

EU Tax Symposium 2023 – Minutes of Parallel Session 3, 24 October 2023

“Balancing incentives and redistribution: The future of Personal Income Taxation (PIT)”

Parallel Session 3 focused on *“Balancing incentives and redistribution: The future of Personal Income Taxation (PIT)”*.

As personal income taxation (PIT) and social security contributions (SSC) are key tools that shape labour market outcomes and promote redistribution, the panel discussed how the design of the tax system can be improved to address long-term trends, which are prompting a major reflection on the taxation of labour income and other forms of personal income. Population ageing but also increasing labour and capital mobility driven by digitalisation and globalisation, can pose several challenges to the sustainability of tax revenues. Panellists also touched upon capital taxation, the role of PIT in the total tax mix, the impact of taxation on the mobility of capital and workers and the adequacy of taxation based on residency.

The panel, moderated by **Joost KORTE** (Director General DG Employment, Social Affairs & Inclusion, European Commission), was composed by:

- **Markus FERBER** (Member of the European Parliament & Vice-Chair of the FISC committee)
- **Jyrki KATAINEN** (Head of Group Public Affairs, Nordea Bank Abp, former Vice President of the European Commission and former Prime Minister of Finland)
- **Cécile BROKELIND** (Chairwoman of the European Association of Tax Law Professors (EATLP))
- **Ana Paula DOURADO** (Editor in chief of Intertax, Director of European Economics and Fiscal Law Research Centre (CIDEFF))
- **Camille LANDAIS** (Professor of Economics, London School of Economics)

Joost KORTE opened the panel highlighting the importance of discussing the future of personal income taxation in the context of megatrends (such as ageing populations, globalisation, and digitalisation), given the megatrends’ impact on the tax base, on inequality levels and on the Single Market.

During the introductory remarks, **Jyrki KATAINEN** highlighted that taxation should: (i) be effectively leveraged to promote the green and digital transitions (e.g., by providing incentives to invest in green initiatives and encourage human capital growth); (ii) ensure stable revenue flows to support equality and social welfare. In this context, he suggested to lower personal income taxation, but it would require exploring alternative tax types, such as indirect taxation (VAT and behavioural taxes), to meet future revenue needs. He also underlined that, while PIT in the EU is also used to address social issues, direct transfers may be more effective tools to enhance social justice.

Ana Paula DOURADO emphasised the redistributive role of PIT within the EU. She acknowledged the challenges of harmonising PIT and notably labour taxation across the EU, particularly in relation to the allocation of taxing rights in the context of intra-EU labour mobility. She suggested the possibility of using trailing taxes or introducing citizenship taxation (similar to the US system) to address these

issues, which could better prevent abuses and foster the Single Market. She also mentioned the need for control mechanisms to prevent abuse in the absence of harmonisation.

Markus FERBER underlined the essential role of SMEs in the EU economy and the need to ensure a level playing field for businesses. Due to the lack of EU competence on direct taxation, he called for leveraging indirect taxation, and in particular taxation on resource consumption, as a significant tax base, mentioning the EU European Trading Scheme (ETS) as an example. He also encouraged to reassess the role of PIT as the main tool to provide incentives and redistribution in view of long-term policy strategies and priorities.

Cécile BROKELIND recalled that the residence of workers is still the most important factor for allocating taxing rights in bilateral double tax treaties. EU Member States are free to allocate tax bases between the working state and the residence state of employees, within the limits set by the EU fundamental freedoms in the internal market. Despite the right for the working state to levy tax on income for detached workers, ultra-mobile workers do not fall in this category and may end up escape taxation all in all. This problem also exists for social security rules, in spite of coordination rules allowing the working state to levy social security contributions on the salary paid for employment carried out on their territory beyond a mere short time mission. She suggested that this approach is not adequate in view of current trends such as the increase of the digital economy and remote working, also arguing that the EU may play a role in advancing the debate. The EU could start with aligning its recommendations in the field of personal income tax with the social security rules on how to allocate tax bases within the EU.

Camille LANDAIS underlined the central role of well-functioning PIT to support the welfare state of modern economies, recalling that an increase of tax revenue as a share of GDP is correlated with the funding of global public goods and economic development. He warned about the risk of putting excessive focus on megatrends in relation to the future of PIT. In particular, he noted that the impact of digitalisation on the nature of work may be overstated as self-employment rates have decreased significantly, and the number of cross-border workers remains limited compared to posted workers. He also argued that a core issue when looking at PIT is the political megatrend that led to an increasing divide in the taxation of capital and labour over the past 30 years.

After the introductory remarks, **Joost KORTE** underlined that the EU is currently experiencing labour shortages, also reflected in low unemployment rates and high vacancy rates. In parallel, there is a large share of Europeans (above 20% of the working age population) who are not participating in the labour market. The moderator asked the panellists about their view and whether PIT could contribute to make work more attractive to people. All the panellists agreed on the need to explore solutions beyond taxation. **Camille LANDAIS** underlined that the differences in terms of employment rate across the EU are mainly resulting from low female employment rates (often caused by the so-called 'child penalty'), and low employment rates at the beginning/end of the life cycle. He claimed that, while PIT can play a role in addressing those challenges, it must be combined with other policy tools such as childcare availability and pension reforms. **Cécile BROKELIND** also suggested to consider a broad set of policy tools to address this challenge, citing the Swedish paternity leave and its child care attendance financed by the state as an example. Both **Jyrki KATAINEN** and **Markus FERBER** stressed that there is potential to increase the activity rate of elderly people, and that joint taxation may disincentivise second earners to work but other policy tools than taxation play a bigger role in this

respect. **Markus FERBER** also emphasised the need to equip young people with skills and training and to ensure the provision of public infrastructure to balance family and work, which might be more effective than tax incentives. **Ana Paula DOURADO** urged to adopt a comprehensive approach, looking jointly at labour taxation, employment policies and capital taxation.

The panel then discussed the role of PIT in the total tax mix, considering the call from the EU in the last decade to shift taxes away from labour. All panellists agreed that EU Member States should further reduce the role of labour taxes within the tax mix. **Camille LANDAIS** recalled the large share (over 50%) of labour taxation including SSCs over total tax revenue, which puts labour taxation at the heart of the financing of global public goods. He argued that labour will remain the largest tax base but there is considerable room to increase capital taxation, also with the support of the EU. Rebalancing capital and labour taxation would also ensure progressivity at the top of the income distribution. **Ana Paula DOURADO** argued that increasing progressivity for top income earners may result in the risk of high net-worth individuals leaving the EU. **Cécile BROKELIND** mentioned the need to prevent double taxation for individuals and to remove administrative obstacles to labour mobility. She also advocated for a broadening of the tax base instead of increasing tax rates. **Markus FERBER** stressed that both tax and benefit tools should be leveraged to incentivise people to work, including by shifting taxes away from labour. **Jyrki KATAINEN** underlined that strengthening the efficiency of tax collection, as well as fighting tax avoidance and evasion, will contribute to ensuring that people pay their fair share of taxes.

The panel also focused on the challenges for the tax system created by cross-border workers. **Joost KORTE** recalled the recent progress in harmonising SSCs for EU cross-border workers, while there remains a considerable room for improvement in taxation. **Markus FERBER** recalled that taxation still requires unanimity in the Council of the EU, which hampers progress at EU level. **Camille LANDAIS** suggested a refocus on the promotion of EU convergence for the treatment of posted workers, which represent around 10 times the size of cross-border workers.

On capital taxation, **Ana Paula DOURADO** suggested that progress in exchange of information leave leeway to raise taxation on capital income, which, if well-designed, could contribute to social justice, redistribution, and labour market participation. **Jyrki KATAINEN** expressed caution on increasing capital taxation due to the high mobility of capital flows and the need to support investments and capital accumulation to finance the green transition. **Camille LANDAIS** warned that top income progressivity and effective tax rates have been declining across the different tax types, due to political decisions. He also explained that empirical evidence would not suggest massive capital flight nor brain drain of entrepreneurial talent in response to more progressive tax designs.

Prompted by a question from the audience, **Joost KORTE** returned to the topic of how ageing is affecting the EU, resulting in a yearly decrease of more than one million citizens in the 20-64 age cohort, and he wondered about the feasibility of shifting labour taxation to pensions. **Jyrki KATAINEN** emphasized the importance of migration in addressing this megatrend. **Cécile BROKELIND** gave the example of the Swedish pension system's reform which increased the minimum retirement age (now 67 years old) to adapt to the population's longevity and in part to the financial needs of State.

Finally, the panel debated whether tax systems should promote neutrality between employees and self-employed workers. **Cécile BROKELIND** highlighted the lack of a clear definition of self-employment, and questioned whether this neutrality between two different situations could be



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recommended as self-employed workers are usually not benefitting from an equivalent welfare coverage as employed workers. **Camille LANDAIS** recalled that the main distortion between employees and self-employed is due to the lack of third-party reporting for self-employed, which is not an easy issue to overcome although technological progress may play a role. **Ana Paula DOURADO** suggested that an increased use of targeted audits may contribute to increase tax compliance for self-employed workers and underlined the need for international coordination and harmonisation.

Joost KORTE concluded the session highlighting the need to promote a tax shift away from labour taxation and pushing for more sustainable solutions at EU and national level, to address long-term challenges and to ensure a fully functioning EU internal market.