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A wind of change? Reforms of Tax Systems since the launch of Europe 2020

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A wind of change? Reforms of Tax Systems since the launch of Europe 2020

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Abstract: This paper reviews the tax reforms implemented by EU Member States since the adoption of the first country-specific recommendations in the framework of the Europe 2020 strategy. Even though there is a need for more action, as evidenced by the number of tax recommendations, overall many Member States have put in place reforms that follow the logic of the EU policy recommendations in most priority areas. A large number of Member States have recently introduced targeted reductions in the tax burden on labour and have shifted the tax burden towards less detrimental tax bases, although these changes have been of a limited magnitude. Tax incentives to support research and development have grown in importance, and have contributed to sustaining R&D investment during the crisis. Regarding private debt, which was one of the roots of the crisis, several Member States have taken measures to reduce the debt bias in their tax system. Almost half of the Member States have shifted some of the tax burden to recurrent immovable property taxes, even if significant increases were only observed in a few countries. Finally, many Member States have worked on strengthening tax compliance with some of them reporting tangible financial results. However, progress has been more limited in relation to environmental tax reforms and VAT.

JEL classification: H11, H20, H24, H25, H26, H27, H87

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Keywords: European Union; European Semester; taxation, tax policy; VAT; fraud; corporate taxation; personal income taxation; environment; research and development; compliance

1. INTRODUCTION

The Europe 2020 strategy for smart, sustainable and inclusive growth, based on enhanced coordination of economic policies, was launched on 3 March 2010[2]. All Member States committed themselves to achieving Europe 2020 targets and translated them into national targets and growth-enhancing policies. In order to coordinate and focus the efforts of Member States, the European Commission has set up a yearly cycle of economic policy coordination called the European Semester.

The European Semester starts with the adoption of the Annual Growth Survey (AGS), which sets out broad policy priorities for the EU as a whole for the coming year. Thereafter, the European Council issues guidance for national reforms on the basis of the AGS. Member States submit their national reforms programmes and stability or convergence programmes to the Commission which take into account the AGS priorities. Based on its assessment of the national programmes, the Commission issues country-specific recommendations (CSR) which contain policy advice to Member States. The CSRs are ultimately adopted by the Council.

The fourth European Semester was launched in November 2013 with the presentation of the AGS 2014. The 5 main priorities, already identified in the AGS 2012 and 2013 were maintained in the AGS 2014: (i) pursuing differentiated, growth-friendly fiscal consolidation; (ii) restoring lending to the economy; (iii) promoting growth and competitiveness for today and tomorrow; (iv) tackling unemployment and the social consequences of the crisis; (v) modernising public administration.

Tax policy can contribute to the achievement of each of these priorities. All in all, the main priorities in the European Semester were translated into the following tax policy priorities:

- A shift of taxes away from labour towards less detrimental tax bases.
- Targeted reductions in the tax burden on labour to promote employment.
- A broadening of tax bases.
- Tax measures to reduce the debt bias in housing and corporate taxation.

[2] European Commission, 2010

- Well-designed taxes to promote growth and competitiveness, notably in housing, environmental and R&D taxation.
- Measures to improve tax compliance.

This paper reviews tax reforms[3] undertaken by the Member States since the first adoption of CSRs in the framework of the European Semester. The aim is to see if and to what extent these reforms were consistent with the tax-related priorities set out in the AGS. The assessment is essentially based on two sets of documents: (1) the Council recommendations addressed to each Member State and (2) the Commission staff working documents, which complement the recommendations.

The paper is organised as follows: section 2 presents the main trends in taxation since the beginning of the crisis; section 3 reviews measures of tax shifts from labour towards less detrimental tax bases; section 4 examines measures to reduce the tax burden on labour; section 5 discusses reforms aimed at broadening tax bases; section 6 focuses on measures taken to reduce the debt bias; section 7 examines measures to promote competitiveness and growth; section 8 gives an overview of actions to improve tax compliance, and section 9 concludes.

2. MAIN TRENDS IN TAXATION

The European Semester was launched at a time when Europe was confronted with a severe economic and financial crisis, and Member States were facing increasing budget deficits. Total tax revenues (from direct and indirect taxes as well as social security contributions) expressed in terms of GDP reached their lowest point in 2010. As shown in Graph 1, direct tax revenues strongly decreased in 2008 and 2009, chiefly caused by a steep fall of Corporate Income Tax (CIT) revenue due to adverse cyclical effects.

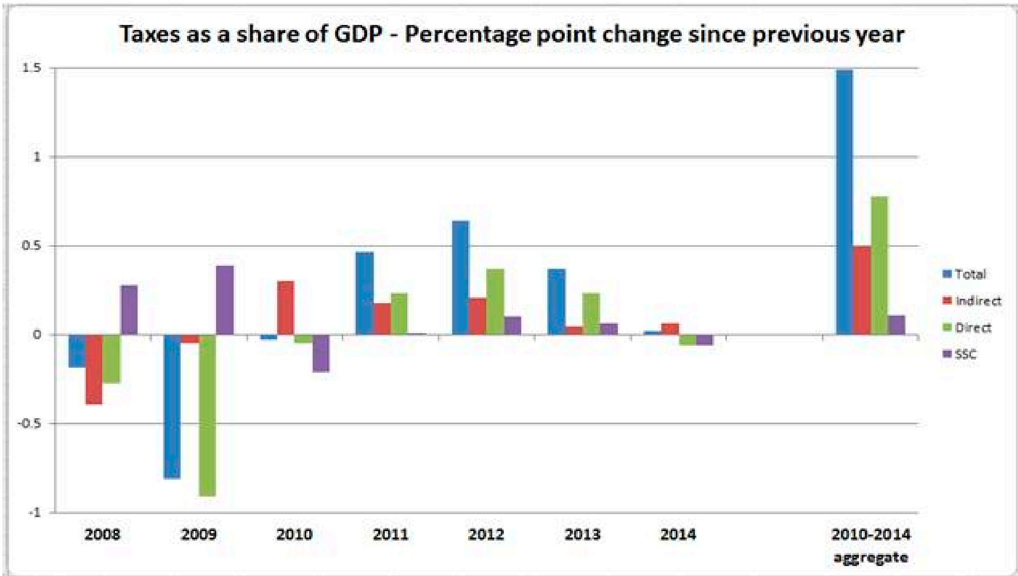
Since then, with the onset of budgetary consolidation, tax revenues in terms of GDP have continued to rise. By 2012, the EU-28 tax-to-GDP ratio slightly exceeded pre-crisis

[3] The list of reforms draws upon the National Reform Programmes (NRP) and the Stability or Convergence Programmes (respectively SP and CP) of the Member States, which can be found on the Europa website 2014, 2013, 2012 and 2011. It also draws upon the Taxation Trends Report (see European Commission, 2011, 2012a, 2013a and 2014d), the International Bureau of Fiscal Documentation (IBFD) database, DG TAXUD databases ("Tax reforms" database and "Taxes in Europe" database) and other sources used by the Commission services in the annual assessment of the NRP, SP or CP.

levels[4] and grew further in 2013. Estimates suggest that the tax-to-GDP ratio is set to stabilise at around 40% in 2014, albeit with a slight increase in indirect taxation revenues and decrease in direct tax revenues.[5]

This recovery in tax revenues is partly due to active taxation measures that Member States took to consolidate their finances. As recalled in the Communication accompanying the 2013 CSRs, there has been in many cases an increase in taxes instead of a reduction in expenditure[6].

Graph (1): Evolution of tax revenues (year-on-year change), EU-27 (% of GDP)



Source: European Commission, AMECO Spring 2014 forecast

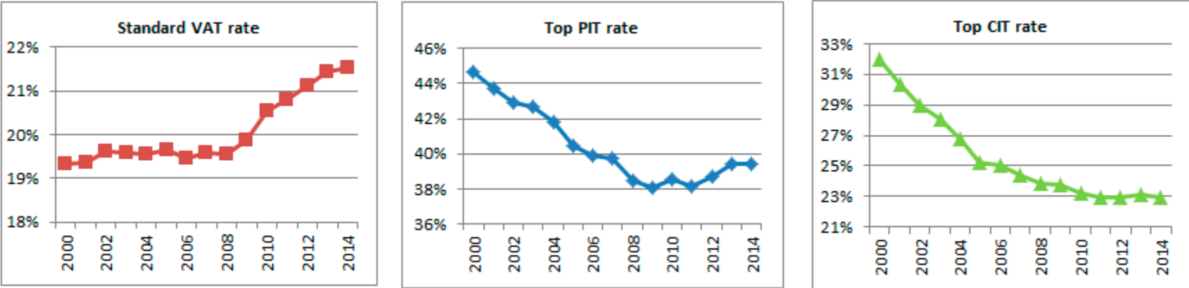
The implicit tax rate on labour increased from 35.4% in 2010 to 36.1% in 2012 in the EU-28. As will be seen in more detail later, some of the increases in labour taxation during these years were concentrated on higher earners while there has been an increasing trend towards introducing targeted cuts for lower-income earners over the last years. During the period 2010-13, 6 or 7 Member States raised their top Personal Income Tax (PIT) rates each year.[7] As shown in Graph 2, this trend levelled off in 2014, with no further top rate increases[8].

[4] European Commission, 2014d
[5] European Commission Annual Macro-Economic database (AMECO). The database includes short-term economic forecasts produced bi-annually by the Directorate-General for Economic and Financial Affairs.
[6] European Commission, 2013c
[7] European Commission, 2014d
[8] However, the overall top PIT rate increased in Italy, Finland and Sweden due to local tax changes. See European Commission, 2014d.

Meanwhile, top CIT rates have changed little on average across the EU since 2010. Most Member States have stopped reducing corporate rates, in contrast to the more widespread cuts that occurred before the crisis.

The increase in indirect tax revenues (in terms of GDP) has been partly driven by the rise in standard Value Added Tax (VAT) rates in many Member States. The EU-28 average standard rate increased by 2 percentage points between 2008 and 2014 (from 19.5% to 21.5%).[9] During the same period, all Member States increased excise duty rates in one or more years.

Graph (2): Evolution of standard VAT rates and of top CIT and PIT rates, EU-28 (simple arithmetic averages)



Source: European Commission, 2014d

In the next sections, we will examine in more detail the reforms that have been undertaken for each tax policy priority and how they relate to the recommendations adopted by the Council since 2011.

3. A SHIFT OF TAXES AWAY FROM LABOUR TOWARDS LESS DETRIMENTAL TAX BASES

During the first rounds of the European Semester, there were tax increases across the board. However, in the last year, a tax shift has been observed in 16 Member States, although probably of a limited magnitude.

The AGS emphasises the importance of pursuing fiscal consolidation in a growth-friendly, differentiated manner. This was reflected in the tax-related priorities of the AGS:

[9] European Commission, 2014d

"*tax should be designed to be more growth-friendly, for instance by shifting the tax burden away from labour on to tax based linked to consumption, property and combatting pollution"*.[10]

The academic literature has identified a ranking of taxes according to their detrimental consequences on growth. The OECD[11] formulates this as follows: "The reviewed evidence and the empirical work suggests a 'tax and growth ranking' with recurrent taxes on immovable property being the least distortive tax instrument in terms of reducing long-term GDP per capita, followed by consumption taxes and other property taxes as well as environmentally-related taxes, personal income taxes and corporate income taxes." Hence, now that consolidation needs are easing, Member States should be able to pay increased attention to the quality and composition of their consolidation programmes in order to limit the negative impact on growth[12]. Less distorting taxes should be preferred over more distorting taxes.

Since the beginning of the European Semester, the Council has every year issued recommendations to 8 to 10 Member States to shift taxes to more growth-friendly tax bases (see table (1) below). Most recommendations have been maintained from year to year, with the exception of Slovakia which implemented targeted reductions for the long-term unemployed and made some progress in combatting tax fraud, notably in VAT.

Table (1): Summary of Council recommendations[13] to shift the tax burden from labour to less distorting bases (2011-2014)

	2011	2012	2013	2014
Member States for which the Council adopted CSRs on tax shift	8 AT, BE, CZ, DE, EE, ES, FR, SK	10 AT, BE, CZ, DE, ES, FR, HU, IT, LV, SK	9 AT, BE, CZ, DE, FR, HU, IT, LV, SK	10 AT, BE, CZ, DE, ES, FR, HU, IT, LT, LV

[10] European Commission, 2013f
[11] OECD, 2010
[12] European Commission, 2013f
[13] A Council recommendation can refer to various tax priorities and will therefore be taken into account in the summary table of each relevant tax priority.

Box 1. Comparing Council recommendations over the years

This paper gives an overview, for each taxation priority, of the Member States to which the Council has issued policy recommendations. This overview is presented for the four years since the start of the European Semester process. However, the evolution of the recommendations should be interpreted with some caution. Firstly, there may have been changes in emphasis of the priorities set out by the AGS. For example, recommendations to reduce the debt bias in personal income tax were only introduced in the AGS 2012. Secondly, the continuation of recommendations does not mean that there has been no progress at all. Rather, it indicates that the Commission and Council considered that a Member State could do more with respect to a given tax priority. A detailed assessment of progress in relation to the Council recommendations can be found in the Staff Working Documents. Finally, it is worth noting that Member States under the Economic Adjustment Programme did not receive any country-specific recommendations in order to avoid duplication with measures set out in the programme.

Macro-economic data do not show a shift from labour to less distorting tax bases in 2011 and 2012. Both the share of indirect taxes and of direct taxes in GDP increased. In addition, the implicit tax rate of labour and of consumption increased on average over the period 2010-2012[14], with the former increasing more in absolute terms. Forecasts for 2013 confirm this trend of simultaneous increases of direct and indirect taxes.

When we look at the number of reforms undertaken by Member States[15], there is no evidence of a tax shift during the first rounds of the Semester. In particular, almost all Member States increased VAT rates and/or excise duties and a majority of reforms aimed at increasing the PIT and/or Social Security Contributions (SSC).

However, over the last year, there has been a change in the trend as more Member States have decreased their PIT and/or SSCs (than increased them). This tendency, combined with the continuous increase in consumption taxes, is a sign that the policy of shifting taxes to less detrimental bases is being followed.

[14] Detailed data are only available up to 2012.
[15] For further information, see European Commission 2012b, European Commission 2013d, and Europa website 2014, 2013, 2012 and 2011 (for access to Staff Working Documents, NRP, SP, CP).

Table (2) analyses the reforms undertaken by the Member States in more detail. The first column of the table identifies Member States that have carried out PIT reductions that relate to labour income only[16] or reductions of social premiums. The second column shows the Member States that have increased indirect taxes on balance. If a Member State has both reduced labour taxation and increased indirect taxation, it is considered to have performed a tax shift and it is entered into the final column of the table. The impacts of various measures in one Member State have been balanced out to determine the overall direction. The table shows that all nine Member States that were issued a CSR to shift taxes from labour to less distorting taxes in 2013 have reduced taxes on labour to some extent. Two thirds of them combined this reduction with an increase in indirect taxation. Among the 14[17] Member States without a CSR on this topic in that year, a tax shift to less distorting bases can also be observed in 10 Member States. The magnitude though is difficult to predict and seems rather limited as shown by the macro-economic forecasts (see Graph 1).

Table (2): Tax shift in 2013-2014

Member States	Net Labour tax or SSC reduction (1)	Net increase of indirect taxes (2)	'tax shift' (1) AND (2)
Member States for which the Council adopted CSRs to shift taxes to less distorting bases in 2013	AT, BE, CZ, DE, FR, HU, IT, LV, SK	AT, CZ, DE, FR, IT, LV	AT, CZ, DE, FR, IT, LV
Member States for which the Council did not adopt CSRs to shift taxes to less distorting bases in 2013	BG, DK, EE, ES, FI, LT, MT, NL, RO, SE, SI, UK	BG, DK, EE, ES, FI, LT, LU, MT, NL, PL, SE, SI	BG, DK, EE, ES, FI, LT, MT, NL, SE, SI
In the Programme or new Member State		CY, HR, PT	

[16] Non-labour income, such as pensions, interest or dividends, has therefore been filtered out.
[17] No CSR was addressed to the Member States that were part of the Economic Adjustment Programme in 2013 and to Croatia (which joined the EU in the course of 2013).

Box 2. Fiscal devaluations: a special form of shifting taxes to less detrimental bases.

A fiscal devaluation is a particular form of tax shift towards consumption, which – in the standard case – specifically targets a reduction in employers' SSC combined with an increase in the VAT rate. The basic idea behind a fiscal devaluation is to lower the price of exports and to raise the consumer price of imports, thereby improving net exports in the short-run as well as employment and GDP in the long-run. While the aim of a tax shift is to make the tax system less distortionary and to promote economic growth in the long-term, fiscal devaluation is a tax policy instrument to improve competitiveness in the short-term.

In recent years, fiscal devaluation has been discussed by governments as a policy alternative to nominal exchange rate devaluation for euro area countries striving to regain competitiveness. In Spain and France the concept of fiscal devaluation was an explicit subject of political debate. Some reforms have already been introduced in these countries and additional measures have been announced for the coming years. Both countries have increased consumption taxation during the last four years. Regarding labour taxation, France took some first steps to strengthen competitiveness and employment by introducing a "tax credit for competitiveness and employment" (*Crédit d'impôt pour la compétitivité et l'emploi*, CICE)[18] and the "Responsibility and Solidarity Pact" (*Pacte de Responsabilité et Solidarité*, RSP)[19]. In Spain, some targeted employers' SSC reductions were implemented in 2013 and 2014.

Results of empirical and model based estimations suggest that a tax shift in the form of a fiscal devaluation is likely to increase net exports in the short-run and to permanently improve employment and GDP. Improvements are, however, small in magnitude[20]. In the case of France, for example, it has been estimated that the introduction of the CICE is likely to increase GDP by 0.1% to 0.3% and to create around 130 000 to 150 000 new jobs in the short-run (IMF 2014, Plane 2012). When combined with the RSP, if it is not financed by spending cuts, it is estimated to boost output by 0.5% and to create around 290 000 jobs in the short run[21]. Nevertheless, it remains difficult to single out the net effect of the tax shift on economic growth and competitiveness, in particular because governments implemented additional changes in the tax and transfer system at the same time.

[18] The CICE is a tax credit on payroll taxes applying to wages not exceeding 2.5 times the French minimum wage.
[19] The RSP foresees reductions of employers' SSCs.
[20] For an overview of the results of econometric and model based studies, see Puglisi (2014).
[21] Espinoza, R., & Pérez Ruiz E., 2014

4. TARGETED REDUCTIONS IN THE TAX BURDEN ON LABOUR TO PROMOTE EMPLOYMENT

Since 2012, a large number of Member States introduced targeted measures in order to reduce the tax burden on specific groups (such as low income earners). This is a positive signal since these measures are expected to boost employment. These measures, combined with tax increases for better earners, have also contributed to increasing the progressivity of PIT.

Combatting the very high levels of unemployment and the dramatic social consequences of the crisis is a top priority for the European Semester. Here again, tax policy can help in achieving these goals by lowering the tax burden on labour. A well-designed tax policy will target the demand or the supply side of labour markets and also focus on those categories of workers that are the most responsive to cuts in taxation and/or social security contributions. In addition, the call for fairer societies[22] can be addressed by tax systems that fulfil a redistribution objective, notably via the progressivity of their personal income taxes.

Since the labour tax burden has a significant effect on the employment outcomes of some well identified groups of workers, the AGS recommends in particular measures targeting these groups such as low income earners and young workers. Other target groups include the low skilled, older workers, women and lone mothers[23]. In addition to the high responsiveness to labour tax cuts of the groups concerned, a further advantage of targeted cuts is budgetary: they are more affordable than overall labour tax cuts, especially against the background of fiscal consolidation.

Each year between 2011 and 2014, 10 to 12 Member States received recommendations to reduce labour taxation, with a majority of these recommendations focusing on target groups. In the most recent exercise (2014), 9 out of the 12 recommendations for a labour tax decrease specified a targeted cut (See table 3). Most recommendations have been maintained over the years.

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[22] European Commission, 2014 b
[23] Garnier et al., 2013

Table (3): Summary of Council recommendations in the field of labour taxation bases (2011-2014)

	2011	2012	2013	2014
Member States for which the Council adopted CSRs in the field of labour taxation*	10 AT, BE, CZ, DE, EE, ES, FR, HU, NL, SK	11 AT, BE, CZ, DE, ES, FR, HU, IT, LV, NL, SK	11 AT, BE, CZ, DE, FR, HU, IT, LV, NL, RO, SK	12 AT, BE, CZ, DE, ES, FR, HU, IT, LT, LV, NL, RO
– of which recommendation for labour tax cut for specific group	*7 AT, BE, DE, EE, HU, NL, SK*	*5 AT, DE, HU, NL, SK*	*6 AT, DE, HU, LV, NL, SK*	*9 AT, CZ, DE, ES, FR, HU, LV, NL, RO*

*All labour taxation specific recommendations called for a decrease, except for the recommendation to Romania in 2013, which dealt with undeclared work.

In the years 2011-12, there was an increase of the implicit tax rate on labour. Some of the increase in labour taxation in these years was concentrated on better earners, in the form of surtaxes on high incomes (often called “solidarity levies”), the introduction of a new highest income tax brackets, hikes in the top PIT rate (see graph in section 2) or increases in the maximum SSC base. In other cases, the increase in labour taxation was the result of an overall tax rise (Bulgaria, Latvia) or the removal of some tax allowances without a clear targeting of high income earners. By 2014, the increasing trend in PIT rates has come to a halt.

Meanwhile, in 2011-2012 already, several countries implemented targeted labour tax cuts: Finland, Germany, Sweden and the UK extended labour tax allowances; Denmark and the Netherlands cut the PIT rate applied to the first bracket; and Lithuania introduced a temporary SSC relief for first-time employees.

The trend gained momentum in 2012-2013 when nine Member States implemented targeted labour tax burden reduction measures. These countries were Belgium, Denmark, France, Finland, Hungary, Italy, the Netherlands, Portugal and Sweden. The measures targeted low earners in general, but also older workers (Belgium, Hungary, the Netherlands, Portugal, Sweden), the low skilled (Belgium, Hungary), the young (Belgium, Hungary, Italy), women (Hungary, Italy) and those employed in some geographical areas (Hungary, Italy).

Several of these changes were implemented as a cut to the employers' tax burdens, such as employers SSC in Belgium and Hungary or business taxes, as in France and Italy.

In 2013-2014, the number of countries implementing targeted labour tax cuts has risen. During this period, the most popular type of measure was the extension of the tax-free allowance or a PIT credit for the lowest earners, implemented in 12 Member States: Belgium, Bulgaria, Denmark, Estonia, Finland, Germany, Italy, Lithuania, Latvia, Malta, the Netherlands, Sweden and planned in the UK. Some of them (such as Latvia and Lithuania) have also increased a tax credit for dependants. Bulgaria and France have extended tax credits for low income earners, while an increase in the child tax credit was adopted in the Czech Republic (to be implemented in 2015). Spain has introduced a PIT break for on-the-job training in new technologies.

At the same time, a handful of Member States have introduced measures to alleviate tax burdens for employers hiring people at the margin of the labour market. Such measures benefited the young unemployed in Slovenia, the long term unemployed in Slovakia and new hires in Belgium (in small firms). The Czech Republic has announced a so far unspecified SSC cut for low income earners and Hungary has extended the duration of the employers' SSC cut applied to mothers of at least three young children and extended a family tax allowance to employees' SSC, which will mainly benefit families with at least three children.

A number of Member States (Austria, Estonia, France and Italy) have implemented measures to cut labour taxes across the board, i.e. affecting both low and higher earners, mostly within the SSC system, while Latvia plans to do so.

The halt in the previously increasing trend of direct tax revenues as a share of GDP in 2014 can be associated with these PIT cuts – both targeted and across the board. In 2013-14, there were significantly fewer measures involving labour tax increases than labour tax decreases. The majority of these increases affected higher earners[24].

[24] In some countries, PIT increasing measures took the form of limiting tax expenditures or allowances where the beneficiaries are typically medium to high earners: the deductibility of service vouchers in Belgium, a family tax credit in France, medical insurance relief in Ireland and, in the Netherlands, mortgage interest deductibility were restricted. In the Netherlands, also the general tax credit and the earned income tax credit (EITC) will be reduced for higher incomes. In Austria, the solidarity levy on 13th and 14th month income, which was originally due to expire in 2016, was made permanent. In Portugal, the extraordinary 3.5% surtax was extended to 2014; similarly, in Spain, the 'complementary surcharges' in PIT were extended to 2014. SSC increases were carried out in Cyprus and Croatia in a general fashion.

It is also worth mentioning that in several Member States where there was a PIT increase, it has mainly or entirely affected non-labour income, such as interest income, dividends, capital gains, pension income or earnings from self-employment (Austria, Croatia, Czech Republic, Finland, Lithuania, Portugal, Sweden). In Hungary and Romania, measures extending SSC to passive income (interest and rental income, respectively) have been implemented.

It can be concluded from the above that there is a trend towards more progressivity in PIT, with tax increases that affected mostly higher earners and tax cuts that were targeted at specific groups. There seems therefore to be an implicit recognition that taxes should be designed in a way that takes fairness more into account.

Table (4): Labour taxation developments in 2012-2014

		2013-2014		2012-2013	
		Increase	Decrease	Increase	Decrease
PIT	**Medium/High income**	AT, BE, ES, FR, IE, NL		NL, PT, FR, AT, SK, CY, EL FI, LU, SI, CZ	HU, DK, MT, UK
	Low income/ other disadvantaged	SI	**BE, BG, CZ, DK, DE, EE, FI, FR, IT, LT, LV, MT, NL, SE, UK**		FI, DK,NL, SE
	Not specific		ES		LV
SSC	**Medium/High income**				
	Low income/ other disadvantaged		**BE , HU, SI, SK**	AT	BE, HU, NL, PT
	Not specific	CY, HR	AT, EE, ES, FR, HU, IT, LV		
Business tax credits	**Low to medium income/ other groups and geographical areas**				FR, IT

Legend: increased progressivity

5. A BROADENING OF TAX BASES

While there have been efforts by Member States to broaden[25] the tax base, these have been insufficient in the field of VAT where reforms often focus on standard rate increases. CIT reforms related most frequently to base narrowing, in particular in the later phase of the crisis when the aim was to stimulate investment and competitiveness.

[25] 'Broadening of the tax base' encompasses here any increase in the base but also any changes in special regimes such as an increase in a reduced rate.

Most tax systems include ‘tax expenditures’, which cover various exemptions, allowances, reduced rates and other specific regimes. These arise in the area of VAT, but are also part of the architecture of PIT and CIT systems. Howver, tax expenditures can be inefficient in achieving their intended policy objectives, especially if they are poorly targeted. This is particularly the case with VAT exemptions and reduced rates, which often translate into significant subsidies to people on higher incomes. Moreover, they produce larger distortions than other types of redistribution, for example those implemented through the PIT system or in the form of direct subsidies[26].

Broadening the tax base not only offers the potential to increase revenues, but also makes paying taxes easier for citizens and businesses, and managing them simpler for administrations.

During the first cycle of the European Semester, there was one recommendation on the broadening of the tax base. By 2014, the total number of CSRs on this topic had increased to 11. Most of them referred to a broadening of VAT as shown in table (5) below. In this respect, only the recommendation addressed to Sweden in 2012 and 2013, was not maintained as, in line with the recommendation, the Swedish government undertook to assess the efficiency of the reduced rate for restaurants and catering services.

Table (5): Summary of Council recommendations in the field of broadening (2011-2014)

	2011	2012	2013	2014
Member States for which the Council adopted CSRs on broadening (VAT, CIT, PIT)	1 FR	8 CZ, DE, ES, FR, HU, IT, SE, SK	10 BE, CZ, DE, ES, FR, HU, IT, LU, SE, UK	11 BE, CZ, DE, ES, FR, HU, IE, IT, LU, PL, UK
- of which recommendations referred to a broadening in VAT	*none*	*4* *ES, FR, IT, SE*	*8* *BE, DE, ES, FR, IT, LU, SE, UK*	*9* *BE, DE, ES, FR, IE, IT, LU, PL, UK*

[26] Mirrlees et al., 2011

5.1. Value added tax

Since the onset of the crisis, Member States have increased their consumption taxes – which is deemed less detrimental to growth – mainly for fiscal consolidation purposes. However, the European Commission has been critical of the progress made by Member States in the design of their VAT systems[27]. Member States mainly chose to increase standard rates for consolidation purpose, rather than removing or limiting the use of reduced rates.

Since 2010, 14 Member States (excluding Croatia) have increased their standard rate while only 9 increased their reduced or intermediary rates. Only one Member State (Slovakia) removed one of its reduced rates (introduced in 2010 in the wake of the crisis) while three Member States introduced additional reduced rates – thereby further fragmenting the VAT system instead of simplifying it (see table 6 below). Similar observations were echoed by the International Monetary Fund (IMF) in several instances[28].

Over the last year, about a quarter of the Member States decided to increase their standard rates. This is notably the case for Cyprus, France, Italy, Luxembourg, Portugal and Slovenia. Poland chose to maintain the temporary increase. Almost half of the Member States broadened their standard VAT bases or increased reduced rates[29]. However, this was often accompanied by the introduction of other exceptions which extended the scope of application of reduced rates for specific good or services. For example, France increased its 7% intermediary rate to 10% as of January 2014, but extended the use of the reduced rate to energy- and social housing-related work and to cinema tickets. Belgium extended the application of the standard VAT rate to notary and lawyer services, but decided to decrease VAT on electricity consumption from 21 % to 6 % from April 2014 – which has a significant budgetary impact. The Czech Republic proposed to shift certain items to the lower VAT rate instead of unifying all rates as initially foreseen[30]. Some other Member States were either

[27] Europa website, 2014 (see the country-specific Commission Staff Working Documents)

[28] See for example Gorringe J. (2014) for a discussion on Ireland, or IMF (2014), for reaction following the government decision to introduce a third VAT rate in Czech Republic.

[29] For example, Germany now applies the standard rate to commercial dealing in art while Croatia, France and Slovenia have increased the reduced rates.

[30] The Czech Government confirmed on July 2, 2014 that it intended to introduce a second reduced rate of VAT of 10% while a uniform VAT rate of 17.5% was originally planned for 2016. See Ernst & Young, 2014.

opposed to the reform of VAT or failed to significantly reform it (Estonia[31] or Ireland[32]). Extending the use of the standard rate would therefore seem to remain politically difficult (e.g. the resistance to remove reduced VAT rates on energy products).

Table (6): Evolution of statutory rates 2010-2014

Table 6-a: Changes in reduced VAT rates only

	Standard VAT rate 2010	*Standard VAT rate 2014*	*Difference 2010-2014*	*Reduced VAT rate(s) 2010*	*Reduced VAT rate(s) 2014*	*Difference 2010-2014*
BG	*20*	*20*	*0*	*7*	***9***	***2***
EL	*23*	*23*	*0*	***5.5/11***	***6.5/13***	***1/2***
LV	*21*	*21*	*0*	***10***	***12***	***2***
MT	*18*	*18*	*0*	***5***	***5/7***	*0/**new***

Table 6-b: Changes in both standard and reduced VAT rates

	Standard VAT rate 2010	*Standard VAT rate 2014*	*Difference 2010-2014*	*Reduced VAT rate(s) 2010*	*Reduced VAT rate(s) 2014*	*Difference 2010-2014*
CZ	***20***	***21***	***1***	***10***	***15***	***5***
IE	***21***	***23***	***2***	***13.5***	***9/13.5***	***new**/0*
ES	***18***	***21***	***3***	***8***	***10***	***2***
FR	***19.6***	***20***	***0.4***	***5.5***	***5.5/10***	*0/**new***
CY	***15***	***19***	***4***	***5/8***	***5/9***	*0/**1***
HR	***23***	***25***	***2***	***-/10***	***5*/13***	***+5/+3***
PL	***22***	***23***	***1***	*7*	***5*/8***	***2/1***
SI	***20***	***22***	***2***	***8.5***	***9.5***	***1***
SK	***19***	***20***	***1***	***6/10***	***10***	*removal/**0***
FI	***23***	***24***	***1***	***9/13***	***10/14***	***1/1***

[31] Estonia announced a restriction of the right to deduct the input VAT on passenger cars and goods and services connected to passenger cars if the car is used for private purposes. The proposal is now under legislative procedure in the parliament. However, the European Commission is assessing the Estonian application to derogate from the VAT Directive (2006/112/EC).

[32] Reduced VAT rate of 9% on tourism and hospitality services (due to expire and revert to 13.5% on 31 December 2013) has been maintained. See Ernst & Young, 2014.

Table6-c: Changes in standard VAT rates only

	Standard VAT rate 2010	*Standard VAT rate 2014*	*Difference 2010-2014*	*Reduced VAT rate(s) 2010*	*Reduced VAT rate(s) 2014*	*Difference 2010-2014*
IT	***20***	***22***	***2***	*10*	*10*	*0*
HU	***25***	***27***	***2***	*5/18*	*5/18*	*0/0*
NL	***19***	***21***	***2***	*6*	*6*	*0*
PT	***21***	***23***	***2***	*6/13*	*6/13*	*0/0*
UK	***17.5***	***20***	***2.5***	*5*	*5*	*0/0*

Table 6-d: No change in VAT system

	Standard VAT rate 2010	*Standard VAT rate 2014*	*Difference 2010-2014*	*Reduced VAT rate(s) 2010*	*Reduced VAT rate(s) 2014*	*Difference 2010-2014*
BE	*21*	*21*	*0*	*6/12*	*6/12*	*0/0*
DK	*25*	*25*	*0*	*-*	*-*	*-*
DE	*19*	*19*	*0*	*7*	*7*	*0*
EE	*20*	*20*	*0*	*9*	*9*	*0*
LT	*21*	*21*	*0*	*5/9*	*5/9*	*0/0*
LU	*15*	*15*	*0*	*6/12*	*6/12*	*0/0*
AT	*20*	*20*	*0*	*10*	*10*	*0*
RO	*24*	*24*	*0*	*5/9*	*5/9*	*0/0*
SE	*25*	*25*	*0*	*6/12*	*6/12*	*0/0*

Source: European Commission, 2014d.

Note to the tables: Super reduced rates and parking VAT rates are not included. Increases are in bold. Decreases are underlined. Increases marked with an asterisk mean that the country has transformed its super reduced rate into a reduced rate.

5.2. Corporate income tax

A broadening of the base in direct taxation (PIT and CIT) usually points to the need to simplify the tax system by reducing its scope and streamlining tax expenditures. Slovakia and the Czech Republic were the only Member States for which the recommendations focused on PIT, while for Hungary the recommendation targeted CIT. The recommendation for Slovakia was removed in 2013 as the government reduced distortions in the taxation of labour across different types of employment.

Table (7): CIT reforms over 2010-2014

CIT	Rate	Base
Increase	CY, EL (2013), FR, LU, PT, SK (2013)	AT, BE, BG, CZ, DK, EL,ES, FI, FR, HU, HR, IT, LT, LU, LV, RO, PL, PT, SK
Decrease	DK, EL (2010, 2011), FI, HU (2010), LT (2010), NL, SE, SI, SK (2014), UK	AT, BE, BG, CY, CZ, DE, DK, EL, ES, FI, FR, HR, HU, IE, IT, LT, LU, LV, NL, MT, PL, PT, RO, SE, SI, SK, UK

Note: When countries changed the CIT rate either at the start of the period or more than once during the period of analysis, the dates of the reforms are shown in brackets.

The fall in CIT rates has slowed down compared to the beginning of the decade and the average top CIT rate has stabilised in recent years (see Graph (2) of section 2). While rates in a few countries continued to drop in the period 2010-2014, a small number of countries increased their rates, often for budgetary reasons through introducing additional surcharges. It would seem that this slowdown in CIT rate cuts, and in some cases the increase in rates, has often been accompanied by base narrowing aimed at stimulating investment.

Looking at CIT changes over 2010-2014 (Table (7)), virtually all Member States narrowed their base (with the exception of Estonia in which corporate tax is levied only on distributed profits). The changes were mostly driven by competitiveness concerns (e.g. increases in R&D tax incentives to upgrade the innovation profiles of companies) and the desire to stimulate private sector investment to kick-start the economy (e.g. new or more generous investment allowances).

At the same time, around 20 Member States broadened their CIT base at some point during 2010-2014. This may appear contradictory, but there are in fact two trends. On the one hand, a narrowing of the base has been carried out in order to stimulate investments and the recovery. This focused on R&D tax credits (discussed in section 7), entrepreneurship incentives for small companies, investment allowances, and new tax credits for some sectors or activities. On the other hand, broadening translates mainly into limiting opportunities for abuses and reducing interest deductibility in order to correct to some extent the debt bias and excessive indebtedness (discussed in section 6). In the context of reducing opportunities for tax avoidance, a few Member States introduced a minimum CIT for all or some companies,

while others brought in provisions to avoid situations where deductions are claimed more than once and where profits have not been effectively taxed.

6. TAX MEASURES TO REDUCE THE DEBT BIAS IN CORPORATE AND PERSONAL TAXATION

Some efforts have been made to limit indebtedness in the field of corporate taxation with a preference for limiting interest deductibility. Regarding the debt bias in personal taxation, a majority of the Member States that had a form of mortgage interest deductibility, have limited or abolished this facility.

While there are signs of an economic recovery, if this trend is to be sustained it will be important to ensure that the financial system performs its lending role again. This will require, among other things, that the over-indebtedness of citizens and companies is kept in check. Personal and corporate income tax systems still typically contain many provisions that offer greater incentives to choose debt rather than other sources of financing. Likewise, tax systems also create incentives to over-invest in specific assets – such as housing – leading to potential disruptions in these markets. A sound tax policy should address these incentives and ensure greater neutrality. The AGS 2014, which makes it a priority to restore lending to the economy, foresees the need "…[*to reduce] the corporate tax bias towards debt financing and review aspects of tax schemes which increase the debt bias of households, typically through tax relief for mortgages…..*"[33].

6.1. Debt bias in corporate taxation

CSRs to reduce corporate tax bias towards debt were addressed for the first time to France, Malta and Spain in 2012. This rose to five Member States in 2013, with the addition of Luxemburg and Sweden. In the 2014 European Semester, the recommendations have been upheld for France and Spain, while corporate debt bias has been mentioned as an issue to watch for Germany, Malta, and Portugal.

Among the countries that received a CSR, Sweden took several measures that addressed the corporate debt bias, and therefore the CSR was not maintained in 2014. Sweden extended the restrictions on interest deductibility to all types of loans, regardless of their purpose. This measure, combined with the corporate income tax rate cut at the beginning of

[33] European Commission, 2013f

2013, aimed to eliminate a large proportion of corporate debt driven by tax avoidance motives, in particular intra-group loans from abroad. Furthermore, Sweden launched a stimulus for equity investments in smaller companies by offering the 'investor's deductibility' as from December 2013. Lastly, the government has set up a corporate tax committee, which in June published its report on the way towards greater neutrality between debt and equity as sources of financing. The committee proposes the non-deductibility of interest coupled with a general standard deduction for all financing costs up to the financial income. France and Spain restricted their interest deductibility rules. However, the ceilings remain high and concerns remain about sufficiency of these measures in addressing the challenge. Malta has an imputation system which corrects the bias for domestic companies; nevertheless issues remain with access to alternative sources of financing.

Table (8): Summary of Council recommendations and recitals in the field of debt bias in corporate taxation (2011-2014)

	2011	2012	2013	2014
Member States for which the Council adopted CSRs or raised concerns within a CSR recital (*) linked to corporate indebtedness	none	3 ES, FR, MT	5 ES, FR, LU, MT, SE	5 DE*, ES, FR, MT*, PT*

Overall, some progress has been made. Over the last few years there has been a tendency of Member States to restrict the deductibility of interest payments. For example, Denmark, France, Portugal and Spain have decided to set a nominal ceiling which applies to both external and internal debt. Greece and Finland have limited the scope of deductibility in case of loans between associated companies. Others have tightened their thin capitalization rules which aim at curbing "excessive" leverage, while the Netherlands decided to abolish its own due to overlap with new rules limiting deductibility. In 2013 and 2014, some Member States encouraged equity investments in smaller companies by introducing or expanding tax breaks for individual investors (Finland, France, Ireland, Spain, Sweden and the United Kingdom) or introduced incentives for reinvestment of profits (Portugal and Spain). Some

Member States have taken steps in the opposite direction, e.g. Latvia abolished its allowance for corporate equity and Belgium decreased the rate on such an allowance.

6.2. Debt bias in personal taxation

In personal income tax, mortgage interest deduction can lead households to take on private debt in order to buy immovable property. If the tax incentive is capitalised into higher prices this can lead to greater indebtedness and instability in the housing market. These facilities can also lead to a substantial loss of revenues, while the benefits accrue to a large extent to the better off.

CSRs to reduce the debt bias in personal income taxation entered the European Semester in 2012 and were addressed to three countries. While measures taken by Spain were deemed sufficient, a CSR to reduce debt bias in PIT was again issued to the Netherlands and Sweden in 2014.

Table (9): Summary of Council recommendations to reduce the debt bias in personal income tax (2011-2014)

	2011	2012	2013	2014
Member States for which the Council adopted CSRs on reducing the debt bias in personal income tax	none	3 ES, NL, SE	2 NL, SE	2 NL, SE

Among the countries that received a CSR, Spain abolished the interest deduction for new mortgages from 2013. The Netherlands limited the interest deduction for new mortgages to mortgages that are being repaid fully over a period of 30 years. Moreover, the maximum tax rate for the reduction will be decreased from 52 % to 38 % for all mortgages over a period of 28 years. This long transitional period was one of the factors that led to the CSR being maintained in 2014. Sweden did not undertake reforms in this area.

In addition, other Member States that applied some form of mortgage interest deduction have taken measures to reduce it. Luxembourg, the Czech Republic and Estonia

have significantly reduced the maximum deduction[34]. In Portugal (from 2012) and Ireland (from 2013), interest on new mortgages is not deductible any more. Finland is in the process of reducing the percentage of interest that can be deducted from 85% in 2012 to 50% in 2018. In Denmark regulatory measures were taken, e.g. reducing the maximum Loan-to-Value. Belgium will apply a fixed deduction rate of 45 % on new mortgages in 2015, in preparation for transferring the deductibility to the regions. In total 10 out of the 14 Member States that had some form of interest deductibility reformed their system.

7. WELL-DESIGNED TAXES TO PROMOTE GROWTH AND COMPETITIVENESS, NOTABLY IN ENVIRONMENTAL, R&D AND IMMOVABLE PROPERTY TAXATION

Tax incentives have grown in importance to support research and development. However progress is mixed for environmental taxes. Almost half the Member States shifted part of the tax burden to recurrent real estate taxes, but a significant increase can be observed only in a few cases. In many countries the taxable values of properties are outdated, but only a few have announced a revaluation of cadastral values.

As recalled in the AGS 2014, one of the biggest challenges currently faced by Europe is to reform in order to improve competitiveness and thereby secure a lasting recovery.

The promotion of growth and competitiveness can be supported by well-designed tax systems that create the right targeted incentives to invest in the future. This is the case for environmental taxation where a carrot-and-stick approach can be employed, and where the the economic cost of pollution can be revealed. Similarly, well-designed R&D tax incentives take into account positive spill-overs from research and innovation activities for the advancement of the economy and the society.

7.1. Environmental taxation

Environmental taxation offers significant benefits both from an economic and resource efficiency point of view. Well-designed tax systems can help develop innovation, protect the climate and promote a green economy. In order to fully exploit their benefits, they should be designed in such a way as to provide appropriate incentives to reduce emissions over time and

[34] In Luxembourg, the maximum deduction was halved. In the Czech Republic, the maximum deductible amount has been reduced from CZK 300,000 to CZK 80,000 in 2014. Finally, in Estonia, the maximum deduction was reduced from EUR 3,169 to EUR 1,920 in 2013.

improve resource efficiency. In addition, relying more on environmental tax bases offers further scope to shift the tax burden away from labour, allowing Member States to gain in competitiveness and foster employment (so-called 'double dividend'). Finally, favouring environmental taxes helps, to a certain extent, countries facing fiscal consolidation challenges to raise revenues/improve public finance in a manner that is less detrimental to growth. These messages have been strongly reiterated over successive cycles of the Semester and are now starting to bear fruit, as there seems to be an impetus and willingness to reform, which is reflected in particular by the number of reforms proposed. However, concrete progress remains limited mainly because the measures adopted were not very significant or in some cases because measures were proposed but not subsequently converted into legislation.

Since the launch of the European Semester, there has been a considerable increase in the number of recommendations related to environmental taxation. There were ten such CSRs in 2014 (table 10). There are only few countries for which a recommendation was not renewed the following Semester. The recommendation was dropped for Austria in 2013 and Romania in 2014 as significant measures had been taken since the previous cycle and time was needed for assessment. As regards Estonia, the Council recommendation on vehicle taxation to achieve Europe 2020 environmental target was broadened to cover other policy instruments.

Table (10): Summary of Council recommendations with a reference to environmental taxation (2011-2014)

	2011	2012	2013	2014
Member States for which the Council adopted CSRs with environmental tax element	5 BE, ES, FR, LT, SK	12 AT, BE, CZ, EE, ES, FR, HU, IT, LT, LU, LV, SK	10 BE, CZ, ES, FR, HU, IT, LT, LU, LV, RO	10 BE, CZ, ES, FR, HU, IE, IT, LT, LU, LV

Between 2012 and 2013, the main measures taken were increases of the excise duty on diesel, increases of the tax rates on energy and reforms of car taxation. The scope of action seemed to be limited and at the margin (e.g. increases of excise duties only correcting for inflation) and tax reforms were sometimes ill-designed (e.g. taxing profits of energy companies instead of consumption) or undermined by other tax reforms giving the opposite

signal (e.g. tax allowances granted to commuters which encouraged the use of private cars instead of public transport)[35].

Looking at reforms adopted in 2013 and first half of 2014, few countries that received a CSR took or announced significant measures to rely more on environmental taxation[36]. During this period, and in line with the trend already observed in 2012-2013, half of the Member States increased excise duties on energy though, in many cases, with a modest budgetary impact (e.g. Latvia, Bulgaria[37]). In addition, several Member States have been developing taxes on pollution and resources.[38] Some countries have also taken measures to improve the design of car taxation.[39]

However, in some Member States the reforms went in the opposite direction. At least seven decreased excise duties on energy or prolonged an existing decrease. Belgium, which received a CSR, introduced a reduced VAT rate (6%) on electricity despite a double recommendation not only to make greater use of green taxes but also to broaden the VAT base in general. Slovakia, which is among the eight countries identified by the Commission Services as having a generous company car taxation system[40], recently reformed its regime to make it even more generous. Ireland and the United Kingdom decided to abolish or reduce their respective flight taxes mainly to boost tourism.

Some failures, suspension or delay to implement reforms are important to mention. This is the case in France (suspension of the *Ecotaxe*), in Estonia (difficulties in passing the limitation of the reduced VAT rate on company passenger cars), in Lithuania (failure to introduce a road tax), in Romania (landfill tax delayed), in Finland and in the United Kingdom (where the planned increase of fuel duties has been frozen).

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[35] Garnier et al., 2013

[36] Hungary put into place road taxes on heavy trucks. France made a similar announcement (*Ecotaxe*) but suspended its entry into force for political reasons. France strengthened its bonus/malus system in car registration tax, introduced a carbon tax and broadened the base of some of its energy taxes. Romania increased excise duties while setting up an automatic indexation system, and introduced a carbon element in taxation to the car tax regime. Lithuania raised some excise duties on energy product to reach the EU minimum level.

[37] In order to comply with EU rules on minimum rates for excise on energy. This applies to other Member States such as Poland or Estonia.

[38] For example, Italy, the Netherlands, Lithuania and Hungary respectively introduced, reintroduced, announced or extended taxes on waste. Latvia increased taxes on natural resources and plans to introduce new ones. Finally, Spain introduced a tax on fluorinated greenhouse gases.

[39] For example, Bulgaria is changing the rates of the tax on motor vehicles to better reflect the environmental impact. Croatia introduced special taxes on motor vehicles. Cyprus pursued its reform of excise duty on motor vehicles, based on environmentally-friendly principles (CO2 emissions). Estonia is also currently revising the taxation of company cars by reducing the VAT deductibility to 50% for company cars used for private purposes.

[40] European Commission, 2013d

The limited progress in the field of environmental taxation in recent years can be partially explained by Member States' concerns about competitiveness and social issues. For example, such concerns were expressed by Latvia where energy costs are already high for households due to long cold winters and poor insulation of property[41]. In its 2013 National Reform Programme[42], Slovakia explicit raised its concerns regarding the regressivity of such taxes and their harmful effects on competitiveness.

7.2. R&D tax incentives

'Good' tax expenditures can co-exist with the priority of base broadening despite a theoretical tension. Base broadening targets inefficient tax expenditures. Certain desirable taxpayers' behaviour could for example benefit the wider economy, but market failures are such that the market price does not reflect the true cost of such behaviour. There are some examples of such expenditures which include R&D tax incentives.

R&D tax incentives have grown into an important policy instrument and are now used in 25 Member States. Over half of the Member States expanded their use of R&D tax incentives in 2013 and 2014 as a result of the crisis in order to improve their competitiveness. If these incentives are well targeted so as to reduce deadweight losses and to promote cost effectiveness, they can help to enhance companies' capacity to innovate.

There was a clear increase in the number of CSRs in the area of research and innovation in recent years. While only three countries received such recommendation at the start of the European Semester in 2011, almost half of Member States had one in 2013 and 2014. This illustrates the increasing importance of competitiveness and innovation challenges. Research and innovation recommendations are rather general without specifying a particular policy instrument. Nevertheless, in 2014, two Member States (France and Poland) received recommendations referring explicitly to the need to review the existing R&D tax incentives so as to ensure they are effective in stimulating innovation. Many research and innovation recommendations focus on the need to improve framework conditions for innovation, of which tax incentives are one element.

Since 2007, six Member States introduced R&D tax incentives (Croatia, Denmark, Finland, Latvia, Lithuania, and Sweden) and all 17 Member States who were already using

[41] Garnier et al., 2013

[42] Abstract from the 2013 Slovakia NRP, p. 25.

R&D tax incentives enhanced them. In addition, two Member States apply accelerated depreciation for R&D expenses (Bulgaria and Cyprus).

The reforms of R&D tax incentives have accelerated since 2011 with a peak in 2013 when 14 Member States enhanced their support for R&D via the tax system. These reforms have been motivated by increasing concerns about deteriorating competitiveness and aim to cushion the impact of the crisis on private sector investments. The major trend was to simplify the R&D schemes, increase their generosity (via rates and ceilings increases) and enlarge the scope of the eligible activities e.g. to encompass innovation activities. Several Member States have made the design of their R&D tax incentives friendlier for smaller innovative companies which usually make losses in their first years of operation. Such measures include providing options for cash reimbursement and allowing a more generous carry forward of unused tax credits (e.g. France, Portugal, Spain and the United Kingdom). More recently, the reforms seem to focus on attracting top talent and improving the quality control of supported expenditure. A few schemes have been modified to offer more generous deductions for hiring PhDs and researchers. Italy introduced a tax credit for hiring new highly-skilled employees for R&D and France extended its tax incentive for young innovative companies, notably to cover employees involved in innovative activities. A few Member States also introduced quality control measures to ensure the relevance of supported R&D expenditure (e.g. Austria, Belgium and Portugal). Since 2013 the Austrian Research Agency assesses the scientific relevance of claims for R&D tax credits on behalf of the Finance Ministry. Portugal made reforms in all the areas mentioned above by introducing a longer carry forward of unused credits, more generous deductions for PhD personnel and mandatory audits by a research agency once the R&D project is over.

The EU is still far from reaching its 3% target on R&D investment, mainly due to the shortfall on business R&D spending. Only marginal progress seems to have been made since the launch of the Europe 2020 strategy.[43] However, this negative picture on spending could underestimate the efforts made.[44] The measures to stimulate private R&D spending via the tax system contributed to the fact that business R&D remained resilient during the crisis years

[43] European Commission, 2014a
[44] European Commission, 2014c

and increased since 2010. These efforts are important as private sector R&D tends to be pro-cyclical, in particular in case of financial constraints.[45]

In addition, some Member State have introduced 'patent boxes' in recent years which target income from intellectual property rather than R&D investments (e.g. Cyprus in 2012, the UK in 2013 and Portugal in 2014). Such schemes could put downward pressure on public revenues and distort the location of patents rather than increase the underlying research and innovation activities[46].

Table (11): Changes to R&D tax incentives support.

	2007	2008	2009	2010	2011	2012	2013	2014
Number of MS changing R&D tax incentives	4	3	5	5	7	7	14	11
MS introduced new ones	**HR**	**LT**				**DK**	**FI**	**SE**
MS enhanced their system	**CZ, FR, IE**	**FR, UK**	**BE, FR, IE, NL, PT**	**BE, FR, PL, RO, UK**	**AT, ES, FR, IE, MT, PT, UK**	**AT, ES, IE, NL, PT, SI**	**AT, CZ, EL, ES, FR, HU, IE, IT, NL, PL, PT, RO, UK**	**CZ, DK, FR, HU, IE*, IT, NL, PT, SK*, UK**

* Announced.

7.3. <u>Immovable property taxation</u>

Recurrent taxes on immovable property are considered to be the least detrimental to growth[47]. Shifting part of the tax burden to this base can therefore increase the growth-friendliness of the tax system. Also recurrent property taxes can help to dampen housing bubbles. However, their use within EU Member States varies largely. In the UK, for example, 3.4 % of GDP is collected from recurrent property taxes, whereas in Malta these taxes do not

[45] European Commission, 2013e
[46] Griffith, Miller, & O'Connell, 2014
[47] OECD, 2010

exist at all. Many EU Member States use outdated valuations for the base of recurrent property taxes. Even when these valuations are indexed, equity issues may also arise as the development of immovable property prices can differ regionally and locally. Therefore, property that was equally priced many years ago, can differ in price now.

In 2011, four Member States were recommended to reform their system of property taxes. A year later, the number had risen to nine. In 2013, the recommendation for Denmark was ended given that it had taken non-tax measures to stabilise the housing market[48]. In 2014, recommendations were addressed to 11 Member States, with the addition of the new Member State Croatia, and of Spain for which the recommendation to reform property taxes is part of the recommendation to shift taxes from labour to less distorting bases.

Table (12): Summary of Council recommendations to shift the tax burden to recurrent immovable property tax or to restructure immovable property taxation (2011-2014)

	2011	2012	2013	2014
Member States for which the Council adopted CSRs on tax shift to recurrent immovable property tax.	4 DK, SE, SK, UK	9 AT, CZ, DK, HU, IT, LT, LV, SK, UK	9 AT, CZ, DE, IT, LT, LV, SE, SK, UK	11 AT, CZ, DE, ES, HR, IT, LT, LV, SE, SK, UK

Statistics, which are only available up to 2012, do not show substantial increases in the share of **recurrent property taxes** to GDP in EU Member States with the exception of Italy and Greece. However, in some Member States (e.g. Ireland), policy changes only took effect in 2013 or 2014 and are therefore not yet visible in the statistics.

Over 2011-2014, nine Member States increased the base and/or the rate of their recurrent property taxes. In 2012, Lithuania and Latvia broadened their property tax base, the former by including dwellings and the latter by, among other property, including auxiliary buildings and parkings. Spain introduced a surcharge on the Real Estate Tax which was due to expire in 2013, but was extended to 2016. Cyprus increased the tax base and the rate of their recurrent property tax in 2013.

[48] See Denmark NRP 2013, p.27.

The Netherlands introduced a tax on the renting out of social housing which will be gradually increased from 2013 to 2017 producing a projected revenue of 0.3 % of GDP. In 2014, Romania introduced a new tax of 1.5 % on the book value of special constructions that were not already subject to local (property) taxes. Reforming recurrent property taxes was also a part of the measures taken while Greece and Ireland were in the Support Programme. In September 2011, Greece introduced a special real estate duty on residential property, to be collected through the payment of electricity bills. This was integrated into a new tax on immovable property in 2014. Ireland introduced a new Local Property Tax from July 2013 (with a rate of 0.18% for residential properties valued below EUR 1 million and a rate of 0.25 % for properties valued above EUR 1 million). Slovenia introduced a new progressive real estate tax, but this was annulled by the constitutional court in April 2014. Croatia plans to introduce a new recurrent property tax which would take effect in 2016.

Two Member States reduced the tax base of recurrent property taxes. Latvia provides for a possible reduction for families with three or more children, while Estonia abolished the land tax for small and medium sized residential properties.

In many countries the values of properties are outdated. A few Member States (Cyprus, France, Greece, Italy and Romania) have announced a revaluation of cadastral values. A major exercise of property revaluation has been recently completed in Portugal.

Apart from recurrent taxes, **taxation of transfers of immovable property** ("transaction taxes") is widely used. These taxes are not levied on the possession or the use of immovable property, but on the transfer from one owner to another. Transfer taxes are considered to be more distortionary than recurrent taxes as they can harm the working of the immovable property market and even of the labour market. Therefore, reducing transaction taxes increases the efficiency of the tax system. The Netherlands has reduced the rate for residential property from 6% at the start of the European Semester to 2% in July 2011. Italy reduced the rate for primary residences to 2 % and increased the rate for other immovable

property to 9 % with effect from January 2014. Other Member States (Czech Republic, Finland, Portugal, the United Kingdom) increased their property transaction taxes[49].

In conclusion, a considerable number of Member States have increased or introduced recurrent real estate taxes. In Italy and Greece this led to a considerable shift of the tax burden to recurrent property taxes which is visible in the Eurostat statistics[50]. For other Member States (e.g. Ireland), the effects of recent measures are yet to materialise in the statistics.

8. IMPROVE TAX COMPLIANCE AND TAX ADMINISTRATION

Member States have actively worked on improving tax compliance. However, sustained efforts over time are necessary to address this structural challenge.

Member States' tax authorities perform an essential public service by collecting the money which is necessary to finance public expenditures such as education, healthcare, defence, etc. In 2012 alone, Member States collected more than EUR 5,000 billion of taxes and social security contributions.[51] This amounts to about 40% of EU-28 GDP. Considering the importance of tax collection for public finances, Member States continuously strive to improve tax compliance. This is particularly relevant in times of crisis. Generally, they do so by pursuing two closely related objectives: gathering all taxes due according to the law while at the same time keeping to a minimum the costs of collecting and paying these taxes.

Improving tax compliance has been a priority of the Semester since the AGS 2012, and incorporates the twin objectives of fighting tax evasion (i.e. making sure all taxes due are collected) and of improving tax administration (measures to make sure revenues are collected efficiently). The CSRs have been referring to both these aspects since 2011 as shown in Table (13).

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[49] In the Czech Republic, the real estate transfer rate was increased to 4 % and in Finland, the rate for apartments that belong to "housing co-operatives" was set at 2 % In the UK, since March 2014, properties valued over GBP 500 000 are subject to higher transaction tax rates (7 % for individuals and 15 % for non-natural persons). The tax has been introduced in March 2012 with a threshold of GBP two million. The UK also laid down in law a capital gains tax on future gains made by non-residents disposing of UK residential property to come into force in April 2015. In 2013, Portugal has introduced a stamp duty of 1 % on high-value properties (above EUR 1 million) on top of the existing municipal real estate transfer tax. The French government enabled the departments to increase their real estate transfer tax from 3.8 % to 4.5 % between 1 March 2014 and 29 February 2016.

[50] European Commission, 2014d

[51] European Commission, 2014d

Table (13): Summary of the CSRs referring to the fight against tax evasion and improving tax administration (2011-2014)

	2011	2012	2013	2014
Member States for which the Council adopted CSRs on fight against tax evasion[52]	3 CZ, LT, SK	9 BG, CY, CZ, EE, IT, LT, MT, PL, SK	13 BE, BG, CZ, ES, HU, IT, LT, LV, MT, PL, RO, SI, SK	14 BE, BG, CZ, ES, HR, HU, IT, LT, LV, MT, PL, PT, RO, SK
Member States for which the Council adopted CSRs on tax administration	1 SK	7 BG, CY, CZ, HU, IT, PL, SK	7 BE, BG, CZ, HU, IT, PL, SK	13 BE, BG, CZ, DE, ES, FR, HR, HU, IT, PL, PT, RO, SK

The number of countries that have received CSRs referring to the fight against tax evasion and tax administration has increased considerably since 2011. This can be explained by i) EU level aspects, particularly the growing attention being paid to tax fraud and tax evasion by the EU institutions, as indicated for instance by the European Commission's action plan against tax fraud and tax evasion of 2012[53]; and ii) changes in country-specific circumstances and priorities, as assessed by the Commission services in the SWDs accompanying the CSRs.

In the case of a few countries, CSRs have not been carried over from one year to another: in the case of Estonia (CSR in 2012 but not in 2013) and Slovenia (CSR in 2013 but not in 2014), this was due to sufficient progress being made by these two countries in addressing the CSRs. For Cyprus, which required financial assistance in mid-2013, no CSR was issued in 2013 and 2014 to avoid duplication with the measures set out in the economic adjustment programme. Croatia, which joined the EU in July 2013, received CSRs for the first time in 2014.

[52] Member States under Economic Adjustment Programme are excluded.
[53] European Commission, 2012c

An increasing number of Member States (from sixteen to twenty-three Member States over 2011-2014) have stepped up the fight against tax fraud and tax evasion since the start of the Semester: [54]

Table (14): Member States fighting tax evasion (2011-2014)

	2011	2012	2013	2014
Member States fighting tax evasion[55]	16 AT, BE, BG, CY, CZ, ES, FI, IT, LT, LV, MT, NL, PL, SI, SK, UK	18 AT, BE, BG, CY, CZ, EE, ES, FI, FR, IT, LT, LV, MT, NL, PL, SI, SK, UK	20 AT, BE, BG, CZ, EE, ES, FI, FR, HU, IT, LT, LV, MT, NL, PL, RO, SE, SI, SK, UK	23 AT, BE, BG, CZ, DE, EE, ES, FI, FR, HR, HU, IT, LT, LV, MT, NL, PL, PT, RO, SE, SI, SK, UK

Member States have used a variety of policies to fight tax evasion, including more controls, measures to promote voluntary compliance, but also higher sanctions, tighter rules for conducting certain activities or types of transactions, more cooperation with other law enforcement activities, increased exchange of information, organisational changes, etc. As an example of increased controls, Bulgaria has introduced fiscal control on movements of goods at high risk of tax evasion within the country.[56] Italy has increased tax checks, investigations into the shadow economy and checks on reported income.[57] Latvia has been implementing a multi-annual programme to combat the grey economy and ensure fair competition.[58] Another common measure to tackle tax evasion is to increase sanctions. For instance, Hungary increased penalties for tax default to 200% for cases of revenue concealment.[59] In several instances, Member States have tightened the rules for conducting certain types of businesses, or limited the opportunities for tax evasion. For instance, Croatia and Hungary have introduced cash registries linked to the tax authorities' information systems to curtail

[54] This is assessed on the basis of references to measures against tax evasion (planned or implemented) using as main source Member States' NRP and SCP (see Europa website 2014, 2013, 2012 and 2011).
[55] Member States under Economic Adjustment Programme are excluded. Croatia is included as from 2014.Key sources of information are NRP, SP and CP. Croatia is included as from 2014.
[56] Bulgaria CP 2014, p. 48. The list of goods of high fiscal risk includes certain types of meat, fish products, vegetables etc.
[57] Italy NRP 2013, pp. 49-51.
[58] Latvia NRP 2012, p. 30.
[59] Hungary NRP 2013, p. 59.

abuses.[60] Member States have stepped up the exchange of information and administrative cooperation, both with other countries' tax authorities and internally, between different agencies (e.g. customs and tax authorities). Fostering cooperation between Member States' revenue authorities has long been a tax policy priority at the EU level. The Commission has stressed on several occasions the importance of administrative cooperation between tax authorities to tackle cross-border tax fraud, recently for example via the 2012 action plan against tax fraud and evasion[61]. Bulgaria, for example, has taken part in joint tax controls with the administrations of Germany, Denmark, Latvia and Sweden.[62] Several measures have also been taken to expand cooperation at the global level:[63] for instance, Malta has expanded its network of double taxation and tax information exchange agreements with third countries[64] and Lithuania has joined the OECD Convention on Mutual Administrative Assistance.[65] There are also cases of cooperation between agencies within the same Member State. For instance, in Spain, the Labour Inspectorate is increasingly cooperating with tax authorities and other law enforcement bodies to fight against tax and employment fraud.[66] Finally, some Member States have reorganised tax administration to make it more effective at fighting tax evasion. For instance, Romania has established an anti-fraud task force by reorganising the operative audit of its revenue administration.[67]

Alongside tax evasion, the need to tackle aggressive tax planning has gained in prominence in recent years, with Member States taking action to - at least partly - address it. The Commission also raised this issue in its 2012 action plan against tax fraud and tax evasion and gave it particular attention in the Communication that concluded the last European Semester[68].

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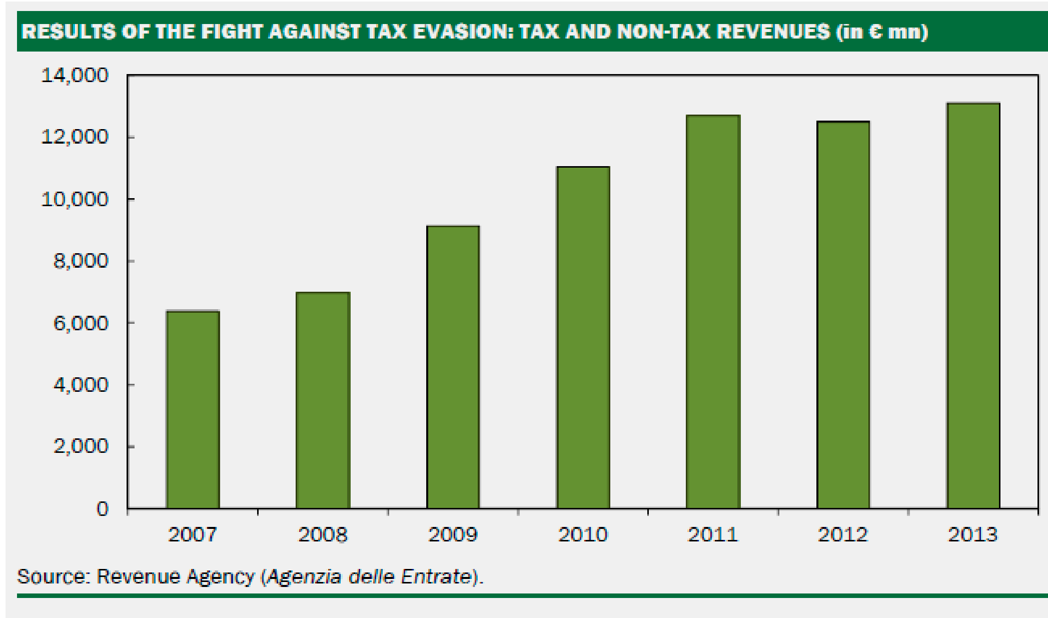
[60] For Croatia, see Economic Programme 2013, p. 21; for Hungary, see CP 2013, p. 59.
[61] European Commission, 2012c
[62] CP 2013, p. 54.
[63] The Commission has recently stressed the importance of a multilevel approach to fight tax evasion. See European Commission, 2013b.
[64] Malta NRP 2012, p. 45.
[65] Lithuania NRP 2014, p. 76.
[66] Spain NRP 2013 of Spain, p. 50.
[67] Romania CP 2014, p. 50.
[68] It called upon "[s]ome Member States need to reflect on ways to maintain revenue sustainability in anticipation of EU and international efforts to address base erosion and profit-shifting and should review their tax conventions to strengthen anti-abuse mechanisms." European Commission, 2014b.

Box 3. Fighting Tax Evasion: Examples of Results Achieved

Few Member States have reported in their national reform and stability or convergence programmes the results achieved in the fight against tax evasion and fraud. In 2011, Italy reported incremental tax and SSC revenues from the fight against tax evasion of EUR 12.7 billion, up by 15% compared with 2010. In 2012, the amount reported was slightly lower than 2011 at EUR 12.5 billion. Results improved again in 2013, reaching EUR 13.1 billion, a 5% increase over 2012. The chart below (extracted from SP 2014 for Italy) shows results achieved by Italy over the period 2007-2013, indicating a positive trend:



Spain has also reported increased yearly revenues from the fight against tax evasion. In 2012, the result was EUR 11.52 billion, up 10.08% compared with 2011. The result was slightly lower in 2013, at EUR 11 billion. In other cases, information given by Member States covers only certain years. For example, Bulgaria reported additional tax liabilities thanks to audits of BGN 3.07 billion in 2012. For the same year, France reported a total of EUR 18 billion of duties and sanctions to be recovered as result of the fight against tax evasion.

Almost all Member States have taken action to improve their tax administration and their number has grown since 2011 (from fifteen to twenty-five):

Table (15): Member States improving tax administration (2011-2014)

	2011	2012	2013	2014
Member States improving tax administration[69]	15 BE, BG, CY, CZ, FR, DE, HU, IT, LT, LV, NL, PL, SE, SI, SK	20 BE, BG, CY, CZ, EE, ES, FI, FR, DE, HU, IT, LT, LV, MT, NL, PL, SE, SI, SK, UK	20 BE, BG, CZ, EE, ES, FI, FR, DE, HU, IT, LT, LV, MT, NL, PL, RO, SE, SI, SK, UK	25 AT, BE, BG, CZ, EE, ES, FI, FR, DE, DK, HR, HU, IE, IT, LT, LV, MT, NL, PL, PT, RO, SE, SI, SK, UK

As in the case of fighting tax evasion, Member States have relied upon various measures to improve tax administration. Areas of intervention include expanding electronic services and more use of information and communication technologies (ICT) by tax authorities, actions to simplify tax compliance procedures, and organisational reforms to increase the efficiency of tax administrations. Examples of ICT reforms in tax collection are those undertaken by Poland, which is implementing a multi-annual "e-Taxes Programme",[70] by Bulgaria, which has expanded the portfolio of e-services offered to taxpayers in recent years,[71] or by Lithuania which has developed the system of electronic education, consultation and information services for taxpayers.[72] Tax simplification measures have been taken in many Member States. As an example, Bulgaria has simplified the process for declaring tax liabilities.[73] Examples of organisational reforms aimed at increasing efficiency are the unification of the collection of customs and taxes in Slovakia[74] and the establishment of a large taxpayers' office and the rationalisation of the local office networks in Croatia.[75]

[69] Member States under Economic Adjustment Programme are excluded. Croatia is included as from 2014.
[70] Poland NRP 2014, p. 70.
[71] Bulgaria introduced 13 new e-services for taxpayers over 2013-2014. See CP 2014 of Bulgaria p. 69.
[72] Lithuania NRP 2014, p .57.
[73] Bulgaria NRP 2014, summary table of measures.
[74] Slovakia SP 2013, p .52.
[75] Croatia NRP 2014 p 14 and Economic Programme 2013 p. 34.

Box 4. Improve Tax Compliance: Progress from Greece

Since 2010, the euro area Member States and the International Monetary Fund (IMF) have supported Greece through an Economic Adjustment Programme (EAP) which, among other dimensions of reform, covers fiscal structural changes to improve tax compliance.

Within the EAP's framework, the European Commission and the Member States have provided technical assistance to Greece on strengthening revenue administration. In this area, progress has been made on several aspects, including the following:

- Improving filing compliance while reducing administrative costs. The Greek authorities were advised to abstain from the practice of regularly extending deadlines for filing tax returns while communicating clearly to taxpayers about how to file and about the importance of filing on time. The 2014 filing period saw good results – with more than 5.8 million returns filed by mid-July and a record of 275,000 tax returns filed on the last day – clearly showing that the firmer approach taken by the authorities and the communication strategy chosen positively influenced taxpayers' behaviour, leading to improved voluntary tax compliance.
- Improving VAT administration. Technical assistance was provided in reviewing VAT legislation and to reduce administrative burden and stepping up the fight against VAT fraud.

Sources: European Commission 2014e and Commission services.

9. CONCLUSION

The European Semester was launched at the end of 2010 when Europe was in the midst of an economic and financial crisis. In that context, the CSRs have been used as a compass to exit the crisis and re-build growth[76]. Tax policy can contribute to achieving the priorities spelled out in the AGS, and accompanying the efforts towards more competitiveness and more fairness while maintaining sound public finances. In 2014, all Member States (not under programme) but three were issued a CSR on taxation.

The assessment of the progress made in following up the recommendations is mixed. Even though there is a need for more action, as evidenced by the number of recommendations, overall many Member States have put in place reforms that follow a logic consistent with the AGS in most priority areas.

While there was no tax shift from labour towards less detrimental tax bases during the first rounds of the Semester, a tax shift of limited magnitude seems to have taken place over the last year. The period under consideration has been characterized by an increase in targeted labour tax cuts that benefits certain categories of workers. This is expected to boost employment given the high responsiveness of the groups concerned. It also enhances the progressivity of the PIT. Almost half of the Member States shifted part of the tax burden to recurrent immovable property taxes, even if a significant increase can only be observed in a few countries. The number of Member States addressing outdated valuation of immovable property remains limited.

When it comes to corporate income tax, reforms taken during the time-frame of the analysis, which includes the deepest period of the crisis, concentrated on narrowing the tax base to stimulate private sector investment and boost competitiveness mostly through extending or introducing new tax incentives, in particular on R&D. R&D tax incentives have grown in importance, and are now used by an overwhelming majority of Member States. This contributed to resilient private R&D investment during the crisis. When base broadening of CIT occurred, it was often done with a view to limit opportunities for tax avoidance and to reduce incentives for excessive indebtedness.

[76] European Commission, 2014b

Increasing public and private debt has been one of the roots of the crisis. Therefore, many Member States took measures to reduce the bias to take on debt that is a feature of their tax system. In corporate taxation this mostly translated into tightening the rules on interest deductibility. In personal taxation interest deductibility was also reduced. In total, 10 out of the 14 Member States that had some form of interest deductibility reformed their system and reduced its generosity.

Member States have demonstrated a growing commitment to improve tax compliance by fighting against tax evasion but also by making tax procedures simpler and tax administrations more efficient. At the EU level, the Council has put increasing emphasis on the challenge of low tax compliance, adopting an increasing number of CSR calling for actions in this area.[77] Member States' have translated their commitments into a wide number of reforms and measures, including increased use of ICT, administrative cooperation and exchange of information, increased controls, higher sanctions and tighter rules, and initiatives to simplify tax rules. Nonetheless, improving tax compliance remains a structural challenge for the European economy, calling for consistent efforts over time. There remains determination both at national and at EU level, as evidenced by the importance granted to the need to tackle aggressive tax planning in the fourth European Semester.

However, in the fields of VAT and to a lesser extent environmental taxes, progress is more mixed. While increases in consumption taxes have played a significant role in the consolidation efforts of the Member States, reforms in the field of VAT are often focused on raising standard rates. Most Member States are reluctant to broaden the standard VAT tax base and remove inefficient tax expenditures. Even though there is an attempt to make a greater use of environmental taxation, progress has been limited. While they could support the consolidation effort, competitiveness in the long term and a cleaner environment, such taxes are often perceived as disproportionately affecting poorer households and energy-intensive industries. Therefore, they would seem difficult to introduce or to increase, particularly in a crisis context.

In conclusion, a 'wind of change' can be felt in tax policy as progress can be observed for most tax policy priorities from the AGS, both in Member States with and without tax-specific CSRs. This is a positive development as European tax priorities are shared by

[77] CSR recitals generally provide insights into high level policy objectives, in particular AGS ones.

national authorities. The importance of tax policy priorities has grown, as reflected by the increasing number and scope of tax CSRs issued in recent years. However, many Member States did not fully comply with the tax recommendations addressed to them. This suggests that more time may be required to implement such structural reforms and to resolve the associated political and social issues.

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