Report "Tax Reforms in EU Member States" 2014

Q&A

What is the Tax Reform Report?

The Tax Reforms in EU Member States is an annual report that reviews the most important tax reforms recently implemented in EU Member States and identifies current policy challenges in the area of taxation. The report is prepared jointly by the European Commission's Directorate-General for Economic and Financial Affairs (DG ECFIN) and Directorate-General for Taxation and Customs Union (DG TAXUD).

What is the main conclusion on recent tax reforms?

The report shows that Member States have increased the overall tax burden in recent years, as part of a policy of fiscal consolidation. In 2014, the tax burden is expected to stabilise. In the year up to mid-2014, a majority of Member States decreased the tax burden on labour, often focusing on low income earners and other vulnerable groups. At the same time, most Member States increased those taxes that are considered relatively growth-friendly, particularly consumption taxes like VAT. Environmental and property taxes were increased to a much lesser extent. Tax measures have been increasingly used to strengthen investment and innovation incentives for businesses. Most Member States took further measures to fight tax fraud and evasion and to improve tax compliance.

Why is it important to identify tax policy challenges?

Improving the design of the tax system is a way for EU Member States to improve their public finances, to support growth and job creation, to strengthen economic stability and to increase fairness.

How does the report identify challenges?

The report makes use of a wide variety of indicators to assess Member States' performance in relevant areas of tax policy. A relatively poor performance on the indicators indicates a potential policy challenge. No automatic conclusions should be drawn however. The indicator-based assessment must be complemented by in-depth country analysis before any firm conclusions on policies can be made. The European Commission carries out such in-depth work in the context of the European Semester.

Which specific areas does the report examine?

The report first discusses ways to make tax structures more growth-friendly and looks at the role that taxation can play in meeting consolidation needs. It also presents an in-depth assessment of areas to be considered in the context of broadening tax bases: housing taxation, the debt bias in corporate taxation, tax expenditures (exemptions, preferential rates) in direct taxation and VAT. It finally examines specific challenges related to the design of environmental taxation and to tax governance, and discusses the issue of income inequality and taxation.

What is the main finding in terms of the growth-friendliness of tax systems?

The tax burden on labour in the EU is relatively high. Reducing this burden, particularly for specific groups such as low-wage earners can have positive consequences on growth and employment. From a public finance perspective, lower labour taxes need to be compensated by a reduction in public spending and/or increases in other sources of revenue. Several Member States that have a high tax burden on labour (overall or for specific groups) would have scope to increase taxes that are less detrimental to growth, such as taxes on consumption, recurrent taxes on immovable property, and environmental taxes. These Member States could consider a shift away from labour to other tax bases.

What does the report find about housing taxation?

The report identifies several avenues to make housing taxation more efficient. First, the report finds that several Member States could make better use of recurrent housing taxation, which is considered relatively more growth-friendly than labour taxation. Second, some Member States could consider shifting the burden from transaction taxes to recurrent housing taxes as the latter create less economic distortions. Finally, the report observes that around one third of Member States provide tax relief for mortgage interest payments, a policy that can encourage household indebtedness and overinvestment in housing, can push up house prices, and can lead to an increased risk of financial instability if not complemented by other measures such as taxation of imputed rents. Recognising these problems, the majority of the Member States concerned are in the process of reducing the generosity of the tax relief on mortgages.

What is the main finding on tax expenditures?

The report highlights the benefit for Member States of regularly carrying out a systematic review of their tax expenditures. Tax expenditures include a wide range of specific tax provisions, such as exemptions, allowances, reduced rates and other special regimes. While some well-designed expenditures can enhance positive spillovers and welfare, it is important to ensure that they do not cause economic distortions and that they are the most cost-efficient means of achieving economic and social policy goals.

What is the main finding on environmental taxation?

Environmental taxation is a relatively growth-friendly source of revenue and it can also contribute to reaching environmental targets. Around a third of the Member States can improve the design of their environmental taxes. They could adjust the level and structure of fossil fuel excise duties or index environmental taxes to inflation. Member States could also restructure vehicle taxation and/or phase out environmentally harmful subsidies such as reduced VAT rates on energy products and income tax expenditures for the private use of company cars.

What is the main finding on tax governance?

All Member States are carrying out reforms to ensure that the full amount of taxes due according to the law is actually paid. Nonetheless, the report identifies a significant number of Member States that need to do more to address tax compliance. It is important to find a good balance between preventive measures that promote voluntary compliance and corrective measures such as audits and fines. The report also identifies Member States where the administrative cost of collecting and paying taxes is relatively high, and where the efficiency of tax administration could therefore be improved.

What does the report tell us about recent changes in income inequality?

During the crisis years 2008-12 inequality of income before taxes rose significantly in the EU. Tax and benefit systems were able to achieve that the increase of inequality after tax was much smaller. This picture, however, varies significantly between countries. Furthermore, low-income households in some Member States have seen their circumstances deteriorate disproportionately.