TAX MEASURES FOR ECONOMIC RECOVERY IN EU

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Abstract: The main objective of this paper is to review the tax measures undertaken by the Member States between 2012-2013, measures aiming for economic recovery. According to the empirical results from the literature, shifting revenues from direct taxes to indirect taxes enhances economic growth. Our main findings show that: i) only a few Member States have taken measures aiming the reduction of personal income taxation (PIT); ii) the majority of the measures aiming corporate income taxation (CIT) are focused on narrowing the tax base, due to the prolonged effect of the crisis on private sector investment, and on decreasing the headline corporate tax rates; iii) property taxation was also subject to changes, more than a dozen of the Member States undertaking reforms, some of which targeting higher-end properties; iv) finally, consumption taxes and environmental taxes have been increased in many European countries, being considered least detrimental to economic growth.

JEL classification: H23, H24, H25.

Key words: personal income taxation, corporate income taxation, environmental taxation, property taxation, economic recovery.

1. INTRODUCTION

In the current economic context, in which Member States need to accelerate their consolidation efforts, taxation becomes undeniably important. Member States must consider measures for increasing the level of revenues, but they also have to preserve a current weak European economic growth.

As a response to the current economic challenges, the European Semester was set up in the EU in 2011, which is in fact a new framework for integrated economic policy coordination. Its main mission is to provide guidance on common steps towards more sustainable, growth- and job-friendly tax systems, and at the same time to ensure substantial fiscal consolidation, to remove distortions that could worsen macroeconomic imbalances and to preserve their redistribution function.

Regarding tax reforms undertaken in the Member States between 2012 and 2013, one can identify an increase in indirect taxes, together with a relatively high cost of labour. Measures aiming the reduction of personal income taxation (PIT) were taken by only a few Member States, while other countries are currently still increasing these taxes, despite the results shown in numerous studies, which clearly suggest that among income taxes, social security contributions and personal income taxes have the strongest negative association with growth (see Arnold et al., 2011 and Acosta-Ormaechea and Yoo, 2012, for a discussion). Among these latter measures we highlight the introduction of new tax brackets, increasing top marginal rates or enlarging the tax base. Not only do we have an uptrend in PIT, but we can also notice that there is a growing progressivity due to lowering the tax burden on low income earners (a measure suggested by Heady et al., 2009), while increasing it on higher income earners.

According to the findings in the specific literature (Prammer, 2011; Heady et al., 2009; Acosta-Ormaechea and Yoo, 2012), consumption taxes and environmental taxes are considered less detrimental to growth. Accordingly, these categories of taxes have been increased in many European countries. VAT reforms were actually increases in statutory rates, while environmental taxes have been increased in far fewer cases.

According to the Annual Growth Survey 2014, which takes stock of the economic and social situation in Europe, the following fiscal priorities were identified: i) Fiscal consolidation should be a growth-friendly mix of expenditure and revenue measures, putting more emphasis on the quality of public expenditure, and the modernization of administration at all levels. Where greater fiscal room for manoeuvre exists, private investment and consumption should be stimulated, for instance through tax cuts and reductions of social security contributions. ii) Longer term investment in education, research, innovation, energy and climate action should be protected and the needs of the most vulnerable in the society should be catered for. iii) Tax should be designed to be more growth-friendly, for instance by shifting the tax burden away from labour to tax bases linked to consumption, property and combating pollution.

2. OBJECTIVES

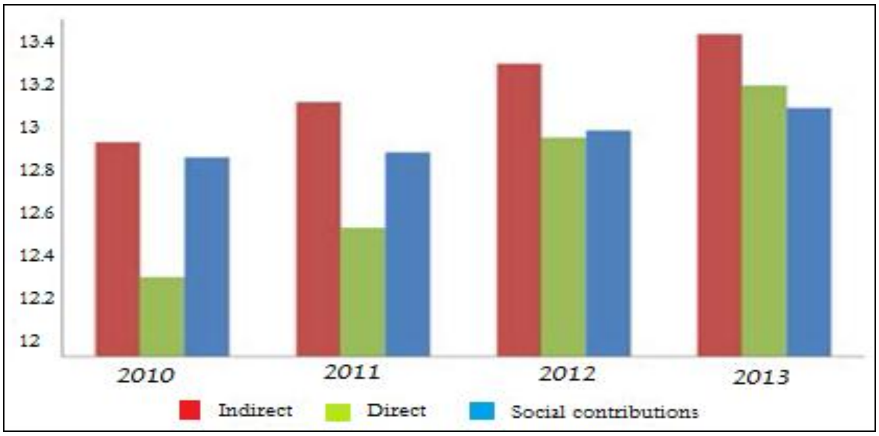
The objectives of this paper can be summarized as follows:

1. to identify and describe the tax reforms related to personal income taxation undertaken in EU Member States.
2. to analyse the measures taken by some of the Member States concerning tax base broadening and competitiveness.
3. to highlight the progress made by some European countries regarding environmental and property taxation.

3. RECENT TAX MEASURES IN THE EUROPEAN UNION

Considering the necessity of fiscal consolidation and the difficult fiscal positions, many Member States have increased the overall tax burden. The increasing trend observed in Figure 1 applies for both direct and indirect taxes as a share of GDP, as well as for social security contributions.

Many Member States have increased the statutory rates related to personal income tax, along with the introduction of progressive “solidarity” contributions for high-income earners. Regarding indirect taxes, the increase mainly refers to different Member States’ decisions to augment the standard VAT rate and/or excise duties.



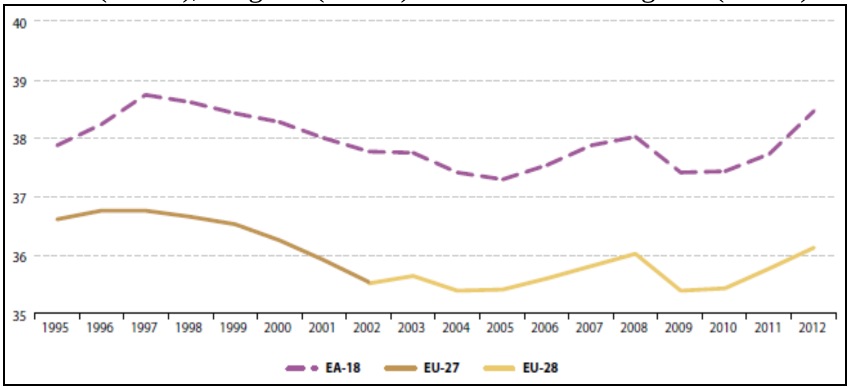
Source: Tax reforms in EU Member States 2013, p. 17.

Figure no. 1 Evolution of tax revenues (EU-27, % of GDP)

3.1. LABOUR TAXATION

Given the crisis and massive unemployment, the distortive effect of high labour taxation threatens working and hiring incentives, and fairness as well. This is a delicate issue considering the continued uptrend in 2012 of the implicit tax rate (ITR) on labour[1], currently both the EU-28 and EA-18 averages having reached the pre-crisis levels (see Figure 2).

According to the European Commission (2014), of the EU-28 countries, 20 registered an increase in the ITR on labour in 2012, the largest rise being recored in Greece (from 30.9% in 2011 to 38.0% in 2012), followed by Cyprus and Poland, each with increases of two percentage points. In Romania, Estonia and the United Kingdom, the ITR on labour fell by more than half a percentage point in 2012. The level of tax burden on labour varies substantially between Member States. The highest ITR on labour is found in Belgium (42.8% in 2012), Italy (42%) and Austria (41.5%), and the lowest in Malta (23.3%), Bulgaria (24.5%) and the United Kingdom (25.2%).

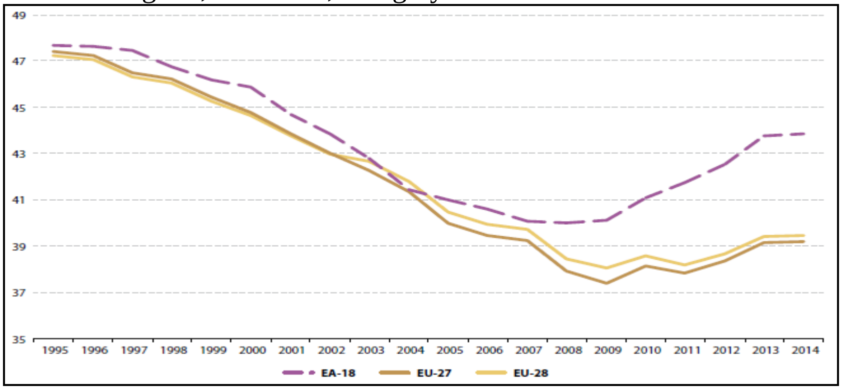


Source: Taxation trends in EU 2014, p. 28.

Figure no. 2 Implicit tax rate on labour, 1995–2012 (% of GDP)

[1] The ITR on labour is calculated as the ratio of taxes and social security contributions on employed labour income to total compensation of employees and payroll taxes.

In 2014, the top personal income tax (PIT) rate was 39.4 % in the EU, 1.4 percentage points higher than its level in 2009. While top PIT rates have been increasing since 2010, there was a levelling off of the EU average in 2014 (see Figure 3). The top PIT rate varies substantially within the Union, ranging from a minimum of 10% in Bulgaria to more than 55% in Sweden, Portugal and Denmark. The lowest rates are registered in Bulgaria, Lithuania, Hungary and Romania.



Source: Taxation trends in EU 2014, p. 29.

Figure no. 3 Development of top personal income tax rate (%), 1995–2014

When looking at decreasing PIT rates, we can observe that there are few countries that have taken such measures (e.g. Latvia and Malta). On the other hand, there are many states that continue to increase PIT, undertaking measures as follow: i) increasing the top marginal rates (e.g. Luxembourg and Portugal); ii) applying of a crisis surcharge (e.g. Czech Republic and Cyprus); iii) introducing new tax brackets (France and Slovakia); iv) broadening the tax base (e.g. Estonia, Greece, France, Luxembourg, Netherlands and Poland); v) increasing social contributions, either through a rate increase or/and base broadening (Cyprus, Czech Republic, Estonia, Ireland, Netherlands, Austria and Slovakia).

Most European countries admit that tax reforms should be aimed towards groups that are most responsive to tax changes, and not carried out at the expense of the poor. In this respect, efforts were made in order to relieve the tax burden on low income earners in general, but also on older workers (Belgium, Hungary, Portugal and Sweden), on the low skilled (Belgium and Hungary), on the young (Belgium, Italy and Hungary), on women (Hungary and Italy), on single parents (Denmark) and on those employed in disadvantaged geographical areas (Italy and Hungary).

Several other countries increased PIT on taxpayers with higher earnings, generating a greater progressivity and fairness of the taxation system. Also, on social equity reasons, some Member States, such as Italy, Hungary, France and Belgium introduced measures to increase the taxation of individuals' capital income, rather than labour income.

Among the measures for tax reduction, some focused on the unemployed by offering tax breaks for new recruits[2]. These measures generally concentrate on the

[2] E.g. the Portuguese Decree-Ruling No 97/2013, of 4 March 2013, which allowed employers to be reimbursed up to 100% of SSC paid for hiring workers older than 45.

employers' tax burden and not directly on the employee/household taxation. Belgium and Hungary decreased employers' social contributions, while France and Italy introduced or extended an employment-related deduction from corporate taxes.

3.2. MEASURES CONCERNING TAX BASE BROADENING AND COMPETITIVENESS

Broadening the tax base has multiple purposes: increasing tax collection, decreasing tax rates and simplifying the tax system. In order to achieve certain objectives (social, environmental or economic), numerous tax systems provide exemptions, reduced rates, allowances and other specific regimes (known as "tax expenditures"). These might not always achieve their set objectives; for example, Mirrlees et al. (2011) enlighten the potential welfare achievements from base-broadening measures, related to certain VAT exemptions and reduced rates. Moreover, the existence of such allowances may generate differences in treating the taxpayers, increasing the system's complexity and also the costs of compliance.

Increasing tax revenues is not the only reason for broadening the tax base; it also makes paying taxes easier for citizens and corporations, and tax collection simpler and transparent for administrations. Most measures taken for broadening the tax base are targeted towards simplifying the VAT system, while for PIT and CIT things are not so clear.

The VAT base was recently broadened in some European countries (e.g. Spain, Belgium, Luxembourg, Latvia, Portugal and Poland), by extending the application of the standard VAT rate. For example, in Spain there are services (e.g. artistic performances, cinemas, and theatres) that were previously subject to reduced VAT rates and now are subject to the standard rate of 21%. In contrast, Sweden decreased the VAT rate for restaurants and catering services in 2012, in order to stimulate job creation.

Furthermore, there are countries that made increases in their PIT bases (e.g. Belgium, Czech Republic, Greece, Spain, France, Luxembourg, Austria and Poland), and also in their CIT bases (Greece, Spain, France, Luxembourg, Austria, Portugal and Finland). Efforts to reduce tax expenditure were made by France, regarding certain tax benefits (e.g. the family quotient and the exemption for overtime wages were reduced or abolished) and Greece, which broadened the tax base at the beginning of 2013, by reducing special tax regimes and tax expenditures.

Given the competitiveness decline of companies, the majority of corporate taxation measures are focused on narrowing the tax base, with some exceptions, justified by the effort to reduce the debt bias[3] through the limitation of interest deductibility (e.g. France, Portugal, Spain, Sweden and Finland). Many Member States have taken measures in order to mitigate the effects of the crisis (especially on small companies) and to stimulate private investments.

Regarding corporate income taxation, there has been a strong downward trend in top CIT rates in the EU over the last decade. The top rates decreased from an average of 35.3% in the mid-nineties, to 23.5% at present (Figure 4).

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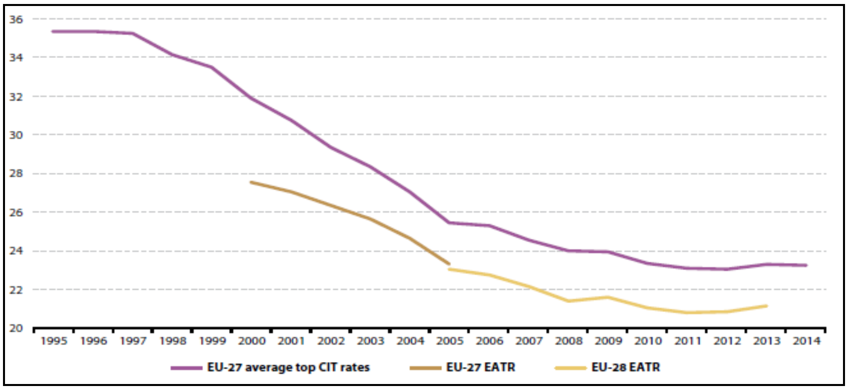
[3] Many corporate tax systems favour financing by debt, by allowing the deduction of interest costs, while there is no such treatment for equity returns. The effect is a corporate tax bias towards debt-financing.



Source: Taxation trends in EU 2014, p. 35.

Figure no. 4 CIT rates and average effective taxation indicators[4], 1995–2014 (%)

As of 2013-2014 measures, the statutory rate was decreased in Sweden from 26.3% to 22%, in Slovenia from 18% to 17% and in the UK from 24% to 23% (and further to 21% in 2014). The UK will continue to lower the corporate tax rate to 20% by April 2015, while Finland will lower it from 24.5% to 20% in 2014. In Denmark, the corporate tax rate will be reduced from 25% to 22% as of 2016, the same as Estonia (from 21% to 20%) in 2015. On the contrary, Slovakia increased its top rate from 19% to 23% in 2013 (only to be followed by a decrease to 22% in 2014), as did Cyprus, from 10% to 12.5%, in 2013 (European Commission, 2013b).

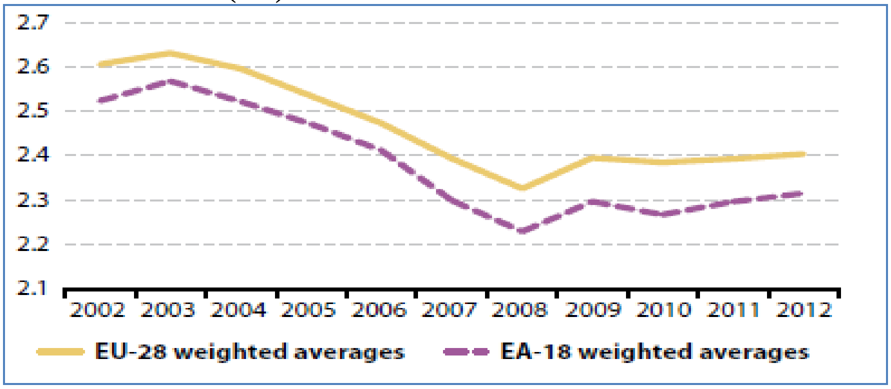
Since the beginning of the crisis, most Member States have applied tax incentives in order to stimulate private research and development investment. The main effort in this respect, which continues nowadays, was to simplify R&D schemes and widen them. Almost half of the Member States made changes in their R&D tax incentives in 2012-2013, creating more generous schemes (Czech Republic, Ireland, Greece, Netherlands and Romania) or changing the eligibility criteria (Czech Republic, France and Hungary).

3.3. ENVIRONMENTAL TAXATION

The economic crisis generated many policy debates, which generated the opinion that environmental taxation is an important instrument for raising revenue in a beneficial way, improving the quality of the environment and also supporting labour tax cuts. The overall trend of environmental tax revenues, at EU level, can be seen in Figure 5: after falling between 2002 and 2008, environmental taxes (as a percentage of GDP) recorded an important increase in 2009, remaining stable since then, at a level of around 2.4% (EU-28 average). Environmental taxes include energy taxes (representing about 75% of EU-28 environmental tax revenues, of which transport fuel taxes

[4] The effective average tax rate (EATR) is a measure of the effect of tax on a non-marginal investment. A non-marginal investment is one that not only covers all of its economic costs but also provides an economic or above-normal profit to the investor. So the EATR is a measure of the difference between pre-tax economic profit and post- (corporate) tax economic profit of the investor. The methodology used for the calculation of EATRs is can be found in the ZEW report by Devereux et al. (2008).

represent more than three quarters), followed by non-fuel transport taxes (21%) and pollution/resources taxes (4%).



Source: Taxation trends in EU 2014, p. 39.

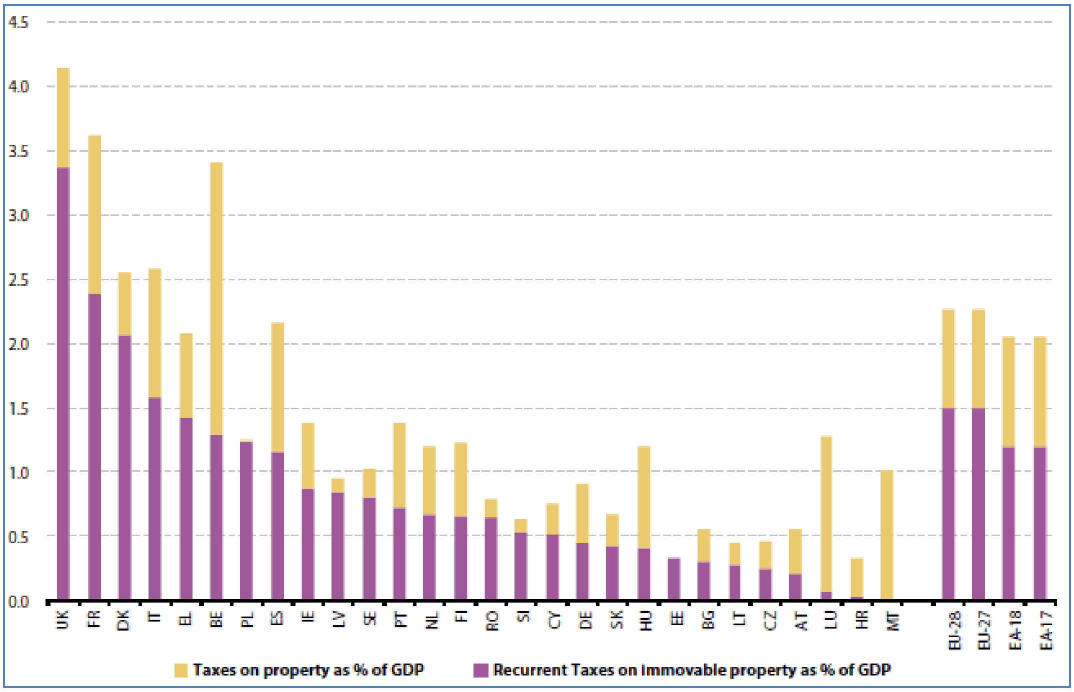
Figure no. 5 Environmental tax revenues, 2000–2012 (% of GDP)

Most of the 2012-2013 measures consisted in increases in excise duty on diesel and other forms of energy in more than a third of EU-27 Member States (e.g. Spain, Greece and Cyprus), and modifying of car taxation. Other European countries introduced new energy taxes: for example, Spain introduced a tax on the production of radioactive waste resulting from the generation of nuclear energy, while Hungary and Italy apply a surcharge on corporate income tax for companies operating in the energy and public utility sectors. However, it is unlikely that these measures will reduce energy consumption (still, they may have negative effects regarding investment in the sector).

As for car taxation, the purpose of the measures was the improving of its design. For example, The Netherlands reinforced the 'green' component of the car taxation system: in 2013, it reduced the upper CO_2 limit for exemption from vehicle tax and increased taxes on vehicles with higher CO_2 emissions. These measures generated important effects, by increasing the purchases of cars with efficient emission. Another example is Slovakia, where car registration fees for new cars have been related to engine power. Lithuania and Estonia remain the only two Member States which do not have any car taxation (Garnier et al., 2013).

3.4. PROPERTY TAXATION

Property taxes contain recurrent taxes on immovable property, which generally are paid annually and are linked to the value of the property, and other property taxes, which include taxes on property transfers and transactions. In the EU as a whole, recurrent property taxes hold the largest share, accounting for 1.5 % of GDP and 66.3 % of all property taxes in 2012 (see Figure 6).



Source: Taxation trends in EU 2014, p. 44.

Figure no. 6 Composition of property taxes by Member State, 2012 (% of GDP)

Policy makers are paying increased attention to recurrent taxes on real estate property since they are susceptible of increasing revenues and are also viewed as being least detrimental to economic growth (given the immobility of the tax base). In this context, Lithuania and Latvia broadened their property tax base, while other Member States are determined to make property taxation more progressive by focusing on higher-end properties.

Consequently, in June 2012, Slovenia introduced a tax on higher-value immovable properties (properties valued over 1 million Euro are subject to the 0.5% rate, while properties valued over 2 million Euro are subject to the 1% rate). In a similar manner, the United Kingdom introduced a new annual tax for properties with a taxable value over 2 million GBP, whose owners are certain non-natural persons (companies, partnerships with a company member and collective investment schemes).

Another measure related to property taxation was the revaluation of cadastral values, taken by only a few Member States (Greece and Romania). Cyprus chose an alternative to updating property values, i.e. increasing property tax rates, as done as of 1st of January 2013. Recurrent property taxation (characterised by a stable and relatively immobile and visible tax base) is generally considered more efficient than taxing property transactions, since the latter tends to discourage transactions, efficient allocation of properties and labour mobility.

However, Finland and the Czech Republic increased property transfer taxes: the new rates are respectively 2% and 4%. In the UK, properties valued over GBP 2 million purchased by individuals and non-natural persons have been subject to higher transaction tax rates (7% and 15% respectively) since March 2012 (European Commission, 2013b).

4. Conclusions

Considering the prolonged effects of the economic and financial crisis, European Union Member States are making considerable efforts for economic recovery. In this context, fiscal policy has aroused extensive debates regarding its role to stimulate the economy, both on the taxes side, and on the spending one. The main conclusions of the studies from the literature show that the most pronounced negative impact on economic growth belongs to personal income taxes (including social contributions) and corporate taxation, while consumption, property and environmental taxes seem to be the least harmful.

Overall, we notice that certain recent tax measures attempted to integrate these considerations. However, given the complexity and diversity of the challenges, further and stronger improvements seem indispensable to stimulate growth and jobs creation. Looking at EU as a whole, we can observe an overall increase of the tax rates. Labour taxes continue to be very high and might hinder growth and jobs. As for indirect taxes (VAT, environmental and property taxes), one can identify an uptrend in numerous Member States.

The majority of tax systems hold too many tax exemptions, allowances, reduced rates and other specific regimes. The tax base broadening and the simplification of the tax system, beyond the primary goal of revenue collection, could make paying taxes easier for citizens and businesses, and managing them simpler for administrations. Also, many Member States have changed or introduced tax reforms to stimulate investment and entrepreneurial activity (e.g. R&D tax incentives, new incentives for start-ups, incentives for investing in unquoted shares).

Finally, regarding environmental taxation, Member States took some initiative; nevertheless, green taxes measures seemed to be taken largely for fiscal consolidation purposes and Member States did not prove to be very sensitive to Country Specific Recommendations. The primary measures taken were excise duties on diesel increases and reforms of car taxation, but overall progress remained limited.

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