

National Report

Tax Expenditures

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Denmark

Nordic Tax Research Council

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A. Reporting of tax expenditures

A.1. Definition of tax expenditures at a general level

The main challenge in analyzing tax expenditures is to identify a reference point (tax norm or benchmark tax system) against which to establish the nature and extent of any concession.

In general this benchmark is set as the regular tax arrangements that apply to similar classes of taxpayers or types of activity. Tax expenditures are then defined as deviations from this benchmark and may take a number of forms such as exemptions, allowances, credits, preferential tax rates, tax deferrals, and so forth.

When identifying tax expenditures in Denmark the following definition of the benchmark tax system is used:

Tax expenditures are defined as deviations from clearly identifiable tax provisions in the legislation which causes lower revenue than the general rule. A tax sanction is defined as a deviation which causes higher revenue than the general rule.

This definition aims at securing a more neutral analysis of the tax system by avoiding dependence on comparisons to a hypothetical and more or less subjective benchmark.

A.2. Definition of tax expenditures at a specific level

Personal income tax

The benchmark for personal income taxation builds on the general principle that all income should be taxed no matter whether it is cash-income or fringe benefits. Expenses in relation to acquiring and maintaining income is deductible.

Labour income

Different tax rates, thresholds and rules for deductions in tax base of bottom-income tax and top-income tax is not perceived as tax expenses. This way the income tax structure becomes part of the benchmark.

Fringe benefits are in some cases valued using average values to reduce administrative costs. This is part of the benchmark.

An important part of the definition of the Danish benchmark system is how interest rate deductions are treated. Interest rate deductions are considered as part of the benchmark system and are not considered to be a tax expenditure or tax sanction in the Danish system.

Capital income

Capital income is taxed at lower rates than labour income varying according to the source of the capital income as part of the benchmark. In this dual income system the lower capital tax is a way to avoid taxation on the part of the capital income which is just compensation for the augmenting effect of inflation.

Taxation of negative capital income is also considered part of the benchmark while taxation of positive capital income is considered a tax sanction as it is higher than taxation of negative capital income.

Unrealized gains are not taxed but due to the difficulties of establishing the benchmark this tax expenditure is not calculated. A lower taxation of capital income in form of gains related to invested pension funds is also considered as part of the benchmark.

Corporate income taxation

The general principle of the corporate income taxation is taxing income in the country which is the source of income. The tax base is the profit in the firms with deductions for operating costs and depreciations. Tax expenditures in corporate income taxation mainly concern special rules for certain activities, groups or industries which in some way reduce the tax payment of the corporations.

The allowed deductions for depreciations in taxable income do not necessarily correspond to the true economic value of the depreciation. This is not considered a tax expenditure. Particular favourable rules for deduction for depreciation in some circumstances, for instance for agricultural buildings, are however considered as tax expenditures.

The special corporate income taxation of income from oil-extraction in the North Sea (Kulbrintebeskatning) is not directly comparable to other parts of the corporate income taxation as it is a tax on economic rents as the oil is a non-renewable resource. It is therefore a part of the benchmark.

VAT

The benchmark for VAT is the standard tax rate and all exemptions are therefore tax expenditures, this also includes exemptions that follow the EU VAT directive.

Real estate taxation

Real estate tax is part of the benchmark. Deviations from the general rules which favour certain groups are considered as tax expenditures. In this benchmark imputed rent from owner occupied housing is not considered as tax expenditure but on the other hand

renovation costs (an expense related to acquiring and maintaining income) are not deductible.

Inheritance tax

The Danish inheritance tax is based on the total amount of inheritance before allocation to the heirs. Taxing income in the form of inheritance through special tax rules is considered part of the benchmark.

Excise duties

There is no benchmark for excise duties as such. The tax expenditure is defined as deviations from the benchmark for each excise duty.

Environmental taxes which are not equal to the external costs are not perceived as tax expenditures even though this is the case from a normative perspective. Excise duties that results in double-regulation along with obligatory international regulation is considered as tax expenditure, e.g. CO₂-taxes in sectors which are already covered by the ETS (European Trading Scheme).

A.3. Reporting tax expenditures

The tax expenditures were published in the Budget Proposal (finansloven) until 2006 and covered the period up to 2009. The government decided not to publish tax expenditures in the Budget Proposal after 2006.

In 2007 the National Audit Office of Denmark (Rigsrevisionen) evaluated the use of tax expenditures in Denmark. Their main critique was a lack of transparency in the use of tax expenditures and they recommended proceeding with a yearly publishing of tax expenditures in connection with the Budget Proposal.

These recommendations are not binding as mandatory reporting of tax expenditures is not required by law. But although it has not been possible to follow this recommendation from the National Audit Office of Denmark there is still a substantial focus on tax expenditures. New procedures have been introduced, e.g. increased the focus on tax expenditures in legislation as described in section B.

A list of the tax expenditures based on mechanical projections of earlier estimates is reported on the website of the Danish Ministry of Taxation. A complete revision of all tax expenditures are not carried out on a yearly basis, but the list is supplemented by new tax expenditures, ad hoc revisions of the existing tax expenditures or changes in tax expenditures due to new legislation (since 2007).

The tax expenditures are presented in a single year (in current prices) which typically is the last year that the tax expenditure has been revised. This means that the tax expendi-

tures are reported for different years and in different price levels and therefore not directly comparable. This is not optimal but in the absence of resources for updating all tax expenditure calculations it is considered better to publish the latest revision when possible.

A detailed description of each tax expenditure is not presented on the website of the Danish Ministry of Taxation but descriptions of tax expenditures in general, methods and benchmark for calculating tax expenditures are published.

The Danish Ministry of Business and Growth also publishes the tax expenditures in business taxation in a yearly report regarding business subsidies. This report contains a detailed description of each of the business-tax expenditures and they are compared to direct spending on business subsidies. The report regarding business subsidies covers the period since 1995 and up until now. The business-tax expenditures in this report are based on the calculations made by the Ministry of Taxation. They are not recalculated on a yearly basis but they are updated where new estimates of the tax expenditures have been carried out. The rest of the tax expenditures estimates are based on mechanical projections of earlier calculations.

The tax committee in the Danish parliament is given a presentation of the tax expenditures with focus on the changes in the tax expenditures during the year. This is merely an orientation of the committee.

A.4. The utilization of tax expenditure reports

In Denmark there are several examples of raising tax revenue by abolishing tax expenditures. Abolishing tax expenditures and thereby broadening the tax bases are generally considered more attractive than raising the rates of taxes on smaller tax bases and have been used in tax reforms to finance lower taxes in other areas or to finance expenditures on the state budget. In the following more recent examples of this is presented.

Tax reform of spring 2009 (Forårspakke 2.0):

The objective of the tax reform was to lower taxes on income and thereby increasing labour supply which will contribute to the consolidation of public finances in the years to come. This was partly financed by abolishing tax expenditures but new tax expenditures were also created to offset some of the distributional effects of the tax reform.

Examples of abolished tax expenditures:

- Abolishing VAT exemptions for sale of new real estate, travel agencies and property management.

- Abolishing the possibility of receiving tax-free bonds from employers and the reduction in the value of stocks that employees can receive to 10 per cent of their income.

Examples of new tax expenditures:

- The new taxes on electricity and fuel used in businesses were reduced in agriculture, the greenhouse sector and mineralogical processes.
- Increase in a special transport allowance for people with low income.

State budget 2011 and 2012

Examples of abolished tax expenditures:

- As part of the agreement of the state budget for 2012 it was decided to completely abolish the possibility of receiving tax free stocks and other tax favoured stocks.
- Reinstating taxation of phone services provided by employers.

Examples of new tax expenditures:

- As part of the agreement of the state budget for 2011 it was decided to increase deductions of VAT on certain services provided by hotels.

A.5. Method used for estimating tax expenditures

The revenue gain method would apparently be the relevant measure for tax expenditures when evaluating whether tax expenditures can be used to finance lower taxes or increases in public spending. E.g. it may be that the activity which causes the tax expenditure only exists because of the favourable tax treatment. Abolishing of this tax expenditure would cause the activity to stop and no tax revenue would be gained.

There are 2 main reasons for not using the measure:

Practical challenge

Estimating behavioural responses involves a high degree of uncertainty. Estimation of a potential tax base and behavioural response will often be hard to estimate on the basis of available statistics as the tax expenditures are often focused on sub-sectors or special activities.

Methodological challenge

Each tax expenditure is estimated independently estimating the behavioural responses for each tax expenditure thereby ignores any interaction effect with other changes in tax expenditures or in changes in other parts of taxation or public spending which the abolishing of tax expenditures are supposed to finance.

This means that if the revenue gain method is used the resulting tax expenditure estimates are not necessarily correct even though an estimate of behavioural effects is included and therefore does not provide the correct basis for evaluating tax expenditures.

Method used in Denmark

In Denmark both the revenue foregone method and the outlay equivalent method has been used. The revenue gain method has not been applied. The revenue foregone method is the most widely used method in Denmark.

Behavioural response is not taken into account using the revenue foregone method, at least not directly. In the longer term the level of tax expenditures will reflect behavioural responses due to the tax expenditure, market conditions etc. But this behavioural response is of course the reason why the tax expenditure often will be different to the revenue if the tax expenditure were to be abolished.

When presenting tax expenditures The Danish Ministry of Taxation therefore always emphasise that the estimated tax expenditures which are reported are not necessarily equal to the amount of revenue which could be obtained by abolishing the tax expenditure.

The estimated behavioural responses are however included in legislative proposals for changes within the tax system which allows us to control for interaction effects as the context in which the change in tax expenditures are carried out is known.

All types of taxes are included in the publishing of tax expenditures; also differences in the timing of tax payment are covered. Tax expenditures are not calculated where a benchmark is difficult to establish as for example owner-occupied accommodation or in private pensions systems, where the time horizon and correlation to public transfers complicates the matter.

A.6. Estimates of tax expenditures in Denmark

In this paragraph the size, distribution and trends of tax expenditures is described. It should be noted, that there are considerable uncertainties when estimating and calculating tax expenditures. The estimates are sensitive to changes in the choice of benchmark and different benchmarks would generate different levels of tax expenditures.

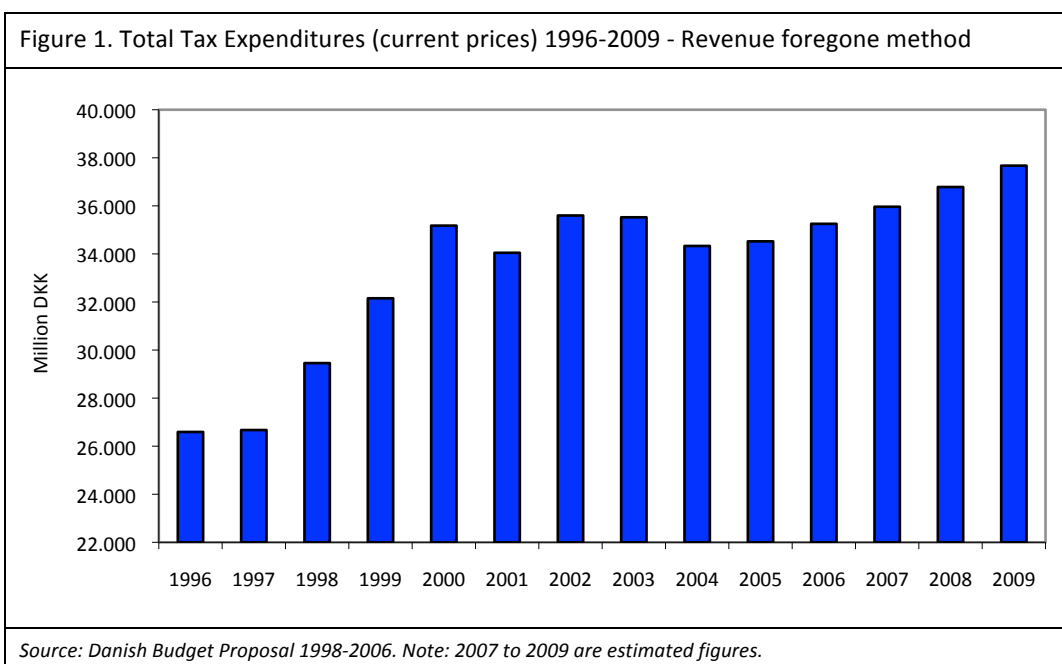
There are also tax expenditures in a number of areas where the statistical and analytical basis for a survey are not sufficient. Therefore the estimates of the total tax expenditures are not complete and must be taken as such.

The estimates are somewhat biased as the changes in tax expenditures since 2009 (primarily reductions in tax expenditures) are not included in the figures. The same reservation applies to figures presented in this paragraph.

Total tax expenditure

Total tax expenditures can be estimated to around 37.8 billion DKK in 2009 using the revenue forgone method. This corresponds to around 2.2 per cent of GDP.

As shown in figure 1, tax expenditures have fluctuated between 26 and 38 billion DKK in current prices in the period from 1996 to 2009. From 1996 to 2000 there was a relatively high increase in tax expenditures, which was mainly due to new legislation regarding health and business development expenditures. The increase in tax expenditures from 2003 and forward was mainly due to economic growth and inflation.



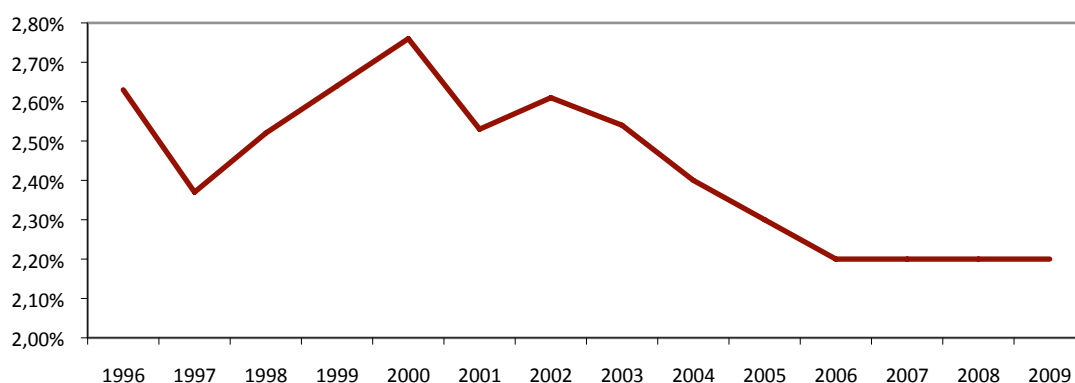
Total tax expenditure as a share of GDP

Another way of analyzing the development is to estimate tax expenditures as a share of GDP as done in figure 2. As the figure shows, tax expenditures constitutes between 2.2 per cent and 2.8 per cent of GDP in the period from 1996 to 2009.

There has been a decline in tax expenditures as a share of GDP from 1999 and forward. This is primarily due to relatively small increases in overall tax expenditures in the period. Tax expenditures to housing conditions have decreased from 2000 and forward. This is due to the reductions in the taxable value of properties, which was given to owners of houses bought before 1 July 1998, in connection with the introduction of a new base for calculation of property taxes at that time.

Not all tax expenditures have been reduced though, and there are still some tax expenditures that are continuing to increase. An example is fringe benefits, which have increased rapidly during the past years.

Figure 2. Tax Expenditures as a share of GDP – Revenue foregone method



Source: Danish Budget Proposal 1998-2006.

Note: 2007, 2008 and 2009 are estimated figures based on development in GDP, hence the constant share of GDP in this period.

Tax expenditures by tax category

Tax expenditures by different categories of taxes is presented in table 1 based on the estimates for 2006 from Danish Budget Proposal 2007. Updated estimates for later years are included where possible.

Schemes related to VAT and excise duties constitutes by far the largest part of the tax expenditures with a total revenue foregone of almost 22 billion DKK or 60 per cent of total tax expenditure. It should be noted that some of the VAT exemptions have been abolished as part of the Danish tax reform of spring 2009.

Table 1. Tax expenditure by type of tax

| | Billion DKK | Billion EURO | Share of total Tax expenditure |
|--|-------------|--------------|--------------------------------|
| Schemes related to taxation of personal income | 8,5 | 1,1 | 23% |
| Schemes related to VAT and excise duty | 21,7 | 2,9 | 59% |
| Schemes related to business taxation | 6,6 | 0,9 | 18% |
| Total | 36,8 | 4,9 | |

Source: Danish Budget Proposal 2007 and calculations by The Danish Ministry of Taxation

10 largest tax expenditures

The 10 largest tax expenditures constitute about 60 per cent of total tax expenditures of approximately 37 billion DKK in 2006, as shown in table 2. They are primarily related to taxation of energy products and VAT, but favourable tax treatment of research and development activities and favourable taxation of property and land value also constitutes significant tax expenditures.

Table 2. 10 largest tax expenditures

| | Billion DKK | Billion EURO | Share of total tax expenditure |
|--|----------------|-----------------|-----------------------------------|
| Lower tax on diesel compared to the tax on petrol (net of compensating tax on diesel vehicles) | 3,4 | 0,46 | 9% |
| Favourable tax treatment of research and development activities | 2,9 | 0,38 | 8% |
| VAT - services provided by doctors and dentists | 2,5 | 0,34 | 7% |
| VAT – services provided by the financial sector | 2,5 | 0,34 | 7% |
| VAT – services provided by day-care institutions | 2,3 | 0,31 | 6% |
| Favourable tax treatment of heat produced in combination with electricity | 2,1 | 0,28 | 6% |
| Property value (former owners) | 1,8 | 0,24 | 5% |
| VAT – Amusement parks and other entertainment | 1,8 | 0,24 | 5% |
| Electricity tax on renewable energy | 1,6 | 0,22 | 4% |
| Land value, land intended for production | 1,3 | 0,18 | 4% |

Source: Danish Budget Proposal 2007 and calculations by The Danish Ministry of Taxation

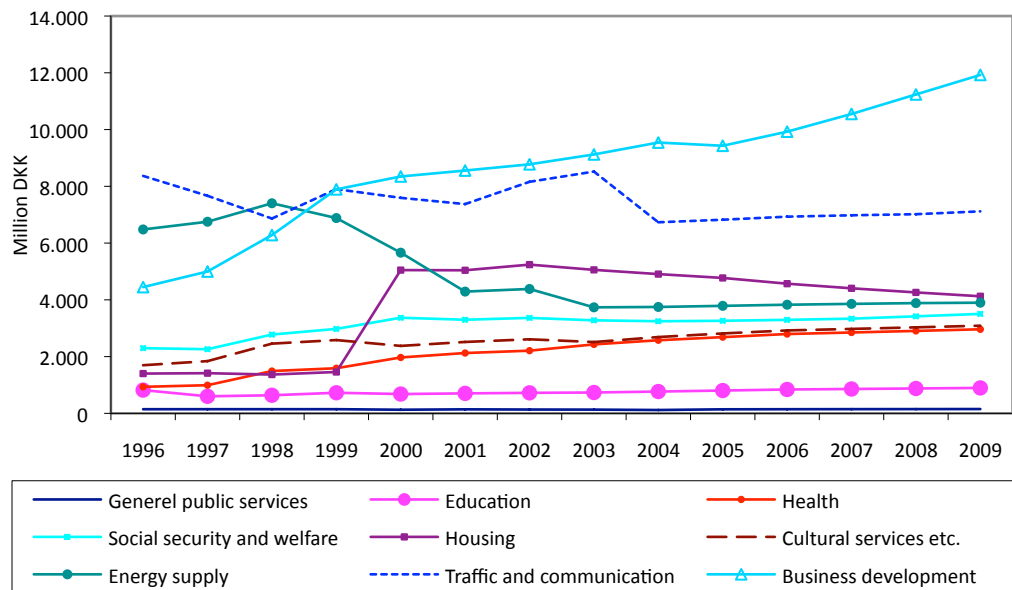
Tax expenditures by sectors/functional areas

In figure 3 and 4 the development in total tax expenditures from 1996 to 2009 is shown split into purposes.

Since 1999 business development has represented the highest level of tax expenditures. In 2007 tax expenditures to business development corresponded to a share of 30 per cent of total tax expenditures.

There has been a relatively rapid growth of tax expenditures in the business development area since 2005. This is partly due to a political priority aimed at stimulating businesses – especially the research and development sector – and small and medium sized business. Also tax-deductions for researchers and key-workers represent some of the growth in tax expenditures.

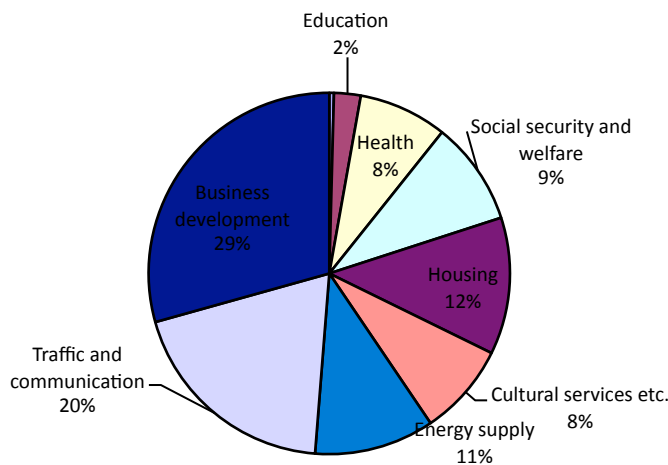
Figure 3. Distribution of Tax Expenditures 1996-2009



Source: Danish Budget Proposal 1998-2006. 2007, 2008 and 2009 are estimated figures
 Note: Defence tax expenditures are added to the category "General public services". Revenue foregone method.

Besides from business development, traffic and communication, housing and energy supply represent areas with a relatively high level of tax expenditures. In 2007 traffic and communication represented 20 per cent of the total tax expenditures.

Figure 4. The distribution of Tax Expenditures 2007



Source: Danish Budget Proposal 2007.

B. Legal issues

B.1. Introduction

Tax expenditures are a form of indirect public spending. It can be seen as tax revenue which isn't collected due to statutory deviations from the general tax regulation as mentioned in section A.1.¹ As opposed to direct spending, where there is a great deal of political influence on and control with the details regarding public spending, the tax expenditures are not as thoroughly regulated. When a provision has the character of tax expenditure, it is up to the courts to decide on how the rules are administered. This means that the cost and effect of tax expenditures are not very easily documented and that if no estimate of the cost is made, it is impossible to say anything about whether tax expenditures will fulfill their goals or at what cost. In the following sections an overview of the Danish regulation of tax expenditures, the presentation of them and their influence on case law will be given.

B.2. The regulation of tax expenditures

The concept of tax expenditures is not defined in either tax law or any other laws. However, in order to verify the amount of public spending in the form of tax expenditures, preparatory drafts of legislation from the Ministry of Taxation includes a description of the tax expenditure that is introduced or changed. The Ministry of Taxation describes tax expenditures as deviations in the tax system that favours certain activities and/or groups of tax payers.² This definition is in line with the OECD definition which describes tax expenditures as “provisions of tax law, regulation or practices that reduce or postpone revenue for a comparatively narrow population of taxpayers relative to a benchmark tax”.³ The Danish benchmark is described in section A.

The publication of tax expenditures has been changed over the years. Until 2006 the tax expenditures were published yearly as an appendix to the national budget proposal as mentioned in section A.3. From 2007 onward new tax expenditures or changes in exist-

¹ NAO report 2007, p. 1.

² Memorandum from the Ministry of Taxation *Referenceramme for skatteudgifter* April 2010, p. 3. See also section A.

³ Tax expenditures in OECD countries , 2009, p. 12. The Danish definition was criticized by the NAO in their 2007 report for not being wide enough. This critique is based on the benchmark tax system rather than the definition itself.

ing ones have been published in the preparatory drafts of legislation.⁴ Since 2007 tax expenditures have been mentioned in app. 50 preparatory drafts of legislation. The level of detail in the descriptions of tax expenditures is highly differentiated. Some of the preparatory drafts include special sections on the tax expenditures in the proposal,⁵ where the tax expenditures are described. Other proposals mention tax expenditures more sporadically.⁶ The objectives of tax expenditures are presented together with the general objectives of the proposed legislation. The motivation of introducing tax expenditures comes in many different forms. Examples are incentives for companies to invest in research and development,⁷ improvement of public health,⁸ expansion of multimedia,⁹ and to reduce shadow economy.¹⁰

B.3. Case law relating to tax expenditures

As there is no legal definition of tax expenditures, the case law relating to these is very limited. There does not exist any case law where the courts have considered whether a provision was a tax expenditure or not. Tax expenditures have not caused any constitutional problems.

⁴ In 2009, five members of Folketinget proposed that the publication of tax expenditures should be brought back into the national budget proposal (*B 106: Forslag til folketingsbeslutning om opgørelse af skatteudgifter i forbindelse med fremlæggelse af finanslovsforslag*).

⁵ Such as *LFF 2011-04-27 nr. 195 Ændring af lov om afgift af elektricitet, lov om tobaksafgifter, lov om afgift af øl, vin og frugtvin m.m. og forskellige andre love (Ændring af afgift på erhvervenes energiforbrug m.v., forkortelse af kredittider for tobaksafgift og lempelse af ølmoderationsordningen)*, *LFF 2010-01-27 nr. 112 Ændring af kursgevinstloven og forskellige andre love (Harmonisering af beskatningen af fordringer i danske kroner og fremmed valuta og nedsættelse af beskatningen af kapitalindkomst m.v.)*, and *LFF 2011-11-21 nr. 32 Ændring af lov om afgift af kvælstofoxider, lov om energiafgift af mineralolieprodukter m.v. og lov om afgift af naturgas og bygas (Højere afgift på luftforurening fra NOx m.v.)*.

⁶ Such as *LFB 2011-12-15 nr. 33 Ændring af chokoladeafgiftsloven, tobaksafgiftsloven, øl- og vinafgiftsloven og forskellige andre love (Afgiftsforhøjelser på chokolade, sukkervarer, is, sodavand, tobak, øl og vin)*, and *LFF 2011-11-21 nr. 29 Ændring af ligningsloven (Skatte kreditter for forsknings- og udviklingsaktiviteter)*.

⁷ *LFF 2011-11-21 nr. 29 Ændring af ligningsloven (Skatte kreditter for forsknings- og udviklingsaktiviteter)*

⁸ *LFF 2011-11-21 nr. 33 Ændring af chokoladeafgiftsloven, tobaksafgiftsloven, øl- og vinafgiftsloven og forskellige andre love (Afgiftsforhøjelser på chokolade, sukkervarer, is, sodavand, tobak, øl og vin)*.

⁹ *LFF 2011-11-21 nr. 31 Ændring af ligningsloven og forskellige andre love (Afskaffelse af multimediebeskatningen, ophævelse af skattebegunstigelsen for medarbejderaktieordninger, ophævelse af skattefritagelse for arbejdsgiverbetalte sundhedsforsikringer m.v., lønsumsafgiftspligt)*.

¹⁰ *LFF 2011-05-19 nr. 208 Ændring af ligningsloven og lov om hjemmeservice (Forsøgsordning med fradrag for hjælp og istandsættelse i hjemmet)*.

As provisions that are tax expenditures include a favourable treatment of certain situations, there are numerous cases regarding the borders of these. The now abolished tax on multimedia that employers put at their employees' disposal, which existed in the income years 2010 and 2011 caused no less than app. 75 cases.¹¹ The cases primarily regarded the delimitation of which multimedia were taxed under the provision. Another area of tax law which has given rise to a number of cases is the provision in the Danish Corporation tax Act, Section 1(1)(6) (institution tax) which entitles certain institutions to tax exemption of income that does not derive from business activities. The typical examples of this kind of tax exempt income are gifts, several types of capital gains etc. The cases relating to this provision are primarily focused on which types of income are exempt.¹²

As tax expenditures by definition favours certain taxpayers, it could be expected that they have given rise to cases where tax payers have tried to circumvent tax regulation in order to gain access to tax incentives. It is, however, seen that the cases regarding the interpretation of tax expenditures do not have the character of circumvention but are merely questions relating to the extent of the tax expenditures.

Tax expenditures have also been subject to attention from EU. As they favour certain taxpayers, tax expenditures may often be seen as a form of state aid subject to Articles 107-109 TFEU. It is important to note that the EU state aid rules only apply to the subsidization of businesses. Further, the benchmark for assessing derogations from a general rule is not necessarily identical to the benchmark defined in respect of tax expenditures. The selectivity of a business subsidy is thus assessed in respect of whether the measure *de jure* or *de facto* is such as to favour certain undertakings or the production of certain goods in comparison with other undertakings which are in a legal and factual situation that is comparable in the light of the objective pursued by the measure in question.

The EU Commission has opened investigations regarding potential fiscal aid measures in a number of cases including:

1) Examples of measures not regarded as State aid within the scope of TFEU Article 107(1):

- Tax reductions for undertakings that install equipment to reduce the NO_x emissions. The scheme was considered to be justified by the nature or general scheme of the system of which it formed part.¹³

¹¹ Most of these are answers from Skatterådet.

¹² See for instance SKM2002.656.LSR and SKM2006.102.LSR

¹³ N 327/2008 OJ 2010 C 166/1.

- Tax relief for supply of surplus heating.¹⁴ The measure did not constitute state aid because it did not confer a selective advantage.
- Taxation of individual herring quotas and the fiscal treatment of quotas. The measure did not constitute state aid, because the same rules were applicable to all companies entitled to receive quotas or payment entitlements.¹⁵
- Tax reduction on donations to cultural institutions. The measure did not constitute state aid, because the activities supported were purely cultural or heritage-related and not commercial.¹⁶
- Scheme on loan loss provisions for credit institutions. The scheme was considered to be justified by the nature or general scheme of the system of which it formed part and accordingly not considered selective.¹⁷

2) *Examples of measures constituting state aid, but exempted under TFEU Article 107(1):*

- Tax reductions for companies with exceptionally high NO_x emissions.¹⁸
- Exemption from Danish Waste Levy in regards to incinerated manure fibre.¹⁹
- Differentiated excise duties on petrol.²⁰
- Tax rate reductions in regards to heat produced in CHP's, heat produced by electricity, and process heat.²¹
- Prolongation and modification of relief from the waste water tax for six sectors (cellulose, vitamin, organic pigment production, fish processing, sugar and pectin production) particularly exposed to the waste water tax.²²
- Tax exemption for biofuels used as motor fuel.²³
- Non-appliance to wind power plants of lower depreciation rate.²⁴
- Duties for Online Gaming in the Danish Gaming Duties Act.²⁵ Subject to the Danish Gaming Duties Act, online providers of casino games and gaming ma-

¹⁴ N 271/2006 OJ 2007 C 41/2.

¹⁵ N 318/B/2004 and N 604/A/2004 OJ 2005 C 275/3.

¹⁶ N 5/2005 OJ 2005 C 280/9.

¹⁷ N 482/2001 OJ 2003 C 154/13.

¹⁸ N 327/2008 OJ 2010 C 166/1.

¹⁹ N 147/2006 OJ 2007 C 68/5.

²⁰ N149/2001 OJ 2001 C 263/5.

²¹ N 391/2006 OJ 2007 C 304/5.

²² N 586/2007 OJ 2008 C 149/5.

²³ NN 59/2005 OJ 2006 162/9.

²⁴ N 394/2007 OJ 2008 C 149/1.

²⁵ Commission Decision of 20.09.2011 on the measure No C 35/2010 (ex N 302/2010) which Denmark is planning to implement in the form of Duties to Online Gaming in the Danish Gaming Duties Act.

chines would be subject to a flat tax of 20 per cent on the gross gaming revenue, compared with up to 75 per cent for land-based casinos and gaming halls. Accordingly, the measure of lower tax rate for online gambling constituted state aid for the providers of online gambling services established in Denmark.

- Measures in favour of large energy consumers. The measures were granted an exemption for 10 years.²⁶
- Refunding of CO₂ tax on quota-regulated fuel consumption in industry.²⁷ The measure involved a CO₂ tax relief to companies covered by the EU Emissions Trading Scheme. The aid was declared compatible under Article 107(3)(c), provided that all beneficiaries would still pay a tax on each energy source which respected the EU minimum tax level.

3) *Example of measure regarded as incompatible aid*

- Danish tonnage tax – information obligation concerning intra-group transactions. The measure consisted of repealing for ship-owners taxed under the Danish tonnage tax the obligation imposed otherwise on all other companies to provide the Danish fiscal authorities with commercial information on all commercial transactions with foreign-based affiliates on the basis of Law No 408 of 1 June 2005. The measure was considered incompatible with the internal market and could accordingly not be implemented.²⁸

4) *Measures under investigation*

- Tax exemption for waste from cement production.²⁹

²⁶ N 840/A/2000 OJ 2001 C 358/3.

²⁷ Commission Decision of 17.06.2009 C 41/2006 (ex N 318/A/04), OJ 2009 L 345/18.

²⁸ Commission Decision of 17.06.2009 C 5/2007 (ex N 469/05), OJ 2009 L 315/1.

²⁹ C 30/2009 (ex N 328/08), notification of decision to initiate proceeding of 28.10. 2010, K(2009)8099 final; invitation to submit comments OJ 2010 C 105/3.

C. Evaluation of tax expenditures

C.1. Comparison of tax expenditures with direct expenditure

Tax expenditures are often substitutes for direct government expenditures, since they are implemented to encourage behavior deemed desirable by policymakers. Often the choice between either of the two relies more on historic and more arbitrary decisions than on economic consideration. Since the use of tax expenditures often requires a certain level of income or profit to make use of it, direct expenditures are somehow more often employed in non-income generating sectors or business such as culture or research activities.

The literature identifies several positive and negative features of tax expenditure programs and direct expenditure program. Some are listed below.

| | Tax expenditures | Direct expenditures |
|--------------------------|--|--|
| Positive features | <ul style="list-style-type: none"> - System usually in place - Pigouvian taxes can enhance optimal resource allocation - Encouraging private sector rather than government decision-making and participation in social programs | <ul style="list-style-type: none"> - Budget transparency - Easy to limit with spending ceilings - Easier to shut down - Can be given to activities with limited revenues |
| Negative features | <ul style="list-style-type: none"> - Distortive, i.e. lowers efficiency - Narrowing the tax base, limiting the scope for tax rate reduction - Reduces horizontal and vertical equity - Open-ended opportunities for state spending - Compliance costs - Complexity of tax system - Less transparent - Dead weight losses possible high | <ul style="list-style-type: none"> - Requires large setup and control - Picking-the-winner strategies by government officials - Favors unproductive sectors |

Direct expenditures are included in the Budget – including business related R&D activities, culture and foreign aid – and are yearly reported in the The Danish Ministry of Business and Growth’s publication regarding business subsidies, *Erhvervsstøttere-degørelse*, see section A.3. Tax expenditures are also included in this publication, but are, as mentioned earlier, no longer mentioned in the yearly Budget.

Such publications create more transparency and help policymakers to prioritize – albeit there is a tendency to resort ministries hold on to their direct expenditures. Thus a major change of magnitude in any of them would require ambitious reforms.

The government is planning to introduce an expenditure cap this year. The final model is thus not known, but tax expenditures are expected to be included in the cap.

C.2. Administrative burden

The new liberal government in 2001 imposed a goal to reduce administrative burden on business by 25 per cent by 2010. By 31st December 2010 the goal was almost met with a total reduction in the administrative burdens of 24.6 per cent compared with ultimo 2001 figures.

An increased use of mandatory reports from businesses and households can establish an improved dataset for evaluating tax expenditures. This extra information must be weighed against the cost to get this information. An extended duty to report data will impose administrative burdens on businesses and households, which conflicts with objectives of further reductions or just keeping the current level.

There are no estimates of tax expenditures share of the administrative burden. With all new legislation, thus also rules implying new or changes to current tax expenditures, changes in the administrative burden are estimated and reported in the proposal. The same reporting method is used for the internally administrative burden for all new proposals, thus also burdens created by tax expenditures.

C.3. Follow up on tax expenditures

There is no systematic follow-up mechanism of the impact of different tax expenditures. In 2003 in the legislation for the increased commuter deduction for outer regions it was agreed upon, that the scheme should be evaluated within a few years. However, the scheme has later over two rounds been prolonged after political pressure without any evaluation has been made.

A newer academic paper sheds light on the effectiveness of a Danish R&D tax incentive.

Tax scheme for foreign researchers and key employees

The Danish tax scheme for foreign researchers and key employees subsidizes high-skilled immigrants by allowing a flat tax of 26 per cent for 5 years instead of working under the regular – and typical higher – income taxation. There is very limited evidence of this scheme's importance for domestic firms, regarding how foreign experts may im-

pact on the productivity of domestic firms. A newer academic paper³⁰ finds that a few foreign experts employed under the Danish tax scheme for foreign researchers and key employees give rise to a significant increase in firm productivity. More specifically, the average wage level in the firm increases significantly by 2.4 per cent in the third year following the employment a foreign expert, which is seen as evidence of a positive productivity effect. The study also shows that the hiring of foreign experts both raises the probability of exporting the following year by 2.7 percentage points and the intensity of exports by approximately 1.5 per cent in the three following years.

C.4. Distributional effects of tax expenditures

When analyzing tax expenditures an important consideration to make is how certain tax expenditures are passed on to different groups of persons, firms or others. The persons or firms that receive the formal tax expenditure might not be the same who benefit from it in the end. Thus, that the final effect of the tax expenditure might first realize in the long run because of lack of competition, sticky prices etc.

There have been no systematic distributional analyses of tax expenditures in Denmark. However, in the yearly reports on trends in fringe benefits the distributional effects were formerly analyzed³¹. The distributional effects are based on the tax expenditures and any possible effects on wages are not included.

It should be noted however, that when analyzing the distributional effect of certain tax expenditure it is important to analyze the tax system as a whole. Analyzing one tax expenditure isolated might give a false impression of the real distributional effect of all elements of the tax and expenditure system. This could be true in the case where the same group of persons or firms receive a tax deduction in one area but have to pay an extra tax or fee in another area.

As all evaluations, frequently analysis of distributional effects is time consuming. Thus, these analyses are usually part of more general analysis in specific topics, i.e. in new tax proposals. In these analyses the law model (a micro simulation model of all Danish households) is usually used if the incidence falls on households, or calculated on specific sectors if the tax expense favors certain businesses or sectors.

³⁰ Do Foreign Experts Increase the Productivity of Domestic Firms? (Nikolaj Malchow-Møller, Jakob R. Munch and Jan Rose Skaksen, September 2011).

³¹ Statusrapport om personalegoder 2007:

<http://www.skm.dk/publikationer/udgivelser/statusrapportompersonalegoder2007.html>