RESHAPING THE PERSONAL INCOME TAX IN SLOVENIA

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"Reshaping the Personal Income Tax in Slovenia", second OECD Tax Policy Review

OECD Tax Policy Reviews
• Slovenia 2018
• Costa Rica 2017

Fact-finding mission
(Ljubljana, February)

Many stakeholders involved
(administration, private sector, unions, academia)
**Slovenia needs a comprehensive tax reform**

**Aim**

- To prepare Slovenia for the *ageing* of its population by incentivising (younger and older) people to work longer through tax reform, to reduce unemployment which remains high, to « **make work pay more** », to put the funding of the welfare system on a more solid footing, and to strengthen the fairness of the tax system.

**Core elements**

- **Rebalance** the tax mix away from employee SSC towards the PIT, recurrent taxes on immovable property & VAT base broadening
- **Shift** the funding of the pension and health system partly from SSCs to general taxation

**Characteristics**

- (At least) tax revenue **neutral** reform **package**
- The tax reform needs to go hand in hand with a **broader set of reforms** (of the pension and health care system)
The population is ageing rapidly…

Source: OECD
… which will increase ageing-related expenditure considerably…

**Public expenditure (% of GDP)**

- **Other primary expenditure**
- **Pension**
- **Long-term care**
- **Health**

<table>
<thead>
<tr>
<th>Year</th>
<th>Pension, long-term care, health:</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>17.9% of GDP</td>
</tr>
<tr>
<td>2040</td>
<td>23.7% of GDP (+5.8 pp)</td>
</tr>
<tr>
<td>2050</td>
<td>26.8% of GDP (+ 8.9 pp)</td>
</tr>
</tbody>
</table>

Source: OECD projections
… and will put tax revenues under pressure (-1.6% of GDP by 2040)

Change in revenues (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>PIT</th>
<th>SSC Employee</th>
<th>SSC Employer</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>-6%</td>
<td>-8%</td>
<td>-10%</td>
</tr>
<tr>
<td>2030</td>
<td>-4%</td>
<td>-6%</td>
<td>-8%</td>
</tr>
<tr>
<td>2040</td>
<td>0%</td>
<td>-2%</td>
<td>-4%</td>
</tr>
</tbody>
</table>

Source: Authors’ calculations based on Ministry of Finance of Slovenia tax records microdata
The participation rate of male and female workers in the category of 25-54 is the highest of the OECD

**Labour force participation rate, people aged 25-54, 2017 (%)**

Source: OECD
Older workers still leave the labour market too soon

Median PIT and SSCs by age

Source: Authors’ calculations based on Ministry of Finance of Slovenia tax records microdata
Increasing the retirement age could lead to significant exchequer gains.
The Slovenian tax and transfer system strongly reduces inequalities...

Source: OECD
The tax-to-GDP ratio in Slovenia is relatively high

Source: OECD; Trends in Taxation in the EU (2017)
The tax mix is titled towards consumption taxes and SSCs

**Tax mix (% of GDP)**

- Taxes on goods and services
- Social security contributions
- Taxes on income, profits and capital gains
- Taxes on property

**Source:** OECD; Trends in Taxation in the EU (2017)
High SSCs revenues reflect high employee SSC rates

Source: OECD
The top marginal tax rate that employees have to pay is very high

Top marginal “all-in” tax rate (PIT and employee SSC), 2017 (%)

Source: OECD
It results in a very high and distortive tax burden on labour income

Income tax plus employee and employer contributions less cash benefits
(% of average wage)

Source: OECD
Core design principles of the welfare system in Slovenia

1. Finance the welfare state (in particular pension and health funds) through SSCs

2. Maintain a strong link between SSCs made and benefits received
The welfare system in Slovenia is under budgetary pressure

1. Financing a welfare system mainly through SSCs in a setting of low and condensed wage distribution
2. Even in the presence of high rates, low incomes do not pay enough. Introduction of a minimum income base for SSCs. Results in very high employer SSCs

<table>
<thead>
<tr>
<th>Employee wage earnings (% of the AW)</th>
<th>40</th>
<th>45</th>
<th>50</th>
<th>55</th>
<th>60</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statutory employer SSC rate (%)</td>
<td>16.1</td>
<td>16.1</td>
<td>16.1</td>
<td>16.1</td>
<td>16.1</td>
</tr>
<tr>
<td>Additional employer SSC rate (%)</td>
<td>7.6</td>
<td>5.7</td>
<td>3.8</td>
<td>1.9</td>
<td>-</td>
</tr>
<tr>
<td>Effective employer SSC rate (%)</td>
<td>23.7</td>
<td>21.8</td>
<td>19.9</td>
<td>18</td>
<td>16.1</td>
</tr>
</tbody>
</table>
TACKLING THE CHALLENGES TO FINANCE THE SOCIAL SECURITY SYSTEM
Main recommendations

• Reduce employee SSCs significantly
• Broaden the SSCs base
• Diversify the financial resources dedicated to health care – HIIS focus on main activities - engage in a review of the funding needs for health
• Lower the minimum SSC income base
• Align the SSCs for regular employees and the self-employed
• Evaluate the link between SSCs paid and benefits received
The SSC loss associated with an employee SSC rate cut will be partly recovered through the PIT system.

Source: Authors’ calculations based on Ministry of Finance of Slovenia tax records microdata
Higher incomes will gain more in EUR from a general cut in employee SSC

Mean disposable income from employment (EUR)

Source: Authors’ calculations based on Ministry of Finance of Slovenia tax records microdata
Slovenia’s welfare system relies mainly on funding through SSCs

Financing sources of compulsory insurance by type of revenue, 2015 (or nearest year) (%)

- Other domestic revenues
- Compulsory prepayment
- Voluntary prepayment
- Social insurance contributions
- Transfers from government domestic revenues

Source: OECD
STRENGTHENING THE DESIGN OF THE PERSONAL INCOME TAX
Main recommendations

• Redesign the PIT rate schedule
  – Abolish the top PIT rate & bracket
  – Increase the PIT rates in the second, third and fourth tax bracket

• Broaden the PIT base

• Redesign the provisions that provide support for children

• Reduce tax disparities between different business legal forms
  – Abolish the flat-rate regime or, at least, make it less generous
Abolishing the top PIT rate does not cost much revenue

Estimated PIT revenue loss from various reductions of top 50% PIT rate (EUR million)

Source: Authors’ calculations based on Ministry of Finance of Slovenia tax records microdata
The bottom PIT rate hits at a relatively high income level

Source: OECD
The effectiveness of the PIT is enhanced by an employee SSC rate cut

Cumulative PIT revenues from selected PIT rate increases, with a 16.86% employee SSC

<table>
<thead>
<tr>
<th>PIT rate bracket increases of:</th>
<th>1%</th>
<th>2%</th>
<th>3%</th>
<th>4%</th>
<th>5%</th>
</tr>
</thead>
<tbody>
<tr>
<td>First</td>
<td>43</td>
<td>85</td>
<td>128</td>
<td>170</td>
<td>213</td>
</tr>
<tr>
<td>Second</td>
<td>26</td>
<td>51</td>
<td>77</td>
<td>103</td>
<td>128</td>
</tr>
<tr>
<td>Third</td>
<td>8</td>
<td>17</td>
<td>25</td>
<td>34</td>
<td>42</td>
</tr>
<tr>
<td>Fourth</td>
<td>1</td>
<td>3</td>
<td>4</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>Total</td>
<td>78</td>
<td>156</td>
<td>234</td>
<td>313</td>
<td>391</td>
</tr>
</tbody>
</table>

Source: Authors’ calculations based on Ministry of Finance of Slovenia tax records microdata
Small reductions in tax allowances/ exemptions would increase PIT revenues significantly

Estimated PIT revenue associated with reducing allowances (EUR million)

Source: Authors’ calculations based on Ministry of Finance of Slovenia tax records microdata
BROADEN THE VAT BASE & INCREASE RECURRENT TAXES ON IMMOVABLE PROPERTY
Indirect taxes: Maintain the 22% standard VAT rate

Source: OECD
# Broaden the VAT base

<table>
<thead>
<tr>
<th>Removing reduced VAT rates on...</th>
<th>Revenue gains</th>
<th>Revenue gains</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR million</td>
<td>% of total tax revenues</td>
</tr>
<tr>
<td>All reduced VAT rates</td>
<td>686.7</td>
<td>4.84%</td>
</tr>
<tr>
<td>Books Admission to shows</td>
<td>9.4</td>
<td>0.07%</td>
</tr>
<tr>
<td>Books Admission to shows</td>
<td>27.3</td>
<td>0.19%</td>
</tr>
<tr>
<td>Newspapers and periodicals</td>
<td>27.3</td>
<td>0.19%</td>
</tr>
<tr>
<td>Hotel accommodation</td>
<td>67.5</td>
<td>0.48%</td>
</tr>
<tr>
<td>Restaurant food</td>
<td>67.5</td>
<td>0.48%</td>
</tr>
<tr>
<td>Passenger transport</td>
<td>16.7</td>
<td>0.12%</td>
</tr>
</tbody>
</table>

Source: OECD consumption tax microsimulation models
Capital incomes are highly concentrated in the very top of the distribution

Capital income distribution - percentiles 1 to 90, by type, 2016 (EUR million)

Source: Authors’ calculations based on Ministry of Finance of Slovenia tax records microdata
METRs do not increase with income

METRs (%)

Low income (67%AW)  
Average income (100%AW)  
High income (500%AW)

- Low income (67%AW)  
- Average income (100%AW)  
- High income (500%AW)

Bank Deposits  
Shares: taxed as dividends  
Shares: taxed as capital gains  
Private Pensions: deductible contributions  
Residential property: equity financed; owner-occupied  
Residential property: equity financed; rented

Source: OECD
EUR 18 million can be raised for each 5 pp increase of the capital income tax rate

Estimated capital income tax from increasing the capital income tax rate by 5 pp, 10 pp and 15 pp (EUR million)

Source: Authors’ calculations based on Ministry of Finance of Slovenia tax records microdata
Revise the tax treatment of immovable property

<table>
<thead>
<tr>
<th>Recurrent taxes on immovable property</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current situation (2015)</td>
</tr>
<tr>
<td>% of GDP</td>
</tr>
<tr>
<td>0.5</td>
</tr>
<tr>
<td>Scenarios</td>
</tr>
<tr>
<td>1.1*</td>
</tr>
<tr>
<td>2.5**</td>
</tr>
<tr>
<td>3.1**</td>
</tr>
</tbody>
</table>

*OECD average in 2015
**OECD best performers
Take the opportunity of the current property tax reform to reform the financing of municipalities

Local governments revenues (% of GDP)

- Personal income tax
- Taxes on property
- Other tax revenues
- Non-tax revenues
- Transfers

Source: Ministry of Finance of Slovenia
Thank you for your attention

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ANNEX
The relatively high PIT rates increase the labour tax burden significantly.

Average tax wedge decomposition by level of gross earnings expressed as a % of the AW, single taxpayer without children.

Source: OECD
Cash benefits reduce the net personal average tax rate for families with children

Average tax wedge decomposition by level of gross earnings expressed as a % of the AW, one-earner married couple with two children (%)

- average central income tax (% of total labour costs)
- employee SSC (% of total labour costs)
- employer SSC (% of total labour costs)
- net personal average tax rate (% of gross wage earnings)
- average tax wedge (sum of the components)
- cash benefits (% of total labour costs)

Source: OECD
Public debt can be reduced further

Source: IMF; Ministry of Finance of Slovenia
The last tax reform (2006-07) had significant impacts on the deficit and debt.

Government deficit and debt (% of GDP)

- Impact on government deficit
- Impact on government debt

Source: Ministry of Finance of Slovenia