inštitút finančnej politiky

Policy brief 2018/6

Ministry of Finance of the Slovak Republic / www.finance.gov.sk/ifp

October 5, 2018

Wage growth supports taxes

Forecast of tax and social security revenues for years 2018 to 2021 (September 2018)

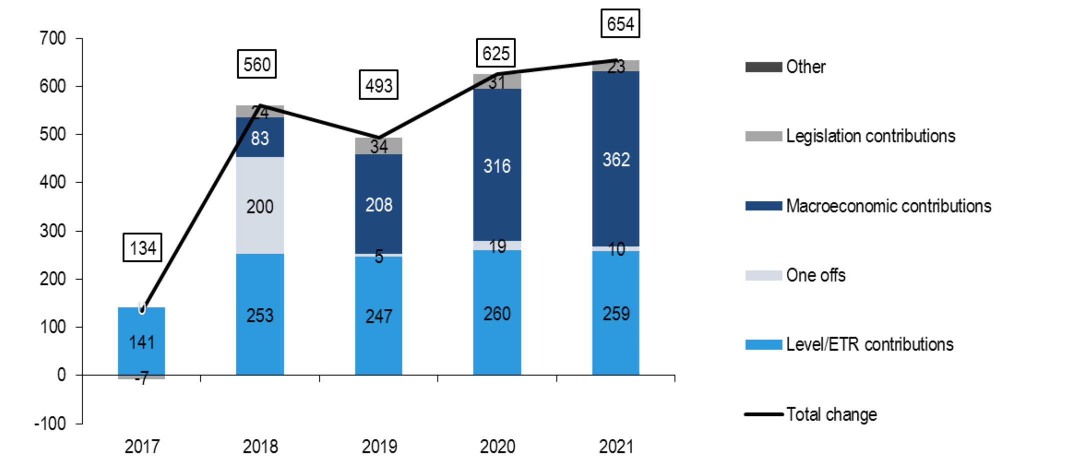
Peter Harvan, Michal Havlát

The current forecast increases tax revenues by 560 to 654 million euros between 2018 and 2021 (0.6% of GDP). While the increasing collection efficiency fosters tax growth in particular in 2018, macroeconomic development via stronger wage growth contributes significantly from 2019 onwards. Better revenue aids mainly municipalities and the Social Insurance Company. On the basis of a better corporate tax settlement, we also revise revenue upwards for the year 2017.

Taxes add more than half a billion in 2018

The September forecast increases the estimated tax and social security contributions by 560 to 654 million euros between 2018 and 2021. (Figure 1)[1]. Increase in efficiency of tax collection in 2018 has a significant impact. An increase in the estimated revenues from 2019 can be attributed to positive wage developments.

Figure 1: Change of GG tax revenues forecast compared to June 2018 (EUR million)



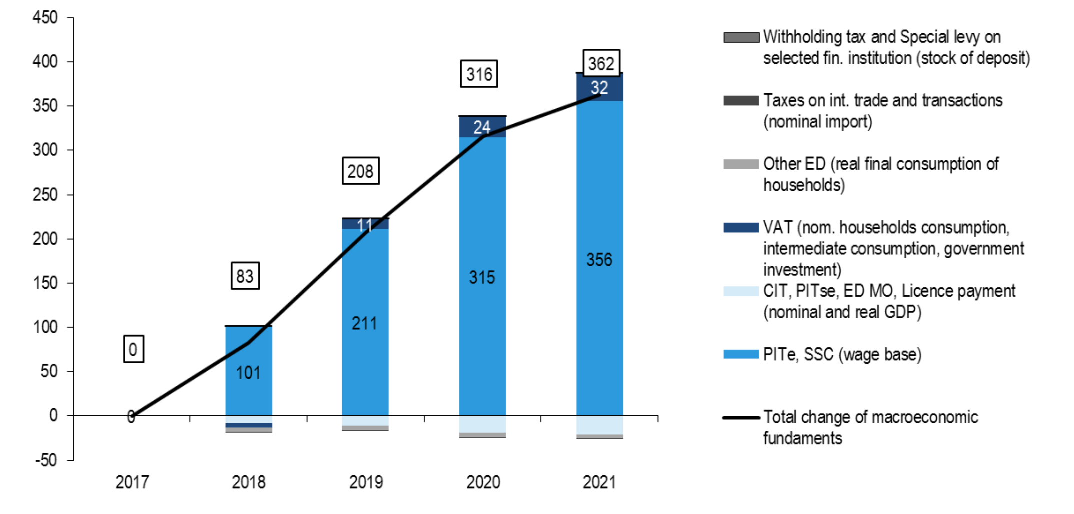
Source: IFP, *UloziskoIFP*

Wage bill breaks records

Positive macroeconomic developments increase tax revenues over the whole forecast horizon, with a more pronounced impact from 2019 onwards (Figure 2). The growth of the wage bill from 2018 is revised by 0.7 p.p. as compared to the June forecast. Growing wages and increasing employment bolsters revenue from personal income tax (PIT). From 2019, the adjusted macroeconomic base for VAT also picks up pace and boosts VAT revenues. The revision of macro bases will marginally affect revenues of excise duties and corporate taxes.

[1] The tax forecast takes into account data until August and the September macroeconomic forecast.

Figure 2: Tax revenues update based on current macroeconomic forecast (EUR million)

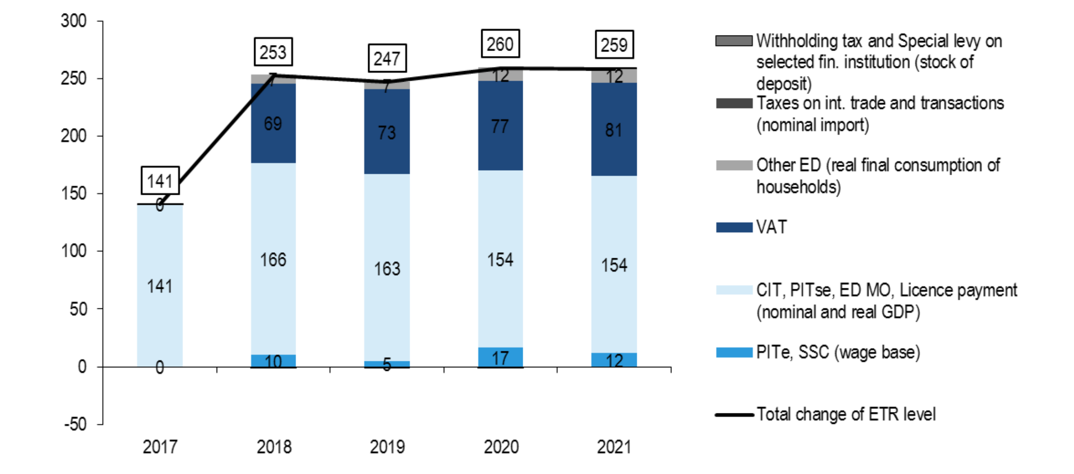


Source: IFP, *UloziskoIFP*

Efficiency of CIT and VAT collection rises

Better tax collection efficiency will continue to boost revenues. The contribution of improved tax collection (effective tax rates or ETR) is positive over the projected period (see Figure 3). Higher corporate ETR stemming from a better tax settlement for 2017 will be carried forward into the next years. In the first half of 2018, ETR of VAT rose above the June estimate. In 2018, revenues for PIT and social contributions are outpacing the growth of the wage bill (more in Box 1). The growth in health insurance contributions is slightly below and converging to the wage bill dynamics, leading to a downward revision of the effective tax rate.

Figure 3: Tax revenues update based on changes in ETR (EUR million)



Source: IFP, *UloziskoIFP*

Positive impact of legislation

New legislation and the update of approved measures slightly increase revenues (Table 1). We take into account preliminary data on the tax exemptions of the 13th salary. Approved changes to the waste disposal fee will increase public revenues, but this income is being transferred from municipalities to the Environmental Fund. The revision of the excise duty on alcohol is driven by new legislation allowing home distilling of spirits for own consumption.

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

Measures	2017	2018	2019	2020	2021
1. New legislation (overall impact of the measure)		**0**	**6**	**18**	**24**
Fee for waste disposal		0	10	21	28
Home distilling		0	-4	-4	-4
2. Revised impact of the previous legislation (difference compared to the quantification of the June Tax Committee)	**-7**	**24**	**28**	**14**	**-1**
Reduction of CIT rate from 22 % to 21 % (since 2017)	-6	-7	-6	-5	-5
Doubling the Special Levy rate in reg. industries (since 2017)	-1	-1	-6	-5	-9
Introducing 13th and 14th salary (since May 2018)	0	33	39	24	13
3=1+2. Total Impact of the legislation	**-7**	**24**	**34**	**31**	**23**

Source: IFP, ***UloziskoIFP***

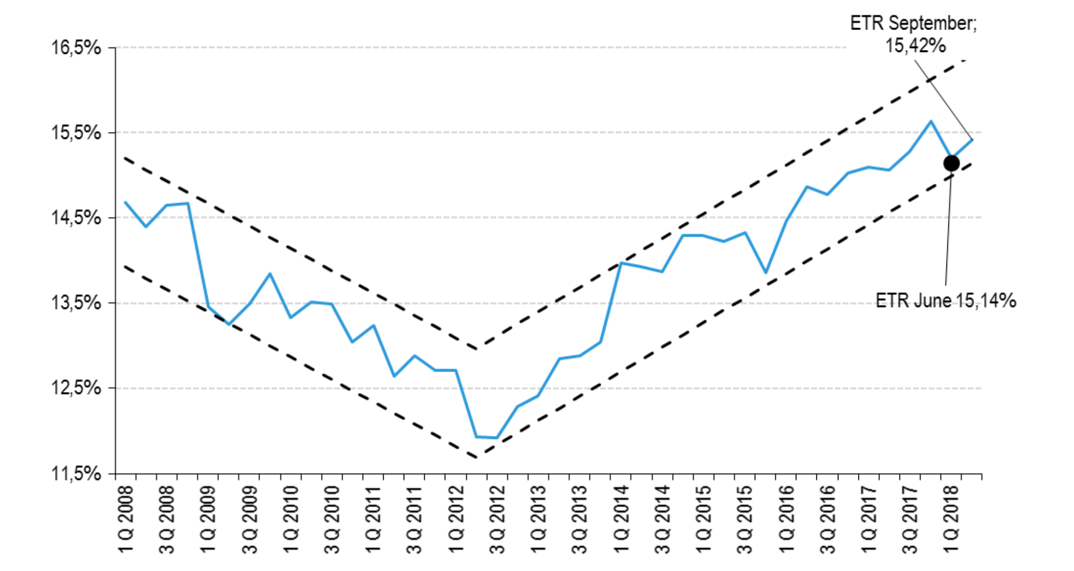
Better settlement of CIT for 2017

Based on a better corporate tax settlement for 2017, we increase the accrual revenue for 2017 and 2018. Based on tax return settlements for 99% of companies, all the positive expectations from the June forecast have been met. The corporate profitability estimate for 2018 is increasing as compared to the June forecast. However, effects of better tax collection in 2017 and 2018 are dampened over the forecast horizon by slower projected growth in profitability of companies.

The effectiveness of VAT collection has increased

On the basis of VAT revenues for the first half of the year we increase the effective tax rate (Figure 4). In the first half of the year, ETR (improved tax collection) for VAT exceeded the expectations of the June forecast. We therefore increase ETR over the forecast horizon to 15.31%, which is the average of two quarters. Revised consumption of households is also positively contributing from 2019 onwards, albeit to a lesser extent.

Figure 4: Effective tax rate VAT (%)



Source: IFP, ***UloziskoIFP***

Excise duties are dragged down mineral oils

Estimates of the excise duty revenues are adjusted downwards. This is in particular due to lower revenues from the mineral oil tax, which is lagging behind the development of the economy. A better collection of excise duty on alcohol exceeds the June forecast. Other excise duties are evolving in line with the June forecast and the economy situation. We slightly raise the expected excise duty revenues on tobacco products from 2020 onwards.

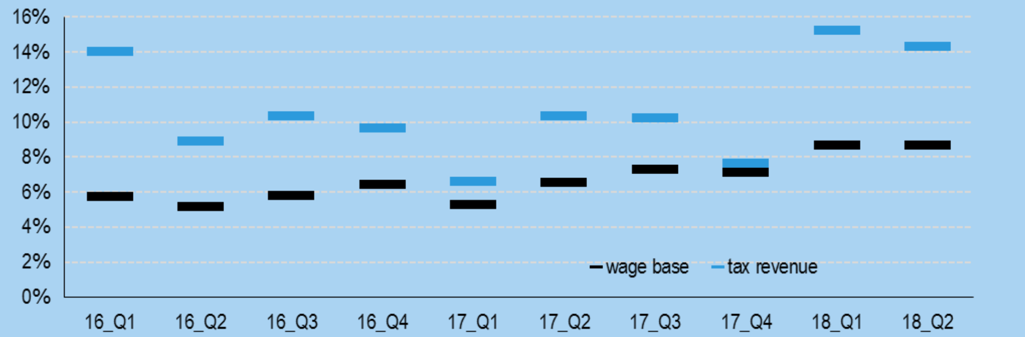
PIT revenues detached from the wage bill

Positive development on the labor market increases revenues. PIT revenues from dependent activity and social security contributions outpaced the strong wage bill growth in the first half of 2018. The rise in the collection of PIT on top of the wage bill dynamics is mainly due to the progressive setup of this tax (more in Box 1). In 2018, the Social Insurance Company recorded one-off revenues as part of state debt relief for hospitals. These revenues stem from the state paying old arrears of hospitals. The faster projected growth in the living minimum, and thus the non-taxable part of the tax base from 2019, reduces the estimated PIT collection. From 2019 the growth in social security contributions is expected to be in line with the wage bill.[2]

Box 1: Progressivity of PIT in practice

PIT revenues over the first half 2018 outpace growth in the wage bill as well as earlier June estimates. The faster growth of tax revenues is in line with the economic analysis of elasticities for Slovakia[3]. For the first half of 2018, however, the overhang of revenues to the wage bill exceed the development of the past three years (Figure A). At the same time, the excess over the wage base is significantly higher than in the case of social security contributions. The whole collection on PIT represents revenues of municipalities and higher territorial units.

Figure A: Year-on-year growth of wage bill and revenues from PIT (% of growth)



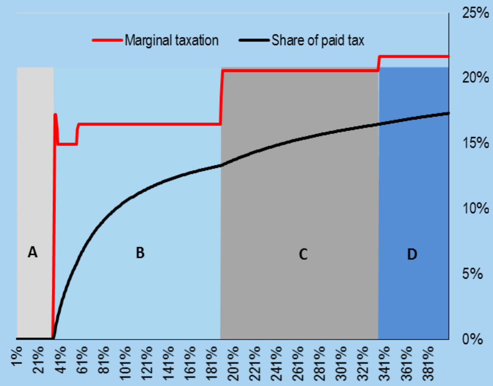
Source: Tax return type B, UloziskoIFP

Tax system of the SR assumes a higher tax liability for those with higher earnings. Lower wages have a higher benefit from the non-taxable part of the tax base (NTPTB). With the rising income, however, this effect fades and the tax liability increases. At the same time, wages above a certain level are subject to the higher tax bracket. The amount of tax paid from the last earned euro (marginal taxes) increases with the wage (Figure B - red line). The income tax of employees with minimum wage accounts for only 4 % of his/her gross income, while a better earning employee pays 17 % of his/her gross wage (Figure B - black line).

[2] For more information see IFP commentary at http://www.finance.gov.sk/Default.aspx?CatID=10738.

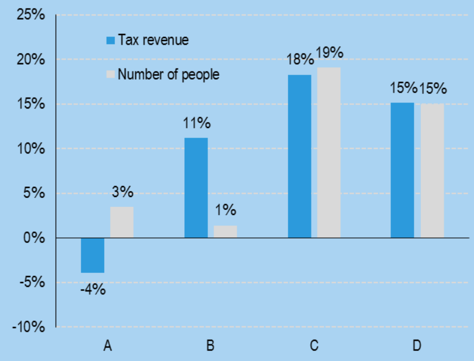
[3] The elasticity of PIT is above 1 for Slovakia. More about elasticity of taxes at http://www.finance.gov.sk/Default.aspx?CatID=11570.

Figure B: Marginal taxation in various bands (% of the average wage)



Source: IFP, *UloziskoIFP*

Figure C: Y-o-Y growth of tax liability and taxpayers (1-2Q, 2018)



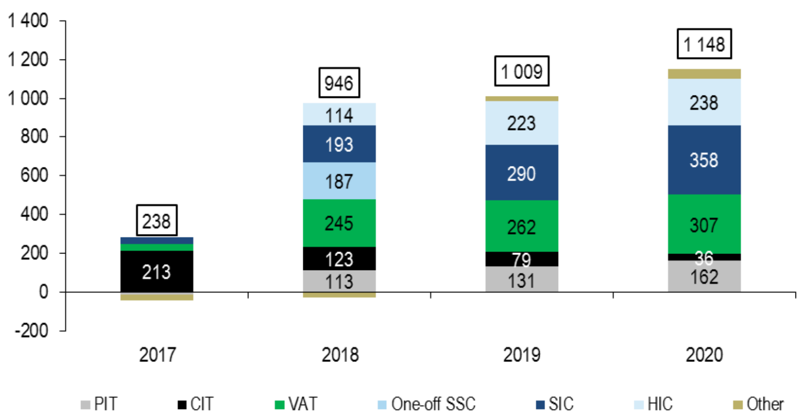
Source: IFP based on SIC data, *UloziskoIFP*

Note: The taxpayers have been divided into 4 cohorts: A - the tax base is lower than the non-taxable part of tax base NTPTB, B - they are receiving a full NTPTB, C - NTPTB is beginning to decrease due to high income, D - the second tax bracket is applied at 25%.

According to IFP estimates based on data of the Social Insurance Company for the first half of 2018, the tax liability has increased mainly for employees with a higher effective rate. Rapid wage growth led to a shift into bands where their tax liability increases faster (Figure C - band C and D). The increase in the number of entities in the higher bands was linked with the year-on-year increase in the estimated PIT revenue by 18 % for employees where the non-taxable part of tax base is beginning to decrease and by 15 % for second-rate payers.

The current tax revenue forecast revises tax revenues for the projection horizon 2018 – 2020 by 946 to 1148 mill. eur as compared to the approved general government (GG) budget (Figure 5). The main differences include higher revenues from social security contributions linked to the better performance of the labour market and higher VAT due upbeat consumption of households. Social insurance contributions are also affected by the above mentioned one-off increase.

Figure 5: Change of tax revenues forecast in comparison to GG revenues (EUR million)



Source: IFP, *UloziskoIFP*

Note: PIT = Personal Income Tax, CIT = Corporate Income Tax, VAT = Value Added Tax, SSC = Social Security Contributions, SIC = Social Insurance Contributions, HIC = Healthcare Insurance Contributions

The Ministry of Finance of the Slovak Republic, in accordance with the Constitutional Act on Budget Responsibility, updates and publishes the forecasts of tax and social security contribution revenues. These forecasts were discussed at the meeting of **Tax Forecast Committee (VpDP), September 20, 2018. The Bureau of Budgetary Responsibility Council (KRRZ), NBS, Tatrabanka, Infostat, SISP, ČSOB a UniCreditBank have assessed the forecast as realistic.**

More on tax forecasts as well as underlying materials can be found at IFP web page in the Economic Forecasts section ⇨ tax forecasts.
Detailed data on the development of individual tax revenues on 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 UloziskoIFP