Tax reforms

IN EU MEMBER STATES 2015

Frequently asked questions

What is the Tax Reform Report?

"Tax Reforms in EU Member States" is an annual report that provides a detailed overview of tax reforms recently implemented in EU Member States. The report also identifies which EU Member States have scope to improve their performance in a number of key areas of tax policy. 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 are the main trends?

The report shows that, after several years of increase, the overall tax burden in the EU is expected to fall very slightly in 2015. Indirect taxes (such as VAT) and direct taxes (such as corporate or personal income taxes) are expected to remain broadly stable in 2015, while social security contributions are expected to see a slight drop. Over the past year, Member States have continued to introduce tax measures to stimulate investment. They have also continued to take action against tax evasion.

Why is it important to identify tax policy challenges?

Carefully-designed tax systems can help ensure stable public finances, boost growth, employment and competitiveness, and contribute to a fair distribution of income. The report provides an indication of the areas of tax policy in which Member States may have scope to improve their performance. As such, it is a basis for further analysis and discussion.

How does the report identify challenges?

The report makes use of a wide variety of indicators to assess the performance of tax policies in Member States. A relatively poor performance on the indicators (compared to the EU average) is an indication that there may be scope for improvement, although no automatic conclusions should be drawn. The indicator-based assessment must be complemented by in-depth analysis, which the European Commission carries out in the context of the European Semester.

What does the report conclude on labour taxation?

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

What are the conclusions on VAT?

The report examines VAT from a number of angles. VAT is a relatively growth-friendly source of revenue compared to sources such as labour taxation. However, the report identifies several Member States in which the use of numerous reduced rates and exemptions creates economic distortions, raises compliance costs and reduces revenues. Although reduced rates and exemptions on items such as food or energy products can effectively serve a social policy objective, such measures are often poorly-targeted and unnecessarily costly. The report also presents figures on the 'VAT-gap', i.e. the difference between the amount of VAT owed to the government according to the law and the revenues actually received, caused by factors including tax evasion and avoidance.

What does the report say about housing taxation?

The report identifies several avenues to make housing taxation more efficient. Specifically, some Member States could consider shifting the burden from transaction taxes to recurrent housing taxes, as the latter create less economic distortions (property sales taxes can discourage labour mobility). Some Member States also provide generous tax relief for mortgages, a policy that can encourage household indebtedness and overinvestment in housing, push up house prices, and lead to an increased risk of financial instability if not complemented by other measures such as taxation of imputed rents.

What is the main finding on environmental taxation?

Environmental taxes are a relatively growth-friendly source of revenue that can help achieve environmental policy objectives. Around a third of Member States appear to have room to improve the design of their environmental taxes.

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

The report examines the development of inequality between 2007 and 2013. It shows that although income inequality before taxes rose significantly in the EU during the crisis, tax and benefit systems significantly moderated the effect on net incomes. This picture, however, varies significantly between countries and low-income households in some Member States have seen their circumstances deteriorate disproportionately.

What is the debt bias in corporate taxation and why is it a concern?

Corporate tax systems encourage companies to prefer debt financing over equity financing because they allow interest payments to be deducted from the tax base and offer no similar provisions for the cost of equity. This asymmetry originates from accounting principles, but has no clear economic rationale. The debt bias in corporate taxation can encourage excessive leverage in the corporate sector, lead to higher volatility in the business cycle, be detrimental to investment, and create opportunities for international tax avoidance. From the policy point of view, the debt bias can be addressed either by limiting the deductibility of interest costs, by extending the deductibility to include the return on equity, or by allowing the deductibility of a notional interest on total capital, regardless whether it is debt or equity.

What does the report tell us about fiscal incentives for R&D?

Investment in research and development (R&D) is essential for economic progress and improves social welfare. Most Member States use fiscal incentives to encourage investment in R&D. However, the effectiveness of tax incentives for R&D depends greatly on their design and implementation. The report therefore reviews the common features of R&D tax relief regimes and highlights good practices related to their design and management.

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