Riktlinjer för nationalrapporter NSFR möte hösten 2007 i Helsingfors

Beskattning av kapital och arbete; mot större eller mindre likhet?

Taxation of capital and wage income; towards separated or more integ rated personal tax systems?

1. General guidelines (= also guidelines for the national fiscal reports)

Note. It is up to the writers of the country reports to decide whether they want to write a joint report, or two separate ones (a fiscal and an economic report).

In a drive to encourage entrepreneurship and competitive fiscal advantage, many European countries have reformed their personal income tax system fundamentally over the last two decades. At the same time, governments are aware that they must maintain taxpayer's faith in the integrity of their tax systems to fund public spending. Fairness and simplicity have become the byword of reformers, but the double challenge has meant that no clear consensus has emerged on an ideal personal income tax. These problems are also emerging on the surface of tax reforms in the Nordic countries.

Although there are large differences in tax policies between European countries, almost all the reforms of personal income tax in the last two decades can be characterised as

a) rate reducing and

b) base broadening.

NSFR seminar in Helsinki aims to examine the general trends in the taxation of capital income and of wage income in the Nordic countries, and the most significant changes that have taken place. It looks closely at the main points of latest country specific reforms, the trade-offs between policy objectives, and design features of personal tax systems.

The principal theoretical systems of taxes on personal capital income and wage income

comprehensive tax,

dual tax and,

flat tax

are to be examined and evaluated in the Nordic countries that each have adopted these different systems or a mix thereof. They will be assessed in country reports in terms of the fundamental principles of tax policy: simplification, efficiency, equity, tax compliance and tax revenue, and their main advantages and disadvantages should be discussed.

Suggestion for the composition of country reports:

1 Introduction to the personal tax system

2 Recent Reforms

3 Taxation of wage and wage-related income

4 Taxation of capital income

5 Problems of income transformation and tax evasion

6 Future tax reforms

7 Integration of capital income and wage income taxation

2. Guidelines for the national economic reports

In the national economic reports, the focus is on the economic consequences of the alternative forms of taxation and tax reforms. However, also questions on whether there is room for a change within the countries' budget constraints are asked. The reports could try to cover the following areas / questions:

Taxes as percentage of GDP, Iceland

	1991	1996	**2001**	**2006**
1 Total revenue	39,78	40,45	42,02	46,68
11 Taxes	34,27	34,27	32,57	37,12
111 Taxes on income and profits	10,12	12,17	15,37	17,99
112 Taxes on payroll and workforce	0,09		0,03	0,03

113 Taxes on property	3,09	3,00	2,7	2,17
114 Taxes on goods and services	17,15	16,08	13,93	16,43
115 Taxes on international trade	0,09	0,00	0,39	0,37
116 Other taxes	3,73	3,01	0,15	0,14
12 Social contributions	2,33	2,80	2,85	3,26
13 Grants			0,12	0,11
131 From foreign governments			0	0
132 From international organizations			0,11	0,11
133 From other general governments			0	0
14 Other revenue	5,98	7,10	6,5	6,18
141 Property income	2,59	2,36	2,82	2,31
142 Sales of goods and services	2,79	3,72	3,32	3,37
143 Fines, penalties and forfeits	0,09	0,07	0,13	0,08
144 Voluntary transfers other than grants			0,17	0,16
145 Miscellaneours and unidentified revenue	0,50	0,95	0,05	0,27

Souces: Statistics Iceland (2001, 2006), authors calculation based on SI data (1991, 1996). When comparing with other Scandinavian countries it need to be said that pensions are privately financed in Iceland.

Main aggregates for general government
% of GDP, estimates for 2007-2009

Hlutfall af landsframleiðslu (%)	Total revenue	Total expenditure	Surplus
1993	39,0	43,4	-4,5
1994	38,6	43,2	-4,7
1995	39,6	42,5	-3,0
1996	40,5	42,0	-1,6
1997	40,5	40,5	0,0
1998	40,9	41,3	-0,4
1999	43,2	42,0	1,1
2000	43,6	41,9	1,7
2001	41,9	42,6	-0,7
2002	41,8	44,4	-2,6
2003	42,8	45,6	-2,8
2004	44,3	44,1	0,2
2005	47,6	42,3	5,3
2006	46,7	41,4	5,3
2007	46,6	43,4	3,2
2008	44,4	45,5	-1,1
2009	43,2	45,7	-2,4

Source: Ministry of Finance, Report on the status of the Icelandic Economy, summer 2007.

Table I.1. Marginal personal income tax and social security contribution rates on gross labour income [1]

Country			% AW			
			67%	100%	133%	167%
2000						
Iceland		Central gvt	24,8%	24,8%	24,8%	31,8%
AW=2142000		Sub-central	11,2%	11,2%	11,2%	11,2%
		Combined	36,1%	36,1%	36,1%	43,1%
		Employee SSC	0,0%	0,0%	0,0%	0,0%
		´All-in´	36,1%	36,1%	36,1%	43,1%
		Employer SSC	4,8%	4,8%	4,8%	4,8%
		Total tax wedge	39,0%	39,0%	39,0%	45,7%
	2001					
Iceland		Central gvt	24,0%	24,0%	24,0%	31,0%
AW=2370000		Sub-central	11,7%	11,7%	11,7%	11,7%
		Combined	35,7%	35,7%	35,7%	42,7%
		Employee SSC	0,0%	0,0%	0,0%	0,0%
		´All-in´	35,7%	35,7%	35,7%	42,7%
		Employer SSC	5,2%	5,2%	5,2%	5,2%
		Total tax wedge	38,9%	38,9%	38,9%	45,5%
	2002					
Iceland		Central gvt	24,7%	24,7%	24,7%	31,7%
AW=2489000		Sub-central	12,3%	12,3%	12,3%	12,3%
		Combined	37,0%	37,0%	37,0%	44,0%
		Employee SSC	0,0%	0,0%	0,0%	0,0%
		´All-in´	37,0%	37,0%	37,0%	44,0%
		Employer SSC	5,2%	5,2%	5,2%	5,2%
		Total tax wedge	40,1%	40,1%	40,1%	46,8%
	2003					
Iceland		Central gvt	24,7%	24,7%	24,7%	29,7%
AW=2669000		Sub-central	12,3%	12,3%	12,3%	12,3%
		Combined	37,0%	37,0%	37,0%	42,0%
		Employee SSC	0,0%	0,0%	0,0%	0,0%

		´All-in´	37,0%	37,0%	37,0%	42,0%
		Employer SSC	5,7%	5,7%	5,7%	5,7%
		Total tax wedge	40,4%	40,4%	40,4%	45,2%
	2004					
Iceland		Central gvt	24,7%	24,7%	24,7%	28,7%
AW=2770000		Sub-central	12,3%	12,3%	12,3%	12,3%
		Combined	37,0%	37,0%	37,0%	41,0%
		Employee SSC	0,0%	0,0%	0,0%	0,0%
		´All-in´	37,0%	37,0%	37,0%	41,0%
		Employer SSC	5,7%	5,7%	5,7%	5,7%
		Total tax wedge	40,4%	40,4%	40,4%	44,2%
	2005					
Iceland		Central gvt	23,8%	23,8%	23,8%	25,8%
AW=2958000		Sub-central	12,5%	12,5%	12,5%	12,5%
		Combined	36,2%	36,2%	36,2%	38,2%
		Employee SSC	0,0%	0,0%	0,0%	0,0%
		´All-in´	36,2%	36,2%	36,2%	38,2%
		Employer SSC	5,7%	5,7%	5,7%	5,7%
		Total tax wedge	39,7%	39,7%	39,7%	41,6%
	2006					
Iceland		Central gvt	22,8%	22,8%	22,8%	22,8%
AW=3188693		Sub-central	12,5%	12,5%	12,5%	12,5%
		Combined	35,3%	35,3%	35,3%	35,3%
		Employee SSC	0,0%	0,0%	0,0%	0,0%
		´All-in´	35,3%	35,3%	35,3%	35,3%
		Employer SSC	5,8%	5,8%	5,8%	5,8%
		Total tax wedge	38,8%	38,8%	38,8%	38,8%

Source OECD

Table I.2. Average personal income tax and social security contribution rates on gross labour income [1]

		% AW		
2000 **Country**	**67%**	**100%**	**133%**	**167%**

Iceland	Central gvt	4,4%	11,2%	14,6%	23,6%
AW=2142000	Sub-central	11,2%	11,2%	11,2%	11,2%
	Combined	15,6%	22,4%	25,8%	34,9%
	Employee SSC	0,3%	0,2%	0,1%	0,1%
	´All-in´	15,9%	22,6%	26,0%	35,0%
	Employer SSC	4,8%	4,8%	4,8%	4,8%
	Total tax wedge	19,7%	26,1%	29,3%	38,0%

2001

Iceland	Central gvt	4,8%	11,2%	14,4%	23,3%
AW=2370000	Sub-central	11,7%	11,7%	11,7%	11,7%
	Combined	16,5%	22,9%	26,1%	35,0%
	Employee SSC	0,3%	0,2%	0,2%	0,1%
	´All-in´	16,8%	23,1%	26,2%	35,1%
	Employer SSC	5,2%	5,2%	5,2%	5,2%
	Total tax wedge	20,9%	26,9%	29,9%	38,3%

2002

Iceland	Central gvt	5,9%	12,2%	15,3%	24,2%
AW=2489000	Sub-central	12,3%	12,3%	12,3%	12,3%
	Combined	18,2%	24,5%	27,6%	36,5%
	Employee SSC	0,3%	0,2%	0,2%	0,1%
	´All-in´	18,5%	24,7%	27,8%	36,6%
	Employer SSC	5,2%	5,2%	5,2%	5,2%
	Total tax wedge	22,6%	28,4%	31,4%	39,8%

2003

Iceland	Central gvt	6,6%	12,7%	15,7%	22,5%
AW=2669000	Sub-central	12,3%	12,3%	12,3%	12,3%
	Combined	18,9%	24,9%	28,0%	34,8%
	Employee SSC	0,3%	0,2%	0,2%	0,1%
	´All-in´	19,2%	25,2%	28,1%	34,9%
	Employer SSC	5,7%	5,7%	5,7%	5,7%
	Total tax wedge	23,6%	29,2%	32,0%	38,4%

2004

Iceland	Central gvt	6,9%	12,8%	15,8%	21,6%
AW=2770000	Sub-central	12,3%	12,3%	12,3%	12,3%
	Combined	19,2%	25,1%	28,1%	33,9%
	Employee SSC	0,3%	0,2%	0,2%	0,1%
	´All-in´	19,5%	25,3%	28,3%	34,0%
	Employer SSC	5,7%	5,7%	5,7%	5,7%
	Total tax wedge	23,8%	29,4%	32,1%	37,6%

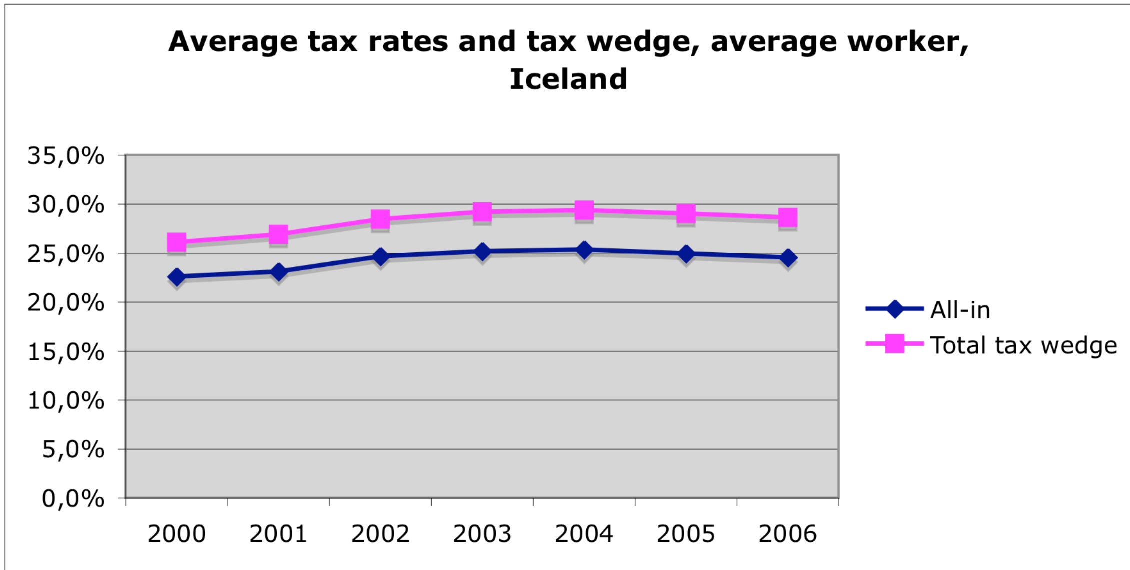
2005

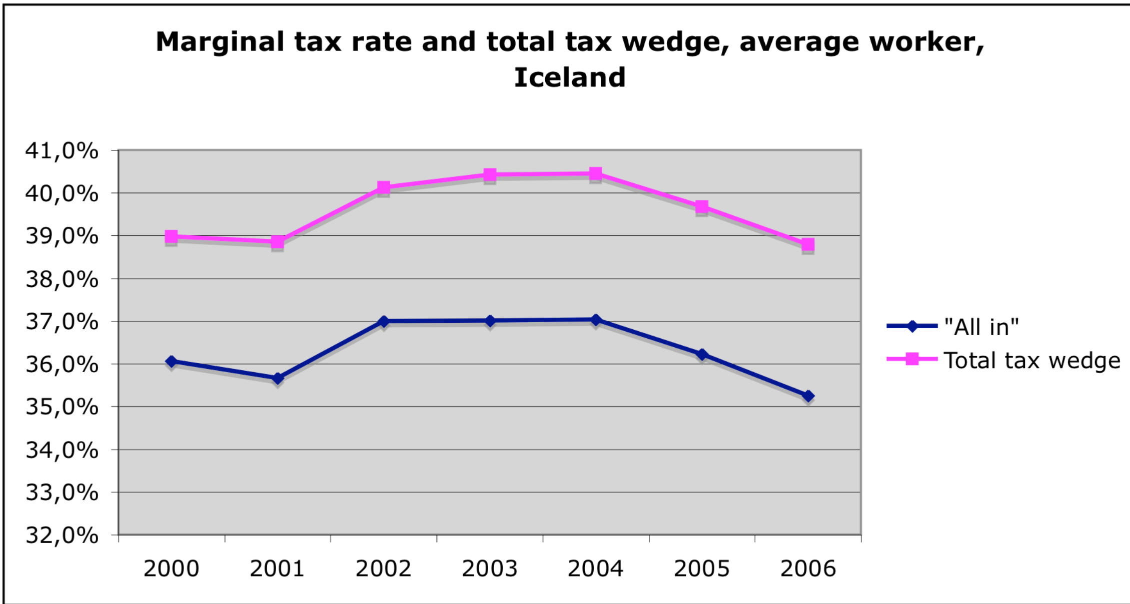
Iceland	Central gvt	6,5%	12,3%	15,1%	18,9%
AW=2958000	Sub-central	12,5%	12,5%	12,5%	12,5%
	Combined	19,0%	24,7%	27,6%	31,3%
	Employee SSC	0,3%	0,2%	0,1%	0,1%
	´All-in´	19,3%	24,9%	27,7%	31,4%
	Employer SSC	5,7%	5,7%	5,7%	5,7%
	Total tax wedge	23,7%	29,0%	31,7%	35,2%

2006

Iceland	Central gvt	6,4%	11,9%	14,6%	16,2%
AW=3188693	Sub-central	12,5%	12,5%	12,5%	12,5%
	Combined	18,9%	24,3%	27,1%	28,7%
	Employee SSC	0,3%	0,2%	0,1%	0,1%
	´All-in´	19,2%	24,5%	27,2%	28,8%
	Employer SSC	5,8%	5,8%	5,8%	5,8%
	Total tax wedge	23,6%	28,6%	31,2%	32,7%

Source: OECD





1.) Start by giving economic **background** in terms of total tax revenues collected annually in the form of the various taxes (by main tax groups), and their time series development (years 1996, 2001, and 2006). Also report the corresponding surplus of deficit of the state budget for these years. Are there any time series forcasts available on how these tax revenues could develop in the near future?

Also produce a graf on the time series development during the last 15-20 years on 1.) the average tax rate for capital income (or, when the country does not have a dual tax system, describe the system), and 2.) the average nad marginal tax rates for the average production worker (according to the OECD definition).

2.) Are there empirical evidence of what changes in the taxation system can bring about? Such evidence can e.g. deal with

-the outcome of a tax reduction combined with a change (broadening) of the tax base;

- a transformation from a progressive schedule to a less progressive / flatter one? Is there evidence of the relative magnitudes of the incentive effects of a lower tax (leading to higher labour supply and a tax income) versus the direct tax reducing effect due to a lower tax rate?

-the question of income tranformation: is there evidence of problems encountered with the current system (or recent reforms) of taxation of labour and capital in the form of income being transformed from one (more heavily taxed form) to another **within the country**, and are there estimates on the economic importance of such income tranformation? Is there evidence of **cross-border** tax evasion caused by e.g. flatter tax rates elsewhere ?

A paper by Bianchi, Gudmundsson et al. (2001) exemines a natural experiment offered when Iceland changed to pay-as-you-earn system in 1987. Income-taxes payable in year 1987 were based on income earned in 1986. Taxes payable in 1988 were based on income earned in 1988. Hence, the income of earned in year 1987 did not affect taxes payable, neither in that year nor in 1988. The marginal income-tax rate was effectively equal to zero. Bianchi, Gudmundsson et al. find that the labour supply response to this varied much. Some individuals increased their supply of work as measured by Bianchi, Gudmundsson et al. Other individuals decreased their supply of work. They calculate estimates for labour supply elasticities and find them to be largely in line with findings by Killingsworth in a survay of American studies. The elasticity of weeks worked was 0.42 for all workers; 0,58 for men and 0,06 for women. They find the response to be non-linear with respect to tax-burden. For individuals with taxburden of 20-40% they find positive response, for individuals with less taxburden they do not find that there is a connection between supply of labour and the income-tax rate.

3.) What are the current "degrees of freedom" in Nordic taxation i.e. describe the trade-off between the Nordic welfare state and the pressures for reduced taxation. Has there been calculations performed on

what type of tax reforms would be economically sustainable? Report on the current debate (if any) relating to this issue.

Points of interest in the ongoing discussion on taxes in Iceland

Distribution of tax-revenue between different levels of government is the point of departure of much of the discussion waged currently. The muncipality level has been undergoing consolidation. Small muncipalities have been merging with larger ones. This process has not been smooth. Proposals for merging has to be put to a general vote and majority of voters in individual muncipalities must agree if a merger is to take place. The number of municipalities was at its highest in 1950 when the number was 229. The number was still in excess of 200 in 1990 when the current drive for consolidation started. The number is now down to 79. A turning point was the decision to move financial responsibility regarding the primary schools from the central government to the municipalities in 1996. A muncipality of 100 people is not well suited to take on board such an important responsibility. Municipalities have announced their desire to take on more of the tasks currently served by the central government. The municipality sector is a collection of heteregenous units, even after the current surge of mergers. They vary in terms of population density and in terms of development of the local economy. Thinly populated municipalities experiencing out-migration are underfunded given the present sources of income. The leaders of the underfunded municipalities have been vocal about their need for more funds. They have pointed out that recent changes in the tax code have left them with subjects that pay taxes to the central government but not to them. There are two seperate but interconnected themes that are discussed.

The capital income tax

The capital income tax is levied on four different sources. First, nominal interest on financial instruments of any kind is taxed at the rate of 10%. Second, capital gains derived due to sale of financial or real capital is also taxed at the rate of 10% (exception is made for home-owners moving house). Thirdly, rental income is also taxed at the rate of 10%. Finally, profits distributed are also taxed at a rate of 10%. The revenue from the capital income tax accrues to the central government and does only reach the muncipalities indirectly though an intergovernmental tax-redistribution fund. The capital income tax has gained importance, since it was first introduced in 1997,, was 2% of total tax receipts in 2000 and 3,8% in 2005.

The surge in private limited liability companies

By a change in the tax code effective since January 1st, 1995 individuals are allowed to organize their economic activity in a limited liability company. Share(s) of such companies are hold by only one person. Individuals who wished to reduce the effect of risk associated with their economic activity on their family finances had to establish a full fledged limited liability company, a process made costly and cumbersome by increased formal demands against such companies. Many individuals, specially fishers and farmers have made use of the change. The change was intended to make it easier to draw a line between a person and the economic activity pursued by that person and allocate the risk associated with the economic activity to the personal one shareholder company. The tax-burden associated with either form of organizing economic activity should be similar. The municipalities claim that there has been a shift so that the one man companies have induced a redefination of personal income from labour income (which is part of the base for "útsvar", the municipality income tax) to capital income. If correct, then the single shareholder companies have induced a reduction in the tax burden as capital income is taxed at a lower rate than personal income. Furthermore, it would also have narrowed the tax base of the municipalities.

Bianchi, M., B. R. Gudmundsson, et al. (2001). "Iceland's natural experiment in supply-side economics." *American Economic Review* **91**(5): 1564-1579.