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Autumn has come

Forecast of tax and social security revenues for 2019 - 2022

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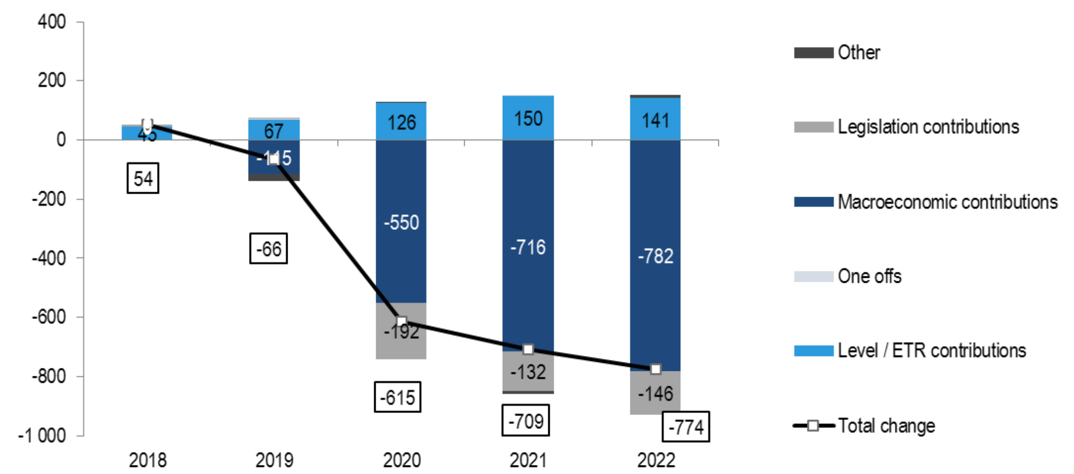
The economic slowdown and legislative effects pull tax and social contribution revenues downwards. For this year, we reduce our June estimate by EUR 66 mil. During the next three years, revenues are expected to drop by EUR 700 mil. on average, thereof, the government stimulus is to reduce the general government revenues by EUR 300 mil. on average, each year. The overall economic downturn will also be marked by the weakening economic performance which will be seen in slack of domestic consumption and the labour market. On the other side, we expect slightly higher tax revenues owing to improved effectiveness of tax collections. The effective tax rate grows, in particular, in corporate tax and VAT revenues.

Tandem of economic slowdown and legislation results in a drop

The cyclical economic slowdown revises tax and social contribution revenues downwards. Lower performance is expected over the whole forecasted horizon in the extent EUR 66 to 774 mil. (Figure 1). The existing pessimism is reflected, in particular, through lower household consumption and labour market. The effect on revenues that the introduced government stimulus is expected to have in following year will be EUR 300 mil. On the other hand, these effects are partly offset by the expected increase in tax rate on tobacco products[1].

Figure 1: Change of GG tax revenue forecast compared to June 2019 (in EUR mil.)



Source: IFP, *UloziskoIFP*

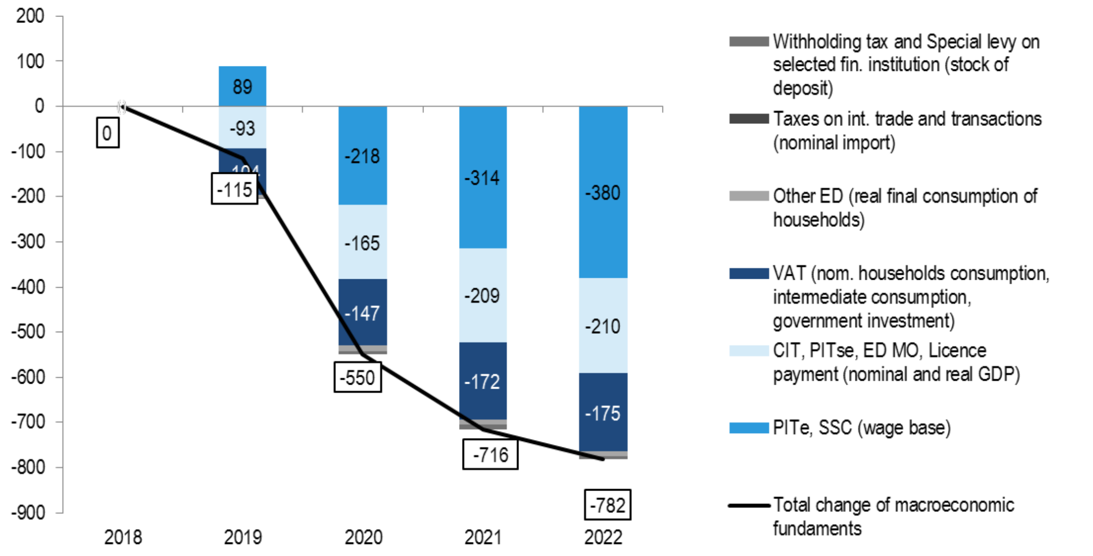
The tax mix reflects economic slowdown

Worse performance over the whole forecasted period reduces tax revenues; this year, the labour market makes a positive exception. In 2020 through 2022, the first fiddle will be played by the labour market, which is expected to slow down and result in reduction of revenues from labour taxes and social contributions. Moreover, expected is also lower

[1] Considering the statute of the tax committee, increase in the excise duty on tobacco products is included in the forecast, as it has been properly approved by the government. However, there is a risk of not approving the measure by the parliament. In such case, in 2020 – 2022, tax income will be lower by EUR 102 - 138 mil.

household consumption accompanied by gradual cooling of the economic growth (Figure 2).

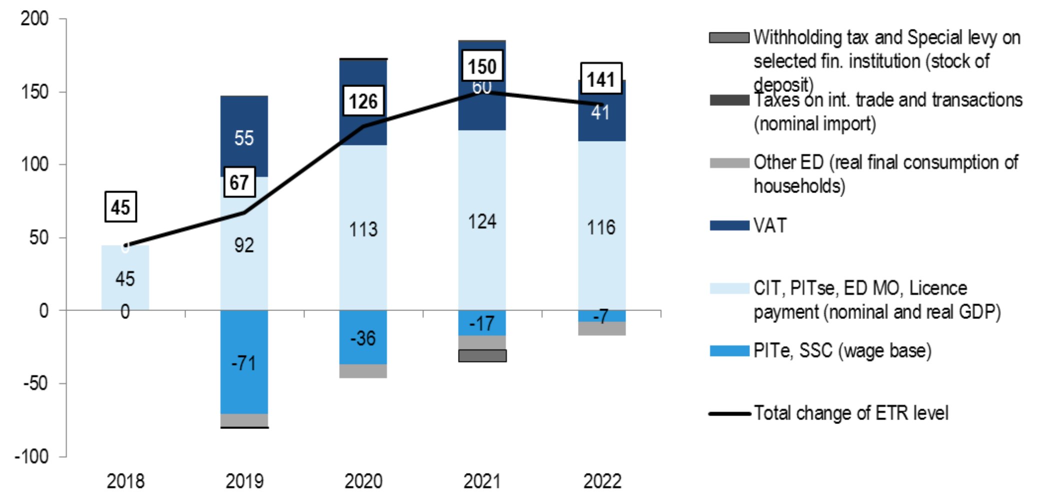
Figure 2: Tax[2] revenues update based on current macroeconomic forecast (EUR million)



*zdroj: IFP, **UloziskoIFP***

The decline in revenues caused by macroeconomic development is partly offset by the growing effective tax rate. More than a half of the reduction in macroeconomic bases in 2019 will be outweighed by growing effective tax rates, starting from 2020, the positive outcome of effective tax rates is expected to slow down (Figure 3). The major driver of the effective tax rate over the whole period will be the corporate income tax. A mild growth in VAT collection continuously contributes to the overall growth of the effective tax rate. The effect of lower effective tax rates surprised on the downside on personal income tax, social and health insurance contributions. This is noticeable, in particular, in 2019 and 2020.

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



*Source: IFP, **UloziskoIFP***

[2] Taxes are categorised based on the macroeconomic aggregate having the major impact thereon. ED = excise duties, PITb = personal income tax (business activities), PITe = personal income tax (employment), ED MO = excise duty on mineral oils, SC= social contributions, HC= health insurance contributions.

The government stimulus reduces revenues by EUR 300 mil.

Adoption of the new legislation will be reflected in reduction of revenues in the following year. The new legislative package will result in a substantial decrease in revenues (Table 1). Major negative effects stem from the increase of the non-taxable part of the tax base, adoption of the reduced VAT rate on selected foodstuffs and 15 % income tax rate. Based on the statute of tax committee, the forecast also assumes budget revenues from the government-approved increase of the excise duty on tobacco products. Revised effects of the existing legislation have slightly positive impact. Another thing that is worth mentioning is the revision of the legislative measure related to the 13th and the 14th salary. The uptake of this measures increased considerably year on year, yet it still falls behind the estimates of the last tax forecast.

Table 1: Legislative measure incorporated in the tax forecast (compared to June, in EUR mil.)

	2018	2019	2020	2021	2022
Increase of the non-taxable part of the tax base to 21 times of the subsistence minimum	0	0	-135	-136	-137
Reduced VAT rate for other foodstuffs	0	0	-77	-81	-84
15% rate of corporate income tax for companies with turnover up to EUR 100 th., 21% for others	0	0	-42	-44	-45
Personal income tax (business) reduced to 15% with turnover up to EUR 100 th.	0	0	-19	-19	-21
Cancellation of concessionary fees for old-age pensioners and beneficiaries of “benefits in material need”	0	0	-8	-8	-8
Reduced VAT rate for print media (daily newspapers only)	0	0	-6	-6	-6
Introduction of sports vouchers	0	0	-2	-2	-2
1. Government stimulus	**0**	**0**	**-291**	**-297**	**-304**
2. Increase of excise duty on tobacco products	**0**	**0**	**102**	**137**	**138**
3. Revised legislation[3]	**9**	**1**	**-3**	**27**	**20**
4.=1+2+3 Total legislative effects	**9**	**1**	**-192**	**-133**	**-146**

Source: IFP, ***UloziskoIFP***

Development of corporate tax revised downwards

Compared to the June forecast, we increase corporate tax revenues for 2018 by EUR 45 mil. based on higher-than-expected settlement.[4] A part of the higher revenue for 2018 results from updating the estimates of cancelling the tax licence based on latest tax returns. Profitability of companies for 2018 was relatively strong. However, based on milder economic growth, revenues are revised downwards for the following years. Introduction of the lower corporate tax rate at 15 % for small companies is associated with a gap of around EUR 45 mil.

VAT in line with economic developments

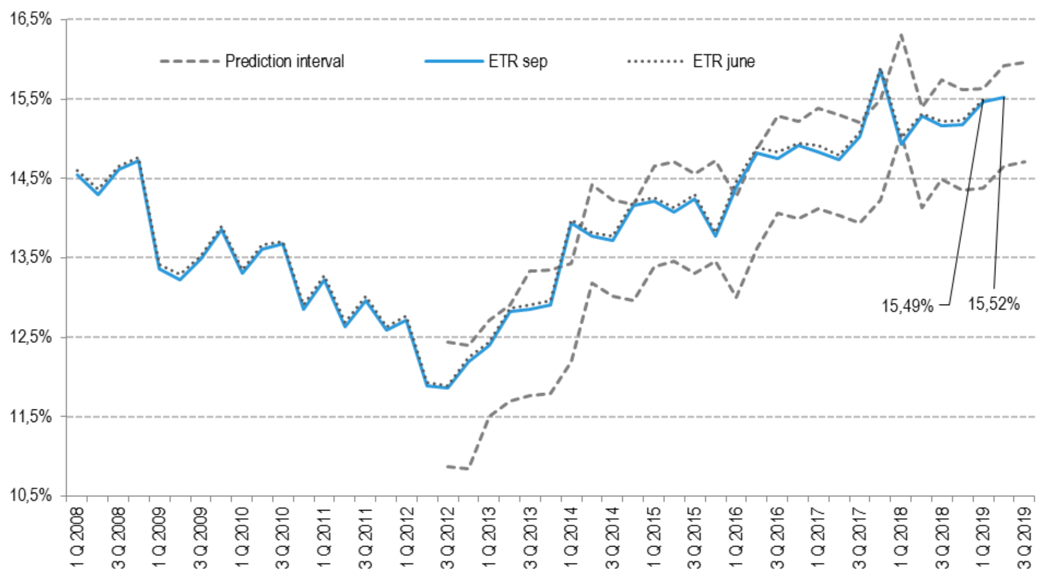
VAT collection copies the economic development with continued growth of collected amounts. VAT revenue is further driven by favourable cash settlement, which is expected to last also in the second half of 2019. On the contrary, macroeconomic indicators relevant for VAT forecasting like household consumption, government investments and intermediate consumption experienced a slowdown compared to the latest forecast. The increased tax rate on tobacco products is another factor that is expected to contribute to better collection of VAT next year. The decline of imports can affect higher collection through customs offices, which is to compensate the lower amount of VAT

[3] These are, in particular, changes in the 13th and 14th salary, revision of legislative cancellation of the tax licence, higher utilisation of the tax refund on R&D, cancellation of the deductible item for health contributions for employers and the waste disposal levy.

[4] Based on individual tax returns for 2018, filled by the end of August 2019.

refunds[5]. The forecast for the years to come assumes a steady effective tax rate from last two quarters at 15.49 % (Figure 4).

Figure 4: Effective VAT rate (%)[6]



Source: IFP, ***UloziskoIFP***

Gap in contributions due to expected slowdown of the labour market

The downward revision of the wage base from 2020 results in a substantial reduction in the forecasted amount of social and health contributions. Despite strong growth of wages in the second quarter 2019, it is expected that for the rest of the year, the labour market is likely to stagnate, and the following years will see a considerable decline. Starting from June, when the amount of social and health insurance contributions decreased, a slowdown in the growth of revenues is seen on a month-on-month basis. In health contributions, the step increase in minimum wage will contribute to higher collection owing to lower applicability of the deductible item for health contributions[7]. The legislative measures will have only a negligible effect on revising the forecasted health and social contributions.

Legislative gap in personal income tax

The weakening macroeconomic environment and the adopted legislative changes push the personal income tax revenues downwards. The slowdown at the labour market decreases the expected revenue for all labour taxes. As with health and social contributions, the growth of the wage bill in 2019 has not been reflected sufficiently in higher labour tax revenues. The approved legislative package has a negative impact on personal income tax revenues as well as on other taxes. Specifically, it relates to increasing the non-taxable part for the taxpayer and adoption of a reduced rate for self-employed persons; which substantially reduces the revenues from personal income tax from business activities (Box 1).

[5] VAT paid at customs offices are claimed by corporations as an input tax, which means a lower amount of VAT refunds and a higher own tax liability.

[6] The bands around the ETR represent prediction intervals for one quarter calculated beforehand from a random process. The resulting intervals are aimed to identify the limits.

[7] The deductible item for health contributions can be used by low-income employees, with monthly earnings lower than EUR 570.

Excise taxes copy the business cycle

Excise duties failed to meet the revenues expectations, in particular, owing to the revenues from mineral oil tax, which is declining for some time now. For the following years, revenues decrease also in consequence of the slowdown of the economic growth. On the contrary, the draft new legislation for taxation of tobacco products increases revenues. Higher revenues from excise duty on tobacco products results from increased rates of tax on cigarettes, smokeless tobacco products and tobacco. The higher excise duty will increase the consumer prices of cigarettes by 40 cents on average and the price of a package of smoke-free tobacco products will go up by around 50 cents. As to other excise duties, slightly higher revenues are expected only from excise duty on wine and electricity.

Box 1: How self-employed persons succeed in doing business

Self-employment is a hybrid scheme in Slovak tax system. In self-employment, business elements (the concept of income and expenses) coincide with employment (application of non-taxable parts and tax bonuses). In terms of tax burden, the self-employed benefit from both worlds. The major legislative changes in form of increasing the non-taxable part of the tax base and introduction of the 15 % tax rate lowers the burden on the self-employed persons and further improves the already high tax-attractivity of self-employment.

Figure A: Distribution of income (self-employed)*

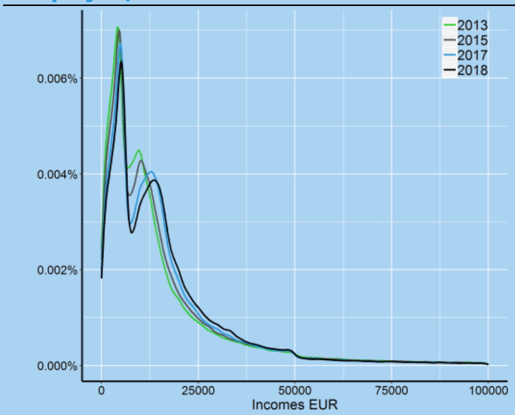
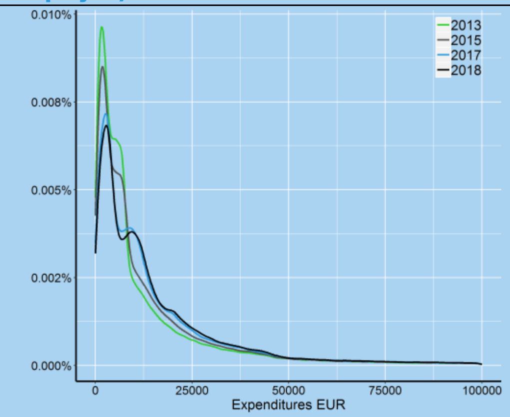


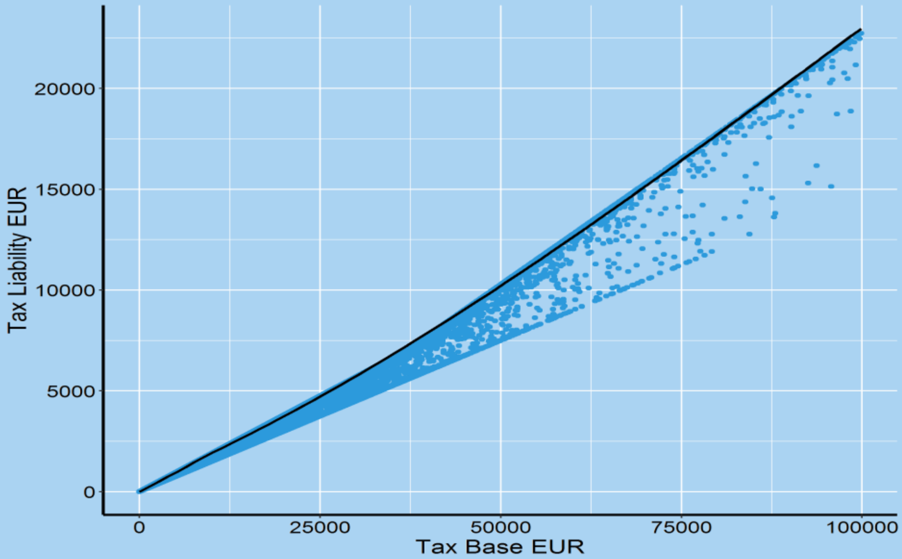
Figure B: Distribution of expenses (self-employed)*



** Estimated probability distribution* *Source: calculations IFP*

During past years, tax burden on the self-employed have been decreasing. In 2013 total number of self-employed persons was decreasing, as well as their income distribution. The situation has changed in 2017 thanks to the introduction of lump-sum allowances. The tax status of self-employed persons has improved not only thanks to the favourable economic situation, but also thanks to targeted legislation in form of lump-sum allowances increasing the attractivity of self-employment and boosted their disposable income (Figures A and B). The latest data reported in tax returns for 2018 indicate that the growth of expenses incurred by self-employed is slowing down. Compared to 2017, the growth rate was lower (2.2 % in 2018 vs. 5 % in 2017). On the other hand, in 2018 the growth rate of income generated by the self-employed accelerated (3% vs. 2.7% in 2017) and outpaced the growth of expenses.

Figure C: Tax base to tax liability ratio – effects of legislation



Source: IFP calculations

Since 2020, a new legislation has been enacted to implement a reduced 15% tax rate for selected group of self-employed persons. The change will increase complexity of the system as it will be necessary to keep records of the amount of income, not only the tax base. The lower rate only applies to certain types of income and the key aspect is no longer the tax base, but the amount of income, which is a substantial change in the existing taxation principle. As a result, two self-employed persons with equal tax base may end up with a different tax liability. In tax terminology, such effect is called horizontal tax injustice and it indicates a complex configuration of the system. Figure C uses real data to illustrate the spread of the tax liability depending on the combination of income earned by the self-employed (from business activities, from employment, from leasing, etc.).

Thus, self-employment is becoming an attractive legal form, despite persisting risks associated with future social security. Those who are expected to benefit from the new legislation are not only groups with income close to the average wage, but also those with higher earnings. Owing to the low level of paid contributions, the self-employed are becoming a group which is at risk in a long-term horizon. The reason is that a considerable percentage of the self-employed (approximately 70 %) only pay contributions from the minimum assessment base. Under the current system, this group of self-employed persons would only receive a minimum old-age pension in the amount of EUR 322 per month.[8] Without additional savings from current earnings (or without a change in the legislation) these persons can be vulnerable in terms of their pension security.

The Ministry of Finance of the Slovak Republic, in accordance with the Constitutional Act on Budget Responsibility, updates and publishes forecasts of tax and social contribution revenues. These forecasts were discussed at the meeting of the **Tax Forecast Committee (VpDP) on 19 September 2019**. **The Bureau of Budgetary**

[8] The calculation is based on the assumption that the self-employed person has constantly worked for 40 years and during that whole period, the person has paid social contributions from minimum basis of assessment. Under that assumption, his/her pension would be EUR 304, which is below minimum pension and, consequently, it would be necessary to top-up the amount, so that the pension is EUR 322.

Responsibility Council (KRRZ), NBS, Infostat, SLSP, Tatrabanka, ČSOB and UniCreditBank acknowledged the forecast as realistic.

For more details on tax forecasts, including supporting documents, visit the IFP website in folder Economic forecasts ⇨ Tax Revenue Forecasts.

Detailed data regarding development of individual tax revenues over the forecasted period, including breakdown of the contributions of individual factors to the update of the forecast, and the data underlying individual disclosures in the Policy Briefs are available at UloziskoIFP.

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