

10 July 2019

Decline on the horizon

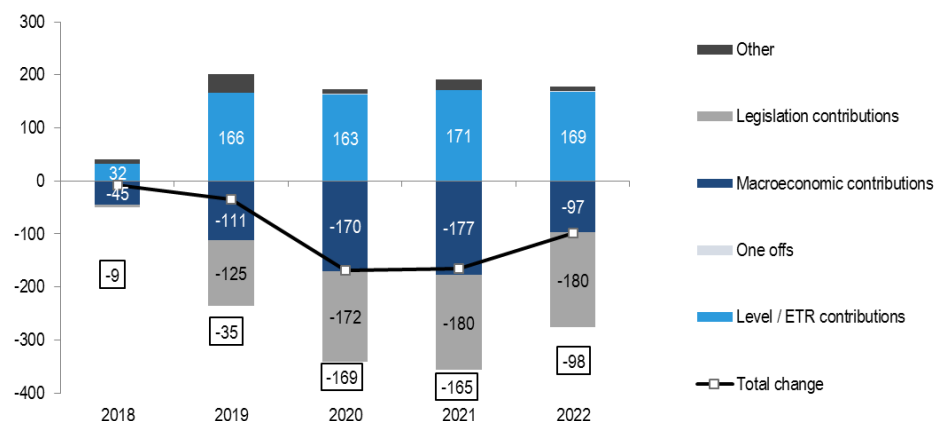
Forecast of tax revenues and social contribution for 2018 to 2022 (June 2019)

Jana Antalicová, Michal Havlát

The current tax and social security contributions forecast expects a decline in revenues on the whole horizon 2019 to 2022. While the 2018 estimate is reduced only slightly, the current year's estimate is forecast to decline by EUR 35 mill. In the following years, the tax shortfall deepens to nearly EUR 170 mill. and by the end of the forecast horizon the drop is expected to reach a peak of EUR 98 mill. The main reasons for this are a slowdown in the economy and legislative measures – specifically the abolition of the Special levy for retail sector. Conversely, the improvements in the tax collection efficiency increases revenues and offsets the negative effects.

The June 2019 tax and social security contributions forecast expects for the whole horizon lower revenues from EUR 35 to EUR 169 mill. (Figure 1). The decline is largely due to lower economic growth. Additionally, legislative measures, including legislative updates from previous years, also have a significant negative effect. These impacts are partially offset by the improvements of the effective tax rate. Other effects have a small positive impact on the entire forecast.

Figure 1: Change to the forecast of tax revenue and social security contributions, compared to February 2019 (in EUR mill.)



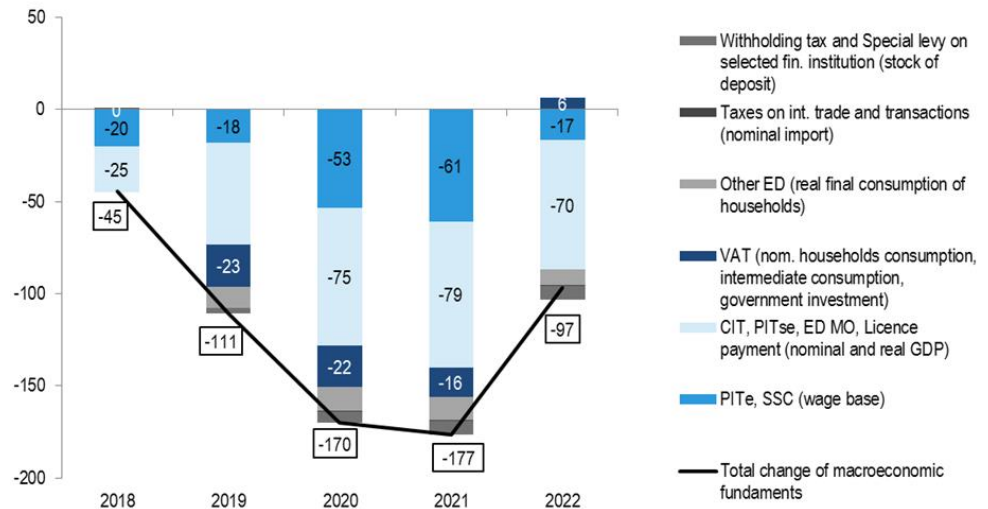
source: IFP, UloziskoIFP

The current developments in the macroeconomic environment impacts tax revenues negatively. The greatest shortfall causes an overall slowdown in economic activity. Revenues react very sensitively to even small changes in labor market forecasts (Figure 2). The anticipated economic slowdown will reduce tax and social security contribution revenues by EUR 111 mill. in 2019, by EUR 170 mill. in 2020, and by EUR 177 mill. in 2021. In the final year of the forecast, the negative impact is expected to decrease slightly to EUR 97 mill.

Decline in revenues across the horizon due to the economy and legislation

Economic slowdown affects taxes...

Figure 2: Impact of the macroeconomic forecast on the tax estimates¹ (in EUR mill.)

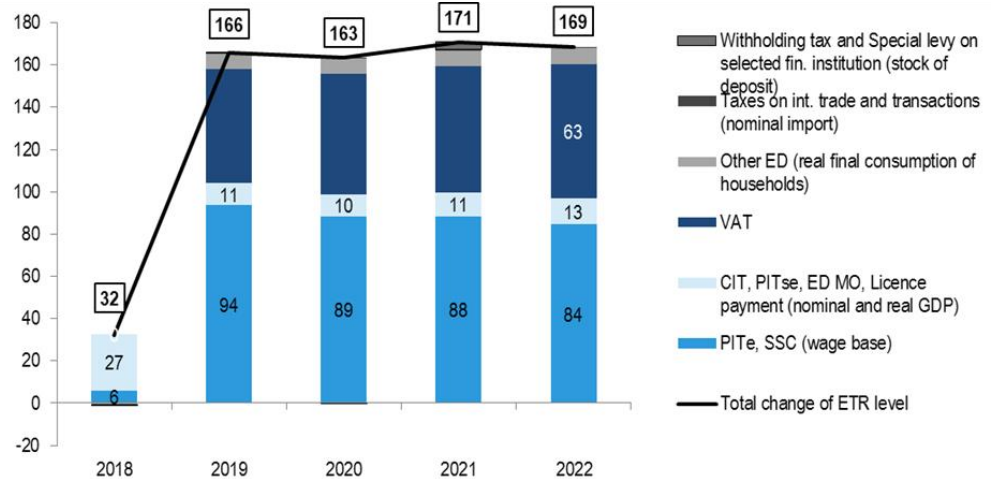


source: IFP, UloziskoIFP

... but ETR adds towards revenues

The impact of effective tax rates (ETR) is positive over the forecast horizon. In 2020 and 2021, about half of the negative impacts of macroeconomic developments and legislative updates will be offset by the positive impacts of ETR. In 2019 and 2022, the impact of ETR offsets approximately two thirds of the decline (Figure 3). In nominal terms, the effective rate contributes more than EUR 160 mill. after 2019. More than half of the positive contribution is due to personal income taxes on dependent activity and health contributions. About a third is due to the effectiveness of VAT collection. Other taxes, except for CIT, also have a small positive impact².

Figure 3: Impact of change in effective tax collection (ETR) on tax forecasts (in EUR mill.)



source: IFP, UloziskoIFP

¹ Taxes are categorized according to which macroeconomic aggregate has the most significant impact on them.

ED = excise duty, PITe = PIT enterpr, PITe = PIT from dependant activity, ED MO = excise duty on mineral oils, SSC =social security contributions and health contributions.

² The macroeconomic base does not fully capture CIT impacts, and therefore the impact of individual contributions of this tax needs to be explained cautiously. The macroeconomic base for CIT is GDP without compensation of employees and not profitability of firms.

Abolition of the Special
levy for retail sector
reduces revenue

The overall impact of the legislative update reduces tax and social security revenues by EUR 125 to 180 mill. as of 2019 (Table 1). New legislative measures reduce tax forecasts by EUR 97 to 147 mill., of which the abolition of the Special levy for retail sector in April 2019 has the most significant negative effect. Other measures with an overall less negative impact are due to the amendment to the Income Tax Act to support electric vehicles, R&D and microenterprises, etc. Contrarily, limiting the tax loss deduction for companies that do not satisfy the definition of a microbusiness will partially offset the negative impact. Revisions of existing legislative measures reduces revenues by around EUR 30 mill. The largest factor of this is the effect of the abolition of the deductible item on health contributions for employers, which according to the most recent data has led to a lower uptake than originally expected.

Table 1: Legislative measures incorporated in the tax forecast (in EUR mill.)

	2018	2019	2020	2021	2022
1. New Legislation	0	-97	-137	-147	-147
Abolition of the Special levy for retail sector	0	-85	-101	-106	-110
Increase of tax depreciation rate for electric cars	0	-7	-17	-15	-9
Increase of R&D super-deduction to 150% in 2019 and 200% in 2020	0	-6	-13	-15	-18
Increase in the non-cash benefit for employees for accommodation (EUR 100 per month)	0	0	-6	-6	-6
Introducing tax depreciation without limitation for tangible assets except buildings (if turnover is below 49 790 eur; since 2021)	0	0	0	-15	-15
Introducing a non-cash benefit for employee transport to work (EUR 100 per month)	0	0	0	-12	-12
Threshold increase (volume of paid tax) from 2 500 to 5 000 eur	0	0	0	-11	0
Introducing tax treatment of value adjustments without limitation (if turnover is below 49 790 eur)	0	0	0	-1	-1
Loss carryforward without limitation during five years following the period of loss (if turnover is below 49 790 eur; since 2021)	0	0	0	0	-4
Loss carryforward loss up to 50 % of tax base during five years following the period of loss (if turnover is above 49 790 eur; since 2020)	0	0	0	36	30
2. Revisions of existing legislative impact	-5	-27	-34	-34	-33
Abolition of the HIC allowance for employers	-5	-26	-32	-32	-31
Increase in the social insurance contribution to the 2nd pillar (automatic from 2017 by 0.25 p.p./year)	0	-1	-1	-1	-1
3=1.+2. Total legislative impact	-5	-125	-172	-180	-180

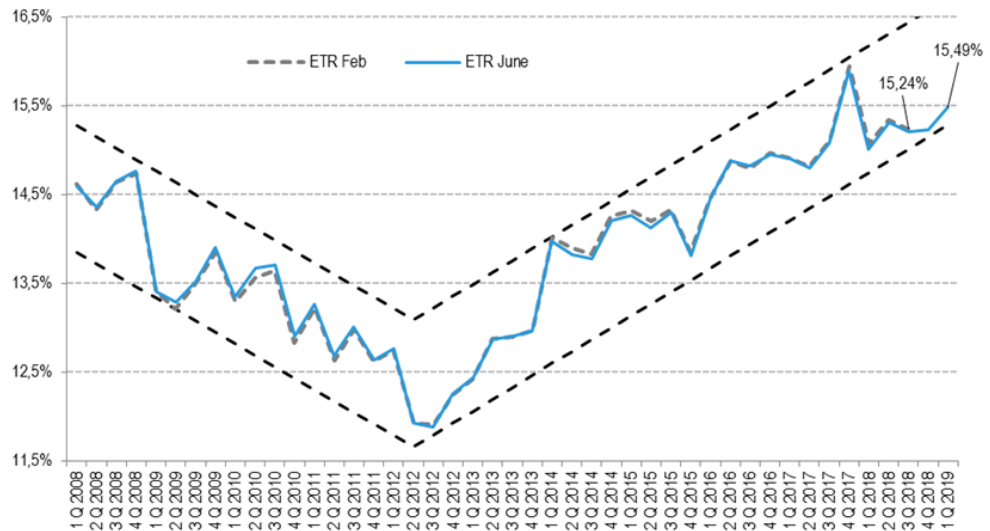
Corporate tax is revised
downwards

Corporate tax collection for 2018 remains in line with the forecast. For 2019 and onward, estimates have been revised downwards, due to slower economic growth as well as corporate profitability. The legislative impact in 2019 include effects of the introduction of a new 2-year write-off group for electric vehicles and a super-deduction for research and development. From 2021, revenues are bolstered due to a change in loss redemption (loss carry forward) for companies, which do not fulfill the definition of a microbusiness (higher turnover than 49 790 eur). On the other hand, the advantage of depreciation of assets and the amortization of losses for micro-taxpayers will reduce corporate tax revenue.

The effectiveness of VAT collection is (again) growing

The growing effectiveness raises VAT revenues despite lower household consumption. VAT revenue is growing due to favorable cash performance in the first quarter of 2019. Lower international VAT refunds are also expected to contribute positively to VAT yields. The positive effect of macroeconomic developments is visible only at the end of the budgeting horizon and stems mainly from growth in intermediate consumption and government investment. The forecast for 2019-2022 expects that the effective tax rate based on the last two quarters will be maintained.

Figure 4: VAT Effective tax rate (%)



source: IFP, UložiskoIFP

The labor market is a primary source revisions in contributions

The estimated slowdown in the labor market contributes to the downward correction in social and healthcare contribution. The performance in the first quarter of 2019 was broadly in line with the most recent forecast. The weakening labor market has a negative effect on forecasted social security contributions. Based on new data, we update the legislative impact of the deductible allowance and revise the estimate of health contributions over the forecast horizon.

Fiscal drag is on the rise

PIT revenues from dependent activity outperform the growth of the wage base, which increases the forecast for the entire horizon. The better return is due to the fiscal drag, which further explains the growth in effective tax collection. The impact of the fiscal drag is recalculated based on the most recent data, confirming strong revenue growth (more on the impact and methodology in Box 1). The PIT forecast is slightly corrected downwards by decelerating macroeconomic development.

Excise duties are decreasing

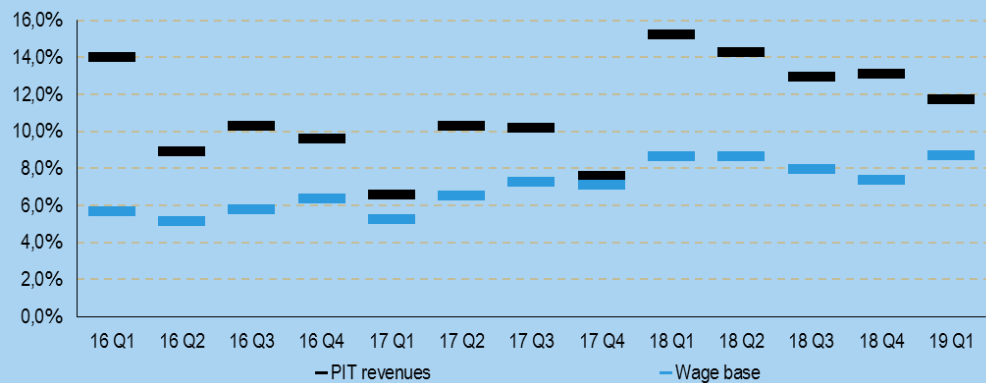
Compared to February's forecast, the overall estimate of excise duties has been revised downwards. As is the case for other tax revenues, the excise duties forecast is negatively influenced mainly by the updated macroeconomic forecast. Higher yields are expected from the excise duty on alcohol and electricity, where higher effectiveness compensates for the slowdown in economic growth.

Box 1: Fiscal drag raises PIT forecast

In the long run, the increase in PIT revenue is higher than the growth of the wage bill – this effect has been particularly pronounced in recent years (Figure A). One of the main factors of such an “overhang” is the fiscal drag. This refers to the situation, when the average taxation of individuals is increased without legislative changes due to the fact that average wages rise faster than the indexation of the tax and social security system.

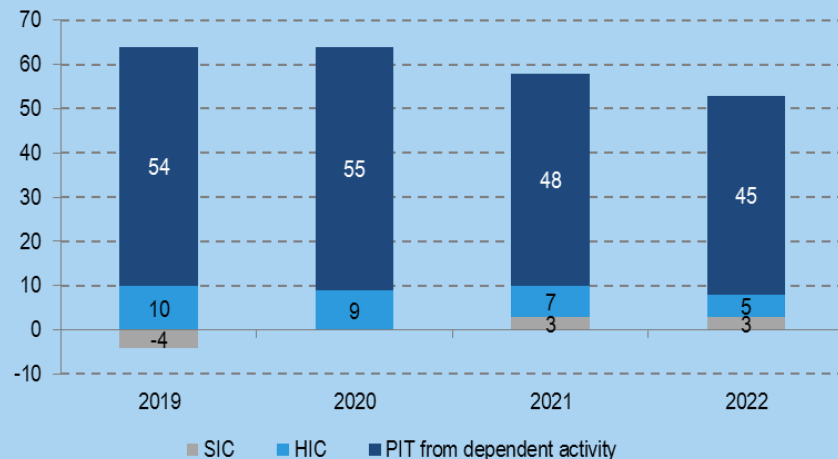
The impact of fiscal drag is included in the PIT forecast yield over the whole horizon. We forecast the revenues from the fiscal drag to the tune of EUR 50 mill. in the coming years and around EUR 45 mill. at the end of the forecast period (Figure B). However, the fiscal drag might be underestimated, if wages continue to grow faster than the original forecasts, as has been the case in the past. Looking at historical data, the impact of the fiscal drag was typically higher than expected.

Figure A: PIT yield overhang exceeds wage bill growth (% year-on-year growth)



source: IFP, UloziskoIFP

Figure B: Fiscal Drag Forecast (EUR mill.)



source: IFP, UloziskoIFP

The calculation is based on administrative data on employee earnings and the current Macroeconomic Committee forecast on average wages and minimum living wage. The forecast effect is the difference between the estimated tax payable in year t under the current legislation and the tax obligation in the hypothetical scenario where the parameters of the tax system in $t-1$ are indexed by wage increases. More about the topic of average taxation and fiscal drag in Slovakia in the upcoming IFP Policy Brief.

The Ministry of Finance SR, in accordance with the Constitutional Act of Budgetary Responsibility, updates and publishes forecasts of tax and social security contribution

revenues. These forecasts were discussed at a meeting of the [Tax Forecast Committee on June 20, 2019](#). The Bureau of Budgetary Responsibility Council (KRRZ), National Bank of Slovakia (NBS), Infostat, SLSP, Tatrabanka, ČSOB, and UniCreditBank considered the forecast realistic.

More about tax forecasts and background materials can be found on the [IFP website](#) in the Economic Forecasts ⇒ [Tax Forecasts](#) section.

Detailed data on the developments of individual tax revenues at the forecast horizon, as well as breaking the contributions of individual factors to update the forecast, or the underlying data for individual data in the comments are available at [UložiskoIFP](#).

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