inštitút finančnej politiky

Ministry of Finance SR / www.finance.gov.sk/ifp

14 February 2020

Growth in Spite of Slowdown

Forecast of tax and social security revenues for 2019 - 2023

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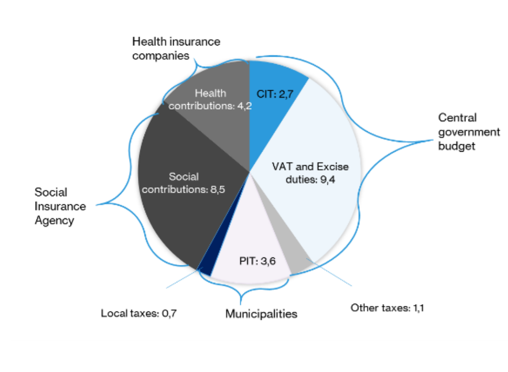
In 2020, the growth of tax and social security contribution revenues will slow down from 6.1% to 3.2%. The reasons include mainly the decline in wage growth and last year's legislative measures[1]. From 2021, the revenue growth will be revived again, thanks to the re-accelerated growth of wages and household consumption. In 2023, the revenue growth will be hit by the end of the Euro fund period. Compared to the previous tax forecast from November, we increase the tax and social security contribution revenues by EUR 78 to 84 million in 2020 to 2022, mainly due to the strong VAT growth in the second half of 2019. From 2020, the property taxes contributes to higher revenues, with the municipalities breaking the long-term taboo increasing the rates by 34 percent in average.

Year on year tax and social security contributions development

Economic slowdown decreasing the tax and social security contributions growth rate

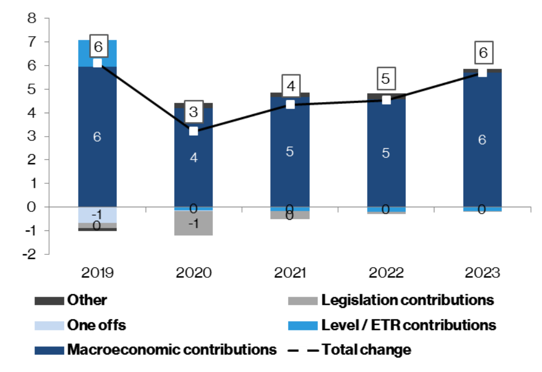
In 2020, we expect the tax and social security contribution revenues of public administration in volume of approximately EUR 30 billion. Thereof, almost EUR 13.6 billion will stream to the national budget (Chart 1). In 2020, the revenue growth rate will decelerate to 3.2 percent compared to 6.1 percent in 2019 (Chart 2). About two thirds of the revenue growth slowdown in 2020 are due to the economic development, the lower wage growth in particular. The legislative measures adopted last year take off additional percentage point from the revenue growth in 2020. In 2021-2022, the revenue growth will be revived again approaching 4.5 percent along with ramp up of the economic growth and the conclusion of the Euro fund period in 2023 will push the revenue growth almost up to 6 percent.

Figure 1: Tax and social security contribution in 2020 (mld. eur)



*Source: IFP, **UloziskoIFP***

Figure 2: Tax and social security contribution revenue growth (y-o-y; %)



*Source: IFP, **UloziskoIFP***

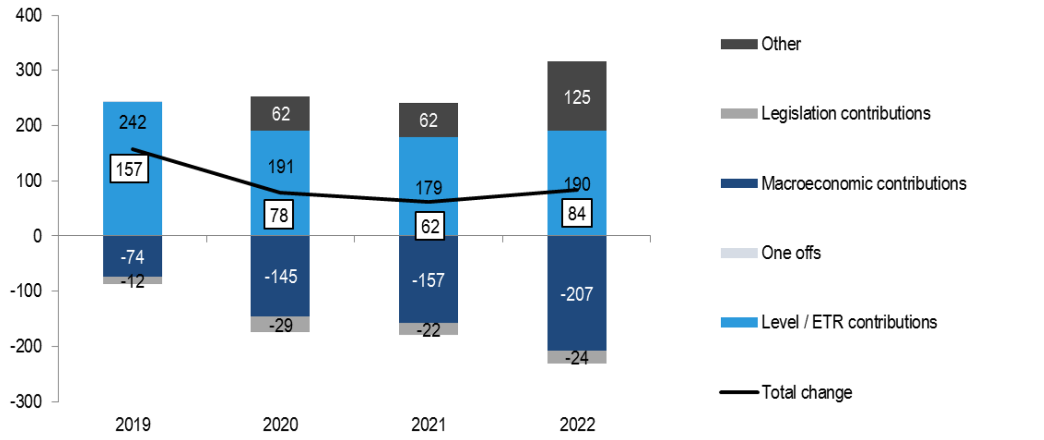
Comparison of the current estimate with the November forecast

Success of the VAT collection increasing the revenues even in spite of the economy slowdown

[1] This is a legislative package including the corporate tax decreased to 15 percent, VAT for select foods decreased, increased non-taxable portion of the tax base and other.

Compared to the latest forecast, we increase the tax and social security revenues for the next three years by EUR 78 to 84 mil. (Chart 3). The core increase on the forecast horizon streams from the improved performance of 2019, in particular the value added tax (VAT), which is transferred to the following years. On the contrary, the economic development will be less favourable in terms of tax and social security revenues over the whole forecast horizon. Since the November forecast, no new legislative measures were adopted at the government level with direct impact on the tax and social security revenues. However, based on the current information, it turns out that some of the measures adopted in the past have a slightly more negative impact on the revenues.

Figure 3: Change of GG tax revenue forecast copared to November 2019 (mil. eur)

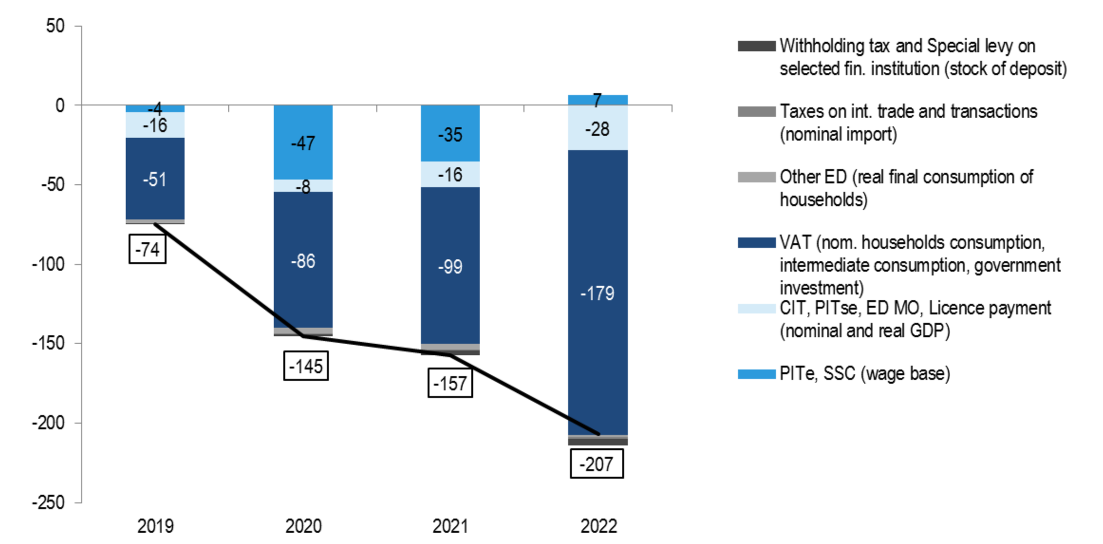


Source: IFP, *UloziskoIFP*

Tax mix reflecting the economy slowdown

Sluggish macroeconomic development cuts off from EUR 150 to 210 mil. compared to the previous forecast of 2020-2022 (Chart 4). The new macroeconomic prediction has a negative impact mainly on the estimated VAT collection over the whole horizon. The slightly lower estimated wages have a negative impact on taxes and social security contributions of 2020-2021; however, by 2022, this impact will fade away with slight improvement on the labour market.

Figure 4: Tax revenues update based on current macroeconomic forecast (EUR million) [2]

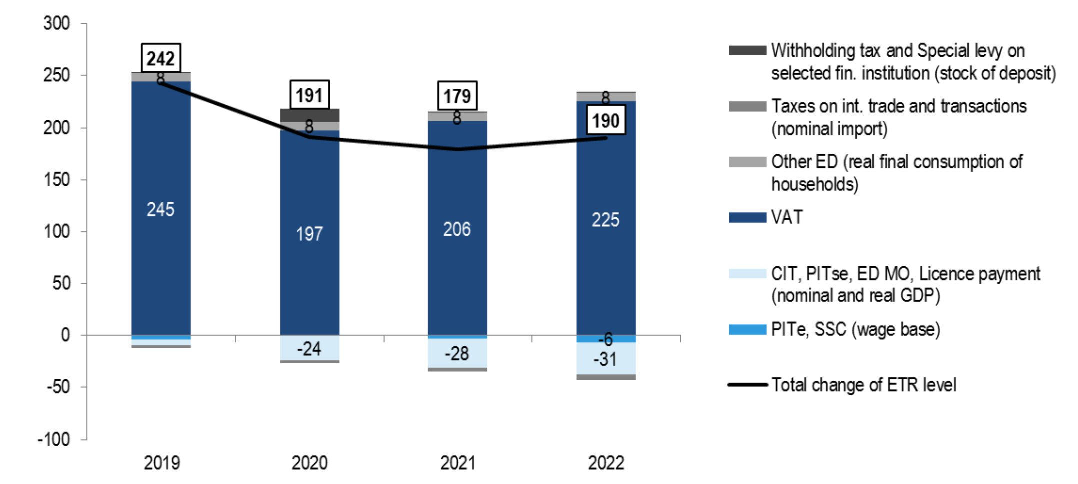


Source: IFP, *UloziskoIFP*

Stronger EDS transferred to the next years

Better collection measured by efficient tax rate will offset the drop of incomes caused by the macroeconomic development (Chart 5). The core of the revenue is due to strong VAT performance from the second half of 2019, which we transfer to the whole forecast horizon. Because of better performance of the tobacco products excise duty, the effective excise tax rate has been slightly growing. On the contrary, the effective corporate tax rate is lower than expected due to the decreased corporate profits.

Figure 5: Tax revenues update based on changes in ETR (EUR million)



Source: IFP, *UloziskoIFP*

Without new legislation but with higher property tax rates

The tax and social security revenue forecast is slightly negatively influenced by the update of the existing legislation impacts. The most significant change is the robust drawdown of the deductions for science and research (impact on corporate tax). This time, no new legislation is included in the forecast. The shift annual account of social insurance by one year (2023 instead of 2022) occurred in November 2019 already. Increase of the

[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.

property tax rate at the level of individual city and municipalities represents the impact increasing the tax forecast from 2020 (Box 1).

Key tax and social security contribution development

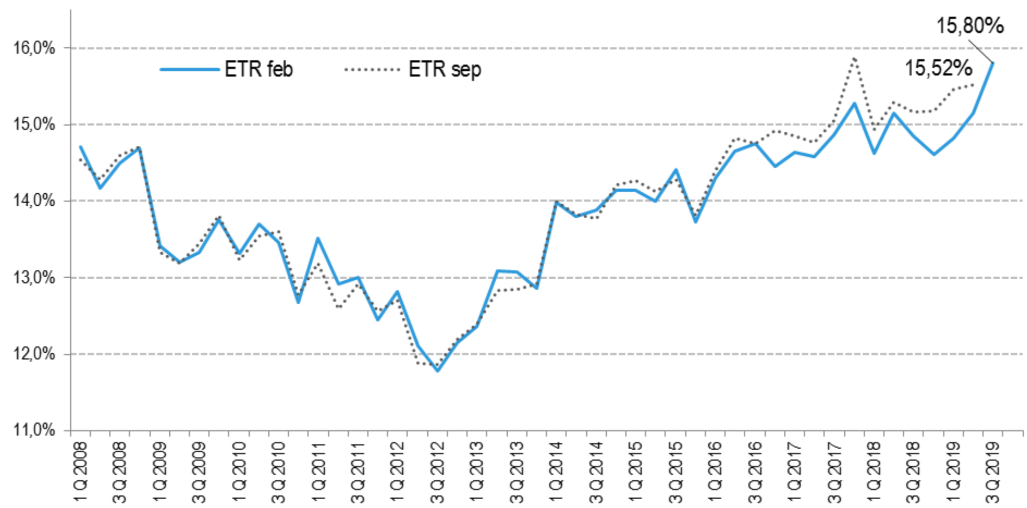
Global economy slowdown reducing the profits of domestic companies

The corporate tax revenue for 2020 is reduced by EUR 67 mil. compared to the November forecast.[3] This s due to the expected decrease of corporate profit for 2019[4], mainly in pro-export industrial companies resulting from the slowdown of the main European partners. The lower revenue is also contributed by the higher drawdown of the deductions for science and research that will continue increasing in the upcoming year due to increased of the relieve up to 200 percent of the expenses.

VAT outrunning the economic expectations

The strong VAT growth in the 3Q 2019 was reflected in the significant increase of the effective tax rate (Chart 6). The strong VAT revenue reflects the growth of sales across sectors[5]. Thus, the improved VAT collection from the 2nd half of 2019 is also reflected in the following years of the prediction. On the contrary, the sluggish household consumption, government investments and intermediate consumption correct the increase of the VAT across the horizon. The export slowdown will hold up the industry performance, based on which lower excess deductions paid are expected[6].

Figure 6 : VAT Effective Tax Rate (%)



*Source: IFP, **UloziskoIFP***

Minimal changes of the social and health insurance contribution forecast

The downward revision of the wage base contributes to the slight decrease of the social and health insurance contributions forecast. Only towards the end of the horizon, the labour market forecast is slightly improving. In health insurance contribution, we reduce the positive impact of the annual account based on lower performance in 2019. On the contrary, higher performance of the social security contributions by December improves

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[3] Based on the individual tax returns for 2018 filed by the end of August 2019.

[4] In 2020, we also forecast the year of 2019 in the corporate tax. In the period from March to September 2020, the companies will file their tax returns for 2019. Profitability for 2019 will decrease by -0.8 percent compared to the profit growth of +1.4 percent expected in November.

[5] Comparison of the year on year growth of sales in entities installing eKasa during 2019, does not show a more significant difference following its introduction. The year on year growth of sales for the period before installing eKasa was 4 percent compared to 3 percent following installing.

[6] The export companies apply the paid VAT as the input tax (decreasing the tax liability), which indicates further possible reduction of the excess deductions in proportion to the tax liability itself.

the future forecast. The amount of the social security contribution forecast is further only influenced by the updated effect of the existing legislative.

Growing number of self-employed

Revenue from the personal income tax from dependent activities has been slightly decreasing; on the other hand, the self-employment is waking up. Lower expected growth of the labour market decreases the revenues from personal income tax. Adjustment of the flat-rate expenditures attracted a number of self-employed persons, the number of which increased by 11 percent since the last increase in 2017. This affects positively the growing business tax revenue, increasing the expectations for this tax.

Excise duties
No change

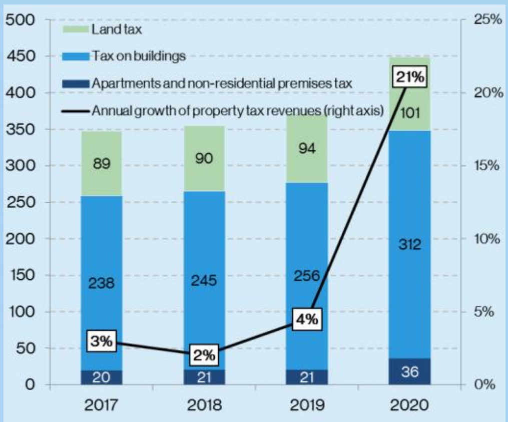
We are not changing the excise duties in global compared to the November forecast. The mineral oil tax revenue is decreasing due to the slowdown of the economic growth. The higher than expected collection of excise duty on tobacco products in the end of 2019 is also expected to continue in the upcoming years. Among other excise duties, only marginally higher revenues in the electricity and coal excise duties are expected.

Box 1: Property tax on a wave of growth

In 2020 the municipalities will collect EUR 78 mil. more in property taxes. As many as 48 of 71 county capitals went on to approve the generally binding regulations adjusting the property tax rate. The property tax revenue has been growing in long term by about 3 percent per annum; however, this time it will bring the revenue growth by 20percent. By increasing the taxes and fees within their competence, the municipalities are partially covering their increased expenditures and lower growth of the personal tax redistributed within the self-government. What will increase the most is the collection of tax on buildings, which form the core of the property tax (EUR 51 mil.). Apartments and non-residential premises will grow by EUR 14 mil., land by EUR 13 mil. (Chart 7).

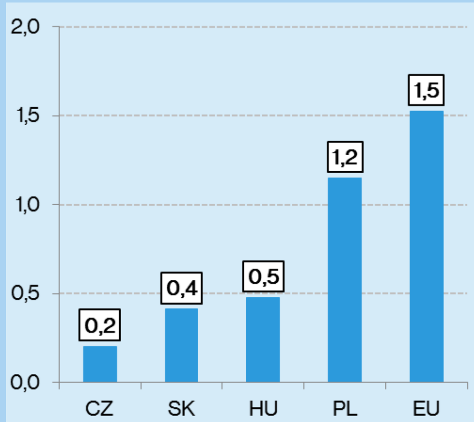
The property taxes generate higher revenue in other countries.[7] Slovakia ranks among the countries with the lowest property tax revenue, achieving around a quarter of the average EU revenue (Chart 8). Even if the Act on Local Taxes enables the municipalities to adjust their individual rates, it limits their maximum amount regardless of the property value. The fair value of the property is not considered in the Slovak legislation.

Figure 7: Property tax revenues (EUR mil)



Source: IFP – State Treasury, DataCenter and Generally binding regulations, UloziskoIFP

Figure 8: Property tax revenues, 2018 (% GDP)

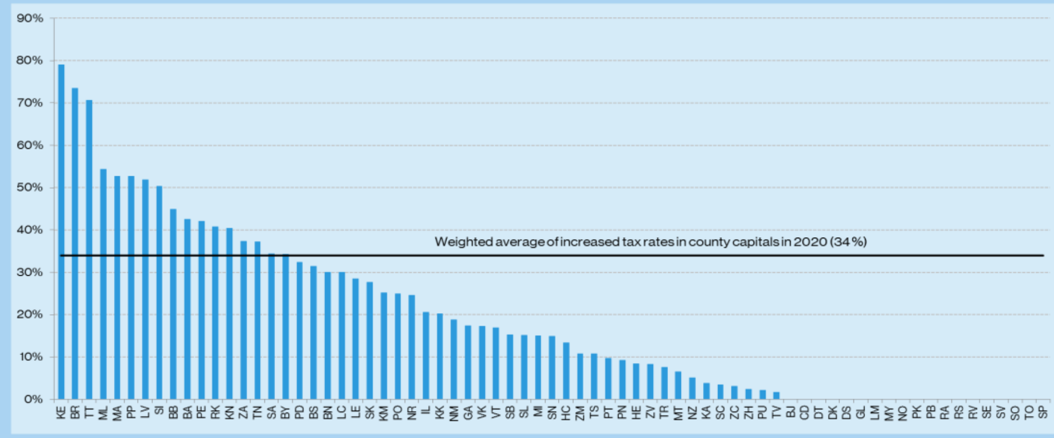


Source: Eurostat, UloziskoIFP

[7]Taxation of labour and redistribution of the personal income tax is the most important source of income of the municipalities, accounting for 75% of total income in the long term.

In absolute terms, the residents of Bratislava will pay most extra, while the residents of Košice top the list in relative figures (Chart 9). In average, the county capitals increased their rates by approx. 34 percent This is the weighted average based on the difference of rates and the historical tax collection for individual property types. The city of Košice has increased the property tax rates the most, followed by Trnava and Banská Bystrica. We assume that the growth of tax collection for municipalities other than county capitals will grow in compliance with the long-term tax collection increase in individual municipalities, which represents roughly a 3 percent growth.[8]

Figure 9: Average increase of property tax rates in county capitals



Source: IFP - DataCenter and Generally binding regulations, UloziskoIFP

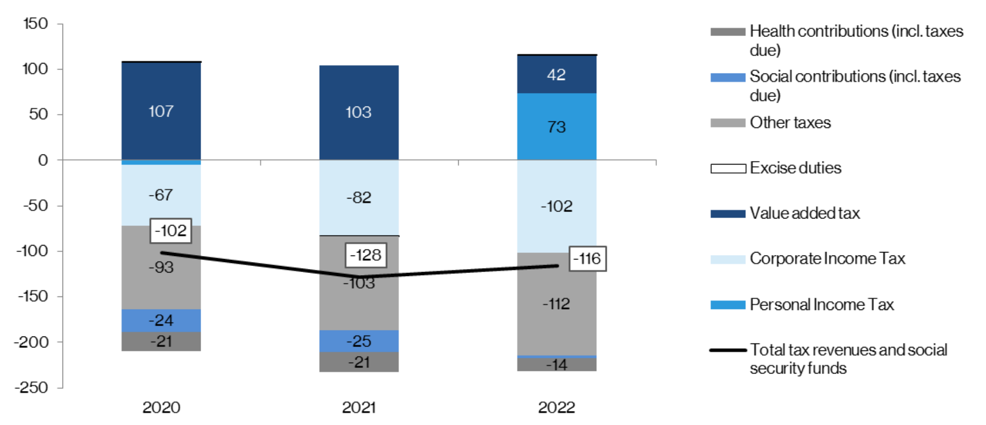
Lapse compared to the approved budget

Comparison of the current estimate with the 2020-2022 public administration budget

Compared to the 2020-2022 public administration budget, the current forecast of tax and social contribution revenues is lower from EUR 102 mil. to EUR 116 mil. (Chart 10). The main reason is that the approved budget in other taxes over the November forecast of the tax committee presented in this comment also includes the revenues from eKasa and nano-markers in amount of EUR 180 to 200 mil. Their impact is reported in the Other Taxes budget item.

[8]Municipalities other than county capitals account for 64% of total land property collection, 30% of total building tax selection and 10% of total apartment and non-residential premises tax collection.

Figure 10: Change of GG tax revenue forecast copared to November 2019 (EUR mil.)



Source: IFP, UloziskoIFP

In compliance with the constitutional Act on Fiscal Responsibility, the Ministry of Finance SR updates and publishes the forecasts of tax and levy revenues. These forecasts were discussed at the meeting of the **Tax Revenue Forecasts Committee on 12 February 2020**. **KRRZ, NBS, Infostat, Tatrabanka, ČSOB and UniCredit Bank consider the forecast as realistic.**

For more information about the tax forecasts as well as the background materials, see the IFP website Economic Forecast section ⇨ Tax Forecasts.

For detailed data about the development of individual tax revenues on the forecast horizon as well as the breakdown of contributions of individual factors to the forecast update or the background data for individual comment entries see the UloziskoIFP.

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