

National Report - FINLAND (19.3.2012)

Tax Expenditures

Nordic Tax Research Council

Spring Seminar, Helsinki 2012

A. Reporting of tax expenditures

A1. Definition of tax expenditures

Tax Expenditures (TE) are defined as deviations from the benchmark tax system. The benchmark tax system is defined in personal income taxation, taxation of corporate income and other enterprise income, inheritance and gift tax, real estate tax, capital transfer tax, value added, excise duties and to some extent, in social security contributions. The underlying principle in personal income taxation for example, is the concept of comprehensive income, where all income is taxable and the tax base is thus as wide as possible. In practice the benchmark system is largely based on the prevailing tax system. TE favor some narrow activities or taxpayer groups and serve specific policy goals closely related to direct spending programs through the creation of tax exemptions, deductions, reduced tax rates, allowances, credits and tax deferral rules. In defining TE the reduction of tax revenue is taken into account as the most important characteristic. Also, the pursuit of non-fiscal goals is seen included in the concept of TE. Convertibility of TE into direct expenditures is not really discussed or been considered.

1.1. Personal income tax

Un the personal income taxation the benchmark system is as comprehensive as possible in nominal terms. It is based on the Schanz-Haig-Simon (SHS) income concept, and includes imputed income, fringe benefits and income transfers. The deductions are based on only actual costs. Dual income taxation is considered part of the benchmark system, including the splitting of income of the self-employed, partnerships and agricultural income. Progressive taxation of earned income, including a standard deduction for low income earners and earned income deduction, is also considered part of the benchmark. The tax rate schedules are incorporated in the structure of the benchmark in such a

form as they have been laid down at any one time. The prevailing tax rates define the benchmark; in capital income taxation it is 30 per cent. The deduction of interest expenses in personal income taxation is not considered part of the benchmark system. On the other hand, capital gains taxation in realization, without taking inflation into account, is considered part of the benchmark. Neither capital gains taxation nor the treatment of losses create tax expenditures or tax sanctions.

1.2. Corporation tax

The definition of tax expenditures in the taxation of business profits and income from professional activities is based on the principle that income is largely subject to tax. Losses can be carried forward 10 years and this is taken as being part of the benchmark. Regarding the depreciation of buildings and machinery over their technical economic life, currently the tax expenditure is calculated based only on the depreciation of machinery. In corporate income taxation the benchmark is the prevailing tax rate. The tax exemption on public companies is considered part of the benchmark tax system. The partial double taxation of dividends is to some extent considered as part of the benchmark system. The 70 per cent of the dividends from listed companies which is taxed as capital income is part of the benchmark. In unlisted companies the difference between the market rate and the yield of 9 per cent to the mathematical value of the share is considered as TE. The same applies to the tax exemption of dividends up to 60 000 euro, 70 per cent of the rest being taxed as capital income. From yield exceeding the 9 per cent, 70 per cent is taxed as earned income based on progressive taxation principles.

1.3. Value added tax

The benchmark tax system is a broad-based, multi-stage value added tax, collected according to the destination principle (that is, with exports exempted, VAT refunds to exporters and taxation of imports). The standard VAT rate (23 per cent) is part of the benchmark, and deviations from the standard VAT tax rate create tax expenditures. Exemption from VAT is considered part of the benchmark system (e.g. financing, education, public or publicly supervised social and health care). Tax exemption for enterprises with turnover below 8 500 euro is considered as tax expenditure as well as the graduated tax relief for enterprises with turnover between 8 500–22 500 euro.

1.4. Inheritance and gift tax

The benchmark system is largely based on the prevailing law and includes all kinds of assignable, tangible or intangible property which has money value. The inheritance tax rates are determined on the basis of two classes of relationship between the beneficiary and the deceased and are considered part of the benchmark. TE is identified in cases of exemption from inheritance tax: the state and its institutions, municipalities, joint municipal authorities, religious communities and non-profit-making organizations. The part of the inheritance tax on business or farm that is not charged creates TE. The same occurs with spouse and child allowances respectively.

1.5. Real estate tax

The benchmark system is designed on the basis of a municipal tax that is levied on all real property. Tax exemptions of water areas, forests and agricultural land are not part of the benchmark system. Municipal councils determine annually the applicable tax rates within statutory limits. The general tax rate range is the benchmark. TE is identified if the rate for buildings used primarily as permanent residence is less than the bottom (minimum) general rate. A tax sanction on the other hand is created if it exceeds the top (maximum) general rate. Tax sanction is created even in the following cases: (i) a special tax rate on buildings used as second (summer) residence (ii) a higher tax rate on vacant lots in the Helsinki Region and the surrounding communities (iii) separate tax rates applied to power plants and disposal sites of nuclear waste.

1.6. Wealth tax

Not applied in Finland.

1.7. Social Security Contributions (SSC)

The benchmark system is defined separately for different groups of SSC. Only a few TE are recognized and they are connected with foreign experts working in Finland, unemployment insurance contributions, seamen and start-up entrepreneurs. In most cases tax expenditure is based on exempt contribution. The TE or tax sanction on employer's unemployment insurance contribution is defined as deviation from the average contribution percentage.

1.8. Excise duties

Excise duties on alcohol and tobacco are considered part of the benchmark system. This is justified as follows: it is internationally common practice that the tax burden of ethyl alcohol is considered heavier than other alcohol beverages, and taxation of various tobacco products is approximately the same.

The benchmark system of energy taxation was revised in 2011 when the general structure of energy taxation was changed. The reform was based on a novel environmental model developed by VTT, the Technical Research Centre of Finland. The model treats the different fuel and energy alternatives objectively, that is, according to their environmental impacts (energy usage, carbon dioxide emissions and emissions into the local environment). The revised fuel tax has an energy component and a CO₂ component, while the replaced tax had a "faceless" fiscal main component (for transport fuels) and a CO₂ component.

The energy component is largely based on energy content but differentiated according to local emissions (and diesel oil having a reduced rate). The new CO₂ component is based on a life-cycle approach to emissions, rather than on combustion gas emissions only.

The tax level of power tools fuels and heating fuels are higher than those of road traffic. This is justified by the fact that it is appropriate to tax production and basic needs (as dwelling) less than traffic sector and because traffic has negative externalities such as exhaust, noise, congestion, accidents and wear and tear of roads.

Total tax rates for other than road traffic fuels were raised considerably. The CO₂ tax rate was raised from €20/t CO₂ to €50 for traffic fuels (€60 as of 2012) and to €30 for heating fuels (50% reduced rate for heating fuels used in combined electricity and heat production). The relative weight of CO₂ in the total tax for coal, natural gas and fuel oils was reduced due to the introduction of the new energy component. Tax adjustments for natural gas will take place in stages up to 2015. A low, ascending energy tax for peat is being introduced in stages by 2015. As a consequence of the energy tax reform, about 50 per cent of the energy tax expenditures have vanished compared to the levels of 2011. A new TE was created by halving the CO₂ tax on combined heat and power plants.

1.9. Capital transfer tax

The benchmark tax system is mainly defined by the capital transfer tax law, which is applied in principal to all sales of real estate and securities. The exemption of quoted stock, first owner occupied apartment and some municipal transactions are identified as TE.

Because not all tax forms are interrelated with a common theoretical framework, the general benchmark tax structure is complicated and can be described neither briefly nor in simple terms. In defining the benchmark system, the tax base coverage plays a central role. For example, as mentioned earlier, in income taxation Finland follows the Schanz-Haig-Simon (SHS) wide income definition where taxable income includes the increase of net worth and consumption levels. In practice applying the SHS definition to the benchmark system is difficult. The benchmark system is indeed based on the on-going taxation system and taxable income is thus defined to include all income whether in cash or money based benefits as well as certain accounting based income.

The energy taxation benchmark system was criticized for many years. The original system was based on the concept that each energy tax is a sanction because it is applied on top of the standard consumption tax (VAT or turnover tax). The prevailing benchmark system is designed based on a energy component and a CO₂ component and applied to all energy taxes. In calculating TE generated from the deduction of voluntary pension savings contributions, only the deduction (and not the future pension income) is taken into account because of lack of data. This does not give the correct estimate of the total amount of the TE. The same problem concerns the deduction of employers' statutory pension insurance premiums. Part of social security contributions are currently left outside of tax expenditure reporting.

The benchmark system may change according to the changes in the newest taxation regimes implemented. However, the need for this is scrutinized case by case. For example the dual income tax reform of 1993, the VAT and family subsidy reforms of 1994 and the energy taxation reform

from 2011 onwards, changed the benchmark system. Several potential tax expenditures linked to particular taxes have not been calculated but left out of reporting due to lack of suitable data.

Health related taxation (e.g. alcohol and tobacco taxation) is part of the benchmark system. For these and environmental taxes, see part 1.8. Tax levied on candies and similar sweets, chocolate, cocoa products, ice cream, popsicles and ice lollies came into effect in 2011. Some candies are tax exempt and create TE.

Some fringe benefits (free or subsidized meals, accommodation and company car etc.) are regarded as taxable income. They are usually valued at a more lenient amount, benefiting the individual tax payer. However, TE is defined only concerning meals. And this has raised discussions. Other kind of fringe benefits, such as occupational health care and employer's subsidy for cultural or leisure activities create TE, but are not calculated due to unavailability of data.

Although in some countries depreciation charges are all part of the basic tax structure, in Finland TE are calculated based on the difference between physical wear and tear depreciation rates and rates currently in force. The calculation, however, gives a biased amount on the true subsidy effect to the enterprises. It only tells us how much the public sector loses tax revenues in a specific year.

Unrealized gains are not considered TE. Deductions for expenses such as professional literature or work tools are considered as part of the benchmark system. The progressive tax rate schedule and the dual income tax system are part of the benchmark tax system.

In Finland, imputed rent from owner occupied housing is in principle considered part of the benchmark system. Because such concept has not been defined, TE is created by considering the imputed rent as capital income and by deducting mortgage loan interest. Defined in this way, interest deduction is not regarded as TE. The implicit TE on interest deduction is anyhow reported for information purposes.

Exemption from VAT is considered part of the benchmark system as far as financing, education, or public or publicly supervised social and health care activities are concerned¹. VAT exempt land of a building, the mark-up of construction (building), sales of the blind or disabled and sales of self-collected natural berries and mushrooms create TE. Tax exemption for enterprises with turnover below 8 500 euro is considered as tax expenditure as well as the graduated tax relief for enterprises with turnover between 8 500-22 500 euro (see also part 1.3).

¹Even the VAT directive defines them as "must be exempted".

A2. The reporting of tax expenditures and the utilization of reports

The reporting on Tax expenditures is not mandatory in terms of being cited in the law as obligatory. However, the Ministry of Finance (MoF) has given a continuous mandate to the Government Institute for Economic Research (VATT) to publish a descriptive report on TE on an annual basis. VATT takes care of the initial gathering of data, the analysis and the reporting, but officials from the MoF also participate actively in the process.

There has not been any discussion regarding narrowly and broadly defined applied TE, because such distinction is rather vague. That is, it is difficult to define the limits and criteria on which is which. Tax sanctions are listed in the report on TE as negative values. The sanctions are those linked to real estate taxation, car taxation and the tax on the propelling force. No borderline problems have been reported.

The reports on TE have been utilized for several tax-related policy-planning and formulation, for example in the comprehensive income tax reforms in the 1990's. The TE reporting enhances transparency in public finances, creates prerequisites for describing better the public subsidies received by different sectors and facilitates the comparison among alternative forms of subsidies. In the latest VAT reforms conducted in Finland in 2009 and 2010, the TE report was used as background material in deciding the level of changes. TE reports have been utilized also when Spending Review Programs have been drafted in connection to the international financial crisis and its consequences.

There is no comprehensive reporting of public subsidy for specific causes, where both tax expenditures and direct budgetary expenditure would be included. The tax expenditures are not reported in connection with subsidies or income transfers that serve the same purpose. It has not been thoroughly evaluated, whether the existing tax expenditures would better reach their objective if replaced by direct expenditure.

The normative systems by form of taxation are based on the tax expenditure report, which was published in 1989 and revised in 2010. The motivation for each individual TE is presented in the tax law proposal when the tax expenditure in question is first introduced.

In the budget document for the upcoming Fiscal Year different data on TE are reported. The data includes the legal basis, distribution by tax type and operational categories, aggregate amounts of individual TE and a listing of new TEs. Also there is a detailed description of those TE whose basic purpose and features have changed considerably. The fiscal year's plus the next two years' estimations are reported. Information on the amount of TE for the forgone year is listed in the Government's statement of Annual Accounts. In the same report one finds how TE estimations, listed in the budget document of the previous year, have been realized. Furthermore, the results of descriptive evaluations of TE are reported. VATT publishes detailed TE tables annually both in VATT's Memorandum Series and in VATT's internet pages. Those reports include also the legal

status of TE, the amount of TE (if this is possible to estimate from the available data) and a list with new and repealed TE. The reporting window of TE is three years in the State Budget (budget year and two preceding years) and two years in the Statement of Annual Accounts (accounting year and one preceding year).

In Finland, there is proof of the increasing importance of TE in the budgetary process. Since 2010, TE related information has been listed together with the main Tax Expenditures (moments) in the yearly Budget document. The results of TE reporting are available for scrutiny by the members of the Parliament's Audit Committee and by officials of the National Audit Office. Researchers from VATT are occasionally asked to give presentations to members of these committees.

Tax Expenditures are measured at central governmental level only and the tax revenue based on which they are estimated include municipal related taxes as well (e.g. municipal tax and real estate tax). Although it would perhaps be interesting for local (municipal) officials to have information on the TE generated at their administrative area, due to lack of resources this has not been attempted until now in Finland.

Calculations on revenue loss caused by TE are based on the Revenue Foregone method. This is a static method of calculation and does not take into account nor does it measure, spillovers and behavioral changes of the target population (e.g. individuals or firms) from the application of one type of TE. The interactions between different taxes and/or tax expenditures are not taken into account either. Estimates of TE for annual cash flows and Present Values of longer run effects are not made during the calculation process. The utilization of the Revenue Foregone method stems from its simplicity and the availability of data suitable for such calculations. Another reason is the need to present standardized calculations for as many TE as possible.

Several data are utilized in the annual TE calculations. For instance, TE calculations in personal income taxation are based on a micro simulation model called TUJA. In corporate taxation they are based on tax returns data from the Finnish Taxation authorities. In value added taxation calculations are based on data from Statistics Finland. Excise Duties related TE calculations are made using data received from the Finnish Customs. Finally, car tax related TE are made from data provided by the Finnish Transport Safety Agency. Some other authorities' assistance is recognized, too.

The methodology is not shown in each and every regular annual TE report. However, a detailed description with the methodology of the calculations on TE is published in the comprehensive reports on the subject. The latest report, where such methodology is presented in details, is from 2010.

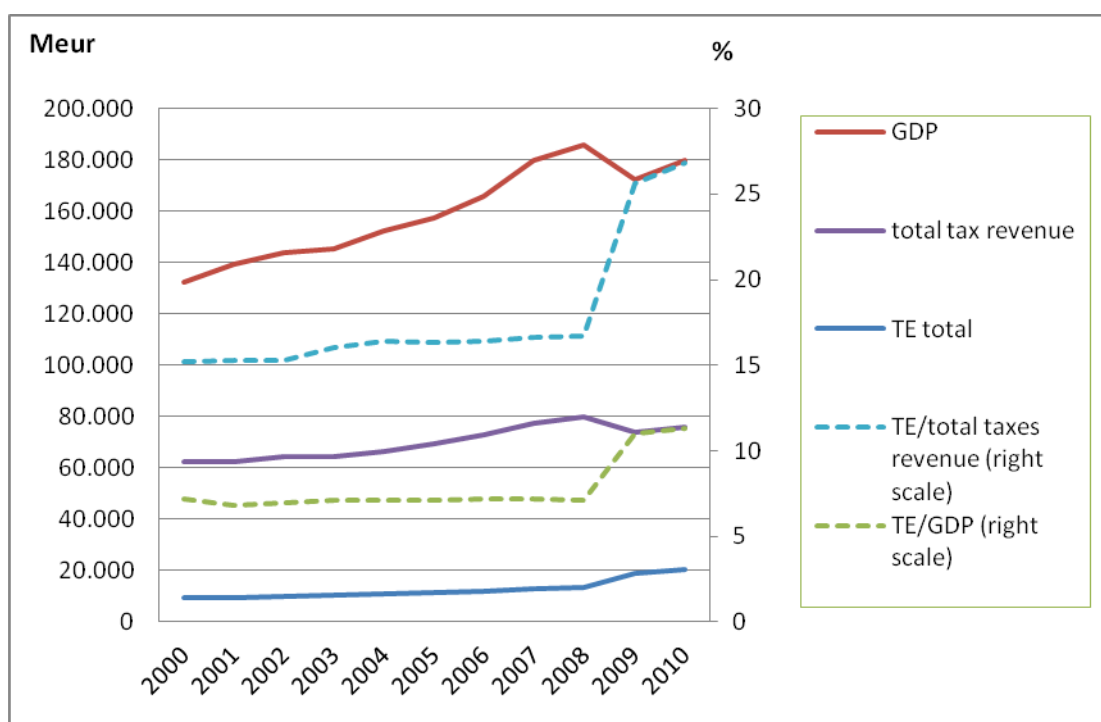
There are indeed challenges in calculating TE, mainly because of lack of appropriate data. Because of this, the amount of several TE are rough aggregate estimations. The individual TE are summed up to arrive at a total. It is emphasized that caution in the interpretation of the total is necessary. However, many politicians don't seem to take this warning seriously.

A3. Estimates of tax expenditures

Examining the amounts of TE in Finland through a longer time frame, we find no considerable short term fluctuations in the amounts of TE. There are nonetheless, rather medium term changes in their aggregate volumes. The main reasons for these changes are benchmark system updates of energy taxation and the availability of new data related to real estate tax, capital transfer tax and corporate tax. In some cases the amount of an individual “new” TE is so big that it has a visible impact on the time series.

In the early years of 2000s the number of different TE remained fairly stable, around one hundred cases. From 2009 onwards the number of TE rose to approximately 200. This was due to the updating of the benchmark systems and better data availability. Because of this, figures are not comparable before and after 2009. The total number of TE gives a realistic picture of the importance of TE only if the benchmark system is up-to-date and every provision has been analyzed.

Figure 1. The total revenue loss due to the tax expenditures in relation to GDP and the total tax receipts during 2000s.



For 2012 there are 183 calculated TE, and four calculated tax sanctions. The actual number is higher, because several tax expenditures are not calculated due to technical and data difficulties. In 2012 there are 42 TE in personal income tax, 56 in corporation etc. tax, 11 in capital transfer tax, 7 in real estate tax, 14 in inheritance tax, 19 in VAT, 28 in excise duties and 6 in social security

contributions. The number of TE decreased sharply in the 1990s, when most means for profit adjusting in corporate taxation were abolished and VAT was introduced. However, dozens of new TE were recognized and calculated in the 2000s due to tax reforms and better data availability.

Figure 2. The revenue loss due to the tax expenditures by type of tax as a percentage of revenue collected under that type of tax during 2000s.

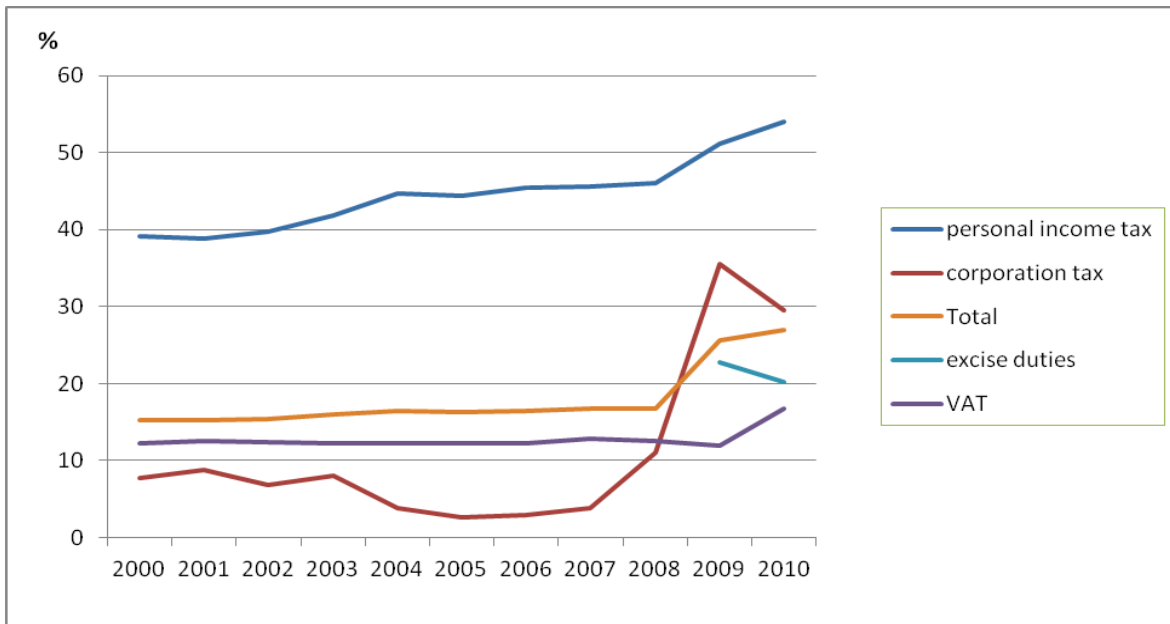
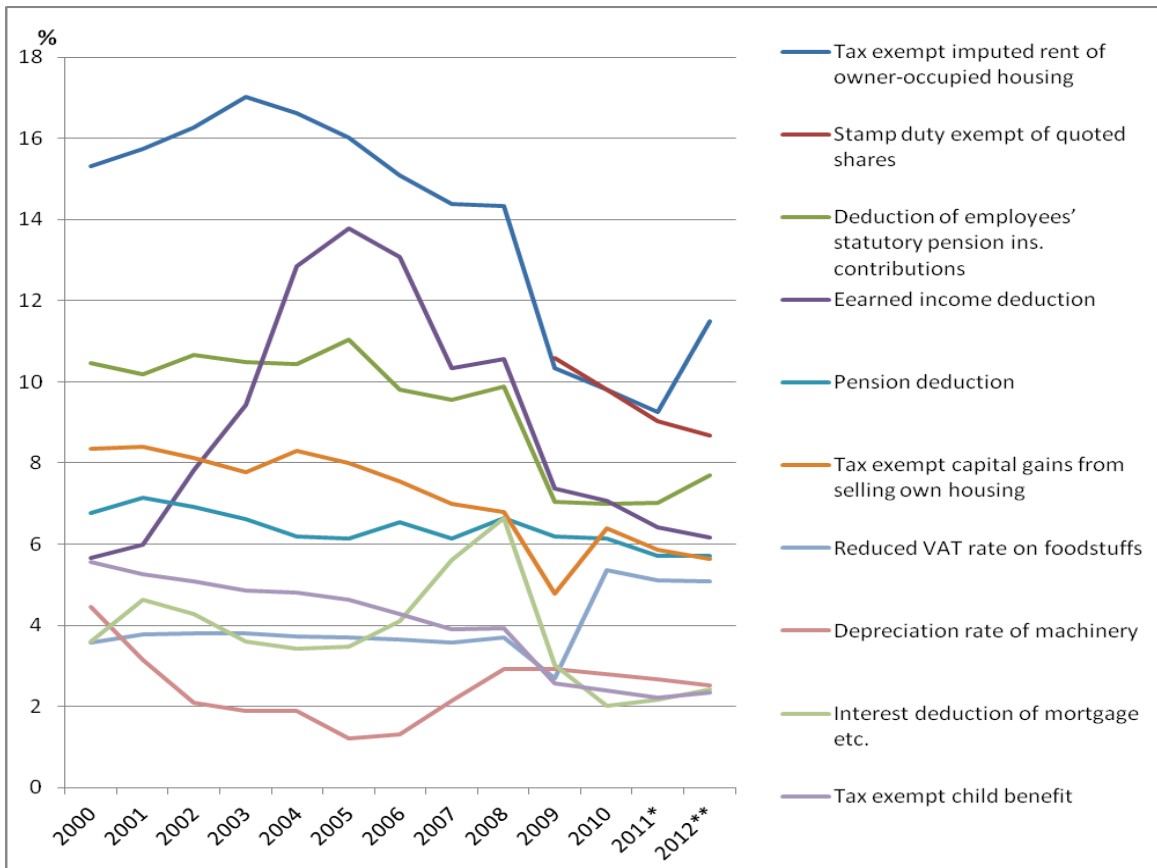


Figure 3. The ten largest tax expenditures in relation to the total amount of tax expenditures during 2000s.



We can list several examples of repealed TE. Temporary tax exempt timber sales provisions were introduced to back up timber sales for the period 2008–2011. Employers’ national pension fese and health insurance fees were repealed 2012 in order to kick-start the economy. Several energy taxation related TE were repealed due to updating the benchmark system. A new TE was created when the reduced VAT rate on restaurant services was introduced in 2010. Another example is the halving the CO2 tax on combined heat and power production in 2011.

Tax expenditures have been classified according to the functional area of the Central Government. They include general administration, education, science and culture, social security, health care, housing and environment, agriculture and forestry, transport and communication, industry, other expenses and miscellaneous Items. The three major categories are industry, social security and health care.

Table 2. Tax expenditures of different functional areas during 2000s, million euro.

	2000	2001	2002	2003	2004	2005	2006
General administration	16	15	15	15	15	15	15
Education, science and culture	168	160	160	165	165	165	155
Social security	3014	2964	3006	3012	3 117	3 302	3 452
Health care	95	101	106	113	116	122	126
Housing and environment	2830	2980	3060	3180	3 330	3 360	3 460
Acriculture and forestry	545	568	583	600	408	420	441
Transport and communication	358	373	379	389	402	422	438
Industry	956	842	749	744	715	671	702
Other expenses	35	-	-	-	-	-	-
Miscellaneous items	1447	1526	1779	2064	2 561	2 765	3 145
Total	9464	9528	9838	10281	10828	11 242	11 934
...cont.	2007	2008	2009	2010	2011*	2012**	
General administration	15	15	15	15	15	15	
Education, science and culture	160	160	160	157	161	171	
Social security	3 536	3872	4204	4400	4606	5020	
Health care	129	140	399	368	382	409	
Housing and environment	3 740	3710	3779	4320	4329	4948	
Acriculture and forestry	464	120	208	135	165	130	
Transport and communication	465	485	1762	1797	1873	1613	
Industry	906	1200	5053	5806	7053	7036	
Other expenses	-	8	25	-	9	5	
Miscellaneous items	3 454	3552	3248	3381	3539	3716	
Total	12 868	13262	18853	20379	22132	23063	

C. Evaluation of tax expenditures

C1. Tax expenditures vs. direct expenditure

In general, the discretionality nature of direct spending programs (DE) can provide more equitable access, by enhancing targeting on beneficiaries. On the other hand, tax expenditures (TE) reduce the need for state supervision of the equivalent DE. TE are easier to access, because they operate in a relatively automatic manner, whereas DE require a collection and selection process. TE are regressive by nature and favor those who pay taxes. The poorest people reap no benefit from TE. TE generate unexpected gains and distort market decision making. DE include sunset provisions by nature whereas TE are open-ended.

	Tax expenditures	Direct expenditures
Pros	<ul style="list-style-type: none"> - reduce the need for state supervision - incentive for private sector participation in economic and social programs - operate in a relatively automatic manner - consumption tax TE can contribute to improving the progressivity of the tax system 	<ul style="list-style-type: none"> - budget transparency and annual scrutiny - enhanced targeting on beneficiaries - control with spending ceilings
Cons	<ul style="list-style-type: none"> - generate unexpected gains - timescale extended typically without formal annual approval by the legislature - favour those who pay taxes - increased room for evasion and avoidance with tax regulations becoming more complex 	<ul style="list-style-type: none"> - require a collection system and a beneficiary selection process

The automatic nature of TE does not contemplate control mechanisms or accountability, whereas DE must be approved by the Parliament as with all other governmental expenditures. Many of TE are programmed, controlled and limited on the personal level by the budget law. The Social Insurance Institution of Finland (KELA) is the main supervisor of the benefit programmes and other social operations in Finland in co-operation with municipalities, pension providers and insurance companies.

Tax Expenditures are not included in the Total Expenditure cap. Although it is hard to prove quantitatively, some TE are most probably used to circumvent the cap. There are no annual caps for TE in the state budget. At individual tax payer level of course, annual caps have been defined. Examples of such caps include credit for domestic work, child maintenance credit, earned income allowance, travelling expenses deduction for travelling between the place of residence and the place of employment, money donations for the purpose of promoting science or art, a deduction granted to sailors, a maximum 1 500 euro tax exemption of individuals' dividends, a car tax relief for taxi cabs and a tax exemption for non-residents importing their vehicles for their own use.

Tax expenditures administratively are less costly than corresponding direct expenditures. In general, the greater the number of tax incentives, the greater the costs in terms of time and money that taxpayers face in order to comply with their tax obligations. For example with regard to income tax, the control of exemptions requires, in many cases, information to be provided by third persons.

By definition, TE make the tax structure more complex, thereby having an environment where there is increasing evasion and avoidance. There are uncertainties created about the correct interpretation of the legal regulations caused by TE. The whole process undermines the tax administration's monitoring capacity, because auditing requires more time due to the more complex rules. The complex rules impose also greater difficulties on taxpayers to comply with their tax obligations, leading to noncompliance with some of them, either through ignorance or in order to compensate for the added costs imposed by the system. And of course, there are also greater opportunities to manipulate the tax system, in view of the increased room for evasion and avoidance that opens up as tax regulations become more complex.

When it comes to implement Tax Expenditures, there are obviously over inclusive and under-inclusive results in terms of who is the final beneficiary. Sometimes the poorest reap no benefit from the tax expenditures. And those with greatest income benefit the most, albeit that in many cases they do what they would have done anyway. In these cases the stimulus finally becomes a windfall for the beneficiary. In this respect one can easily claim that TE are not targeted, because they benefit both the target group and anyone else who just complies—or pretends to comply—with the legal requirements.

In Finland, an example of a policy change where TE were replaced with DE is with the family-related subsidies reform of 1994. The main goal was to strengthen the subsidies geared towards individual children by aborting custodian benefits. Also there was an attempt to focus the assistance towards families with the greatest needs, such as those with many children and single parent families. TE linked to the number of children and to single parent families were abolished and at the same time the monthly allowance per child, increased. Also the additional increases of child benefit for under three year old were stopped and child benefit for the 16+ year olds was multi-scaled. With these measures the total family related subsidies decreased by about 500mil FIM (84 mil euro) in just three years, from 1992 to 1994.

There have been no scientific experiments to test the appropriateness of TE versus DE. That is, there has not been any attempt, for example, to apply tax expenditures in one part of the country and direct expenditures in another. This perhaps could be a good idea to implement in the future. However, because of moral and equity problems involved (as to who will be in the two groups which may cause complaints within the targeted populations), this needs more than anything else, political consensus by the decision makers. Otherwise the scale/coverage of the experiment will be very small and general inferences of the results questionable.

An example where TE and DE are not substitutes but supplements of each other, is found in housing policy. Interest expenses are tax deductible if the debt is related to the acquisition or repair of the taxpayer's or his family's permanent dwelling. This is not regarded as tax expenditure. However, the resident is also entitled to housing allowance i.e. direct expenditure. There have not been any studies conducted examining this phenomenon.

C2. *The administrative burden*

In 2009 the Government approved a decision-in-principle on an Action Plan aimed at reducing the administrative burden on businesses during 2009–2012. The objective was to reduce the administrative burden by 25% compared to the 2006 level, by the end of 2012.

For this, an overall estimate of the initial level of the administrative burden caused by taxation was drawn up in conjunction with the Ministry of Finance (MoF) and the tax and customs authorities. Measurements of administrative burden based on company interviews were conducted in relation to value-added tax and other self-initiated, unprompted taxes belonging to the tax account procedure. According to that estimate, the overall administrative burden on businesses by taxation is approximately 447 million euro per year. With regard to tax expenditures, the share of value-added tax was 160 million euro. A major part of this is due to the reduced VAT-rates that increase administrative burden by complicating book keeping and invoicing. In relation to turnover, small businesses bear the greatest costs caused by the reduced rate. Since 2010 each value-added taxable person and firm has been able to utilize the business tax account –system. The system allows Small and Medium-size Enterprises (SME) to report annually or quarterly instead of on a monthly basis as previously.

There is no regular and systematic evaluation of tax expenditures in Finland, even though the transparency is often called for. It has not been required by law either. However, there are a few examples of more thorough evaluations of some of the tax expenditures. They are related to reduced VAT rates on restaurant services and labor-intensive services such as barbers (Kosonen 2010, Harju and Kosonen 2010). The results refer to the fact that the pass-through effect from tax reduction to prices is weak and thus the demand and employment impacts are small. There are some empirical estimates of housing policy, too.

A comprehensive study on VAT on foodstuffs (Holm et al. 2007) reviewed the effects of reducing the value added tax rate from 17 per cent to 12 per cent. There would be no budget neutrality – adjustment via public sector deficit. As a consequence foodstuffs would become 3,5 per cent cheaper and the consumer price index would come down by 0,5 per cent. Consumers’ real income, as well as private consumption, would grow approximately 0,5 per cent. The reduction of the value added tax on foodstuffs would benefit the low income households. It would be more favourable for around 40 per cent of households compared to equal reduction of income tax. However, the richest would cash in euro twice as much as the poorest.

Differences in the Finnish and the Swedish tax reduction for household services and the use of tax reduction in different groups were studied by Häkkinen Skans (2011). In Finland the use of tax reduction for household services is most frequent among individuals over the age of 75, home owners, entrepreneurs, two-parent households and individuals with postgraduate education. Much more detailed data is, however, needed to evaluate the effects of tax reduction for household services on employment and economic efficiency.

Since the end of 2011, acknowledging the importance of TEs and the need for fiscal consolidation, under a mandate from the MoF, a working group consisting of MoF officials and VATT has been set up to decide these issues.

C3. Distributional impacts

With regards to distributional impacts of tax expenditures, there have been several relevant studies and calculations, but not precisely motivated from the point of view of TE. Most of them are mimeos for the political decision makers that have not been published. Finland for example does neither apply nor has really considered to apply non-wastable tax credits

The Working Group for Developing the Finnish Tax System (2010) studied the impact of its proposals on the income distribution of households and on tax revenue. These studies were based on static calculations, which do not take behavioural effects into account. The changes proposed for personal income taxation consisted of reductions in the earned income taxation scale, increases in capital income taxation, and the limiting of the deductibility of interest expenses and domestic help credit. According to the study the changes in personal taxation increase real disposable income in all income deciles. Income growth varies from 0,8 per cent to 2,2 per cent and is on average 1,6 per cent. At the highest income levels, the tightening of capital taxation clearly reduces growth of disposable income, because households at these income levels have most capital income. Similarly, the impact of the limitation of the domestic help credit and the deductibility of interest expenses will be greater at higher income levels. On the other hand, the effects of earned income taxation are relatively smaller at low income levels and disposable income increases proportionately more the higher the income level. The income distribution effects of tightening indirect taxation (valued-added tax and excise duties) are similar. The tax increases are directed towards all income classes,

but proportionately more to those at low incomes. Excise duties, however, have a slightly more regressive effect than value-added taxation has.

Riihelä et al. (2010) provide evidence on the evolution of top incomes in Finland over the period 1966–2007. The paper shows that the total share of the highest earners fell consistently between the mid 1960s and the beginning of the 1990s but then began to rise. The main factor that has driven up the top one per cent income share in Finland after the mid 1990s is in an unprecedented increase in the fraction of capital income; in 2007 it was 62 per cent of incomes in the top one per cent group. In 1990 this fraction was just 14 per cent. The authors argue that the 1993 tax reform has contributed to this trend.

REFERENCES

Final Report of the Working Group for Developing the Finnish Tax System, Ministry of Finance publications 51/2010

Holm, Pasi – Kiander, Jaakko – Rauhanen, Timo – Virén, Matti (2007): Effects of reducing the value added tax rate on foodstuffs. Pellervo Economic Research Institute Reports No. 200.

Harju, Jarkko and Tuomas Kosonen (2010): Ravintoloiden arvonlisäveroalennuksen hintavaikutukset (The effects of VAT rate reduction on restaurants, in Finnish). VATT mimeo 10.

Häkkinen Skans, Iida (2011): Kotitalouspalveluiden verovähennykset Suomessa ja Ruotsissa (The Finnish and the Swedish tax reduction for household services, in Finnish). VATT Valmisteluraportit 11/2011.

Kosonen, Tuomas (2010): What was actually cut in the barbers' VAT cut? VATT Working Papers 18.

Riihelä, Marja, Risto Sullström and Matti Tuomala (2010): Trends in top income shares in Finland 1966–2007. VATT Research Reports 157/2010.