DELANOTE
DEDICATED TO TAX LAW

How to develop a fair tax system?
The Belgian case

UNIVERSITEIT GENT

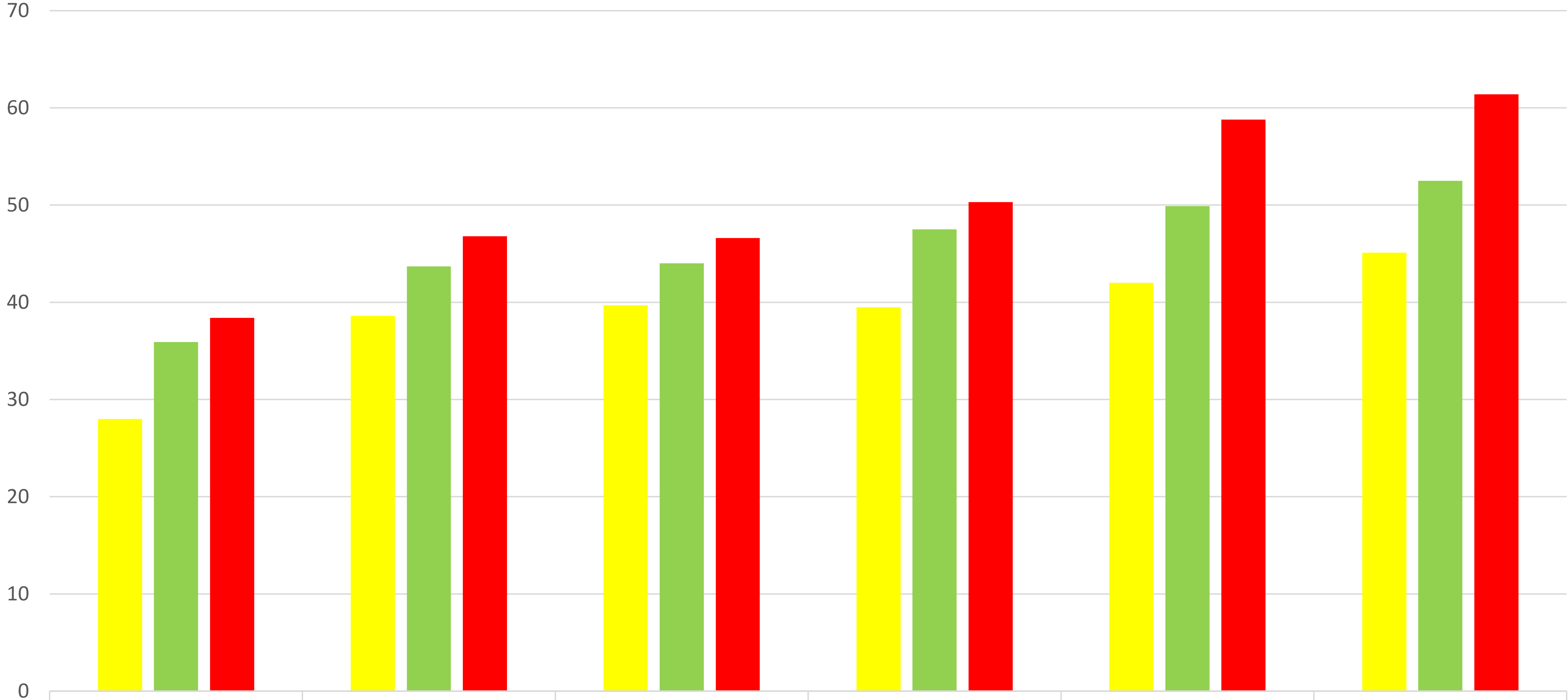
How big is your government ?

Tax system driven by the need for public funds

➔ **EQUITABLE USE OF PUBLIC FUNDS**

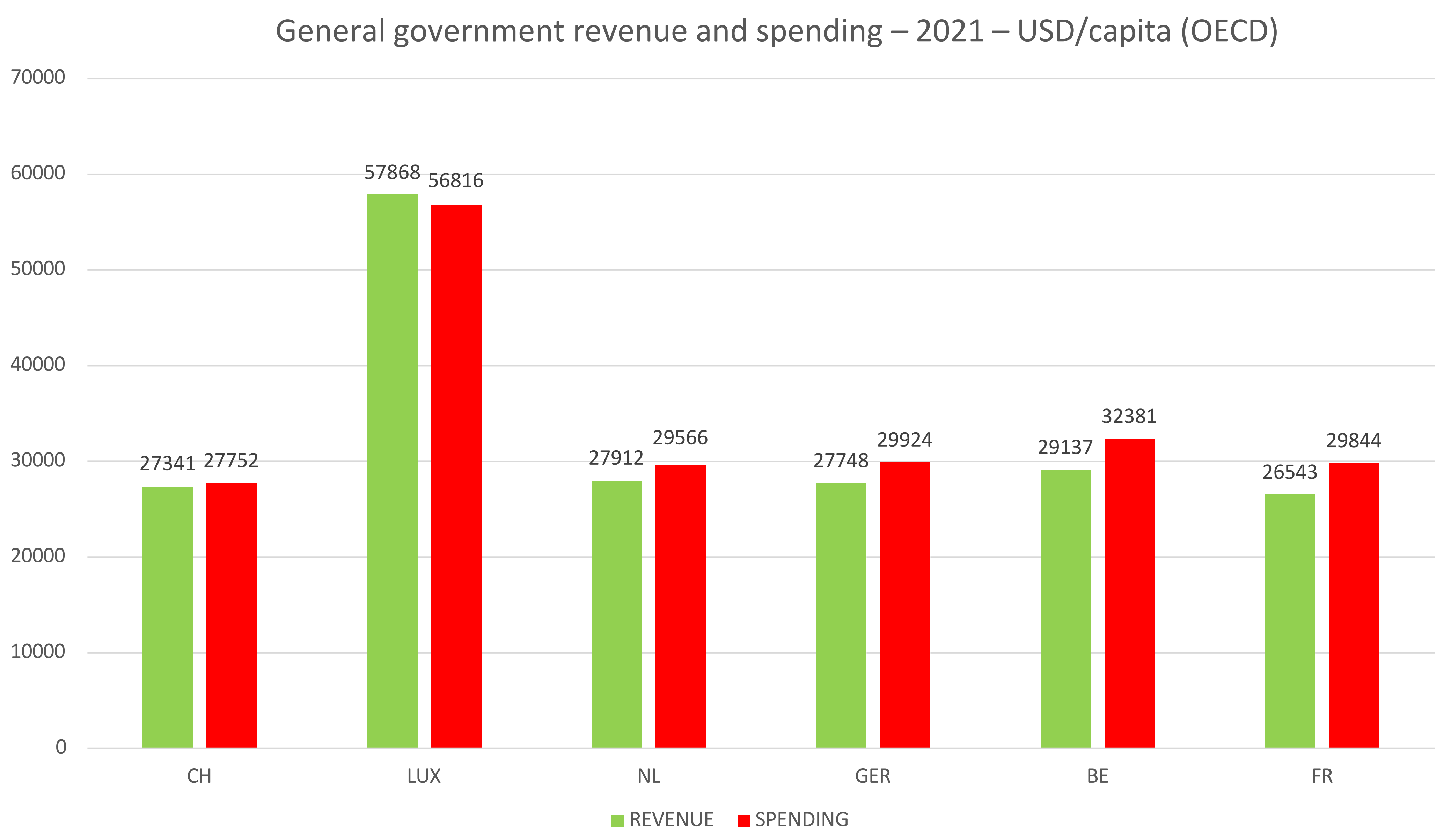
- Amount of resources desired by a government and how these resources are spent
- Largely political debate, though direct link with tax wedge, implicit tax rate,…

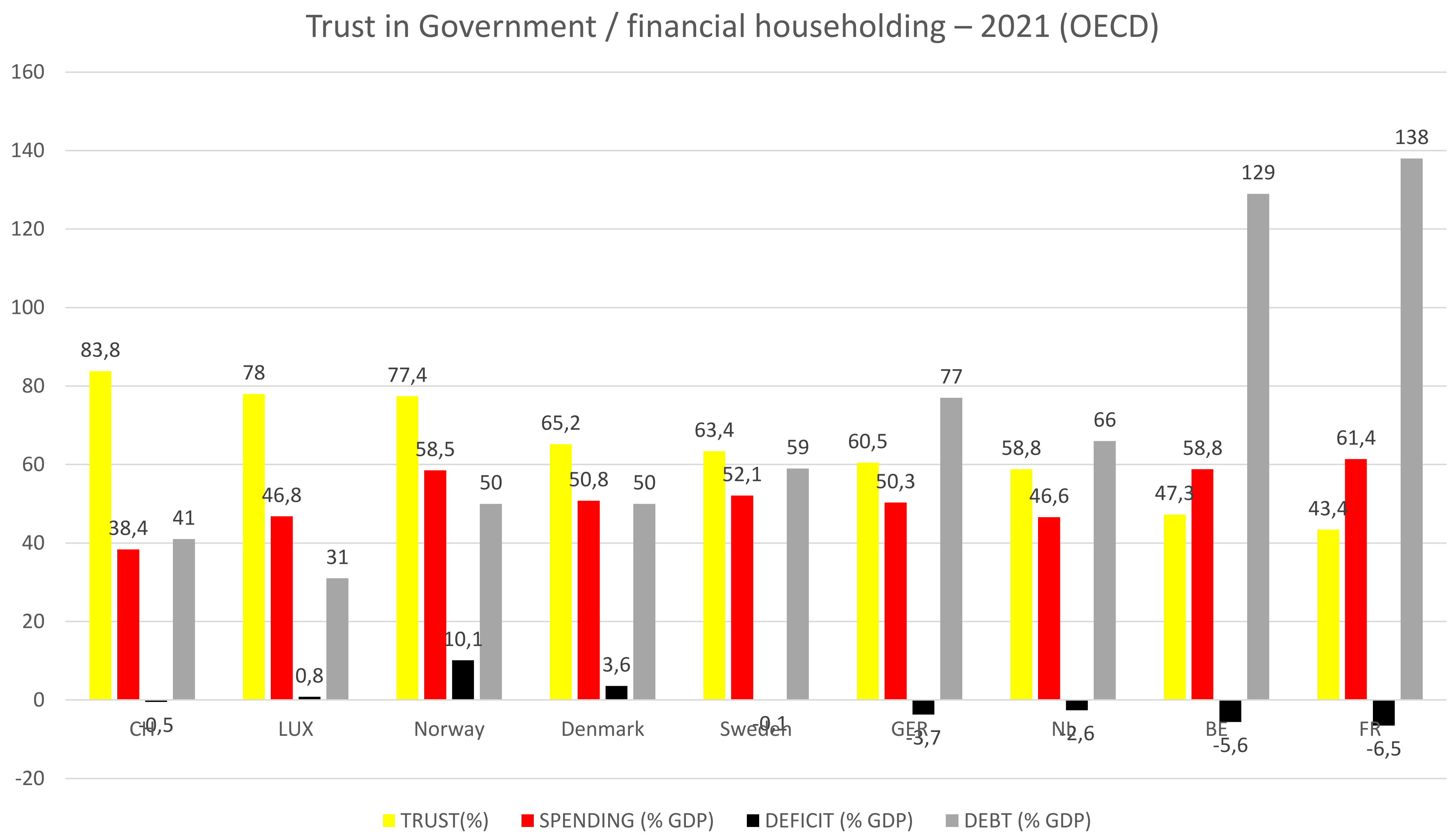
General government (tax) revenue and spending – 2021 - % GDP (OECD)



	CH	LUX	NL	GER	BE	FR
Tax revenue	28	38,6	39,7	39,5	42	45,1
Revenue	35,9	43,7	44	47,5	49,9	52,5
Spending	38,4	46,8	46,6	50,3	58,8	61,4

Tax revenue Revenue Spending

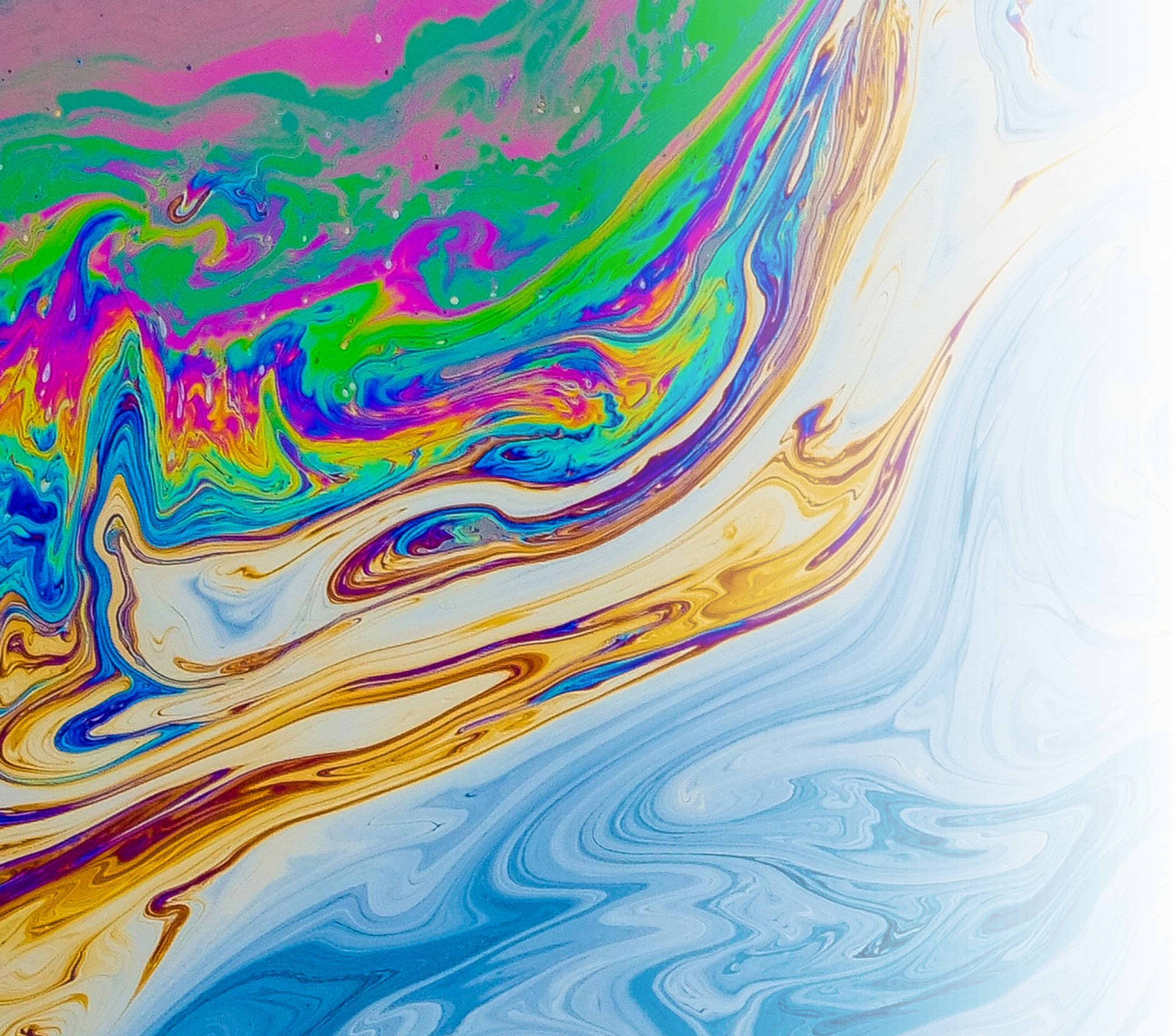

General government revenue and spending – 2021 – USD/capita (OECD)
70000
60000
50000
40000
30000
20000
10000
0
27341
27752
57868
56816
27912
29566
27748
29924
29137
32381
26543
29844
CH
LUX
NL
GER
BE
FR
REVENUE
SPENDING


Trust in Government / financial householding – 2021 (OECD)
160
140
120
100
80
60
40
20
0
-20
83,8
38,4
-0,5
41
78
46,8
0,8
31
77,4
58,5
10,1
50
65,2
50,8
3,6
50
63,4
52,1
-0,1
59
60,5
50,3
-3,7
77
58,8
46,6
-2,6
66
47,3
58,8
-5,6
129
43,4
61,4
-6,5
138
CH
LUX
Norway
Denmark
Sweden
GER
NL
BE
FR
TRUST(%)
SPENDING (% GDP)
DEFICIT (% GDP)
DEBT (% GDP)

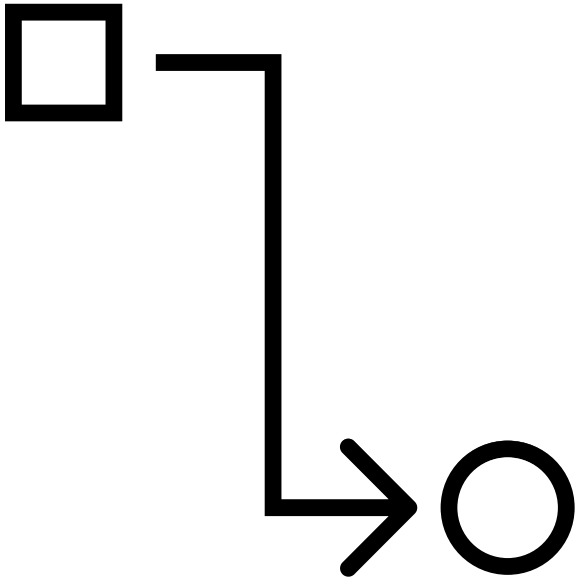
Let’s talk about the tax structure

Efficiency and redistribution

Efficiency ➔ horizontal equity of the tax system	Treating taxpayers with THE SAME ability to pay in THE SAME way
	Treat EQUAL revenue / taxable events in THE SAME way
	Largely legal-economic debate → technical review
Redistribution ➔ vertical equity of the tax system	Extent to which policy decisions are made to make taxpayers with HIGHER ability to pay also contribute proportionately MORE
	Largely political debate → linked to labour participation, promotion trap and social welfare function / technically modulable via (inz.) rates (+ tax credits, tax free allowance,...)



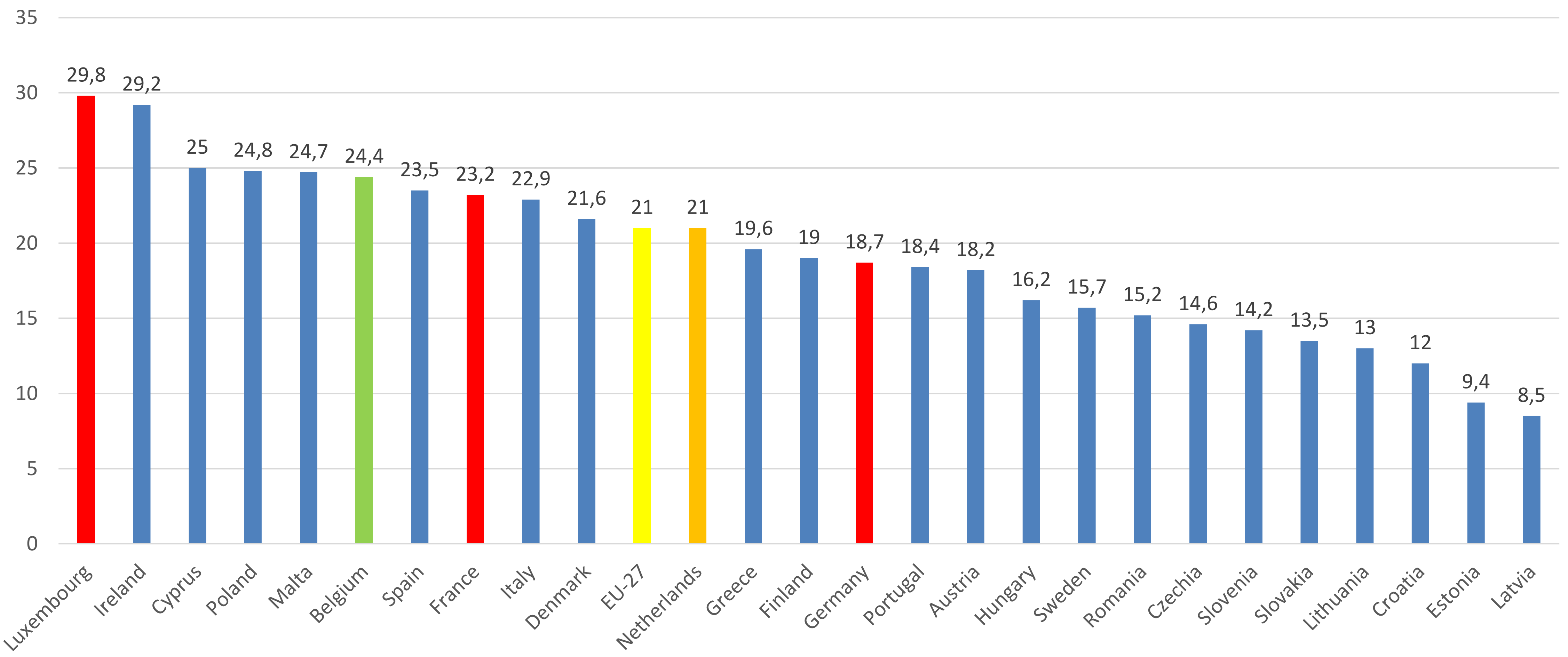
The tax mix



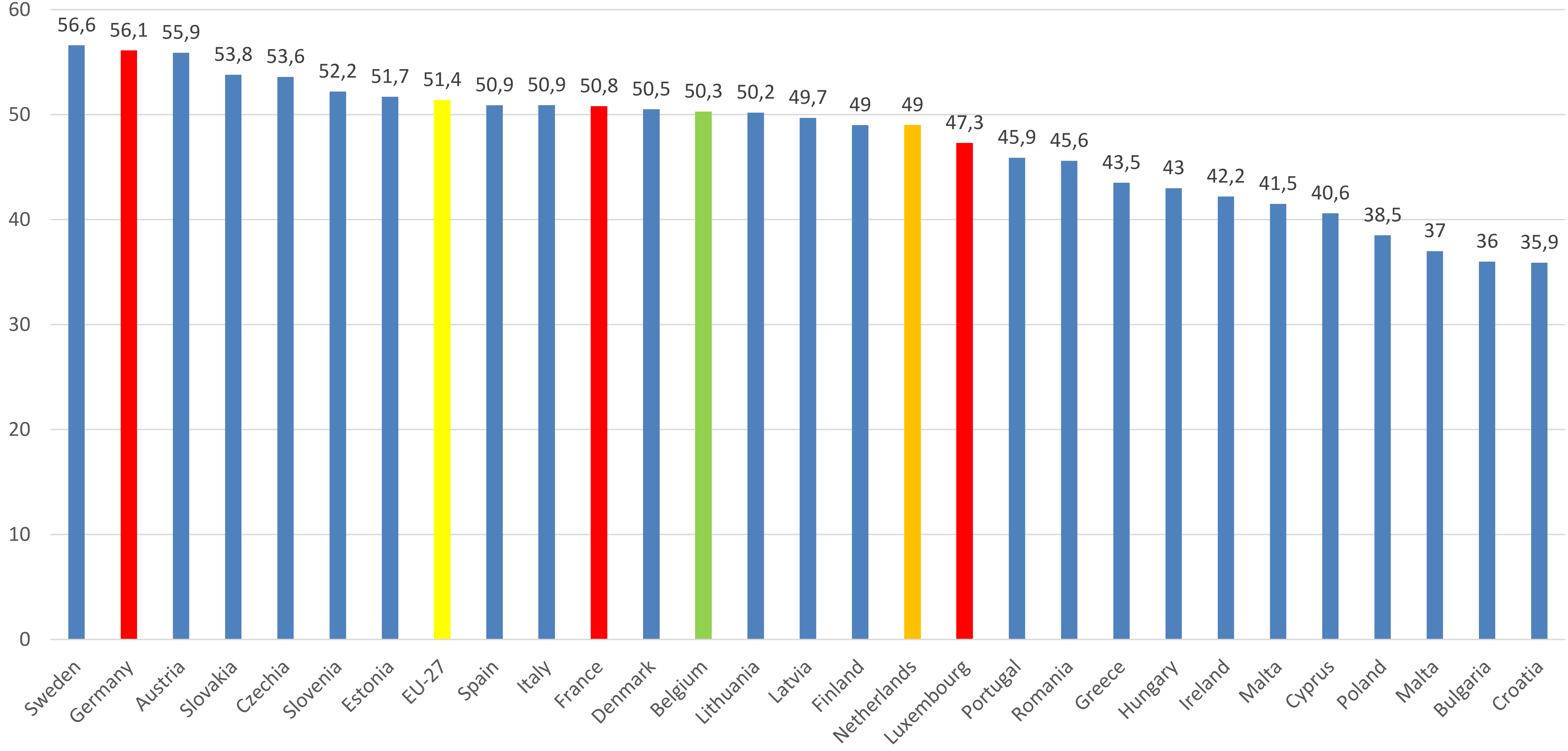
Distortive effect of taxes

- ➔ Corporate income tax
- ➔ Personal income tax
- ➔ Consumption tax
- ➔ Recurrent tax on residential immovable property

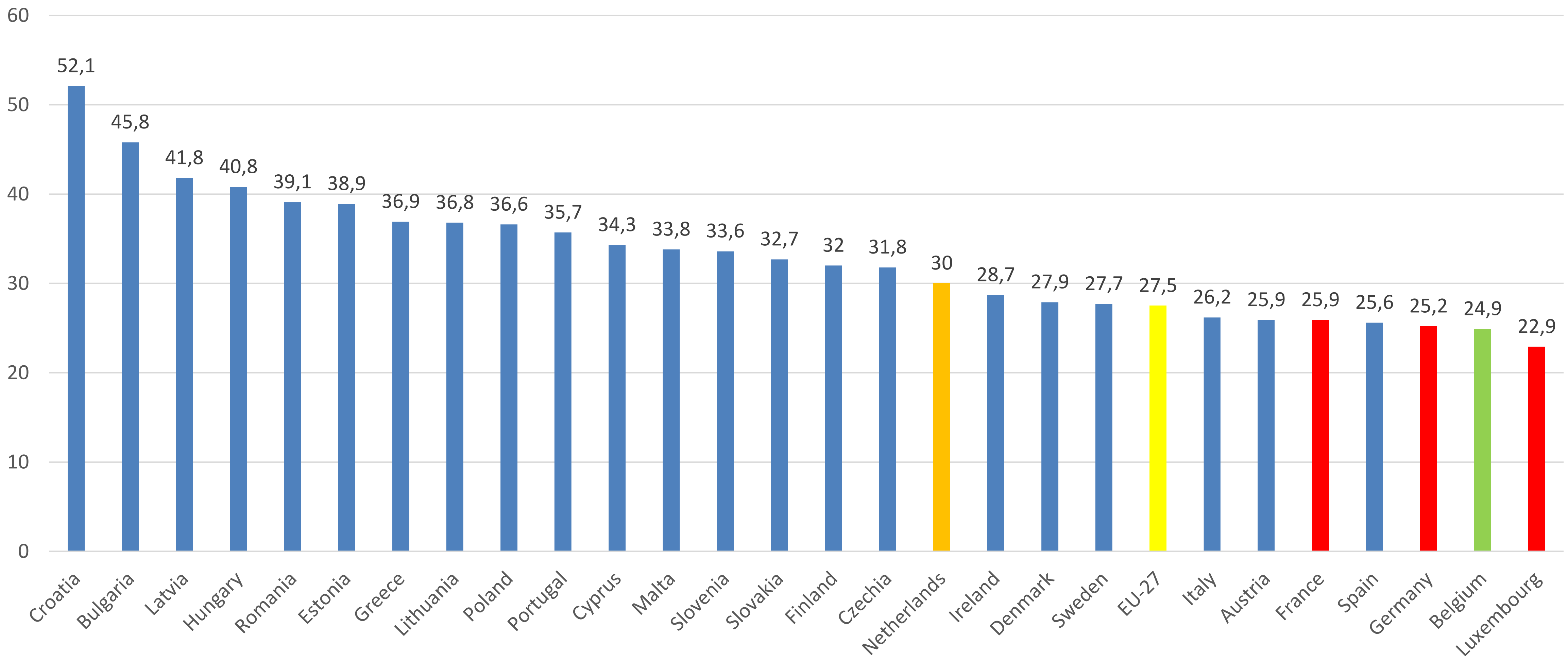
Taxes on capital as % of total taxation – 2021 (EC)



Taxes on labour as % of total taxation – 2021 (EC)



Taxes on consumption as % of total taxation-2021 (EC)

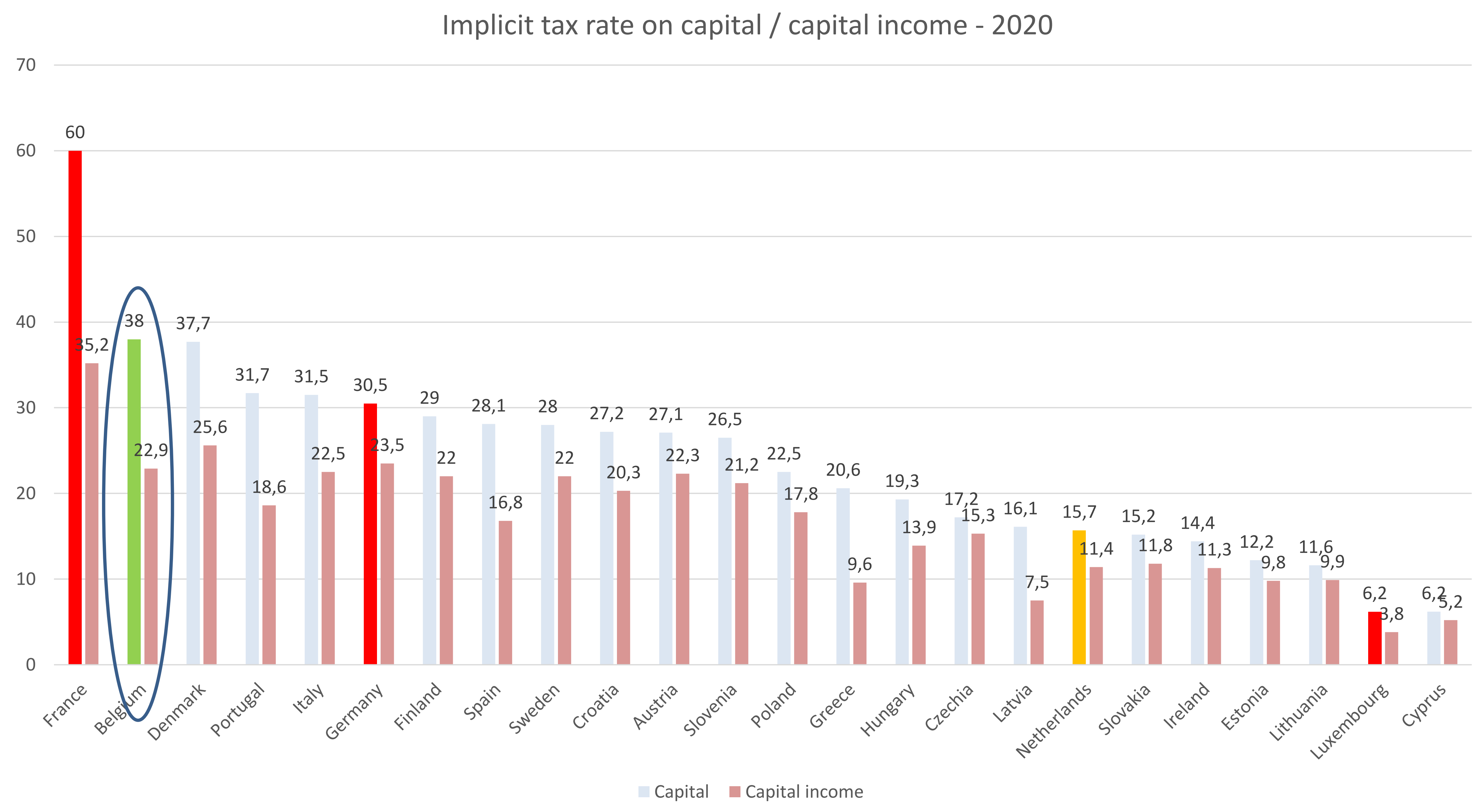


Belgium:

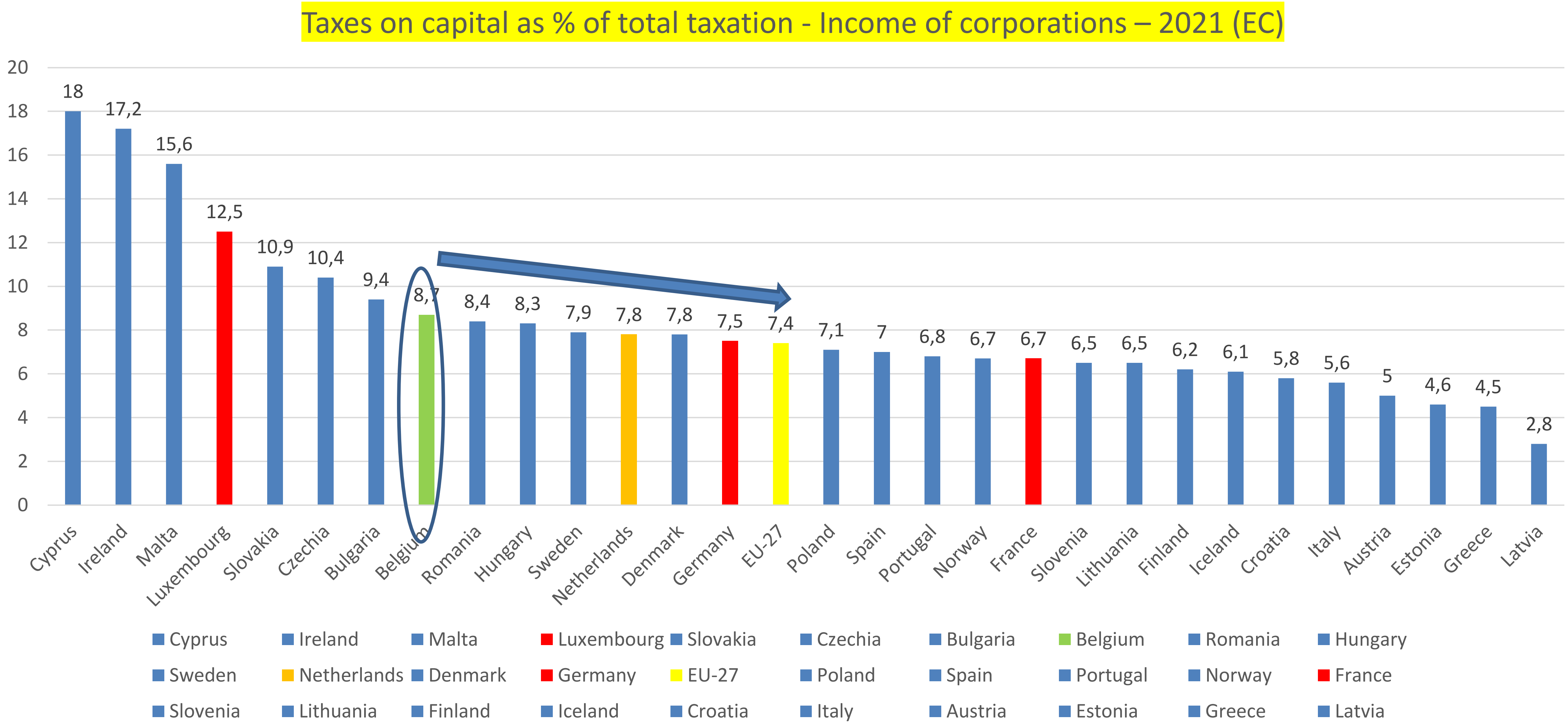
- Predominantly relies on the taxation of labour and capital
- Income from consumption taxes seems rather low

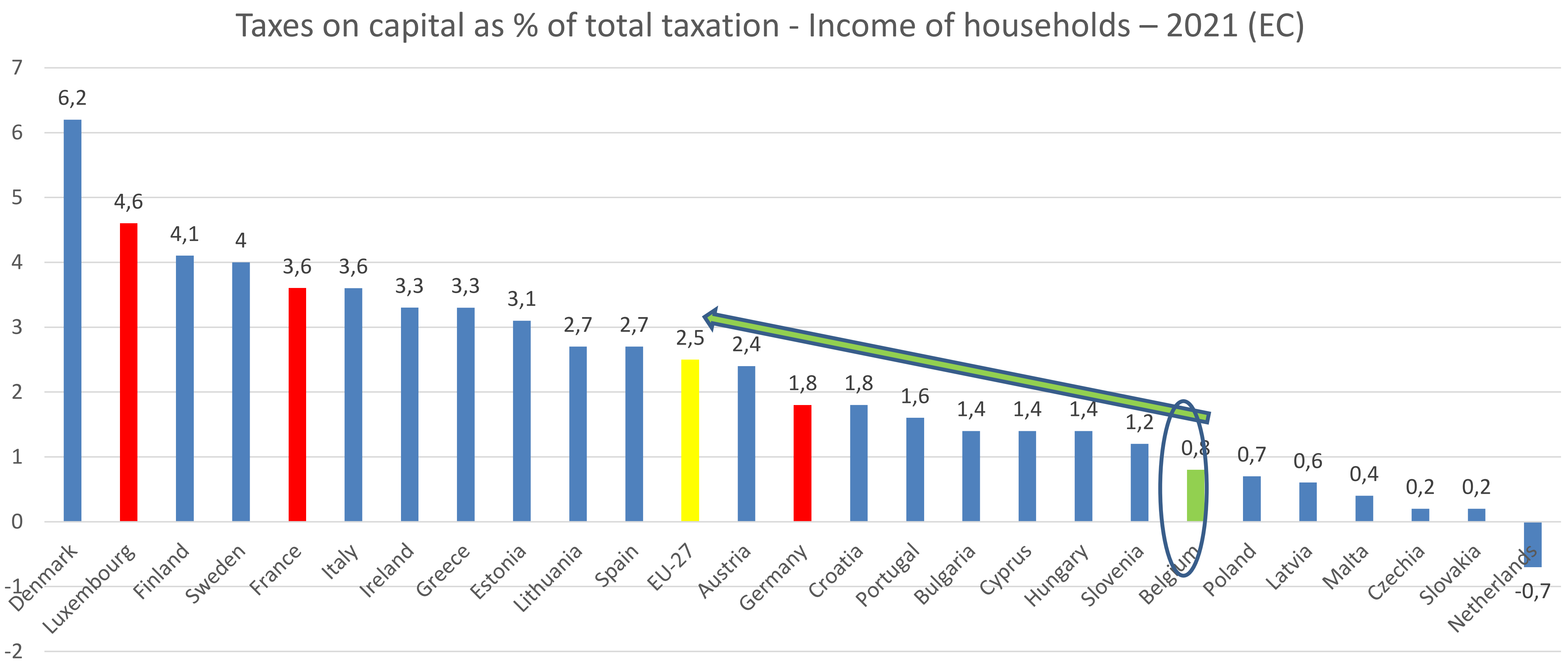
Shift away from capital and labour to consumption?

Taxes on capital – more in detail

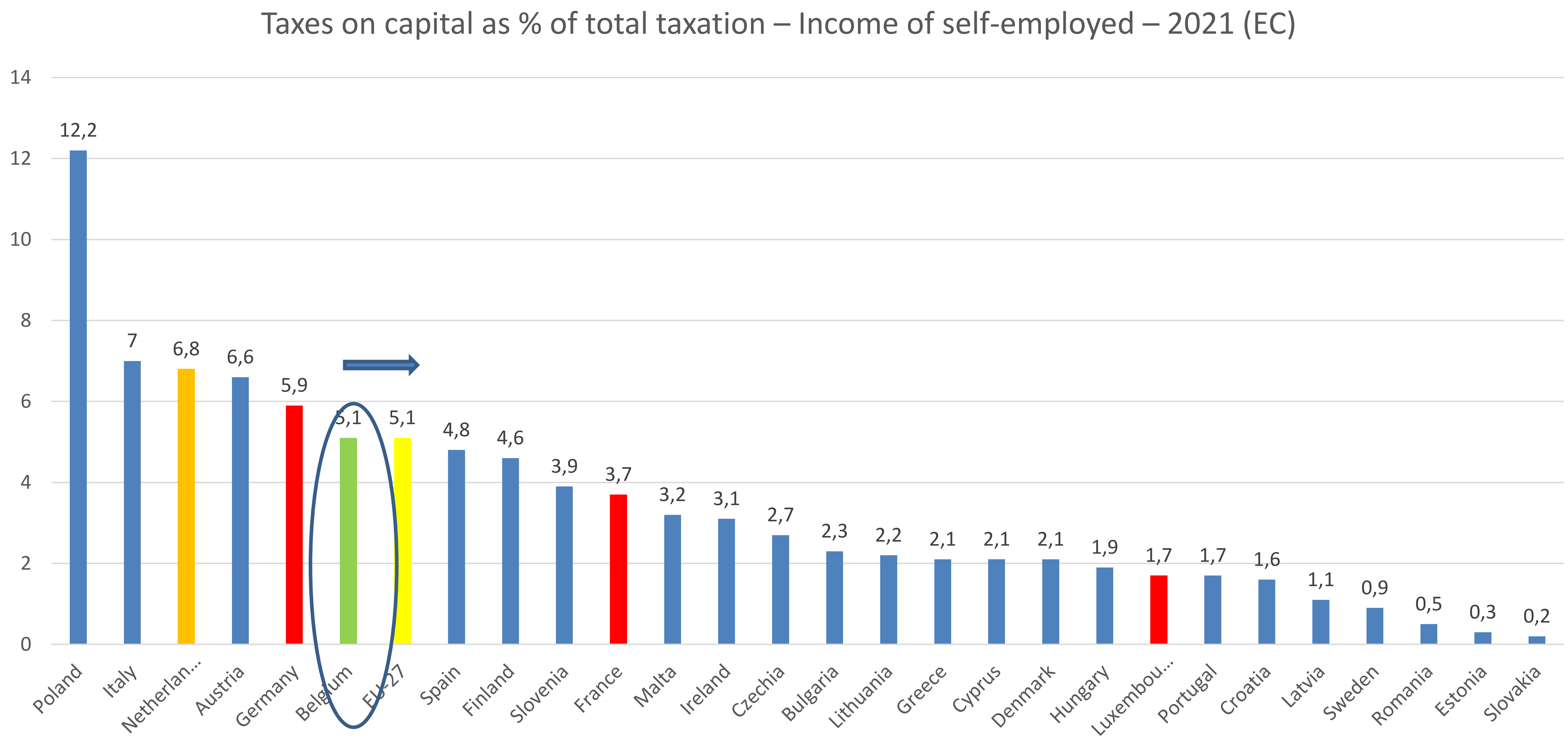


Implicit tax rate on capital / capital income - 2020
70
60
50
40
30
20
10
0
60
35,2
38
22,9
37,7
25,6
31,7
18,6
31,5
22,5
30,5
23,5
29
22
28,1
16,8
28
22
27,2
20,3
27,1
22,3
26,5
21,2
22,5
17,8
20,6
9,6
19,3
13,9
17,2
15,3
16,1
7,5
15,7
11,4
15,2
11,8
14,4
11,3
12,2
9,8
11,6
9,9
6,2
3,8
6,2
5,2
France
Belgium
Denmark
Portugal
Italy
Germany
Finland
Spain
Sweden
Croatia
Austria
Slovenia
Poland
Greece
Hungary
Czechia
Latvia
Netherlands
Slovakia
Ireland
Estonia
Lithuania
Luxembourg
Cyprus
Capital
Capital income

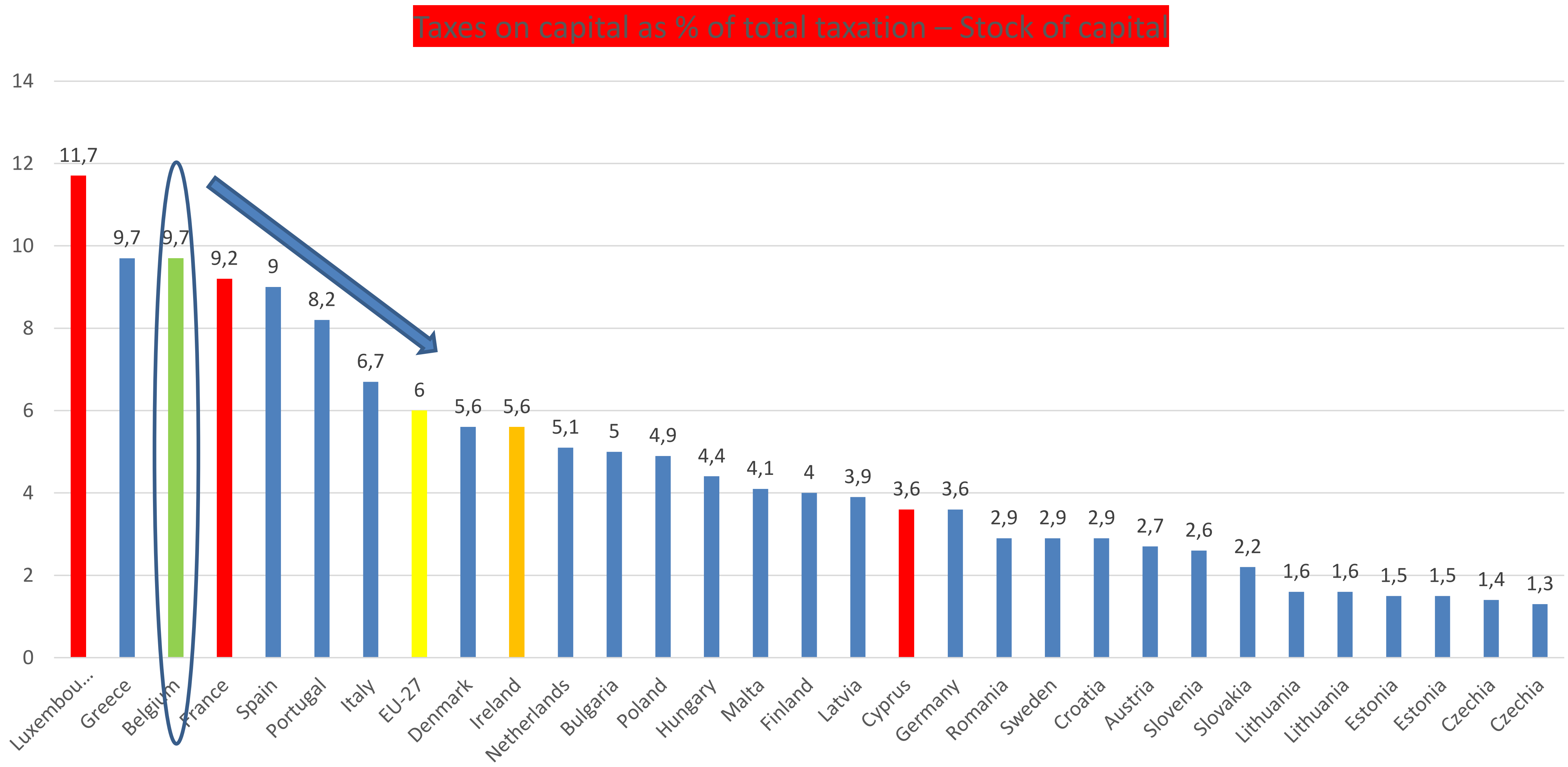

Taxes on capital as % of total taxation - Income of corporations – 2021 (EC)
20
18
16
14
12
10
8
6
4
2
0
18
17,2
15,6
12,5
10,9
10,4
9,4
8,7
8,4
8,3
7,9
7,8
7,8
7,5
7,4
7,1
7
6,8
6,7
6,7
6,5
6,5
6,2
6,1
5,8
5,6
5
4,6
4,5
2,8
Cyprus
Ireland
Malta
Luxembourg
Slovakia
Czechia
Bulgaria
Belgium
Romania
Hungary
Sweden
Netherlands
Denmark
Germany
EU-27
Poland
Spain
Portugal
Norway
France
Slovenia
Lithuania
Finland
Iceland
Croatia
Italy
Austria
Estonia
Greece
Latvia



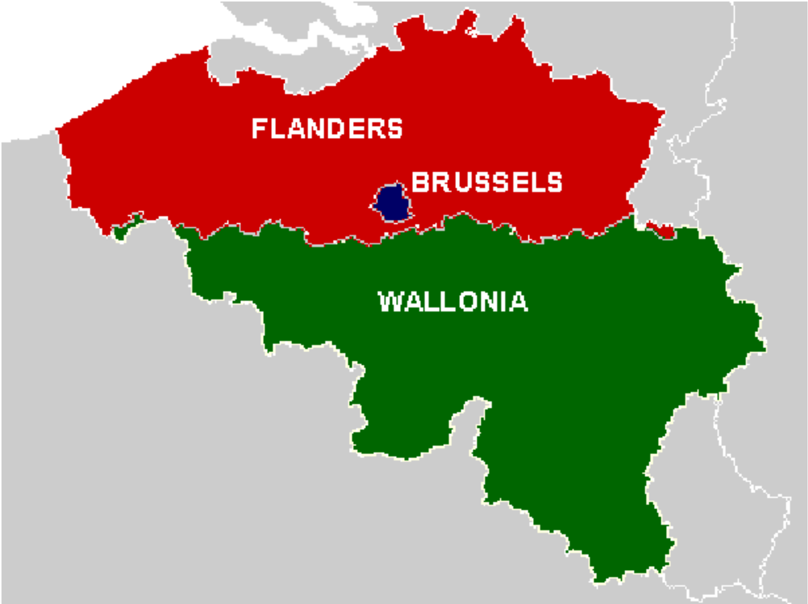
Taxes on capital as % of total taxation - Income of households – 2021 (EC)
7
6
5
4
3
2
1
0
-1
-2
6,2
4,6
4,1
4
3,6
3,6
3,3
3,3
3,1
2,7
2,7
2,5
2,4
1,8
1,8
1,6
1,4
1,4
1,4
1,2
0,8
0,7
0,6
0,4
0,2
0,2
-0,7
Denmark
Luxembourg
Finland
Sweden
France
Italy
Ireland
Greece
Estonia
Lithuania
Spain
EU-27
Austria
Germany
Croatia
Portugal
Bulgaria
Cyprus
Hungary
Slovenia
Belgium
Poland
Latvia
Malta
Czechia
Slovakia
Netherlands



Taxes on capital as % of total taxation – Income of self-employed – 2021 (EC)
14
12
10
8
6
4
2
0
12,2
7
6,8
6,6
5,9
5,1
5,1
4,8
4,6
3,9
3,7
3,2
3,1
2,7
2,3
2,2
2,1
2,1
2,1
1,9
1,7
1,7
1,6
1,1
0,9
0,5
0,3
0,2
Poland
Italy
Netherlan...
Austria
Germany
Belgium
EU-27
Spain
Finland
Slovenia
France
Malta
Ireland
Czechia
Bulgaria
Lithuania
Greece
Cyprus
Denmark
Hungary
Luxembou...
Portugal
Croatia
Latvia
Sweden
Romania
Estonia
Slovakia


Taxes on capital as % of total taxation – Stock of capital
14
12
10
8
6
4
2
0
11,7
9,7
9,7
9,2
9
8,2
6,7
6
5,6
5,6
5,1
5
4,9
4,4
4,1
4
3,9
3,6
3,6
2,9
2,9
2,9
2,7
2,6
2,2
1,6
1,6
1,5
1,5
1,4
1,3
Luxembou...
Greece
Belgium
France
Spain
Portugal
Italy
EU-27
Denmark
Ireland
Netherlands
Bulgaria
Poland
Hungary
Malta
Finland
Latvia
Cyprus
Germany
Romania
Sweden
Croatia
Austria
Slovenia
Slovakia
Lithuania
Lithuania
Estonia
Estonia
Czechia
Czechia

	REG	FED
Taxes on financial and capital transactions		
Registration rights	€ 5.336,80	
Mortgage rights	€ 92,90	
Court rights		€ 30,10
Taxes on stock exchange business		€ 434,60
Duties on written documents		€ 48,30
Taxes on land, buildings or other structures		
Advance tax payment on property (PP)	€ 4.001,10	
Advance tax payment on property (Corp)	€ 1.864,20	
Regional tax (Brussels Capital Region) -	€ 94,20	
Taxes on the use of fixed assets		
Traffic taxes paid by corporations	€ 629,90	
Tax on automatical recreation appliances	€ 12,50	
Business and professional licences		
Contribution to the Guarantee Fund for Financial Services		€ 445,50
Contribution for Financial Stability to the Resolution		€ 346,90
Other taxes on production n.e.c.		€ 2.514,20
Current taxes on capital		
Taxes on patrimony (grounds and buildings)	€ 311,30	
Taxes on the NPIs		€ 50,70
Transfer to the Fund for Industrial Accidents		€ 320,80
Tax on securities accounts		€ 379,00
Other taxes		€ 24,10
Taxes on capital transfers		
Death duties	2947,70	
Gift taxes	715,70	
Capital levies		
Taxes on long-term savings		207,10
One-off tax regulation (bis)		36,90
One-off tax regulation (ter)		171,60
	€ 16.006,30	**€ 5.009,80**
	76%	**24%**



Facts

- ➔ Capital (income) is a substantial part of the Belgian tax mix
- ➔ Unevenly distributed between income and stock of capital
- ➔ Rather low share of taxes on income of households

Recommendations:

- ➔ Shift away from ‘harmful’ taxation on capital stocks (a.o. transaction taxes), possibly by balancing with taxes on income of households
- ➔ Some work to do at the regional level… (especially registration rights and property tax due by corporations)

Taxes on capital – in even more detail

Efficiency

A **tax on capital** income distorts intertemporal neutrality by changing the relative price of future versus current consumption.

Nevertheless, efficiency arguments do exist for taxing capital:

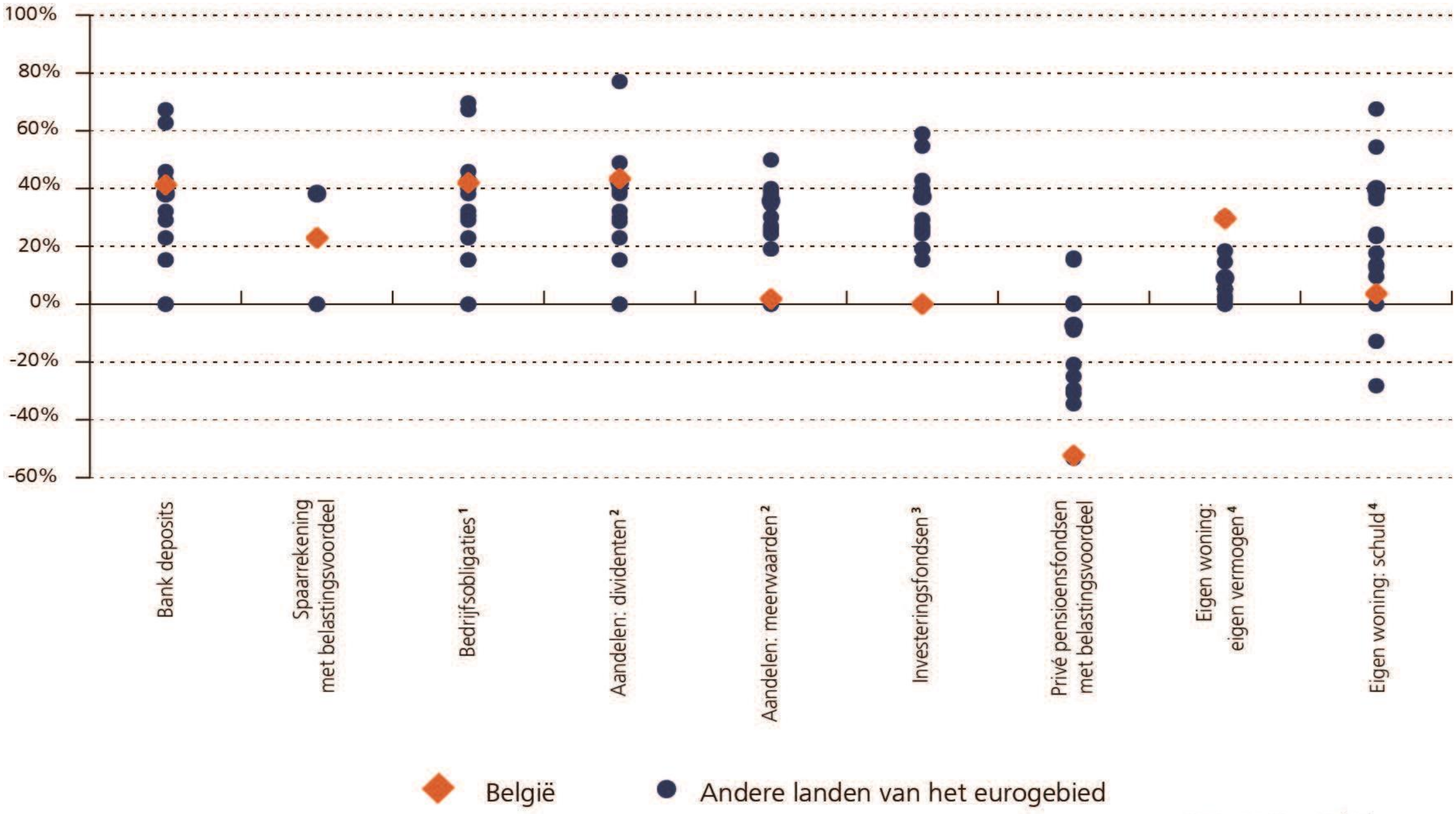
- Taxing pure economic interest is appropriate; PM: an incomplete tax on total return is administratively simpler than a tax only on pure economic return
- Compensating for 'distortionary' tax on labour;
- Taxing the volatile component of capital income, with compensation for losses, provides investor insurance and does not discourage risk-taking.

In case of a tax on capital income, an inflation adjustment should be taken into account.

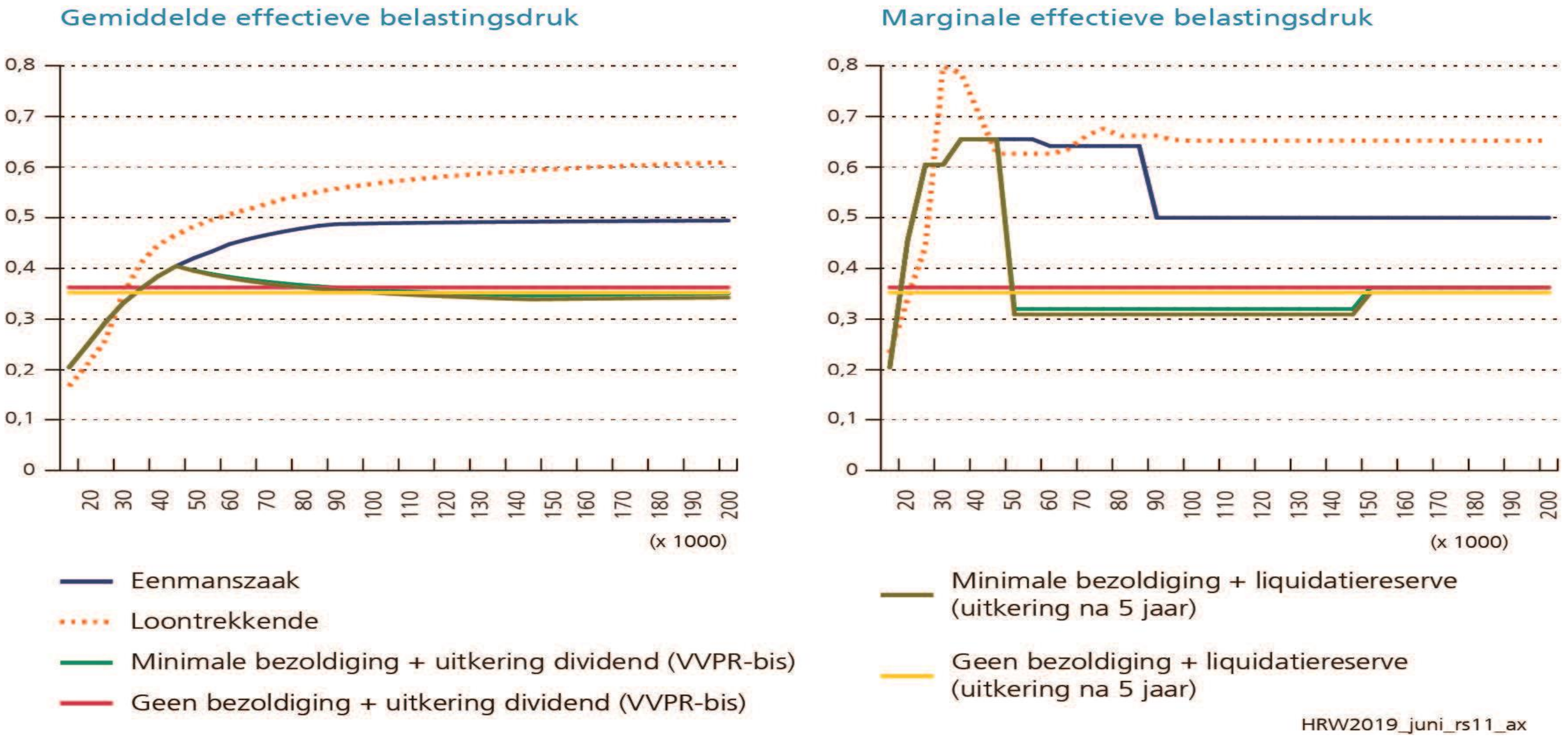
Efficiency

<u>Additional concerns:</u>

1. In an optimal tax system, neutrality with respect to income from various financial assets (measured through the **METR**) applies. This should take into account different taxes on a given asset.
2. Interference with corporate tax:
   - Corporate tax as an 'advance' on personal income tax
   - Economic double taxation avoidance through tax credits, reduced rates on dividend income and capital gains on shares.
3. Incentive to convert labour income into capital income, should be avoided to the maximum extent possible (cf. also debate around incorporation).



HRFin_2019_sv01(bis)_ax


Gemiddelde effectieve belastingsdruk
Marginale effectieve belastingsdruk
0,8
0,7
0,6
0,5
0,4
0,3
0,2
0,1
0
20 30 40 50 60 70 80 90 100 110 120 130 140 150 160 170 180 190 200
(x 1000)
Eenmanszaak
Loontrekkende
Minimale bezoldiging + uitkering dividend (VVPR-bis)
Geen bezoldiging + uitkering dividend (VVPR-bis)
Minimale bezoldiging + liquidatiereserve (uitkering na 5 jaar)
Geen bezoldiging + liquidatiereserve (uitkering na 5 jaar)
HRW2019_juni_rs11_ax

Existing recommendations

Some features of the tax system distort investment choices and lead to overinvestment in certain assets. Taxation of immovable property is a case in point, since rents are undertaxed and interest on housing loans for secondary residences are tax-deductible. In Wallonia, homeowners continue to benefit from favorable tax treatment for their mortgage payments ('*chèque habitat*'). Moreover, some features of the tax framework, including the tax incentive for savings and the rigid design of the tax rules applying to long-term savings and pension schemes, create obstacles to a better allocation of capital. The tax on securities accounts also acts as a disincentive to invest in financial instruments.

REFORM THE TAXATION AND BENEFIT SYSTEMS TO REDUCE DISINCENTIVES TO WORK BY SHIFTING THE TAX BURDEN AWAY FROM LABOUR AND BY SIMPLIFYING THE TAX AND BENEFIT SYSTEM. REDUCE TAX EXPENDITURES **AND MAKE THE TAX SYSTEM MORE INVESTMENT-NEUTRAL.**

Existing recommendations

Introduction of a capital-gains tax should be considered a priority to address non-neutrality and reduce tax arbitrage opportunities. More generally, in reforming the income tax system, consideration could be given to the "Nordic model" of dual income taxation, which, combines a relatively low, flat tax rate applied on all forms of capital income with progressive taxation applied to all forms of labour income. If well-implemented, the dual income tax system could restore horizontal equity and eliminate distortions. For example, applying the same schedules for taxable business income and salary income would eliminate differences in average tax burdens between entrepreneurship and salaried employment thus eliminating tax planning opportunities.

Belgium could make better use of recuring real estate taxes, which are significantly underutilized relative to their potential. Property values-the basis of real estate taxation-do not reflect current market prices, but are instead based on cadastral values not updated since 1975.

Existing recommendations

Ensure the neutrality of taxation of different sources of income of financial assets.

Selected building blocks

Taxed elements

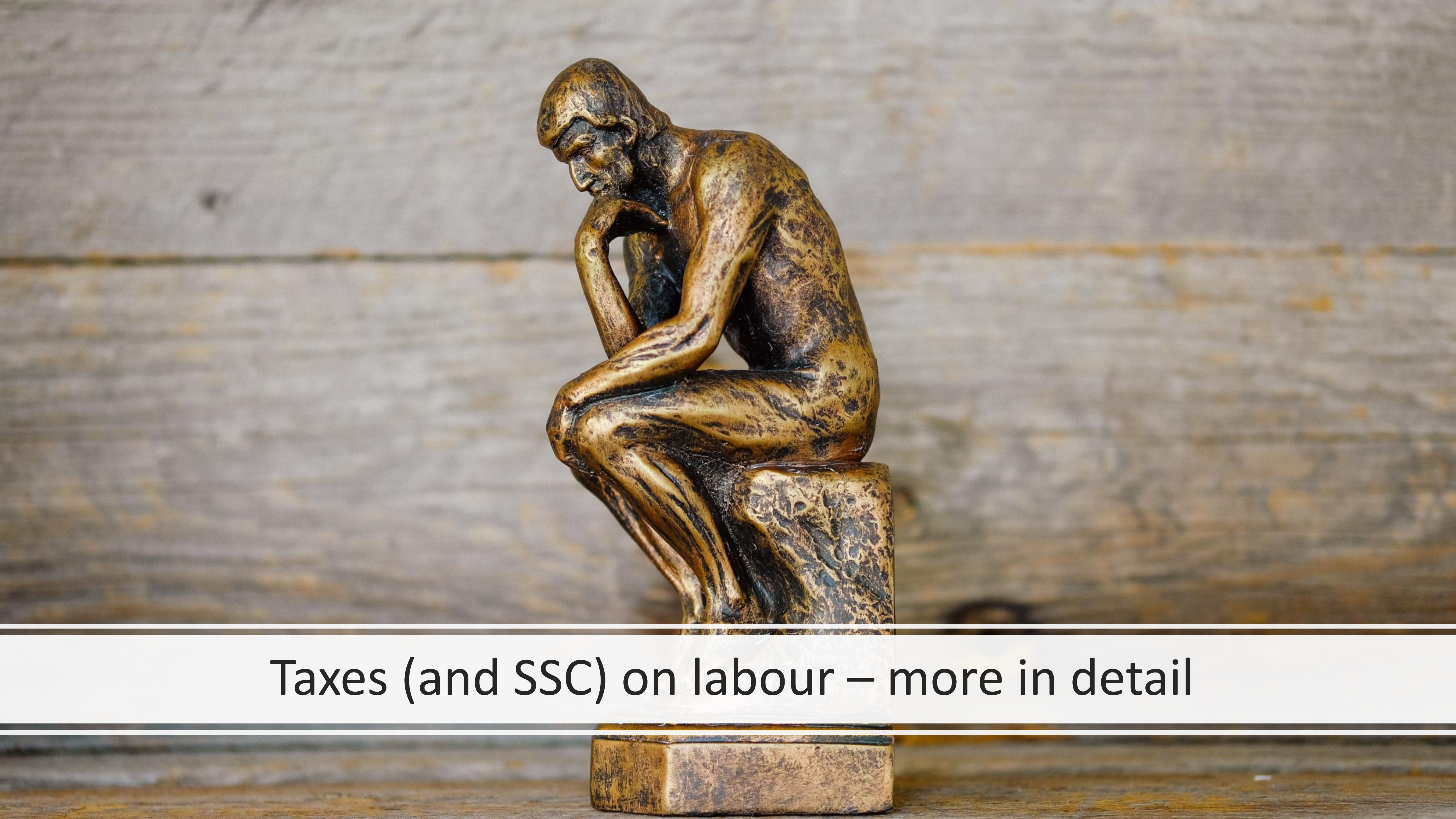
- Any form of remuneration for an asset used or realized is taxed in the same way. This includes:
    - neutrality with respect to income from various assets is sought. Here different taxes on a given asset must be taken into account. The existence of various taxes at regional level is also taken into account, with the understanding that the existing division of competences is assumed (see above);
    - Remunerations associated with asset-related investments should also be taxed as such, even if these assets are professionally affected, which translates, in particular, into (i) the recognition of a capital return regarding sole proprietorships and (ii) minimizing the risk of conversion of employment fees into capital income.

Tariff structure

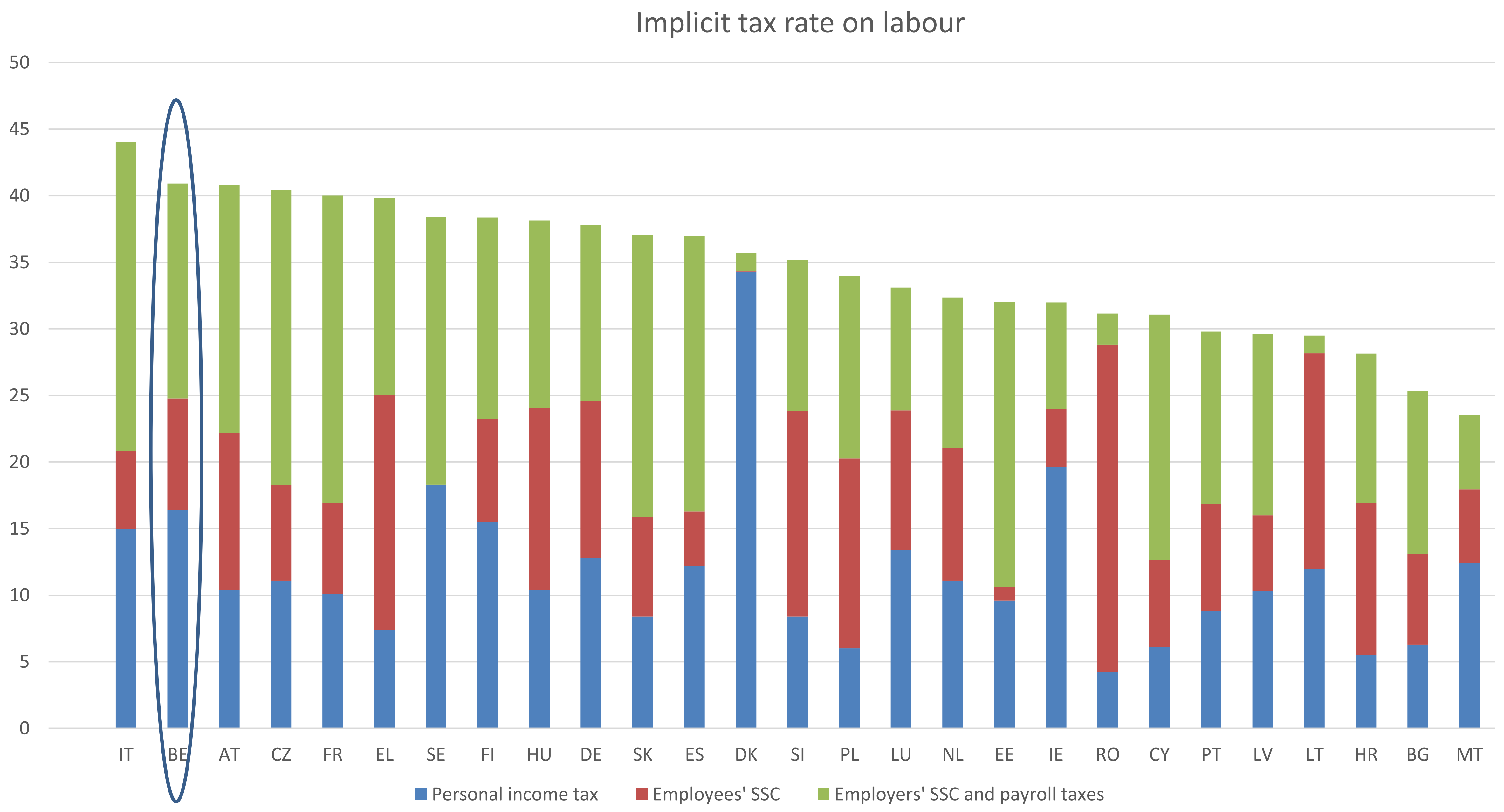
- A tariff structure adapted to the unique nature of capital income, theoretically composed of (at most) three components, namely (i) the risk-free rate of return, (ii) the allowance for risk and (iii) the purely economic interest rate.

Only justifiable specific systems

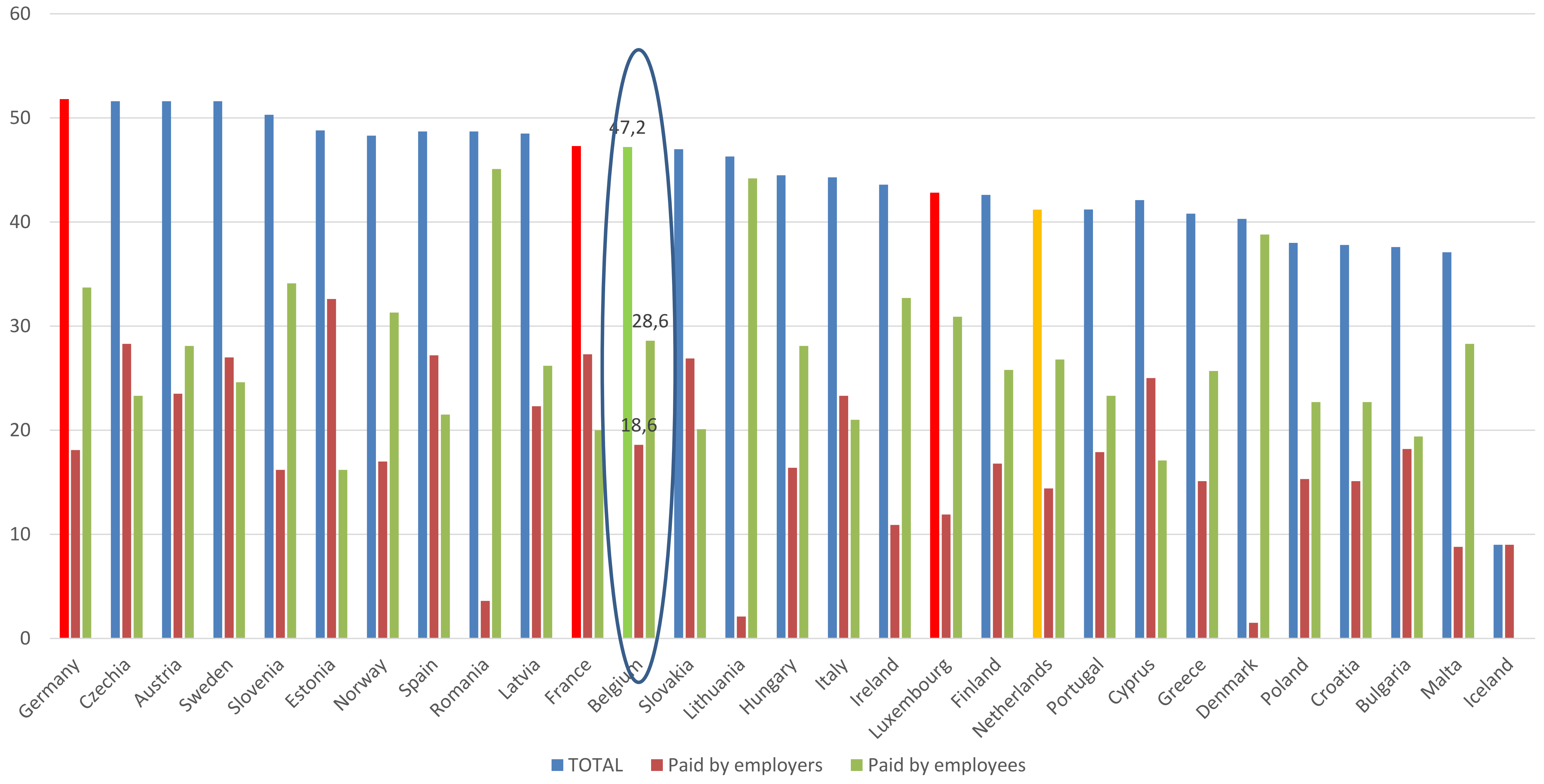
- Divergent systems must:
  - be justifiable in a special way
    - e.g., SME-oriented policies (?)
    - e.g. own home (?)
  - Be purposeful, straightforward and specific
    - e.g. investments in transformation funds, sustainability, innovation, growth,...
  - be recurrently reevaluated



Taxes (and SSC) on labour – more in detail


Implicit tax rate on labour
50
45
40
35
30
25
20
15
10
5
0
IT
BE
AT
CZ
FR
EL
SE
FI
HU
DE
SK
ES
DK
SI
PL
LU
NL
EE
IE
RO
CY
PT
LV
LT
HR
BG
MT
Personal income tax
Employees' SSC
Employers' SSC and payroll taxes

PM: Taxes on labour as % of total taxation – 2020 (EC)

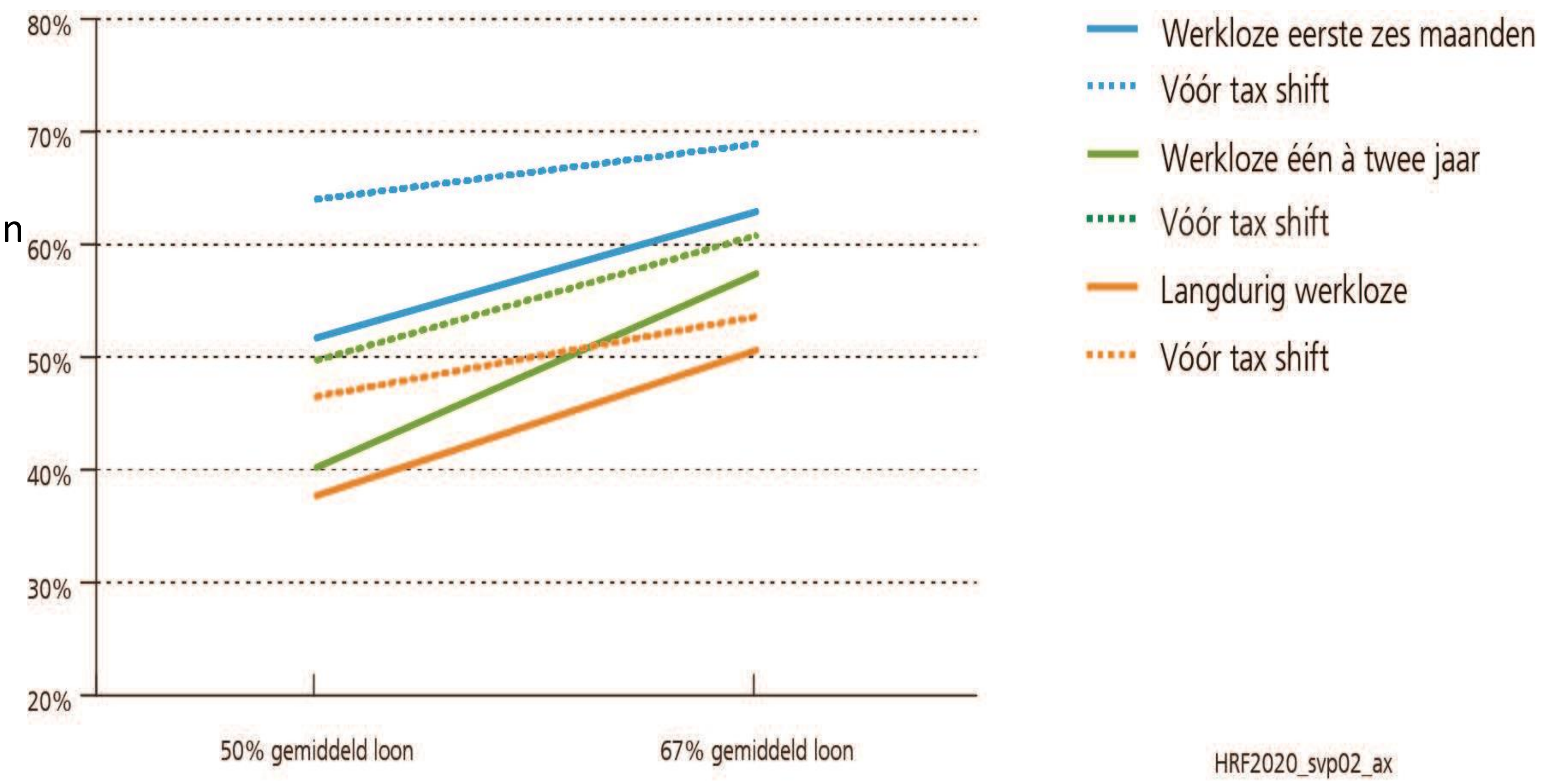


Tax on labour

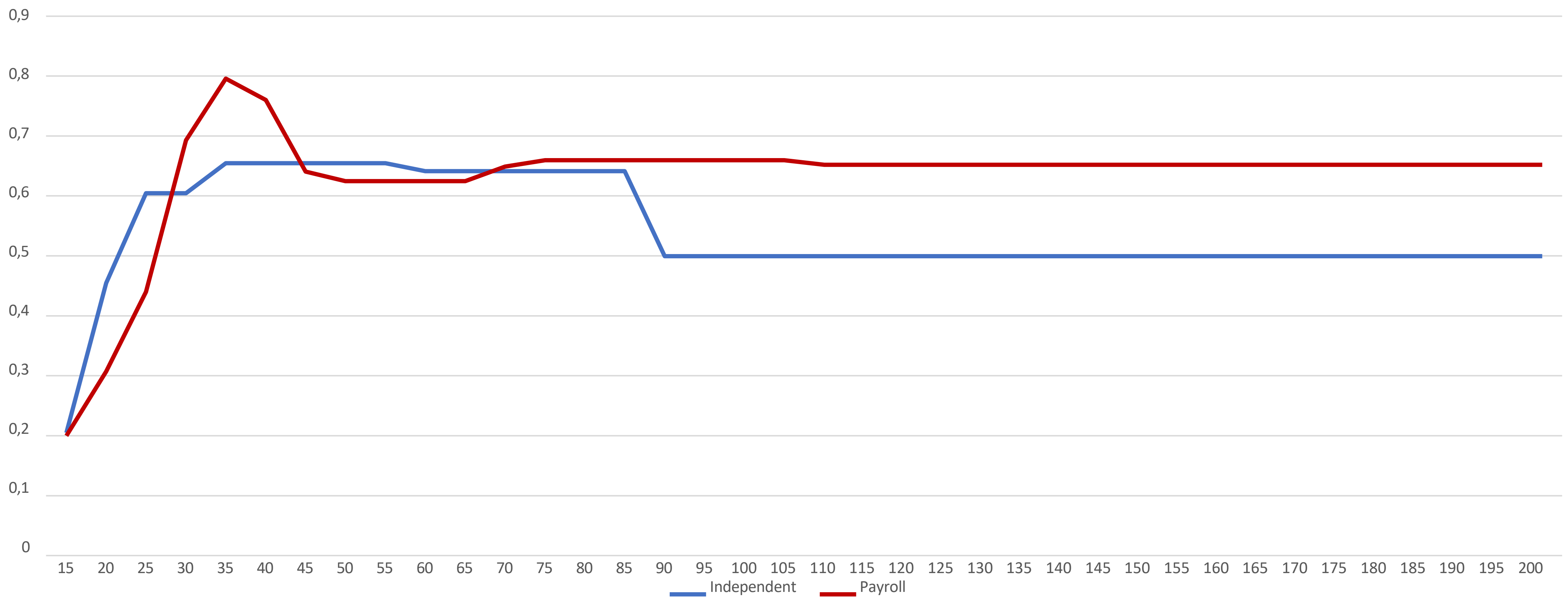
- Efficiency, measured by:
  - Participation tax rates (% gross wages returned to government upon entry into the labour market)
  - Marginal tax rates (% of gross wages returned to government when wages increase)
  - Tax wedge (% of labour cost returned to government)
- Redistribution - as a function of progressivity and average tax rate

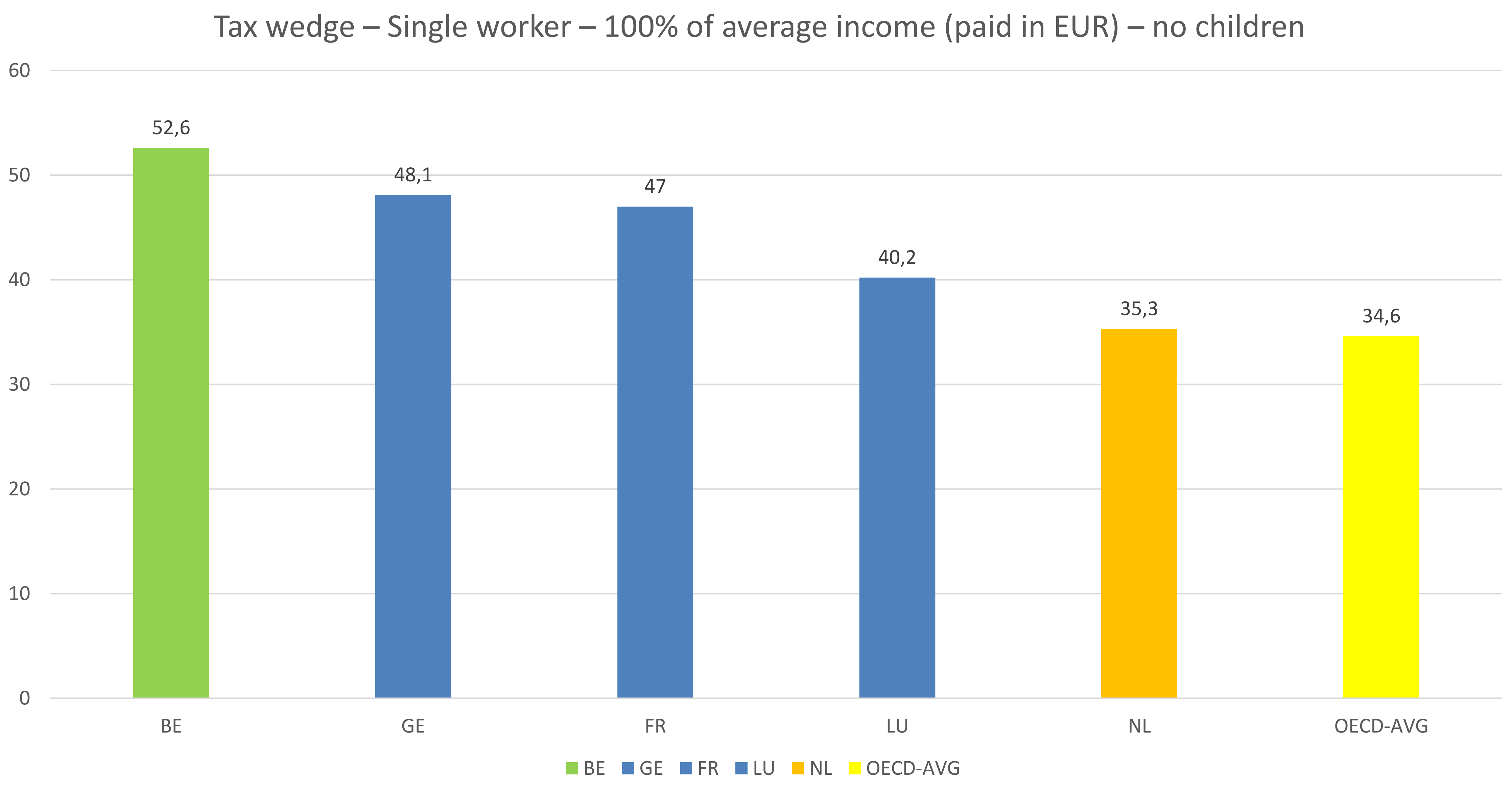
Participation tax rate

Single unemployed person without children
Source: FOD Financiën

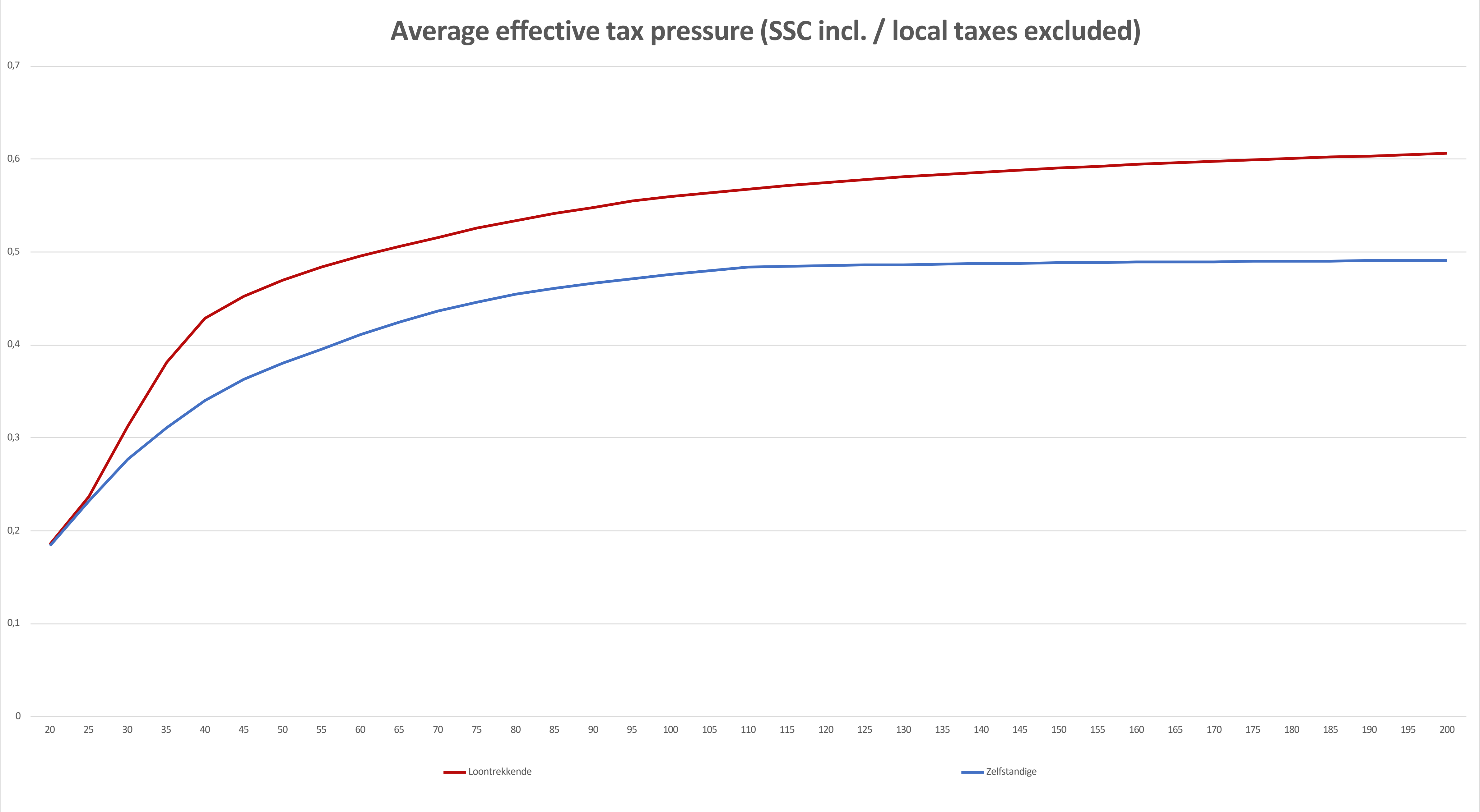


Promotion trap





Tax wedge – Single worker – 100% of average income (paid in EUR) – no children
60
50
40
30
20
10
0
52,6
48,1
47
40,2
35,3
34,6
BE
GE
FR
LU
NL
OECD-AVG
BE GE FR LU NL OECD-AVG


Average effective tax pressure (SSC incl. / local taxes excluded)
0,7
0,6
0,5
0,4
0,3
0,2
0,1
0
20
25
30
35
40
45
50
55
60
65
70
75
80
85
90
95
100
105
110
115
120
125
130
135
140
145
150
155
160
165
170
175
180
185
190
195
200
Loontrekkende
Zelfstandige

Special schemes

Existing recommendations

High labour taxes discourage more people from working or looking for a job. While the 2016 tax reform reduced the tax burden on labour for the lowest income earners, the tax wedge (social security contributions and taxation of labour income) remains the highest in the EU for those earning the average wage. Moreover, the tax brackets of the personal income tax system are rather narrow. As a result, even average income earners are subject to the highest income tax rates (45% and 50%), limiting the real progressivity of the system. In addition, high labour taxation may also discourage participation in lifelong learning.

Existing recommendations

The extensive use of special schemes makes the tax-benefit system complex and creates distortions. To offset the heavy tax burden on labour, wage subsidies have been broadly used. In particular, the withholding tax exemption for overtime, R&D work and night/shift work is costly in budgetary terms and leads to inefficiencies (Schoonackers, 2020). Various features of the corporate tax system (e.g. tax shelter for audio-visual and film productions) do not seem to be the most cost- efficient means of supporting specific sectors. Moreover, some personal income tax deductions disproportionally benefit high-income earners. Broadening tax bases and reducing tax rates would make revenue collection easier and reduce distortions or disincentives to work, invest and consume.

REFORM THE TAXATION AND BENEFIT SYSTEMS TO REDUCE DISINCENTIVES TO WORK BY SHIFTING THE TAX BURDEN AWAY FROM LABOUR AND BY SIMPLIFYING THE TAX AND BENEFIT SYSTEM. REDUCE TAX EXPENDITURES AND MAKE THE TAX SYSTEM MORE INVESTMENT-NEUTRAL.

Existing recommendations

Belgium's PIT features an overly-narrow range of middle tax brackets, with the highest PIT rate starting at a relatively- low income threshold. To provide relief to low-to-middle income employees, broadening of the two middle bands could be considered, with the top marginal tax rate threshold starting to apply at a higher income level. Determination of the optimal brackets and the threshold of the top marginal tax rate should follow a thorough analysis and calibration of the Mirrlees-Saez model to fit the income distribution in Belgium and derive an optimal schedule of marginal tax rates. Ultimately, the marginal-rate structure will also reflect the authorities' objectives for work-incentive improvements and fairness, as well as revenue constraints.

With taxation limits eroded and a shift of the burden to lower-wage earners, the system of special SSCs could be eliminated.

Existing recommendations

Additional revenue needed to compensate for the lowering of the labour burden may be generated from the PIT itself. Reduction and eventual elimination of tax expenditures, including sectoral preferential treatment (e.g., actors, athletes, flexi-jobs, hospitality), as well as tax advantages that benefit high-income earners and their employers (e.g., deductions for private-pension savings), have significant revenue potential. Further, the importance of "monetization" of in- kind benefits, with gradual conversion to equivalent cash benefits to be taxed within the standard tax system could not be overemphasized. **Indeed, with reforms that reduce the labour tax burden-at significant fiscal cost-the existence of extra-wage benefits cannot be justified**. The agreement to amend and "green" the company car regime is an important first step, the complete elimination of this benefit should remain a longer-term objective.

Existing recommendations

Introduce in-work benefits for low-wage workers with children.

Further lower social security contributions for low wages, financed by increases in less distortive taxes.

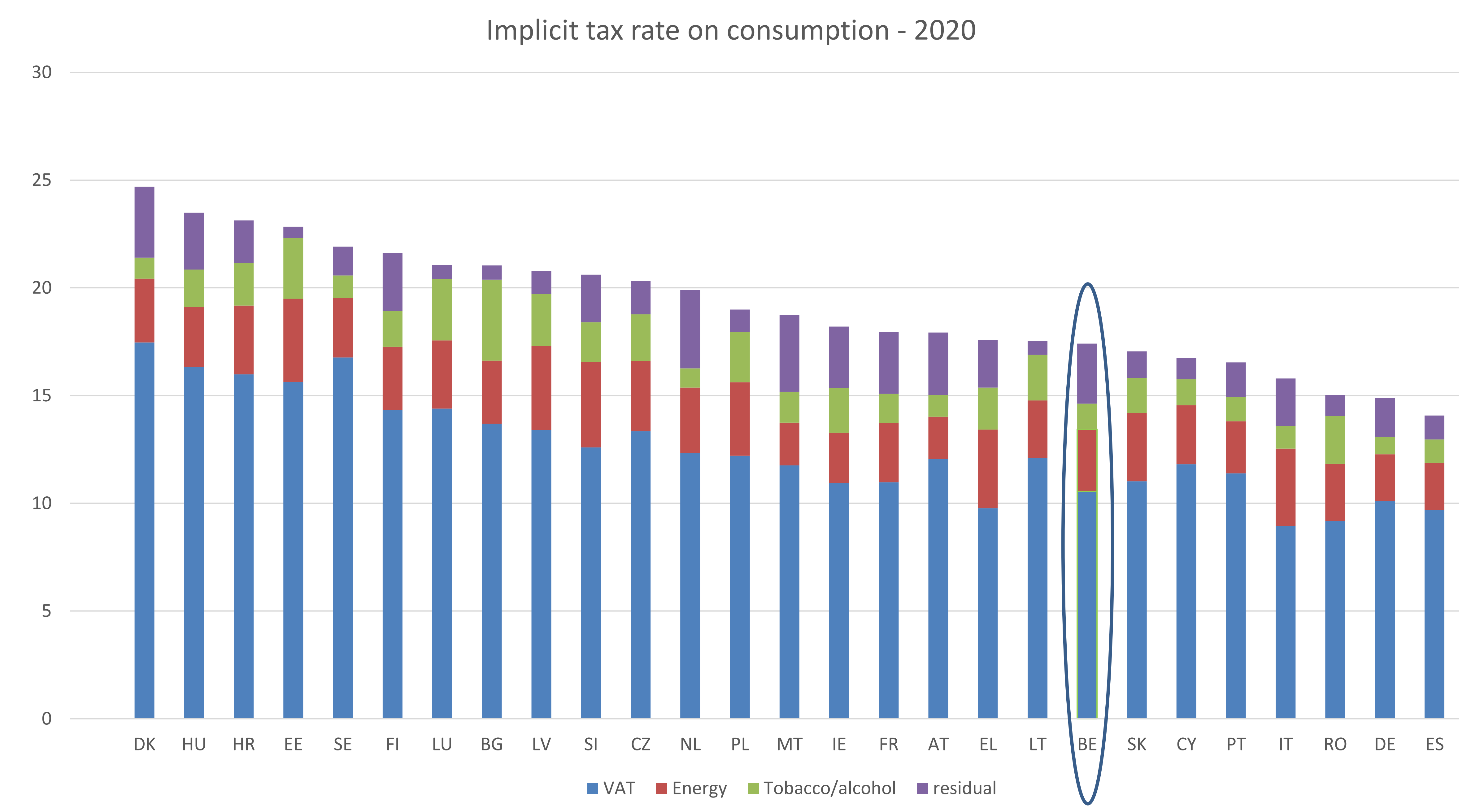
Selected building blocks

- <u>Taxed elements:</u>
  - Any form of remuneration for labour (regardless of statute, name or legal form of company) is taxed in the same way. This includes:
    - clearly define what is understood by "labour" in order to distinguish it from income from "assets”.
    - tax and social wage concepts are aligned to the maximum extent possible;
    - The distinction between "profit" and "income" is eliminated;
    - cash compensation is conceptually taxed in the same way as alternative forms of compensation;
    - compensation for labour should be allocated in a market-based manner to the natural person providing the labour services and taxed accordingly, even if these services are provided through a legal entity.
- <u>Tariff structure:</u>
  - A progressive rate structure, with the understanding that it does aim to lower the average rate, which can be achieved through a reduction in tariffs and/or a widening of the tariff brackets.
  - A further reduction in participation tax rates (which, e.g., after Tax Shift Michel, are still 63% for short-term unemployed with 2/3 of the average wage).
  - A reduction in high effective marginal tax rates (> 80%) in the range of 0.5 to 0.7 times the average wage.

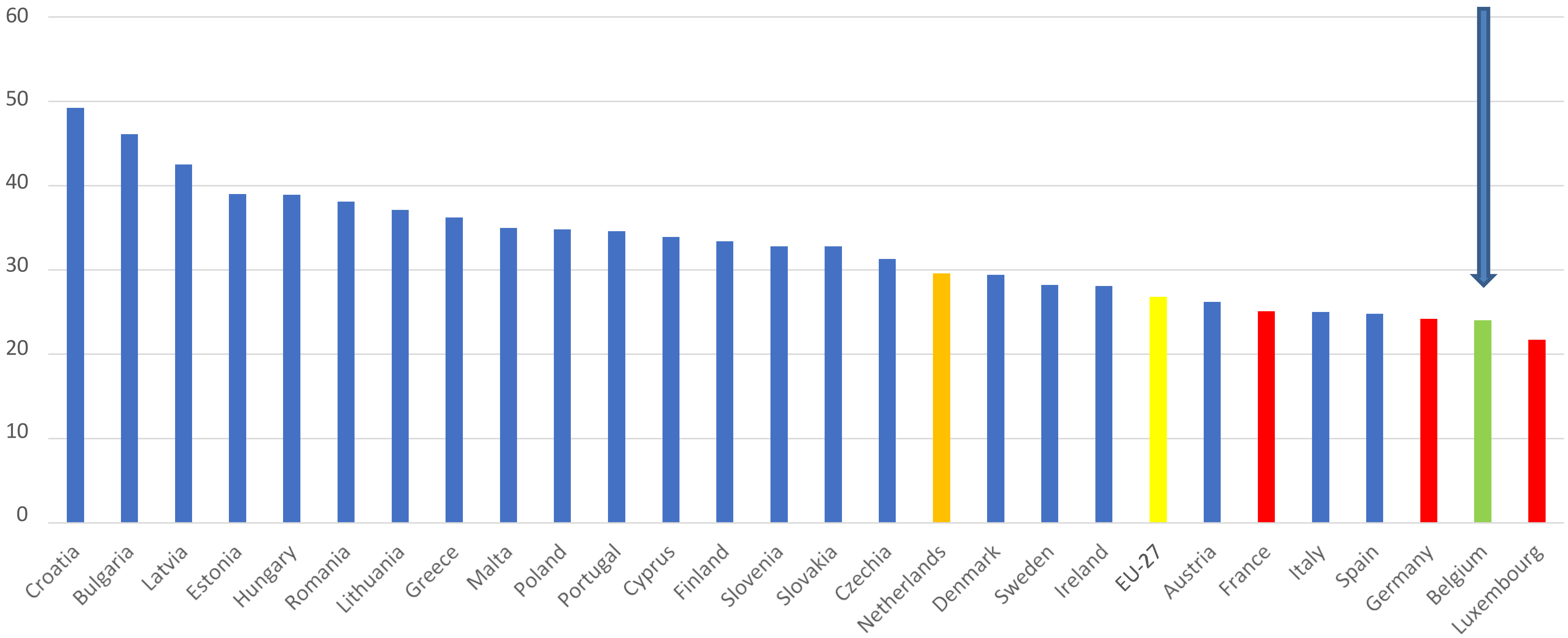
Only justifiable specific systems

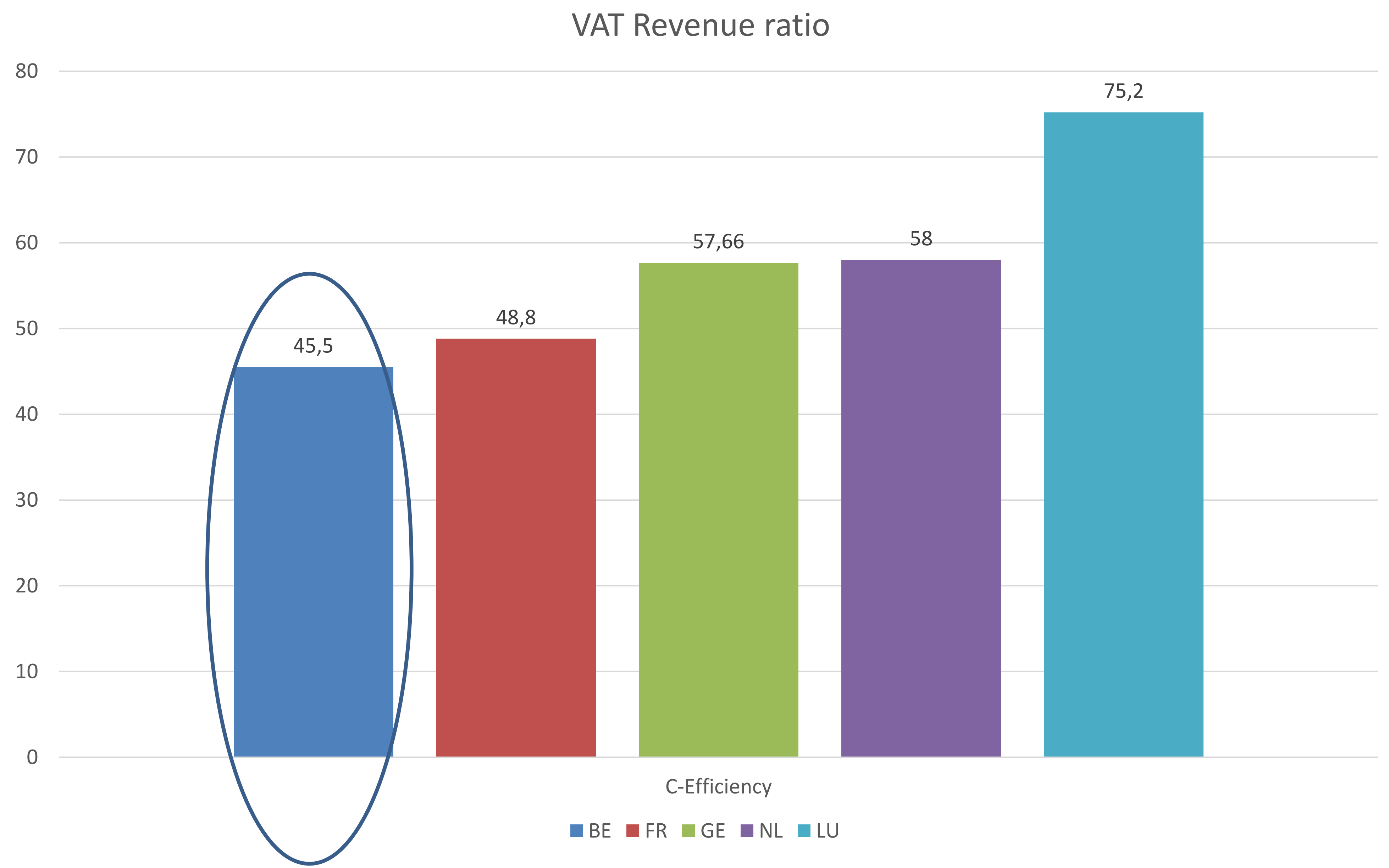
- Divergent systems must:
  - be justifiable in a special way
    - e.g. greening the corporate vehicle fleet → environment
    - e.g. competitive attractive rewards for the senior staff of growth companies in competitive sectors → international competitiveness
    - e.g. investment deduction → investing and entrepreneurship
    - e.g. lump sums for costs and reimbursement of costs proper to the employer → administrative simplification
  - Be purposeful, straightforward and specific
    - e.g. avoid unwanted use of copyright regime
    - e.g. tighten exemption from withholding tax pass-through payment
  - be recurrently reevaluated

Consumption taxes – more in detail


Implicit tax rate on consumption - 2020
30
25
20
15
10
5
0
DK
HU
HR
EE
SE
FI
LU
BG
LV
SI
CZ
NL
PL
MT
IE
FR
AT
EL
LT
BE
SK
CY
PT
IT
RO
DE
ES
VAT
Energy
Tobacco/alcohol
residual

Taxes on consumption as % of total taxation




VAT Revenue ratio
80
70
60
50
40
30
20
10
0
45,5
48,8
57,66
58
75,2
C-Efficiency
BE
FR
GE
NL
LU

Existing recommendations

IMF: A revenue neutral, growth-oriented reform could include a fairness-enhancing rebalancing of taxes, with some shift of the tax burden from labour taxes to less- distortive taxes, such as consumption or recurrent real estate taxes. Consideration could be given to raising the standard VAT rate but, given the relatively low productivity of the Belgian VAT and the size of VAT tax expenditures- 2.3 percent of GDP in 2018- the focus could instead be on harmonizing reduced VAT rates and cutting back exemptions. Efforts to improve Belgium's VAT C-efficiency should address VAT policy and compliance gaps. Undertaking VAT-gap analysis based on methodology of the IMF Fiscal Affairs Department to estimate policy and compliance gaps would be an important first step. In addressing reduced rates, a gradual, well communicated, and predictable process to converge rates could help with buy-in, taking also into account the overall objective to reduce the labour tax burden (trade-off).

Broadly speaking, social security contributions finance both earnings-linked and quasi- universal expenditures in Belgium, with the demarcation between taxes and the social- security system blurred. Thus, as a longer-term objective, the role and the weight of mandatory SSCs should be carefully analyzed. Consideration could be given to shifting the revenue-raising role of social contributions for quasi-universal outlays to other, less- distortive instruments, including a reformed and streamlined VAT.

Selected building blocks

Taxable elements:

Equal consumption taxes on various goods and services should be pursued as much as possible, subject to indirect taxes that neutralize indirect effects (e.g., environmental taxes, tobacco, alcohol, etc.).

Tariff structure:

A proportionate tariff structure, which (where applicable) allows the externalities of production and consumption to be reflected in prices.


thank you