INSTITUTE FOR RESEARCH IN ECONOMICS AND FISCALITY

INSTITUT DE RECHERCHES ECONOMIQUES ET FISCALES

Taxation in Europe 2009

Overview of tax systems in:

Austria, Belgium, Bulgaria, Croatia, Czech Republic, Denmark, France, Germany, Italy, Luxembourg, Netherlands, Slovakia, Spain, Switzerland, Romania, United Kingdom

IREF
Institute for Research on Economic and Fiscal issues

IREF is a private institute founded in 2002 by members of the academic and business worlds with the aim to establish an efficient platform to investigate fiscal and taxation questions. Taxation is a many-faceted issue and existing studies are mostly incomplete, if not biased. It is the aim of IREF to explore systematically and comprehensively the question of taxation.

IREF has a strong European dimension. Tax studies can no longer ignore the globalisation process and its impact on tax competition. Tax authorities are currently under the strain of two opposing forces: centralisation and harmonization on one hand, devolution and competition on the other.

In order to achieve its goals, IREF relies on a network of specialists. Its first task has been to gather a team composed of economists and lawyers and to invite members of the team them to establish qualitative as well as quantitative reports on the nature and evolution of tax policy in their respective countries or regions.

IREF pursues an interdisciplinary approach to tax policy, combining economics, statistics, law and politics, in order to generate practical public policy proposals in the area of fiscal and economic management.

IREF reports are available on line at www.irefeurope.org

Table of contents

What's new on the taxation front?

A unique report

What is the current state of public finance in the EU countries? How did various governments react to the crisis which developed in the second half of 2008? To what extent did it trigger a change in tax policy? IREF has asked scholars and experts from fifteen different EU countries to present and evaluate the 2008 tax policies of their respective countries. This resulted in 16 reports —Austria, Belgium, Bulgaria, Croatia, Czech Republic, Denmark, France, Germany, Holland, Italy, Luxemburg, Romania, Slovakia, Spain, Switzerland, United Kingdom—which, together, offer a fairly accurate picture of policy trends inside the European Union.

Publications comparing tax policies in EU member states are common. They are produced by public institutions—such as the European Commission, the World Bank or the OECD—as well as private ones—Economic Freedom of the World Index, Index of Economic Freedom, Ernst & Young, KPMG, Pricewaterhouse Coopers. While most—if not all—of these publications heavily rely on statistics, IREF reports instead deliberately underline qualitative changes and causality.

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Hence, one of the guiding principle for these contributions, is to provide, sometimes in great detail, a description of tax mechanisms. For indeed, it is not infrequent that some "great idea" stemming from the legislative body translates into unfortunate machinery. The reports below give us many instances of such unintended consequences.

In the same vein, the reports do not hesitate to summarize the political debates and put them in perspective: how big is the gap between public discourse and implemented policies? Which governments turned out to be trustworthy and which one were quick to breach their promises?

For those reasons, IREF 2009 yearbook on taxation in Europe provides a necessary complement to the statistical reports for whoever wishes to understand fiscal policies, and beyond, political trends.

2008: Obviously a difficult year

The financial crisis started to seriously hit European economies in the Fall of 2008, and most European governments have chosen to respond with Keynesian policies. This was the case in France, Germany, Italy, Spain (although a bit later), the UK and virtually all European countries although, as usual in Europe, there were exceptions to the rule: in Czech Republic, government spending *decreased* in 2008. Still, the most frequent outcome was the end of fiscal discipline and fiscal reforms in general. As Giorgio Brosio reports from Italy, "the global economic crisis has shifted the attention from structural changes in the tax system to the immediate impact of fiscal packages on the level of economic activity."

On the fiscal front of Keynesian policies, immediate measures have often included a lowering of personal income tax rates and, sometimes, a lowering of VAT rates. In the meantime, corporate income tax rates remained mostly unchanged for fear of losing business.

Many reports also emphasize a trend towards a new centralization of fiscal decision making, even in countries such as Italy or Spain which had a clear agenda for further decentralization (see IREF 2008 Yearbook).

If fiscal reforms have been consequently often put on hold, some countries—often the smallest ones—have nonetheless kept the general direction towards establishing a simpler, more transparent and economically friendly fiscal system. Such is the case of Denmark which, in 2008, maintained a tax freeze (that was voted back in 2001), while of Romania and Slovakia, so far, have maintained their flat tax on personal and corporate income (at 16% and 19%, respectively). Similarly, Luxembourg, in spite of the recession, has introduced various measures to remain attractive to European business; while in Switzerland, a reform limiting the double taxation of distributed profits was adopted.

But, surely, the most active reformer in the field was Bulgaria. As Peter Ganev reports: "The lowest flat tax on personal income in Europe (10%) was welcomed by the people in the country, basically because of three main characteristics –simplicity, fairness and lower rate. Along with all that, the flat tax had a positive effect on state revenues which have reached another record high level". He also recalls that GDP in Bulgaria grew at an healthy 7% in 2008.

Robin-Hood Tax packages and the like

Parallel to this trend towards lower and simpler taxes— a trend which, as we just saw, prevailed only in some countries—one can clearly note a trend going in the opposite direction, that is, a trend towards more redistributive policies. Hence, Italians did not hesitate to label one of their 2008 tax reform: the Robin-Hood tax package. That package imposes a higher fiscal burden on some "privileged" sectors of the economy (energy, bank, insurance) in order to finance various "social plans". A similar trend has been observed in the UK where, as explains Tony Curzon Price, the Labour Party "redistributive instinct" surfaces again. There, the wealthy of the City were easy target for "sacrificial victims". In Germany, Jan Schnellenbach observes, as he did last year, what he labels a "populist" trend. In Holland, steps were taken to reduce the global income of top executives through taxation. In France, although the tax shield was maintained, the wealth tax was not abolished and a new tax on capital gains has been introduced in order to finance a new "safety net" for the unemployed and low income earners.

Abandonment of tax neutrality

What was once a virtue and a symbol of good tax policy—tax neutrality—is falling out of fashion in many places. The new trend is obviously towards "double dividend" taxation: taxation is used, not only to raise funds and finance public goods, but also to change the way economic agents behave. Modern tax policies frequently attempt to "kill two birds with one stone". Illustrations are numerous: we have a tax policy to induce economic agents to buy new cars; a tax policy to induce them to pollute less; a tax incentive to use renewable energy; tax incentives to build new houses (instead of fixing old ones); tax incentives to keep family business within the family; tax incentives to finance research; tax incentives to fight unemployment. The list is endless! If these policies sometimes reach their targets, they inevitably bring with them unintended consequences (the German reform of inheritance law described below offers an interesting example).

But to resort to such policies was surely too tempting for governments whose financial records are miserable: it allows them to remain "active" in the eyes of their electorate without, they believe, further worsening the public deficit. This, however, is pure illusion; for these policies have a cost beyond the tax revenues; a cost which, although not immediately identifiable, is nonetheless real.

Lessons to be drawn and predictions for coming months

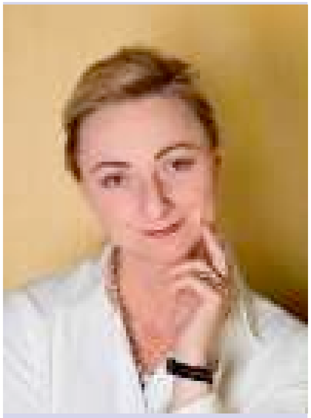
As was the case last year, this yearly report underlines the diversity of tax systems throughout Europe and, beyond that and maybe most importantly, the diversity of the "social contracts" in various parts of Europe. Clearly, European countries are far from homogeneous in terms of political agenda and while some countries attempt to "rethink" their model of social-democracy to adjust it to a globalized world (France, Germany, UK, Spain...) others are now clearly set on a different track, moving away from this model. That such diversity can prevail is a sign that Europeans remain free to choose the type of society they wish to live in. One interesting development in 2009 will be to see whether the European elections endanger this fundamental freedom.

In the short run, the fiscal policies chosen in 2008 and 2009 will no doubt have an impact on the recovery phase. It is likely that those countries which have not "loaded the boat too much" during the years 2008-2009 will quickly sail towards better economic performance as soon as the wind of recovery starts blowing. These countries will also be able to go back to tax reforms.

For the others, the lesson to be drawn is that if one does not clearly commit to reforms in quiet times, then the times of crisis will drive one away from the virtuous path and make further reforms not only more necessary but also much more costly.

This being said, one should remain aware of the danger of oversimplification and, for this reason, I strongly invite you to read the 16 reports gathered in this document; reports which include, for the first time an analysis of the Austrian and Croatian fiscal systems.

Austria´s trends in taxation



Dr. Barbara Kolm

Secretary General of Hayek Institute, Vienna

Structure and development of tax revenues

The tax burden of an average Austrian employee (all must be insured under the social security system) is close to fifty percent of his income (including social contributions) more than four percentage points of GDP above the EU average (42%) with the Nordic Countries, Belgium, France and Italy recording higher rates.

Austria derives more than one third of tax revenues from indirect taxes, of which VAT accounts for more than half (the standard VAT rate is 20 % and a reduced rate of 10 % applies to basic foodstuffs, books and newspapers, public transport and renting of residential immovable property.) Austria raises a substantial amount from other taxes on production, in particular from an employer's contribution to the fund for equalisation of family burdens and a payroll tax payable to communes. By contrast, excise duties bring in relatively little revenue, reflecting the moderate rates imposed. Direct taxes account for nearly one third of revenue (31.5 %) in line with the EU average. Social contributions account for more than a third of receipts (34.4 %).

Efforts to improve the state of government finances in the run-up to EMU led to an increase in the overall tax-to-GDP ratio between 1995 and 1997 (from 41.3 % to 44.0 %), achieved mainly through the broadening of the base for corporate and personal income tax. Tax levels remained stable at this level until the cut in income taxation in 2000 led to a dip to 42,8 % while a rise to 44.7 % in 2001 resulted from base-broadening measures, reductions in tax credits and significantly increased tax pre-payments, stimulated by the introduction of interest charges on tax arrears. Additional reforms enacted since then have resulted in a decline of the Tax-to GDP ratio to 41.8 % (2006). In particular, the 2004/2005 reform lead to an annual tax relief of about 3 billion euro (1.2 % of GDP).

Hence, the Austrian ratio for taxation of consumption, labour and capital and environmental taxation has somewhat decreased since 2002; but is most likely to rise in the future due to current discussions in government.

The share of taxes on capital in GDP (6.8 %) is below the EU-27 average and well below the euro area average. The tax on capital stocks and transactions yields less than half of the average amount in the euro area (1.0 % of GDP, euro area 2.4%).

Current topics and prospects; policy orientation

According to the current government program, the federal government intends to implement a major **tax reform with a significant tax relief in the course of 2008 to 2012.**

The abolition of death tax and gift tax in June 2008 as well as the attack on Liechtenstein´s foundations by the German government created additional incentives for **foreign capital to flow into Austria** resulting in tax gains for Austria. The above mentioned abolition has equated the Austrian **Privatstiftung (Private Foundation)** with other legal forms. The Austrian Private Foundation is an optimal vehicle to preserve assets.

However the current financial crisis encourages politicians to implement redistribution measures by raising taxes on personal income, foundations and capital gains.

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

Personal income tax

Between 1988 and 2000, income tax rates were slashed and the base was broadened. The consolidation package of 2001 included the reduction of tax credits and other tax increasing measures. In 2004 step 1 of a far reaching tax reform focused on the reduction of the income and wage tax of low and middle income earners. Under Step

2 a new system with four brackets came into force in 2005 replacing the old five bracket system. Further changes referred to, inter alia, the introduction of an additional children's tax credit for single parents and sole earners.

Austria has **a comprehensive and progressive personal income tax scheme.** The four brackets have marginal rates of 0 %, 38.333 %, 43.596 % and 50 %. The zero-rate bracket goes up to a taxable income of €10.000, which means that – as a result of other tax credits – annual gross earnings of about €15.800 for employees and €13.500 for pensioners are tax-free. The top rate starts at a taxable income of €51.000. For partnerships and other unincorporated enterprises only half of the average tax rate is applied to the first €100.000 of retained profits. As **a substantial proportion of enterprises are unincorporated,** the reform of PIT affects both individuals and enterprises to a greater extent than elsewhere.

Capital gains are usually not included in taxable income. However, this does not apply for gains realized as part of commercial activity or on speculative gains (e.g. from shares within a one-year holding period and immovable property within a ten year period) and in the case of substantial shareholdings. Dividends, interest and investment fund income are subject to a final withholding tax of 25 % while royalties are taxed at the normal progressive rates.

Corporate Taxation

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

The deduction of losses from former years is restricted to 75 % of taxable profits, but there is an indefinite loss carry-forward period. Similar rules apply to personal income tax. In 2005 the group relief system (Organschaft) was replaced by a system of optional group taxation. As a consequence of the 2005 tax reform, foreign losses are considered deductible in computing the domestic income tax base, making Austria one of the few countries in Europe in which this is permitted. If a group breaks up within 3 years the effects of group treatment is reversed.

A number of taxes and contributions are based on payroll and borne by the employer, among them the municipal tax (3 % on the salaries and wages paid) and the contribution of the Family Burdens Equalization Fund (payable at a rate of 4.5 % on gross wages and salaries).

Suggestion

A top marginal tax rate of 25% on income should be implemented in addition to the corporate tax rate of 25%. An annual exemption of €12.000 per family member guarantees no disadvantage for individuals with less income. Tax relief for middle income families creates growth and incentives for top executives to stay/return to Austria would increase Austria´s tax revenues. Austria´s ratio of public debt to GDP must be marked down to at least 39% in order to remain competitive. This can be achieved by means of reforms of the public sector — e.g. administration, the pension and the health care system -- as well as by tax cuts.

Additionally, geographic location, safety and respect for the rule of law make Austria an attractive business location. Promoting Austria´s Foundation law abroad will attract business and capital.

The key element of a successful Privatstiftung is that it is established in a country with a high degree of external and internal security with a proven track record of fair and stable jurisdiction. While the tax aspects are undoubtedly very important, these become secondary when compared to the primary objective. Austria, being a country with a long tradition regarding internal and external security and an outstanding judicial system, is well equipped to serve a potential Grantor's needs. Its membership in the European Union – unlike Liechtenstein and Switzerland – make Austria a preferred candidate for the location of Privatstiftungen as we consider the European Union as one of the future economic and political strongholds in the world.

Special report: The Austrian Foundation/ the Austrian Privatstiftung: an attractive alternative to Trusts and Foundations

The Austrian Privatstiftung is a unique institution endowed with special features which distinguish it from foundations in Liechtenstein and Switzerland or trusts in the United Kingdom, USA etc. The purpose of all of these institutions is basically the same: To create a legal framework for preservation of family wealth and consequently avoid the splitting-up of family property, as well as to optimize the tax situation especially regarding inheritance and gift taxes when passed to the next generation.

Family situations and concerns are almost always unique and complex, and require special attention. There are basically two types of foundations in Austria: The Privatstiftung and charitable foundation. Typically, charitable foundations prevailed in the past while **the Privatstiftung has gained tremendous importance during the past years**.

A Privatstiftung is a legal entity, the internal organization and purpose of which is largely determined by the grantor, who donates the assets necessary to achieve the object of the Privatstiftung. The Privatstiftung is bound to execute the intentions of the grantor as documented in the declaration of establishment (deed).

The Privatstiftung does not have proprietors but beneficiaries. It has its legal domicile in Austria and is entered in the public register of firms. Neither the establishment of a Privatstiftung nor its practices are however subject to supervision by public authorities.
The following elements are required to found a Privatstiftung:

a) Grantor
b) Beneficiaries
c) Declaration of Establishment
d) Type of Business
e) Board of Trustees

f) Advisory Board
g) Supervisory Board (if necessary)
h) Certified Public Accountant

A Privatstiftung can be dissolved if the term of the Privatstiftung expires, bankruptcy, unanimous decision of the Board of Trustees, revocation by the Grantor, if provision has been made in the Declaration of Establishment of fulfillment of the aims of the Privatstiftung, or if it is no longer possible to achieve the same. The dissolution of a Privatstiftung is effective upon its entry in the register of firms. After satisfaction of the claims of creditors, the remaining assets of a Privatstiftung are distributed to the final Beneficiary or Beneficiaries.

Tax Aspects

Establishing a Privatstiftung: Contributions made by a Grantor to a Privatstiftung are taxed at a flat rate of 5%. Contributions in the form of real estate are subject to an additional real estate transfer tax of 3,5 percent calculated on the basis of the treble taxable value (Einheitswert). The reduced favorable 5 percent tax rate is also applied to later contributions to the Privatstiftung made by the Grantor (so-called-subsequent contributions), but not to supplementary contributions made by other persons who were not initial Grantors. It may therefore be advisable to have also other Grantors e.g. the Grantor's children to act as Grantors with a minimum amount.

Taxes on income and capital gain: The Privatstiftung must prepare annual financial statements pursuant to commercial law. An annual audit by a chartered public accountant is mandatory. The regular rate of corporate tax of 25% will usually only apply to income derived from rental or leasing, income earned as limited partner in a partnership or income from agriculture and forestry which the Privatstiftung is exceptionally permitted to conduct. For interest income (bonds, deposits) and capital gains a special rate of 12,5% ("Zwischensteuer") has to be retained and can be charged against taxes on distributions to beneficiaries. All other types of income are exempt from any tax until distributed to the Beneficiaries. In particular, earnings which would otherwise be subject to capital yield tax (dividend income, if held more than 365 days) are exempt from both corporate and capital yield taxes.

Distributions from *Privatstiftungen* are considered as a Beneficiary's or final Beneficiary's earnings on capital and are treated in the same way as declared dividend payments by incorporated firms.

Distributions to Beneficiaries resident in Austria are classified as income from capital and are subject to income tax at a rate of 25%. Taxation of Beneficiaries resident in other countries depends on their national tax laws and the double taxation treaty applicable. Under the OECD Model Treaty, distributions to Beneficiaries should rather be qualified as other source income than as dividend income. In that case, most treaties would not provide for Austrian withholding tax being levied.

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Belgian taxes in 2008

Thierry Afschrift

It would be difficult to argue that 2008 was a good year in terms of the tax situation in Belgium. Figures show that **the aim of reducing the tax burden was not achieved**, with the proof being that the reforms put in place cost the State nothing.

The Doing Business survey produced by the World Bank ranks Belgium in 19th position in terms of the ease of doing business. Also, according to a survey produced by the publishing house KLUWER in 2008, over 57% of tax professionals believe it is becoming difficult to track the evolution of tax law, which is falling prey to an ever-increasing number of rules of every kind. At the same time, **Belgium ranks only 4th in terms of who regulates the creation of businesses the least…**

All of which means that it is easy for businesses to come into being in Belgium, but they then struggle to grow and, often, to survive.

An explanation for this unfortunate inconsistency comes from the fact that, according to various reports, Belgium is **ranked 2nd, 3rd or 4th among the most heavily taxed countries in the world.** This is due to the high level of taxation for the upper tax bracket and the very low threshold on the tax sliding scale reach 50% from €32,860 – with mandatory tax levies in Belgium representing 46.2% of GDP) – which strikes directly at average earnings. However, in its statement issued on 20th March 2008, the government heralded a rise in purchasing power, an increase in the earnings bracket exempt of tax (which is due to rise over time from € 6,400 to €8,400 and which, according to the Minister of Finance, should create a "gain for taxpayers" in the region of 3 to 4 billion EUR), a rise in fixed expenses for professionals (known as "jobkorting") and the fight against tax fraud – a point that the government again emphasised in its statement on general policy issued on 14th October 2008.

Hence there is a significant discrepancy between the statements put out by the government and what goes on in reality – all the more so given that, in addition to the traditional policy on taxation and the current crisis, certain structural problems remain (like the fact that, according to the Audit Office, only €390 million, out of the €25 billion of VAT revenue stated in the 2008 budget, are effectively available to fund the Federal State's own expenditure). As a result, the State is constantly short of money, which makes substantial tax cuts impossible – at least not against the current economic and institutional background. Nevertheless, it was possible to take some interesting measures that came into effect in 2008 – measures that we intend to set out in diagrammatic form below.

The new system for copyright fees and related rights

This is an important new law (Act of 16th July 2008, B.O.J. 30th July 2008), which applies retroactively from 1st January 2008.

Until now, earnings from copyright fees and related rights could be taxed in a number of different ways (professional income, miscellaneous earnings or earnings from the concession of moveable property). This created uncertainty and confusion – all the more so because depending on the system used, the rate of taxation was different.

By inserting a new article 17, §1, 5°, into tax credits on research (C.I.R.), the Act of 16th July categorises earnings that "result from the assigning or concession of copyright fees and related rights, as well as the statutory and mandatory licences covered by the Act of 30th June 1994 relating to copyright fees and related rights, or by equivalent provisions in foreign law" with capital income, so that these earnings are taxed as follows:

- if earnings are not allocated to the beneficiary's professional business: an advance levy at source of 15% (article 261, para. 1 C.I.R. '92) will be retained; this means that these earnings will not be subject to any taxation.

- if earnings are allocated to the exercise of the beneficiary's professional business, they will be taxed as professional earnings on condition that this qualification as professional earnings, and any subsequent taxation, will only apply to that part of the earnings that exceed an amount of €37,000, (€49,680 for the 2009 tax year). Hence, there will be a dual system in place, the legal accuracy of which appears doubtful, with the same earnings being dealt with differently, depending on whether or not they exceed the ceiling of €37,000 set by law.

- €10,000-20,000 (€26,500 for the 2009 tax year): 25%, if they are copyright fees.

Taxable base – The Royal Decree for implementing CIR '92 provides for the option to deduct a fixed amount for overheads from the taxable base, calculated as follows:
- €0 to €10,000 (€13,250 for the 2009 tax year): 50%

To avoid some people being able to benefit from deductions for overheads that are too large, the tax department has announced that it will check the composition of the income of taxpayers benefiting from these measures. However, pursuant to article 313 C.I.R. '92, there is no obligation to declare earnings that are subject to an advance levy at source. But, in the event of an inspection, the tax department can request a tax surcharge if the levy deducted at source is considered to be insufficient, even though legal texts talk about deducting a levy, and not a sufficient levy…

Persons who need to pay the levy: residents in the Kingdom, resident companies, associations, institutions, establishments and bodies of any kind, and legal entities subject to company tax, as well as non-resident taxpayers.

System of benefits linked to results

Brought into being by Collective Labour Agreement n° 690 and the Act of 21st December 2007 (Act of 21st December 2007, B.O.J. 31st December 2007) relative to the implementation of the 2007-2008 inter-professional agreement, employers can pay workers an indexable maximum bonus of €2,200 without this bonus being taxed as part of the beneficiary's personal income tax and without incurring a deduction for social security contributions.

For this tax system to be applied, the following (stringent) conditions must be met:

a. This system is restricted to employers and workers who come under the scope of the Act of 5th December 1968 on collective labor agreements and joint representation committees, but excludes company directors working under the system of self-employed workers.

b. The bonus thus defined by the Act as "non-recurrent linked to results" must **depend on the achievement of a collective target relating to the company or a group of workers and the allocation must also be made to a group of workers.**

c. The targets must be clear and real (and able to be checked over a minimum period of 3 months that may begin, at the earliest, on 1st January 2008): there is no question here of disguising a bonus payment made to claim that a non-existent or vague target has been achieved and/or the achievement of which leaves no room for doubt. Otherwise the system is tainted because it smacks of fraud or pretence.

d. The exclusion from social security contributions only comes into effect when a ceiling of €2,200 is reached "per calendar year, per worker, at each employer that employs that person": hence, in terms of social security law, a worker may combine several bonuses if he has more than one employer; on the other hand, on a taxation level, the situation is taken overall in such a way that if the bonus exceeds €2,200, the excess amount will be subject to tax.

e. The possible institution of a system of bonuses may not be used to replace any element of the existing remuneration. However, it can replace an existing system of allocating benefits linked to the company's results.

f. Provided the special 33% employer contribution at source to social security is paid to the ONSS/RSZ, on the one hand, the bonus will not be subject to personal income tax in terms of the worker (art. 38,§1, para. 1, 24° C.I.R. '92) and, on the other, both the employer contribution to social security and the bonus itself paid are deductible in terms of the company, this makes **this system attractive for companies, particularly those that employ a large number of workers.**

Amendment to the Belgian-French preventative agreement on double-taxation relating to cross-border workers

An amendment to the preventative agreement on double-taxation between Belgium and France, dating from 10th March 1964, was signed by the Ministers of Finance for Belgium and France on 12th December 2008, exactly one year to the day after the signature of the previous agreement (contrary to the model established by the OECD.), which has never been agreed on unanimously. The importance of the issue at stake can be seen more clearly when we consider that there were **33,000 French cross-border workers in 2006** and that the tax department evaluates the total tax involved at between 29 and 65 million EUR.
This new agreement, which satisfies the Belgian government because it **puts an end to a system considered to be discriminatory and halts the incessant loss of tax receipts**, maintains the principle

that residents of Belgian municipalities working abroad contribute to the funding of local goods and services by paying an additional tax calculated on an imaginary tax paid in Belgium and despite the fact that they do not pay any tax in Belgium.

This agreement will come into effect from the 2009 tax year (earnings from 2008) and will apply to all professional earnings of workers, regardless of their origin or the status of the worker. The forthcoming system can be summarised as follows (article 2 of the Amendment):

For residents of Belgium working in the French frontier zone, the tax system in their state of residence (Belgium) is repealed with retroactive effect to 1st January 2007. Taxation will therefore take place in France.

For residents of France working in Belgium:

Period 2009-2011: the cross-border worker taxation system (applied in France) will apply to workers whose sole home is in the French frontier Suzanne area and who do not leave the Belgian frontier zone for more than 30 days per calendar year.

From 1st January 2012: the cross-border worker taxation system will be maintained for 22 years only for residents of France who benefit lawfully from this system on 31st December 2011; the number of exits remains set at 30.

By virtue of this agreement, the municipalities may collect additional local taxes calculated on the professional earnings of Belgian workers, even if they only pay income tax in France.

Finally, the amendment provides for the payment by France, during the period of 22 years beginning in 2012, of an amount of financial compensation for the loss of revenue for Belgium resulting from the cross-border worker taxation system for residents of France during this period. The amount of this compensation is set at €25,000,000 per year for the first three years and will be reviewed subsequently based on the total of gross salaries paid to cross-border workers.

It should be pointed out that if this amendment is ratified by the Belgian and French parliaments (as it involves the modification of an international treaty), it will no longer be possible, for Belgian residents to "become cross-border workers" by going to reside in France, from 1st January 2009.

Extension of taxation periods

The programme law of 22nd December 2008 (Belgian Official Journal dated 29th December 2008 – 4th ed.) modifies the taxation periods by extending them significantly.

It should be remembered first of all that the amount of tax should normally be established before 30th June of the year after the one designating the taxation period.

Under the previous system, the tax department had the power, pursuant to article 333 C.I.R. '92, to carry out investigations and establish tax surcharges for 3 years. It was also able to extend the period of investigation to 7 years on condition that the tax office **notified the taxpayer of any indications of fraud** on the taxpayer's part within an additional period of 2 years; **this period has now become 4 years.**

The 3-year **taxation period** could also previously be extended by 2 years in cases of fraud; under the new law, **this period is increased to 4 years,** which brings the total period to 7 years. The lawmakers also took the trouble to modify article 376 C.I.R. '92 allowing exemption at the request of the taxpayer. However the period allocated to the tax department to proceed automatically with an exemption remains set at 3 years.

Similar provisions now apply for VAT.

Finally, we note that pursuant to its article 193, this law came into effect on the day of its publication and that it was published in the Belgian Official Journal on 31st December 2008 - 4th edition: **the aim of the legislators is clearly to extend the periods expiring on 31st December 2008 and which will now expire under the effect of the new law on 31st December 2010, both for the investigation and the taxation itself…**

Retention of accounting documents

Article 55 of the Act of 8th June 2008, making various provisions (I)

(B.O.J. 16th June 2008, 2nd ed.) states that the period during which accounting documents must be kept is now 7 years (instead of 5) from 1st January of the year following the year in which the accounts were closed.

Hence article 6, paragraph 4, of the Act of 17th July 1975 relating to the accounting of companies is modified, with the 10-year period for retaining documents reduced as a result; this provision must also be linked to the modification of article 315 C.I.R. '92 in which the period of 5 years provided for in this article also rises to 7 years.

Savings directive: the rate of withholding tax rises to 20% for foreign residents

We are aware that the Council's Directive 2003/48/EC dated 3rd June 2003 on the taxation of savings earnings in the form of interest payments is designed to allow the taxation of residents from one State who receive earnings on their savings in the form of interest payments through a paying agent established in another State; for this to be possible, an exchange of information system has been put in place between the signatory countries for the purpose of enabling the tax authorities in a person's State of residence to be notified that one of its nationals, who is a taxpayer in that country, has received interest from his savings. **For those countries that have not agreed to exchange the information they hold (Belgium, Luxembourg and Austria), a withholding tax was set up during the period of transition on payments of the benefits dealt with under the Directive.** However, this deduction of tax does not affect SICAV (unit trusts) investing less than 40% in securities that generate interest, or SICAV with no European passport, or interest paid to companies or, finally, paying no dividends.

Reduction in the stock exchange tax on sales of capitalisation SICAV

Since 1st January 2008, the stock exchange tax on sales of capitalisation SICAV has been revised downwards, falling from 1.1% to 0.5%. However, the ceiling of €750 per transaction in capitalisation shares has been maintained. Also, anyone subscribing to the issue of new securities no longer has to pay the tax on stock exchange transactions nor the tax on bearer securities. This has applied since 15th July 2004.

What does the future hold for us?

In economic terms, we note that the budget was passed on Thursday 8th January 2009 and concerns have already begun about how it was possible to vote a budget based on the assumption of a growth of 1.2%, whereas recent forecasts point to a negative growth in gross domestic product of minus 0.2% in the best-case scenario; the Secretary of State for the budget justified himself by saying that, in October, it was impossible to anticipate that the situation would get even worse…

But he omitted to mention the fact that the government has been unrealistically optimistic. The consequence, anyway, is that, at the present time, **the government has a shortfall of over €13 billion pensions.** It does not come as a surprise, therefore, that the government has **extended its tax and inspection deadlines** by stressing once again that it "will strengthen all of the tools available (datamining, for example, and the improved exchange of data) so that sufficiently frequent checks are carried out both in tax-related and social areas".

It will certainly have to find the missing money somewhere as it did in 2007 when notwithstanding the fact that the government's estimates had turned out to be too optimistic and even with the economic recession, tax receipts rose by 5.3% compared with 2006.

But for all that, there has been at least one significant advance: the **transposition into Belgian law**, through the Act of 11th December 2008 (B.O.J. 12th January 2009) **of the European directive on cross-border reorganisation** (90/434/EEC of 23rd July 1990, amended by Directive 2005/19/EC). The aim naturally is **to ensure that tax neutrality for the system of mergers and splits is extended to cross-border transactions**. Which means:

a. the absorbing or benefiting company does not have to be Belgian, but can also be intra-European (established from a tax point of view in an EU member country – article 2, §1 5° a new article 5°b) b C.I.R. '92).

b. compliance with the Company Code is transformed with regard to the compliance of similar provisions in our Company Code under the law of the country where the intra-European company is established; (see art. 772 of the Company Code)

c. the transaction must now have "valid business motives" (article 183b C.I.R. '92 new, introduced by article 11 of the Act of 11th December 2008): tax fraud and/or evasion, prohibited by the Act, are presumed non-irrefutable if the transaction is not carried out for valid reasons (there is tax evasion if seeking tax benefit is "abusive": the benefit is purely fiscal, the transaction without effect, motive).

If the company to be absorbed is Belgian, the proposed merger must state whether the absorbing company is required to maintain the elements being absorbed as part of a Belgian operation for the purpose of avoiding Belgium losing taxable earnings. In the event of a dispute, the burden of proof naturally rests on the tax department, according to jurisprudence.

This represents significant progress and it is a pity that the government has also taken advantage of proclaiming this law to replace article 90.9° C.I.R. '92 (article 6 of the Act of 11th December 2008), resulting in a change to the system for the tax handling of profits made by a private individual acting outside a business. From now on, when a profit is made outside the normal management of private assets, the whole gain will be taxed under the heading of miscellaneous earnings (at the rate of 33%) and not just the "abnormal" part (according to the Court of Cassation, in its decision handed down on 30th November 2006, the tax department is required to distinguish, within the profit generated, the part that relates to a normal transaction and exclude it from the taxable base, and the part that relates to a normal transaction considered to exceed the normal management of the taxpayer's assets).

However, this does not modify the system of exempting "normal" profits, in particular those generated on organised deals.

IREF

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The Year of the Flat Tax

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The first year of the flat tax in Bulgaria is already behind us and we can easily say that it was a tremendous success. The lowest flat tax on personal income in Europe was welcomed by the people in the country, basically because of three main characteristics – ***simplicity****,* ***fairness*** *and* ***lower rate****. Along with all that, the flat tax had a* ***positive effect*** *on state revenues which have reached another* ***record high level****.*

Speaking of labour taxes, from the beginning of 2009 the social security system became far more complicated. Along with social contributions paid by the employee and the employer (as in most European countries), from this year onward the State itself will pay social contributions for every worker. These ***"new" government contributions*** *are more of an* ***accountant trick*** *than a real reform. Actually, the State has always made payments from the budget to the Pension Fund – the difference is that they were called* ***transfers*** *(or subsidies) and now they are called* ***contributions****.*

Globally, the tax policy in Bulgaria has played a ***crucial role*** *for the development of the economy in the recent years. The policy of relatively low taxes proved to be a success and made it possible for the economy to grow as never before.*

Introduction

The first year of the flat tax in Bulgaria is already behind us and we can easily say that it was a tremendous success. The lowest flat tax on personal income in Europe was welcomed by the people in the country, basically because of three main characteristics – **1) simplicity** (you just deduct 10 percent from your income – no tax-exempt minimum and no special preferences and other loopholes); **2) fairness** (we are all treated equally) and **3) low rate** (the 10 percent flat rate is two times lower than the lowest marginal rate of the previous progressive scale). Along with all that, the flat tax had a positive effect on state revenues and those revenues reached another record high level. No doubt that this is a success story.

After cutting the corporate tax in 2007 and the personal income tax in 2008, the year of 2009 was calls for a change in the other main type of direct taxation – namely social contributions. Nevertheless, the change that we face now is far from repeating what happened in the years before. After having lower taxes and simplified tax code in 2007 and 2008, now in 2009 social contributions became as complicated as possible. Along with social contributions paid by the employee and the employer (as in most of the European countries), from this year onward the State itself will pay social contributions for every worker. It may look as a third party (as it is not money from workers' salaries or from employer expenses), but these contributions are actually financed from all the other taxes and in fact, at the end of the day, they are still people's money.

Speaking of money, 2009 is expected to be the year of record high government revenues – roughly about €15 billion. In comparison, at the beginning of the new century (2000), government revenues were roughly €5 billion, or three times less than now. Still, even if the government is collecting more money from its citizens than ever before, only a small amount goes directly to local government..

Fiscal decentralization continues to be an issue in Bulgaria, as local authorities are still highly dependent (through transfers and subsidies) on the central budget.

Fiscal Decentralization

Most of the taxes in **Bulgaria** are collected at central level. The local governments' share in consolidated government tax revenue (excluding social security payments) is only 3.5% (2008), which is lower than in the other European countries ("Index of Fiscal Decentralization – Methodology and Findings", Victoria Curzon Price & Jacques Garello; 2003). To compare, in countries like Spain, Slovenia and Czech Republic local government raises around 20% of consolidated public revenue. In Germany, Sweden, Denmark, Poland and Hungary local governments get to raise around 30% of public revenue, while in Switzerland the share of local authorities (cantonal and municipal) in consolidated government revenue is more than 60%.

Since January 1, 2008 Bulgarian municipalities are allowed to determine the rates of local taxes (not just local fees as earlier). This includes real estate tax, property transfer tax, vehicle tax, gift tax, inheritance tax and local fees (e.g. garbage collection). However, the newly adopted law states that municipalities should set rates within **prescribed limits** (a minimum level was set equal to the current levels in 2007), which excluded the possibility of establishing lower taxes, to avoid tax competition between municipalities. This restriction on local authorities was highly controversial and was expected to be abolished by 2009. Nevertheless, at the end of 2008 the budget debate was entirely influenced by the financial crisis and somehow fiscal decentralization was left behind.

In 2009, just as the year before, local governments must set new rates of local taxes by the end of January (within prescribed limits) and expectations are that they will be increased, mainly due to new criteria for valuation of real estate (land and buildings) for tax purposes, reflecting a significant increase in the value of the real estate in the main cities (e.g. Sofia, Plovdiv, Varna, Bourgas) and in all resorts.

Corporate tax

In the beginning of 2007 the corporate tax rate in Bulgaria was **reduced from 15% to 10%**. Surprisingly for the state authorities the revenues from corporate taxes went straight up – both in 2007 and 2008. If we compare the government revenues before the reform (2006) and today (2008), we can see that in 2008 the government collected around 75% more money from corporate taxation than in 2006. These favorable results are due to the positive effects of lower taxes – companies coming out from the gray economy, more foreign investment and economic growth due to increased incentives for entrepreneurship.

The success story of the corporate tax cut gave wings to the flat tax proposal, which was passed the year after. With both income and corporate tax at a flat 10%, at the end of 2008 there were wide discussions in the country towards abolishing the dividend tax – mainly as a reaction to the financial crisis. Nevertheless, nothing changed and in 2009 the tax rate for dividend income and income from sale of shares will be again 5% for individuals.

Personal Income Tax

Bulgaria introduced the lowest flat tax in Europe at the beginning of 2008, replacing the progressive scale (20%, 22% and 24%) with one singe rate – namely 10%. The flat tax was welcomed by the people for its simplicity and fairness, and also for being two times lower than the lowest marginal rate of the previous progressive scale. The people obviously liked it (and they do have their reasons), but the main question stays – what did actually happen, in economic terms, after the first year of the flat tax? The fact is that despite the financial crisis (which reached Bulgaria at the end of 2008) the benefits from the introduction of the flat tax in Bulgaria are unquestionable.

Employment is rising – the official data shows that in the middle of 2008 the number of people employed reached record high levels (around 3,4 million people). **Wages are rising sharply** – last available data (September '08) shows that the average wage in the country increased by almost 25 percent (compared to the same period of previous year). Those observations can be partly explained with the fact that many people started to declare a larger share of their income. Nevertheless, social security payments remain high (above 30%) and continue to be an obstacle for people to honestly declare their income. Because, once you declare your income, you first pay social contributions and then income tax, so the positive effect of the low flat tax is limited by high social security contributions.

Lower marginal tax rate – the regular worker in Bulgaria used to pay (PIT & SSC) almost 45 cents for every euro earned in 2007, while in 2008 this figure dropped to 35 cents. This means that the disposable income per capita is increasing and, furthermore, that there are strong incentives to work more, as the biggest part of every additional euro earned stays with the worker. Such an incentive can only have a positive impact on long term economic growth.

Higher revenues – even though the flat tax rate was two times lower than the lowest marginal rate of the previous progressive scale, in 2008 the government collected more money from its citizens than ever before. The last available data shows that for the period January – November 2008, government revenues (from income tax only) increased by 10% in comparison to the same period in 2007. In other words, the government has collected an additional €80 million.

Social Security Contributions

Starting 2009, the social security payments became far more complicated, at least on paper. Along with social contributions paid by the employee and the employer (as in most of the European countries), from this year onwards the State itself will pay social contributions for every worker. The big change comes from the pension contributions, as the proportions are changed from 13.2% of gross wage paid by the employer and 8.8% paid by the employee (60% : 40%), to 12% paid by the state, 10% of the gross wage paid by the employer and 8% by the employee. The overall change (on paper only) is from 22% to 30% pension contributions. The health contribution also increased from 6% to 8% of the gross wage.

Still, if we look deeper into the system, we see that the change is a minor one. Those "new" State contributions are more of an accountant trick than a real reform. Actually, the State has always made payment from the budget to the Pension Fund – the difference is that those payments were called **transfers** (or subsidies) and now they are called **contributions**. For 2008, those transfers will exceed €1 billion (more than 1/3 of the expenses of the Pension Fund). The reality is that the 12% social "contribution" paid by the government is just another form of the same payments as before.

Leaving these government payments aside, the employees will continue to pay as much as before – namely 13%, while the employers will pay 2.4 percentage points less – from 20.5% to 18.1%. As both of these payments lie, one way or another, on the shoulders of the employee (as they are taxes on labor), the effective change is from 33.5% to 31.1% social security contributions (of the gross wage).

Further changes in the social security contributions are to be expected in the forthcoming year.

Social Security Contributions in Bulgaria (% of gross wage)

Social Contributions	2008			2009			
	Total	Employer	Employee	Total	Employer	Employee	State
Pension	22%	13.2%	8.8%	30%	10%	8%	12%
Illness & Maternity	3.5%	2.1%	1.4%	3.5%	2.1%	1.4%	0%
Unemployment	1%	0.6%	0.4%	1%	0.6%	0.4%	0%
Labor Accidents & Professional Illness *	0.5%	0.5%	0%	0.5%	0.5%	0%	0%
Salary Guarantee Fund	0.5%	0.5%	0%	0.1%	0.1%	0%	0%
Health	6%	3.6%	2.4%	8%	4.8%	3.2%	0%
OVERALL	33.5%	20.5%	13%	43.1%	18.1%	13%	12%

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

Taxes on Consumption

Taxes on consumption include VAT and excise duties on special goods such as cigarettes and alcohol. **Bulgaria** has to harmonize its tax regime with that of the European Union by introduction of the minimum excise duties of the European Community on tobacco, alcoholic beverages, and fuels. Starting in 2002, the harmonization process is scheduled to be completed by the end of 2013. In 2009 excise duties on kerosene, coke and coal, electricity for industrial purposes and cigarettes will increase, while on gasoline and diesel, as well as on liquor there will be no price adjustments.

Despite deductions in the social security contributions, in personal income tax and in corporate tax, the increase of excise duties and the widening of the tax base due to ***"lighting up"*** of a part of the informal economy ensure greater revenues from indirect taxation than expected. As far as the excises are a part of the taxable base for VAT, additional excises lead to additional revenues from VAT. As a whole, indirect taxes are the largest and most rapidly growing component of tax revenues, accounting for almost half of the consolidated public revenues or in other words for more than €6 billion.

Let us finally mention that one of the leading tax issues in 2008 was the debate on the implementation of VAT differentiation. Despite all the pressure put upon the politicians by all kind of groups of special interests, the rule stayed untouched and in 2009 there will be a single VAT rate for all commodities and services, namely 20 percent. There is only one exception in the recent years – 7 percent VAT on tourist services.

Conclusions

The tax policy in Bulgaria has played a crucial role for the development of the economy in the recent years. The policy of relatively low taxes proved to be a success and made it possible for the economy to grow as never before. GDP growth reached above 7 percent for the first six months of 2008 and stayed close to that level in the third quarter. These are quite good numbers especially when most of the other European economies perform poorly partly due to the negative effects of the financial crisis.

Taxation in Croatia

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Overall Structure

The Croatian tax system is based on the typical broad-based taxes, such as personal income tax (PIT), corporate income tax (CIT), value added tax (VAT) and excises. The structure of its revenue is somewhat different from that prevailing in the European Union member countries. The main differences are: i) the huge importance of VAT, 62 percent of total national tax revenue; ii) the very small role played by the personal income tax, 3 per cent of total collections, and iii) the practical non-existence of property taxation. Changes in tax policy and, consequently, in the structure of the tax system and of the revenue it generates have been very few in the most recent years. Changes will also remain very few in the near future, according to government documents. The present peculiarity consisting in the minimal role played by personal income tax will thus remain. It is even likely to be reinforced, due to consequences of the reform of financing local government introduced in January 2007, as will be explained later.

The overall tax pressure, including taxes and social-security contributions, is approximately 38 percent of GDP.

Table 1. **Structure of Tax Revenue in Croatia. 2007**

(millions of kunas)

	Kn. Mn.	%
Personal income Tax	1772,7	2,9
Profit tax	8816,3	14,5
Taxes on Property	578,6	1,0
VAT	37747,9	62,0
Sales tax	168,5	0,3
Excises	9096,9	15,0
Taxes on games and gambling	505,1	0,8
Taxes on international trade	1641,5	2,7
Other taxes	509,6	0,8
Total tax revenue	60837,1	100,0

Source: Ministry of Finance of Croatia.

Tax collections represent 22 percent of GDP, while social security contributions amount to the remaining 16 percent. Tax pressure has been reduced in Croatia over recent years and is presently in line with the EU average. This does not mean, however, the absence of problems with the Croatian tax system, particularly from the point of view of its impact on the competitiveness of the Croatian economy. In theory, the large share of VAT collections should be an advantage for Croatia, because VAT does not burden exports and the small role of PIT could mean the absence of distorting effects of taxation on the supply of labour and on effort. In practice, the marginal tax rates of PIT are rather high, and labour is heavily taxed *via* social security contributions.

While the Croatian system fares well, in terms of its overall burden, with tax systems of European Union member countries, it fares less well in comparison with tax systems of other Eastern Europe countries that compete with Croatia and that have recently reformed their tax systems with a view to increase the competitiveness of their economic system.

Table 2 shows, for a selected group of Eastern European countries, the top statutory rates for personal income and corporation income tax. Croatia has among the highest tax rates. Clearly, statutory tax rates tell only a small part of the story, because of the existence of allowances, deductions and other loopholes in the tax base that will determine the real burden of taxation. However, the table shows a substantial difference between Croatia and the other countries in favour of the latter.

The main components of the system

As mentioned before, personal income tax plays presently a minor role in terms of total national collections, despite its rather wide legal tax base that includes salaries and pensions, profits, income from self employment and rents. Tax rates are progressive and range from 15 to 45 per cent. A rather large basic monthly allowance of 1800 kunas (approximately €250) exists and is supplemented by rather generous family allowances. This basically explains the rather limited size of PIT collections, since a large number of wage earners are *de facto* exempted. This small size is likely to stay the same in the near future as a consequence of a recent reform in the financing of local government, which consisted in the elimination of the sharing of the profit tax between the central and the local governments and in the centralization of revenue. As a compensation for local governments, the sharing of the personal income tax has been substantially in-

Table 2. **Top statutory Tax Rates in Selected Countries**, 2005

	PIT	CIT
Czech Republic	32,00%	26,00%
Estonia	24,00%	24,00%
Latvia	25,00%	15,00%
Lithuania	33,00%	15,00%
Romania	16,00%	16,00%
Serbia	14,00%	14,00%
Slovakia	19,00%	19,00%
Croatia	45,00%	20,00%

Source: C. Edwards, Catching Up to Global Tax Reforms, Cato Institute, 2005

At presently, almost 90% of PIT collections are devolved to local governments. As a consequence, the central government has no more interest in PIT collections. Evidence of this statement is the fact that since 2007 central government legislation has consistently expanded the basic monthly allowance for PIT, thus eroding the base of the tax.

The profit tax is a typical corporation income tax. It taxes profits according to rules for their determination that are broadly in line with the international practice. The tax rate is 20% and there is a rather broad system of tax allowances for regional development and for growth stimulating purposes. More specifically, firms located in war affected areas and in mountainous regions receive, either an outright exemption, or a reduction of the tax rate to 10%. Furthermore, there is a rather generous system of tax benefits for research expenditures, for training programmes and for investment projects aimed at expanding employment in firms.

The VAT came into effect on 1 January 1995, replacing the existing retail sales tax. A threshold of 85.000 kunas (approximately €11,500) exists for registration of taxpayers. However, businesses with a lower turnover can register, if they think that this can be advantageous for their operation. VAT treatment of banks, insurance companies and other financial institutions is perfectly aligned to that of the EU. There are presently three VAT rates: zero, 10 and 22%. The standard rate - 22% – is among the highest in the EU and explains the considerable role played by VAT collections in Croatia.

The zero rate applies to milk, bread, medical, cultural and educational goods and services. A reduced rate of 10% as been recently introduced for tourism.

Excise duties are levied on oil products, tobacco, beer, alcoholic and non-alcoholic beverages, coffee, cars, motorcycles, boats, aircraft, and luxury products. The broad range of items subject to excises explains their substantial revenue amounting to 15% of total collections, although in many cases the tax rates are lower than those levied on average in the European Union.

Property taxes play an extremely small role in Croatia. Transfer of property is taxed by the transfer tax with a tax rate of 5%, whose impact on collections is diluted by the rather generous system of exemptions and allowances. There is no tax on ownership of real property.

Local taxation

Local taxes, whereby local governments are responsible for the burden they ask their citizens, play a limited role for subnational governments in Croatia. Local governments are primarily funded by the sharing of the personal income tax that is collected by the central government. They are assigned a few minor local taxes, such as a tax on holiday homes, tax on the use of public land and a consumption tax on beverages sold in bars and restaurants.

The only important tax for local governments is the surcharge on the personal income tax, whose burden varies according to the size and the importance of local governments. More specifically, communes can levy a tax rate of up to 10%, cities with a population below 30,000 can levy a surcharge rate of up to 12%, cities with a population over 30,000 can levy a surcharge rate of up to 15%, while the capital city of Zagreb is allowed to levy a rate of up to 30%. Because of the combined effect of sharing and surcharge, the income tax base is almost fully exploited by local governments. However, as we have seen collections are small and in perspective not very dynamic, since the central government determines the tax base and has no incentive to expand it.

Counties (Zupanjas) are assigned the revenue of the inheritance tax. The latter has a very small revenue potential due to problems in assessment made by the central government and the low tax rate. Only the vehicle tax can be considered as a true local tax, since counties have only in this case a limited discretion in the determination of the tax rates.

Fees and user charges play an important role for both local government and counties. Cities derive substantial revenue from building permits and from the so-called municipal fee, which is a distant proxy of a property tax being assessed, at very low rates, on the size (square meters) of property.

Other revenues for subnational government derive from central government transfers and from the sale of land and other property.

However, this latter source of revenue will soon be exhausted.

The alignment of Croatian tax legislation to EU (Community acquis)

The Croatian tax system is broadly in line with the acquis following measures taken in the recent years. Items still not in line with the aquis refer to the treatment of dividends, royalties interests and commissions paid by Croatian businesses to non residents, to the treatment of mergers and subsidiary relations. In the field of VAT the main objections refer to the 10% rate applied to the tourist sector and to zero-rating of bread, milk, books, educational materials, medical products and cinemas. (It may be useful to recall that, according to EU regulation, only reduced rates of no less than 5% can be applied, while zero rate should apply only to exports). Extensive adjustment is still required in the field of excise taxes. Here, some exemptions are not in line with the acquis and some tax rates are still below the EU minimum levels.

The debate on the property tax

There is at present no property tax in Croatia and there is extensive debate on furthering decentralization by devolving new responsibilities to local governments, particularly in the field of education and agriculture. These new responsibilities are substantial in terms of the expenditure involved. Thus, new sources of revenue will be needed if devolution is to take place—unless revenues are also decentralized. The best candidate is the property tax and this issue has been widely debated in the recent years particularly under the impulse of foreign donors and international organizations that have suggested the gradual transformation of the existing "municipal fee" into a fully-fledged property tax.

The property tax is rightly considered as the most proper tax instrument for subnational governments, particularly for cities and municipalities. The tax has a broad base, that can generate substantial collections even with moderate rates. Its revenue is stable over time. The tax is strictly in accordance with the benefit principle: most of activities undertaken by local governments impact on property values. It can also be structured in an equitable way, since there is a strict correlation between income and wealth conditions of owners/users and the value of the property they own or use.

As mentioned, at the present time there is no property tax in Croatia, but Croatian local governments are entitled to levy the Municipal Fee (alternatively translated as Public Utilities Fee or Municipal Compensation), that shares some of the characteristics of a property tax and could be gradually trasformed into a simplified version of a fully fledged property tax.

At present the individual burden of the municipal fee is very low and correspondingly its contribution to the revenue side of the budget of local governments is also low. However, thanks to this tax, local governments have lists of owners/users of property; procedures for sending tax bills and receiving the payment of the fee. The number of parameters used in the formula could be expanded with a view to represent, as closely as possible, the actual value of the property. For example, some parameters could be inserted describing the characteristics of the building (such as, for condominiums, the construction year, the state of maintenance, the quality of the building, the presence of elevators etc). Additional parameters could describe the quality of each single unit (number of bathrooms, presence of running water, etc). Then the annual payment could be determined as with the present formula, by multiplying the basic value for the parameters by a tax coefficient.

Czech Tax System in 2008

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Year 2008 was the first year with a single-rate personal income tax which was adopted as a part of fiscal reform focused on stabilization of public finance. The personal income tax revenue drop was smaller than expected and was more than balanced by increase of other tax revenues, especially from the corporate income tax which increased by 11.2% even though its rate went down by three percentage points. The government expenditures were in absolute terms lower than in 2007. Tax rate decrease accompanied by general tax deduction planned for 2009 was abolished because it would penalize especially low-income tax payers. Instead, social insurance contributions were lowered. The Ministry of Finance presented a proposal on the future of Czech tax system with a possible scenario of merging the personal income tax and social insurance contribution into one tax. By the end of the year, some possible solutions to the upcoming economic crisis were outlined with an emphasis on public finance stabilization and greater economic environment flexibility.

Figure of the year: Annual increase of corporate income tax revenue reached 11.2%.

Impacts of new tax system

Czech Republic went into 2008 with a new tax system. To shortly recall, due to problems with fiscal system that peaked in 2007 with public finance deficit exceeding the 3% of GDP Maastricht criterion, Czech government decided that a fiscal reform was needed. Leaving expenditure side of the public budget practically intact, few changes were adopted on the revenue side: single-rate personal income tax, higher VAT rate, social insurance contribution ceiling and ecological tax. The main goal was to balance the budget and decrease deficit under the level set by the Euro convergence criteria. Unfortunately, tax code simplification was not part of the debate and, indeed, the Income Tax Act increased its size by five pages (more than 4%) between 2006 and 2008.

Was the goal fulfilled? The plan was to increase total government revenues by 9.2% to 1,037 billion CZK and expenditures by 6.4% to 1,107 billion CZK which would lead to deficit decrease from 91.3 billion CZK planned in 2007 to 70.8 billion CZK. On the revenue side, the biggest year-on-year growth (17.3%) was expected in VAT revenues due to increase of its reduced rate from 5% to 9%. Even though the corporate income tax rate decreased by 3 percentage points to 21% by the beginning of 2008, the revenue planned in the state budget was expected to grow by 9.7%. Together with an expected 2.7% increase of revenue from excises, these tax revenues were supposed to balance an 8.1% decrease of personal income tax revenue due to above mentioned single-rate adoption.

However, the comparison of actual figures from 2007 and 2008 shows a completely different picture. The actual total government revenues reached almost 1,065 billion CZK which constitutes a 3.8% year-to-year increase. Tax revenues went up by 2.2% mainly thanks to direct taxation revenues. VAT revenue was higher by 6.8% compared to 2007 which is much lower growth than expected. Excises revenue even went down by 4.6%. The main reason for this development was the forward buying of tobacco products at the end of 2007 due to anticipation of the excise tax rate in 2008. Still, the fuel taxes were substantially above the minimal levels set by European Commission. Czech Republic has the fifth highest diesel tax in the EU. In sum, indirect taxes constituted 55.7% of the overall tax revenues which was 0.2 percentage points lower than in 2007. On the other hand, the share of direct taxes on the budget increased by 0.1 pp to 40.8%. Corporate income tax revenue increased by 11.2% and personal income tax revenue decreased by 7% in 2008 compared to year before. Both figures ended up better than expected in the state budget. Last but not least, total income from social insurance contributions grew by 5% and constitutes more than 36% of total revenues.

Government expenditures went down to 1,084 billion CZK, by 8.3 billion CZK (0.8%) lower than government expenditures in 2007! Obviously, this was mainly due to exceptionally high expenditures in 2007 but it is nonetheless quite interesting. An absolute year-on-year decrease in the government expenditures is in an international context something remarkable. Final deficit of 19.4 billion CZK in 2008 was the lowest since 1997.

Future of personal income tax rate

Year 2008 was very rich in public finance debates. Already in the first months a fierce political dispute started on the future of personal income tax. The plan sketched in the reform proposal of 2007 was to decrease the personal income tax rate from 15 to 12.5 percent in 2009, both from a "super-gross" wage. The adjective "super-gross" means standard gross wage plus health and social insurance contributions paid by the employer. This shift was to be accompanied by a decrease of general tax deduction to keep the income tax revenue on an approximately identical level. However, this plan was opposed by a number of coalition MPs from the beginning because it would increase the tax burden on low- and average-income taxpayers.

The largest opposition party (Social Democrats) came up with a proposal to return to multiple tax brackets by replacing the single 15% tax with three rates 10%, 20%, and 30% from the previously used gross wage. If we recalculate the 15% tax rate to a corresponding rate from a common tax base (gross wage) using the current average wage, we arrive at approx. 23% flat income tax rate. The social-democratic progressive income tax would, therefore, decrease the tax burden on lower-income taxpayers but at the same time, by restoring the tax progression, increase the burden on those with high income. Their motivation was that they wanted to attract low- and middle-income electorate but, at the same time, needed to get enough tax revenues. However, no coalition MPs were in favour of this proposal and the debate turned to fine tuning the combination of income tax, tax deduction, and social insurance contribution decrease.

The first proposal following this path was to keep the planned tax rate and general tax deduction decrease and find such social insurance contribution decrease which would lighten the overall tax burden on all income groups. Problem with this approach was, according to the minister of finance, that it would have a large negative impact on tax revenues. The minister himself suggested that the tax rate stay 15% and the insurance contributions of employees decrease by one percentage point. Three coalition members of parliament were strongly against this small decrease and insisted on the planned tax rate reduction. In the end the minister proposed to reduce the insurance contribution by another 0.5 pp. This amendment to the reform act from 2007 was approved in the very last days of 2008. Due to the amendment, the personal income tax rate in 2009 stays at the 15%, the general tax deduction is also kept unchanged and the social insurance contribution payable by the employee decreases by 1.5 percentage points to 6.5%. Although the tax burden is lowered for all income groups, higher-income tax payers pay a little less than they would under the previously suggested 12.5% + lower general deduction tax regime.

Tax reform proposal

Also interesting was a radical tax reform proposal prepared and introduced by the Ministry of Finance in April 2008. The main idea was to simplify the system both for the tax payers and administrators, tax only economic activity (not corporate capital) and remove double taxation. The simplification on the side of tax payers would stem from a completely new legislature that would be built on general principles and would decrease the number of exemptions, as well as different taxes and other payments. Under one of the scenarios, social insurance contributions were even merged with personal income tax. This would have led to a single personal income tax deducted from the above defined super-gross wage at a rate of about 40 percent.

Such a system would radically improve tax transparency because today the rates per se do not provide enough information about the real tax burden due to a number of different tax exemptions and large tax deductions. Burden on different income groups can nowadays be easily and without much publicity altered by changes in exemptions and deductions. Under the proposed system, the only way to change the tax burden would be through movements in the tax rate. The only country with a similar single income tax regime in Europe is currently Denmark.

Effects of health system regulatory fees

The senate, municipal, and county elections in October 2008 were unexpectedly won by the opposition Social Democrats which stopped any further discussions about the future tax system. The only reform undertaken in 2008 was a law which increases the retirement age to 65 (effective from 2030) and the required insurance period to 35 years. This parametric change should decrease expenditures of the pension system by the end of the century by 2 pp to approx. 11% of GDP and the unfunded debt of the state pension system from 250% of GDP to 150%.

Changes in health care system

Outcome of the elections was to a large degree influenced by regulatory fees per prescription (30 CZK), day of hospitalization (60 CZK), and visit to an accident and emergency department in the hospitals (90 CZK). Although the fees were symbolic than real cost covering (average wage around 23 000 CZK), and their main purpose was creation of incentives for rational use of public health care, they provoked strong public opposition. The impact of fees on the health system however turned out to be substantial and positive. In 2008, approx. 6 billion CZK was collected from the fees and another 5.5 billion CZK was saved due to lower overconsumption of health care (overall Czech health sector costs are about 220 billion CZK a year). In 2006 the average Czech citizen visited a doctor thirteen times, whereas in 2008 the number of visits dropped to eleven. However, Czech Republic still ranks second among European countries while, in Western Europe, people visit a doctor only about six times a year.

First debates about the financial crisis

It began to be clear by the end of 2008 that the Czech Republic would not be spared from the consequences of the financial crisis, although Czech banks went through the most volatile period practically intact. Both the governing conservative Civic Democrats and opposition Socialists presented during December their first plans to deal with economic recession which was likely to be soon imported into Czech Republic. The four main ideas of the action plan of the Czech government were the restoration of trust in the financial sector, prevention and elimination of possible risks stemming from the world economic crisis, stabilization and flexibility of the economic environment, and impulses to economic growth if needed. However, no particular proposals were provided. The prime minister only indicated that he would continue with previously outlined reforms to stabilize public finance and improve institutional flexibility rather than directly stimulate the economy.

On the contrary, the Socialists introduced a very detailed anti-crisis plan. However, to a great extent they only used the topic of economic crisis to sell their own program. Most of their suggestions, such as reintroduction of progressive taxation, euro adoption, or stopping the decrease of overall tax rate would have at best a questionable impact on the development of the economic crisis in the Czech Republic.

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Taxation in Denmark

Jacob Braestrup

Confederation of Danish Industry

In November 2008, the government's ***"tax freeze" celebrated its 7 year*** *anniversary, having been in effect since the current centre-right government took power in 2001. The most significant change in terms of taxation in 2008 came with the implementation of first half of a tax package aimed at lowering marginal taxes for low and especially middle income tax payers. The second half of the package took effect January 1st 2009. The top marginal tax will, however, remain unchanged at 63 percent. As expected in the 2007-report, the government set up a tax commission in early 2008 with the mandate to propose a new tax structure with lower taxes on labour. The commission is set to report in early February 2009, with the tax reform planned to take effect from January 2010. More disturbingly, parliament this year chose to unilaterally cancel the double taxation agreements with France and Spain with effect from January 1st, 2009. The cancellation was an effort to prevent Danish pensioners from avoiding taxes on their private pensions by moving to either of these countries, but the move is expected to affect on companies with activities in these countries.*

Tax freeze still in effect

Upon taking office in November 2001, the centre-right government of Prime Minister Anders Fogh Rasmussen instituted a so-called "tax freeze": **No tax or duty could be increased**. If the tax is defined in terms of a percentage, that percentage could not be increased. If defined as an amount, that amount could not be increased (and is thus effectively lowered by inflation). Furthermore, the property tax on owner-occupied property (one percent of the property value as evaluated by tax authorities) was fixed in nominal terms, so that the basis of the tax is the lower of the following: The 2001-evaluation of property value + five percent; the 2002-evaluation; or the most recent evaluation.

The tax freeze **may only be violated, if it is absolutely necessary, including for environmental reasons**. But then any revenue from higher taxes must be reserved for lowering other taxes. Also, should the EU or other international obligations force Denmark to lower a tax, the lost revenue may be recovered through other taxes.

This tax freeze is still in effect today, although it can be argued that some of the minor tax changes since 2001 have violated its principles

Lower income tax 2008-9

In 2007, the parliamentary majority agreed on a minor tax package aimed at **lowering the marginal tax for lower and middle income earners (salaried income)**. The changes, which were to be implemented in two stages in 2008 and 2009, can best be seen in the context of the 2004-changes, agreed upon in 2003. At that time tax deduction was instituted for all wage-earners, effectively lowering the marginal tax on lower incomes earners. Furthermore the basic allowance for the middle income tax bracket was raised, substantially lowering the number of persons affected. The 2008-9-changes further increase the earned income tax credit as well as the basic allowance for middle income earners, while also raising the basic personal allowance (benefiting all taxpayers, not just wage earners).

As mentioned, the change will not take full effect till 2009. The changes in 2008 were:

- Basic personal allowance raised by DKK 500 (€ 67) to DKK 41,000 (€5,502)
- Earned income tax credit raised by 1.5% to 4.0% of earned gross -income with a maximum of DKK 12,300 (€1,651). However, the deduction only applies to municipal taxes and health contribution (total of 33.5%), so tax value is really 1.34% (4.0% times 33.5%) with a maximum of DKK 4120.50 (€ 553), that is 12,300 times 33.5%.

In 2009, the basic personal allowance will be raised by a further DKK 500 (€ 67), while the earned income tax credit will be increased to 4.25 percent with a maximum of DKK 13,100 (€1,758). Also, the basic allowance for the middle income tax bracket will be increased to DKK 365,000 (EUR 48,984), which is the same as the basic allowance for the top income tax bracket (the exact basis for the two taxes remain different from each other).

Please note that all the above mentioned amounts are 2008-figures. Because basic allowances and the maximum earned income tax credit are regulated each year to adjust for inflation, the actual 2009 amounts will be somewhat higher than stated here.

Finally, the political parties behind the 2007 tax package, agreed that the total number of top income tax payers should not increase beyond the 2007-figure. In 2007 it is currently estimated that **some 935,000 persons – more than 40 percent of all full-time employees – paid the top marginal tax**. In 2009, the number is estimated to be 980.000 persons. The political agreement stipulates that the basic allowances for the top *and* middle income tax brackets be raised extraordinarily in 2010, so that the number affected returns to the 2007-level. However, it is widely believed that this agreement will be nullified by the forthcoming tax reform (see below).

The 2007 tax package will **lower tax revenues** by some DKK 9.5 billion (1.3 billion euro) **financed primarily through a cancellation of the tax freeze on energy duties**, which will now be increased by 1.8 percent/year till 2015 (since this was officially done to benefit the environment, and since all revenue was used to lower other taxes, this was not a violation of the tax freeze). Another big contribution came from the **cancellation of a hitherto mandated tax reduction due to (unexpected) surplus in some labour market funds funded by labour market contribution**. The labour market contribution ("arbejdsmarkedsbidrag") was introduced in 1994 as a tax (originally 5 percent, but rising to 8 percent from 1997 onwards), applying only to salaried income. The contribution, which was deductible against all other income tax, funded certain labour market funds. Due to unprecedented low unemployment, these funds were to yield a surplus, which would have entailed a lowering of the labour market contribution (and thus the marginal tax on labour income) by some 0.5 percentage points. The 2007 tax package in effect closed the labour market funds, severing the link between the funds and the labour market contribution. As of 2008, the labour market contribution is thus an income tax like all others.
Somewhat controversially, the2007 tax package was under-funded by some DKK 2 billion (0.3 billion euro), which were projected to come from the positive effects the package would have on income (lower marginal taxes) and spending.

With the 2008 changes in effect, the marginal taxes on labour income are:

- 8% (labour market contribution) of income below DKK 44,565 (5,981 €)

- 42.6% (labour market contribution + municipal income taxes + health contribution + lower income tax – earned income tax credit) of income from DKK 44,565 to 304,130 (€ 5,981 to 40,815). Note that municipal taxes include church tax of 0.73 percent, which is effectively voluntary, but which applies to more than 80 percent of tax payers. Also, the marginal tax on income between DKK 304,130 and 307,500 (€ 40,815 to €41,267) is reduced by 1.3 percentage points due to the earned income tax credit.).

- 49.4% (all the contributions applied to the previous tax bracket + middle income tax bracket) of income from DKK 304,130 to 365,000 (€40,815 to 48,984)

- 63.0%(all the contributions applied to the previous tax bracket + top income tax, with a maximum of 59 percent excluding church tax and labour market contribution) of income above DKK 365,000 (€48,984).

Cancellation of double taxation agreements with France and Spain

In 2008, parliament agreed to unilaterally cancel the existing double taxation agreements (DTA) between Denmark and France and Denmark and Spain. The reason for the cancellation was the fact that differences in the taxation of private pensions allowed Danish pensioners to virtually avoid paying tax on their pension savings by moving to either of these countries.

In **Denmark virtually all private pension contributions are exempt from income taxes**, save the labour market contribution of 8% (thus, pension contributions made before 1994 were tax free). Consequently, **private pension payments are taxed as income** (without labour market contribution), i.e. at a tax rate varying between 39.0% and 59.7% depending on income. The existing DTAs were based on income – including pensions – being taxed exclusively in the country of residence, thus allowing high income Danes, having paid virtually no taxes on their pension contributions, to move to either France or Spain in their retirement, and withdraw their pensions at a significantly lower tax rate.

Having failed to agree with either Spain or France on a revision of the DTA's, **Denmark decided to unilaterally cancel the DTA's with effect as of January first 2008**, giving the Danish state the possibility to tax pension payments to Danish pensioners in Spain and France. Danes already residents of either France or Spain were, however, allowed to continue under the existing rules.

The effect of the cancellation of the DTA's will not, however, be limited to (future) pensioners. The Confederation of Danish Industries (DI) has warned that the **change will also affect Danish companies doing business in Spain and France**.

Tax reform 2010

As mentioned in the 2007-report, the government decided after the general election of November 2007 to **set up a tax commission to prepare a tax reform**. The commission was set up in the spring of

2008 headed by a former tax minister from the main opposition party, the Social Democrats. The remaining nine members of the tax commission are economic and legal experts.

The terms of reference for the commission – as termed by the government – is to deliver one or more model(s) for how the tax system may be changed in order to :

- **Reduce the tax on income "substantially"**, including a reduction of the marginal tax,
- Induce persons and companies to **act in a more environmentally friendly and energy efficient manner.**

The terms of reference place a number of further restraints on the upcoming tax reform, which the tax commissions proposal(s) are to deliver the basis for:

- The redistributive consequences of the reform must be "socially balanced", but focus in this regard should not exclusively be on the static redistributive effects, but also include effects on the distribution of life-time earnings (dynamic redistributive effects), and take into account the interplay between tax and transfer payments as persons go from transfer income to employment.
- The reform shall be implementable within the limits of the government's economic 2015-plan (i.e. it must not alter the **long-term balance between public expenses and tax revenue**).
- The reform should **take into account the effects of globalization** as well as the "robustness" of the tax system.
- The reform may be financed by elements outside the

tax system, as long as these are in line with the overall purpose of the reform.

- The reform may be implemented over a number of years
- The government's **tax freeze is to be continued** unchanged after the reform. As part of the reform, a tax or duty may only be increased provided another tax or duty is reduced by the same amount. The tax on owner-occupied property is to continue unchanged.

As mentioned, the tax commission is to deliver its recommendations in the beginning of February 2009. The Prime Minister has stated that it is the (minority) government's ambition to muster a majority in parliament behind a "substantial and ambitious" tax reform to be implemented from 2010. This requires the legislative process to be completed by early June, 2009.

Taxation in France 2009

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Prof. Pierre Garello

General macroeconomic outlook

In 2008 France maintained its unfortunate position among the countries with the highest fiscal burden, high public deficit and fast growing debt. The ambitions of the government to reduce budget deficits and public debt have been recently abandoned. According to the generally pro-government National Institute for Statistics, public deficit which was targeted at 2.5% of GDP finally reached 3.4% of GDP and public debt reached a record high of 68% of GDP (it was 63.8% in 2007) (http://insee.fr/fr/indicateurs/indic_conj/donnees). This time, central—and not local—government is mainly to be blamed for the budget drifting which is a direct consequence of its Keynesian approach to the crisis.

This combination of high taxes and high public deficit should not come, however, as a surprise since France is **at present the OECD country with the highest ratio of public spending to GDP** (see Ernst & Young, 2008 Barometer of fiscal competitiveness). In other words, France is in a way the most "socialist country" among all developed economies. And things are unlikely to change: the fiscal plan for the next three years is to maintain the tax burden at its present level, which is 42.8% of GDP, while the original project was to reduce it to 40% by 2012. In the meantime, public deficit is expected to be around 6% of GDP in 2009, well above the once "non-negotiable" Maastricht criterion. The national debt is also creeping up and should reach 70% of GDP in 2009.

Direct taxation

Personal Income Tax

Revenue scale for marginal tax brackets has been raised by 2.9% to reflect the expected inflation rate. Apart from this, the tax structure remains the same, that is, with five brackets:

Personal Income (€)	Tax rate
< 5 852	0
From 5 852 to 11 673	5.5%
From 11 673 to 25 926	14%
From 25 926 to 69 505	30%
> 69 505	40%

Looking for a rapid way out of the crisis, an **income tax reduction was granted to taxpayers of the second bracket** (between €5,852 and 11,673): in 2009 they will have to pay only one third of their taxes based on 2008 incomes. This measure directly concerns 2.1

million households and indirectly 6 million (there will be a tax credit for incomes in the lowest bracket and tax exemptions for incomes in the third bracket). The tax reduction should average €200 per household and cost the State some €1,100 million.

Flat tax for micro-enterprises

A positive, albeit minor, change concerns the taxation of micro-enterprises. We are here talking about individual running their business in their own name with sales below €25,195. Those individuals will henceforth have the possibility to choose, instead of the progressive income tax**, a lump sum payment based on the sales of the previous year**. Depending on the type of activity, the rate will be 1.2 or 2.2% of previous year's sales with a tax allowance between 34 and 71%. Hence, through the backdoor we have **here a welcome flattening of income tax rates**.

Wealth tax

France is among the few countries in the world which **still levies a wealth tax**. Tax starts as soon as the household's wealth reaches 770,000 € (easily reached since it takes principal and secondary homes into account). The threshold has been increased by 2.9% for 2009 reflecting the inflation rate (some have suggested that an index of housing prices would be more relevant). This is **a progressive tax** with six different tax rates, going from 0.55% to 1.80%. More than 500 000 households in France pay this tax, which an explanation among others of the fiscal exodus observed in the past few years. According to the Ministry of Budget, 719 households potentially benefiting from the tax shield (see below) left the country in

2007, compared with 843 in 2006.

Tax shield

Although **under attack** from the right and the left—especially since the beginning of the crisis—the government (that is, the President) repeatedly asserted that **it will not get rid of the tax shield** which, according to article 1 of the fiscal code, limits all direct taxation that an individual has to pay to 50% of his/her annual income. The "good news", for those who were close but still below that limit, is that from this year on they can add in the account the RSA tax (see below) of 1.1% and another social contribution, the CSG at 5.8%.

Various income tax exemptions

There is still a strong tendency to use **taxation as an instrument to influence taxpayers' choices**. Among the most famous examples of tax incentives are the rebates for buying a **non-polluting car and for the purchase of a house or apartment to rent** out. The latter tax rebate is supposed to help solve the housing shortage prevailing in the country for over half a century, while the former aims at helping automobile industry while "doing some good" to the environment. These tax rebates can be quite substantial: For a building constructed or renovated in 2009 or 2010 the investor can deduct up to 25% of the value of the building from future tax payments (Loi Scellier). However, in order to benefit from this exemption, the owner has to set the rent within the limits imposed by the government.

Also, beneficiaries will have to worry about the decree of 18 November 2008 promulgated by the government in order to **reduce**

tax loopholes. Indeed, according to the government's own evaluation there are some 500 tax loopholes in French tax law and the benefits hence granted cumulate to approximately €73 billion. This is too much, believes the government, and consequently the **decree limits the total amount of tax credit granted to a taxpayer to 10% of taxable income to which can be added another €25,000**. Some tax credits are not taken into account in the calculation of the limit, as for instance, trade union membership dues. The decree has been approved by the Constitutional Council (*Conseil Constitutionnel*)—which had invalidated a similar proposal in 2005. Critics say that the gain in terms of tax revenues will be modest, around €200 million.

Financing the "*Revenue de Solidarité Active*" with a new tax on capital gains

A law dated from December 2008 establishes a **new scheme to provide a safety net** to unemployed and low-income-recently-hired individuals: the RSA (Revenue from Active Solidarity) is replacing the RMI and other mechanisms. The new mechanism guarantees that no disposable income will be lost when going back on the labour market. In order to finance it, however, the government will levy **a new tax on capital gains** (starting in 2009). Few returns on investments will be exempted from that new tax (among the privileged ones are "Livret A", and Investment for Sustainable development—former CODEVI). The new tax **rate is 1.1%** and shouls expected to be revised every year.

Taking into account a 12.1% social tax levied on almost all capital gains (Livret A and LEP exempted), and a 18% fiscal tax on most revenues from savings, **those revenues are now taxed around**

32.2%. Not good news for the elderly who derive an important share of their revenue from various retirement funds.

Corporate income tax

Corporate tax in France applies on profits realized during the fiscal year. There are no major changes in this tax and the rate for this year **remains fixed at 33.33%** for firms with a turnover equal or superior to 763,000 € Those with turnover under this amount are taxed at 15% on the first 38,120 € of profits and then switch to the 33.33% rate.

Abolition of the local tax on businesses (*taxe professionnelle*)

Created in 1975 to succeed to the "patente" (itself dating back to 1791), this tax has always been the target of criticism. It is based partly on the turnover of the firm (hence, penalizing its dynamics) and partly on the value of its equipment and land property. In 2008, both the Prime Minister, Mr. Fillon, and President Sarkozy heralded its suppression. The logic put forward is "**to fight delocalization**" by making France fiscally more attractive for companies. The problem, however, is that local government (*communes, départements and régions*) rely on this tax which accounts for approximately 16% of tax revenues. The government needs therefore to find another source of revenue (the cost is evaluated between 8 and 20 billion euro). Among the favored solution is a **carbon tax**.

Indirect taxation

Green taxes and subsidies

Another example of the instrumentalization of tax policy is green taxes/subventions. Today, the most concerned by these policies are **automobile manufacturers** (a road licence was suppressed in 2000). Green taxes on polluting cars are without any doubt politically correct. The "polluter pays" principle has even a constitutional legitimacy, since the adoption in 2005 of the *Constitutional Charter for the Environmen*t. But the economic impact of these taxes is dreadful. Indeed, **in 2008 the Parliament voted a new tax/subsidy plan concerning the purchase of new cars**. The plan, called "*bonus-malus*", is designed to guide the choice of consumers towards less polluting cars. The purchase of an "ecological" car is therefore rewarded with **a bonus varying from €200 to €1000**. If the car is considered polluting (emissions of over 160 CO2/km), the purchaser is **penalized with a tax ranging from €200 to € 2,600**. The "*bonus-malus*", considered by the officials as a huge success, engendered an extra €200 million deficit for the first semester of 2008.

The "green taxation" extends to other areas, such as domestic heating equipment, insulation, and so forth. Since 2005, tax exemptions have been granted for the installation of such facilities and, since 2007, it is possible to get a zero-rate loan for that purpose. According to the 2009 Fiscal law, those two advantages may now be cumulated. This is one of the amendments added by the government in order to "respond to the crisis". A special commission has been charged to explore the idea of generalization of these eco-taxes to all kinds of consumption goods.

Also, there is also another green tax, called *Taxe générale sur les activités* *polluantes* (**General tax on polluting activities**), which is paid by firms with polluting activities. The initial idea was to use the corresponding revenues to reduce the social security deficit, but today they serve to patch up the general state budget deficit.

Value added tax

The logic of exemptions and favoritism is maintained with the VAT. There are currently three rates of VAT in France – **the "normal" rate is 19.6%, the reduced rate is 5.5% and the "super reduced" rate is 2.1%**. The reduced level applies to such sectors as fast food, books, construction, etc. The super reduced rate is reserved to a very restrained range of goods such as specific drugs or cultural goods. For the departments outside of metropolitan France (Corsica and oversea departments) there exist also special reduced rates.

Early in 2009, "regular restaurants" (as opposed to fast food outlets) were granted a long awaited reduced rate of 5.5% (to which Brussels had long barred the way). Also, end 2008, Christine Lagarde, Minister of Economic Affairs, suggested the introduction of a new intermediate rate at 12%. Finally, some have suggested, following Germany's example, that a "social VAT" be introduced. The idea is to increase the VAT rate and use the proceeds to finance social security. It was also pointed out that such scheme would lower "production costs" for national producers and therefore increase their competitiveness. This project has been abandoned, at least for the moment. It would make more sense to reform the social security scheme.

Conclusion

At the end of the 2008 fiscal year all the warning lights were flashing. The fiscal balance was desperately negative. Economic growth has been almost nonexistent and a recession is expected for 2009 and probably 2010. State budget and social security budget are showing huge deficits. Public debt is increasing as is unemployment. The government has tended to put the blame on the economic crisis and has been quick to abandon the promised return to budget equilibrium and lower taxes. The saddest thing, however, is that public money has not been used wisely. When the world is ready for recovery, France will be buried under a mountain of debt, without any fast growing activities to rely on.