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TAX RELATED MEASURES AS AN ANTICRISIS INSTRUMENT – A CASE OF ESTONIA, FINLAND, GREECE, IRELAND, SLOVAKIA AND ROMANIA[1]

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Abstract

The paper is focused on tax related measures used for solving the economic crisis in selected countries. The impact of the economic crisis on public finances varies across the European Union. As there are 27 sovereign Member States with independent tax policy and none of them are identical, each government has been dealing with its problems individually and the choice of instruments for crisis management reflects the economic and budgetary conditions of each state. The applied measures have various forms – from ad hoc tax measures to substantial structural reforms and they may have a general fiscal impact or only a cash flow impact.

Keywords: recession, economic crisis, taxation, corporate income tax, personal income tax, value added tax

JEL Classification: *E62, E63, F4*

1. Introduction

The world is currently facing the most severe financial and economic crisis in decades. The latest data shows that the world economy is now in recession. Therefore governments have tried to find solution how to support the economic growth and to consolidate public finance. Also **taxation impacts on and is influenced by the development in financial**

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markets. There are different views of how this problem should be dealt with in general and also applied tools of individual countries have various forms – from ad hoc tax measures to substantial structural reforms. The removal of tax barriers which hamper the effective functioning of financial markets, particularly at the international level, could help countries overcome to the crisis. This includes tax provisions which distort investor choices as to whether to invest directly or by means of collective investment vehicles, and tax provisions which act as a barrier to the use of different financial products which reduce the cost of capital. Governments should also consider the broader tax implications of the government bailout packages for financial institutions and how they may influence the future attitudes of these institutions to risk taking[1].

The aim of the paper is to present tax related measures used to tackling the economic crisis in the selected countries and to summarize the main approaches common to all countries.

2. Economic crisis and tax related measures in the selected countries

The impact of the economic crisis on public finance varies across the Member States. In countries with strong macroeconomic imbalances and/or where the bursting of an asset bubble adds to the effect of the global downturn (e.g. the UK), the budgetary deterioration is more pronounced than in other countries. In some of these countries, the increase in government deficits combined with low growth is set to give rise to a large increase in debt positions.

There are 27 sovereign member states in the EU with independent tax policy and none of them are identical. Each government has been dealing with its problems individually and the choice of instruments for crisis management is influenced by many factors as for example divergence in economic performance, consequences of the crisis on economic growth, employment, inflation, balance of payments, export, etc. It is important to be aware of the time constrained function and assess their potential impact on long-term fiscal stability when applying anti-crisis measures. The variability of these measures reflects the economic and budgetary conditions of individual states. Such measures may have a general fiscal

[1] Valentine, T., Gordon, C. (2009), p. 8-11.

impact or only a cash flow impact[1].

2. 1 Tax related anticrisis measures in Estonia[2]

Estonia's years of rapid catching up, with growth more than 8 % on average between 2000 and 2007, gave way in 2008-9 to the deepest economic contraction since the country's independence. Sizeable imbalances accumulated during the years of high growth, ultimately leading to a reversal of the cycle, which started with a contraction in domestic demand. Given the need to correct significant external and internal imbalances, the Estonian authorities implemented an ambitious fiscal consolidation with a mixture of permanent and temporary measures, both on the revenue and expenditure sides in 2009. In particular, the reduction of the public sector wage has contributed positively to the imbalances in the economy, while scaling down planned pension increases and other changes to the pension law, will also improve sustainability of public finances in the medium term. It ´s possible to give an example of tax related measures taken in response to the crisis following:

- Increase in the reduced VAT rate from 5 % to 9 %, narrowing of the range of goods to which the reduced rate is applicable;
- Deferral of the income tax rate cut by 1 percentage point;
- Deferral of the increase in the annual personal allowance;
- Increase the excise tax on tobacco in 2010 and 2011.

2.2 Tax related anticrisis measures in Finland[3]

After a decade of rapid export-driven growth, Finland entered the global crisis in 2008 from a relatively strong position, having built up a substantial surplus in the current account and government finances. The global crisis has had a strong impact on the export dominated Finnish industry, as well as on the domestic sectors through negative confidence

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[1] Dvořák (2008), p. 326-331.

[2] Based on data from Taxes in Europe [database online], Taxation trends in the European Union (2009), Tax responses to the global economic crisis (2009) and European Economic Forecast Autumn 2009.

[3] Based on data from Taxes in Europe [database online], Taxation trends in the European Union (2009), Tax responses to the global economic crisis (2009) and European Economic Forecast Autumn 2009.

effects. At the outset, the global crisis had a sharply negative impact on consumer confidence, even though domestic factors implied a solid rise in consumer purchasing power in 2008 and 2009. Given the sizeable surplus in public finances recorded in 2008, Finland allowed the full operation of automatic stabilisers and in addition provided for a relatively large fiscal stimulus

In 2009 and in 2010, the fiscal stimulus is heavily concentrated on tax cuts (primarily cuts to personal income tax), making up about 80 % of the stimulus packages. Finland is the only country reducing VAT rate. A cut of VAT on food by 5 % from 1 October 2009 (it is assumed to reduce inflation by about 0.5 %) should be partly offset by a rise in alcohol and tobacco excises. A rise of the general VAT rate by 1 % from July 2010 is offset by a 9 % cut in VAT on restaurant services. Adopted changes can be summarized as follows:

- Increase in the excise duties on alcohol and tobacco by 10 %;
- Adjustment for inflation of the income tax scale by 4 %;
- Rate reduction in all the four state income tax brackets (between 1 % and 1.5 %);
- Introduction of a new labour income tax credit targeted at low- and medium-income earners;
- Increase in the pension income allowances in state and municipal income taxation;
- Increase in the tax credit for paid household work to € 3 000 per taxable person;
- Decrease in the national pension contribution paid by employers by 0.8 % as of 1 April 2009;
- Decrease in the VAT rate on food from 17 % to 12 % as of 1 October 2009;
- A rise of the general VAT rate from 22 % to 23 % from July 2010, reduction reduced VAT rate from 17 % to 8 % on restaurant services.

2.3 Tax related anticrisis measures in Greece[1]

Currently Greece is one of the most crisis affected country. Having experienced a decade of economic growth of 4% on average, the Greek economy entered a recessionary phase in 2009. The accumulation of growing and long-term persistent domestic and external imbalances was accelerated by the unfolding of the ongoing crisis, weighing on the sustainability of the real convergence process in the long run. As public revenue depends strongly on indirect taxation and customs, weak consumption and decreasing imports translate swiftly into lower tax receipts and significant revenue shortfalls. In addition, the economic downturn is burdening social protection expenditure, leading to a further fiscal deterioration. With the general government deficit well above 3% of GDP on average over the current decade, and the accumulation of large debt increasing below-the-line operations, public debt is quickly returning to levels well above 100% of GDP, which can raise the cost of financing government debt. The economic downturn, coupled with high budget deficits has prompted the Government to take these tax oriented measures:

- Introduction of extra tax on personal income for high income earners (income above € 60 000). The tax is gradually increased from € 1 000 for income between € 60 001 and € 80 000 to € 25 000 for income above € 900 000;
- Income policy 2009 for public servants, doctors in the national healthcare system, employees of public law corporate bodies, local authorities, Police, Fire Department, Port's Corps and the Army, consists of a non-taxable amount of € 500 for gross income up to € 1 500, and € 300 for gross income between € 1 501 and € 1 700. No other wage increase was granted in 2009.
- Introduction of a special benefit of € 500 to unemployed persons or low-income pensioners who had contracted a mortgage loan in March 2009;
- Introduction of a special social cohesion benefit for 2009 to low-income pensioners, farmers-pensioners and long-term unemployed

[1] Based on data from Taxes in Europe [database online], Taxation trends in the European Union (2009), Tax responses to the global economic crisis (2009) and European Economic Forecast Autumn 2009.

persons. The benefit is non-taxable and ranges from € 100 to € 200 depending on the geographic region of residence;

- Reduction from 2 % to 0.5 % of a local authority duty imposed on shortstay accommodation (in hotels, motels, bungalows, rooms-to-let facilities, camping) and on gross revenue of restaurants, clubs, bars, etc. Suspension of the banking fee of 0.6 % on loans to hotels or other types of accommodation facilities for 2009;
- For the years 2009–10, reduction of the applicable rate of the single property tax from 1 % on owner occupied buildings and 6 % on building plots to 0.33 % for real estate owned by hotel businesses;
- Car registration tax reduction of 50 % for the period April–August 2009;
- Suspension of airport landing and parking fees for the period April–September 2009 (excluding Athens International Airport).

Moreover the Government has decided on a stricker on combating tax avoidance (provided in the EU stability program).

2.4 Tax related anticrisis measures in Ireland[1]

Irish economy entered recession in 2008. After over a decade of strong economic growth that had been increasingly driven by domestic demand, a sharp adjustment from its 2006 peak started in the Irish housing market and has since spread to the wider economy. This development was amplified by the decline in global demand and especially by the recession in Ireland's main trading partners (euro area, US and UK). The international financial crisis contributed to the deepening of the downturn, given the weight of the financial services sector in the Irish economy and banks' high dependence on foreign wholesale funding. The domestic property market correction and the financial crisis have deepened Ireland's problems regarding public finances. Starting from mid-2008, the Government implemented deficit-reducing measures estimated to amount to 4.5 % of GDP in 2009. In 2009, a series of tax-increasing measures

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[1] Based on data from Taxes in Europe [database online], Taxation trends in the European Union (2009), Tax responses to the global economic crisis (2009) and European Economic Forecast Autumn 2009.

moderated the revenue decline which followed the severe economic downturn and ongoing adjustment in housing market. It´s necessary to point out the next measures:

- Increase in the standard VAT rate from 21 % to 21.5 % in December 2008 and in some excise duties;
- Widening of the standard tax band by € 1 000 for a single person, and by € 2 000 for a married couple with 2 incomes;
- Introduction of income levy of 1 % on gross income up to € 100,100 per annum and a rate of 2 % for income above this amount. On income in excess of € 250,120 a further 1 % is payable. Social welfare payments are excluded from this levy. From 1st May 2009 the income levy rates were doubled to 2 %, 4 % and 6 %. The exemption threshold is € 15,028. The 4 % rate applies to income in excess of € 75,036 and the 6 % rate to income in excess of € 174,980;
- Introduction of a pension levy on public sector wages. New arrangement: first € 15,000 of earnings exempt, 5 % on next € 5,000 of earnings, 10 % on earnings between € 20,000 and € 60,000 and 10.5 % on earnings above € 60,000;
- Increase in the employee SSC ceiling from € 50,700 to € 52,000. From 1st May 2009 increase in the employee SSC ceiling from € 52,000 to € 75,036;
- Increase in the capital gains tax from 20 % to 22 %. From 8 April 2009, it increased to 25 %;
- From 8 April 2009 increase in capital acquisitions tax rate from 22 % to 25 %;
- From 8 April 2009 increase in Deposit Interest Retention Tax (DIRT) from 23 % to 25 %;
- Increase in the R & D tax credit from 20 % to 25 % of incremental expenditure;
- Reduction of the stamp duty top rate from 9 % to 6 %;
- Payment dates for corporation and capital gains tax were brought forward in 2009.

The Government believe that tax revenue developments in 2010-11 will be in line with the expected economic growth, while also reflecting the effect of measures taken in the course of 2009 (as well as the disappearance of some deficit-reducing one-off measures in 2009). The shift away from tax-rich domestic demand-driven growth to export-led growth, with sluggish employment and consumption growth, would lead to only a moderate tax revenue increase once the economic recovery takes hold.

2.5 Tax related anticrisis measures in Slovakia[1]

With an average real GDP growth rate of over 7 % during the period 2003-08, Slovakia was one of the best-performing EU countries. At the same time, the external position remained 2 % to 5 %. These achievements enabled Slovakia to adopt the euro in January 2009, which helped to shield the country from potential exchange rate pressure and supported confidence during the crisis. Given its high degree of trade openness, the Slovak economy has been particularly exposed to the crisis. It has been affected primarily through the trade channel, as the demand from trading partners has plummeted, triggering a plunge in exports by some 25 % in the first half of 2009 compared to the same period of 2008. This was followed by an even larger fall in imports, as uncertainties related to the crisis led to a massive increase of savings by both households and the corporate sector. Private investment and consumption fell, the same as real GDP. Several years of expansionary policies during the economic boom phase increased the Slovak structural deficit. In line with the European Economic Recovery Plan, the Government decided to let automatic stabilisers operate freely in 2009. Recent amendments to Slovakia´s Income tax Act and changes to the VAT law (both effective from 1 March 2009) were not introduced specially to address the financial crisis, but may have some anti-crisis effects:

- The input price of tangible assets and technical improvements on intangible assets has increased to € 1,700 and that for intangible items increased to € 2,400;
- For depreciation of tangible assets, "component depreciation" allows taxpayers to depreciate certain identified individual separable parts (for buildings, computer network infrastructure, personal and cargo elevators, escalators, etc.);

[1] Based on data from Taxes in Europe [database online], Taxation trends in the European Union (2009), Tax responses to the global economic crisis (2009) and European Economic Forecast Autumn 2009.

- Increase in the PIT basic allowance from € 3,435.27 to € 4,025.70 per year;
- Introduction of an employee tax credit as a form of negative income tax in the maximum amount of € 181.03 per year;
- Decrease in the rate of contribution to the Social Insurance Agency (reserve fund of solidarity) from 4.75 % to 2 % for mandatorily insured self-employed;
- Reduction of the period for refunding VAT deductions from 60 days to 30 days;
- Changes in rules of property depreciation increase the input price for investment property depreciation, accelerated depreciation and depreciation of components;
- Changes in tax legislation concerning business environment group registration of VAT, retroactive registration and simplification of record-keeping for tax purposes for small entrepreneurs;
- State subsidy and corporate income tax allowance for research activities carried out by the business sector.

2.6 Tax related anticrisis measures in Romania[1]

The economic boom between 2004 and 2008 has led to overheating pressures and unsustainable fiscal and external imbalances. Moreover, years of procyclical budgetary policy had led to a sizeable deterioration in the underlying fiscal position, with the structural deficit rising from 2.4 % of GDP in 2005 to 8.5 % of GDP in 2008. Market participants and economic agents became increasingly concerned by these developments. This resulted in a significant tightening of capital flows to Romania and stress in the banking system. Pressures on the exchange rate increased, resulting in a more than 30 % cumulative depreciation between August 2007 and January 2009. Balance sheet effects and a sharp decline of export demand plunged the economy in a severe recession in late 2008. In these conditions, the authorities decided to seek external financial support. The EU, the IMF, the World Bank, the EIB and the EBRD responded by making available to

[1] Based on data from Taxes in Europe [database online], Taxation trends in the European Union (2009), Tax responses to the global economic crisis (2009) and European Economic Forecast Autumn 2009.

Romania medium-term financial assistance of up to EUR 20bn. This assistance is conditional upon the implementation of a comprehensive economic policy programme, comprising fiscal consolidation and reform measures in the area of fiscal governance, structural reform and financial sector supervision. The following tax measures have been taken to address the global financial crisis:

- Beginning in 2009, dividends are exempt from the tax on dividends if distributed and reinvested in the distributing company´s own activity, or in the share capital of another Romanian legal entity, for the purpose of securing and creating new job;
- Also starting from 2009, an additional 20 % deduction is applicable for qualifying R&D expenses, and accelerated depreciation applies to equipment used for R&D activities;
- VAT rate reduction (from 19 % to 5 %) for the construction of social dwellings and, subject to conditions, private dwellings not exceeding 120 m^2 and a value of RON 380,000 (about € 90,000);
- Taxpayers who derive income from agricultural activities will be required to pay a 2 % tax on their gross income;
- Increase in employee's and employers' SSC rates; decrease in employers' contributions for work accidents and professional diseases by 0.5 %;
- Increase in level of deductibility of voluntary health insurance (from € 200 to € 250) and threshold of deduction for employees' contribution to facultative pension schemes (€ 200 to € 400);
- Increase in the cap for the deductibility for voluntary pension and health contributions from corporate and personal income;
- Temporary tax exemptions on capital gains from trading securities on the Romanian stock market;
- Specific types of capital gains realised by non-residents are now subject to permanent tax exemption;
- Reduction in dividend taxes of non-residents from 16 % to 10 %;
- Reduction in the car pollution tax;
- Increase in excise duties on alcohol beverages, cigarettes and fuel as from April 2009.

In addition from 1 January 2009, interest income derived from term deposits and / or other saving instruments are deemed nontaxable income when derived by individuals. If such individuals are resident in non-EU member states, such income is exempt from withholding tax in Romania.

3 Common features of tax related measures in European Union member states

Tax measures implemented in a period 2008 – 2009 may be divided into several groups.

One of the most common type of tax measures was the direct support of household spending power by reductions in the personal income tax (PIT). This happened more often through increases in allowances than cuts in rates, because of equity considerations but also because an increase in allowances, having a proportionally higher impact on lower-income households, is expected to more directly boost private consumption. In a few cases, PIT rates were even increased, but this was typically limited to higher incomes. Some countries suffering from particularly pronounced drops in GDP decided to defer previously decided PIT rate cuts[1].

Another group consists of measures relating to corporate taxation. Measures reducing the general corporate income tax rate were rare, presumably owing to the fact that such a measure, while boosting confidence in the long run, has no short-term impact on loss-making companies. Many member states also attempted to support business investment through measures such as more generous depreciation allowances or investment tax credits. The cuts were targeted towards small and medium enterprises in a few cases. Some European states have opted for granting these incentives for a limited period of time only, in order to give an immediate boost to capital spending.

As to indirect taxation, EU member states have generally not opted for temporary VAT rate cuts as a way to boost consumer spending in the short run. One exception is possible to find as Finland decreased VAT on food. In contrast, a number of Member States hiked VAT rates, curtailed the scope of exemptions and reduced rates, or increased excise duties to

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[1] Taxation trends in the European Union (2009).

help cover the budgetary shortfall generated by the slump. Member States did not cut excise duties on energy products, although for example Italy cut excise duties on gas for industrial use and granted some tax and social contributions relief to road haulage operators.

One more effect of the crisis can be seen: demands for fairness have come more clearly to the forefront. This idea, together with the budgetary needs, has stimulated international cooperation on ensuring more effective taxation of portfolio investments held abroad. There is now visibly greater international consensus on information exchange, the final objective of the Savings Directive and of the Mutual Assistance Directive, which represent the EU approach in this area.

4. Conclusion

The response to the crises may have various forms. Some European Union member states have decided to introduce substantial structural reforms, reduce tax burden from income taxation and increase tax burden of consumption, or have introduced a unified VAT rate. Other states have made only minor changes and amended the tax codes by introducing measures protecting the tax base. There are 27 sovereign member states in the EU with independent tax policy and none of them are identical. Each government has been dealing with its problems individually and the choice of instruments for crisis management is influenced by many factors. International tax cooperation in tackling economic crisis is limited to the determination of what member states should refrain from doing, such as protectionism, discrimination of non resident taxpayers, and reverse discrimination of resident taxpayers.

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