capitão, Gali Macedo e Associados**

General outlook

2009 was a particularly hard year for Portugal: economic activity fell, unemployment rose sharply, inflation became deflation and interest rate spreads soared.

To respond to such a dismal situation, the Portuguese government approved emergency measures to hike up investment and boost consumer spending, including the creation of a new type of estate fund with a lower tax rate, new tax deductions, several incentives to foreigners, the creation of a Investment Fiscal Code to help growth-spurring sectors, lower indirect taxation and help the unemployed. These measures, combined with the difficult economic

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situation of the country led to a 13.2% decrease in tax revenues and a deficit of “eight to nine percent” of GDP by the end of 2009 (up from 2.7%).

Portuguese tax system is complex and ever-changing. In fact every Budget law changes little details in all taxes, making it impossible to detail them all. The following pages describe the most important ones on the main taxes.

Personal Income Tax

In 2009, besides the usual inflation-adjustment of the brackets (using a 2.5% rate), the changes focused on deduction extensions. The biggest of all the deduction changes was on housing credit. The deduction can reach now € 879 on the first two brackets (up 50%), € 703 on the third (up 20%) and € 644 on the fourth (up 10%). To support the unemployed, the government created a fund to pay for half the monthly capital and interest due on a loan if used to acquire his own and permanent residency; this support lasting at most 24 months.

Another measure to spur the housing market was the extension of one year of the time to reinvest housing gains. From 2009 on, whoever sells its own permanent residence and buys a new one will be exempt from housing gains tax under the personal tax if the sell occurs 24 months prior to the buying (previously 12) or if purchase is less than 36 months prior to the sell (previously 24).

A noticeable new deduction added was the 30% of the value of electric registered vehicles or any other renewable energy propelled vehicle bought by the person, capped at € 796.

Under the fiscal transparency scheme, partners in a society are now taxed over the value received as advanced distribution of profits when this value is superior, for the given fiscal year, to their share; the tax that will then be deductible in the following years. This works basically as a tax advance.

Despite all the various and extended changes to the code, the measures had however small influence on the budgets of Portuguese families.

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In 2009, several and significant changes were introduced in the non-residential scheme to attract foreigners to Portugal.

Persons who live in another European Economic Area country with which Portugal has fiscal information exchange agreements and who earn in Portugal wages or pensions that exceed 90% of their total earnings can choose to be taxed as residents.

The new incentive comes from a special scheme applicable for 10 years to any person considered resident in Portugal by the fiscal administration and who in the last 5 years was not taxed as resident. Under this scheme, the tax rate is 20% of the earnings, when those earnings result from high value-added activities. Earnings obtained in other EEA countries from some high value-added scientific, artistic or technical activities (defined in a specific regulation, or “Portaria”), from Intellectual Property rights, Industrial Property rights, know-how transfer, capital gains, property income or assets increases, can be tax-exempt if the earnings can be taxed:

1. In a country with which Portugal has a Double Taxation Agreement;
2. In another country, according to the rules defined in the OECD’s Model Tax Convention if (i) the territory is not under privileged treatment (defined in a specific regulation) and (ii) it is considered that the earnings have not been obtained in Portugal, according to Portuguese Personal Tax Code.

Earnings from dependent work obtained abroad can also benefit from Personal Tax exemption, given that (i) they are taxed in a country with which Portugal as a Tax Convention or (ii) the country does not has a Tax Convention with Portugal, but they are taxed in the country source of income and the income was not obtained on Portuguese territory. Pensions obtained abroad, from contributions not considered as tax deduction in Portugal, can be exempt under similar conditions.

The earnings exempted from Personal Tax according to this scheme will nonetheless be considered in the determination of the applying bracket and, thus, of the applicable tax rate to other earnings, unless the exempt earnings are capital gains from housing, dividends and interests obtained abroad, or wages subjected to the 20% tax rate mentioned before.

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Taxpayers can opt for the Tax Credit instead of the above-mentioned exemptions, in which case earnings will be taxed at the general rates and regular deductions will be used.

Corporate Tax

Corporate Tax also faced several small changes in 2009, ranging from the suspension of the simplified scheme for small companies, extension of the Holdings scheme to companies from other EU member states and the creation of the Investment Fiscal Code.

The most significant change was the introduction of a Dual System, under which two brackets are defined: one for earnings under € 12,500, with a rate of 12.5%, and a second for earnings above that value, with a rate of 25%. Before this introduction, 25% was the tax rate for all companies. Please note that this scheme is not applicable for companies that report taxable earnings of less than € 12,500 due to spin-offs or other capital reorganization, neither if the capital of the society was realized in part due to the transmission of intangible assets used by another society or individual.

It is now also possible to return, totally or partially, the tax withheld and paid by residents in other EU member states (and EEA other than EU, if there is a fiscal information exchange agreement), for that part which is above what would have been paid if the person had been resident in Portugal.

To promote investment, the Investment Fiscal Code was created to support productive investment projects in mining, agricultural, manufacturing, tourism, information services, research and development, technology, environment, energy, audiovisual and telecommunications. The benefit translates in the reduction or exemption of taxes over assets and tax credits.

This code is also suitable to promote Portuguese companies' internationalization, as well as Portuguese direct investment abroad related to competitiveness clusters, construction, public works and associated

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architectural and engineering, and also transport and logistics. The benefit here translates in a tax credit of 10% of the investment made in (i) establishments of branches or permanent representations, (ii) acquisition of shares in non-resident companies, or (iii) setting up companies abroad or campaigns to promote markets.

In accordance to the change in personal tax, social transportation monthly passes bought for the company employees are now also fully exempt of corporate tax if its attribution is general.

In 2009 the “Sistema de Normalização Contabilística”, Portuguese version of the International Financial Reporting Standards, was finally published. This publication seeks to promote the standardization of European accounting under International Accounting Standards Board (IASB) guidelines and altered some norms of the Corporate Tax Code. This standard will become law in January 2010.

Value-Added Tax

No major change for this tax. However, the current rate may be altered as pressure raises on the revenue side to curb the deficit and this is the tax with more immediate effect on public accounts and because such a move was already done in the past (by José Manuel Barroso and José Sócrates, both by 1%).

The changes with most impact in 2009 concerns the minimum value to qualify for a reimbursement (now € 2,500) and the time frame during which a warranty should be kept, in the case of a reimbursement request, when the value exceeds € 1,000, which is now 6 months (down from 12).

The government also made several small changes, more for marketing than to achieve significant effects. As an example, the government granted the reduced rate to municipal companies' constructions, urban re-qualification, children seats on cars and prosthetics maintenance and repairing and granted

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full exemption for goods given for later distribution to the needy. Other example is the VAT exemption for imports if the import value is under € 22 or the tax is below € 10.

Emergency Measures

Unemployment is one of the worst difficulties facing Portugal in 2009. This provided an incentive for the Portuguese government to change the tax system in several areas to benefit companies who hire in these difficult economic conditions.

One of those measures was the extension of the fiscal benefits for companies who recruit young candidates, raising the limit to 35 years (up from 30), allowing them to multiply by 1.5 all the costs related with the recruiting when computing their profits (defined on the Fiscal Benefits Statute).

An illustration of the benefits is the change brought to the definition of long-term unemployment, which now includes all persons unemployed for 9 months (down from 12), giving all the benefits of hiring these workers to all companies, namely € 2,000, and no Social Security contributions for 24 or 36 months (pursuant to Portaria 130/2009).

Portuguese Public Deficit is another ongoing problem. It breached the 3% Stability and Growth Pact rule before the international crisis hit and can't be brought down easily for several reasons. First and foremost, because the expenses have been difficult to control, let alone to cut. Second, because these expenses are mainly current expenses (91%) and not investment. To give an example Portugal spent only 0.26% of GDP to deal with the current crisis against a European average of 1.7% (according to an European Commission report). Third, because taxes are already high and the financial situation of families and companies is so difficult that failure to pay back loans is at a all time highs. And last but not least, because the government presented in December the second amendment to the budget, claiming it could not run with the first, raising further the public debt limit to € 15,102

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million without even presenting a definitive deficit figure (that will be “between” 8 and 9 percent of GDP).

Despite his intentions to further increase the scope of fiscal exemptions, the government will most likely have to undertake bold action to answer IMF, European Commission and creditors’ pleas to control the deficit.

Report on Fiscal Competitiveness, Efficiency and Justice

On October 3rd 2009, the Portuguese government published a report on the prevailing fiscal system, which was made available on Internet (the report is available in Portuguese at:

http://www.portugal.gov.pt/pt/Documentos/Governo/MF/Rel_Comp_Efic_Justic_Fiscal.pdf and

http://www.min-financas.pt/inf_fiscal/GPFRelatorio_Global_VFinal.pdf).

The 853 pages report identifies the main bottlenecks of Portuguese fiscal system and possible solutions to tackle them.

The main hindrances to a better relation between the “fiscal machine” and the taxpayer pointed in the report are the constant changes in the law and the length of fiscal disputes. The first thwarts the principle of legal certainty. It is a consequence of the already referred changes approved in every budget (and for 2009 there were three) and in response to several policy changes. The second is caused by the vacancy of 20% of staff and the ratio of 1/3 of fiscal judges to their administrative counterparts. It is manifested by the expected timeframe to get a first instance decision (5 years) and can be solved by changes in the staff management. All changes are detailed in the report and a willing government could easily implement them.

Public discussion of new fiscal laws, better legislative technique to avoid unneeded, contradictory and in-need-of-interpretation laws, adequate disclosure of interpretations from the Tax Administration and normative stability are presented as the solutions for the problems within the system. These solutions are presented with lengthy detail.

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Meanwhile, the Portuguese's Court of Auditors ("Tribunal de Contas") in its most recent report, presented in December 23rd 2009 but referring to 2008, pointed out that it is not possible to correctly assess neither the revenue, nor the expenses or the assets of the state due to creative accounting and questionable budget operations (health and road systems and BPP guarantee). This leads us to doubt the existence of the political will necessary to solve the problem.

Conclusions

Portugal has some very attractive conditions for investors: its location, weather, and history make it a prime location for logistics, for specialized agriculture (e.g. wines) and tourism. Other traditional sectors, facing Asian competition, are adapting and thriving under the current market shift between mature economies and emerging ones. Portugal is a relatively free country (see the report: <http://www.heritage.org/index/Country/Portugal>), where one can invest in any sector of the economy, including health and education, and property rights are well protected.

However, government weight (46.5% of GDP in 2008 and rising), imbalances, bureaucracy and tax policy, manifesting themselves in cumbersome labour laws, high taxes and lengthy cases, threaten any economic recovery, even when the European markets recover.

Although some measures have been approved, and a major report was produced on the problems and respective solutions for the fiscal apparatus, the apparent lack of political will signals that a major plan to tackle the issues, though highly needed, is not likely in the immediate future. Portuguese best hope is that the crisis will force the government into action.

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Radu NECHITA, PhD
Faculty of European Studies, University
“Babes-Bolyai”, Cluj-Napoca
Independent Center for Studies in
Economics and Law

General outlook

The crisis affected Romanian economy by at least five major channels:

- A drop in foreign demand hit export-oriented companies;
- Foreign direct investments diminished by 60%;
- Remittances from Romanians working abroad (1-2 millions, about 5-10% of total population) diminished;
- Real estate crashed after a prolonged boom;
- Government deficit (over 5% in 2008, over 7% in 2009), financed mainly on internal capital market, dried out available resources for private investments.

Figure of the year

2,100,000 % implicit maximum marginal rate of the “minimum corporate income tax” resulting in a 1,000.59% increase of business suspension of economic activity in 2009

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Economic and political instability of 2008 (economic crisis, local and legislative elections) continued in 2009. Electoral campaign started actually in the first quarter 2008 (if not in June 2007, with European elections). It continued until end 2009 (December 6th), when the second round of presidential elections confirmed Traian Băsescu (DLP) for a second term. End 2008, a new coalition, painfully constituted between Democratic-Liberal Party (center right) and Social-Democratic Party (center left), invested a government with a solid majority in Parliament (about two third), but with a weak program. Actually, each party proposed its own “anti-crisis” plan, generating confusion and uncertainty. The DLP-SDP government withdrawn the draft budget for 2009 proposed in November by NLP government, but it did not submitted an alternative proposal until February 2009. Ambiguities of Romanian Constitution prevented another ad-hoc coalition to form a new government. From September to December 2009, Romania had only provisory governments, successively rejected by the Parliament.

This situation generated a high level of uncertainty and maintained a “wait-and-see” attitude in private and public economy all over 2009. Uncertainty concerned especially fiscal matters: tax rates were increased, private pension contributions were actually confiscated for the public pension system, a minimum corporate income tax was decided and enforced during the fiscal year, flat tax on personal income was under heavy ideological attacks, different changes in VAT were proposed by political parties and opinion leaders, special taxes (on oil companies, on hypermarkets, etc.) were proposed by government and by opposition members.

On October 1st 2009, SDP withdrawn from the government and, for the first time in post-communist period, Parliament was able to destitute a government (13th October 2009).

Overall, compared to the innumerable propositions, changes enforced were rather limited. However, their direct and indirect impact was significant.

Taxes

Personal Income Tax

Flat tax was implemented in 2005 by a NLP-DLP coalition. Since 2006, it was maintained by a NLP government without an explicit Parliamentary majority, but with an implicit support from SDP, an opponent of this form of taxation. As in previous years, in 2009, the flat tax principle was under strong attacks from the left (SDP's formal and informal leaders, trade union leaders) and from well connected "opinion makers".

Flat tax opponents referred to the high level of income and wealth inequalities in Romania allegedly caused and amplified by this fiscal regime. This approach is not very convincing for those who remember the privatization process of the early nineties. Indeed, the chances to be listed in the 2009 edition of Capital's Top 300 richest Romanian had little to do with the level of one's personal taxable income during previous years. Another threat against flat tax was the proposal to tax at a marginal rate of 90% the incomes of public sector employees earning more than RON 8000 per month (about € 2,000, or 5-6 times the average income). This "solidarity contribution" was imagined by the government as a way to cap excessive incomes earned by high rank civil servants. Besides its unconstitutionality, this idea is contradictory: either the government can establish a nominal limit of its own employee's income (therefore, there is no need for a special taxation), or it can't and therefore the privileged employees will manage to increase their gross income at a level that leaves unchanged their nominal income. The proposal hadn't yet any practical consequences other than increasing fiscal uncertainty.

Despite ideological disagreements on flat tax, the new DLP-SDP coalition formed in January 2009 maintained the 16% flat tax on personal income. Someone more familiarized with economic and political doctrines than with Romanian effervescent political life could wonder why two parties in favor of flat tax prefer the alliance with an opponent to this fiscal regime. Besides conflicts and mistrust among leaders, an explanation must take in account the

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fact that NLP and DLP are competing for the same “political market” and for who will play the role of the “real right-wing party”. A recent change in electoral law (replacement of proportional representation with a “winner takes all” system) transformed a usual electoral competition into a survival struggle for these two parties.

Romanian “flat tax” is flat only relative to the taxable income, and it’s actually progressive with gross income. Indeed, since 2005, the flat tax is combined with a system of fiscal allowances, which depend positively upon “dependent persons” (children and/or other family members) and negatively upon gross income level.

Monthly fiscal allowances
(Average exchange rate for 2009: € 1= RON 4.2373)

Dependent persons Monthly Gross Salary (RON)	0	1	2	3	4 and more
Below 1000	250	350	450	550	650
1001-3000	$250 \times A$ (*)	$350 \times A$	$450 \times A$	$550 \times A$	$650 \times A$
Above 3000	0	0	0	0	0

(*) $A = \left(1 - \frac{VBL - 1,000}{2,000}\right)$, where VBL is the gross monthly salary.

Source: Romanian fiscal regulation (Art, 56 Fiscal Code and Finance Ministry’s Order No 1016/2005)

Besides these general fiscal allowances, other expenses fiscally deductible were:

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- Contributions to voluntary pension schemes (“third pillar”, according to World Bank’s classification), up to € 400/year for the employer and the same amount for the employee (increased from € 200 in 2008);
- Contributions to voluntary medical insurance schemes up to € 250/year for the employer and the same amount for the employee (increased from € 200 in 2008);
- Savings (up to RON 300 or € 71) in an already subsidized “Savings and Loans” program, meant to encourage house ownership.

The very existence of fiscal allowances and the fact that their level can be changed represent a source of uncertainty for the future. Indeed, the list of fiscal allowances can be modified each year (but, in practice, also during the fiscal year), which allows and stimulates lobby activities in this field.

Corporate Tax

In 2009, corporate income tax remained at 16%. Dividends received by a Romanian company from another Romanian company are not submitted to corporate income tax. This is also the case for dividends paid by or to a non-resident from another EU member, under certain conditions (two years of uninterrupted control, at least 15% of capital in 2008 and 10% in 2009). However, at the individual level, distributed profit is taxed once again at 16% because distributed dividends are considered part of personal taxable income. This means that, from an economic point of view, the tax rate on capital as a production factor is eventually 29.44%; not 16%.

Although authorities left unchanged the symbolic 16% tax rate on corporate income, they modified the tax base by reducing and even eliminating tax deductibility of company-owned car-related expenses (gas, maintenance, etc.). These changes were decided in 2009 (without a proper debate), and took place during the second half of the same fiscal year. There are many exceptions, exemptions and special cases and the deductibility of car related expenses depends on the company main activity, car’s type and car’s actual use. The obvious consequence is that the advantage of a relatively small

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corporate income tax is more and more counterbalanced by the growing complexity of the Fiscal Code and by its permanent changes.

More importantly, in April 2009, an Emergency Government Ordinance introduced the “minimum corporate tax”, effective May 2009. Its level was calculated on pro-rata basis and concerned all Romanian companies, subjected to either corporate income tax or turnover tax. Again, this law amended Romanian Fiscal Code, ignoring at least the spirit, if not the letter, of its article 4 that states:

“Al, 1, The present Code shall be modified and completed only by Act of Parliament, adopted, as a general rule / usually, six months before its enforcement.

Al, 2, Any modification or completion to the present Code shall be enforced in the first day of the year following that in which it is adopted by Act of Parliament.”

Article 4 was meant to offer a shield against arbitrary changes in taxation, but it is actually meaningless: since the Fiscal Code was introduced (2003), the so-called 6 months “general rule” has never been applied. Moreover, even the explicit first part of Article 4 (modification only by Act of Parliament) was systematically ignored. Taxpayers initiated legal actions against what they considered an abuse, but this didn't suspended ordinances' fiscal effects.

Previous to the minimum tax on corporation, micro-enterprises (less than 9 employees and less than € 100,000 turnover) had the possibility to opt for 3% turnover taxation as an alternative for profit taxation. Employers used extensively micro-enterprises as tax-avoidance device by incorporating highly paid employees. Authorities amended the Fiscal Code in order to close the loophole, with a limited success because other tax-avoidance devices were adapted to the same purpose. In 2010, the turnover tax option is no longer available and all companies pay a 16% corporate income tax.

The minimum corporate income tax was considered by its promoters—the DLP-SDP coalition—as an anti-tax evasion device and an efficient way to raise revenue for the government. Opponents contested the very logic of fighting tax evasion by rising taxes. They exposed also the potential damaging

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effects on small and medium enterprises and on the economy in general. Indeed, minimum corporate tax was actually a regressive tax, with a relatively higher burden on small companies.

Minimum corporate income tax

Annual turnover (RON) 2008	Minimum annual tax (RON)	Equivalent turnover tax rate (%)	Threshold effect Maximum marginal rate (%)
0 – 52,000	2,200	∞ - 4.23	220,000
52,001 - 215,000	4,300	8.27 – 0.02	210,000
215,001 - 430,000	6,500	3.02 – 1.51	220,000
430,001 - 4,300,000	8,600	2.00 – 0.20	210,000
4,300,001 - 21,500,000	11,000	0.26 – 0.05	240,000
21,500,001 - 129,000,000	22,000	0.10 – 0.02	1,100,000
Over 129,000,001	43,000	Less than 0.03	2,100,000

Source: Romanian fiscal regulation (OUG, MO PI Nr, 249/14,04,2009) and author's calculations.

As illustrated in the above table, tax basis in 2009 (a crisis year) was 2008 turnover (a pre-crisis year). The difference was significant for many companies. Moreover, minimum corporate income tax was due even for companies without a significant economic activity or registering losses. Therefore, economic analysts anticipated a wave of bankruptcies and enterprises' closures. This didn't worried Finance Minister, who considered that any company unable to make € 500 profit (the equivalent of the minimum corporate tax) should be closed anyway.

Another characteristic of this minimum corporate tax was the significant threshold effect generated, but this aspect received little attention. For example, a 1 Leu increase in turnover from RON 129,000,000 to RON 129,000,001 can generate an increase in taxes up to RON 21,000. In more technical terms, this is equivalent to a 2,100,000% marginal tax rate...

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According to ONRC (National Trade Register Office), many companies ceased or suspended officially any activity in 2009 (below table). However, government decided to maintain for 2010 the idea of a minimum corporate income tax, but to apply it only in sectors with high tax evasion.

Number of companies that suspended or ceased their activity

Requests of:	2008	2009	Variation
Suspension of economic activity	12,019	133,362	+1009,59%
Voluntary liquidation	3,762	18,766	+398,83%
Radiation	17,676	43,615	+146,75%

Source: ONRC, in Moraru, 2010

Excises

Excise duties on energy, tobacco and alcohol continued to increase in 2009, in order to achieve conformity with EU regulation. Transition periods are allowed, according to a schedule agreed by EU and Romanian authorities. As a general rule, since 2007, excises were increased in advance relatively to deadlines established. However, excises remain inferior to EU minima level. Hence, excise on gasoline and diesel gas are respectively €336/1000 l and € 284/1000 l, compared to EU minima of € 359/1000 l and €302/1000 l.

Social contributions

Romanian legislation maintains the conventional distinction between employer's and employee's social contribution. Next table outlines the evolution of social contribution rates during 2004-2009 period and the

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perspectives for 2010. The tax base is usually the gross wage, including bonuses and all other work-related income. Social contributions were almost 9% lower in 2008 compared to 2005, but in 2009 they increased by 3.55%. As remarked also by World Bank's Doing Business Report, Romanian social contributions remain among the highest in EU, in strong contrast with social benefits. This explains the low social acceptance of these contributions and the efforts made by employers and employees to avoid them.

Labor taxation in Romania, 2004-2009

Type of contribution	Fiscal liability	2008 Jan.-Jun.	2008 Jul.-Nov	2008 Dec.	2009 Jan.	2009 *** Feb-Dec	2010 Forecast
Pension*	Employee* *	9.5	9.5	9.5	9.5	10.5	10,5
	Employer	19.5	19.5	18	18.5	20.8	20.8
		24.5	24.5	23	23.5	25.8	25.8
		29.5	29.5	28	28.5	30.8	30.8
Health	Employee	6.5	5.5	5.5	5.5	5.5	5.5
	Employer	5.5	5.5	5.2	5.2	5.2	5.2
Unemployment	Employee	0.5	0.5	0.5	0.5	0.5	0.5
	Employer	1	1	0.5	0.5	0.5	0.5
Risk and accidents	Employer	0.4-2	0.4-2	0.4-2	0.15-0.85	0.15-0.85	0.15-0.85
Labor inspection	Employer	0.25-0.75	0.25-0.75	0.25-0.75	0.25-0.75	0.25-0.75	0.25-0.75
Salaries' guarantee fund	Employer	0.25	0.25	0.25	0.25	0.25	0.25
Sick leave and indemnities	Employer	0.85	0.85	0.85	0.85	0.85	0.85
Total**		44.25-46.35	43.25-45.35	40.95-43.05	41.20-42.40	44.50-45.70	44.50-45.70
		49.25-51.35	48.25-50.35	45.95-48.05	46.20-47.40	49.50-50.70	49.50-50.70
		54.25-56.35	53.35-55.35	50.95-53.05	51.20-52.40	54.50-55.70	54.50-55.70

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* Employer's contributions are for "normal", "uncommon" and, respectively, "special" conditions of work.

** Since 2008, employee's pension contribution (9.5% or 10.5%) is split between 7.5% or 8.5% for the first pillar ("pay-as-you-go", public) and 2% for the second pillar (capitalization, privately administrated) of the pension system.

** The tax base differs slightly from some contributions and changed over time, but in most cases, it is gross salaries (payroll) or very close to it. Therefore, the total is not always rigorously precise but represents a useful approximation.
Source: Romanian legislation

*** On 2nd February, government announced an increase – effective immediately – in pension contributions from 27.5% in December to 31.3% (10.5% employees' contribution to 1st and 2nd pillar + 20.8% employers' contribution). Government limited the contribution to the second pillar at 2%, although it was scheduled to increase at 2.5% in 2009, according to Pensions' law.

Pension contributions

After a slight but continuous drop since 2005, pension contributions were increased in two steps (in January and February 2009), with a total amount of 3.8%. Employee's contribution increased from 9.5% to 10.5% in February 2009. For eligible employees, this contribution is actually split between the public pension fund (first pillar, "pay-as-you go", 8.5%) and the privately owned and administered pension funds (second pillar, capitalization, 2%).

A controversial topic was government's decision to maintain contributions to second pillar pension funds at 2%. According to Pensions' Law, this contribution was set to increase annually by 0.5% (with a corresponding decrease in first pillar contributions) until 2016. This decision represents actually a (re)nationalization of the corresponding sums, which are not deposited on a privately-owned pension account but retained in a public fund without any probable benefit. This decision reduces Romanian government's credibility among domestic and foreign investors, especially among pension funds administrators. Indeed, by a simple executive decision, this specific market was reduced by 20% of its expected size, established by law just a year before.

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The losses for Romanian contributors are not negligible because the nominal average increase of pension fund units was about 15% in 2009 (or 17% weighted average), compared to an inflation rate of 4.74%. They lost also the corresponding potential capital gains resulting from investments in historically low priced stocks.

There were no changes concerning tax deductibility of contributions to the third pillar, which is open to all employees on voluntary basis.

Other labor based contributions

Mandatory health care contributions for the public system remained unchanged. Also unchanged, despite a probable increase of unemployment, were unemployment contributions. The lowest rate of contributions for risks and accidents was reduced from 0.4% to 0.15% and the top rate decreased from 2% in 2008 to 0.85%. The rate of the labor inspection contribution due to finance the Territorial Labor Inspectorate also remains untouched. Finally, contributions for salaries' guarantee fund (0.25%) and for sick leave and indemnities (0.85%) remained constant since their introduction in 2007.

Local taxes

Transfers from the national budget represent the main source of revenue for local authorities. The amount of these transfers is calculated as a percentage of locally collected corporate income tax, personal income tax and VAT. Taxes on real estate (land and buildings) and on vehicles are another important financing source for local authorities. Real estate taxes are different for individuals and companies. No major changes occurred in 2009, but the fiscal value of buildings is set to increase starting with 1st January 2010.

Quasi-taxes and other administrative fiscal burden

Quasi-taxes represent a significant fiscal burden in Romania (see previous year's report). An undetermined number of "self-financed" agencies generate

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about 500 taxes in Romanian economic environment. Until June 2009, the government eliminated 42 and merged 142 of them, but without reducing (and even increasing) their total levels or rates. The promise to eliminate 50% of these agencies wasn't followed by remarkable measures: their over 400,000 employees kept their jobs in 2009.

Fiscal authorities publicly acknowledged also the existence of a serious problem in the field of administrative burden and promised improvements, which are still waited by all economic actors. Despite authorities' proclaimed good will, obvious failures were registered especially in creating a predictable fiscal and regulatory environment. Even worse, steps backwards were registered. For example, since April 2009, VAT reports for intra-community acquisitions are to be filled monthly; not once every quarter as previously.

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Slovakia



Radovan Ďurana
Analyst, INESS – Institute of economic
and social studies
radovan.durana@iness.sk

General outlook

The economic crisis in large developed economies has significantly affected production in Slovakia. Instead of a growth of GDP above EU average, a 5.7% decrease is expected. Together with lower production, significant drop in tax revenues has been recorded. The government has responded to the crisis with quite a few measures, but left the structure of the tax system unchanged. Despite lower tax revenue, the government has also decided to leave the budget unchanged. Such inability to adapt to circumstances will probably lead to an increase of tax burden in the coming

Figure of the year

The difference between the budgeted and expected corporate income tax revenues should reach – 26% in 2009 percent of all government revenues are used to pay for mandatory and quasi-mandatory expenditures

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years. This extra burden will come through a broadening of tax basis rather than higher tax rates.

General environment in 2009

Slovak economy recorded the highest real GDP growth among EU countries in 2008. Although this result represented slowdown from previous growth (from 10.4% in 2007 to 6.2%), it was still promising, leading to optimistic expectations of above average growth in 2009. In September 2008, the government as well as most of bank analysts predicted that the economy in 2009 would produce 4.5% more than the year before. Compared to actual year-end estimates, the predictions have never ever been so far from truth.

Harsh reality proved that small, open, and export-oriented economies such as the Slovak one suffer more from decrease in overall consumer demand than strong developed economies of Western Europe. Although, as late as February 2009, the OECD was still predicting that Slovakia would be the only member of the club in black numbers, the 14% drop of production in the first quarter threw Slovakia to the opposite end of the rankings. Current estimate of an annual 5.7% drop in the GDP reflects the dependence of Slovak economy on globalized business world, as well as the fact that the country had so far thrived thanks to the economic growth powered by the debt financed consumption of developed West. Obviously, such a large drop in production had to hit the tax base and the tax revenues. Slovak government had reacted by adopting three crisis packages of fiscal and economic policy measures. The first most expensive crisis package of anti-crisis measures has been adopted by government in Spring 2009 and could be divided into two basic categories, the first oriented towards the individual taxpayer, the second targeting the corporate sector.

In general, these measures have not been financially extensive and therefore their impact couldn't be vast. Total costs of the measures adopted in spring reached 0.5% of GDP.

Money for people

From a tax revenue point of view, changes in taxation of individuals have been the most expensive. An increase in basic allowance from € 3,435.3 to € 4,025.7 valid for two years should decrease the personal income tax (PIT) revenues by € 367 mil. (10% a year). Together with the increase of this value, the annual maximum income up to which the allowance is applied has been decreased by € 2,505 to € 15,387, strengthening the effective progressiveness of this tax. The goal of the measure was to support domestic consumption by giving a push to disposable income and hopefully households' consumption. In reality, an average wage earner gets 1.2% more than before. Because domestic production is dependent mainly on foreign consumption, the rationale of this traditional Keynesian fiscal measure is not clear. Although total households consumption remained relatively stable, annually - 0.2% for the 9 months period beginning in January, this measure had not met its goal as domestic retail sales dropped by 10% in the same period.

It should be mentioned that the definition of basic allowance includes annual valorization based on growth of subsistence level. Nevertheless, after the increase in 2009, the government refused to valorize it for the next year due to fall in tax revenues.

Another change adopted in the tax code does not leave the money in taxpayers' wallet but, working like a negative income tax, represents rather a social financial benefit. It is applicable solely for employees with the lowest wages. In general, a person whose salary is lower than basic allowance, receives the tax credit in the maximum amount of € 157.04 per year. Due to numerous restrictive conditions for granting the tax credit, the employees will receive the payment in one shot, after the tax clearance. This measure has already been discussed before the start of economic recession in order to try to reflect the fact that tax wedge is too high, discouraging an unemployed person to start working. This is due to especially high contribution rates, which are applicable at their full rate from the first cent earned. To annualize the tax credit payment is, however, in contradiction with the typically unstable working contracts of low earners with minimum qualification.

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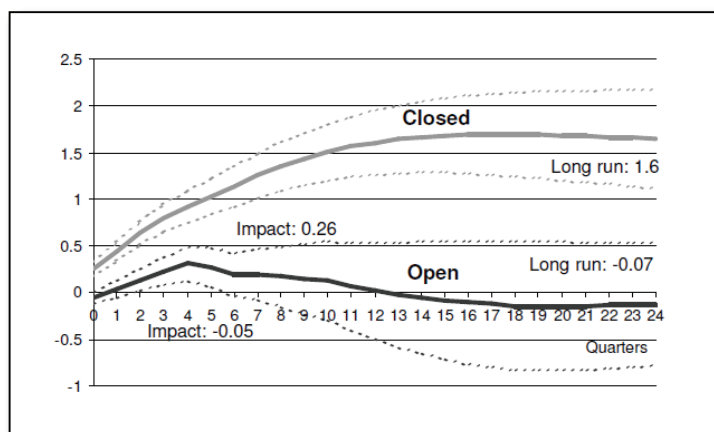
Based on the two measures detailed above, the government will collect € 147 million less in personal income tax. At the same time, growing unemployment and stagnating wages contribute an additional € 236 million fall compared to budgeted PIT revenues. Annually, taxpayers are expected to pay 9% less compared to previous year (see table below). The question mark hangs over the ability of government to return the base allowance back to its original value in 2011. As it gave more cash to lower middle class, it might not be very welcomed by the electorate.

Production hobbles

Industrial production still plays the most significant role in Slovak economy. An annual 20% decrease of the production index provides an unambiguous signal of future low profitability of the sector and consequently low revenues from corporate income tax (CIT). The government has admitted having no way to supplement vanished demand from abroad. For this reason, it has withdrawn from planning large stimuli for production sector.

Also empirical studies show that fiscal stimulus in an open, export-oriented economy is, if any, of little help. This point is illustrated in the following chart. The chart traces the impact of one euro of government consumption on output. In a closed economy, the extra euro spent leads to an increase in GDP of 26 cents during the first quarter and the total impact of this euro of government expenditures cumulates at €1.6 over 6 years. In an open economy such as Slovakia, the same euro of government consumption has almost no impact on output.

Impact of a fiscal stimulus in open economy and closed economy



Source: How big are fiscal multipliers? Ethan Ilzetzki, Enrique G. Mendoza and Carlos A. Vegh; October 2009, Centre for Economic Policy Research

Note: "Impact" represents how much output delivers an additional dollar in government's consumption

There were more than 20 anti-crisis measures adopted, although none of them of significant importance. Some of them are decreasing the actual tax burden.

- Joining the government program for subsidizing R&D increases the tax deductible.
- The interest from credits between related parties becomes tax expense.
- It will be possible to carry forward losses during seven years.
- Changes in the rules of depreciation allow higher input prices for investment property depreciation and accelerated depreciation.

All the measures somehow related to tax code have not exceeded € 50 million in 2009. Despite the relatively low cost of these measures, the total fall of CIT driven by economic slowdown should exceed € 616 million or a drop of 26 % compared to budgeted revenues.

Slovakia

It should be noted that certain measures touched also at the hidden part of the taxation system, its indirect costs, but not significantly. The extent of tax code measured by the number of words it contains, which had been significantly reduced after the introduction of flat tax reform in 2003, already broke through the original maximum of 50 thousand words. Also, Slovakia is one of the few countries, which does not allow electronic filling of tax return. This increases indirect costs of taxation (compared to, for instance, Sweden where a company can pay all kind of taxes including social contributions, VAT or property taxes in a single payment). The government already initiated a project called UNITAS which should not only decrease the indirect costs by introducing electronic filling, but also by merging the agencies responsible for collection of taxes and social contributions hence allowing a taxpayer to pay all his taxes at once. The project is not expected to be completed prior to 2014.

Indirect taxes

The only tax rate that government increased was the excise duties on alcohol. Nevertheless, it hardly could be considered as a strategy to support public finance in a time of crisis, as its effect was rather minimal, adding to 2010 budget a modest € 13 million.

This year increase of excise duties on tobacco had been scheduled to comply with EU legislation that requires harmonization. Nevertheless, despite application of the new increased rates since February, the budget will not profit from it until 2010, as Slovak retailers fed the inventories with 10-month reserves paying previous lower taxes.

As a response to the crisis some changes have been adopted in the area of value added tax. This does not concern VAT rates but the processing rules. The most significant amendment with real fiscal effect has been the shortening to 30 days of the period for refunding VAT deduction. This has improved the cash flow of companies.

Slovakia

Although government has not proposed any measures that would directly decrease the VAT and the consumption of households remained stable, the revenues from VAT encountered the second largest absolute drop after CIT tax revenues.

	Budget 2009	Estimate 2009	Estimate 2009 / Budget 2009	Estimate 2009 / Reality 2008
Personal Income Tax	2 034 986	1 651 239	-19%	-9%
Corporate Income Tax	2 430 260	1 804 352	-26%	-14%
VAT	5 010 091	4 429 160	-12%	-4%
Excise Taxes	1 960 698	1 745 307	-11%	-4%

Source: Ministry of Finance SR.

One of the reasons for this is the fact that part of the domestic consumption was satisfied abroad. There are two relevant factors for such a change. First, VAT rate applied for foodstuffs is relatively high; it is 19% as for other consumption goods (only books, medicines and health requirement have a reduced 10% rate). The other Central European countries apply a reduced rate to foodstuffs (except in Hungary). Second and more important, Slovakia switched to the Euro in January 2009 at a relatively strong exchange rate, while local currencies in neighboring countries weakened significantly throughout the crisis. Slovakia was the only Visegrád country—i.e., among Czech Republic, Hungary, Poland and Slovakia—with a massive 10% drop in retail sales at the beginning of 2009.

Another reason for the fall in VAT revenues comes from the decrease in investment activity of corporate sector (more than 10%) and the overall decrease in inventories.

Slovakia

Social and Health Contributions

While the share of direct taxes to GDP is the lowest in the EU, the share of contributions (both social and healthcare) belongs to the highest. The government collects almost 40% of its tax revenues from labor, from which about two thirds fuel the social security system. Therefore, growing unemployment combined with stable wages necessarily lead to large fall of income from this source. Hence, growing unemployment (in one year the rate grew from 7.5% to 12.4% as of November 2009) worsens the balance of social security system, as the unemployed withdraw large amount of resources that were previously used to finance pensions. The system does not contain stabilizing mechanisms that would match expenses with revenues and furthermore suffers from the existence of a private pension scheme that draws off about 15% of social contributions. As a result, in 2009 the Social insurance agency will collect less in contributions than it pays out only in pensions. Unemployment or sickness payments must be currently financed either from retained revenues from previous years or must be subsidized from state budget. Negative balance will continue next year, swallowing € 1.5 billion or 11% from all non-EU budget expenses.

Private pension scheme has been established to guarantee the stability of public finance. Every newcomer to labor market must decide either to enter the saving scheme, and so the transfer of 9% of salary to his/her own account, or to contribute to the PAYG system. Private savings will in the future decrease the liabilities of the PAYG system. Nevertheless, the PAYG system requires further changes to support its ability to sustain current and potential future slowdown in revenues. Most probably retirement age and average pensions paid will be changed. Paradoxically, the substantial amendments adopted this year as a response to financial crises were related only to private pension investment scheme. Indirectly, by forcing managers to cover potential losses on a 6-month basis, the government pushed pensions funds into replacing stocks with bonds and coincidentally the funds miss one of the greatest rallies in the history of capital markets and weakened their ability to increase the value of savings.

Slovakia

On the other hand, high social contributions levied on labor continue to represent the most significant barrier for tackling high unemployment among low skilled workers. Small cuts in contributions paid by self-employed, adopted within the first anti crisis package, could not make much difference. The second measure related to contributions had probably a bigger effect: the government decided to pay, for 60 days, the full contributions normally paid by employers to their employees when those employees must temporarily stay home due to a lack of orders (the employer must still pay 60% of regular salary).

In general, the system of contributions and social benefits financed by them will need to undergo significant changes in order to achieve its sustainability. If there is a lack of will for more control over future pension payment costs, it will be necessary to increase either the contribution rates or the taxable income. In both ways, the overall taxation will need to increase.

Fiscal policy in general

The financial crisis bypassed Slovakia due to good health of its banking sector, which has not been significantly involved in risky debt financing businesses and which underwent a costly cleansing process already in 2001. The government hasn't had to spend a cent to support the finance sector. But the economic slowdown and shrinking tax revenues found the state institutions unable to adequately change the structure of their expenditures. Only € 330 million from originally planned budget capital expenditures have been committed to finance crisis response packages. Except for the measures devoted to reduce the tax burden, the packages contained several costly measures with rather questionable effects. A good example is the car scrapping scheme, which effectively supported only car sellers, not the economy, as approx. 90% of all cars sold in Slovakia are produced abroad. Another example is the financial support of so called "social enterprises" which are supposed to generate jobs and train long term unemployed. Media reports indicate that these projects are crowding out existing companies and

Slovakia

provide training at excessive costs. Instead of the 10 000 jobs expected, only a few hundred had been created at the cost of € 8.5 million.

The other measures adopted within the anti crisis packages aimed at creating jobs or maintaining existing ones. The results were limited, as witnesses the 65% increase of the unemployment rate. As a matter of fact, relatively small amounts went to the anti crisis packages, and the general budgeted public spending played by far the main role in preventing larger drop in GDP. Despite a huge decrease in tax revenue, public sector had not revised its initial spending plan. In fact, public consumption has been the only growing part of the GDP, reducing the impact of decreasing production in the private sector. However, notwithstanding government's claim that public spending will provide the required stimulus for the economy, several independent think tanks have been reporting on public procurements chronically overpriced, marked with waste and corruption. Again, maintaining the size and the structure of the budget despite significant drop of production, in an open economy, can hardly be considered as a stimulus but rather as inefficient use of resources.

Conclusion

Recession in the United States of America and European Union has significantly hit the performance of Slovak economy. Decreased external demand led to capacity decrease or closing down of many businesses resulting in significant growth of unemployment. Decreasing labor force, stagnating wages and lack of profit making opportunities affected tax revenues significantly. The government adopted some fiscal measures with limited impact on overall production. Tax system remained largely unchanged, only minor amendments have been adopted.

Inability of the government institutions to decrease their own consumption led to high deficit. This will in turn result in an increase for 2009 by more than 33% of Maastricht debt. If the economy does not recover next year, and the government does not come up with considerable cuts in its spending, the

Slovakia

misbalanced financing of public sector will require an increase of tax burden. Rather than increasing the tax rates, a broadening of tax base is expected; more specifically, the first step to increase government income would be the use of a broader base for social contributions.

Main Sources

[Paying Taxes 2009 The Global Picture](#), PricewaterhouseCoopers and the World Bank, 2009, [Statistical Office of the Slovak Republic](#), [Ministry of Finance of the Slovak Republic](#), [Financial Policy Institute of the Slovak Republic](#), [Center for economic policy research](#), www.plytvaniestatu.sk

Slovakia

Sweden



Anders Ydstedt
Scantech Strategy Advisors
anders@scantechab.se

General Outlook

In the fall of 2006, a center-right government came to power in Sweden on a promise to lower the world's highest taxes. Some taxes were lowered in 2007, 2008 and 2009. The government decided to abolish the wealth tax in 2008 retrospectively from January 1 2007. With these tax cuts Sweden has now the world's second highest tax burden with 46.6 percent of the GDP.

The socialist-green-communist opposition opposes to this policy, although they all have different views on tax policy. In the 2010 elections, taxes will be an important issue.

Personal income tax

Sweden has highly progressive taxes on personal income. The personal income taxes start with the local tax decided at the local level. The local tax averages 31 percent, ranging from 28.89 to 34.17 percent. For an annual income above SEK 380,200 (1€ is approx. SEK 9.7), Swedes also have to pay

Sweden

state taxes with a marginal rate of about 50 percent. The highest rate for direct taxation on income is 55 percent and starts with an annual income of SEK 538,800.

Central on the political agenda was the idea to develop incentives to work via the tax system. In 2007 Sweden introduced an earned income tax credit, or in-work tax credit, as the government prefers to say. This first step has been followed by two more steps -- in 2008 and 2009 -- and a fourth step will start from January 1st of 2010. In total the four steps of earned income tax credit correspond to a reduction of SEK 71 billion on personal income taxes. For the Swedish government this in-work tax credit is the most important single measure to get more people working and reduce exclusion.

The level of the earned income tax credit depends on the total income. It is constructed to give the highest tax credit for lower income levels. The tax credit makes it more worthwhile for people outside the labor market to work. The maximum tax credit is reached at a yearly income of SEK 330,000. Above that income, the earned income tax credit stays the same. The earned income tax credit also depends on the level of the local taxes and generates a higher tax credit in those municipalities with higher taxes. The amount also depends on the age of the taxpayer. In total the earned income credit is worth up to SEK 21,600 for those under 65 years old. In 2009, 97 percent of all full time workers received a tax credit above SEK 12,000.

In the political debate it is highly questioned if the earned income tax credit will have any effect on the labor market. Calculations from the Swedish National Audit Office, Riksrevisionen, and the Ministry of Finance indicate that the reform will increase the amount of worked hours in the long term by 2.6 percent. The scheme is quite complicated and to have any impact it is necessary that most Swedes be aware of the system. A poll made in the fall of 2009 by the Swedish National Audit Office showed that almost every second Swede didn't know anything about the earned income tax credit system.

The socialist party, in opposition, strongly criticizes the system of earned income tax credit, arguing that it doesn't provide lower taxes for retired

Sweden

citizens. In response, the government will next year decrease taxes on people over 65 years old for a total amount of SEK 3.5 billion. Meanwhile, the green party has accepted three of the four steps in the earned income tax credit.

Taxes on Capital

The wealth tax was abolished in 2008 in effect from January 1 2007. Since December 17 2004, Sweden has no inheritance- or gift tax.

The capital gain tax rate is 30 percent and the same rate applies to income from dividend, interest and rent.

The opposition parties all have different views on capital taxation. The socialist party wants to restore a wealth tax if they win next year's elections, while the green party supported its abolition by the government in 2008. Calculation from the Swedish Tax Agency and Statistics Sweden indicates that over SEK 1,000 billion left the country when Sweden had the wealth tax. The communist party has been talking about restoring an inheritance tax.

Corporate taxes

In 2009 the government lowered taxes for business by a global amount of SEK 16 billion. The aim was to increase investment and create more jobs. The corporate tax level was lowered from 28 to 26.3 percent and the indirect tax on labor paid by the employers was lowered from 32.42 to 31.42 percent.

In 2010 the indirect tax on labor paid by self-employed and partners in partnerships, named social security contributions, will be reduced by 5 percentage points, but by no more than SEK 10,000 per year and per company.

Both the Minister of finance, Anders Borg from the moderate-conservative party, and the socialist party are in favor of further cuts in corporate taxes.

Sweden

The organization for smaller companies wants more tax cuts in the indirect tax on labor and so does the center party. In 2008 there was an open conflict between the moderate party and the center party, both in the government, to decide whether businesses would be better off with cuts on the corporate tax level or cuts on the indirect tax on labor. This will probably be an issue for the coming years if the center-right government wins the elections in 2010.

Future tax policy in Sweden

The Swedish Tax Agency lobbies aggressively for tighter rules for companies on transfer pricing, and also against deduction of interest on internal debt in corporate groups. Upon the request from the Tax Agency, the Minister of finance has so far introduced new rules. Sweden has agreed to reduce red tape for businesses by 25-percent. Indeed, when it comes to the tax system applied to business, there is a high risk for a heavy administrative burden.

The Minister of finance Anders Borg has appointed state secretaries with a fiscal background. In December 2009 he also recruited a new state secretary with a background from the labor union. This will probably affect future tax policy. Business organizations have criticized the center-right government for not lowering taxes on entrepreneurship, capital gains and for leaving unchanged the highest level in the personal income tax system. There is still a lot to be done in Sweden!

Switzerland



Pierre Bessard
Institut Constant de Rebecque,
Lausanne
Liberales Institut, Zurich

Financial privacy for non-Swiss residents under heavy pressure

The year 2009 was testing for Switzerland's financial privacy policy. While the dispute with the European Union over cantonal corporate tax regimes took momentarily a backseat, the mounting pressure and open threats of financial and economic sanctions from G20 countries over the exchange of banking information for tax purposes led to a dramatic policy U-turn and the formal adoption of the OECD standards on administrative assistance. The Swiss government's decision followed that of several other governments in countries dubbed as "tax havens" in Europe and elsewhere.

In effect, this means that tax evasion (called "tax subtraction" in Switzerland) will no longer be protected by banking secrecy laws for non-resident clients of Swiss banks. Swiss law makes a distinction between simple tax evasion (i.e., the mere omission of declaring some revenue, which may occur by oversight), an administrative offense subject to fines, and tax fraud, which involves the

Switzerland

forging of documents, for instance by means of fake invoices, and is a criminal offense. Under the principle of double criminality, i.e., the need for an offense to be a crime in both contracting countries, the Swiss government had so far refused to provide information to other governments in suspected cases of tax evasion, although other countries do not make the distinction between tax evasion and tax fraud in their legislations.

The Swiss distinction is based on a deeply rooted recognition for appropriate protection of privacy from unwarranted state intervention. This has applied to banking since the 19th century, and the laws were reinforced in 1934 in order to protect the assets belonging to German Jews subject to state expropriation and spoliation. With its decision to adopt the OECD standards on administrative assistance for tax purposes, the Swiss government reiterated that it had no intention of abandoning banking secrecy. The decision will have no bearing on Swiss and non-Swiss residents in Switzerland. The situation will change, however, for non-residents who hold a bank account in Switzerland: In the future, information may be exchanged on a case-per-case basis in response to specific requests.

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. The pressure on financial privacy will therefore hardly diminish in the years to come. As a result, the Swiss government is contemplating, among other ideas, the implementation of a tax at source for revenues of non-resident clients of Swiss banks. This proposal, which emerged from the banking sector itself as a way to preserve banking secrecy, is controversial, as it would extend the Swiss banks’ role as tax-collecting entities. It seems unlikely at this point that the EU would accept such a proposal as an alternative to the automatic exchange of information, although a similar withholding tax agreement for savings income has been operational since 2005 with tax revenues in excess of CHF

Switzerland

738 million in 2008, to the benefit mostly of the German, Italian and French governments.

In the meantime, the Swiss government's decision to adopt the OECD standards for administrative assistance is being implemented within the framework of bilateral double taxation agreements. The extended scope for exchange of information according to the OECD standards will therefore only have practical effects when the renegotiated agreements come into force, that is, after ratification by both contracting states and, in Switzerland, after a possible referendum, expected in the course of 2010 at the earliest. The Swiss parliament is expected to ratify the first renegotiated double taxation treaty in the spring of 2010. In exchange, the Swiss government would like to negotiate adjustments to the Savings Income Agreement with the EU. Furthermore, the Swiss government attempts to obtain improved market access for Swiss international financial services in EU countries. So far the EU and individual countries have not signaled their willingness to make concessions on these matters.

The Swiss government also posed the following conditions for its future policy on administrative assistance for tax purposes: respect for established administrative assistance procedures; restriction of administrative assistance to individual cases (no "fishing expeditions"); fair transitional solutions; and limitation to taxes covered by the OECD Model Tax Convention.

Although these statements were meant to place Switzerland in a strong negotiating position after the government's abandonment of its policy on banking secrecy, and although Switzerland was removed from the OECD secretariat's "grey list" on behalf of the G20 after the Swiss government renegotiated over 12 double taxation treaties according to the OECD standards, the tensions with neighboring countries have not diminished. The German government showed no intention of linking improved administrative assistance to enhanced access to the German market for Swiss financial firms. The Italian government launched a demonstrative raid on Italian branches of Swiss banks and openly promised to "bleed dry" the financial sector of the Swiss canton of Ticino, the fourth largest in the country, where many Italian

Switzerland

residents have traditionally protected their assets from inflation and excessive taxation (see below). Finally, the French government proclaimed to hold and attempted to use stolen data from Swiss branches of foreign banks, which led the Swiss government to suspend the ratification process of the renegotiated double taxation treaty with France until further notice.

Critics maintain that the Swiss government's pragmatism over the years proved fatal in international relations and placed the country in an irreversible position of weakness. The compromise over savings income with the EU in 2005, which some believed had "saved" banking secrecy seems to have enticed the EU and individual governments to ask for ever more. Instead of arguing in favor of individual rights to privacy and the protection of legitimately earned property, the Swiss government often placed Swiss "jobs" and "competitiveness" at the core of its argumentation, with the prospect of increased tax revenues for itself (the Swiss government keeps 25% of the EU withholding tax revenues). Switzerland's position in coming years will likely remain uncomfortable. It remains to be seen whether Swiss citizens will want to reverse the course of government policy in a possible referendum and whether they will be able to avert any automatic exchange of information. Under the threat of financial and economic sanctions in some of the most important import and export markets for Swiss business, and given the high degree of globalization of the Swiss economy, the case for one way or another will hardly be easy to decide.

Worsening tax dispute with Italy

To prevent any further escalation in the dispute with the Italian government on tax policy issues, the Swiss government appointed a special working group. Similarly to the case of France, the Swiss government had to suspend negotiations with the Italian government on the revision of the double taxation treaty until further notice after the Italian banking raids in the context of a fourth Italian tax amnesty directed against the financial center of the Swiss canton of Ticino.

Switzerland

The negotiations on the revision of the double taxation treaty with Italy had been in progress since 2001. In 2007 the Italian government submitted a proposal that was ready for signature containing a ruling on the exchange of information in cases of tax fraud and similar offences, but the Italian government eventually broke off negotiations because it did not want to see Switzerland being removed from its internal black list for political reasons. Only in June 2009 did the Italian government request a resumption of the negotiations with Switzerland. Subsequently two rounds of talks took place, whereby the Swiss delegation called for Switzerland to be removed from any Italian black list. The negotiating teams have failed to reach a conclusion mainly due to political reasons.

Italy has for several years been listing Switzerland on various “black lists” because of Switzerland’s cantonal corporate tax regimes. However, the various concessions made by the Swiss government have led to no improvements in bilateral relations. Italy has systematically refused to apply a provision in the Savings Income Agreement with the EU, which foresees a 0% tax rate on cross-border interest payments, dividend payments and royalty payments, although the current bilateral double taxation treaty already provides for the highest basic tax burden on dividends, interest and royalties that Switzerland has agreed with any other EU neighboring country. Nevertheless, the Italian government seems unwilling to give up its leverage. The ongoing dispute is indicative of the climate of resentment prevailing towards Switzerland’s relative competitiveness.

Mild tax reductions for Swiss taxpayers

In the coming years Swiss taxpayers will benefit from mild federal tax reductions to the extent of CHF 2 billion in total. First, the Swiss parliament decided to adjust the fiscal drag due to progressive tax tariffs every year as of 2011, instead of only when cumulated inflation (based on the consumer price index) reaches 7%, as had been the practice so far. This measure should lower the total tax burden by CHF 360 million as of 2012. Fiscal drag adjustment is a constitutional obligation. The new practice will limit to some extent the tax

Switzerland

penalty arising from inflation and will have the effect of index-linked tax brackets.

As a further enhancement for taxpayers, couples and individuals with children will be able to reduce their tax bill by CHF 250 for each child. In addition, childcare by third parties will be deductible of taxable income up to CHF 10,000 per child. Other child deductions remain unchanged. These measures should result in tax reductions of CHF 600 million as of 2012.

In addition, VAT reform, whose first part was adopted by the Swiss parliament, will alleviate the administrative burden for businesses and result in a tax reduction of CHF 200 million per year as of 2010 (see below). Finally, the attenuation of the double taxation (at company and investor levels) of distributed dividends, a measure that was approved in a referendum in February 2008, will result in tax reductions between CHF 60 and 80 million at federal level.

However, in September 2009, Swiss citizens also voted for a temporary tax increase as of 2011 in order to stabilize the government's heavily indebted invalidity insurance fund. Until the end of 2017, the standard VAT rate will rise from 7.6% to 8%, resulting in an annual tax burden increase of CHF 1.1 billion.

Abrogation of rental value for property owners

The Swiss government put forward a proposal to abolish the rental value for property owners in the coming years in response to a popular initiative planned by the Swiss property owners association. According to the current doctrine, property owners must pay a tax on the rental value of their own housing, considered to be income. This has sometimes proved an unbearable burden to retirees with only pension income and no mortgage interests to deduct from taxable income. To alleviate this situation, the Swiss property owners association intends to put to the vote the abrogation of rental value taxation for retirees by means of a popular initiative. The Swiss government

Switzerland

rejects the plan as it would create an inequality of treatment and prefers to abolish the taxation of rental value for all property owners.

As a consequence, current deductions for mortgage interests and repairs would also be abolished. In order to take into account the constitutional mandate to encourage housing ownership and energy-saving mechanisms, two deductions would still be maintained at this stage of the debate: mortgage interests for first-time housing purchase for a limited period and the costs of implementing significant energy-saving improvements. However, the government intends to design its legislative project so as to avoid any fall in tax revenues.

VAT reform

In 2009 the Swiss government maintained its plan to radically overhaul the value-added tax, in particular by introducing a single rate and abolishing many exemptions. In the meantime, the parliament approved the first part of the VAT reform, designed to alleviate the administrative burden for businesses by 11%. According to the government, the second part of the reform yet to be debated should enhance economic growth. It would include annual tax reductions of CHF 1.8 billion, a diminution of delimitation problems among tax rates and exemptions resulting in reduced tax-liability risks for businesses, an additional decrease of the administrative burden by 22%, and a lower tax rate on the products of around 280,000 out of 320,000 taxpaying businesses.

Switzerland

United Kingdom



Tony Curzon-Price
Editor-in-Chief
openDemocracy
tony-2004@curzon.com

Phoney austerity

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, macro-economic footing 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. The big tax dates of the calendar---the April 2009 budget, the November 2009 Pre-budget report and the April 2010 budget have thus been dominated by the logics of crisis and of politics, making---with a few exceptions that I shall return to---unusually uninteresting reading for the analyst of the minutiae of tax decisions.

United Kingdom

The Labour government responded to the 2008/9 economic crisis with broadly Keynesian accommodation. As reported in this series last year, over and above the automatic stabilisers of higher social security payments and reduced tax revenues, the UK passed an emergency reduction of VAT rates from 17.5% to 15%; introduced a “cash for bangers” car-scrapping incentive to help the car industry; introduced an emergency reduction in sales tax on domestic housing transactions (“stamp duty”) and a number of temporary incentives to help the bloated construction industry.

Falling tax revenues and increasing expenditure has made the state particularly reliant on borrowing. Total government revenues in 2010-11 are forecast to be 37% of GDP (of which 35% come from taxes), while government spending is forecast to be 48% of GDP. 11% of GDP (around £160bn) needs to be borrowed to balance the books in 2010, about the same as was needed in 2009-10.

The borrowing requirement and the election has meant that fiscal policy has been conducted between Scylla and Charybdis: abandonment of Keynesian demand support and recession would have meant giving up all hope of defeating the Conservative opposition in May 2010, while any hint of sovereign default or large-scale currency depreciation would have meant a debt crisis, like the one of 1976 that brought down the last Labour government.

But there is widespread understanding in markets, amongst political parties and in the Treasury that this Scylla and Charybdis are both short-term phenomena. The Keynesian deficit spending cannot last forever, and the electoral constraint will be lifted by the start of May. By necessity, the two legislative periods between 2010 and 2018 will require wholesale fiscal rebalancing and opportunities for fiscal innovation. Whoever wins the election of May 2010 will be in a unique position to redefine the role of the British state. Everyone is expecting hardship; unlike the situation in 1979 or 1983 there is a kind of resignation to it amongst all parts of society that everyone will be hit; the political opportunity for reshaping taxation is therefore unprecedented.

United Kingdom

So, just as all the fiscal excitement is ahead of us, most developments in the 16 months since our last UK report have been tactical and constrained—fiscally phoney.

Making future governments responsible for probity

Most, but not quite all. First, the double constraint of borrowing and election has led to one interesting fiscal innovation: the “Fiscal Responsibility Act (2010)”, (http://www.hm-treasury.gov.uk/fiscal_responsibility_bill.htm) by which the government has tried to persuade lenders in sovereign bond markets that the British state, like St Augustine, is going to be “virtuous, but please, Oh Lord! not yet”.

The Bill, as described by the Treasury, requires that the government:

- ensures that borrowing is 5.5% of GDP or less in 2013-14
- halves public sector net borrowing as a share of GDP over four years from its forecast peak in 2009-10;
- reduces borrowing as a share of GDP in each and every year from 2009-10 to 2015-16;
- ensures that public sector net debt is falling as a share of GDP in 2015-16.

By the principle of Parliamentary sovereignty in the UK system, it is not possible for one Parliament to bind the actions of another. However, if the government fails to deliver on these pledges, then the Treasury is under obligation to report the failure to Parliament and provide an explanation. It increases the political embarrassment and cost of future fiscal irresponsibility. If the UK was indeed facing a Keynesian recession in which intervention is effective as long as interest rates do not rise to crowd out increases in public sector spending, then this fiscal commitment device should be seen as being sensible. In increasing the chance that Keynesian demand support does not extend for too long, it reduces the cost of that support in reduced private sector investment.

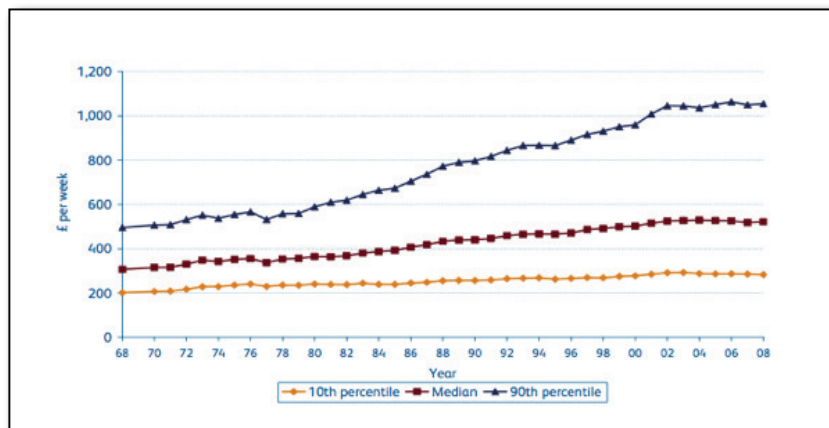
United Kingdom

Taxing the rich (or trying to)

In 1998, Peter Mandelson, the close ally of Tony Blair (now Lord Mandelson, Secretary of State for Industry), famously set the tone for New Labour's attitude towards redistribution in tax policy by saying: "we are intensely relaxed about people getting filthy rich as long as they pay their taxes." New Labour, in other words, was going to adopt a sort of State Rawlsianism: wealth creation was good and justified by its contribution to the income of the state.

This state Rawlsianism is reflected in aggregate measures of earnings distribution on the one hand and taxation receipts on the other through the period from 1997 (when New Labour came into power) until the economic crisis.

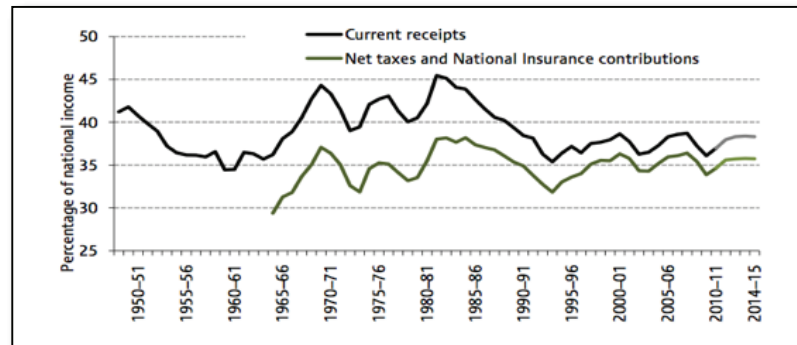
Full-time weekly earnings at 2008 prices, 1968 to 2008, men



Source: NEP, based on 1968-1996 New Earnings Survey (NES) (GB), 1997-2008 ASHE (UK)

United Kingdom

Government revenues since 1948-49



Note: Projections are from 2010 Budget

Sources: Public sector current receipts to 2008-09 (series ANBT) from ONS, GDP to 2008-09 (series BKTL) from ONS. Net taxes and National insurance contributions, and all projections, from HM Treasury, *Public Finances Databank*, 24th March 2010 (http://www.hm-treasury.gov.uk/psf_statistics.htm)

Net tax revenue rose as a proportion of GDP for most of the period under New Labour between 1997 and 2008 (there were falls in the recession of 2001-2) while income inequality rose.

However, the financial crisis proved an embarrassment for the state Rawlsian justification, in that the blame for the crisis was placed with the high income earners while the costs were borne by the whole of society. This was the political difficulty presented by the “privatisation of gains/socialisation of losses” view of the financial crisis.

It is little surprise that the rhetoric of tax policy has therefore shifted from the original stance of “intense relaxation” about wealth. Starting with the April 2009 budget, the following measures have been taken to increase the redistributive impact of the tax system:

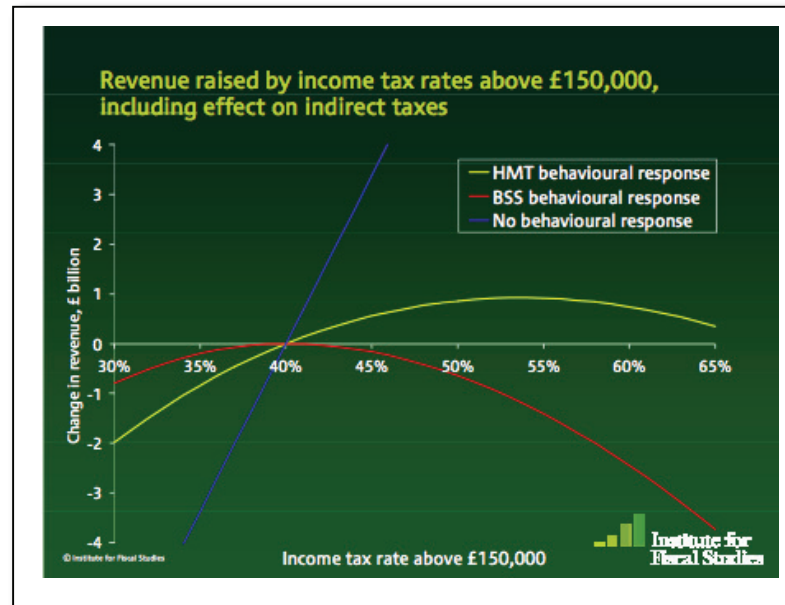
United Kingdom

1. A new 50% tax rate for incomes above £150,000 (up from 45%)
2. Incomes above £100,000 would no longer benefit from a tax-free allowance of £6,500
3. Tax exemption of pension contributions to be greatly reduced for incomes above £150,000
4. A one-off super-tax of 50% on any financial sector bonus above £25,000
5. A freezing of the zero-rate inheritance tax threshold at £325,000 (against an announced increase in the tax-free amount in 2007 to £350,000)

There are 750,000 people with incomes above £100,000 (2% of adults), 350,000 with incomes above £150,000 (1% of adults). The incidence of these tax changes should be to make the tax system substantially more progressive while affecting a relatively small number of very rich individuals.

Of course, there is nothing to say that these tax changes will be effective, implementable or indeed to say that the high income individuals will not change their behaviour to avoid the incidence of the tax. M. Brewer, E. Saez and A. Shephard, ('Means-testing and tax rates on earnings', 2008, http://www.ifs.org.uk/mirrleesreview/press_docs/rates.pdf) have a fascinating analysis that attempts to take into account these factors to compute a "taxable income elasticity" which predicts the fall in taxable income as marginal tax rates rise. Their results are shown for the incomes of £150,000 in the figure below:

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The major effects captured in these simulations are:

- the reduction in spending, and therefore VAT receipts resulting from income tax increases;
- the move to work less, retire earlier, emigrate, contribute more to pensions or charity, convert income to capital gains, incorporate, and other investments in tax avoidance.

The fascinating aspect of this “micro-Laffer curve” is the Treasury’s-eye-view of the situation. Think of the Treasury as a tax farmer who understands the response of its herd to different regimes; the optimal tax rate for high income earners may be as low as 40% (on the academic, BSS estimate) or somewhere between 45% and 60% on the Treasury view. The BSS estimate provides some support for the view that the measures to tax the rich introduced since April 2009 have more to do with the politics of the election than with fiscal efficiency.

The one-off tax on banking bonuses appears to have provided a windfall for the Treasury of £ 2.5bn (<http://www.ft.com/cms/s/0/fad98c36-27d8-11df->

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[9598-00144feabdc0.html](#), Supertax pulls in £2.5bn for UK Treasury, Financial Times, March 4th 2010). At the time it was announced in November 2009, there was much talk of avoidance schemes, of bankers moving offshore, etc. However, as banks showed very healthy end of year profits and as other countries announced similar one-off measures, the large banks all decided to pay bonuses as usual and to pay the 50% supertax. It is hard to avoid the view that this should not be viewed as a rule-based approach to taxation, but rather as a naked piece of bargaining between two powerful actors: the state and a finance sector that knows it is in for a long process of regulatory negotiation and lobbying.

... while being business friendly

New Labour has continued to try to use the tax system to encourage investment. Capital gains tax has been maintained at the very low 18% – very low, that is, compared to corporation and income taxes. Such a large disparity between capital gains taxes and other types of profit tax seems like a gift to accountants and tax-optimisers. Now that we know that a great deal of the financial innovation of the past 15 years has been based on tax and regulatory arbitrage, this disparity seems to be a gift to the kind of creative activity which everyone agrees should be discouraged.

Amongst the “business friendly” measures introduced since April 2009, we have:

- a delay in the rise of small company corporation tax rate from 21% to 22% for at least another year;
- empty business properties are exempt of property tax for another year;
- income from patents is to be reduced to 10% from 2013;
- 100% tax write-down for first £100,000 of investment (up from £25,000) ;
- 40% write-down for plant and machinery investment in the first year above £50,000;
- capital gains tax relief for entrepreneurial activity increased from £1m to £2m;

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- a number of temporary micro-measures to help the construction industry;
- Tax relief for investment in the video games industry (see “Video game developers get tax relief”, The Guardian, March 24 2010. <http://www.guardian.co.uk/technology/2010/mar/24/budget-2010-video-games-tax-relief>);
- a new levy on phone lines (£0.5 per line per month) to pay for the next generation of superfast broadband networks.

The last two of these signal a return to a more active “picking-winner” style of industrial policy (and seem to have the support of both Labour and Conservatives). Although small and symbolic, the move is a political response to the perception that the UK economy needs to be rebalanced away from excessive reliance on financial services. There is a wide-spread enduring hope that high technology based growth will save the British economy from the hardship ahead, so we can expect more of this kind of policy over the years to come.

The months and years ahead

The reality of the years to come is that taxes will rise and spending on public services fall. The extent of the problem, little spoken about in the political class because of the election in May 2010, is sure to become the centre of political debate soon afterwards.

Borrowing in 2010 will be £167bn, around 11% of GDP. The Fiscal Responsibility Act calls on this to be reduced by a half in 2013-2014. The Conservatives have called for a zero structural budget deficit – the cyclically adjusted, non-investment elements of government expenditure and revenues – over this period, which is a slightly more stringent requirement. So, over the next three years, the government will need to produce a combination of revenue increases and spending cuts amounting to £90bn per year. The current projection is that approximately half of this will come out of automatic factors: a return to economic growth and a reduction in social

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security payments will still leave approximately £45bn per year of shortfall. Capital spending is set to be cut by 15% per year in the name of protecting “front line services” – in health and education. Both Labour and Conservative parties have conjured rather miraculous “efficiency savings” of £20bn to avoid the charge, before an election, that they will need to bring unpopular cuts to some area of service or other. Expect the gloves to come off in May, whoever it is who wins the election.

The underlying cause of the austerity ahead is not so much the temporary borrowing spike on 2008-2010 but the recognition by the Treasury that its forecasts of the productive capacity of the economy pre-crisis were overly optimistic. Forecasts of non-inflationary GDP potential, used to develop long-term public sector fiscal plans, have been revised downwards by 5% per year. The UK is less well off than it thought it had been, largely because the crisis has led to a revision of forecasts of the profitability of the financial sector. Being less well off than we had anticipated has repercussions for all budget projections, including the public sector's.

The public sector tightening amounts to a reduction in income of around £2,500 per household per year by 2018. The next decade will be dominated by a battle over the allocation of that sum: how much should be cuts in public sector service and investment; how much should be cuts in other parts of the household budget to maintain the public sector share. The first decade of the 21st Century ends in fiscal phoneyess, and the second decade will be marked by real fiscal battles. The optimistic view is that this presents a rare opportunity to reform the British state.

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