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Monitoring revenue trends and tax reforms in Member States 2008

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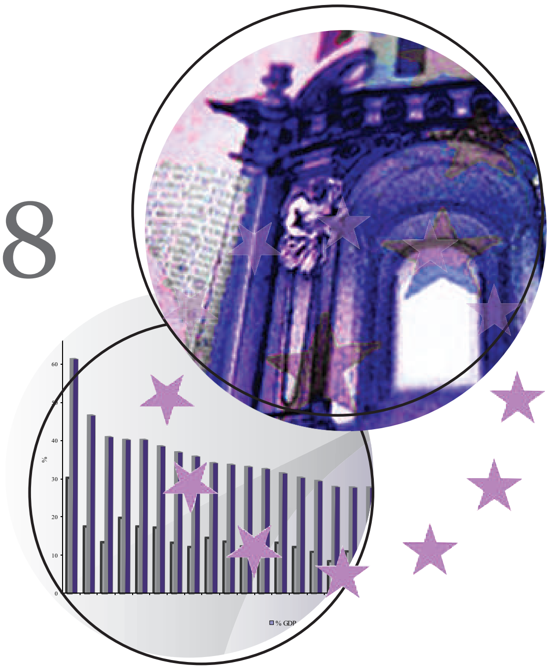

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Monitoring revenue trends and tax reforms in Member States

Joint EC-EPC 2008 Report

EUROPEAN ECONOMY 4/2009

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In line with the June 2007 ECOFIN Council conclusions which reaffirmed the need for Member States to exchange information on current and planned tax reforms and their impact on growth and employment within existing procedures, this is the first joint EPC-EC Annual Report on Revenue Trends and Reforms of Tax Systems. In accordance with its normal practice, the EPC mandated a working group, the Working Group on the Quality of Public Finance (QPFWG) under the chairmanship of Peter Part, to take forward the work needed to discharge this remit.

This report is presented by the EPC and the European Commission (Directorate General for Economic and Financial Affairs - DG ECFIN and Directorate General for Taxation and Customs Union - DG TAXUD) after full discussion on the basis of the QPFWG comprehensive work.

The report was prepared under the supervision of Gert Jan Koopman (Director of DG ECFIN-B), Philip Kermode (Director of DG TAXUD-E), Christian Kastrop (Chair of the EPC), Peter Part (Chairman of the QPFWG), Giuseppe Carone (Head of Unit-DG ECFIN), Jean-Pierre De Laet (Head of Unit-DG TAXUD). The main contributors were Sebastian Kessing (DG ECFIN) and Florian Wőhlbier DG TAXUD) with contributions from the members of the QPFWG (see list of Members below).

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ABBREVIATIONS

AETR	Average effective tax wedge
AW	Average wage
CO2	Carbon-dioxide
DG ECFIN	Directorate-General Economic and Financial Affairs
DG TAXUD	Directorate-General Taxation and Customs Union
EC	European Commission
ECOFIN	Economic and Financial Affairs (Council)
EMU	European Monetary Union
EPC	Economic Policy Committee
EU	European Union
GDP	Gross domestic product
ITR	Implicit tax rate
METR	Marginal effective tax rate
OECD	Organisation for Economic Cooperation and Development
PIT	Personal income tax
pp	percentage points
QPFWG	Quality of Public Finances Working Group
R&D	Research and Development
SSC	Social security contribution
VAT	Value added tax

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SUMMARY AND CONCLUSIONS

Following the mandate of the ECOFIN Council conclusions and the work program of the Working Group on the Quality of Public Finances (QPFWG), this is the draft of the first joint EPC-EC Annual Report on Revenue Trends and Reforms of Tax Systems. Revenue systems play a key role for the efficient allocation and the distribution of resources, and are a fundamental determinant of the sustainability of public finances. Making European revenue systems more conducive to employment, growth and equity while insuring stable revenues are important policy objectives underpinning long-term sustainability. Tax reforms that modify revenue systems in this direction are therefore an integral part of the Lisbon Strategy for Jobs and Growth and are key to assuring fiscal sustainability in the context of ageing populations.

The consequences of the financial crisis will be deeply reflected in Member States' government revenues. Tax revenues from profit and capital income are likely to be severely reduced, but also revenues from labour and consumption taxes will subsequently negatively affected, as employment follows the cyclical downturn, wage growth slows down and consumption weakens. Finally, active fiscal stabilisation policies on the revenue side will also directly and indirectly (via their effects on economic activity) affect government revenues.

Tax policies are important instruments Member States have at their disposal to counter the financial crisis and its impact on the real economy. Revenue systems play an important role as automatic stabilisers and are a key instrument for active counter-cyclical fiscal policy. Sound tax policies to revive the economy should combine cost-efficient fiscal stimulus with improvements of incentives to invest and to work.

In terms of overall tax burden, a trend that emerges from the data is a renewed pick-up of the overall tax burden over recent years. The increase in the tax-to-GDP ratio slowed down in the 1980s before growing again more strongly in the 1990s. The total tax-to-GDP ratio in the EU peaked at the turn of the century before starting to decrease. The latest data, however, show a reverse in this downward trend.

The analysis of the composition of tax revenue or ‘tax mix’ shows that the vast bulk of tax revenue raised in the EU, indeed more than 90 per cent, comes from three main sources: income taxes, taxes on goods and services, and social security contributions. With the caveat regarding the disentanglement of cyclical and structural components of the actual movements in mind, it appears fair to say that indirect taxes have slowly been gaining importance over recent years. At the same time, social security contributions have lost some importance, potentially reflecting the fact that governments have been trying to reduce the tax burden on labour. As regards direct taxes, there appears to be an upward movement as well, but this is more difficult to assess given the presence of pronounced cyclical effects. Tax revenues from environmental taxation have been falling slightly over recent years on average (in % of GDP), but their importance across Member States has been diverging since 2003.

Revenue systems in the EU seem to be slowly converging, much as a result of individual and country-specific actions of Member States. There is increasing awareness that all Member States could benefit from increased communication, co-operation and co-ordination. In the years to come, Member States should cooperatively work together to achieve mutually beneficial outcomes in line with the June 2007 ECOFIN Council conclusions which reaffirmed *the need for Member States to exchange information on current and planned tax reforms and their impact on growth and employment within existing procedures.* ([1])

Revenue systems can play an important part in the strong disincentives to take up work or to increase hours of work/effort levels in many Member States. In a number of Member States taxes and social security contributions contribute to substantial inactivity traps, unemployment traps, or low wage traps. These Member States need to consider how to design sound tax reforms to reduce these traps in view of their impact on employment. This may be partly achieved by shifting the tax burden to alternative tax bases, such as environmental or property taxes, or by a better balance of the tax burden across the tax schedule.

Member States need to continue their efforts to implement rate-cut cum base-broadening reforms taking into account their policy objectives and sustainability. However, they also need to be more aware of the limits of base broadening reforms. Taxation of firms, whether incorporated or not incorporated, needs to sufficiently allow for efficiency-enhancing provisions to avoid excessive distortions of firms' financing, operating and investment decisions.

Tax competition for mobile tax bases affects the design of revenue systems. Member States may be called to consider how such competition may be set in an appropriate framework to benefit from the healthy aspects of such competition, while limiting the downside risk of an accelerated race to the bottom which puts additional pressure on immobile tax bases with the associated efficiency losses.

([1]) (ECOFIN) Council conclusions of June 5, 2007 (Council document 10319/07).

1. INTRODUCTION

Based on the mandate of the ECOFIN Council, the work program of the Working Group on the Quality of Public Finances (EPC-QPFWG attached to the Economic Policy Committee (EPC)) has identified the efficiency of tax systems as a key issue for further work. The EPC-QPFWG has decided that this work should, among others, take the form of an annual report on revenue system developments and tax reforms in order to gauge better the development of the revenue side of government budgets and to improve the basis for informed policy choices and increased quality of public finances in Europe.

The joint EC-EPC Annual Report on Revenues (ARR) is prepared by the Commission (jointly by DG ECFIN and DG TAXUD) and the EPC-QPFWG. It builds on the substantial work carried out by the Commission services, such as assessments of the budgetary implications of tax reforms, analyses on the key role of revenue systems for the sustainability of public finances and the studies considering their effects on employment, growth and equity and their contribution to the achievement of environmental policy objectives. The report is for the most part descriptive. The intention is not to offer specific tax policy recommendations, but simply to spotlight the most recent trends and to present major tax reforms undertaken by a number of Member States. The report does not aim to provide a comprehensive overview of the structure of revenue systems in the EU. With the Annual Report on Taxation Trends prepared by DG TAXUD and Eurostat (cf. European Commission (2008a)) a comprehensive overview of the level and structure of taxation is already available on a yearly basis. ([2]) The ARR focuses more on specific aspects and developments that are considered to be particularly relevant for growth, employment and equity and that are key to the Lisbon Strategy for Jobs and Growth and the Strategy's implementation. In addition, it considers those aspects of revenue systems that are important for macroeconomic stability. These comprise the role of revenue systems to stabilise the economy in the face of adverse shocks, as well as the medium and long term sustainability of public finances. Being more selective in topics, the analysis allows to concentrate on the key developments of European revenue systems and to provide economic analysis of various tax policy options that have been enacted or are being considered in the Member States.

The report pursues several objectives. First, it identifies the way European revenue systems are evolving and the related fiscal, economic, and social challenges policy makers are facing in their pursuit of improved revenue systems. It describes the tax reforms that have recently been carried out, and what kind of tax reforms are being considered in the policy debate. It discusses in depth the drivers behind the key developments and balances the pros and cons of particular tax policy alternatives.

Second, the report aims at enhancing the communication and exchange best practice among Member States on tax reforms and encourages an intensified debate on the role of improved revenue systems for growth, employment, and equity. The identification of the challenges faced and the stocktaking of the main tax policy changes in the EU enables an improved exchange of information between Member States, as well as an exchange of views regarding the challenges and the pros and cons of different policy responses. This will facilitate the diffusion of better tax policies across the EU as Member States may learn from each others' policy experience. Better communication can reveal the existence of common challenges and may suggest ways in which Member States may coordinate their actions to achieve better outcomes for all. An intensified discussion of tax reforms will also raise the awareness of potential spill-over effects of particular tax policies, and Member States may draw lessons from the discussion on how to avoid potential negative effects on other Member States.

The Report may additionally play a role to support the reduction of differences among revenue systems in the EU where this is appropriate. Making tax and social security regulations increasingly compatible across Member States reduces compliance costs for firms and citizens and thereby encourages cross border activities by firms and worker mobility within the EU.

([2]) Box 4.1 in section 4 provides an overview of significant recent tax reforms that have been carried out in Member States. It does not, however, presents an exhaustive list of all tax changes in all Member States.

Increased coordination of revenue system design and convergence towards more compatible tax policies reduce tax-induced distortions of the internal market and thus contribute to increased efficiency of European factor and product markets. This underlines the common European interest to advance the important process of mutually beneficial co-operation among Member States regarding reforms of their revenue systems.

The Report is structured as follows. Section 2 provides a discussion of the importance of revenue systems from an economic and fiscal policy perspective. Section 3 describes the level and structure of taxation in the EU. Section 4 discusses the common trends in the development of European revenue system, lists the major recent tax reforms carried out by Member States and considers the role of revenue side policies to address the challenges posed by the financial and economic crisis. Finally, Section 5 considers several selected tax policy topics in more detail with an appraisal of various policies and remaining challenges.

2. THE IMPORTANCE OF REVENUE SYSTEMS

The level of government revenues is largely determined by government expenditures. However, revenue systems are much more than the pure budgetary counterpart of government spending since they have important implications in terms of the allocation of economic resources. They impact on key economic decisions, such as physical and human capital investments, labour supply (whether individual or collective) and labour demand, the decisions to engage in entrepreneurial activity and to start up a business, innovation decisions, and many others. Taxes also redistribute economic resources between economic agents. These effects at the micro level translate into the aggregate, so that the design of revenue systems substantially impacts on the macroeconomic outcomes in terms of employment, growth and equity. Therefore, the proper design of revenue systems represents a key determinant of a strong employment and growth performance while insuring fairness and social equity.

From a policy perspective, improving the structure of revenue systems has a key role to play for the successful implementation of the Lisbon Strategy for Jobs and Growth, in particular in the context of activating employment policies and in the promotion of investment and innovation. This high policy relevance is reflected by the fact that the recent Annual Progress Report on the Integrated Guidelines endorsed by the Spring 2008 European Council makes specific recommendations addressed to Member States forming part of the euro area to "improve the quality of public finances by reviewing public expenditures and taxation, with the intention to enhance productivity and innovation, thereby contributing to economic growth and fiscal sustainability".

The EMU@10 Communication and report by the Commission (cf. European Commission (2008b)) also stress deeper fiscal policy coordination and the better integration of structural reform in overall policy-coordination within EMU, including the reform of revenue systems. This is due to the importance of revenue systems for structural improvements of the euro area economy's performance but also to the role tax policies can play to address the impact of idiosyncratic shocks faced by individual countries within the monetary union, as well as the likelihood of tax reforms to generate spill-over effects to other euro area countries.

The importance of sound revenue systems is also reflected in the increased efforts to include tax reforms more closely in the monitoring of the implementation of the Lisbon Strategy for Jobs and Growth. The Commission is stepping up these efforts. In particular, it considers establishing a new database (TAXREF) on tax reforms in the Member States. ([3]) This database would complement the databases on labour market (LABREF) and product market reforms (MICREF) that contain comprehensive overview of Member States' reform efforts in key areas of the Lisbon Strategy. The TAXREF database would similarly allow Member States and the Commission to track better revenue systems changes to assess the progress in making European revenue systems more supportive of employment and growth.

Given the high policy relevance of revenues systems, policy makers need sound advice regarding the direction of reform. To define this direction, it is important to consider the various shortcomings of current systems and assess the available alternatives using an appropriate set of criteria for sound revenue systems. While there is no consensus in the literature, some observers have singled out the high levels of taxation as a key reason for low employment levels and unsatisfactory economic performance in the EU. High and progressive taxes can discourage labour supply and demand, and reduce investment incentives. Accordingly, these analysts recommend a substantial reduction in tax levels to revitalise European economies. However, some EU Member States have been able to combine elevated levels of taxation with a strong economic performance and low unemployment. This indicates that the determination of the optimal aggregate level of taxation is not straightforward and may be of secondary importance. Rather, this highlights the relevance of the optimal structure and design of the

([3]) The TAXREF database would be managed by European Commission (DG TAXUD) and would build on existing databases and the information provided by Member States in the context of the Working Group "Structures of the Taxation Systems". No additional reporting outside the reporting mechanism of the Working Group "Structures of the Taxation Systems" will be introduced.

tax system for a given level of revenues, along with the structure and cost-efficiency of public spending. As consequence, much could potentially be gained from tax reforms that improve the structure of the tax system. Such reforms need to address issues related to the optimal tax composition, but also the details of the tax schedule (in particular regarding tax progressivity) and the interaction of taxes with the benefit system. Moreover, since the expenditure side is unaffected by revenue-neutral tax reforms, such reforms may be easier to implement politically, compared to measures that aim to reduce the overall level of expenditures and taxation. The analytical framework required to assess the improvements toward an optimal tax structure ultimately also requires taking into account the policy trade-offs between efficiency, and long-term growth, respectively, and the equity objectives. This normative judgement is political in nature and is up to the national democratic process to resolve.

An optimal revenue system should fulfil several conditions. First, it should be efficient. An efficient tax-benefit system insures growth, moves the economy towards a desired distribution of income, and raises the necessary public funds for spending on publicly provided goods with minimal distortions. ([4]) This includes the avoidance of excessive negative incentive effects for employment, investment, and innovation, as well as proper internalisation of social costs and benefits of research and development, human capital formation, polluting activities, and other activities that generate positive or negative externalities. It also encompasses dynamic efficiency, i.e., the system should not negatively impinge on investment, innovation and growth. Second, an optimal tax system should be fair as it aims at moving the economy towards a desired distribution of income or other desired equity goals. Third, an optimal tax system should be simple and transparent. Fourth, it should minimise incentives and opportunities for tax avoidance, evasion and fraud. Finally, it should have low administrative demands and low compliance costs.

These important dimensions of revenue systems have also been stressed by the (ECOFIN) Council conclusions in the June 2007 stating that "The Council therefore stresses the need for revenue systems that can enhance growth and employment and deliver as stable as possible revenues. It encourages Member States in their national responsibilities to move further towards robust, fair, efficient and growth-enhancing revenue systems." Such criteria for sound revenues systems make it possible to consider the current state of revenue systems in the EU and to assess whether ongoing tax reforms are moving European tax systems closer towards such optimal revenue systems and what kind of reforms may be appropriate to better achieve these objectives.

([4]) This is in fact the key question in the literature on optimal taxation: How can the government maximise the welfare of its citizens subject to the requirement of raising a given amount of tax revenue to provide public goods and services or to redistribute income subject to technical and informational constraints?

3. THE LEVEL AND STRUCTURE OF TAXATION IN THE EU

Based on the most recent available yearly indicators (2006 or 2007), this section provides an overview of the structure of revenue systems in the EU and their evolution. ([5]) For a more comprehensive and detailed description the reader is referred to the Commission's annual report on the "Taxation trends in the European Union (see European Commission 2008a). The present overview sets the scene for a more detailed discussion of some key developments in sections 4 and 5.

3.1. TOTAL TAXES

Tax burdens – measured by total taxes (including social security contributions) as a percentage of GDP ([6]) – are high in the European Union, in comparison to other developed countries. ([7]) These high tax levels were gradually built up since 1970, cf. Graph 3.1. The growth of the total tax burden was strong in the 1970s, but slowed down in the 1980s, before growing again more strongly in the 1990s. The total tax-to-GDP ratio in the EU peaked at the turn of the century before starting to decrease. The latest data, however, show a renewed pick-up of the overall tax burden. ([8])

Taxation levels mainly follow the financing needs stemming from government expenditure decisions. The many years of increasing tax burdens in most Member States mainly reflect increases in public expenditures. The 1970s were a period of rapid growth of public expenditures, and this shows up in the strong increases in tax levels. The 1980s saw lower expenditure grows, with expenditures picking up again in the early 1990s. More recently, overall levels of expenditure have started to be reduced in an effort to consolidate public finances. For the years to come one can expect that due to

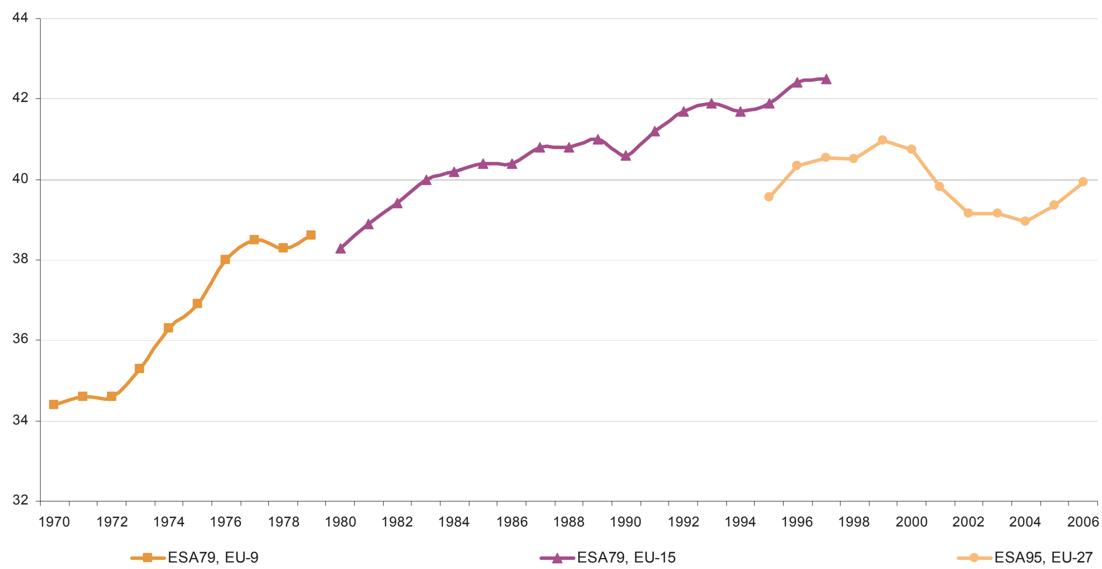
([5]) This section partly draws on Carone et al. (2007) and European Commission (2008c), but updates and complements the data and analysis where appropriate.

([6]) Despite its simplicity – or rather because of it – the total tax-to-GDP ratio remains a rough indicator that carries interesting summary information but also suffers from deficiencies. The indicator cannot be seen in isolation of the level of public expenditures and of the use of other alternative means of government intervention such as regulation. Moreover, total tax revenues convey little information on the impact – in terms of distortions and in terms of redistribution – of tax systems.

([7]) According to OECD data (based on a slightly different methodology than the Commission data used in the present analysis), the group of 19 EU OECD members had a total tax-to-GDP ratio of 38.7% compared to the OECD average (including the EU countries of 35.9% in 2006.

([8]) Short-term changes in the ratio of taxes to GDP need to be interpreted with care, as direct taxes, in particular, are pro-cyclical.

Graph 3.1: **Evolution of total taxes (incl. SSCs) in Europe, 1970-2006**

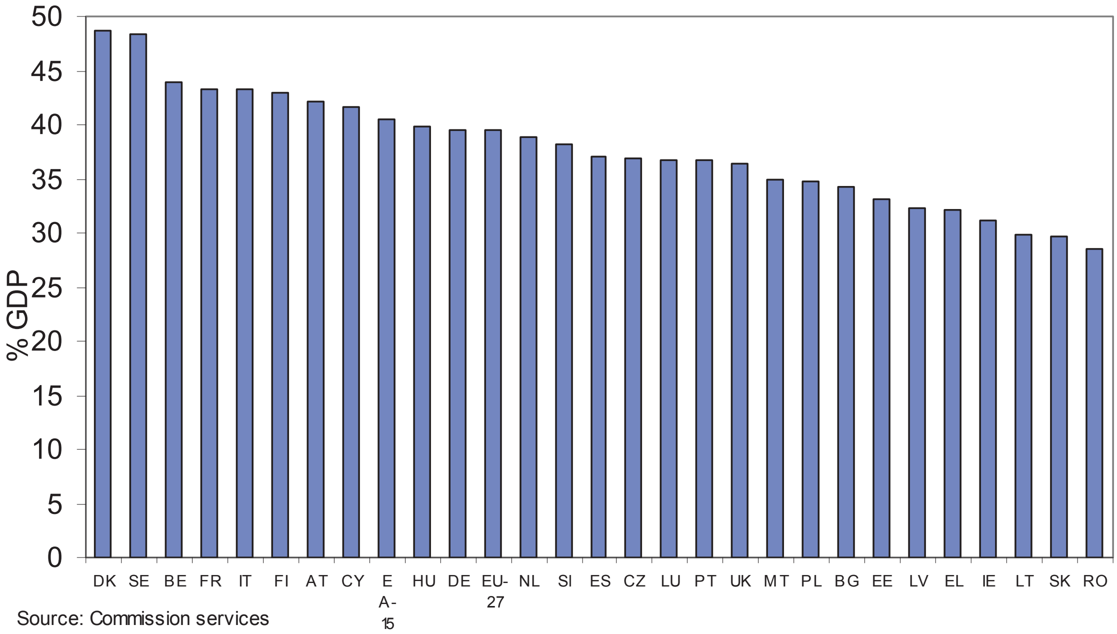


Source: Commission services

various factors, such as ageing populations, high demand elasticity of public services, relatively low productivity growth in the public sector ([9]), changing life and work patterns, etc., spending pressures and, as a consequence, tax burdens are likely to remain high. This outlook indicates that, on the on hand, Member States need to increase the efficiency of their spending. On the other hand, Member States increasingly need to look to the revenue side for efficiency-enhancing reforms that can boost employment and growth, and promote the desired fairness and equity.

([9]) Given that the public sector provides goods and services (education, health care, long-term care, etc.) that are more labour intensive than goods and services provided by the private sector, productivity tends to grow slower in the public sector. This observation is referred to as "Baumol's Law".

Graph 3.2: **Total taxes (incl. SSCs), % GDP, 2007**



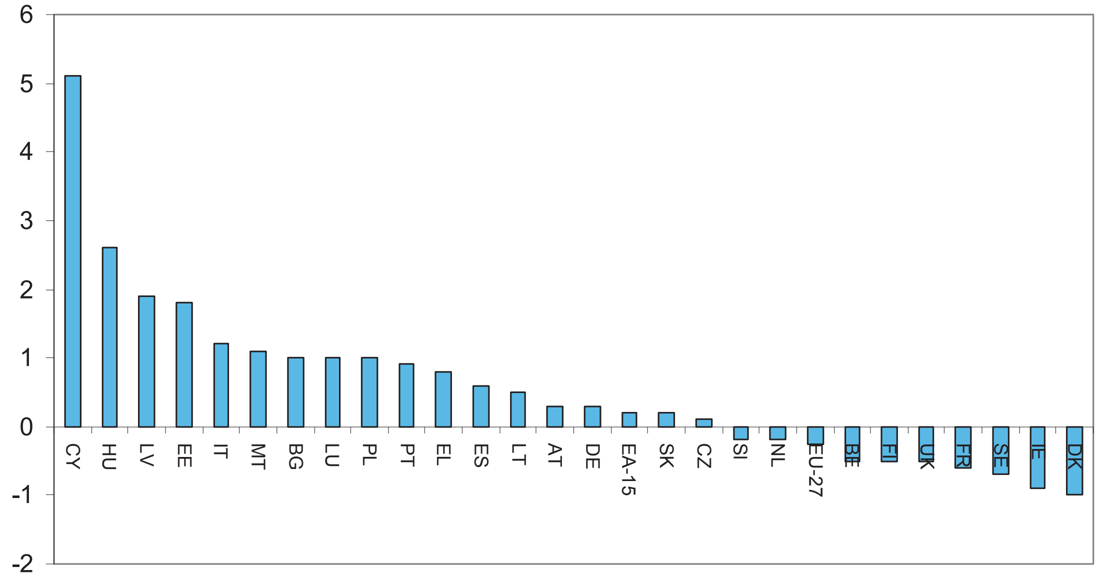
Source: Commission services

Note: RO refers to 2006.

While the EU as a whole may be considered a high tax economy there is wide variation in the tax levels across Member States, cf. Graph 3.2 and Graph 3.3 . The cross country differences are not only interesting from a static perspective but also provide case studies on the dynamic experiences that may have differed substantially from the average development in the EU. Several cases stand out. First, some countries have been particularly successful to stabilise their total tax-to-GDP ratio either from the 1970s – this is the case of Ireland – at a level around 35%, or from the 1980s – such as Germany (at about 40%), Belgium, Luxembourg and the Netherlands (all at about 45%). ([10]) Second, the level of taxes in the economy dramatically increased – by some 10 percentage points (pp) – in Finland, Greece, Italy, Portugal and Spain in the 1980s and 1990s, although starting from comparatively low levels. The same 'catch-up' effect occurred in Cyprus and Malta over the last decade. Third, some of the recently acceded Member States experienced in the period 1995-2006 important decreases in their total tax burdens. This is the case of the Slovak Republic (10.9 pp), Estonia (6.7 pp), Hungary (4.4 pp), Poland (3.3 pp) and Latvia (3 pp). Finally, about half of the Member States experienced a decrease in their tax-to-GDP ratio between 2000 and 2006. This decrease was especially marked in Germany, Greece, Finland, Slovakia, and Sweden. The GDP-weighted average for the EU-27 was at 39.5% in 2007, ranging from 28.6% in Romania (in 2006) and 29.6% in Slovakia (in 2007) to 48.7% in Denmark (in 2007).

([10]) Data for the 1970-1995 period are based on ESA79 data. Those for the 1995-2006 period are based on ESA95.

Graph 3.3: **Change in total taxes (% GDP) in percentage points, 2006-2007**



Source: Commission services

Given these important differences across countries, it is interesting to consider how the dispersion of the tax burden in EU Member States has been evolving over recent years. Graph 3.4 displays the evolution of the coefficient of variation ([11]) of total taxes in the EU 27 countries since 1995. ([12]) The dispersion of tax burdens is diminishing, and this trend appears to be more pronounced over recent years. This indicates some convergence across Member States, although differences remain substantial.

3.2. TAX COMPOSITION: DIRECT TAXES, INDIRECT TAXES AND SOCIAL SECURITY CONTRIBUTIONS

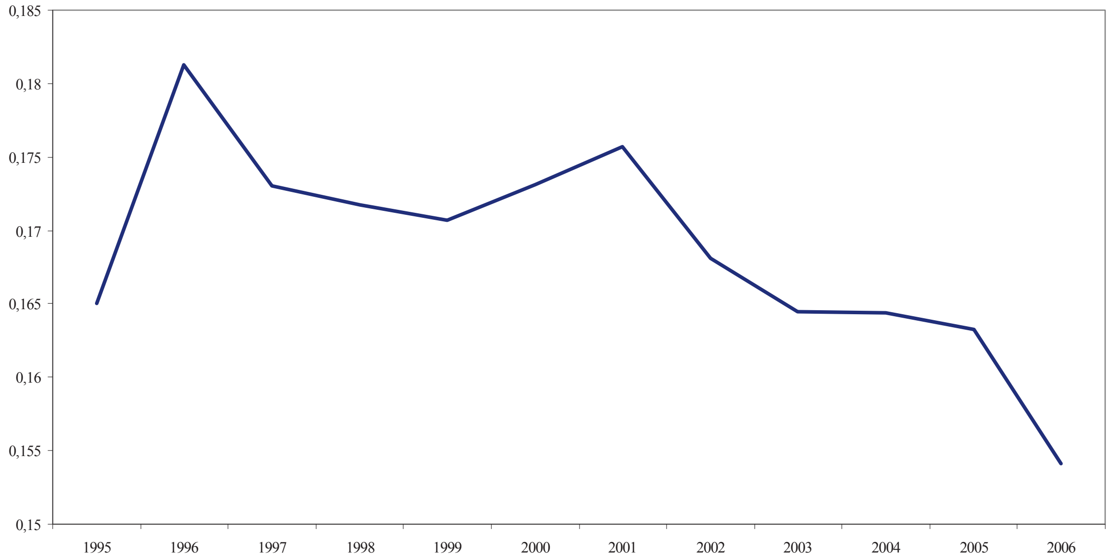
Aggregate tax revenues are the most general way to describe revenue systems. Moreover, as discussed, they are closely related to government expenditures, and in particular to the extent of redistribution and social spending. The preferences for such spending, and similarly for other publicly provided goods and services may differ substantially across Member States. Revenue systems can be described in more detail. The first step in this direction is to consider tax composition. The composition can be considered in terms of the type of tax levied, such as direct taxes, indirect taxes and social security contributions (SSCs). The composition can also be looked at according to a classification of the taxes according to economic function, such as taxes on capital, taxes on labour and consumption taxes, as well as environmental taxes. ([13])

([11]) The coefficient of variation is a normalised dispersion measure. It is computed as the standard deviation divided by the mean. Calculation was carried out using arithmetic mean of EU 27.

([12]) Please note that data for Bulgaria and Romania are available only from 2000 onwards for the former and 2001 for the latter.

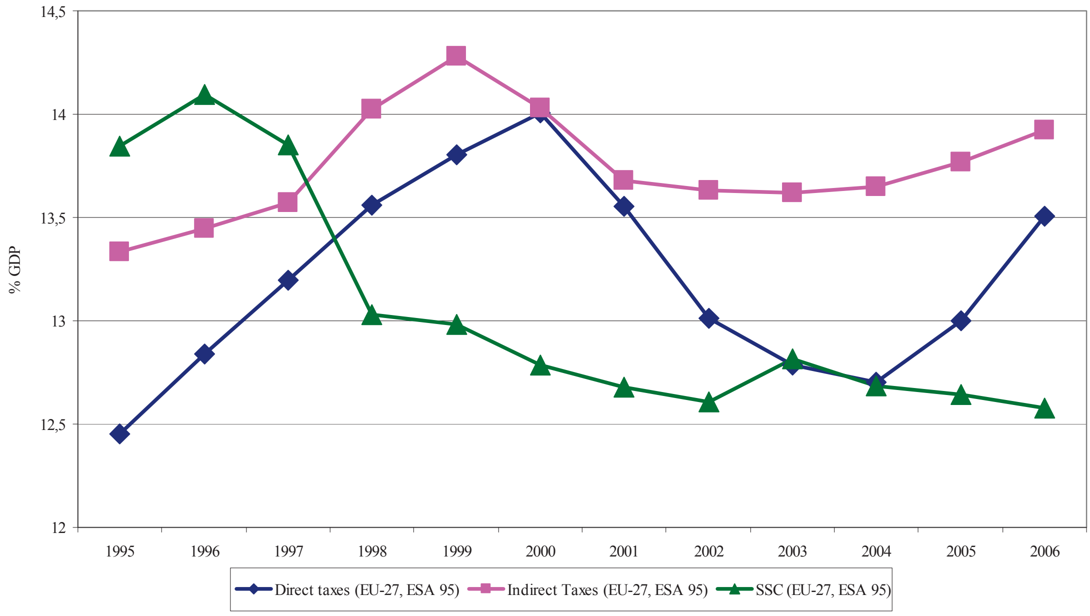
([13]) There are, of course, potentially other ways to decompose tax revenues. The current decomposition follows the one applied in European Commission (2008a). All data on tax revenues are from European Commission (2008a). The 'Annex C: Methodology and explanatory notes' of that publication gives extensive details on the underlying methodology. The data may also be found in electronic format from the Eurostat web page and via the following link to the DG Taxation and Customs Union homepage: http://ec.europa.eu/taxtrends.

Graph 3.4: **Dispersion (coefficient of variation) of total taxes % GDP, EU-27**



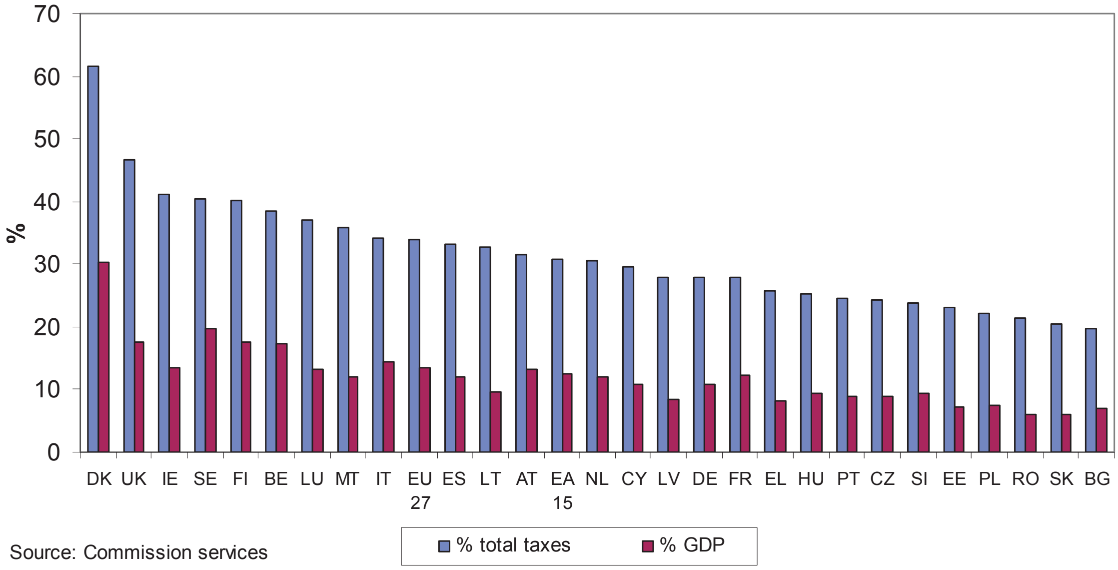
Source: Commission services

Graph 3.5: **Direct taxes, indirect taxes and SSCs, EU-27**



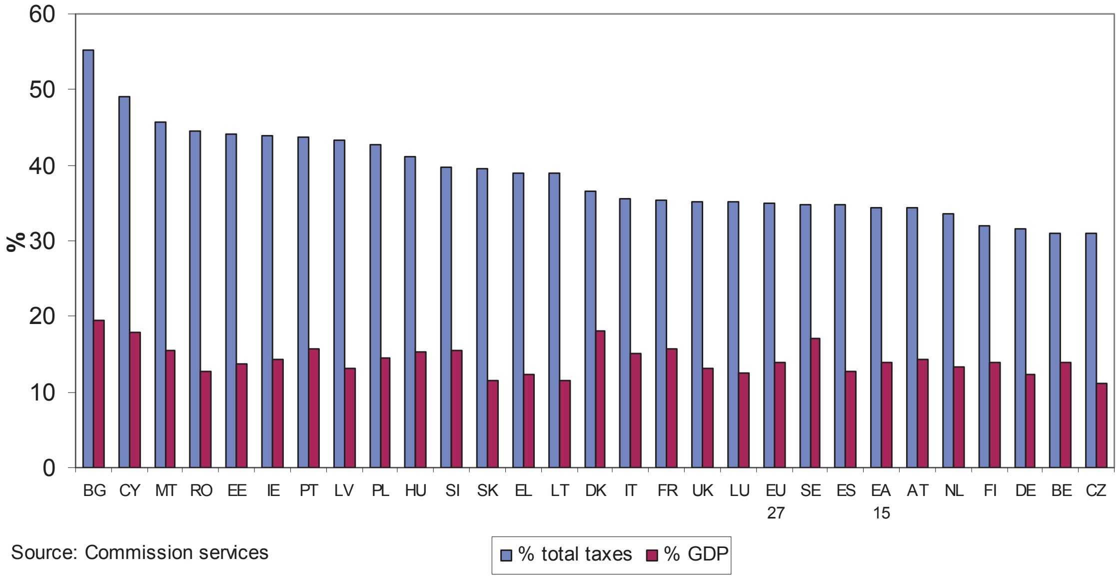
Source: Commission services

Graph 3.6: **Tax revenues from direct taxes, 2006**



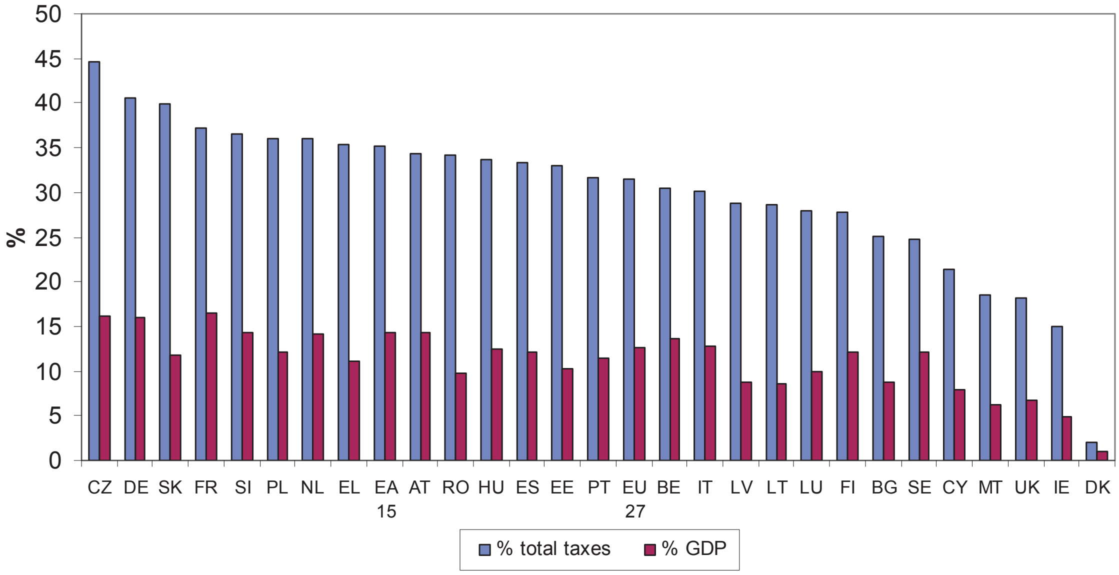
Source: Commission services

Graph 3.7: **Tax revenues from indirect taxes, 2006**



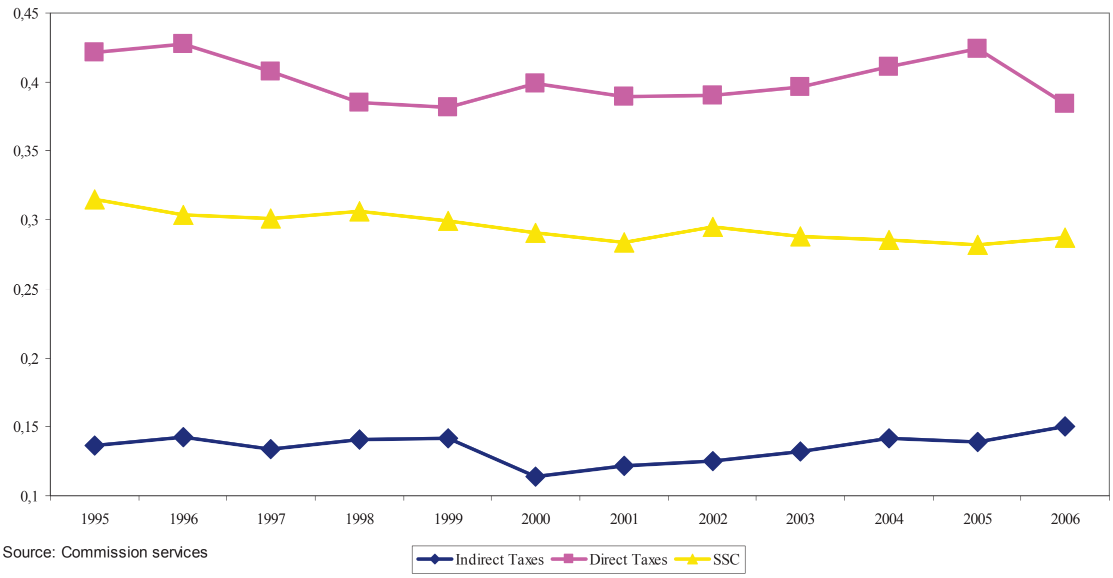
Source: Commission services

Graph 3.8: **Tax revenues from SSCs, 2006**



Source: Commission services

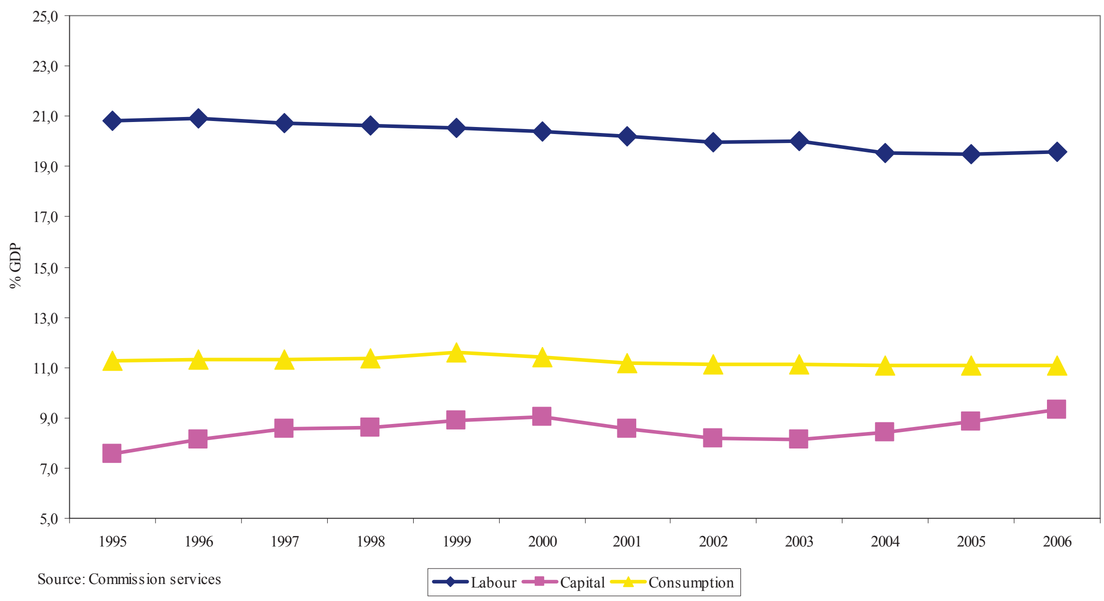
Graph 3.9: **Tax dispersion (coefficient of variation) of direct taxes, indirect taxes and SSCs, EU-27**



Source: Commission services

The analysis of the composition of tax revenue or 'tax mix' shows that the vast bulk of tax revenue raised in the EU, indeed more than 90 per cent, comes from three main sources: income taxes, taxes on goods and services, and social security contributions (SSCs). Graph 3.5 displays the evolution of tax revenues from direct taxes, indirect taxes and SSCs from 1995-2006 in the EU. When considering the evolution of tax revenues from these three broad categories, it is important to recall that tax revenues from different sources are differently affected by the business

Graph 3.10: **Tax revenues by economic functions, EU-27**



Source: Commission services

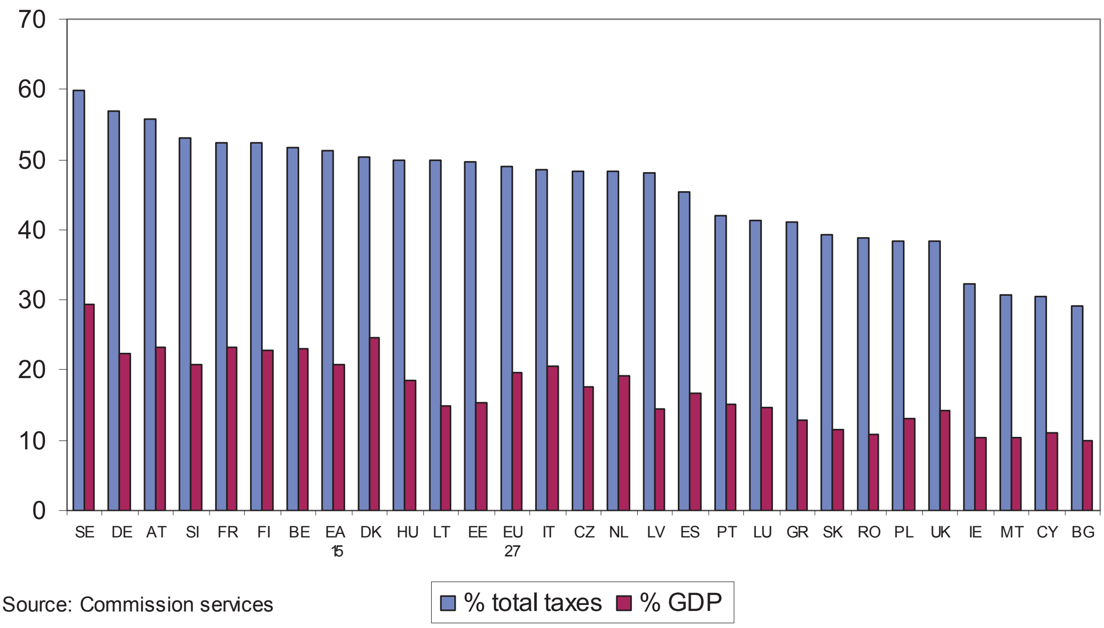
cycle. This complicates the interpretation of changes in the importance of these tax components because structural and cyclical components should be taken into account. Direct taxes are moving most pro-cyclically because of the sensitivity of corporate taxes to the business cycle and because of the progressive nature of personal income tax (PIT) schemes. SSCs, which are closely related to the aggregate wage bill, tend to move somewhat counter-cyclically, mainly due to the counter-cyclical movement of the labour share. Finally, indirect taxes should be theoretically relatively stable, but appear to move slightly pro-cyclical in practice.

With the caveat regarding the disentanglement of cyclical and structural components of the actual movements in mind, it appears fair to say that indirect taxes have slowly been gaining importance over recent years. At the same time, SSCs have lost some importance, potentially reflecting the fact that governments have been trying to reduce the tax burden on labour. As regards direct taxes, there appears to be an upward movement as well, but this is more difficult to assess given the presence of pronounced cyclical effects. The statistical annex provides a more detailed overview of the developments of direct and indirect taxes and SSCs since 1995, including a finer disaggregation of these tax categories.

There is substantial variance across Member States in the importance of direct taxes, indirect taxes and SSCs as is shown by Graph 3.6, Graph 3.7 and Graph 3.8. Direct taxes take on less than 20% of total taxes collected in Bulgaria but reach over 61% in Denmark. The share of indirect taxes in total taxation varies from about 30% in Belgium, in the Czech Republic and in Germany to over 55% in Bulgaria. Finally, SSCs represent only about 2.1% of the total taxation in Denmark, and also play only a rather small role in Ireland, the UK, and Malta, but make for over 40% of the total taxes in Germany, in Slovakia and in the Czech Republic. More recent 2007 data using the OECD classification are provided in Table A1.2 in the statistical appendix (Section Statistical annex). These data also indicate that the tax composition as displayed in Graph 3.5 has remained relatively stable from 2006 to 2007.

The dispersion among Member States of tax revenues from direct and indirect taxes in the EU has remained somewhat stable over recent years, cf. Graph 3.9. The dispersion of direct taxes appears to be somewhat pro-cyclical. The dispersion of SSCs appears to display a slight downward trend, although this decline has been levelling off in recent years. This reduced dispersion of SSCs revenues potentially reflects a certain convergence in the financing of social

Graph 3.11: **Tax revenues from taxes on labour, 2006**



Source: Commission services

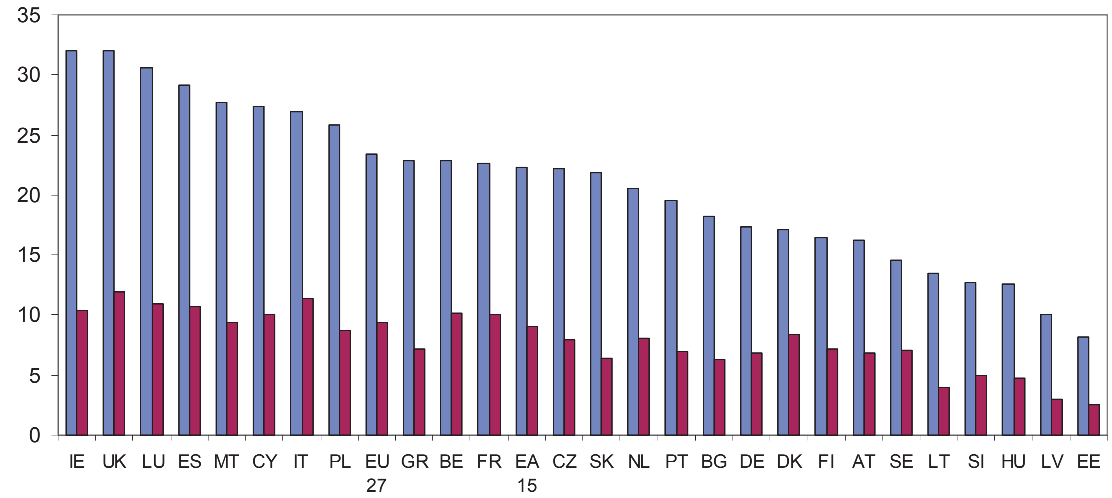
protection across the EU. Some Member States that traditionally have been relying mostly on SSCs to finance social spending have introduced several elements of tax financing and reduced SSCs. Indirect taxes are the least dispersed in Europe due to the high level of harmonisation. While the late 1990s saw some further convergence, since 2000, revenues from indirect taxes have been slowly diverging again.

3.3. TAX COMPOSITION BY ECONOMIC FUNCTION

The tax structure can also be decomposed in relation to the economic function, such as consumption, or factors of production, i.e. capital and labour. The imputation of certain tax revenues to economic functions is based on the imputation of certain revenues to the tax bases they are originating from. From an economic perspective it must be underlined that the actual incidence of a given tax may be very different from the base a tax is legally attached to. Graph 3.10 provides an overview of the development of tax revenues from taxes on labour, capital and consumption over recent years.

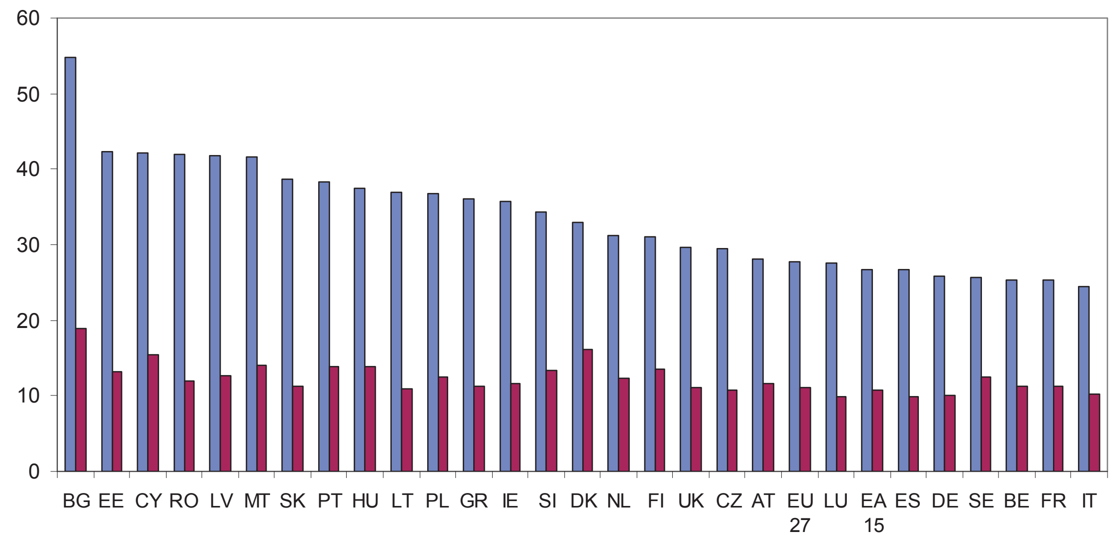
Tax revenues from consumption have remained fairly stable across EU Member States in the 1995-2006 period. In response to the need to put in place more employment-friendly tax systems one noticeable trend has been the decrease in labour taxation in a number of countries over the last decade. This is reflected in the slight downward trend of taxes on labour. However, measures have tended to be either narrowly targeted or of limited scope so that only a small reduction is visible at the aggregate level. Section 5.1 of this report looks in more detail at how tax reforms have reduced disincentives to work. Tax revenue from taxes on capital is substantially cyclical but shows a slightly upward trend since 1995. This is considered in more detail in section 5.3.

Graph 3.12: **Tax revenues from taxes on capital, 2006**



Source: Commission services

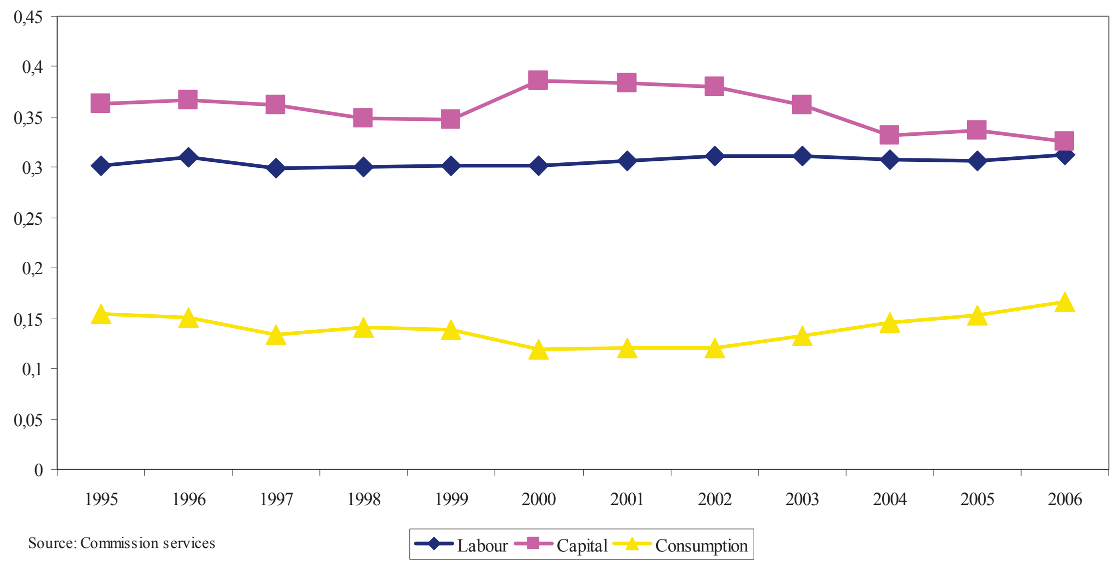
Graph 3.13: **Tax revenues from taxes on consumption, 2006**



Source: Commission services

There is large variation across Member States with regard to the relative importance of taxes on labour, capital and on consumption, cf. Graph 3.11, Graph 3.12, and Graph 3.13. Taxes on labour vary from slightly above 10% of GDP in Romania, Bulgaria, Ireland and Malta to over 29% in Sweden in 2006. Overall EU Member States still largely rely on taxes on labour but they differ as to whether those taxes are payable by employees or employers. On average, in 2006 about 43% of taxes on employed workers are paid by employers but the share varies from 2.5% in Denmark to around 60% in a range of countries. Tax revenues from taxes on capital also vary largely among

Graph 3.14: **Dispersion (coefficient of variation) of tax revenues, % GDP, by economic function, EU-27**



Source: Commission services

Member States, ranging from below 3% of GDP in Lithuania to over 11% in the UK and Italy in 2006. ([14])

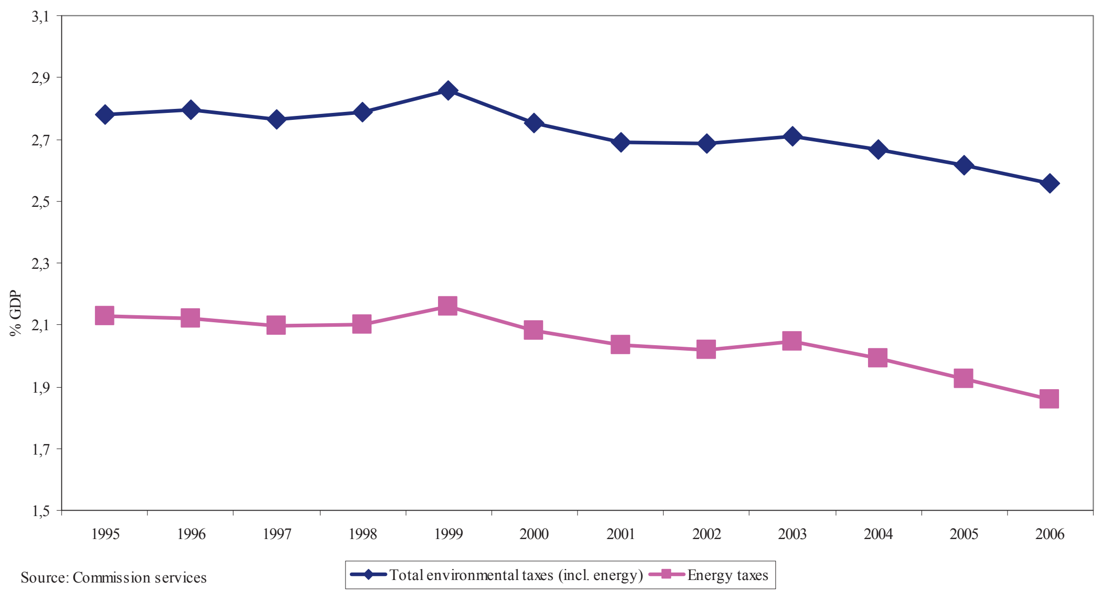
Taxes on consumption carry a relatively similar weight across Member States, while there is much more variation across Member States in the taxation of labour and capital. This is due to the higher degree of tax harmonisation in important consumption taxes such as the VAT and motor fuel excises in Europe, and this is reflected in the lower dispersion of consumption taxes relative to taxes on labour and capital, cf. Graph 3.14. The dispersion of taxes on labour appears to have remained rather constant over recent years. The tax revenues from capital, however, show a tendency towards a reduced dispersion reflecting some convergence mainly in corporate tax revenues, cf. also section 5.3 and Graph 3.17, where a rather strong convergence of tax revenues can be observed over recent years. As regards consumption taxes, further convergence appears to have occurred in the late 1990s, partly due to the enlargement of the European Union and the preparation of the new Member States for accession. However, since 2003 the dispersion of consumption tax revenues has been increasing again. This could reflect the divergence process that can be observed in the field of environmental, and in particular energy taxation at about the same time, cf. section 3.4 and Graph 3.17.

3.4. ENVIRONMENTAL TAXATION

Environmental taxation is frequently regarded as an important pillar of government finances and often meant to play an increasing role for financing government in the future. Advocates of a stronger reliance on this sort of taxation point to the potential of welfare enhancing nature of such taxes. In particular, such taxation could serve as a welcome instrument to internalise social costs of polluting activities. At the same time the tax revenues could be used to reduce the tax burden on labour with the associated beneficial effects on employment. This potential double beneficial effect of environmental taxes is usually referred to as the "double dividend" hypothesis.

([14]) European Commission (2008a) also includes so-called implicit tax rates which measure the effective average tax burden on different types of economic income or activity, i.e. on labour, consumption and capital, as the ratio between the revenue from the tax type under consideration and its (maximum) possible base. These ratios are also a good measure to compare the tax burden in Member States and to analyse the development over time.

Graph 3.15: **Environmental and energy tax revenues, % GDP, EU-27**



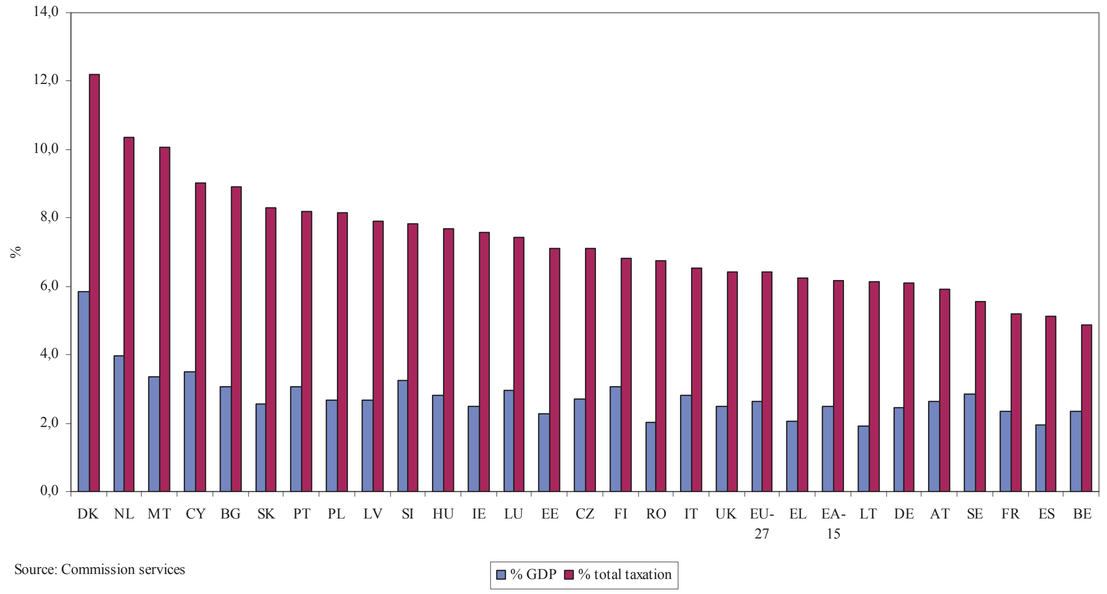
Source: Commission services

In practice, however, the importance of environmental taxation has been decreasing in the EU on average. This trend is largely driven by the declining role of energy taxes which represent the most important environmental taxes (cf. Graph 3.15), accounting for some three quarters of environmental taxes at the European Union average. ([15]) This downward trend may be due to a number of reasons. First, for a given level of taxes, an income elasticity of energy demand below unity will result in lower tax revenues (as a percentage of GDP) from energy taxes as the economy grows. Second, energy taxes are usually applied on a pro rata basis, i.e., per litre, or per cubic metre, etc. As energy consumption reacts negatively to increases in energy prices, revenues from energy taxes are being reduced, without any changes in tax policies. Thus, reduced revenues from energy taxes may partly reflect the surge in energy prices over recent years. Accordingly, if the current reduction in energy prices continues, tax revenues from energy taxes are likely to recover. Moreover, pro rata taxes are automatically reduced by inflation in real terms, so frequent adjustments are necessary to maintain the same level of revenues in real terms. Adjustments that fall short of inflation accordingly result in reduced revenues. Finally, policy instruments other than taxes, such as emission trading, have gained importance in recent years.

While the data show that environmental taxes have seen their importance reduced on average in Europe over recent years, there are substantial differences across Member States. This variance may be explained by differences in income levels, as the demand for environmental quality is typically highly income-elastic. Member States also differ in their need to levy environmental taxes as congestion charges, which is a more important policy objective in more densely populated Member States. This can also be seen from Graph 3.16 which shows the importance of environmental taxes in all Member States in 2006.

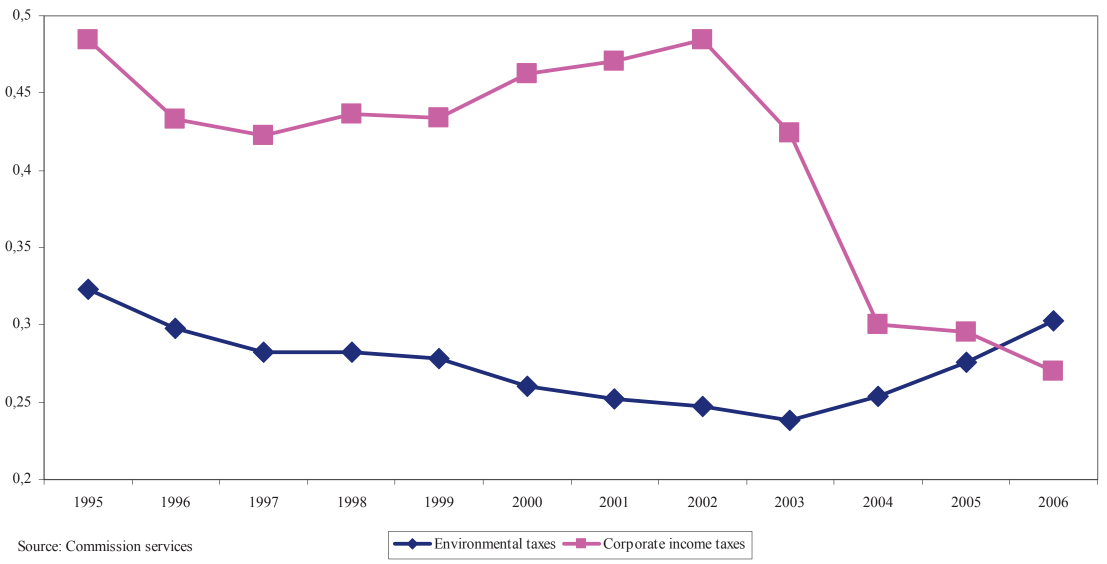
([15]) The other two categories of environmental taxation are taxes on transport and taxes on pollution and resources. Tax revenues from these two categories have remained stable in the EU-27 at 0.6% of GDP and 0.1% of GDP, respectively, over the period from 1995 to 2006. For further details and information on the taxes comprised by these categories, see European Commission (2008a).

Graph 3.16: **Tax revenues from environmental taxation, 2006**



Source: Commission services

Graph 3.17: **Dispersion (coefficient of variation) of corporate and environmental tax revenues, % GDP, EU-27**



Source: Commission services

Accordingly, tax revenues from environmental taxation show large dispersion across Member States cf. Graph 3.17. However, there has been substantial convergence until 2003 in the importance revenues from environmental taxes as a percentage of GDP. This convergence may reflect the relative harmonisation introduced by the European minima but also the limits to national tax policies in this field due competitive pressures. These pressures arise either directly in the form of cross border shopping of motor fuels or indirectly as high after tax energy prices can result in the relocation of energy intensive sectors to Member States providing lower after tax energy prices. In recent years, however, this process has been reversed. This may reflect a divergence in the importance attached to these taxes by Member States. Another explanation may be that the European minima in energy taxation have become less binding and thus their potential to compress the variance in tax revenues from energy taxes.

The importance of reducing greenhouse gas emissions has added another key objective to environmental taxes. This has led some Member States to include such objectives into their tax systems. For example, several Member States have already made vehicle taxes dependent on average CO2 emissions. In the years to come it will be interesting to observe how the different designs that are being introduced by Member States perform to address the imminent climate change challenges.

Energy and environmental taxes have a European dimension. This regards their impact on short-run macro-developments, as well as their importance for European competitiveness, employment, growth and equity. Many key environmental challenges, such as climate change, the protection of the seas, biodiversity, etc. are international by nature, so coordinated action at the European and international level are pivotal for proper policy responses to these issues. Finally, differential energy and environmental taxes can severely distort the functioning of the internal market and need therefore particular attention from the European perspective which is well reflected by the relatively pronounced policy competence at the European level on these tax issues, in particular in comparison with other aspects of tax policy. The review of the Energy Tax Directive (ETD) provides a welcome opportunity to update the framework for improved environmental taxation by the Member States.

4. MAIN TRENDS AND RECENT REFORMS OF REVENUE SYSTEMS IN THE EU

Over recent years, Member States have carried out many reforms of their tax systems. These reforms have been driven by several interrelated factors. First, high unemployment rates and low participation rates in many Member States have posed the question of how to improve the conditions for more employment. The growing awareness that an excessive tax burden on labour and its interaction with the benefit systems lowers labour demand and labour supply incentives, especially for those with low earnings potential, has led Member States to consider the move towards more employment-friendly labour taxation. In doing this, they have also faced the difficulty of finding alternative tax bases to finance their expenditures.

Second, some Member States have also tried to rationalise and simplify their tax systems. Tax cut cum base broadening reforms are one important element of such a strategy. Such base-broadening often implies economic benefits but, particularly in the field of corporate taxation, the base-broadening measures need to be carefully assessed.

Third, increased economic integration, ageing societies and technological progress rapidly change the environment in which revenue systems are operating. The design of revenue systems is an important determinant of how Member States can cope with the challenges that arise from these relevant changes.

Fourth, the desired level and type of fairness and equity continues to be a key issue of the political debate in the Member States, and the role of revenue systems (along with other government policies) plays a fundamental role for how these objectives can be achieved. These debates directly relate to the previous three factors, while the judgement on how to optimally address the corresponding policy trade-offs remains a political decision.

4.1. COMMON TRENDS IN THE EUROPEAN REVENUE SYSTEMS

Section 3 has provided evidence that substantial differences in the level and the structure of taxation exist among Member States. This raises the questions of whether European revenue systems are evolving in similar ways, and to what extent there are common trends in the European revenue systems. Section 3 has already provided some rough quantitative evidence on this. There appears to be some indications of similar developments among the revenue systems of Member States, at least along several dimensions:

- There appears to be some convergence in the size of government expenditures and thus, in the need for government financing. This tendency is reflected in the reduction of the dispersion of the tax burden documented in Graph 3.4 and appears to be more pronounced since 2001.

- Social protection represents the biggest part of government expenditures. Thus, the financing of the social protection systems is a key determinant of the structure of revenue systems. In this area we can observe that countries that have traditionally relied predominantly on tax financing for their social protection systems are considering stronger links between payments and benefit entitlements. On the other hand, we see that many countries that have traditionally almost exclusively relied on SSCs to finance their social protection systems are increasingly complementing or substituting this traditional financing with some additional tax-financed funds from the general budget. This is reflected in the reduction of the dispersion of revenues from SSCs (cf. Graph 3.9).

- Member States are increasingly moving away from comprehensive income taxation. The classic Schanz-Haig-Simons approach to income taxation treats all income streams such as labour income, capital income, income from entrepreneurial activity, etc. equally. The different income components are added up and subjected to the income tax schedule. However, the differential mobility of the underlying tax bases has led several Member States to tax incomes form different sources differently. This is explicitly the case in the Nordic "dual" income tax systems, which are increasingly viewed by other Member Sates as a potential role model for their tax systems.

- Mobile tax bases see their tax burden reduced. The move away from comprehensive income taxation to dual income taxes is one sign of this development. The specific reduction in the tax burden carried by more mobile tax bases can also be inferred from the differential treatment of incorporated and non-incorporated businesses. Non-incorporated firms, which are typically smaller and less mobile internationally do not profit from reductions in corporate tax rates but are often subject to the same base broadening measures that determine taxable profits. Thus, the more mobile corporate firms are favoured over the less mobile non-incorporated firms.

- The recent enlargements of the EU have resulted in a greater variety of tax systems. This also holds for corporate taxation. Over the past years, however, there are several signs that indicate some convergence among Member States in the taxation of corporations. ([16]) This seems to be driven by at least two factors. First, the decisions of the ECJ regarding the (non-)discrimination between domestic and cross-border activities has reduced the freedom of individual Member States in the design and application of their corporate tax codes. Second, the two-dimensional (tax) competition for physical capital and book profits has led Member States to cut statutory taxes to increase their attractiveness as a location for book profits, and to use adjustments of the tax base, in particular appropriate depreciation rules, to target the marginal effective tax rate on physical capital investment or to limit revenue losses, cf. Devereux et al. (2008).

- Classic wealth taxes are less used in Europe. Sweden and Spain have abolished their wealth taxes in 2007 and 2008, respectively, joining other Member States, such as Austria and Denmark, while some keep wealth taxes.

- A frequent advice to policy makers in the EU and elsewhere has been to choose large tax bases with small tax rates. This recommendation has strong conceptual foundations in economic theory given that the excess burden of taxation grows more strongly in the rate than in the base. This policy advice has been put into practice over recent years in several tax policy fields, however with important differences across Member States, tax fields and timing. In the field of corporate taxation where declining statutory tax rates have been accompanied by an expansion of the tax base. While many Member States had engaged in such reforms already in the 1990s, the German 2008 corporate tax reform is a more recent example. Luxembourg has introduced a base broadening corporate tax reform effective as of 2009. Base broadening efforts can also be observed in the field of personal income taxation in some Member States were tax deductions have been reduced or have been completely discarded. In the field of indirect taxation the pattern is less clear, since some Member State governments appear more willing to employ their possibilities to resort to deviations from the standard VAT rate with the consequence of narrowing the tax base to which the standard rate applies.

The common trends in the European revenue systems and the degree to which they are actually converging need further in-depth evaluation. Nevertheless, one can already consider the various facets of this process. Convergence will make Member States' revenue systems more compatible with each other. This will reduce administrative and compliance costs, and will improve the functioning of the internal market. The process may also indicate the diffusion of successful policies, while it could possibly also reflect the effect of fiscal competition. Some Member States may see themselves forced into the adoption of tax policies that are either in conflict with their national preferences regarding the specific allocation of the tax burden and the associated equity-efficiency trade-off, or that are suboptimal from an efficiency perspective. These considerations suggest that there may be benefits in more actively co-ordinating tax policies.

Another important point may be the nature of the convergence process. One possibility is that policy

([16]) Considering the development of all EU 27 Member States, such signs of convergence are the tendency towards lower statutory corporate tax rates, cf. Graph 5.13, and the lower dispersion of the importance of corporate tax revenues, cf. Graph 3.17.

makers are adjusting their revenue systems in response to external competitive pressures, or because of imitation of successful policies observed elsewhere. However, it may also be that Member States themselves (and their economies and the preferences of their populations) are converging. In this case, tax policies, and the outcome of such policies should also be converging. In the latter case, however, tax policies only play an adjusting role.

4.2. TAX REFORMS IN MEMBER STATES

This section provides an overview of some major tax reforms in Member States in Box 4.1 below. While it does not provide a comprehensive summary of all policy changes that affect the revenue systems of Member States, it focuses on the developments in a few Member States where substantial tax reforms have been enacted. Of course, since nearly all Member States update their tax systems and their tax administrations by minor changes and amendments to existing tax legislation and administrative procedures, the definition of a tax reform requires some degree of discretionary judgement to decide whether modifications are sufficiently substantial to be singled out and to be called reforms. ([17])

([17]) At present, this is based on a necessarily subjective assessment. The current report uses information on tax reforms from various internal and external sources. Future issues would additionally draw on the forthcoming TAXREF database, managed by the European Commission (DG Taxud) in cooperation with Member States (the Working Group "Structures of the Taxation Systems"), when available.

Box 4.1: **Recent tax reforms in Member States**

Bulgaria

Bulgaria introduced a flat tax scheme for its PIT in 2008 with a tax rate of 10%, replacing a progressive scheme with three tax brackets (10-24%). Contrary to other flat tax schemes in the EU there is no basic tax free allowance in the introduced scheme. The corporate tax rate remained unchanged at 10%. The move to the flat tax regime was motivated by economic and governance motivations. On the one hand, policy makers wanted to increase investment incentives to speed up Bulgaria's catching up process with the EU. On the other hand, the flat tax is regarded as an important instrument to increase transparency of the tax system and to reduce the administrative burden and the potential scope for corruption which has frequently be seen as an important impediment to an accelerated development of the country. The share of social security contributions was modified in favour of the employer (from 65% to 60% for the employer and up from 35% to 40% for the employee)

Czech Republic

The 2008 tax reform that was enacted in the Czech Republic is potentially the most substantial tax reforms in the EU in 2008. While its most outstanding feature is the move to flat tax regime, the reform package also comprised a range of additional changes. The PIT was changed from a four-tier progressive tax (top bracket at 32%) to a flat tax rate of 15%. At the same time, the tax base was increased to include SSCs. The reform also comprises changes in corporate and indirect taxation. The corporate tax rate will be gradually reduced from 24% before the reform to a target value of 19% by 2010. The reduced VAT rate is increased from 5% to 9%. Finally, ceilings were introduced on pensions and health insurance contributions. Social security contributions are set to be reduced in 2009, by 1 percentage point for the employer and by 1.5 percentage point for the employee.

Germany

Germany carried out a substantial corporate tax reform in 2008. ([1]) The first important element of the reform was a sharp reduction in the statutory corporate tax rate from 25% to 15%. Together with the local trade tax (varying by location) and the solidarity surcharge which are also levied on corporate income, the overall tax rate after the reform is about 30%.

In 2007, the PIT for high income earners was adjusted. Above a gross yearly income of € 250000 an additional tax bracket of with a marginal tax of 45%, the so-called "tax on the rich" was introduced, replacing the former top rate of 42%. On the other hand, the 2008 CIT reform introduced a number of base broadening measures. These not only affected incorporated, but also non-incorporated businesses. The reform can thus be seen as a classic rate-cut cum base-broadening reform. Important elements of the base broadening aspects of the reform were the repeal of declining-balance depreciation, stricter transfer pricing rules, stricter loss deduction rules (in particular in case of acquired firms), and restrictions on the deductibility of interest.

Two further aspects of the reform are the new preferential treatment of retained earnings in sole proprietorships and partnerships (non-incorporated businesses) and the introduction of a final withholding tax of 25% that will as of 2009 apply to interest payments, dividends and most forms of capital gains.

Greece

Greece enacted a substantial tax reform of the PIT in 2008. The reform stipulates a reduction of marginal tax rates from 29% to 27% and from 39% to 37% in the respective tax brackets.

([1]) A good description and a proper assessment of the German reform can be found in Homburg (2007).

(Continued on the next page)

Box (continued)

Spain

The last phase of the Spanish corporate tax reform of 2006, starting effectively as of 2007 entered the second stage in 2008. The tax rate was further reduced from 32.5% to 30% for taxable periods commencing on 1 January 2008. The reduction for companies under the special hydrocarbons regime was reduced to 35% in 2008. For small and medium-sized companies, the reduction was made in a single phase from the 2006 reduced rate of 30% to 25% from 1 January 2007.

Spain also abolished the wealth tax and provided a € 400 tax rebate on the personal income tax. Furthermore, several further tax measures have been introduced over the year 2008, in particular to provide mortgage relief to homeowners (see the summary table in section 9 for details).

Latvia

At the end of 2008 a number of corporate income tax incentives were introduced to stimulate investments into machinery, to promote research and development and to favour reinvestment of earned profit as well. The period of loss carry-forward was changed from 5 to 8 years.

Along with increase of the VAT standard rate from 18 % to 21 %, the PIT rate was reduced from 25 % to 23 % and basic personal income tax allowance and tax allowances for children, unemployed spouse and disabled persons were raised as of 1 January 2009. At the same time several goods and services were deleted from the list of goods and services to what VAT reduced rate is applicable. After shortening of the list, the VAT reduced rate is applicable only to few items (electricity and natural gas to households for private consumption, central district heating, pharmaceutical products, medical equipment, transport of passengers). Besides that, the VAT reduced rate is applicable to periodicals until the end of 2009.

From 1 January 2009, the excise duty on cigarettes was increased and has reached the EU minimum level. From 1 February 2009 excise duty rates on fuel (the EU minimum level on unleaded petrol, gas oil and kerosene was reached), alcoholic beverages and other smoking tobacco were increased.

Lithuania

In April of 2008 the amendments to Corporate Income Tax Law were adopted, under which special tax incentives for research and development (R&D) were introduced, allowing triple deduction of R&D costs.

At the end of 2008 Lithuania has adopted some important amendments to the tax laws which are applied from 1 January 2009. Taking into consideration that direct 6 per cent pre – tax health insurance contributions were introduced instead of allocating 30 per cent share of personal income tax to Compulsory Health Insurance Fund, the personal income tax rate was reduced to 15 per cent (except dividends which are subject to 20 per cent income tax). Moreover, the procedure of application of tax-exempt amount was changed: tax exempt amount is applied only to employment income and is increased for low-income persons and gradually reduced taking into account a level of the income of the individual.

The corporate income tax rate was increased from 15 per cent to 20 per cent. On the other hand, corporate income tax incentive for entities which invest into essential technological modernisation was established allowing the reduction of taxable profit up to 50 per cent by expenses incurred acquiring the property, defined in the Law.

From 1 January 2009 the standard VAT rate was increased from 18 per cent to 19 per cent. Furthermore, the reduced VAT rates were abolished (with the exception of a reduced 5 per cent VAT rate for the supply of some pharmaceuticals and medical aids, a reduced 9 per cent VAT rate for books and not periodical informational publication applicable until 30 June 2009).

(Continued on the next page)

Box (continued)

Excise duties on fuel and alcoholic beverages were significantly increased as from 1 January 2009. Moreover, excise duties on tobacco products will be increased from March and September 2009.

Sweden

In 2008, the earned income tax credit that was introduced in 2007 was raised by SEK 11 billion. After the raise, the earned income tax credit in total amounts to SEK 51 billion, or 1.7 percent of GDP. Sweden has eliminated its state property tax on private homes and apartment buildings, as of January 2008. It has instead introduced a municipal fee that has a ceiling of SEK 6000 per private home and SEK 1200 per apartment. The ceiling is indexed with the average income growth (income index). The change amounts to a substantial reduction of the property tax for owners of high value properties, but the raise is offset by an increase in the taxation of capital gains from housing. Sweden has also abolished its wealth tax as of 2007.

4.3. TAX POLICY RESPONSES TO THE FINANCIAL CRISIS

Member States' governments and the EU as a whole are currently facing the challenge of how to address the financial crisis and its impact on the real economy. Individual Member States have been, and will be, affected by the crisis in different ways depending on several factors. First, the size, the structure and the risk exposure of their financial sectors; second, the macroeconomic stability, in particular the sustainability of public finances and the capacity to avoid exchange rate and balance of payments crisis; third, the speed and degree with which the crisis will spread to the real economy; fourth, the external shocks to Member States' aggregate demand which depend on their main trading partners' economic performance. As pointed out in the Commission Communication " From financial crisis to recovery: A European framework for action" ([18]), government budget positions are likely to deteriorate considerably in coming years. Tax revenues from profit and capital income are likely to be severely reduced, but also revenues from consumption and labour taxes will be reduced somewhat lagged, as employment follows the cyclical downturn and wage growth and consumption slow down. Counter-cyclical fiscal policies on the revenue side will also have a direct impact on total revenues and an indirect one via their effect on economic activity.

As stressed in the European Economic Recovery Plan ([19]), (the Commission's response to the current economic situation), given the scale of the crisis we are facing, the EU needs a co-ordinated approach. There is a need to bring together all the policy levers available at EU and national level, most of which, and in particular those which can stimulate consumer demand in the short term, are in the hands of the Member States. This of course includes measures on the revenue side. Member States have very different starting points in terms of fiscal room for manoeuvre and that makes effective coordination all the more important.

Tax policies have an important role to play for stabilisation and recovery. The degree to which revenue systems will fulfil their role as automatic stabilisers depends substantially on their characteristics, such as the degree of progressivity of the PIT and various provisions for the taxation of incorporated and non-incorporated firms (loss-offsets, tax accounting rules, etc.). Beyond the automatic stabilisers, however, the mainstream view among economists assigns the stabilisation task principally to monetary policy and assigns active fiscal policy a secondary role. This is mainly due to the time lags and the complexity of engineering sound counter-cyclical fiscal policies and the advances in the conduct of monetary policy. However, problems in the financial sector suggest that the effectiveness of monetary policy is impaired in the current circumstances. Discretionary fiscal policy thus needs to assume a more important stabilisation role than in a situation

([18]) COM (2008) 706 final, 29 October 2008.

([19]) COM (800), 26 November 2008.

with a smoothly functioning financial sector. The Commission has recently outlined the role and the necessary features of a sound fiscal stimulus, including measures on the revenue side, in its European Economic Recovery Plan (EERP), which are reproduced in Box 4.2.

Box 4.2: **Criteria for a sound fiscal stimulus**

The European Commission's (2008e) European Economic Recovery Plan (ERRP) spelled out the following criteria for a sound fiscal stimulus:

(1) It should be timely, temporary, targeted, and co-ordinated

National budgetary stimulus packages should be:

– *timely* so that they quickly support economic activity during the period of low demand, as delays in implementation could mean that the fiscal impulse only comes when the recovery is underway;

– *temporary* so as to avoid a permanent deterioration in budgetary positions which would undermine sustainability and eventually require financing through sustained future tax increases;

– *targeted* towards the source of the economic challenge (increasing unemployment, credit constrained firms/households, etc. and supporting structural reforms) as this maximises the stabilisation impact of limited budgetary resources;

– *co-ordinated* so that they multiply the positive impact and ensure long term budgetary sustainability.

(2) It should mix revenue and expenditure instruments

In general, discretionary public spending is considered to have a stronger positive impact on demand in the short-run compared with tax cuts. This is because some consumers may prefer to save rather than spend, unless the tax cuts are limited in time. Taking the different situations of Member States into account the following measures could be considered.

– *Public expenditure* has an impact on demand in the short-term. Measures that can be introduced quickly and targeted at households which are especially hard hit by the slowdown are likely to feed through almost directly to consumption, e.g. temporarily increased transfers to the unemployed or low income households, or a temporary lengthening of the duration of unemployment benefit. This can also be done through frontloading public investment in projects which could benefit SMEs and could support long-term public policy goals such as improving infrastructure endowments or tackling climate change;

– *Guarantees and loan subsidies to compensate for the unusually high current risk premium* can be particularly effective in an environment where credit is generally constrained. They can help bridge a lack of short-term of working capital which is currently a problem for many companies;

– *Well designed financial incentives* for speeding up the adaptation of our economies to long-term challenges such as climate change, including for example incentives for energy efficiency;

– *Lower taxes and social contributions*: lower social contributions paid by employers can have a positive impact on job retention and creation while lower taxation of labour income can support purchasing power in particular for low wage earners;

– *Temporary reductions* in the level of the standard rate of VAT can be introduced quickly and might provide a fiscal impulse to support consumption.

(3) It should be conducted within the Stability and Growth Pact

Budgetary policy should be conducted within the Stability and Growth Pact, so as to provide a common and credible framework for policy. The 2005 revision of the Pact allows better account to be taken of cyclical conditions while strengthening medium and long-term fiscal discipline. The resulting framework is more

(Continued on the next page)

Box (continued)

demanding in good times, it affords more flexibility in bad times. Extraordinary circumstances combining a financial crisis and a recession justify a co-ordinated budgetary expansion in the EU. It may lead some Member States to breach the 3% GDP deficit reference value. For Member States considered to be in an excessive deficit, corrective action will have to be taken in time frames consistent with the recovery of the economy. This is fully consistent with the procedures of the Stability and Growth Pact which guarantee that the excessive deficit will be corrected in due time, ensuring long-term sustainability of the budgetary positions. The Stability and Growth Pact will therefore be applied judiciously ensuring credible medium-term fiscal policy strategies. Member States putting in place counter-cyclical measures should submit an updated Stability or Convergence Programme by the end of December 2008. This update should spell out the measures that will be put in place to reverse the fiscal deterioration and ensure long-term sustainability. The Commission will then assess the budgetary impulse measures and stability and convergence programmes based on updated forecasts and will provide guidance on the appropriate stance, relying on the following objectives:

– ensuring the reversibility of measures increasing deficits in the short term;

– improving budgetary policy-making in the medium-term, through a strengthening of the national budgetary rules and frameworks;

– ensuring long-term sustainability of public finances, in particular through reforms curbing the rise in age-related expenditure.

(4) It should be accompanied by structural reforms that support demand and promote resilience

While the most immediate impact on growth and jobs in the short run needs to come from a monetary and fiscal stimulus, a comprehensive recovery plan also needs to encompass an ambitious **structural reform agenda** tailored to the needs of individual Member States, and designed to equip them to emerge stronger from the crisis. In part, this is because some structural reforms can also contribute to bolstering aggregate demand in the short term. Moreover, structural reforms are necessary to address some of the underlying root causes of the present crisis, as well as to strengthen the economy's adjustment capacity needed for a rapid recovery.

A resilient, flexible economy helps mitigate the adverse impact of an economic crisis. The Lisbon Strategy has already strengthened the European economic fundamentals. Appropriately tailored, Lisbon strategy structural reforms could be an appropriate short-term policy response to the crisis as they strengthen economic resilience and flexibility. Member States should consider the following measures:

– *Supporting consumer purchasing power through improved market functioning*: policies that improve the functioning of key markets can help sustain demand by helping bring down prices, thus supporting the purchasing power of households;

– *Addressing immediate competitiveness problems*. In Member States with inflation and competitiveness problems measures need to be taken urgently that reinforce the link between the wage setting mechanism and productivity developments;

– *Supporting employment and facilitating labour market transitions*: today's prime labour market challenge is to avoid wasteful labour shedding by industries temporarily affected by short-term demand disturbances. To that end, more flexibility in working time arrangements or enhanced employment services could help;

– *Reducing regulatory and administrative burdens on businesses*. Such reforms help increase productivity, and strengthen competitiveness. Measures that can be implemented rapidly include continuing efforts to reduce the time to start up a business.

Revenue side measures typically play some role in all Member States that are addressing the crisis. The importance of these measures is closely related to the overall scope of counter-cyclical fiscal measures that Member States governments have already put in place. This scope naturally differs among Member States, since some have been hit early by the crisis, or since in some Member States domestic problems additionally impact on the economic situation, whereas some Member States have only recently seen their economies affected. Moreover, given that the financial system remains fragile and the impact of the crisis on the real economy crisis is still unfolding, Member States' revenue side measures to counter the crisis are also still evolving. Due to the evolving nature of the crisis and of Member States' policy interventions, an overview of the specific measures taken is notoriously incomplete, and an evaluation of the impact of the specific measures taken by individual Member States is clearly premature. A meaningful in-depth analysis of a comparative nature needs to be postponed to a later date, when a clearer picture of the measures undertaken and data on their consequences become available. An extensive overview of revenue side policies taken in 2008, including those in response to the crisis, is provided in Annex II.

5. SELECTED TOPICS IN THE DEVELOPMENT OF EUROPEAN REVENUE SYSTEMS

5.1. CHOICE OF SELECTED TOPICS

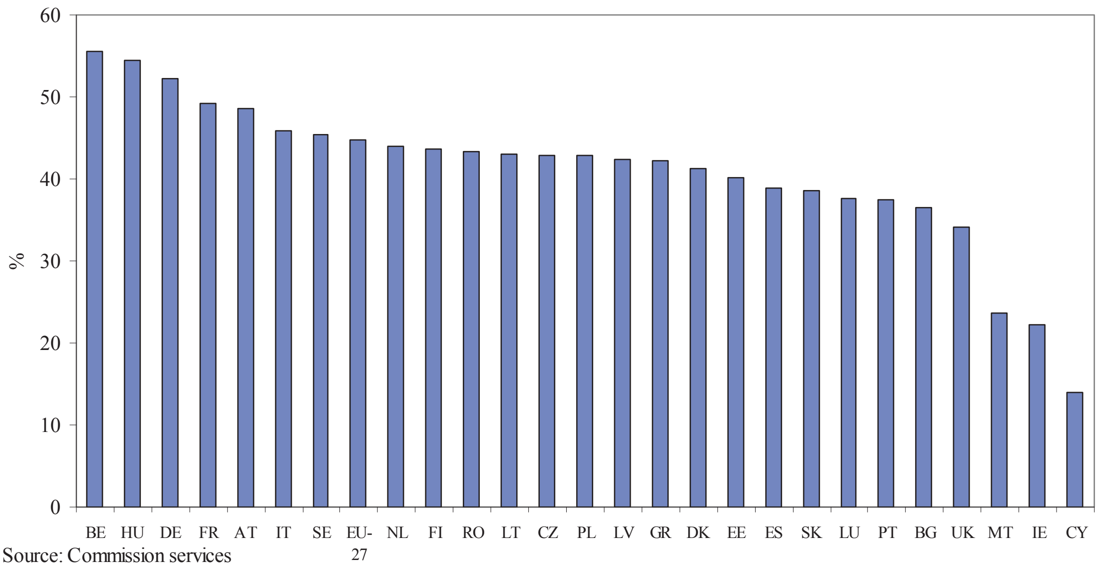
The final section of this report considers several topics that represent important developments of revenues systems and that are particularly relevant for policy making. These topics include the employment friendliness of European revenue systems, the adoption of flat taxes by some Member States, and tax competition. The selection is not meant to imply that other aspects that are not treated are less relevant for policy making. Future issues of the ARR will address other equally relevant topics related to the efficiency, equity, administration and revenue stability aspects of revenue systems.

5.2. THE EMPLOYMENT FRIENDLINESS OF EUROPEAN REVENUE SYSTEMS

The tax burden on labour is on average very high in Europe, although substantial differences across Member States exist. This heavy tax burden has been considered by some observers as one of the factors behind the unsatisfactory European employment performance over recent years, in the form of high unemployment rates, low participation rates and low numbers of hours worked. ([20]) Such outcomes constitute a loss of human capital, create social tensions and make it difficult to finance European welfare states, particularly in the context of ageing societies. In response to this challenge, the EU, as part of the Lisbon Strategy for Growth and Jobs, has set ambitious targets to improve the labour market performance, and adjusting European revenue systems is a key measure towards this end.

([20]) However, other significant factors are also often suggested: the effect of a minimum wage and the low flexibility on the labour market. The importance of high tax burdens for unsatisfactory labour market outcomes has been stressed by Prescott (2004). Other authors, such as Pissarides (2007) and Blanchard (2004), have questioned this claim or the welfare implications. Kessing and Konrad (2006) and Alesina et al. (2006), among others, have pointed out the importance of different labour market institutions, in particular collective wage setting, in this context. Gordon (2006) provides an overview of the US-Europe comparison.

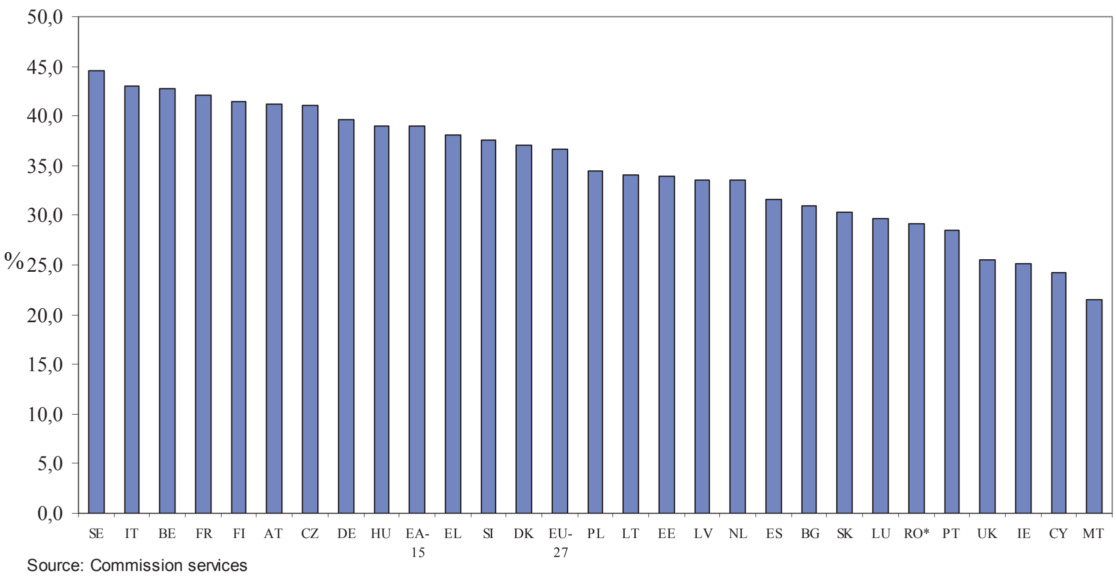
Graph 5.1: **Total (average) tax wedge, 2007, single worker, 100% AW**



Source: Commission services

Note: SI not available

Graph 5.2: **ITR on labour (%), 2006**



Source: Commission services

Note: * refers to 2005 data.

The tax burden on labour is composed of several elements. First, employers have to pay payroll taxes and/or employers' social security contributions. Second, employees have to pay social security contributions on their wage income. (21) Finally, the labour income is subject to the personal income tax. These different taxes and social security contributions constitute the different components of labour taxation, and they can be summed up to give the aggregate tax wedge due to labour taxes. (22) It is also often referred to as the average effective tax rate (AETR). An overview of these tax wedges in the Member States is given in Table A1.4 in the statistical annex (section 7), and in Graph 5.1. It illustrates the high tax burden on labour showing the substantial incentive problems that arise in some Member States from these high levels of average tax levels.

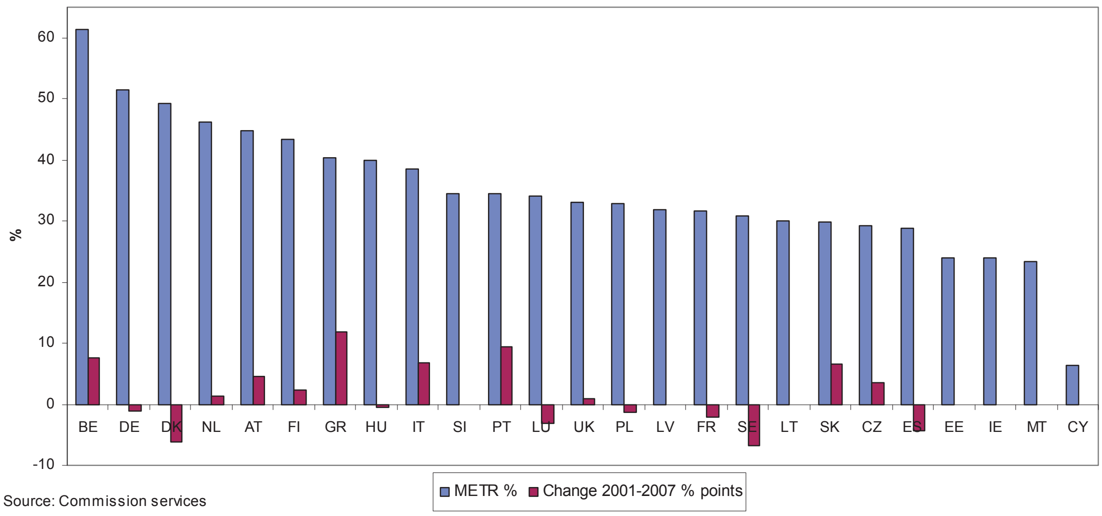
Similarly, marginal effective tax rates (METRs) indicate the tax burden on additional earnings. (23) Graph 5.3, Graph 5.4, and Graph 5.5 provide an overview of the METRs that a single worker is facing when earning 67%, 100%, and 150%, respectively, of the average wage. Such measured marginal tax wedges on labour remain high in most EU countries and contrasts with that of non-EU OECD countries, where the total tax wedge is substantially lower on average than in the EU, see European Commission (2008c).

(21) Contrary to taxes, social security contributions (whether paid by the employer or employee) give right to individual benefits. Therefore, only to the extent to which the link between contributions and benefits in such social insurance schemes is not actuarially fair, i.e. the extent to which the contributions are disproportionately high, the contributions actually constitute a tax. Given that it is very difficult to isolate the tax component in the various social security contributions paid in the different Member States, the standard approach is to include the full amount in the measure of the tax burden.

(22) The so-measured tax wedge on labour may also be considered incomplete, because it does not consider the importance of consumption taxes such as the VAT and others. Consumption taxes reduce the value of wages for the worker and therefore also increase the wedge between the value of gross and net wages for the worker.

(23) The METR expresses how many cents of an additionally euro earned have to be paid in taxes and SSCs or are foregone as a consequence of reduced in work benefits. The additional net earnings from the additional Euro are thus 1-METR. The details of the methodology used to calculate the METRs are decribed in Carone et al. (2003).

Graph 5.3: **METR at 67% AW, single worker, 2007**



Source: Commission services

Note: For CY, IE, LT, MT and SI 2001-2007 changes not available

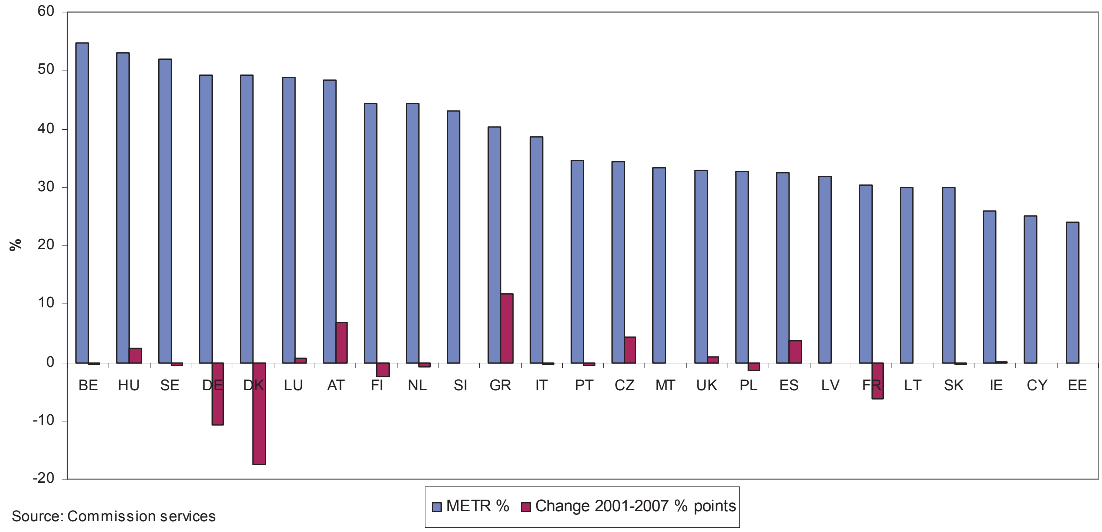
Another way to measure the tax-burden on labour is the so-called implicit tax rate on labour (ITR on labour). In contrast to the tax wedge, it gives a picture of the average tax burden on labour across all income classes and family types and therefore compliments the AETRs and METRs. The ITR on labour is based on the classification of the taxes by economic function as described in section 3.3 and calculated as the ratio of taxes and social security contributions on employed labour income to total compensation of employees see European Commission (2008a) for a detailed description. Graph 5.2 provides an overview over the dispersion of the tax burden on labour as measured by the ITR on labour.

The effects of taxes on labour market outcomes have been extensively studied. See Pissarides (1998) and Bovenberg (2006) for useful summaries, and Nickell (2006) and Arpaia and Carone (2004) for empirical evidence. ([24]) Alongside these analytical and empirical contributions, several policy proposals on how to reduce the high tax burden on labour have been brought forward over recent years. These proposals can be grouped into two categories that may be appropriately combined. Tax shifting proposals, as the first kind of common suggestions, usually consider the aggregate tax burden on labour and suggest alternative tax bases to which the tax burden can be shifted. Such tax bases need to be broad - to avoid excessive rates and the related distortions - and stable - to assure revenue collection. Several potential bases have been suggested, in particular consumption, capital, polluting goods, property, inheritances and wealth.

Of such tax shifting policies, the shift from labour to consumption has probably been the policy that has seen at least some implementation over recent years. Such a policy to rely more heavily on consumption taxes (increasing VAT) and reducing labour taxes (typically in the form of reduced SSCs or payroll taxes) was pursued in the context of the 2007 tax reform in Germany which increased VAT by three percentage points while using about one third of the proceeds to lower social security contributions. The recent reforms in the Czech Republic and Bulgaria also involved simultaneous changes of income (or SSCs) and indirect taxes.

([24]) There is clear evidence that an increased tax burden on labour has negative effects on aggregate employment in the short run. The effects in the long run are more debated with some studies finding no clear effect, whereas others claim substantial negative effects also in the long run.

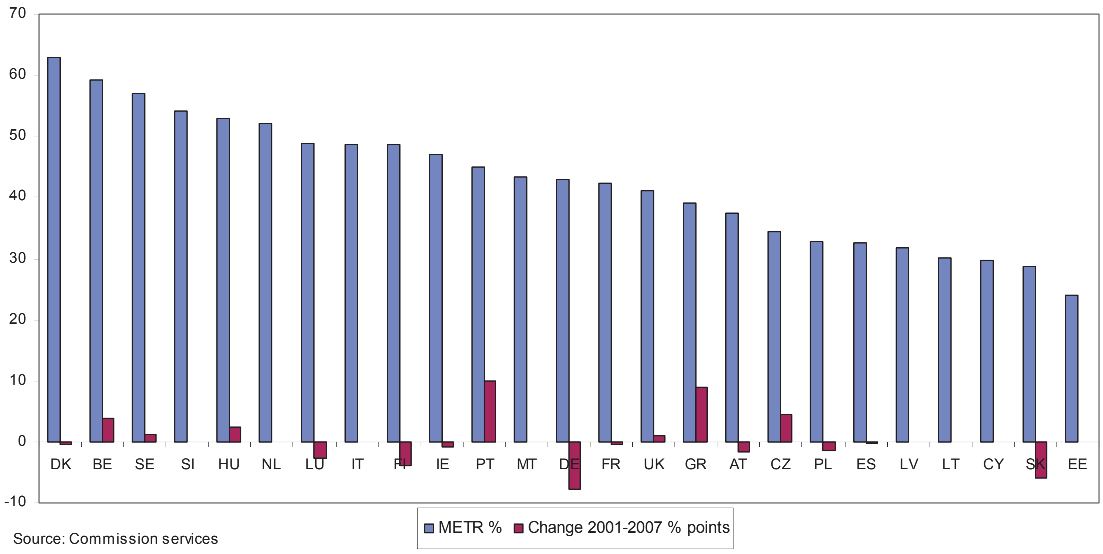
Graph 5.4: **METR at 100% of AW, single worker, 2007**



Source: Commission services

Note: For CY, IE, LT, MT and SI 2001-2007 changes not available

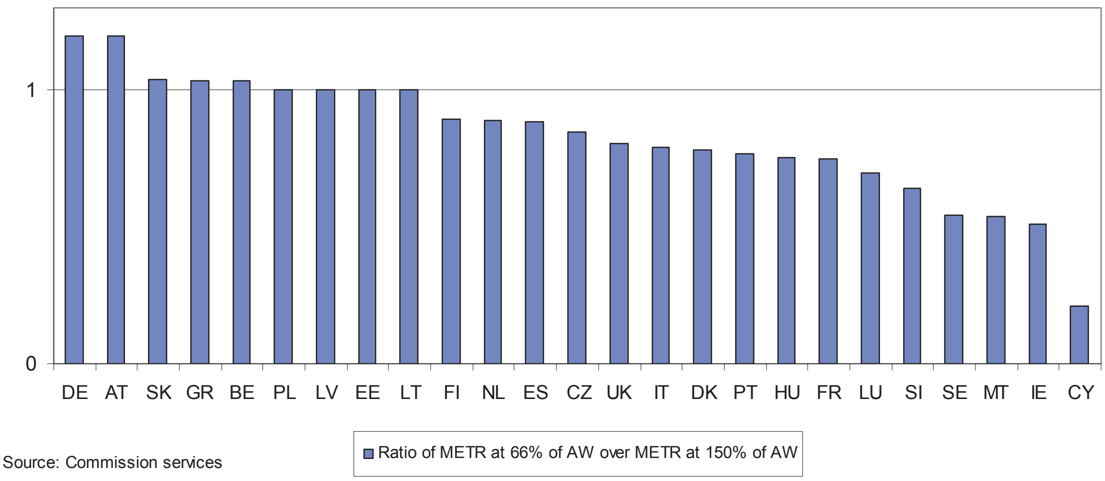
Graph 5.5: **METR at 150% of AW, single worker, 2007**



Source: Commission services

Note: For CY, IE, IT, LT, MT and SI 2001-2007 changes not available

Graph 5.6: **Relative METR of low income worker (67% AW) to high income worker (150% of AW), single workers, 2007**



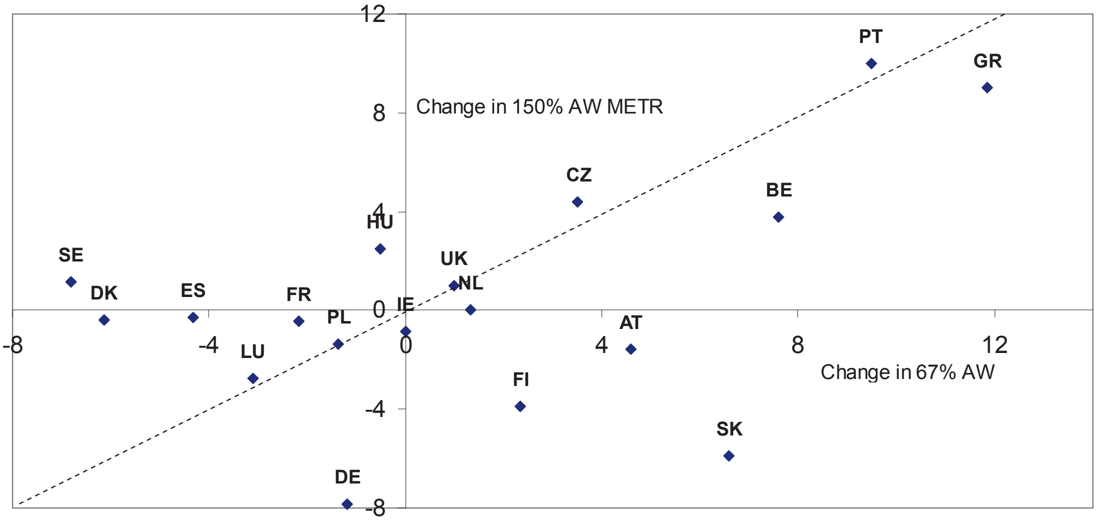
Source: Commission services

Consumption taxes leave savings untaxed and are thus conducive to capital accumulation and growth. Recent work by the Commission (cf. European Commission 2008c) shows that tax shifting from labour taxes to consumption taxes actually can have positive effects on employment and growth. However, such effects tend to be modest in size and cannot serve as substitutes for more appropriate structural reforms. Moreover, such tax shifting may have adverse equity effects and the timing and the magnitudes of such policies need to be carefully assessed, to avoid inflationary pressures. In particular, given the current macroeconomic situation and concerns about the purchasing power of low-income households, further reform steps of this kind may currently not be advisable, unless accompanied by appropriate compensation of low income earners and transfer recipients.

The increase in tax revenue from capital may indicate that some tax shifting to capital may have actually taken place (c.f. the discussion in section 5.3), although this remains difficult to establish given the importance of the cyclical component of tax revenue from capital. This option also appears to be increasingly problematic for the reasons discussed in section 5.3. Also, capital taxes are levied on a smaller base than labour taxes, reducing the scope for this kind of tax shifting.

Although the size of the tax base also limits the tax shifting potential of environmental taxes, these are often named as the preferred alternative because of the potential double dividend, see section 3.4. However, despite the ongoing rhetoric and popular perception, environmental taxes have seen their importance reduced in the EU, cf. Graph 3.15. Lower energy prices, if sustained, are, however, increasing the room to rely more strongly on environmental taxation. Property taxes are an alternative basis that appears to be a valid alternative, mainly because of the efficiency properties of such taxes. Moreover, such taxes are excellent sources of revenues, because they potentially allow the introduction of benefit taxation at the local level. Finally, inheritance and wealth taxes are quantitatively insufficient to provide a broad alternative to labour taxes, and their efficiency and equity effects also require close examination.

Graph 5.7: **Change (pp) in METRs at low (67% AW) and high (150% AW) income, single workers, 2001-07**



Source: Commission services

Note: For SI, MT, LT IE, CY, EE, IT 2001-2007 change not available.

Besides these various suggestions for tax shifting to reduce the aggregate tax burden on labour, and thus more or less across the board for all workers, a second set of policy changes has focussed more on how to distribute the tax burden across different types of workers by changing the progressivity of the tax schedule. As is evident from Graph 5.6, Member States place quite different relative METRs on different types of workers, and the question regarding how to optimise these individual burdens to achieve better aggregate employment outcomes has been pushed to forefront. This ratio between the METR of a low income may be seen as a proxy measure of progression (see also OECD (2007)). ([25])

In this context it is also interesting to consider how the METR of low and high income earners have evolved in the Member States over recent years. This evidence is presented in Graph 5.7. It appears that Member States have been moving in quite different directions since they can be found in all four quadrants of Graph 5.7. Thus, while in some Member States high and low income workers face higher METRs (BE, CZ, GR, PT, UK), in others both face lower METRs (DE, DK, ES, FR, LU, PL). Similarly, while in some Member States the high income earners have seen their METRs reduced and the low income earners increased (AT, FI, SK) in other Member States the METRs of low income earners has been reduced while the METRs of high income earners has gone up (HU, SE). It should be stressed, however, that these changes cannot be interpreted in isolation, but need to be considered against the existing METR levels.

([25]) A frequently used local measure of tax progressivity is the ratio of the marginal tax to the average tax for a given income level. Since the average tax is typically different for any two income levels, the ratio of the two METRs does not directly relate to such local progressivity measures, but nevertheless gives an indication of the relative marginal taxes faced by low and high income earners. Global measures of tax progressivity consider how the entire distribution of income is changed through the tax system. However, to calculate such measures, the tax (and benefit) schedule needs to be complemented with data on the distribution of income, which raises several conceptual and data availability issues.

Box 5.1: Recent adjustment in labour taxes and SSCs in the Member States

Austria granted tax allowances on commuting and reduced unemployment insurance contributions. It also raised by one year to 57 the age limit for the relief of these contributions.

Belgium extended the basic tax-allowance and reinforced the 'work bonus', consisting of a digressive reduction of individual social security contributions in favour of the lowest-income workers. It also introduced tax allowances on professional expenses to support R&D.

As described in box 2, **Bulgaria** introduced flat tax and modified the share of social security contributions in favour of the employer in (from 65% to 60% for the employer and up from 35% to 40% for the employee).

Cyprus extended the basic tax free allowance. Moreover, the reform package presented in 2008 envisages seven phased increases in contribution rates on insured income, by 1.3 pp each time, every 5 years from 2009.

In the **Czech Republic** a major tax reform was enacted, see box 2.

Denmark extended the basic tax-free range in 2008 and introduced (under certain conditions) lump-sum tax reduction for 64 years old tax-payers and a basic personal allowance for old-age pension recipients who wish to work. It also increased the earned income tax credit. From 2009, the income level threshold for the third tax bracket (out of four) will be raised.

Estonia reduced the personal income flat tax rate from 22% to 21% in January 2008.

Germany further reduced SSC in the form of unemployment insurance contributions, but SSC remain under upward pressure from sickness insurance contributions (which until now are not directly controlled by the government).

Hungary abolished the supplementary tax refund and the simplified the tax refund.

Malta extended the basic tax-free range in 2008.

Spain reduced social security contributions for self-employed workers in specific sectors (e.g. the textile sectors) and for employers offering permanent contracts. Social security contributions paid by employers and employees were also cut in and Spain also enacted a 400 Euros tax break in the income tax.

Finland granted tax allowances on earned income and on a second house for work purposes. The income tax of wage earners was reduced by raising the allowance on earned income and by relaxing the income tax scale.

In **France**, the government has proposed the introduction of a conditionality clause over the reduction of social security contributions on low-wages employees in order to ensure that companies and sectors fulfil their obligations in terms of pay negotiations. One of the aims of the measure is to inject some dynamism to the social partners' negotiations on pay and to keep under control and rationalise the evolution of the statutory minimum wage.

In **Italy**, a flat tax rate of 10% for the part of the wage linked to productivity or extra hours worked was introduced on an experimental basis from the second half of 2008, applying to private sector employees only.

Latvia has introduced tax allowances to compensate groups that are negatively affected under the flat tax scheme.

(Continued on the next page)

Box (continued)

In **Lithuania** the personal income tax rate was reduced to 15 per cent (including employment income) as from 1 January 2009, at the same time direct 6 per cent pre – tax health insurance contributions instead of allocating 30 per cent share of personal income tax to Compulsory Health Insurance Fund were introduced. The procedure of application of tax-exempt amount was also changed: basic tax exempt amount now is applied only for employment income and is increased for low-income persons and gradually reduced for middle-income persons. Additional tax exempt amount for parents growing up children was also increased, depending on the number of children.

The Netherlands modified SSCs in favour of the employer. They also raised the earned income tax credit along with tax rebates for the second earner and a reduced tax credit for earners in households with children. The Netherlands slightly increased the tax rate for earnings between € 17,579 and € 31,589, while the tax wedge of low-wage workers was moderately increased

In **Portugal**, in view of the entry into force of the new Labour Code, a general reduction of employers' social security contributions on open-ended contracts is planned, along with an increase in social security contributions paid on fixed-term contracts. Moreover, social security contributions paid by employers will be reduced by 50% during 3 years in the case of former self-employed workers who are offered a permanent contract. This incentive applies only for hires carried out in the 6 months following the entry into force of the new Labour Code.

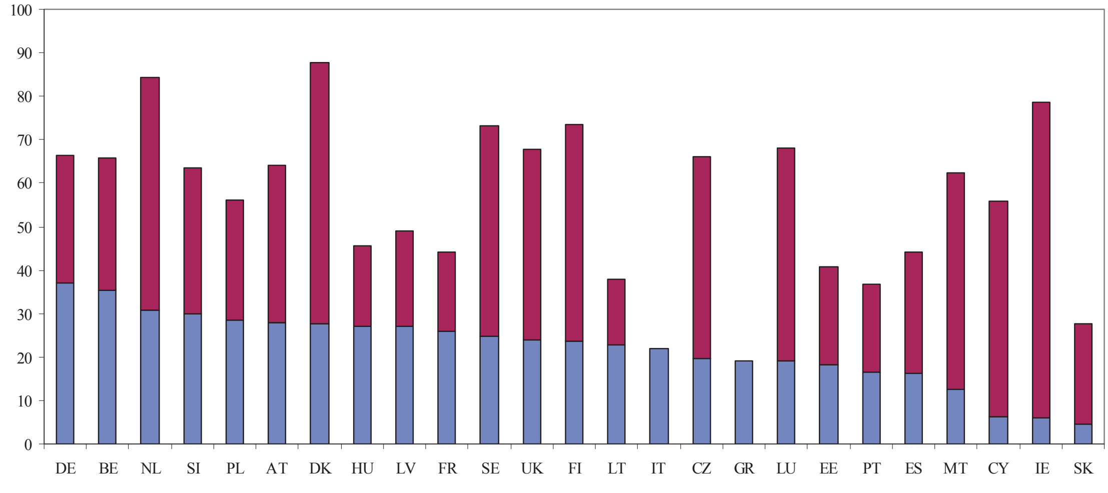
Sweden introduced an earned income tax credit 2007, that was raised in 2008 and in 2009. Employers' SSC on wages paid to the youth was halved in two steps in 2007 and 2009. The employers' SSC on wages paid to the 26-64-year olds was reduced from 32.42% to 31.42% in January 2009. SSC for self-employed was also reduced by one percentage point in January 2009. Payroll tax for the employed or self-employed older than 65 years was abolished in two steps in 2007 and 2008. The lower state income tax threshold was raised in 2009.

In **Slovenia**, the decline in the payroll tax continued in 2008 and the tax will be completely eliminated in 2009. It also introduced an income dependent tax relief as a response to relatively high inflation in 2007.

The **UK** increased the personal allowance to compensate individuals affected by changes introduced in the number and level of tax brackets.

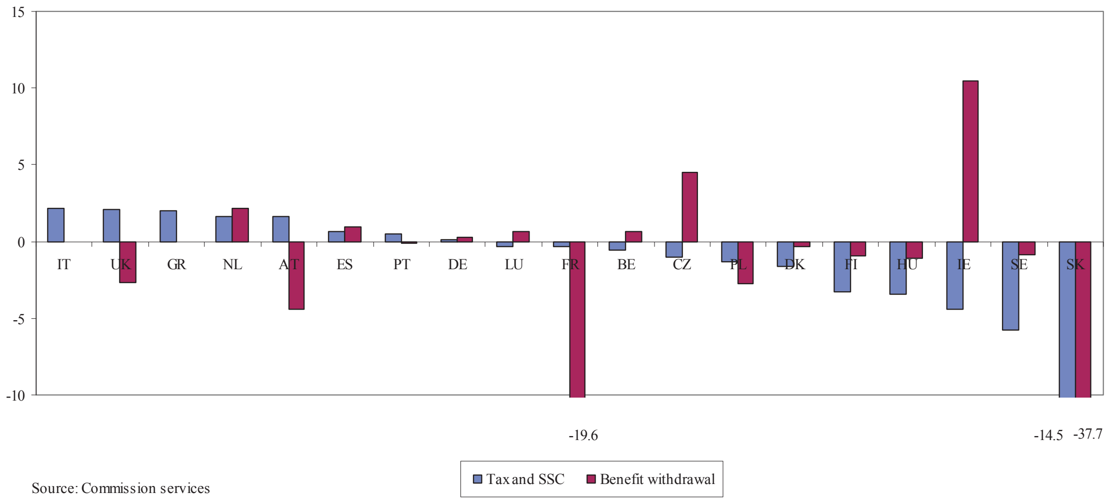
Additional graphs in the appendix provide an overview of the full METR profiles in the Member States for a single worker. Contrary to the METRs at given wage levels provided in Graph 5.3, Graph 5.4, and Graph 5.5, these METR profiles also contain the disincentive effects arising from the withdrawal of benefits. These profiles underline the substantial differences between the Member States with respect to the disincentives to work imposed by the tax and benefit system. This regards the levels as well as the structure of these disincentives. They also show that in some Member States these profiles have changed substantially since 2001, either over a specific range, or over the entire profile. Substantial reductions over the entire income range can be observed in France, Poland and the Slovak Republic from 2001 to 2007. In Sweden, the METRs were reduced for all wage levels above approximately 40% of AW. METRs were reduced in Finland for low wage levels (below 44% of AW). In Greece and Ireland increases in the METRs could be observed, and in Germany, the METRs were reduced at very low income levels (between 11% and 36% of AW) and, increasingly, at medium and high income levels. In Estonia and Latvia, modest reductions can be observed for all single workers earning more than approximately 20% of AW since from 2005 to 2007. Over the same period, METRs decreased at very low income levels, below approximately 55% of AW, whereas they increased above approximately that value in Lithuania.

Graph 5.8: **Contributions of taxes to inactivity trap, transition from inactivity to work (66% AW), single worker, 2007**



Source: Commission services

Graph 5.9: **Components of inactivity trap (67% AW), Changes 2001-2007, in percentage points**



Source: Commission services

Thus, for a full analysis of the discrete decision dimensions of taking up work, the benefit systems also needs to be considered. Particularly high disincentives to work exist for several specific groups that originate in the tax and benefit systems. These groups are, in particular, low income workers, single parents, and second income earners and the specific disincentives for these groups need to be targeted through appropriate analysis and reforms. Such disincentives relate to the incentives for unemployed to take up a job (unemployment trap), the disincentives to join the labour force (inactivity trap), and the disincentive to increase working hours and effort for those who already have a low income job (low wage trap). A good indicator of the latter is the METR faced by a low income worker as displayed in Graph 5.3.

Analogous indicators that measure the discrete disincentives individuals are facing when considering a transition from unemployment to employment (unemployment trap), or from inactivity to employment (inactivity trap), have also been constructed, cf. Carone et al. (2004). These indicators measure the percentage of the additional revenues that the individual foregoes due to increased taxes and social security contributions and the withdrawal of benefits in the process of a transition from inactivity or unemployment to employment. ([26])This multiple perspective is well in line with the recent literature on optimal labour taxation, see e.g. Saez (2002) and Immervoll et al. (2004), which has pointed to the importance of considering the extensive margin (whether to work or not) and the intensive margin (how many hours to work) and have derived results how these margins may be optimally balanced. Thus, the employment friendliness of labour taxation must also be considered against the extensive margin. Finally, it should be stressed that a trade-off between the tax disincentives at the extensive (that is disincentive to take up a job) and the intensive margin (increasing work hours or effort) exists, which needs to be taken into account when designing an employment-friendly tax system.

Recent work by the Commission on tax and benefits, cf. Carone et al. (2008) underlines that unemployed or inactive workers face substantial adverse incentive effects to take up work in many Member States. There are sizeable unemployment and inactivity traps. ([27]) These disincentives to work are composed of several components. On the one hand, there are the various benefits, such as social assistance or unemployment benefits, but also family and housing benefits, which an individual has to give up when moving into employment. On the other hand, taxes and SSCs also contribute to the disincentives by reducing the net take home pay from taking up employment. For informed policy choices it is important to disentangle these various components. Thus, the importance of revenue systems for these disincentives can be assessed by considering to what extent taxes, potentially also including earned income tax credits as a specific form of in work benefits administered through the tax system, and social security contributions play a role in EU Member States for these disincentives. This gives an indication of the scope that governments have by using the instrument of appropriately designed tax reforms to reduce these disincentives. By considering the development of the various components of the inactivity and unemployment trap over recent years one can also gather information on how changes of revenue systems have impacted on the disincentives to move into employment. ([28])

The decomposition of the inactivity trap with respect to benefit reductions on the one hand and taxes and SSCs on the other hand, cf. Graph 5.8, reveals that the tax and SSC disincentives to work are substantial in some Member States. These Member States may consider reducing these disincentives through appropriate tax reforms.

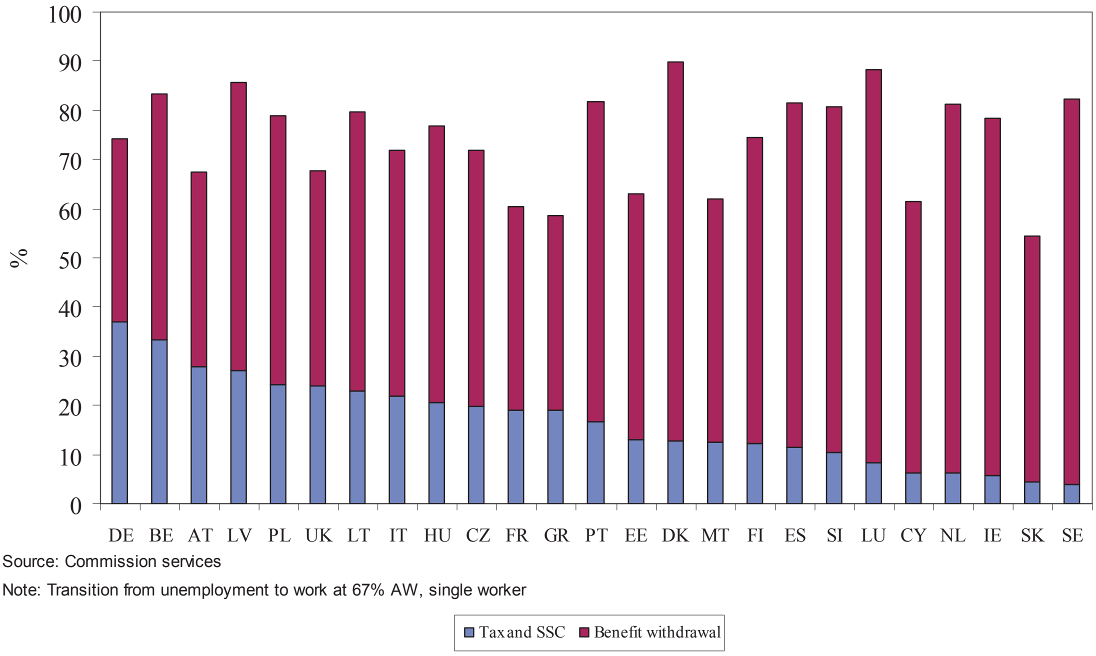
The lower panel of Graph 5.8 displays that reductions in tax and SSCs have substantially contributed to the reduction of the inactivity traps in Slovakia, and Sweden. They have provided small contributions to a reduction in Hungary, Finland, Denmark and Poland. On the other hand, they have worsened the trap in Italy, Greece, and the Netherlands. They have reduced the inactivity trap in the Czech Republic and Ireland but the trap

([26]) The low wage trap also needs to consider the phasing out of family and housing benefits. However, these are typically phased out at a specific threshold, which only by coincidence may be given at a given wage level, such as the 67% of the average wage used above. The METRs provided in Graph 5.3 ignore such potential coincidences and only report the METR due to taxes, in-work benefits and SSCs.

([27]) The inactivity trap is made up of the withdrawal of benefits (social assistance, housing benefits, family benefits) and the tax wedge experienced when working, which is made up of income taxes, in-work benefits, and SSC. The unemployment trap considers the withdrawal of unemployment benefits instead of social assistance, but otherwise takes into account the same components. The inactivity and unemployment traps considered here concern a transition from inactivity or unemployment to a job paying 67% of AW.

([28]) It should be observed, however, that the contribution of taxes and social security contributions to the overall METR at a given wage level can also change over time due to factors such as changes in the wage distribution or through inflation resulting in fiscal drag in the context of progressive income tax schedules.

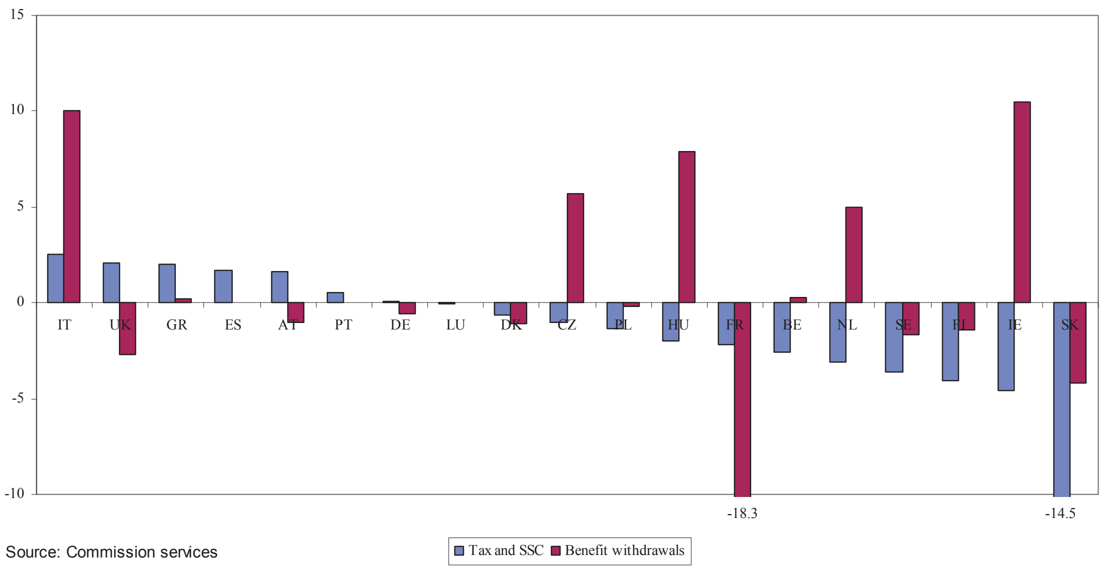
Graph 5.10: **Contribution of taxes to unemployment trap, 2007**



Source: Commission services

Note: Transition from unemployment to work at 67% AW, single worker

Graph 5.11: **Components of unemployment trap (67% AW), Changes 2001-2007 (percentage points)**



Source: Commission services

nevertheless widened due to the development of benefits.

Graph 5.10 illustrates the role played by taxes and SSCs for the unemployment trap. Just as in the case of the inactivity trap, there are several countries where the contribution of the revenue system to the trap is sizeable. Thus, appropriate tax reforms can provide a significant contribution to the needed improvements in labour supply incentives.

Finally, the lower panel of Graph 5.10 shows that revenue systems, i.e. taxes and SSCs also have played a role in reducing the unemployment trap in Slovakia, Finland, Sweden, Belgium, and France. They have played a more minor role in the reductions in Denmark and Poland. In Ireland, the Netherlands, Hungary and the Czech Republic they played a positive role, but could not over-compensate the negative effects of benefit changes. In Italy, Greece, Spain and Austria they increased the unemployment trap. In the UK they increased the trap, but this was overcompensated by benefit changes, so that overall a slight reduction in the unemployment trap could be observed

Member States where the component of taxes and SSCs play a major role in the inactivity or unemployment trap need to consider appropriate reforms of their revenue systems aimed at reducing this trap. Of course, such reforms aimed at reducing the inactivity and unemployment traps need to take into account the necessity for compensating tax increases to balance the government budget with the associated negative incentive effects from those compensating tax increases. These efficiency costs must be balanced with the gains from reducing the inactivity and unemployment traps. Nevertheless, the comparative evidence suggests that some Member States, where taxes and SSCs contribute substantially to high inactivity and unemployment traps, can engineer efficiency-enhancing tax reforms that reduce these traps substantially. In the context of ageing populations and the challenge to meet the ambitious Lisbon employment targets, the concerned governments need to move forward in this direction.

5.3. THE ADOPTION OF FLAT TAXES BY SOME MEMBER STATES

In 2008 Bulgaria and the Czech Republic joint the group of hitherto 5 Member States (EE, LT, LV, RO, SK) that have introduced so-called flat tax schemes, bringing the total number of EU Member States operating a flat tax scheme to 7. ([29]) Within the EU, all flat tax countries belong to the group of recently acceded Member States.

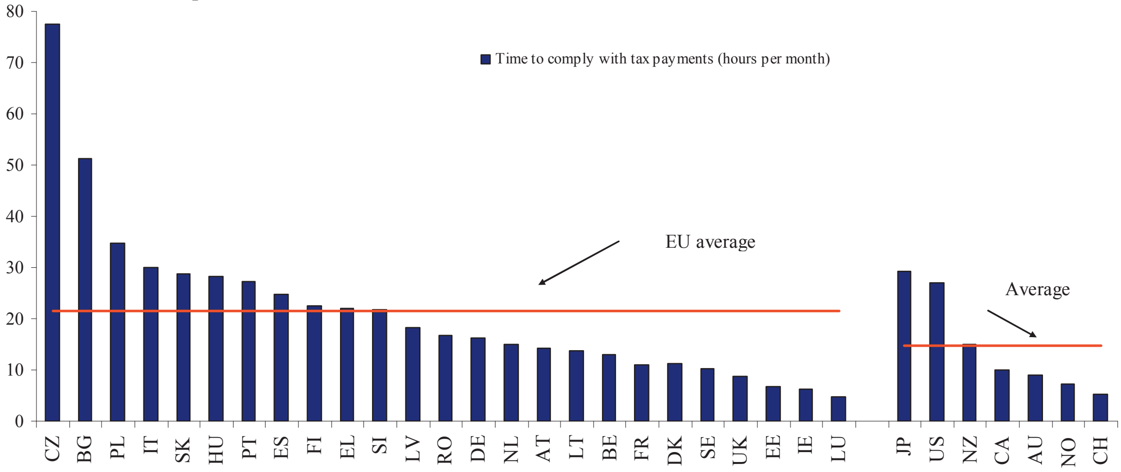
A flat tax scheme typically consists of a single marginal tax rate that is applied at any income level exceeding some basic tax free allowance. ([30]) There can be, and there are, substantial differences between the various flat tax regimes that have been introduced in many countries over recent years, including the flat tax schemes of several Member States. These differences refer in particular to the basic tax free allowance (which may again vary according to family status or the number of children), the flat marginal tax rate on income exceeding the basic allowance and the determination of the tax base. Moreover, the complementary design of SSCs as well as the corporate tax regimes may be quite different. Because SSCs continue to be non-proportional due to ceilings or progressivity, and because these contributions are often quite important in countries having adopted a flat tax structure, effective taxation on labour is often far from being flat in practice.

Supporters list several advantages of flat tax schemes. First, flat taxes seem particularly attractive because their proponents propose low levels of tax rates. However, while many flat tax rates observed in practice are characterised by relatively low rates, this is not by itself a characteristic of a flat tax scheme. It is very well possible to have an income tax scheme with different marginal tax rates that are all lower than the single rate of a flat tax scheme. More importantly, critics of flat taxes have pointed to the problem that low income earners – who already often have difficulties in the labour market – may actually see their marginal tax rate increased in flat tax scheme, given that they are likely to earn just

([29]) The original flat tax proposal by Hall and Rabushka actually referred to a tax scheme that applies a tax rate to businesses cash flows and to labour income at the same rate, with a basic, potentially family status-dependent, allowance for wage income. Such a scheme basically amounts to an expenditure tax. While still being discussed, in practice no country has implemented a tax system based on the Hall-Rabushka proposal.

([30]) In principle, flat tax scheme can be implemented without a basic allowance. In practice this is rarely the case. In the EU only the Bulgarian flat tax introduced in 2008 does not provide a tax free allowance. Outside the EU only Georgia has adopted a flat tax without a basic allowance.

Graph 5.12: **Administrative burden of tax systems for mid-sized company, 2007**



Note: Time to prepare, file and pay (or withhold) corporate income tax, value added or sales tax and labour taxes, including payroll taxes and social contributions based on a case study company. No data available for CY and MT. Averages are unweighted.
Source: World Bank and Price Waterhouse Coopers (2008) *Paying taxes 2008. The global picture*.

above the basic allowance, and this is often the range where marginal taxes are higher under flat taxes compared to traditional non-flat schemes.

Second, flat taxes are attractive because they are transparent. Transparency is indeed a distinctive feature of the flat tax, notably because each worker knows about her marginal tax rate (something more difficult to assess in a progressive tax system). An important related argument for flat taxes is their alleged superiority in terms of tax administration and compliance costs for individuals and businesses. Flat taxes are easy to administrate because they are usually accompanied by a removal of most (complex) tax deductions from the tax base to replace them with a general tax allowance. Graph 5.12 illustrates that the former tax systems in Bulgaria and the Czech Republic were placing an administrative burden on businesses that was substantially above the European average, so that the argument of tax simplification is likely to have been an important driver behind the recent introduction of flat tax rate schemes in these Member States. ([31]) However, complexity of tax systems and administrative burden do not only depend on the tax schedule, but also on the definition of the tax base, as well as on the procedural requirements set up by the tax administration. Ivanova et al. (2005) find no evidence that the Russian flat tax reform of 2001 reduced complexity. On the other hand, 4 out of the 5 Member States that had already introduced a flat tax scored below the European average in the ranking of administrative burden imposed by the tax system on individuals and firms in 2007 displayed in Graph 5.12. It will thus be very interesting to see whether the introduction of flat taxes in Bulgaria and the Czech Republic will reduce the administrative burden of paying taxes significantly in these countries.

Proponents of the flat tax also claim that so-called "Laffer-curve" effects from the introduction of flat taxes will increase tax revenues. ([32]) Tax revenues have actually increased in some countries after the flat tax has been introduced - albeit not in all of them – but research has not found Laffer effects or sizeable labour supply effects (cf. Keen et al. (2008)). It seems that a large part of the increased revenue was due to the fact that the introduction of

([31]) While the administrative burden measure used in Graph 5.12 provides suggestive evidence, it needs to be interpreted with care, as the indicator only captures one particular dimension of the tax system.

([32]) Named in 1978 after economist Arthur Laffer, the Laffer curve concept states that tax rates and tax collection are linked by an inverted U-curve relationship. If one country is on the right-hand side of the peak, then reducing tax rates shall increase revenues (thanks to more economic activity).

the flat tax at a rate that was lower than the rates that prevailed before was generally accompanied by stricter rules to combat tax fraud and improve compliance. The analysis of Ivonova et al. (2005), for example, concludes that this has been a key channel that made the Russian flat tax reform successful. Thus, increases in tax revenues may be rather due to higher compliance than to increased labour supply.

The introduction of a flat tax system is also frequently regarded as a signal to foreign investors that a country is engaging in business-friendly policies. Thus, flat tax reforms may play a role to improve the position of a country in the competition for international direct investments vis-à-vis competing countries. Of course, as more countries have been adopting a flat tax system the signalling function of such tax reforms has been increasingly eroded, and its benefits may be questioned under current conditions where flat tax schemes have proliferated substantially across the world, cf. Table A1.3 in the statistical annex which provides an overview of the flat tax schemes that have been implemented in 17 countries since 1994. ([33])

The introduction of a flat tax system also impinges on the long run growth potential of an economy. In particular, the associated change in the marginal tax rates for high incomes and in tax progressivity affects incentives for investment, entrepreneurship, risk taking and human capital formation which are all important determinants of growth. If the flat tax scheme reduces progressivity, this will by itself increase human capital formation incentives. On the other hand, the reduction of the top marginal income rate will make investment in capital more attractive, so that investment in human capital may become relatively less attractive compared to the alternative investment in physical capital. Reduced progressivity may also reduce risk-taking as progressive taxation can serve as an insurance device against risk. Similar considerations may apply to the decision to become an entrepreneur itself, but in this case, the positive effects of reduced marginal tax rates at high incomes may prevail. This is at least underlined by some empirical evidence from the US (cf. Gentry and Hubbard (2000)). On the other hand, Fossen (2008) finds that a reduction in tax progressivity tends to reduce self employment in Germany. Thus, there are a number of dynamic effects related to the introduction of a flat tax that will have repercussions on the long run growth performance of the economy. However, at this stage, more empirical research on these dynamic effects of flat taxes is necessary for a sound judgement. Of course, these will also depend on the respective designs of flat tax schemes.

Reforms towards flat taxes are not neutral in terms of redistribution. The distributional effects obviously depend on the details of the specific flat tax scheme. However, in general, flat tax reforms tend to favour the lower-end and top-end classes of revenues whilst increasing the tax burden on the middle-class. These distributional implications have to be taken into account when contemplating the move to, and the design of, a flat tax scheme and each government will have to make its own value judgement regarding the equity-efficiency trade-off associated with the move to a flat rate scheme. ([34])

Given the rapid proliferation of flat taxes across the new Member States, and elsewhere, it is not surprisingly that similar policy proposals have also surfaced in many of the old Member States. Until now, however, they have not gathered sufficient support for implementation. The recent simulation study by Fuest et al. (2008) illustrates that a mature and sizeable welfare state has either little to gain from a move to a flat tax, if the flat tax is designed in such a way that the degree of inequality is kept constant. Intuitively, such an equality-preserving reform requires a high basic allowance and a high marginal flat tax rate, which reduces potential efficiency effects. On the other hand, if a flat tax is constructed to keep the current basic allowance and total tax revenue constant, the transition to a flat tax that has small efficiency gains but implies substantial redistributive effects at the expense of the middle class and in favour of high income earners. These results underline the problematic equity effects of flat taxes in more extensive welfare states which can also explain the political

([33]) Further information and analysis on flat taxes can be found in Nicodème (2007).

([34]) Of course, this holds as well for tax reforms that do not consider a move to a flat tax.

opposition faced by flat tax proposals in countries characterised by extensive welfare states.

The stark contrast with the wave of adoption of flat taxes in the recently acceded Member States as well as in other non-EU transition economies may not only be explained by the higher importance of raising revenues in mature welfare states. Additional advantages from increased tax compliance and/or reduced administrative burdens are likely to be systematically different between these groups of countries. These potentially positive effects of flat tax systems are likely to be greater in transition economies where there may be substantial challenges regarding the governance of public administration, or where tax advisory services and the tax administration are not as developed as in the old Member States.

5.4. TAX COMPETITION

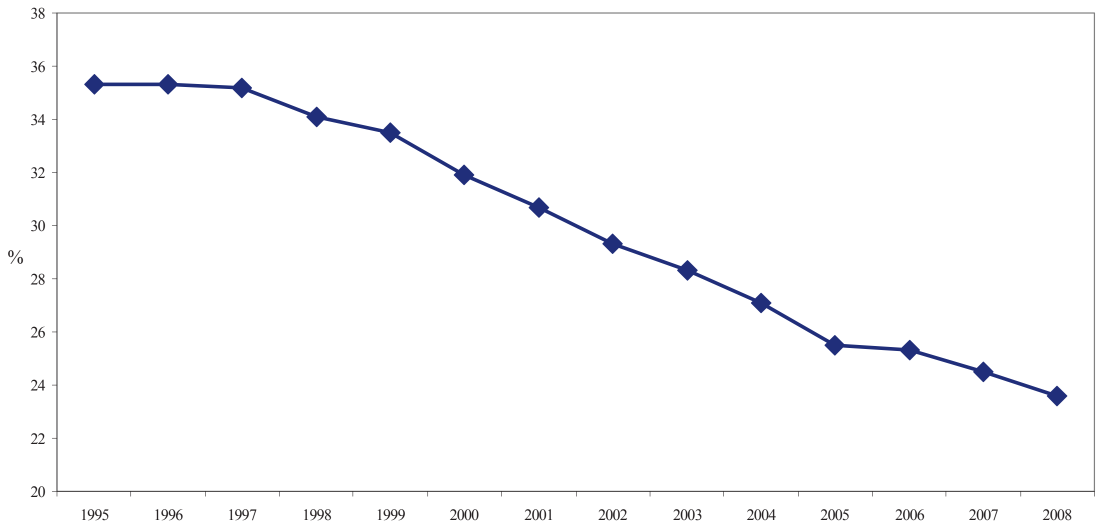
Increased economic integration with the associated higher mobility of several important tax bases makes it potentially more difficult to collect taxes from these mobile tax bases. This has fuelled fears of erosion of the overall revenues, and of an undesired shift of the tax burden from mobile to immobile factors of production, mainly labour (particularly unskilled workers), and of a reduced ability of revenue systems to contribute to the achievement of income redistribution objectives. The international competition for these mobile tax bases arises not only for pure fiscal reasons of revenue generation. Additionally, some of these mobile bases, in particular physical capital investments or skilled labour, also generate rents for the immobile factors, such as land or immobile unskilled workers. This reinforces the competitive pressures on governments to compete for these mobile bases.

Several observations point to the conclusion that competition for internationally mobile tax bases is increasingly shaping tax policy in the EU and beyond. As is evident from Graph 5.13, statutory tax rates of corporate taxes have been falling continuously in the EU over recent years and there is mounting evidence for the existence of tax competition for internationally mobile physical capital, as well as for accounting profits. Similarly, countries appear to take cross-border interactions in the form of internationally mobile cross-border shoppers into account when deciding on indirect, in particular excise taxes. ([35]) Thus, governments in the EU and beyond appear to increasingly take the international dimension of their tax policy decisions into account.

However, the view that increased economic integration and the associated increased competition between governments for internationally mobile tax bases has dramatically altered the composition of government revenues and reduced its capacity to finance the welfare state is so far not fully supported by the data. While capital can be considered a quite mobile tax base, according to available aggregate figures, taxation has not been shifted massively from capital to labour or consumption. In particular, while there has been a strong and ongoing EU-wide decline in statutory corporate income tax rates, revenues from capital taxation, including corporate taxation, have not been eroded so far, and recent figures even show a further increase in the importance of corporate tax revenues as measured in % of GDP, cf. Graph .

([35]) Evidence on tax competition for internationally mobile capital is provided by Devereux et al. (2008), Huizinga and Laeven (2007), among others. Evidence on tax competition for cross border shoppers is found by Egger et al. (2005).

Graph 5.13: **Statutory corporate tax rates (incl. local taxes and surcharges), EU-27 (arithmetic average)**



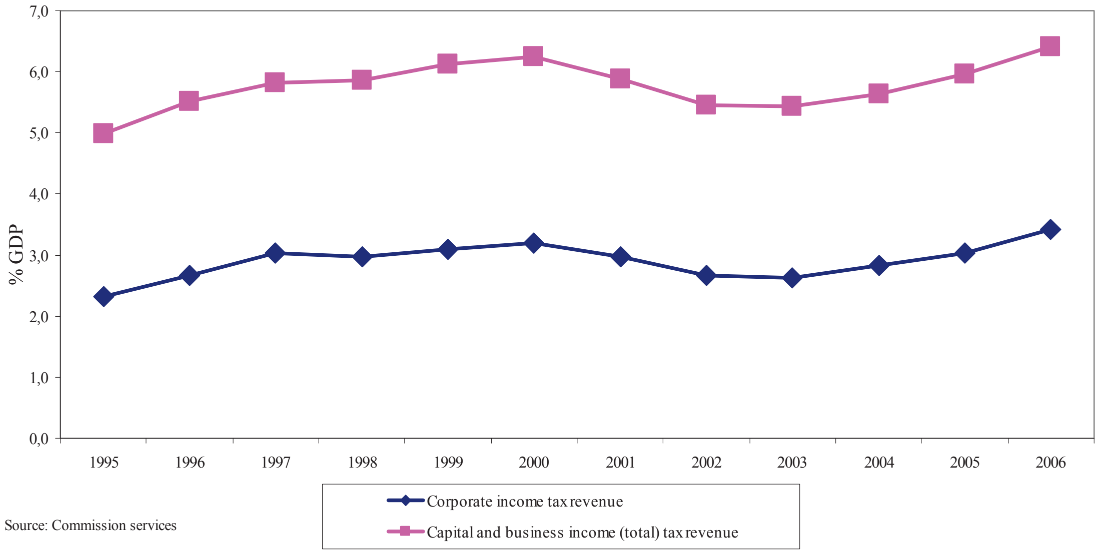
Source: Commission services

Several explanations have been put forward for this finding. First, base broadening efforts may have partly compensated the reduction in tax rates. Second, globalisation may have increased profitability and hence tax revenues, for any given tax rate. This is related to the observation of an increased share of profits as % of GDP over recent years. Third, policy initiatives such as the EU Code of Conduct on Business Taxation adopted in 1997 may have reduced harmful tax practices. Fourth, increased incorporation incentives due to reduced corporate taxes may have resulted in increased tax revenues from corporate income but reduced revenues from personal income taxation (see de Mooij and Nicodème (2008)). Member States assessing the budgetary effects of corporate tax reforms need to be aware of the foregone revenues from personal income taxes that arise from increased incorporation incentives of planned corporate tax reform. Moreover, the reductions in corporate tax rates may imply that the corporate tax is losing its function as a "backstop" for personal income taxes. ([36])

The importance of increasing competition for mobile tax bases raises the question of appropriate policy responses not only at the national level, but also at the international level. National policies have tried to adjust to these circumstances through various measures, in particular by reducing the tax burden on mobile bases. The answer to the questions of whether and how to regulate tax competition internationally, or at least at the European level, typically depends on the view one takes on the effects of tax competition. Some observers see tax competition as a beneficial disciplining device that will make governments more efficient. Others see the reduced revenue raising capacity as a threat to the welfare enhancing role of government, in particular to its capacity to redistribute income. However, even if one believes in the beneficial effects of tax competition on government activity, it should also be noted that tax competition occurs between countries of given characteristics, which are often

([36]) The backstop function of the corporate income tax refers to the possibility that entrepreneurs may avoid tax liabilities by declaring personal income as corporate income. This backstop function is potentially an important reason that limits further reductions in corporate tax rates. On the other hand, as ownership is becoming increasingly international, this effect may be weakened, cf. Fuest and Hemmelgarn (2005). Of course, it could also be that this function is becoming less important as a consequence of increased efforts against fraud and evasion, which could be an additional explanation for falling corporate tax rates.

Graph 5.14: **Tax revenue from corporate income tax and total tax revenue from capital and business income, EU-27**



Source: Commission services

not possible to change, such as country size. ([37]) The given characteristics may structurally put certain countries at a disadvantage. For example, small countries will, ceteris paribus, typically be in an advantaged position vis-à-vis large countries, see Bucovetsky (1991) or Kanbur and Keen (1993). Moreover, competition among governments is likely to fail in many instances, because governments are typically active in sectors where private activity typically does not work very well. The market failure that was the original reason for government intervention will typically reappear in the competition between governments (cf. Sinn (1997)). Furthermore, even if governments are not fully benevolent, the welfare effects of reduced tax competition will depend on the relative effects that this will have on the wasteful activities (a negative effect) and on the increase in public good provision and redistribution (a positive effect), cf. Edwards and Keen (1996). Finally, some economists maintain that capital should not be taxed and thus see the reduction in corporate tax rates as efficiency enhancing. However, such results are typically based on models that have too restrictive assumptions, cf. the extensive discussion of this by Banks and Diamond (2008). However, a recent empirical study by Arnold (2008)) finds that corporate taxes are particularly harmful for growth.

Tax competition in corporate taxes can take the form of rate-cut cum base-broadening reforms. An important aspect that is frequently overlooked in this context is that base broadening is not always innocuous. In the domain of corporate taxation many provisions that reduce the tax base such as loss carry-forwards and a proper deduction of costs are important features of the tax regulations to preserve efficiency of economic decisions taken by firms. Similarly, some other aspects of corporate tax codes, such as privileged treatment of investments in R&D, for example in the form of immediate or accelerated depreciation schemes, serve the purpose of internalising the positive external effects that are often generated by such activities. Broadening the base of corporate taxation thus may carry the danger of reducing efficiency, if such efficiency-preserving provisions in the corporate tax code are repealed. There are concerns that base broadening policies, often driven by attempts to restrict firms' possibilities to relocate profits to low tax countries, can get into conflict with the objective of efficient investment and financing decisions. There exists a tension

([37]) Note that this situation is different from classic market competition where firms usually can choose freely their organisation, financing, technology, etc. so all firms are competing on a level playing field.

between the base broadening to increase efficiency and defend tax revenue and the objective of reducing distortions of firms' decisions. When considering base broadening corporate tax reforms, one needs to carefully assess the various alternatives and restrict the policy to those base broadening elements that do not substantially distort investment and financing decisions.

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ANNEX 1
Statistical annex

Table A1.1:
EU-27: Total taxes (incl. social security contributions) and tax structure, % of GDP, 1995-2006

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Average 1995-2006	pp change 1995-2006
Total taxes (including SSC)	**39,6**	**40,3**	**40,5**	**40,5**	**41,0**	**40,7**	**39,8**	**39,2**	**39,1**	**39,0**	**39,3**	**39,9**	**39,9**	**0,4**
Indirect taxes	**13,3**	**13,4**	**13,6**	**14,0**	**14,3**	**14,0**	**13,7**	**13,6**	**13,6**	**13,7**	**13,8**	**13,9**	**13,7**	**0,6**
VAT	6,6	6,7	6,8	6,8	7,0	7,0	6,9	6,8	6,8	6,8	6,9	7,0	6,9	0,4
Excise duties & consumption taxes	3,1	3,1	3,1	3,1	3,1	3,0	3,0	3,0	3,0	2,9	2,8	2,7	3,0	-0,3
Other product taxes incl. import duties	1,6	1,6	1,6	1,7	1,7	1,7	1,6	1,6	1,6	1,7	1,7	1,8	1,6	0,2
Other taxes on production	2,0	2,1	2,1	2,5	2,4	2,3	2,3	2,3	2,3	2,3	2,3	2,4	2,3	0,3
Direct taxes	**12,4**	**12,8**	**13,2**	**13,6**	**13,8**	**14,0**	**13,6**	**13,0**	**12,8**	**12,7**	**13,0**	**13,5**	**13,2**	**1,1**
Personal income taxes	9,2	9,3	9,2	9,7	9,8	9,9	9,7	9,4	9,3	8,9	9,0	9,2	9,4	0,0
Corporate income tax	2,0	2,4	2,7	2,6	2,7	2,8	2,6	2,3	2,2	2,4	2,7	3,0	2,5	0,9
Other	1,2	1,2	1,2	1,2	1,3	1,4	1,2	1,2	1,3	1,3	1,3	1,3	1,3	0,1
Social security contributions	**13,8**	**14,1**	**13,8**	**13,0**	**13,0**	**12,8**	**12,7**	**12,6**	**12,8**	**12,7**	**12,6**	**12,6**	**13,1**	**-1,3**
Employer SSC	7,5	7,7	7,6	7,4	7,3	7,3	7,3	7,2	7,4	7,3	7,2	7,2	7,4	-0,3
Employees SSC	4,7	4,7	4,6	4,2	4,2	4,1	4,0	4,0	4,0	3,9	3,9	3,9	4,2	-0,9
Self and non-employed SSC	1,6	1,7	1,7	1,5	1,5	1,4	1,4	1,4	1,4	1,5	1,5	1,5	1,5	-0,2

Note: GDP-weighted averages. Totals may be affected by rounding. SSC: social security contributions.
Source: Commission services.

Table A1.2:
Tax structure in EU-19, % GDP, 2007, OECD classification

	Taxes on goods and services	Taxes on income	SSC	Taxes on payroll and workforce	Taxes on property	Other taxes
Austria	11,5	12,6	14,1	2,7	0,6	0,4
Belgium	11,2	16,7	13,7	0,0	2,2	0,0
Czech Republic	10,9	8,7	16,1	0,0	0,4	0,0
Denmark	16,3	29,3	1,0	0,2	1,9	0,0
Finland	12,9	16,9	11,9	0,0	1,1	0,0
France	10,8	10,4	16,2	1,2	3,5	1,5
Germany	10,6	11,3	13,2	0,0	0,9	0,0
Greece	11.3*	7.5*	11.1*	0.0*	1.4*	0.0*
Hungary	14,7	10,0	12,9	0,6	0,8	0,2
Ireland	11,7	12,5	4,9	0,2	2,8	0.0*
Italy	10,6	14,8	13,1	0,0	2,1	2,6
Luxembourg	10,1	12,9	10,2	0,0	3,6	0,0
Netherlands	11,4	11,1	13,8	0,0	1,2	0,2
Poland	12.8*	7.0*	12.2*	0.3*	1.2*	0.0*
Portugal	14,0	9,5	11,7	0,0	1,2	0,1
Slovak Republic	11,5	5,9	11,9	0,0	0,4	0,0
Spain	9,6	12,6	12,2	0,0	3,0	0,2
Sweden	12,8	18,7	12,6	2,7	1,2	0,1
United Kingdom	10,7	14,4	6,8	0,0	4,6	0,0
EU 15	11.8*	13.8*	11.1*	0.5*	2.2*	0.3*
EU 19	12.0*	12.6*	11.5*	0.4*	1.9*	0.3*

Note: GDP-weighted averages. Totals may be affected by rounding. SSC: social security contributions.
Source: OECD

Table A1.3:
Flat taxes in the EU and elsewhere

		Personal Income Taxes rates			Corporate Income Taxes rates			Basic allowance*
	Flat tax adopted	Before**	After**	2008	Before**	After**	2008	
Bulgaria	2008	10–24	10	10	10	10	10	Eliminated
Czech Rep.	2008	12–32	15***	15	24	21*****	21	Substantial increase
Estonia	1994	16–33	26	21	35	26	22	Modest increase
Latvia	2004	10–35	25	25	25	25	15	Increase by 67%
Lithuania	1994	18–33	33	24	29	29	15	Substantial increase
Romania	2005	18–40	16	16	25	16	16	Increase
Slovakia	2004	10–38	19	19	25	19	19	Substantial increase
Russia	2001	12–30	13	13	30	35	24	Modest increase
Ukraine	2004	10–40	13	15	30	25	25	Increase
Georgia	2005	12–20	12	12	20	20	20	Eliminated
Kyrgyz Rep.	2006	10–20	10	10	20	10	10	Unchanged
Macedonia	2007	15–24	12	12f	15	12	10	Unchanged
Kazakhstan	2007	5–20	10	10	30	30	30	Substantial increase
Mongolia	2007	10–30	10	10	15 and 30	10 and 25	10 and 25****	Substantial increase
Iceland	2007	36.72 and 38.72	35,72	35,72	18	18	18	Modest increase
Albania	2007	1–20	10	10	20	20	10	Increase
Montenegro	2007	15–23	15	15k	15/20	9	9	Increase

* Change due to the introduction of flat tax.
** Rates relate to year before and after flat tax adoption.
*** This rate applies to income inclusive of the 35% employers' SSC. The implied rate on income exclusive of these contributions — comparable with other rates in the table — is 23.1%.
**** Threshold for the higher rate has been substantially increased.
***** CIT rate was reduced to 20% in 2009 and is scheduled to be further reduced to 19% in 2010.
Source: Keen et al. (2008) and Commission services

Table A1.4:
Total tax wedge on labour (including employers' social security contributions)

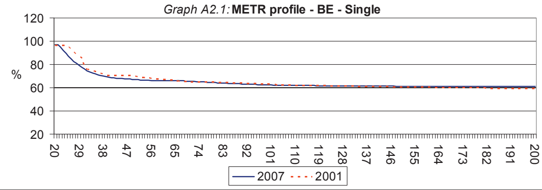
	Total tax wedge (average rate, including employers' SSC), single person without children, 100% of AE									Total tax wedge (average rate incl. employers' SSC), single person without children, 67% of AE								
	2001	2002	2003	2004	2005	2006	2007	2008	Change 2001-08	2001	2002	2003	2004	2005	2006	2007	2008	Change 2001-08
Austria	46,9	47,1	47,4	48,1	47,9	48,1	48,5	48,9	2,0	42,9	43,1	43,5	43,9	43,1	43,5	44,1	44,5	1,6
Belgium	56,7	56,3	55,7	55,4	55,4	55,4	55,5	55,9	-0,8	50,7	50,5	49,6	48,9	49,2	49,1	49,6	50,2	-0,5
Bulgaria	40,4	39,6	39,0	38,9	38,9	35,4	36,5	n.a.	n.a.	35,9	35,2	35,0	34,9	35,3	31,1	32,3	n.a.	n.a.
Cyprus	20,9	17,3	18,5	18,6	13,6	14,1	13,9	n.a.	n.a.	17,0	17,2	18,5	18,6	11,9	11,9	11,9	n.a.	n.a.
Czech Republic	42,6	42,9	43,2	43,5	43,8	42,6	42,9	43,5	0,9	41,3	41,5	41,7	41,9	42,1	40,1	40,5	40,1	-1,2
Denmark	43,6	42,6	42,6	41,3	41,4	41,3	41,3	41,2	-2,4	40,5	39,8	39,8	39,3	39,3	39,3	39,3	39,0	-1,5
Estonia	39,7	42,2	42,5	41,4	41,6	40,2	40,1	n.a.	n.a.	37,4	40,2	40,7	38,9	39,8	38,4	38,7	n.a.	n.a.
Finland	46,4	45,9	45,0	44,5	44,6	44,1	43,7	43,5	-2,9	41,4	40,9	40,0	39,4	39,5	38,9	38,2	38,2	-3,2
France	49,8	49,8	49,8	49,9	50,1	50,2	49,2	49,3	-0,5	47,6	47,4	45,0	42,4	41,8	44,5	44,4	44,5	-3,1
Germany	53,0	53,5	54,2	53,2	52,4	52,5	52,2	52,0	-1,0	47,7	48,1	48,8	47,8	47,3	47,4	47,4	47,3	-0,4
Greece	38,1	37,7	37,7	39,5	40,4	41,2	42,3	42,5	4,4	35,1	34,3	34,4	34,9	34,8	35,4	36,7	37,7	2,6
Hungary	54,0	53,7	50,8	51,8	50,5	51,0	54,4	53,9	-0,1	48,1	48,2	44,5	44,8	42,9	42,9	45,9	46,6	-1,5
Ireland	25,8	24,5	24,2	25,0	23,5	23,1	22,3	22,7	-3,1	17,3	16,7	16,2	20,0	16,8	16,3	15,0	15,7	-1,6
Italy	46,0	46,0	45,0	45,4	45,4	45,2	45,9	46,5	0,5	42,7	42,7	41,1	41,4	41,7	41,5	42,0	43,0	0,3
Latvia	42,7	42,9	42,2	42,5	42,2	42,9	42,4	n.a.	n.a.	41,2	41,4	40,8	41,2	40,9	41,8	41,1	n.a.	n.a.
Lithuania	45,2	44,6	43,4	43,7	44,4	46,3	43,0	n.a.	n.a.	42,2	41,2	39,5	40,0	41,0	43,9	41,3	n.a.	n.a.
Luxembourg	37,0	34,2	34,7	35,1	35,9	36,5	37,5	37,2	0,2	31,2	29,0	29,3	29,6	30,2	30,6	31,4	31,2	0,0
Malta	23,4	24,1	23,3	23,6	23,9	24,5	23,6	n.a.	n.a.	17,0	17,7	17,4	17,6	17,8	18,4	18,6	n.a.	n.a.
Netherlands	37,2	37,4	37,1	38,8	38,9	44,4	44,0	44,8	7,6	38,9	39,1	40,0	40,8	41,6	40,6	40,2	41,4	2,5
Poland	42,9	42,9	43,1	43,3	43,6	43,7	42,8	39,8	-3,1	41,8	41,7	41,9	42,2	42,4	42,5	41,6	38,7	-3,1
Portugal	36,4	36,6	36,8	36,8	36,3	36,3	37,4	37,4	1,0	32,2	32,3	32,4	32,4	31,8	31,7	32,6	32,6	0,4
Romania	47,9	47,3	46,2	45,8	44,0	43,7	43,4	n.a.	n.a.	45,2	44,6	43,4	42,9	42,4	42,2	41,8	n.a.	n.a.
Slovak Republic	42,8	42,5	42,9	42,5	38,3	38,5	38,5	38,9	-3,9	41,3	40,8	40,9	39,6	35,3	35,6	35,6	36,1	-5,2
Slovenia	42,3	42,5	42,5	42,6	42,4	44,0	n.a.	n.a.	n.a.	41,0	41,1	41,1	41,1	39,4	39,8	n.a.	n.a.	n.a.
Spain	38,8	39,1	38,5	38,7	38,9	39,1	38,9	37,8	-1,0	35,3	35,7	34,7	35,2	35,5	35,9	35,6	33,8	-1,5
Sweden	49,1	47,8	48,2	48,4	47,9	47,9	45,4	44,8	-4,3	47,8	46,8	47,0	47,1	46,5	46,0	43,3	42,5	-5,3
United Kingdom	31,8	31,9	33,3	33,4	33,5	33,9	34,1	33,0	1,2	28,0	28,1	29,6	29,7	29,9	30,4	30,8	30,0	2,0
EU-27	44,9	45,0	45,4	45,2	44,9	45,1	44,8	n.a.	n.a.	41,3	41,4	41,3	40,7	40,4	40,7	40,6	n.a.	n.a.

Source: OECD and Eurostat
Note: Change 2000-08 in percentage points, 2008 provisional values, AE: Average earnings

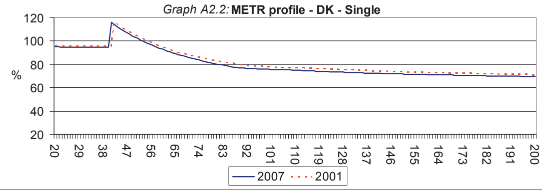
ANNEX 2

Additional graphs

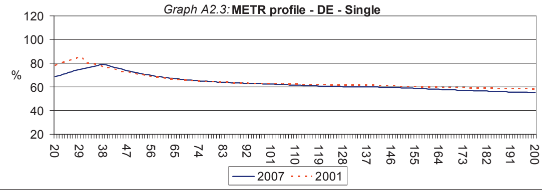
Graph A2.1: **METR profile - BE - Single**



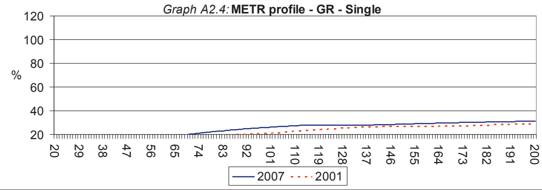
Graph A2.2: **METR profile - DK - Single**



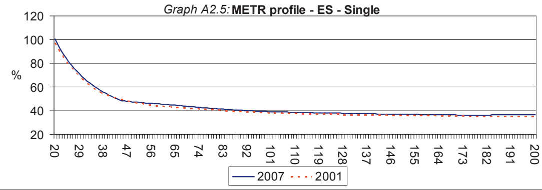
Graph A2.3: **METR profile - DE - Single**



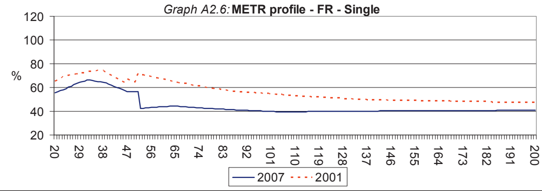
Graph A2.4: **METR profile - GR - Single**



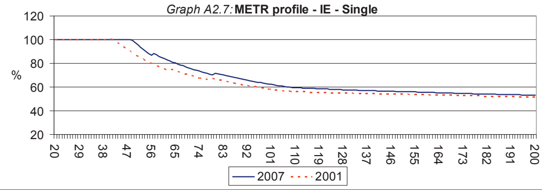
Graph A2.5: **METR profile - ES - Single**



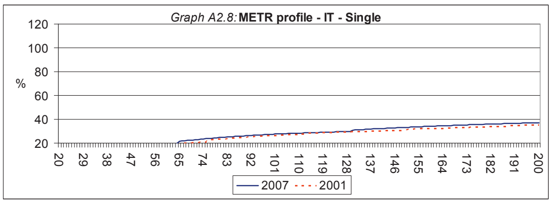
Graph A2.6: **METR profile - FR - Single**



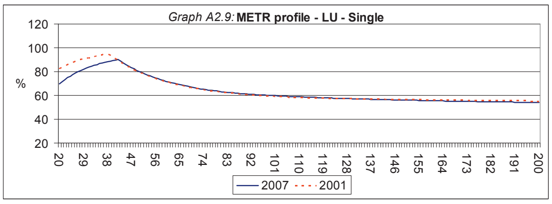
Graph A2.7: **METR profile - IE - Single**



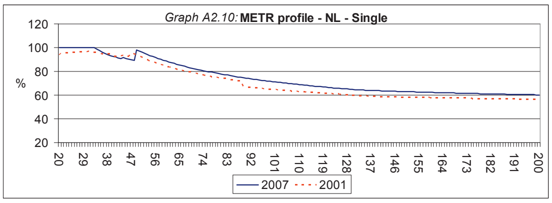
Graph A2.8: **METR profile - IT - Single**



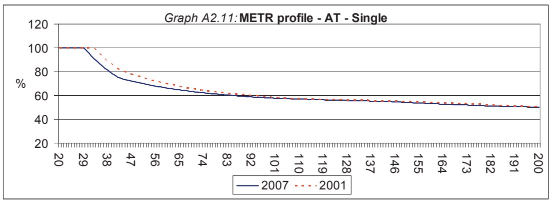
Graph A2.9: **METR profile - LU - Single**



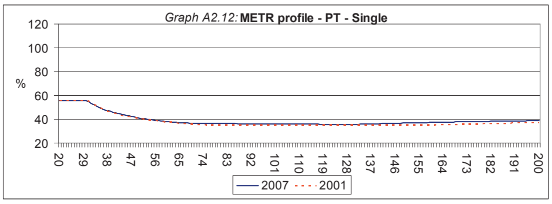
Graph A2.10: **METR profile - NL - Single**



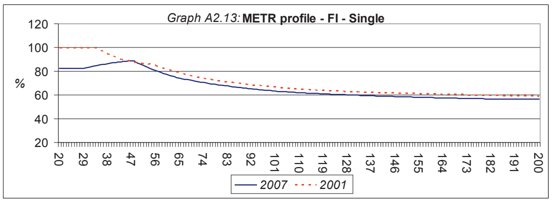
Graph A2.11: **METR profile - AT - Single**



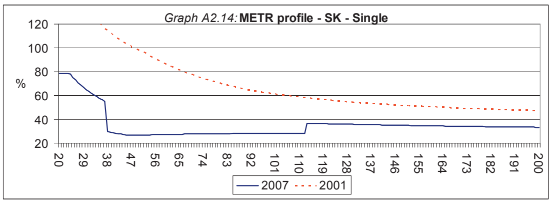
Graph A2.12: **METR profile - PT - Single**



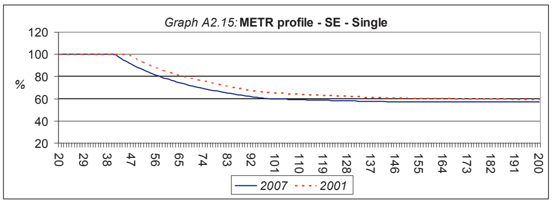
Graph A2.13: **METR profile - FI - Single**



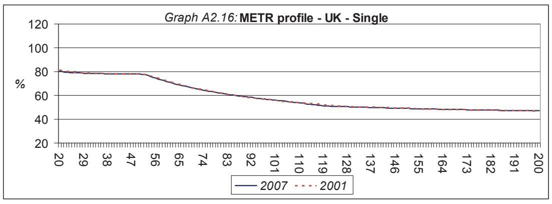
Graph A2.14: **METR profile - SK - Single**



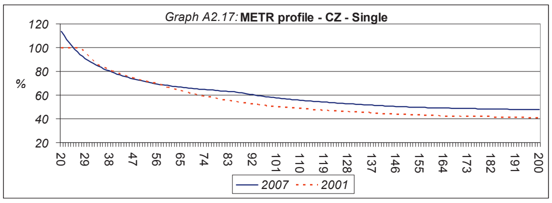
Graph A2.15: **METR profile - SE - Single**



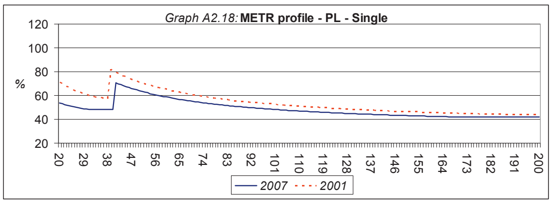
Graph A2.16: **METR profile - UK - Single**



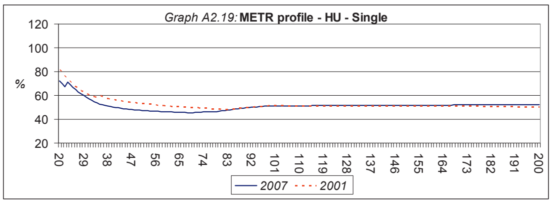
Graph A2.17: **METR profile - CZ - Single**



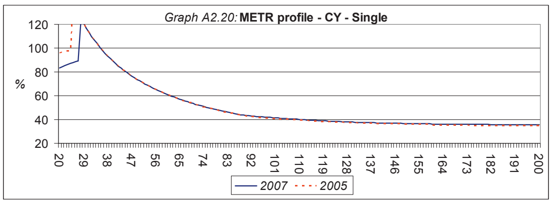
Graph A2.18: **METR profile - PL - Single**



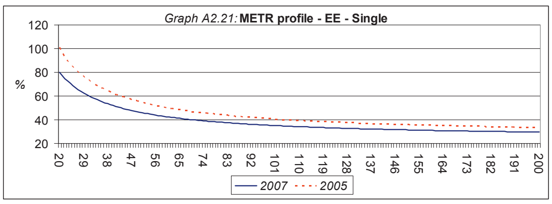
Graph A2.19: **METR profile - HU - Single**



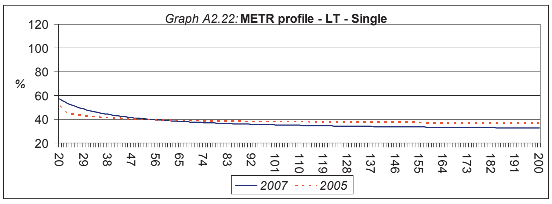
Graph A2.20: **METR profile - CY - Single**



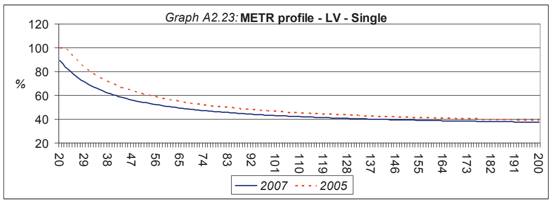
Graph A2.21: **METR profile - EE - Single**



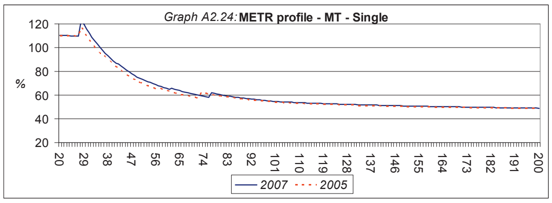
Graph A2.22: **METR profile - LT - Single**



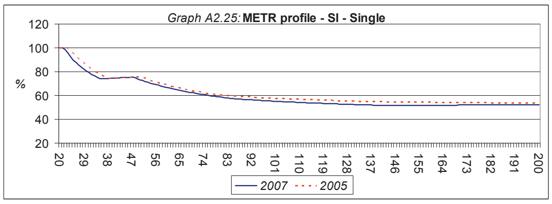
Graph A2.23: **METR profile - LV - Single**



Graph A2.24: **METR profile - MT - Single**



Graph A2.25: **METR profile - SI - Single**



Source: All graphs are based on data from the joint OECD-EC METR project. BG and RO are not available. METR profiles include the withdrawal of social assistance, housing benefits, family benefits and the effects of in-work benefits, income taxes and SSCs.

ANNEX 3
2008 Tax measures

Table A3.1:
Summary of nature of measures taken in response to the financial crisis

Country	Explicit measures						Implicit measures					
	Labour		Capital		Consumption		Labour		Capital		Consumption	
	Up	Down	Up	Down	Up	Down	Up	Down	Up	Down	Up	Down
AT		✓						✓				✓
BE								✓		✓		
BG							✓	✓		✓		
CY												✓
CZ								✓		✓		
DK												
EE												
FI		✓									✓	✓
FR										✓		
DE		✓		✓		✓						
EL									✓	✓		
HU			✓									
IT												
IE							✓		✓	✓	✓	
LV		✓		✓	✓		✓	✓		✓		
LT		✓		✓	✓							
LU								✓		✓		
MT												
NL								✓		✓		✓
PL								✓				
PT								✓		✓		✓
RO				✓								✓
SK								✓				
SI		✓		✓				✓		✓		
ES		✓		✓		✓	✓					
SE		✓		✓				✓		✓		
UK								✓	✓	✓		

Source: Commission services and EPC.

The tables in this section list the tax measures taken by Member States since January 2008 to counteract the effects of the economic crisis. The measures include two categories: (a) those explicitly taken to counteract the effects of the crisis and (b) those that are not explicitly taken to counteract the crisis but whose effects may act against the effects of the crisis. The table only includes measures that have been adopted or introduced, not those under discussion.

Table A3.2:
Detailed list of tax measures taken

Country	Title of the reform	Date of adoption	Description
Austria	**Temporary increase of tax credit**	4-juin-08	Finance Committee of Austrian Parliament (Finanzausschuss) decided a temporary increase in tax credit for commuting expenses and the kilometre allowance to compensate for increasing petrol prices. The measure takes effect from 1 July 2008 to 31 December 2009.
Austria	**VAT rate**	oct-08	From December 2008, VAT rate for pharmaceuticals is reduced from 20% to 10%. In addition, supplementary payments for overtime work become tax free up to 86 Euros/months.
Austria	**Economic growth package**	30-oct-08	Increase of limits on income tax deductible savings from 1000 Euro to 1200 Euro for savings in Bausparkassen., which are supposed to provide the acquired liquidity to SMEs.
Belgium	**Reduction social contributions on low-income**	Implemented October 1st, 2008	Personal social contributions are lowered by up to € 32 euro a month for low income households.
Belgium	**Tax plan 2008**	Adopted on 29 May, 2008	- Retroactive from January 2008, an exemption for additional personnel applies for companies with less than 11 employees. The exemption amounts to EUR 3,720 for each additional employee if gross wage does not exceed EUR 90.32 per day or EUR 11.88 per hour. - From 1st July 2008, the amount of wage tax withheld would be increased from 25% to 50% for salary paid to researchers employed under an R&D program. From tax year 2009, the basic allowance for income not exceeding EUR 15,220 is increased from EUR 4,059 to EUR 6,150. For income greater than EUR 15,220 but lower than EUR 15,365, the allowance will increase by the difference between the taxable income and EUR 15,220. - From January 2009, costs incurred by employers for providing transport for personnel, between home and work and costs of SMEs for safety measures are deductible at 120%.
Bulgaria	**Amendments to the Law on Local Taxes and Fees**	The amendments entered into force as of 1 January 2008; Published in Official Gazette on 21 December 2007	- The alternative lump-sum tax for small individual entrepreneurs becomes a local tax. - From January 2008, the rates for the taxes and fees covered by each municipality shall be fixed within new limits set by the law.
Bulgaria	**Amendments to the Corporate Income Tax Law**	Published in Official Gazette on 21 December 2007	- With retroactivity from January 2007, the withholding tax rate on dividends is reduced from 7% to 5%, the exemption on withholding tax for payments made by permanent establishments located in a tax treaty partner is abolished, the penalty for hidden distributions is decreased from 50% to 20%, the thin capitalization rules are amended to exclude interest expenses capitalized into the value of an asset, the threshold for depreciable assets is increased from BGN 500 (approximately EUR 256) to BGN 700 (approximately EUR 358). Asset of lower value are expensed immediately, expenses for marketing surveys, business plans, strategies cannot be treated as depreciable intangibles. - The provisions for the Parent-subsidiary directive are modified to exempt dividends from 95% to 100% from corporate income. - New detailed provisions are introduced for the transformation of closely held companies into sole property companies. - Advanced payments for taxpayers with sales below BGN 200,000 (about EUR 102,300) and new taxpayers are exempted from advanced payments.
Bulgaria	**Amendments to social security contributions for 2008**	Budget of the Public Social Security for 2008 published in the Official Gazette on 28 December 2007 Budget of the Public Social Security for 2009 published in the Official Gazette on 23 December 2008	Changes to the social security contributions from 1 January 2008: - The maximum monthly social security base is increased from BGN 1,400 (approx. EUR 716) to BGN 2,000 (approx. EUR 1023). The minimum social security base for self-employed is increased from BGN 220 (approx. EUR 112) to BGN 240 (approx. EUR 123). - The share of employer and employee in social security contributions is changed from 65/35 to 60/40. Changes to the social security contributions as of 1 January 2009: - The maximum monthly social security base is preserved at its 2008 level of BGN 2,000 (approx. EUR 1023). The minimum social security base for the self-employed is increased from BGN 240 (approx. EUR 123) to BGN 260 (approx. EUR 133). - The share of the employer and the employee in the social security contributions is 60/40, excluding the pension contributions, for which the distribution was changed to 10-to-8.

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Table (continued)

Bulgaria	**Amendments to the Personal Income Tax Law**	Entered into force as of 1 January 2008; Published in Official Gazette on 28 December 2007	- Progressive personal income tax rates reaching a top marginal rate of 24% is replaced by a flat 10% tax, without allowance (with few exceptions). - Fixed deductions to business and independent services income are decreased. - 10% fixed deduction for management fees is abolished. - Introduction of a 10% capital gain on immovable property. - Withholding tax on dividends to resident individuals is reduced from 7% to 5% - Withholding tax rate on insurance income is decreased from 15% to 10%.
Bulgaria	**Amendments to the VAT law**	Entered into force as of 1 January 2008; Published in Official Gazette on 28 December 2007	- VAT on partial advance payment made prior to the chargeable event is due only on the part of the taxable amount corresponding to the payment. - Abolition of the zero rate on intermediary services supplied outside the EC.
Bulgaria	**Amendments to the Corporate Income Tax Law**	Enter into force as of 1 January 2009; Published in Official Gazette on 5 August 2008	- New rules for inbound and outbound dividends to/from companies and other entities resident in the EEA, which are identical to the rules for domestic dividends (i.e. no withholding tax).
Bulgaria	**Changes to inheritance allowance**	Adopted with the 2009 budget law	- Lower inheritance allowance of BGN 250,000 (approx. EUR 127,800) to BGN 70,000 (approx. EUR 35,800).
Bulgaria	**Changes to Corporate Income Tax Law**	Adopted with the 2009 budget law	- Abolition of the employment aid scheme for depressed regions.
Bulgaria	**2009 State Budget of the Republic of Bulgaria Law**	Adopted with the 2009 budget law	Measures aimed at stimulating the economy, as well as a number of measures to minimize the eventual effects of the financial crisis, grouped in three packages: - "Economic Activity": public investment program. - "Market Flexibility": access to credit for small SMEs. - "Flexibility of Social Networks": labour market flexicurity.
Cyprus	**Amendments to the VAT law**		- Reduction of the VAT rate from 15% to 5% on specific goods and services such as confectioneries and entrance fees to cultural and sport events – 19/10/2007. - Reduction of VAT rate from 15% to 5% on importation of items of archeological value of CN code 9706.00.00 – 30/5/2008. - Reduction of VAT rate from 8% to 5% on the supply of services by school canteens – 25/7/2008.
Cyprus	**Reduction tax on heating**		Reduction in the excise duty levied on heating oil – 1.11.2008.
Czech Republic	**Major changes to corporate and individual taxation**	Government submitted to the lower chamber of the Parliament an amendment to the Income Tax Law. The changes would generally apply from 1 January 2009.	- Thin capitalization: scope extended to credits and loans provided by unrelated parties. In addition, de minimis rule for annual financial costs of up to CZK 1 million is abolished. - Participation exemption - capital gains: scope of exemption of capital gains extended to include capital gains derived by qualifying parent companies resident in other Member States. - Cross-border donations: donations to eligible bodies resident in other Member States, Norway and Iceland would be deemed tax-deductible, subject to conditions. - PIT rate. The flat 15% personal income tax rate would not be reduced to 12.5%, as originally envisaged. - Personal tax credits: basic tax credit (CZK 24,840) and credit for dependent spouse (CZK 24,840) would not be reduced to CZK 16,560 from 1 January 2009. - Social security contributions paid by employees reduced by 1.5 percentage points from 8% to 6.5% of the gross employment income. - Exemption of capital gains from securities: would apply to any securities (as opposed to "transferable securities and securities issued by collective investment undertakings"); and only direct participation in the capital or voting rights of the issuer (as opposed to "direct or indirect participation") would be relevant for claiming the exemption.
Denmark			No fiscal measures announced
Estonia			No fiscal measures announced

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Table (continued)

Denmark			No fiscal measures announced
Estonia			No fiscal measures announced
Finland	**2009 budget bill tax proposals**	January 20009	To boost economic growth and employment, taxes on earned income will be eased by: Decrease rates of the national income tax table by 1 or 1.5 percentage points, depending on the bracket; - Indexation of approximately 4% to the bracket amounts in the income tax table; and - New employment income deduction, - Increased pension income allowances, both national and municipal. - Maximum household allowance increased from EUR 2,300 to 3,000. - VAT on foodstuffs reduced from 17% to 12% as of 1 October 2009. Taxes on tobacco will be raised by 10% (cigarettes) or 25% (hand-rolled cigarettes). Tax on alcohol will be increased by 10%.
France	**Bill on Economic Modernization**	Adopted on 23 July 2008	(a) Micro-enterprise tax regime: monthly or quarterly withholding tax would apply at the rate of 13% for income from the sale of goods and at the rate of 23% for income from services. (b) Inward expatriates: entitled to an income tax exemption of 30% of taxable French income for the first 5 years, provided that all applicable exemptions do not exceed 50% of the taxpayer's total taxable income. (c) Foreign source dividends, interest and royalties would be exempt from income tax up to 50% of their amount. (d) Capital companies would be able to make an election to be taxed as personal companies (i.e. société de personnes) under conditions. (e) Transfer of shares of SAs and SARLs subject to registration duty of 3% (instead of 5%).
France	**Local business tax exemption**	Announced	Exemption from local business tax for investments made from mid-October 2008 until 1st January 2010.
France	**Finance bill 2009**	Adopted by the Council of Ministers on 30 September 2008	From 1 January 2009: - Personal income tax rates for 2008 income unchanged at 5.5%, 14%, 30% and 40%. However, the corresponding income brackets would be indexed and uniformly increased by 2.9%, as would various deductions and thresholds - Capital gains from occasional sale by private individual of quoted and unquoted shares in companies which are subject to corporate income tax, are tax-exempt if the amount of the proceeds from sales of securities sold throughout a given year by the fiscal household is below EUR 25,730. - Global cap for the tax relief resulting from incentive measures for investment in the French Overseas Departments. - Progressive abolition of the annual minimum lump-sum tax for companies. - Extension to 2009 of the exceptional windfall tax on oil companies. - Net wealth tax brackets uniformly indexed and increased by 2.9%. - Brackets, thresholds and deductions applicable to gift and inheritance tax indexed and increased by 2.9%.
Germany	**Federal Cabinet approves economic stimulus package**	5-nov-08	- Introduction of declining-balance depreciation at a rate of 25% for movable fixed assets acquired or produced after 1 January 2009 and before 31 December 2010 - increased thresholds for accelerated depreciation of the cost of movable fixed assets. - Maximum credit for services supplied by self-employed persons for household repairs increased to 20% of EUR 6,000 (i.e. maximum EUR 1,200) - Incentives for buyers of environmentally friendly cars. - Non-tax measures (infrastructure projects, energy efficiency in buildings, and loans for SMEs).
Germany	**Reduction in SCC**	Adopted on 07.10.08	From January 2009 the rate to the unemployment insurance lowered from 3.3% of income to 2.8%. From July 2010 the rate will be raised again from 2.8% to 3%.
Greece	**Tax reform 2008**	Enacted on 2 October 2008	- 10% withholding tax for distributed profits from Greek corporations (those falling within the scope of the Parent-Subsidiary Directive 2003/123/EC will be exempt). - Inbound dividends from foreign corporations to resident individuals bear a 10% final tax (before PIT). - Capital gains from listed shares subject to a 10% withholding tax. - director's fees to board members of a corporation subject to final withholding tax at a rate of 35%. - percentage of advance corporate tax is increased to 80%; - gradual reduction by 1 percentage point per year of the corporate income tax rate for the years from 2010 to 2014. This bring the current rate of 25% to 20%.
Hungary	**Special Energy Tax**	10-nov-08	Special energy tax on energy suppliers, from 1st January 2009 until 1 January 2011 (tax base is same as the CIT base and the rate is 8%).
Italy	**Decree Law n. 93/2008 (converted into Law n. 126/2008)**		Provisions to support household purchasing power. The Decree envisages scrapping property tax ("ICI") on houses used as primary residences and outlining new ways to renegotiate mortgage loans taken out for the purchase and renovation of primary residences (an agreement between the Treasury and the Bank Association was signed on 19 June 2008). Specific aids to sustain low income persons have been envisaged through the use of a "social card".
Italy	**Art. 83 Decree n. 112/2008 converted into Law n. 133/2008**		Stronger measures to fight tax evasion; resulting savings earmarked for tax cuts.
Italy	**"Robin Hood" tax (art. 81.16 Decree Law n. 112/2008)**		The so-called "Robin Tax" is and additional corporate income tax charged on oil, gas and electricity industries in relation to extra profit generated from exceptional high oil prices. It is forbidden for those firms to shift the tax on price under the surveillance of Energy Authority.

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Italy	**Art. 83 Decree n. 112/2008 converted into Law n. 133/2008**		Stronger measures to fight tax evasion; resulting savings earmarked for tax cuts.
Italy	**“Robin Hood” tax (art. 81.16 Decree Law n. 112/2008)**		The so-called “Robin Tax” is and additional corporate income tax charged on oil, gas and electricity industries in relation to extra profit generated from exceptional high oil prices. It is forbidden for those firms to shift the tax on price under the surveillance of Energy Authority.
Italy	**Decree Law n. 185 dated 28 November 2008**		- Reduction of the corporate income tax and IRAP (Italian regional tax on business activity) - VAT payment by the taxpayer/seller only when its effective collection has been accomplished - Incentives - in terms of fiscal benefits- for the return of Italian researchers working abroad - Tax reduction on wages linked to productivity.
Ireland	**Budget for 2009 (direct and indirect taxation)**	14-oct-08	With effect from 1 January 2009: - Payment dates for companies paying more than EUR 200,000 corporation tax on their profits are to be brought forward in 2009. - R&D tax credit increases from 20% to 25% of incremental expenditure. - An income levy of 1% for all income up to EUR 1,925 per week (i.e. just over EUR 100,100 per annum), and 2% on the balance above this amount (i.e. over EUR 100,100 per year) is introduced. - Standard tax rate band increased by EUR 1,000 for a single person, and by EUR 2,000 for a married couple with 2 incomes. Reduction of the annual earnings limit for tax-relieved pension contributions. Deposit Interest Retention Tax increases from 20% to 23% on ordinary deposit accounts, and from 23% to 26% on life assurance policy and investment fund payouts. - Deemed interest to be assessed as a benefit on a loan from an employer to an employee raised from 13% to 15% for loans other than home loans. For home loans, the rate remains at 5.5%. - Employee social security contribution ceiling raised from EUR 50,700 to EUR 52,000. - Mortgage interest relief for first-time buyers. - Capital gains tax is to increase from 20% to 22%. - Standard rate of VAT of 21% increased to 21.5% in December 2008. - Excise duty on cigarettes increases by 50c per packet of 20. Excise duty on a bottle of wine increases by 50c. Excise duty increases by 8c per litre of petrol. All from October 2008. - Motor tax rates increased by 4% for small cars and vans in the low CO2 bands, 5% increase for larger cars in the higher CO2 bands. All from 1 January 2009. - Top rate of stamp duty on commercial property is to be reduced from 9% to 6%. - EUR 10 air travel tax for departures from Ireland, and EUR 2 for short flights within Ireland, and to western parts of Britain. - Betting tax increased from 1% to 2%.
Latvia	**Changes to social security**	Adopted by Parliament on 19 June 2008, published in Official Gazette on 9 July 2008. Took effect from 23 July 2008.	- Suspend the application of the maximum taxable base from 1 January 2009 until 31 December 2013. - Self-employed persons opting for simplified fixed income tax scheme must make social security contributions if their income reaches the statutory threshold for social security Contributions to recognized private pension schemes and "with-profits" life insurance premiums paid by the employer on the employee's behalf will be deductible from the taxable base, under conditions.
Latvia	**Amendments to corporate tax law**	Adopted by Parliament on 14 November 2008. Became effective on 1 January 2009	- Incentive for acquiring new machinery - the increase of the asset value for the depreciation purposes providing investment incentives. The amendments provide for increase of depreciation coefficient of assets up to 1.5 applicable for 5 year-period, namely, from 2009 till 2013; - Allowance for corporate equity (ACE)- the law provides for decreasing of taxable income by the amount of interest payable by taxpayer in case the increase of equity capital was financed by a loan; - Incentive for registration of patents and trademarks (incentive for investment in R&D) - law provides for increase of depreciation coefficient for intangible assets up to 1,5 (likewise for new manufacturing equipment) if such investment results in registration of patents and trademarks; - Rollover relief for assets - law provides for corporate income tax exemption on gains derived from alienation of assets of an enterprise, if the gains are used for acquisition of a similar asset within 12 months period of date of alienation. - Abolition of 5% withholding tax imposed on payments made to non-residents for the use of aircraft employed in international transportation. - Extension of loss carry-forward from 5 to 8 years.
Latvia	**Changes to personal income tax**	Adopted on 19 December 2006 and published in the Official Gazette of 2 January 2007. Became effective on 1 January 2008	- From January 2008 PIT rate on business income is reduced from 25% to 15%.
Latvia	**Amendments to the VAT law**	Adopted by Parliament on 12 December 2008. Became effective on 1 January 2009	- VAT standard rate was increased from 18 per cent to 21 per cent ; - VAT reduced rate was increased from 5 per cent to 10 per cent. From the list of goods and services to what VAT reduced rate is applicable were deleted: accommodation services, subscription on radio and television, veterinary medicaments, books, supply of water, funeral services, sewerage services, hairdresser services, simple renovation of housing, entrance tickets in cinema and sports events, the supply of the firewood and wood fuel to households. VAT reduced rate is applicable periodicals until the end of 2009.

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Table (continued)

Latvia	**Changes to personal income tax**	Adopted on 19 December 2006 and published in the Official Gazette of 2 January 2007. Became effective on 1 January 2008	- From January 2008 PIT rate on business income is reduced from 25% to 15%.
Latvia	**Amendments to the VAT law**	Adopted by Parliament on 12 December 2008. Became effective on 1 January 2009	- VAT standard rate was increased from 18 per cent to 21 per cent ; - VAT reduced rate was increased from 5 per cent to 10 per cent. From the list of goods and services to what VAT reduced rate is applicable were deleted: accommodation services, subscription on radio and television, veterinary medicaments, books, supply of water, funeral services, sewerage services, hairdresser services, simple renovation of housing, entrance tickets in cinema and sports events, the supply of the firewood and wood fuel to households. VAT reduced rate is applicable periodicals until the end of 2009.
Latvia	**Amendments to the Excise tax law**	Adopted by Parliament on 14 November and 12 December 2008. Became effective on 1 January and 1 February 2009	- The specific excise duty on cigarettes was increased from LVL 17.8 (EUR 25) to LVL 22.5 (EUR 32), the ad valorem excise – from 32.2 % to 34.5% and an overall minimum EU excise duty (specific duty plus ad valorem duty excluding VAT) of EUR 64 per 1000 cigarettes for most popular price cigarettes was reached - Excise excise duty on other smoking tobacco was increased from LVL 14 (EUR 20) to LVL 23 (EUR 32)
			- Excise duty on unleaded petrol was increased from LVL 228 (EUR 322) to 269 LVL (379 EUR) per 1000 litres and the EU minimum level of EUR 359 per 1000 litres was reached (according to the Council Directive 2004/74/EC a transitional period was set until 1 January 2011), on leaded petrol – from LVL 297 (EUR 419) to 300 LVL (423 EUR) per 1000 litres on gas oil and kerosene – from LVL 193 (EUR 272) to LVL 234 (330 EUR) per 1000 litres and the EU minimum level of EUR 330 per 1000 litres was reached (according to the Council Directive 2004/74/EC a transitional period was set until 1 January 2013) as well as on liquid petroleum gases – from LVL 87 (EUR 123) to LVL 90 (EUR 127) per 1000 kg of product; - Excise duty on ethyl alcohol was increased from LVL 630 (EUR 888) to LVL 825 (EUR 1163) per hectolitre of pure ethyl alcohol, on beer – from LVL 1.30 (EUR 1.83) to LVL 1.45 (EUR 2) per hectolitre/degree of alcohol of finished product, on wine and other fermented beverages – from LVL 30 (EUR 42) to LVL 40 (EUR 56) per 100 litres.
Latvia	**Changes to personal income tax**	Adopted on 12 December 2008 and became effective on 1 January 2009	- From January 2009 PIT general rate is reduced from 25 per cent to 23 per cent.
Lithuania	**Changes to tax laws**	Adopted by Parliament in December 2008 as part of measures to counteract the effects ot the economic crisis (Became effective on 1 January 2009)	- Personal income tax rate reduced to 15% (except dividends which are subject to 20% income tax) with an introduction of direct 6% pre – tax health insurance contributions (instead of allocating 30 per cent share of personal income tax to Compulsory Health Insurance Fund.). - Application of basic tax exempt amount revised, applying it only for employment income, also increasing it for low-income persons and gradually reducing taking into account a level of the income of the individual. Additional tax exempt amount for parents increased, depending on the number of children. - All income tax incentives were reviewed by abolishing those which were not socially-grounded and saving-orientated. - Corporate income tax rate increased from 15% to 20 %. - Corporate income tax incentive for entities which invest into essential technological modernisation was established allowing to reduce taxable profit up to 50 per cent by expenses incurred acquiring the property, defined in the Law. - Sectoral corporate income tax incentives for most agricultural entities and credit unions were abolished. - Standard VAT rate increased from 18 % to 19 %. All reduced VAT rates were abolished (with the exception of a reduced 5% VAT rate for the supply of some pharmaceuticals and medical aids, a reduced 9% VAT rate for books and not periodical informational publication applicable until 30 June 2009). - Excise duty on 1000 litters of unleaded petrol increased from LTL 1116 (EUR 323) to 1,500 LTL (434 EUR), on leaded petrol – from LTL 1454 (EUR 421) to 2000 LTL (578 EUR), on diesel fuel and kerosene – from LTL 947 (EUR 274) to LTL 1140 (330 EUR) as well as on petroleum gas and gas hydrocarbons – from LTL 432 (EUR 125) to LTL 1050 (EUR 304) per ton of product. - Excise duty on ethyl alcohol increased from LTL 3840 (EU 1112) to LTL 4416 (EU 1279) per hectolitre of pure ethyl alcohol as well as excises duties on beer, intermediate products wine and other fermented beverages increased 10-20 %. A reduced rate of duty for small breweries was abolished. - Excise duties on tobacco products will be increased two times – in March (the specific component of excise duty on cigarettes will increase from 79 LTL (EUR 22,9) to LTL 95 (EUR 27,5), and the ad valorem component - from 20 % to 25 %) and in September (the specific component of excise duty on cigarettes will increase once more to LTL 132 (EUR 38,2) 2009.
Luxembourg	**Changes to company taxation**	Law of 19.12.2008	- Corporate income tax reduced from 22% to 21%. - Capital duty abolished from 1 January 2009. - Dividends paid to companies that are members of a country with which Luxembourg shares a tax convention are exempt from withholding tax (under certain conditions).
Luxembourg	**Changes to personal taxation**	Law of 19.12.2008 Grand-Ducal Regulation of 9.12.2008 Finance Bill 2009	- Tax brackets are adapted linearly by 9% to inflation, whereas the current progressive tax rates varying from 0% up to 38% would remain unchanged. - Tax allowances for the employed, the retired and monoparental families are replaced by tax credits. - Housing: Full exemption for the interest paid on accounts with an authorized home savings institution in Luxembourg or another EU or EFTA Member State. - Extension of the preferential tax treatment for the construction or renovation of owner-occupied dwellings (increase of the threshold from € 416.667 to € 500.000 for which the reduced VAT rate of 3% is applied). - From the 1.1.2009 VAT rate for district heating and wood for use as firewood is reduced from 12% to 3%.
Malta	**Changes to the personal income tax**	Announced (1 January 2009)	Revision of the income tax bands, including specific fiscal measures aimed to encourage higher female participation.

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Table (continued)

Luxembourg	**Changes to personal taxation**	Law of 19.12.2008 Grand-Ducal Regulation of 9.12.2008 Finance Bill 2009	- Tax brackets are adapted linearly by 9% to inflation, whereas the current progressive tax rates varying from 0% up to 38% would remain unchanged. - Tax allowances for the employed, the retired and monoparental families are replaced by tax credits. - Housing: Full exemption for the interest paid on accounts with an authorized home savings institution in Luxembourg or another EU or EFTA Member State. - Extension of the preferential tax treatment for the construction or renovation of owner-occupied dwellings (increase of the threshold from € 416.667 to € 500.000 for which the reduced VAT rate of 3% is applied). - From the 1.1.2009 VAT rate for district heating and wood for use as firewood is reduced from 12% to 3%.
Malta	**Changes to the personal income tax**	Announced (1 January 2009)	Revision of the income tax bands, including specific fiscal measures aimed to encourage higher female participation.
Malta	**Changes to environmental taxes**	Announced (1 January 2009)	Overhaul of the motor vehicle registration tax and annual circulation tax to one based on the polluter pays principle.
The Netherlands	**Tax plan 2009**	Announced by the Ministry of Finance on 16 September 2008	- Withdrawal of planned increase of the standard VAT rate from 19% to 20%. - Larger part of the profits of SMEs will be exempt from tax. - Broadening of research and development incentive scheme. - Parental leave tax credit for working parents raised because entitlement to parental leave is being extended from 13 to 26 weeks. - Tax credit for working parents will be increased. - Measures for fuel-efficient cars. - Threshold for quarterly VAT returns increased from EUR 7,000 to EUR 15,000.
The Netherlands	**Reform of the inheritance tax**	Adopted by the Council of Ministers on 24 October 2008	- Current 28 inheritance rates would be replaced by 4 rates. - New exemptions.
Poland	**New PIT rates**	1-sept-08	Retroactively from 1 January 2006: - the increase of tax-deductible costs - the increase of tax-free amount From 1 January 2009, there would be only two personal income tax rates, i.e. 18% and 32% (tax threshold of PLN 85,528).
Poland	**Amendments to Individual Income Tax Law approved by government**	23 September 2008, adopted by Parliament on 30 October 2008. To be ratified by President and enter into force on 1 January 2009.	In September 2008, the government approved the draft law amending the Individual Income Tax Law. - Mandatory social security contributions and mandatory health insurance contributions paid by a Polish taxpayer located in another Member State and that cannot be deducted in that State may be deducted in Poland. - Extension of the child allowance to include foster parents and legal guardians and children studying outside of Poland. - Extension under conditions of the possibility to file a joint tax return by "spouses in a marital property" - Exemption for income from sale of residential property if fully used for acquiring another residential property within two years.
Portugal	**Reduction in VAT rate**	Announced in end-March, published in 27th June 2008 to enter into force in the 1st July 2008	- Reduction in VAT standard rate from 21% to 20%.
Portugal	**State Budget for 2009 (tax incentives)**	Presented to the parliament on 15 October 2008; approved and published on 31st December 2008 to enter into force the 1st January 2009	- Multiple tax exemptions for Housing Investment Funds (Fundos de Investimento Imobiliario para Arrendamento Habitacional) - New regime for urban rehabilitation (exemptions).
Portugal	**State Budget for 2009 (corporate income tax)**	Presented to the parliament on 15 October 2008; approved and published on 31st December 2008 to enter into force the 1st January 2009	- Two new corporate income thresholds with following rates: (i) 12.5% (new rate) for the first EUR 12,500 of taxable profit and (ii) general 25% (current rate) for taxable profit exceeding EUR 12,500. - Reduction in the advance payments made by small and medium companies. - Deductibility of employees' commuting borne by the employer. - New specific regime for deduction of additional mandatory contributions to pension funds by insurance companies. - Abolition of possibility to opt for the simplified tax regime (tax simplification measure).
Portugal	**State Budget for 2009 (individual income tax)**	Presented to the parliament on 15 October 2008; approved and published on 31st December 2008 to enter into force the 1st January 2009	- Commuting expenses are no longer subject to individual income tax. - Extension of reinvestment periods for relief from taxation of capital gains on the sale of owner-occupied permanent residences. - Extension of deduction of costs incurred on renewable energy equipment. - Increase in the personal deduction for disabled taxpayers.

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Table (continued)

Portugal	**State Budget for 2009 (corporate income tax)**	Presented to the parliament on 15 October 2008; approved and published on 31st December 2008 to enter into force the 1st January 2009	- Two new corporate income thresholds with following rates: (i) 12.5% (new rate) for the first EUR 12,500 of taxable profit and (ii) general 25% (current rate) for taxable profit exceeding EUR 12,500. - Reduction in the advance payments made by small and medium companies. - Deductibility of employees' commuting borne by the employer. - New specific regime for deduction of additional mandatory contributions to pension funds by insurance companies. - Abolition of possibility to opt for the simplified tax regime (tax simplification measure).
Portugal	**State Budget for 2009 (individual income tax)**	Presented to the parliament on 15 October 2008; approved and published on 31st December 2008 to enter into force the 1st January 2009	- Commuting expenses are no longer subject to individual income tax. - Extension of reinvestment periods for relief from taxation of capital gains on the sale of owner-occupied permanent residences. - Extension of deduction of costs incurred on renewable energy equipment. - Increase in the personal deduction for disabled taxpayers.
Portugal	**State Budget for 2009 (other taxes)**	Presented to the parliament on 15 October 2008; approved and published on 31st December 2008 to enter into force the 1st January 2009	From January 2009, changes in the real estate tax, the property transfer tax and stamp duty, leading to simplification and decrease of those taxes.
Portugal	**State Budget for 2009 (value added tax)**	Presented to the parliament on 15 October 2008; approved and published on 31st December 2008 to enter into force the 1st January 2009	From January 2009, the reduced VAT rate of 5% is extended to: (i) safety car seats for children; (ii) maintenance works and repair of prosthesis; and (iii) construction works contracted in respect of properties owned by municipal entities for the rehabilitation and urban management - the VAT referring to unrecoverable debts higher than EUR 750 and lower than EUR 8,000 can be deducted - VAT exemption may be requested in respect of sublease of industrial properties. - Assets granted to charities may benefit from VAT exemption.
Portugal	**Package of tax measures aimed at minimizing the effects on taxpayers of the current movements in the financial and petroleum markets**	10 July 2008, Submission to parliament; approved and published as Law nº64/2008 on 5 December	With retroactivity from January 2008: - The reduction of Municipal Property Tax, by extending the exemption period, cutting the maximum rates by 0.1 percentage points and establishing a regressive exemption of the income tax allowances for housing expenses, which can be as much as 50% for the lowest income taxation brackets, benefiting almost one million households. - Mandatory use of the FIFO method or the average cost method as valuation criteria for oil stocks and the difference between the old and new methods is subject to specific final taxation at 25%. - The increase of the specific final tax on fringe benefits (e.g. motor vehicles expenditures), regarding corporate and individual income tax.
Romania	**Emergency Ordinance No. 127/2008 Changes to direct and indirect taxation**	Published in Official Gazette on 16 October 2008	- Temporary exemption in 2009 of capital gains from trading securities on Romanian stock markets. - Permanent exemption of several types of capital gains realized by non-resident. - Carry forward for 1 year of capital losses by individuals. - Increase in the cap for deductions of voluntary pension and health contributions from corporate and personal income. - Retailers of petrol, diesel, kerosene, LPG and natural gas must register with the local tax authority.
Slovenia	**Amendment to Corporate Income Tax Law**	Published in Official Gazette on 6 June 2008, in force from 7 June 2008	- Possibility that interest rate on loans issued between associated enterprises could be different form published interest rate if a taxpayer proves that in equal or comparable circumstances a loan would also be issued at an interest rate which is different (lower/higher) than the published interest rate.- Extension of tax relief for donations on (listed) payments to EEA residents (provided that exchange of information is enabled). - Exemption from withholding tax on outbound interest payments extended to any interest paid by a bank (under conditions). - Exemption from the withholding tax for dividends paid to recipients resident in other Member States and/or in EEA (if there is exchange of information) provided that the withholding tax cannot be credited in the recipient's residence state. - No withholding tax is levied on dividends and interest paid to pension funds, investment funds and insurance companies which provide pension schemed and are resident in other Member States and are resident in other Member States provided that the withholding tax cannot be credited in the recipient's re
Slovenia	**Amendment to Corporate Income Tax Law**	Published in Official Gazette on 25 July 2008, in force from 26 July 2008	With retroactivity from January 2008: - New investment allowance for investment in equipment or intangible assets by companies.
Slovenia	**Amendment to Personal Income Tax Law**	Published in Official Gazette on 30 July 2008,in force from 31 July 2008	With retroactivity from January 2008: - Increase of thresholds for the additional general allowance. - Introduction of investment allowance for sole entrepreneurs investing in equipment or intangible assets. - Introduction of investment allowance for agriculture and forestry activities. - Introduction of flat tax deduction for sportsmen. - Introduction of tax exemption for beekeepers.
Slovenia	**Amendment to Personal Income Tax Law**	Published in Official Gazette on 30 December 2008,in force from 31 December 2008	With retroactivity from January 2008: - Increase of investment allowance for sole entrepreneurs investing in equipment or intangible assets. - Increase of investment allowance for agriculture and forestry activities.

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Table (continued)

Slovenia	**Amendment to Personal Income Tax Law**	Published in Official Gazette on 30 July 2008,in force from 31 July 2008	With retroactivity from January 2008: - Increase of thresholds for the additional general allowance. - Introduction of investment allowance for sole entrepreneurs investing in equipment or intangible assets. - Introduction of investment allowance for agriculture and forestry activities. - Introduction of flat tax deduction for sportsmen. - Introduction of tax exemption for beekeepers.
Slovenia	**Amendment to Personal Income Tax Law**	Published in Official Gazette on 30 December 2008,in force from 31 December 2008	With retroactivity from January 2008: - Increase of investment allowance for sole entrepreneurs investing in equipment or intangible assets. - Increase of investment allowance for agriculture and forestry activities.
Slovenia	**Amendments to Act on Excise Duty on Fuel**	Published in Official Gazette in December 2008	Increases of excise duties on petroleum products.
Spain	**Economic package of November 2008**	Royal Decree 1975/2008, 28 November	Employers that provide indefinite contracts to unemployed workers with dependent children will benefit from a social security rebate of up to 1,500 euro per year for two years. This applies to all new hires through December 2010. - Advance of the tax credit for habitual dwelling mortgages: Possibility of receiving the Personal Income Tax credit for mortgage payments on a monthly basis. Applicable for salaried and self-employed workers with annual earnings of less than 33,000 euro. Implemented via a 2% reduction in Personal Income Tax withholdings (salaried employees) or prepayments (self employed). The advance is voluntary. - Extension of the deadline for using the savings in home purchase savings accounts: Account holders whose deadline for home acquisition is between 1.1.08 and 31.12.10 will have an extension to 31.12.10. Additional contributions are not eligible for tax credit - Extension of the 2-year deadline for tax exemption on the sale of the habitual dwelling: People who acquired their habitual home in 2006, 2007 or 2008 have
Spain	**Measures for the impulse of the economic activity adopted in April 2008.**	The Royal Law-Decree 2/2008 of 21 April 2008, published in the Official Gazette on 22 April 2008.	(a) Extension of the deadline for the tax prepayment due by companies. (b) New credit of EUR 400 for individual taxpayers who obtain employment and business income. (c) Extension of exemption for income derived from Spanish government bonds for all non-residents (d) Improved tax treatment of building refurbishment in VAT and Personal Income Tax. Refurbishment whose cost is over 25% more than the acquisition price (not including the land). The goal is for more projects to be eligible for a more neutral beneficial tax scheme, improving input VAT recovery and stimulating the construction industry. The same applies to the rehabilitation credit allowed for the habitual dwelling under Personal Income Tax. Effective January 2008. (e) For a two year period, possibility to demand the extension of the lifetime of a mortgage credit with no financial costs, no fiscal expenditures and no registry and notary expenditures.
Spain	**Modification of VAT refunds system and elimination of wealth tax and other tax measures. With the exception of the modification of the depreciation system, all these measures were foreseen in the April package.**	Act 4/2008, 23 Dec.	Possibility as of January 2009 of requesting VAT refunds on a monthly basis. So far, this return was carried out in one single payment by the end of the year. Elimination of the wealth tax. Its will reduce the savings distortions generated by the tax system. It will be effective in 2008 already. Expansion of the R&D tax credit in the Corporate Tax: From 2008, the credit may be applied to companies with more than 25% of their research activity in another EU or European Economic Area country Modification of the depreciation system in the Corporate income tax: businesses are free to take accelerated depreciation on investments made in 2009 and 2010 in new property, plant and equipment for use in economic activities, subject to the condition that, in the following two years, the company's headcount remains in line with the average headcount of the previous 12 months.
Sweden	**Budget for 2009 presented to parliament**	22-sept-08	From January 2009: - Reduction in the corporate tax rate from 28% to 26.3%. - A 1 percentage point reduction in the rate of social security contributions for employees as well as self-employed, further reductions for persons aged under 26. - Amendment of the 3:12 rule, applicable to closely-held companies by reducing the amount taxed as employment income. - Introduction of an option for inventory not exceeding a value to be deducted immediately. - Introduction of a limitation on the interest deduction available to affiliated companies - Increased earned income tax credit. - An increase in the lower tax bracket for central government income tax. - Increase in the tax free personal allowance for taxpayers aged over 65. - Increase in the amount of non-deductible commuting expenses from SEK 8,000 (EUR 825) to SEK 9,000 (EUR 928) for travelling between work and home.
United Kingdom	**Reduction in corporate tax rate**	avr-08	The main rate of corporation tax for the 2008 financial year is reduced to 28%. The corporation tax rate for small companies is increased to 21%, and the marginal relief fraction is adjusted to 7/400.
United Kingdom	**Tax reforms Budget 2008-2009**	avr-08	From April 2008: - reform of the capital gains tax regime with introduction of an entrepreneurs' relief; - abolition of the 10% rate of income tax in respect of non-savings income; - reduction in the basic rate of income tax from 22 pence to 20 pence; - extension of the non-payable dividend tax credit to dividends from non-UK resident companies, where the investor owns less than a 10% shareholding.

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United Kingdom	**Increase in tax-free personal allowance**	13-mai-08	Increase in the tax-free personal allowance for taxpayers aged below 65.
United Kingdom	**Pre-Budget Report**	24-nov-08	Temporarily reducing the VAT rate to 15% with effect from 1 December 2008 to 31 December 2009. Increase in alcohol and tobacco duty to offset the overall level of taxation remains unchanged following the VAT reduction. Increase in tax free personal allowance for taxpayers aged below 65. Increase in fuel duty by two pence per litre. Deferral of the increase in the the small companies' rate of corporation tax. Temporary increase in threshold at which empty property becomes liable for business rates. From April 2010, restriction in the income tax personal allowance for incomes over £100,000. From April 2011, new higher rate of income tax of 45% for incomes above £150,000. From April 2011, increase in national insurance contributions by 0.5% for employees, employers and self-employed.
Sources: IBFD, EC, EPC, Press Reviews,			

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Based on the mandate of the ECOFIN Council, the work program of the Working Group on the Quality of Public Finances (EPC-QPFWG attached to the Economic Policy Committee (EPC)) has identified the efficiency of tax systems as a key issue for further work. The EPC-QPFWG has decided that this work should, among others, take the form of an annual report.

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