inštitút finančnej politiky

Policy brief 2018/2 Ministerstvo financií SR / www.finance.gov.sk/ifp

14. February 2018

The growing economy continues to pull tax revenues upwards

Tax revenue forecast for 2017-2021 (February 2018)

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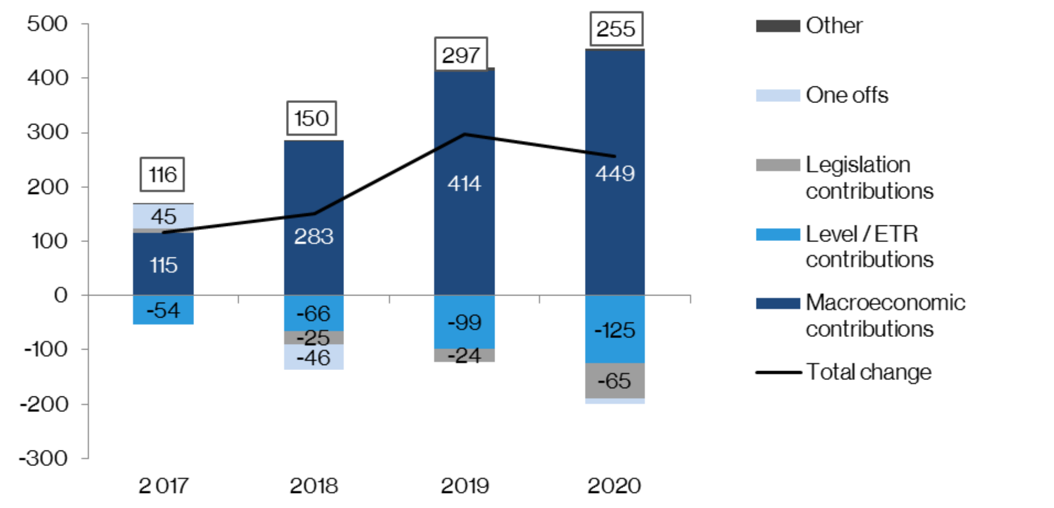
We are revising the forecast of tax and contribution revenues over the entire forecast horizon upwards by EUR 150 to 255 million (0.2 to 0.3 % of GDP) compared to the September projection. Growth of the wage base and household consumption will positively affect General Government revenues. Revenues will increase mainly for the Social Insurance Agency and public health insurance, while the state budget will benefit from the stronger labor market only marginally. Compared to the General Government budget for 2018 to 2020 the revision increased revenues by EUR 134 to 223 million.

Tax revenues grow over the whole forecast horizon

In the years 2018 to 2020, we increase our tax and contribution revenue estimate[1] by EUR 150 up to 297 million (Figure 1). A higher estimate is based on the current tax and contribution collection as well as the new macroeconomic forecast. The higher collection is the result of mainly the positive situation on the labor market and the growing consumption of households. The update of the legislation already takes into account the gradual exemption of the 13th and 14th salaries from taxes and contributions and has a negative overall impact on revenues. Improvements in the efficiency of VAT collection continue, and on selected taxes the macroeconomic base growth outpaces revenues with an impact on the effective tax rate (ETR).

Figure 1: Change of GG tax revenue forecast compared to September 2017 (EUR million)



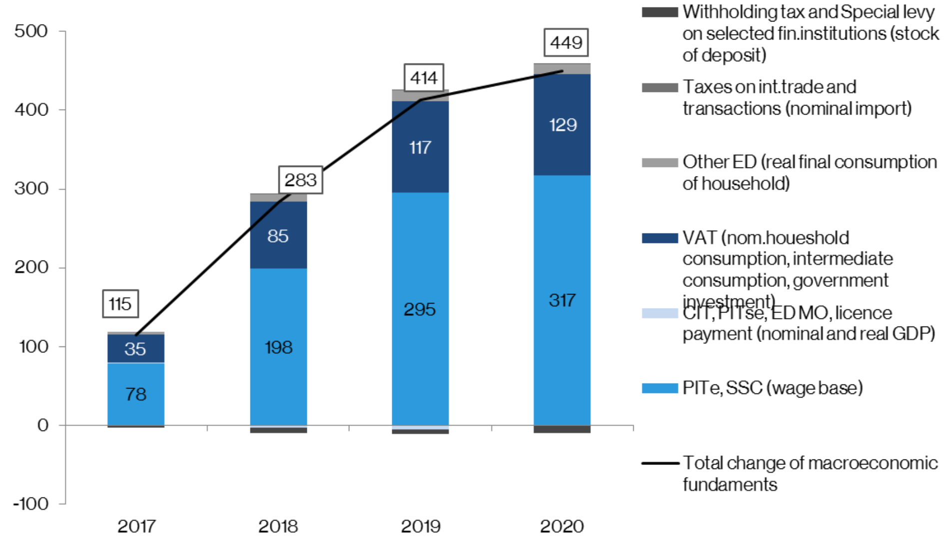
source: IFP, *UloziskoIFP*

The wage base and household consumption are pushing tax revenue upwards

The estimated stronger economic development increases revenues over the entire forecast horizon (see Figure 2). Improvement in revenues is mainly due to a higher wage base, as both wages and employment rates grow faster. The wage forecast already includes increase in surcharges for work at night, during the weekend and during holidays. VAT revenues are increasing mainly due to stronger growth of household consumption.

[1] Furthermore, tax revenue only.

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



*source: IFP, **UloziskoIFP***

Table 1: Update of main macro indicators, February 2018 vs. September 2017

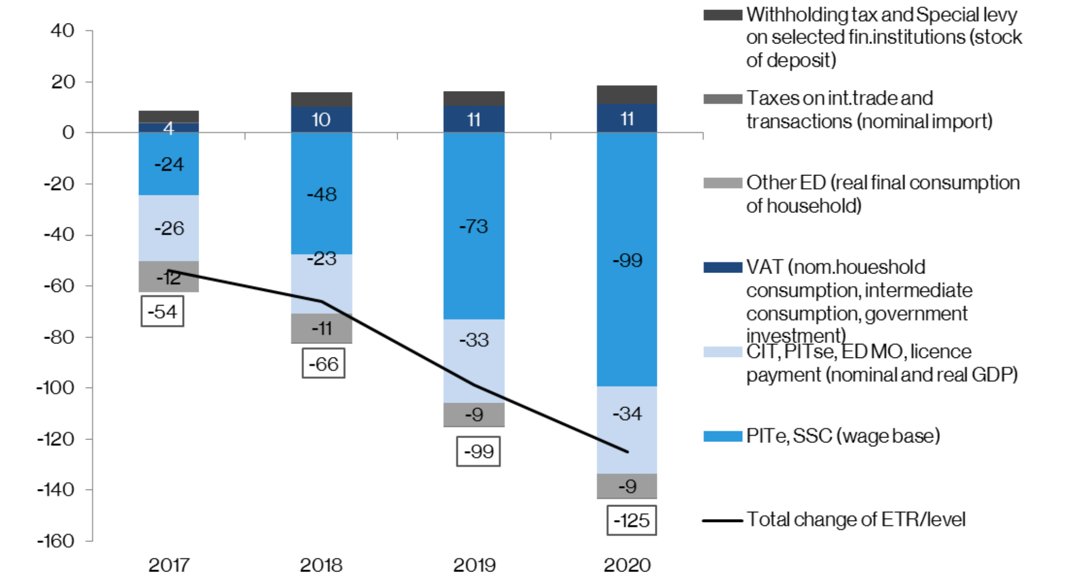
	growth in %					change compared to September 2017 (in pp)			
	2017	2018	2019	2020	2021	2017	2018	2019	2020
GDP, real	3.4	4.2	4.5	3.9	3.4	0.1	0.0	0.1	0.0
GDP, nominal	4.8	6.1	6.6	6.2	5.8	0.3	0.3	0.1	0.1
Final household consumption, real	3.7	3.5	3.2	2.8	2.5	0.4	0.6	0.3	-0.1
Final household consumption, nominal	5.2	5.7	5.3	5.1	4.9	0.4	1.0	0.5	0.0
Adjusted base for VAT	4.7	5.0	5.1	4.9	4.8	0.6	0.8	0.4	0.1
Wage base	6.5	7.0	6.5	6.3	5.9	0.6	0.9	0.6	0.0
Stock of deposit	5.3	6.5	6.3	6.4	6.1	0.0	0.6	0.0	0.3

*source: IFP, **UloziskoIFP***

Latest ETR update based on cash collection in 2017

Compared to the previous forecast, we are reviewing the ETR estimate due to improved VAT collection. The growth of the wage base in 2017 outweighs labor market revenues, which negatively affects the ETR. The revision of the ETR impact is also due to a slightly more negative final settlement of CIT in 2016 and a slower-than-expected increase in revenues from major excise duties.

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



source: IFP, UloziskoIFP

Legislation includes impact of the 13th salary tax exemption

Legislation update has an overall negative impact on revenues in all years of the forecast (Table 2). In line with the Committee's statute, the forecast takes into account the legislation in an advanced stage of adoption, particularly the new exemption of the 13th and 14th salaries. This measure has a negative impact on revenues, which is increasing with gradual phasing of exemption from health insurance contributions, the PIT, and from 2019 onwards also from social insurance contributions.

Table 2: Legislation incorporated in the forecast (in millions of Euro)

	ESA 2010			
	2018	**2019**	**2020**	**2021**
1. New legislation	-28	-25	-58	-122
Introduction of 13th and 14th salary (1.5.2018)	-37	-82	-82	-135
Abolition of HIC allowance for employers	22	85	75	66
Introduction of SIC allowance for pensioners (1.7.2018)	-9	-19	-19	-19
Other	-4	-9	-32	-34
2. Existing legislation update	3	1	-7	
HIC allowance update	25	17	12	
Withholding tax: tax from dividends	-12	-14	-16	
Other	-9	-2	-3	
TOTAL LEGISLATION IMPACT	**-25**	**-24**	**-65**	**-122**
TOTAL LEGISLATION IMPACT (% of GDP)	**-0,03**	**-0,02**	**-0,06**	**-0,11**

source: IFP, UloziskoIFP

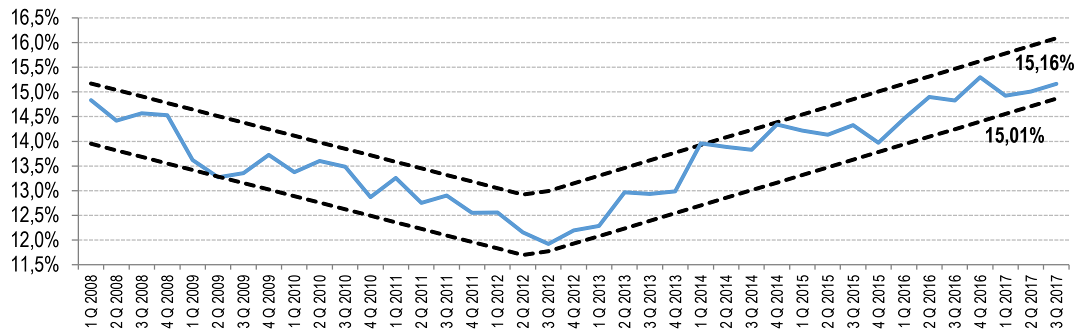
Legislative changes have a negative impact on CIT

We lower projected corporate tax revenue compared to the September forecast. We adjust the final yield data for 2016 by EUR 13 million downwards due to a lower tax settlement with the impact on the following years. We continue to assume a stable level of corporate profitability for 2017. From 2018, the accrual yields are negatively affected by lower growth of the macroeconomic base, which includes the impact of higher wage costs for night, weekend and holiday work. The updated tax legislation adjusts the estimate of the revenue loss due to the abolition of the minimum CIT tax[2] from 2018 and a new exemption on income from sale of business shares.

ETR of VAT has increased

The efficiency of VAT collection continues to grow. The effective VAT rate has risen from 15.01 % to 15.16 % in the third quarter of 2017. The tax yield in 2017 is revised upwards in line with a stronger growth in household consumption, which will contribute to higher collection also in the coming years. Increased audit activity of the Financial Administration[3] increased revenues in late 2017, which is assumed to be a positive one-off by the projection. The forecast for 2018-2021 assumes that the effective VAT rate will remain at the level of the 2017 estimate, which corresponds to the last two available quarters (Figure 4).[4]

Figure 4: VAT Effective Tax Rate (%)



source: IFP, UloziskoIFP

Better labour market increases contribution revenues

Increasing wages bring additional revenues in social insurance contributions and health insurance contributions. Social and health contributions grew faster in the last quarter of 2017 than would indicate the wage base development.[5] The overhang of revenues compared to the first half year has decreased somewhat. In contrast to the estimated increase in social insurance contributions, we leave health insurance contributions revenues almost unchanged for 2017. In the years 2018 to 2020, we expect growth of contributions in line with the wage base.[6] The additional revenues from the abolition of the HIC allowance for employers is partially offsets the shortfall due to new exemption of the 13th and 14th salary.

The end of 2017 influences excise duties revenues

Compared to the September forecast, we reduce the overall yield estimate of excise duties especially for mineral oils (MO). The weaker than projected collection on ED MO and tobacco at the end of 2017 has transformed into a decrease of effective tax rate. In the following years, we assume only a part of ED MO shortfall as real consumption is projected to rise. The more positive development of the macroeconomic base partly offsets the worse than projected growth of excise duties in the coming years.

Forecast is balanced

Risks of the forecast are balanced. New legislation (annual settlement of social insurance contributions, abolition of exemptions from excise duties, new insurance premium tax)

[2] For more information, IFP commentary Licencia spravodlivosti?

[3] Tax Authority in Slovakia

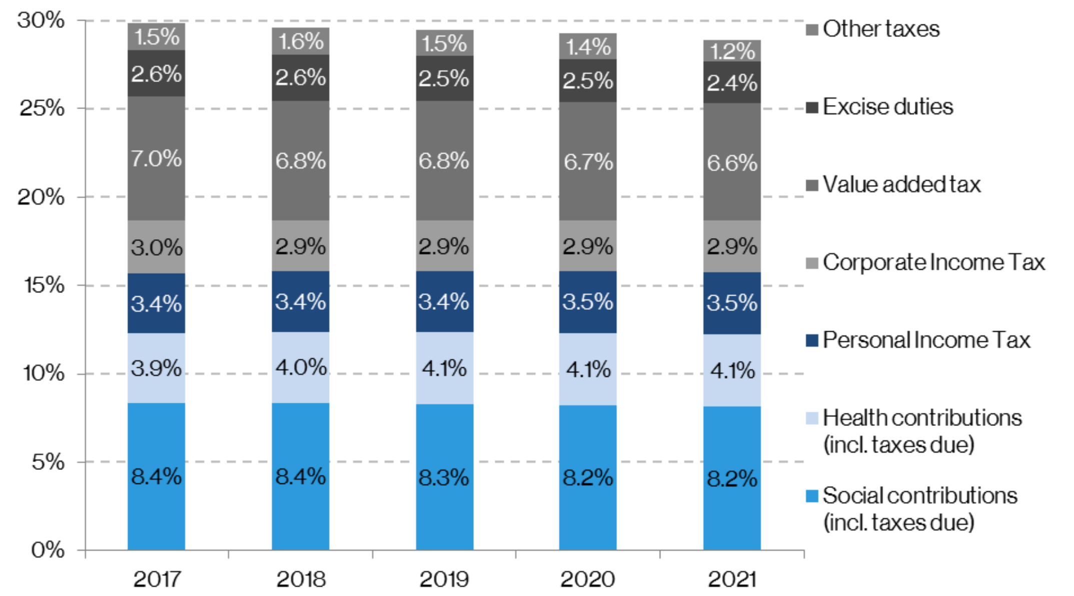
[4] In the case of increasing VAT success, we anticipate its development at the forecast horizon, in line with the ETR average for the last two quarters, on the contrary in case of decrease at the ETR level of the last quarter.

[5] The wage base represents the macroeconomic basis for the contributions forecast and PIT and is calculated as the product of the number of registered employees and the volume of wages. More in the IFP manual http://www.finance.gov.sk/Default.aspx?CatID=8958.

[6] More in Box 1 of the commentary http://www.finance.gov.sk/Default.aspx?CatID=10738.

poses a positive risk for revenues. The new measures of Financial Administration aimed at combating tax evasion can further increase VAT collection. The corporate income tax represents a negative risk.

Figure 5: Ratio of taxes to GDP



source: IFP, UloziskoIFP

The Ministry of Finance of the Slovak Republic, in accordance with the Constitutional Act on Budget Responsibility, has updated and published the forecasts of tax and levy revenues. These forecasts were discussed at the meeting of the **Tax Forecast Committee (VpDP) on February 8, 2018.** **The Bureau of Budgetary Responsibility Council (KRRZ), NBS, Infostat, SISP, Tatrabanka, CSOB a UniCreditBank have marked the forecast as realistic.**

More on tax forecasts as well as background materials can be found on IFP web page under Economic Forecasts ⇨ tax forecasts.

Detailed data on the development of individual tax revenues at the forecast horizon, as well as the breakdown of the contributions of individual factors to the update of the forecast, or the underlying data for the individual data in the commentary are available at UloziskuIFP.

The paper presents the views of the author and the Financial Policy Institute, which may not necessarily reflect the official views of the Ministry of Finance of the Slovak Republic. The purpose of commentaries publishing by the Financial Policy Institute (IFP) is to encourage and improve expert and public debate on current economic issues. Text quotations should therefore refer to the IFP (and not the MF SR) as the author of these opinions.