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VAT collection: as good as it gets

Tax Forecast for 2016 - 2019

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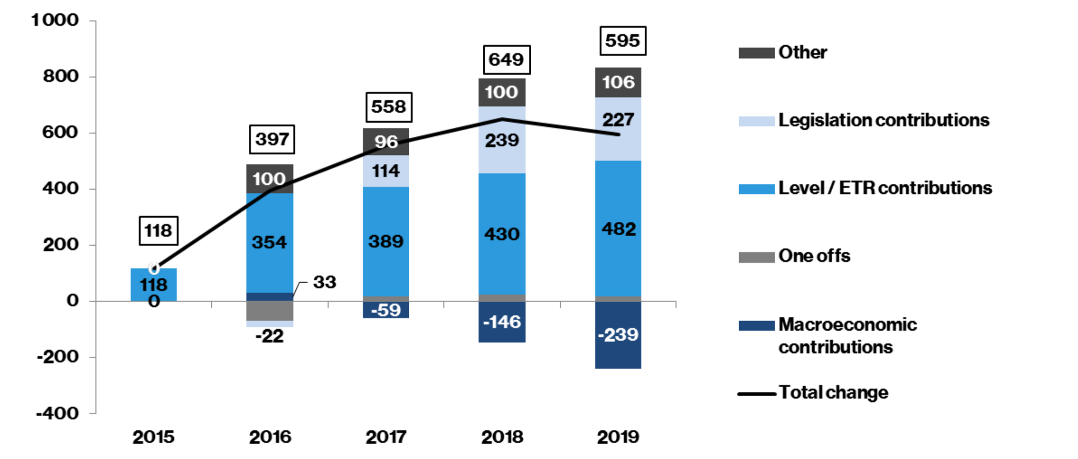
We nudge up tax revenues forecast[1] for 2016, by EUR 397 mil. (0.49 % GDP) compared with June figure. Higher than expected profitability of companies has a positive effect on CIT collection. Besides, we have observed significant improvement in VAT effective tax rate. Updated forecast increases tax revenues by EUR 558 mil. for 2017 (0.66 % GDP), EUR 649 mil. for 2018 (0.73 % GDP) and EUR 595 mil. for 2019 (0.63 % GDP) compared to June. New legislative measures further increase tax revenues, while macroeconomic outlook has a negative impact on forecast.

Higher tax revenues forecasted over the medium-term

Higher effectiveness of CIT, VAT and SSC collection accounts for more than three-fourths of increased tax revenues. **Accrued general government tax revenues for 2016 are expected to be higher by EUR 397 mil (0.49% GDP).** New legislative measures (described in more detail in Table 1) will positively affect tax revenues as of 2017. Updated macroeconomic forecast[2], mainly revision of real GDP growth and lower price level, drags down revenues in 2018 and 2019. Ongoing growth of SSC over wage base (defined as Other in Figure 1) will increase tax revenues by approximately EUR 100 mil. Improved CIT settlement is reflected in higher tax revenues for 2015.

Figure 1: Change of GG tax revenue forecast compared to June 2016[3] (EUR million)



Source: IFP, UloziskoIFP

Lower inflation dampens the revenues

The revised macroeconomic forecast decreases tax revenues in years 2017 - 2019 (Figure 2). Stronger domestic and external demand and outperforming labour market have positive impact on tax revenues in 2016. Higher profitability of companies in second quarter of 2016 (annual growth about 18.6 %) increases CIT revenues in 2016. Impact of

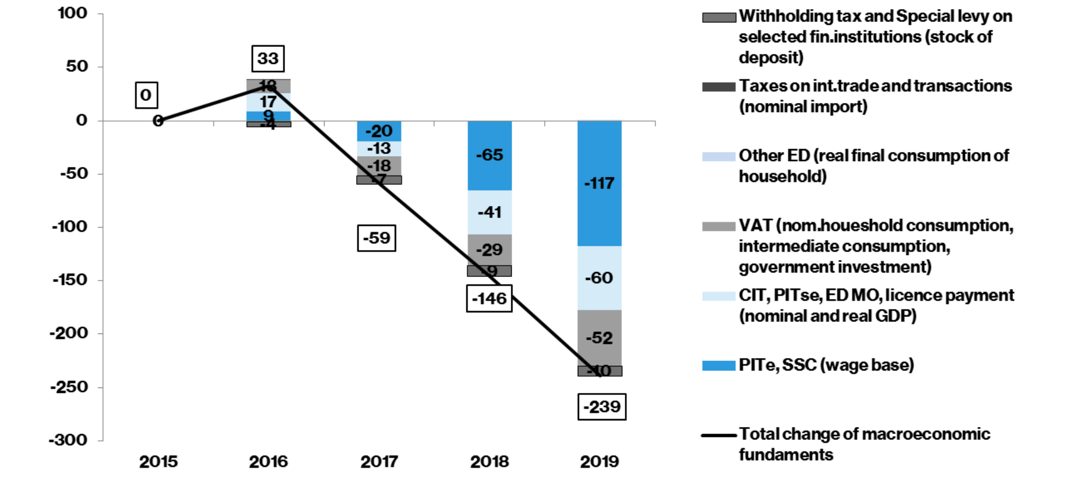
[1] Including social security contributions (SSC) – sum of social insurance contributions (SIC) and health insurance contributions (HIC). Taxes are categorized as follows: PIT = Personal income tax, CIT=corporate income tax,, VAT=Value added tax ,ED = excise duty, ED MO = excise duty on mineral oil

[2] The updated (September 2016) macroeconomic policy brief is published at IFP website

[3] The methodology for calculation of contributions can be found in forecast evaluation methodology manual (only in Slovak)

Brexit slightly decreases economic growth in following years. Ongoing weaker price level growth will result in slower growth of corresponding nominal macro (tax) basis. Slower growth of GDP will have a negative effect on excise duties and CIT as of 2017. Updated growth of nominal wage generates weaker revenues from SSC and PIT compared to previous forecast. Low expected interest rate drag down revenues from withholding tax.

Figure 2: Macroeconomic impact on tax revenues forecast (EUR mill.)



Source: IFP, *UloziskoIFP*

Table 1: Update of main macro indicators, September 2016 vs. June 2016

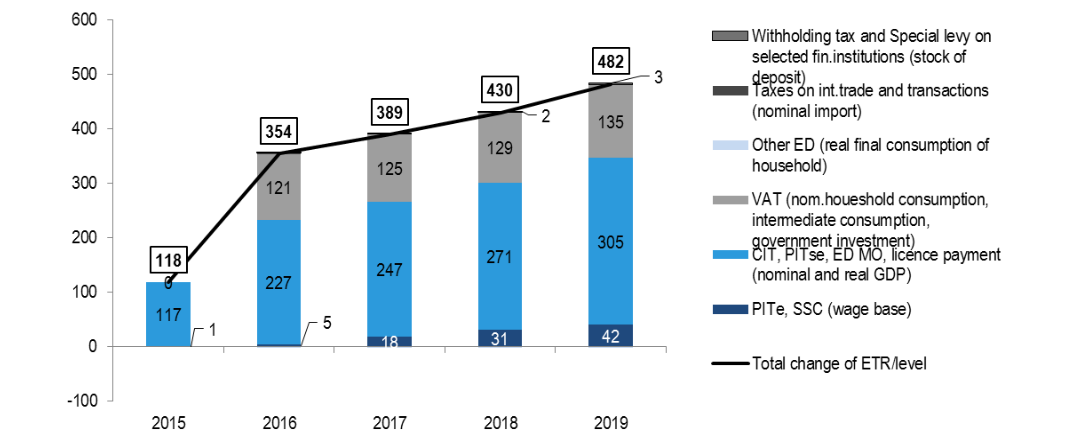
	growth in %					change compared to June (in pp)				
	2015	2016	2017	2018	2019	2015	2016	2017	2018	2019
GDP, real	3.6	3.6	3.5	3.9	4.4	0.0	0.4	-0.2	-0.2	-0.2
GDP, nominal	3.3	3.2	4.3	5.4	6.4	0.0	0.2	-0.6	-0.5	-0.3
Real household consumption	2.4	2.9	2.5	2.7	2.9	0.0	-0.1	0.1	0.0	0.1
Nominal household consumption	2.2	2.4	3.4	4.4	4.9	0.0	-0.3	-0.3	-0.1	-0.1
Adjusted base for VAT	5.0	0.2	2.7	3.8	4.6	0.0	0.2	-0.6	-0.2	-0.4
Wage base	5.1	5.0	5.0	5.4	5.7	0.0	0.1	-0.2	-0.3	-0.4
Stock of deposit	7.2	7.2	6.0	3.8	5.4	0.0	0.1	0.6	-1.4	-0.2

Source: IFP, *UloziskoIFP*

Improved tax collection increases expected tax revenues

Improved tax collection (especially CIT and VAT) **increases expected tax revenues by EUR 354 mill. (0.44 % GDP) in 2016.** We expect this trend to continue in 2017-2019 (Figure 3).[4]

Figure 3: Impact of ETR on the tax revenue forecast (EUR mill)



Source: IFP, *UloziskoIFP*

[4] The effectivness of tax collection is measured by effective tax rate („ETR")

New legislative changes

Update of previously approved legislative measures and new legislative measures have been included within current revision. Their impact on tax revenues is shown in Table 2.

Table 2: Major changes in legislation (ESA 2010, EUR mil)

Measure	ESA 2010			
	2016	2017	2018	2019
1. Ex-post revision of legislation included in the budget	**-22**	**-24**	**-25**	**-26**
Health Insurance Contribution allowance	-23	-25	-26	-27
Withholding tax (annual clearing of HIC allowance, pharmaceutic companies)	1	1	1	1
2. Revision of legislation included in June forecast	**0**	**-10**	**-3**	**-5**
Decrease of CIT rate from 22 % to 21 % (from 1.1.2017)	0	-9	-6	-7
Abolition of tax license[5] (from 1.1.2018)	0	0	4	4
Keeping of the Special levy on enterprises in regulated sector	0	0	-1	-2
3. New legislation – approved by government	**0**	**148**	**267**	**257**
Excise tax tobacco – rate increase (from 1.2.2017 and 1.2.2019)	0	30	32	68
Special Levy on selected financial institutions	0	50	52	55
VAT – interest on excess credit	0	-4	-4	-4
VAT – shifting of self-taxation	0	0	0	0
Special levy on enterprises in regulated sector (higher rate and others changes)	0	91	93	52
Dividend tax (7 % rate) and abolition of HIC from dividends	0	0	51	50
Resolution fund contribution relief	0	-5	-5	-5
Increase of lump-sum allowances for self-employment	0	-13	-21	-25
Keeping tax license (from 1.1.2018)[6]	0	0	67	65
TOTAL	**-22**	**114**	**239**	**227**
TOTAL (in % GDP)	**-0.03**	**0.14**	**0.27**	**0.24**

*Source IFP, **UloziskoIFP***

Higher than expected profitability boosts CIT

For CIT we are experiencing ongoing positive growth since February 2014. Relationship between macroeconomic fundaments and CIT elasticity is strongly pro-cyclical. During financial crisis (2008-2012) CIT effective tax rate declined and began to soar right afterwards financial crisis phased out. Accrued CIT revenues in 2015 were positively affected by better settlement (EUR 123 mill.). Ongoing growth of profits in second quarter of 2016 (almost 20 % annually) further increase CIT revenues in current year.

The highest VAT collection since financial crisis

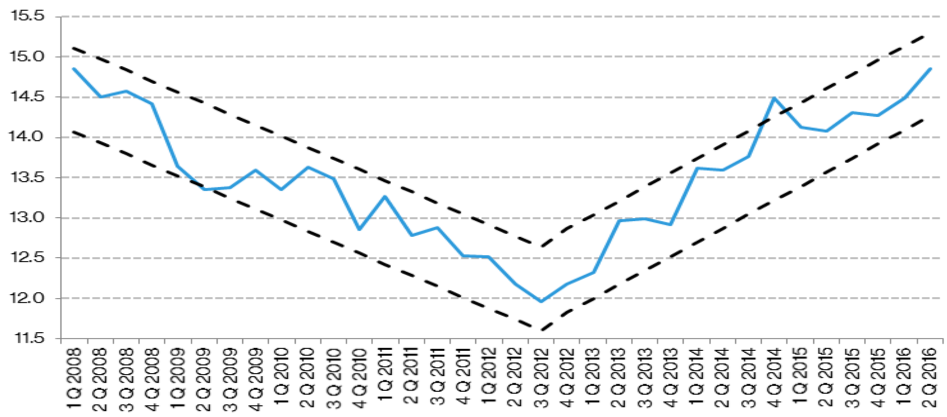
VAT effective tax rate in second quarter above our expectation from June. The VAT effective tax rate (ETR) reached a new peak (Figure 4). For years 2017 – 2019 we expect stable ETR development.[7] Higher tax collection is partially offset by revised household consumption.

[5] Tax license represents a minimum tax which is paid annually by companies if: 1)company's tax liability is lower than tax license, 2)company has a zero tax liability, 3) company suffers a tax loss.

[6] According to Tax Revenue Forecast Committee Statute the impact of abolition of tax license (approved in Stability Pact by government) was included in June forecast. But it was not included in amended Act on Income Tax in September and therefore not approved by government. We keep the tax license and adjust CIT revenue accordingly.

[7] Defined as an average ETR of the last two quarters.

Figure 4: VAT Effective Tax Rate (in %)



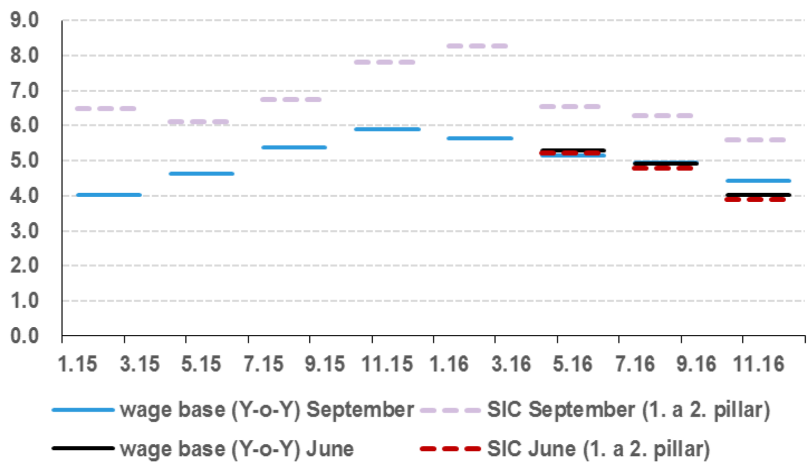
Source: IFP, UloziskoIFP

SSC growth above wage base growth

The growth of SSC above wage base has continued in second quarter of 2016. As a result we adjusted our expectation about SSC collection. For the rest of year we expect SSC to grow above wage base accordingly to their growth in second quarter (Figure 5)[8]. For 2017 – 2019 we expect equal growth of SSC and the wage base (unit elasticity)[9].

Based on the figures from Health Insurance Agencies we updated the impact of health insurance contribution (HIC) allowance. The overall effect of HIC allowance (which is linked with wages paid in 2015) on HIC revenues is expected to be EUR 209.1 mill., which is by EUR 22 mill higher than our initial expectation. From this amount, EUR 69.4 mill. was claimed from February 2015 to January 2016. This amount will decrease accrued HIC in 2015. The rest (EUR 139.7 mill.) is going to be claimed in annual tax clearing and decrease accrued HIC in 2016.

Figure 5: Annual growth of SIC[10] and wage base (in %)



Source: IFP, UloziskoIFP

[8] Higher growth SSC above wage base is not a result of improved collection. We suspect that wage base is seriously underestimated. In Figure 1 we consider this discrepancy as „Other“.

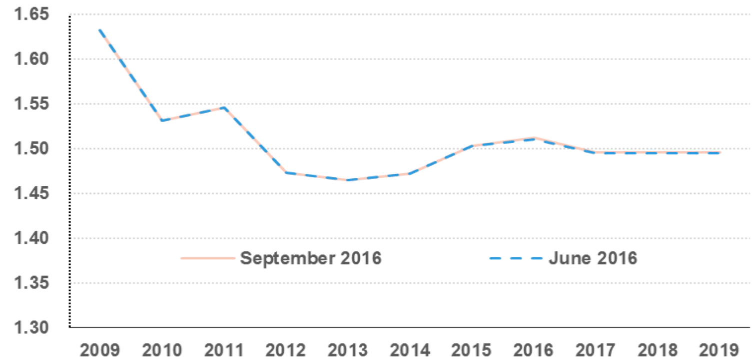
[9] In recent forecast SIC elasticity was 0.99 and HIC elasticity was 0.995. Elasticity lower than 1 is underestimated due to pro-cyclicality of SSC and expected macroeconomic development. Therefore we updated SSC elasticity in current forecast.

[10] SIC without revenues of privately-managed fully funded second pillar.

Stable ED MO collection

Excise duty from mineral oils is in line with our expectation from June (Figure 6). An update of macroeconomic fundaments for years 2017 - 2019 slightly adjusts forecasted MO revenues. Excise duty from tobacco is drag down by current legislative changes[11] and by repayment from unsold supplies.[12] The expected negative impact of the repayment is EUR 7 mill. Forecasted growth of other excise duties is in line with previous forecast.

Figure 6: Excise Duty from Mineral Oils, ETR development (in %)



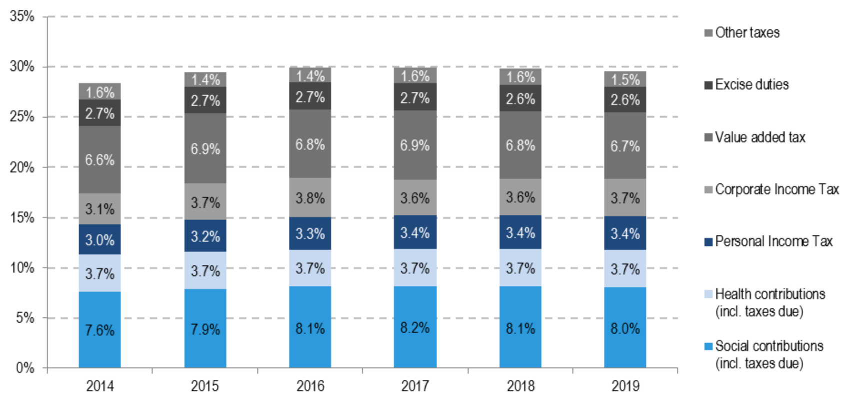
Source: IFP, UloziskoIFP

Taxes as % of GDP

Tax revenues account for almost one/third of GDP in 2016 (29.9 %). Tax-to-GDP ratio is higher, approximately about 1 % compared to previous forecast due to updated GDP growth and improved tax collection. The share of tax to GDP is expected to slightly decline from 2018.

VAT and CIT are expected to grow faster than other taxes due to improvement in their collection. Boosted profitability materializes in higher CIT revenues. Slow growth of nominal wage offsets improvements in labour market. For 2017 - 2019 we expect stable share of direct taxes to GDP. Indirect taxes are slightly declining due to weaker consumption relative to GDP and non-indexation of specific tax rates in case of some excise duties which automatically lead to deterioration of this revenues over corresponding macro fundaments.

Figure 7: Ratio of taxes to GDP



Source: IFP, UloziskoIFP

[11] Taxation based on weight of tobacco (instead of pieces), increased number of cigarettes in package from 19 to 20, increased tobacco weight in package from 20g to 30g, warning labels on package ("ugly pictures").

[12] Excise duty on tobacco is levied immediately after tobacco products are released into tax free circulation (more information about tax free circulation in Act No. 106/2004 Coll). After legislative change, register tobacco traders are obliged to withdraw inappropriate tobacco products. Excise duty, which was already reimbursed on those tobacco product (which represent unsold supplies), would be refunded.

The Ministry of Finance (MoF) prepares and publishes forecasts of tax and social contribution revenues in accordance with the constitutional Fiscal Responsibility Act. The forecast of tax and social contributions revenues was discussed at the meeting of **The Tax Revenue Forecast Committee on 22th September 2016. The forecast was evaluated as realistic by every member of the Committee (KRRZ, NBS, Infostat, ČSOB, SLSP, Tatrabanka a UniCreditBank)[13].**

More about tax forecast, including materials and relevant documents can be found on the IFP website in the section "Economic forecasts ⇨ tax forecast".

This documents presents the views of its authors and of the Institute for Financial Policy which do not necessarily reflects the official views of the Ministry of Finance of the Slovak republic. The analyses prepared by Institute for Financial Policy (IFP) are published to stimulate and enhance professional and general discussion on various economic topics. Therefore, any quotations of this text should refer to the IFP (and not the MFSR) as to the authors of these views.

Detailed information about tax forecast, decomposition of contributions and source data to each figure and table in this policy brief can be found on UloziskoIFP

[13] NBS=National Bank of Slovakia, KRRZ=Council for Budget Responsibility and Infostat are public organizations. SlSP, Tatrabanka, UnicreditBank and ČSOB are private banks.