The 2013 Annual Growth Survey: Towards fair and competitive tax systems

National tax reforms in 2011 and 2012 were driven more by consolidation needs than in the preceding few years, resulting in increases in income tax and/or VAT in most Member States. However, Member States have also faced the challenge of balancing their increased revenue needs with the need to support recovery and growth over the medium to long term.

It is here that the dual function of taxation comes into play. Taxation is more than just a revenue raising instrument. Depending on how it is applied, it can be used to promote growth and competitiveness, boost employment and address specific social needs. Member States should therefore harness this potential of taxation. In their reforms they should focus on making their tax systems growth-friendly, as well as a source of quality revenues.

### Tax changes in 2011 and 2012

<table>
<thead>
<tr>
<th>Statutory rates</th>
<th>Base or special regimes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Personal Income Tax</strong></td>
<td></td>
</tr>
<tr>
<td>Increase</td>
<td>BE, DK, CY, FI, EL, ES, IE, IT, LU*, NL, PT</td>
</tr>
<tr>
<td>Decrease</td>
<td>FI, HU, LV, NL</td>
</tr>
<tr>
<td><strong>Corporate Income Tax</strong></td>
<td></td>
</tr>
<tr>
<td>Increase</td>
<td>FR, PT</td>
</tr>
<tr>
<td>Decrease</td>
<td>UK, FI, EL, SI, NL,</td>
</tr>
<tr>
<td><strong>Social Security Contributions</strong></td>
<td></td>
</tr>
<tr>
<td>Increase</td>
<td>AT, BG, CY, FR, EL, HU, LV, PL, PT, UK</td>
</tr>
<tr>
<td>Decrease</td>
<td>DE, IE</td>
</tr>
<tr>
<td><strong>Value Added Tax</strong></td>
<td></td>
</tr>
<tr>
<td>Increase</td>
<td>PT, UK, CY, ES**, IE, HU, LV, PL, SK, IT, FR, BG, EL, CZ</td>
</tr>
<tr>
<td>Decrease</td>
<td>CY, EL, ES, IE, LT, PL</td>
</tr>
<tr>
<td><strong>Excise Duties</strong></td>
<td></td>
</tr>
<tr>
<td>Increase</td>
<td>AT, BE, BG, CY, CZ, DE, EL, ES, FI, FR, HU, IE, IT, LT, LU, LV, MT, NL, PL, PT, RO, SE, SK, SI, UK</td>
</tr>
<tr>
<td>Decrease</td>
<td>SI</td>
</tr>
<tr>
<td><strong>Taxation of Property</strong></td>
<td></td>
</tr>
<tr>
<td>Increase</td>
<td>CY, EL, ES, IE, PT, UK</td>
</tr>
<tr>
<td>Decrease</td>
<td>NL</td>
</tr>
</tbody>
</table>

Note: The table encompasses major tax changes implemented in 2011 and the first half of 2012 including temporary but significant changes.

What does the 2013 Annual Growth Survey say on taxation?

This year’s Annual Growth Survey is consistent with last year’s, in terms of the guidance given for Member States’ tax reforms. The 5 key objectives which Member States should pursue for growth-friendly tax reforms are as valid now as they were 12 months ago. They should continue to be followed and implemented. These 5 objectives are:

- Shift taxes away from labour towards more growth enhancing taxes such as consumption and property
- Broaden tax bases rather than just arbitrarily raising rates, for smarter revenue raising
- Increase environmental taxation;
- Improve tax collection and compliance, particularly through the fight against evasion
- Remove the tax bias which encourages debt

In addition, this year the Commission urges Member States to focus on increasing both the competitiveness and fairness of their tax systems, as these 2 principles determine the legitimacy of any tax system for the public.

Why is a "tax shift" advised?

Economic studies show that certain types of taxes – such as those on labour and income – are more distortive, while others such as consumption and environmental taxes are considered to be more growth-friendly. These latter can also steer certain behaviours in a way that meets wider societal needs and objectives. The Commission therefore advises Member States to shift taxes away from areas that impede growth (labour, corporate taxes) towards more growth-friendly taxes (consumption, environment).

The Commission recommends in particular limiting the tax burden on labour, notably for the low-paid. Not only can this create more incentive for workers to work and employers to employ, but it also contributes to a fairer tax system by reducing the burden on the most vulnerable.

Despite the general consensus on the need to lower taxes on labour, in 2011 and 2012, the tax burden on labour has remained high. The latest analyses shows that 1/3 of Member States\(^1\) could do more to shift taxes away from labour towards consumption, environment or property. Moreover, the extent to which focus has been put on redistributing the burden and benefits of this taxation in an equitable way varies considerably depending on the Member State. Therefore, the Commission reiterates the need for Member States to work on a growth-friendly and fairer tax shift in their reforms.

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\(^1\) First screening: BE, DE, FR, IT, AT, CZ, LV, HU, RO. From Table 5.8 Overview: tax structure indicators, Tax reforms in EU Member States, European Commission (2012).
Why does the Commission recommend broadening tax bases, and how can this be done?

Increasing tax rates isn't the only way of increasing tax revenues. In fact, a smarter way can often be to remove or reduce the number of tax breaks and exemptions. For example, limiting the use of reduced VAT rates could provide Member States with important new revenue, without any need for further standard rate increases. In fact, studies show that if all reduced rates were removed, the standard rate could actually be lowered by up to 7.5 percentage points in some cases, without any impact on overall revenues.

Tax breaks, exemptions and hidden tax subsidies not only reduce national income. They also contribute to a more complex tax system, which creates burdens for businesses and compliance difficulties for taxpayers. Therefore broadening the tax base can also improve the overall efficiency of the tax system and ease life for companies. A yearly independent review on all tax exemptions and reduced VAT rates is recommended by the Commission to make sure that intended economic and social objectives are achieved. Very often, this does not seem to be the case.

At EU level, a fundamental reform of the VAT system is currently underway, in order to make it simpler, more efficient and more robust (see IP/11/1508). As part of this reform, the Commission is carrying out a review of reduced VAT rates, to see whether they are all still justifiable. A public consultation on this issue was recently launched (see IP/12/1079), and the feedback should feed in to a Commission proposal on reduced rates next year.

The Financial Transactions Tax, which 11 Member States are currently keen to push forward through enhanced cooperation (see IP/12/1138) is another way for Member States to broaden their tax base without burdening ordinary citizens. One of the objectives of the FTT is to ensure that the financial sector makes a more equitable contribution to public finances.

What is the benefit of increasing environmental taxation?

Green taxes (environment and energy) are considered to be amongst the most growth friendly, and also support wider policy objectives related to climate change, resource efficiency and energy security. Twenty Member States increased excise duties and other environmental taxes in 2011 and the first half of 2012. However, this comes from a low starting point, and environmental taxes remain underdeveloped in many Member States. Therefore, the Commission encourages Member States to take further measures to improve the existing design of taxes in this area including by adjusting the structure of tax rates on fossil fuels, indexing environmental taxes, or considering the abolition of reduced VAT rates on energy.

At EU level, the revision of the Energy Tax Directive (IP/11/468) would support Member States in a growth friendly shift towards environmental taxation, while also contributing to the EU's climate change and energy efficiency goals and removing competitive distortions that currently exist between fuels.
**Environmental tax revenues**

2000-2010, % of GDP, arithmetic averages

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**Environmental Tax Revenue across Member States**

2010, in % of GDP

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*Source: Commission Services*
Why has the Commission made fighting tax fraud and evasion a priority objective?

Hundreds of billions of euros are lost from national budgets every year due to tax evasion and fraud. Not only does this affect public income, but it also undermines the fairness of tax systems. Honest taxpayers must pay higher taxes to compensate for evaders not paying their share. Member States need to strengthen their administrations to combat this problem, and ensure that the controls and sanctions they have in place are strong enough deterrents.

Given the inherently cross-border nature of tax evasion, this is a problem that needs a multi-facetted approach. Different and complementary actions need to be built up at national, EU and international level if the fight against evasion is to be effective. Close cooperation between Member States’ authorities is crucial for success, as is a strong common approach in dealing with third countries that facilitate EU evaders. In June, Commissioner Šemeta presented concrete measures to crack down on tax fraud and evasion in the EU (see IP/12/513). This will be reinforced in the coming weeks with the Commission's Action Plan to tackle tax evasion and Recommendations on tax havens and aggressive tax planning. An immediate step that Member States must take, to bring quick and important results in the fight against tax evasion, is to agree on the revision of the EU Savings Directive and the mandates to negotiate stronger agreements with Switzerland and other neighbouring countries. (see MEMO/12/353).

Why should Member States address the debt and housing bias in their tax systems?

Today’s high levels of debt means that many EU economic actors need to reduce their financial exposure. However, the tax system of some Member States appears to encourage both households and corporate indebtedness. The favourable tax treatment of mortgages is regarded as one of the contributing factors to over-investment in real estate and the housing price bubble that has played an important role in the crisis in several countries. In some Member States, EU companies have tax incentives to favour the use of debt over equity. Malta, Greece, Luxembourg and France stood out as the countries with the highest gap between the tax treatment of debt and equity in 2011. Although clearly lower, the gap was also significantly above the EU average gap, in Portugal and Italy, and above the EU average in Belgium, Spain, Germany and Sweden in 2011. Tax induced incentives for debt financing should be reduced and debt bias in corporate and housing taxation kept under control. Similarly, aspects of tax schemes which increase the debt bias on households, typically through tax relief for mortgages, should be reviewed.
How can tax systems support competitiveness?

The competitiveness of a tax system extends far beyond merely the tax rate. In fact, just as important are the cost and ease of compliance, the level of administrative burden, the transparency and stability of the system improving the business environment. Moreover, a competitive tax system is one that supports the modernisation of the economy. Dealing with the challenges of developing environmentally friendly taxation can help here, as can addressing the debt bias issue.

At EU level, the Commission is promoting a simpler, more efficient and more robust VAT system and has already initiated work to achieve this. The proposed common consolidated corporate tax base (CCCTB), could also considerably contribute to the competitiveness of Member States and of the EU as a whole. By providing harmonised and simplified rules for businesses tax returns, it would lower compliance costs by nearly €1 billion, reduce the administrative burden for cross-border businesses and ensure greater legal certainty. This, in turn, would create a more favourable environment for business and a more attractive market for investors.

What contributes to the fairness of a tax system?

A fair tax system is one in which everyone pays no more and no less than their share, everybody pays what they owe and the benefits of the tax are evenly redistributed. Among the ways that Member States can ensure fairer tax systems are by clamping down on tax evasion and avoidance, removing hidden tax subsidies which create competitive distortions, ensuring that social effects are taken into account, and rewarding desirable activities (e.g. rewarding work and enterprise, or environmentally-friendly behaviour). Fair taxation is an issue which also extends beyond national borders, to the extent that every Member State should be able to collect the tax revenues that it is due.

EU coordination in taxation ensures greater fairness by limiting non-taxation and abuse and preventing a “race to the bottom” approach which can curtail national reform efforts. It also allows Member States to draw on their strength in numbers when tackling common problems such as harmful tax competition from third countries.