inštitút finančnej politiky

Policy brief 2021/08

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

30 June 2021

Good News

Forecast for 2020 - 2024

Jaroslav Bukovina, Dušan Paur

The current revenue forecast is marked by a moderate drop in corporate income tax revenues in 2020 and a faster than expected rate of economic recovery in 2020. The 25% drop of corporate profits seen in 2009 did not recur in 2020. The tax returns filed so far indicate lower losses by half in comparison with initial expectations, which translate into over EUR 200 million higher revenues from businesses in 2020. Accordingly, the estimated reduction in revenue from taxes and social security contributions for 2020 is rather low, only 1%. The accelerated economic revival in 2021 will drive a buoyant, 5% rise in tax revenue. Strong revenue growth will continue in the following years, supported by funding from the Recovery Plan. The forecast risks are balanced in line with the persisting uncertainty, with a negative scenario anticipating a worsened pandemic situation in autumn and a positive scenario based on expectations of higher consumption in both the domestic and European economies.

Year-on-year changes in tax and social security contribution revenues

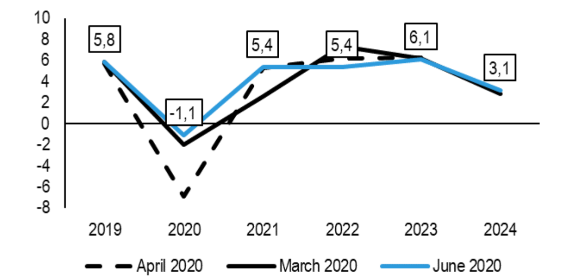
Moderate slow-down during the pandemic and...

The corporate income tax returns filed for 2020 so far have lowered the revenue reduction effect of the pandemic. The total estimated loss of tax revenues and social security contributions (ssc) for 2020 is about 1% (EUR 320 million), while the initial estimation was 6.9% (EUR 2 billion). The reduction in revenues in 2020 was thus significantly lower compared to around 7% recorded in 2009. Higher revenues in comparison to March (Graph 1) are based on the new corporate tax data. Tax returns have been filed by 150,000 firms and they suggest a profit reduction at a half of the initially expected rate of -25%.

...stronger growth of revenues

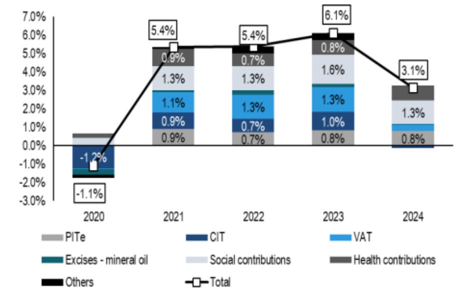
Public finance revenues in 2021 are marked by economic revival. Driven by a strong growth of consumption, the collection of VAT and excise duties seems to offset the low figures seen in the first months of 2021 and eventually exceeds the pre-pandemic levels. Also, the labour market remains stable and is supposed to drive revenues from public insurance contributions. Generally, tax and public insurance contribution revenues will reach a solid growth rate of around 5% in the current and next two years, which is mainly attributable to revenue sources linked to the labour market (public social and health insurance contributions and personal income tax). These in aggregate generate over one half of the growth (Graph 2). The post-crisis recovery of tax and public insurance revenues will thus be faster than in the past. In 2010, the rate of growth of tax and public insurance contribution revenues was only 2%.

Graph 1: Year-on-year changes in tax revenues and social security contributions (%)



Source: IFP

Graph 2: Year-on-year changes in taxes and ssc (%)



Source: IFP

Higher revenues based on filed tax returns

Compared to March estimate, revenues are nearly EUR 1.1 billion higher. The main recipient will be the central state budget with an inflow of VAT, excise and corporate income tax revenues of EUR 0.9 billion. Revenues of local governments, the Social Security Fund and the Health Insurance Funds will grow at a lower rate. The forecast for 2022 to 2024 is higher by around EUR 0.6 billion than in March and a major parts of this increase is attributable to corporate income tax (Graph A in the Annex). No legislative changes have been adopted since the March session that could have a material impact on the current estimate (Annex - Table 1).

Development of key tax and public contribution revenue items

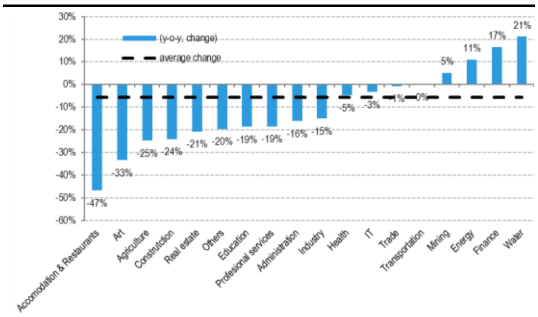
More revenues in the state wallet

The drop in rate of corporate income tax revenues recorded in 2020 was at a half of that seen in 2009, while still reaching a two-digit level. The June revision of the forecast is based on corporate tax returns for 2020. They indicate a tax revenue decrease markedly lower than the last year's expectations. Moreover, firms' sales figures declared in VAT returns suggest a one-digit rate of loss of revenues, compared to the foreseen 25% (refer to the Box). The major decline was recorded in the *accommodation and restaurant* sector and *arts* sector, which fell by 47% and 33%, respectively, year-on-year. The rate of decrease in *industry* was also at a two-digit level (Graph 3). More favourable developments were seen in the *finance, retail* and *wholesale* and *IT* sectors. As regards the size of businesses, those experiencing a major decline were small and medium-sized firms with a 9% rate of decrease[1]. Tax revenues receivable from large corporations, in contrast, remain at the pre-crisis level (for more details refer to the Box). The closing of the year 2020 is pending the receipt of the tax returns of over 100 thousands firms that have made use of the filing postponement option. The forecast reflects our assumption that the amount of corporate income tax to be paid by those firms is about the same as that already received from the firms which have filed their tax returns[2].

Major corporate income tax payers with lower losses

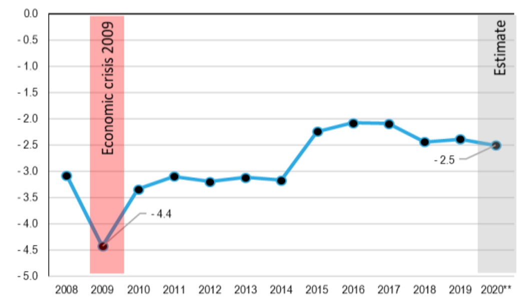
We have revised the estimated loss deductions for 2021. While the pandemic has driven firms' profits to the red, overall losses were much lower as initially expected in view of the post-crisis development in 2009. To the contrary, the level of losses seems not to markedly deviate from the last years' trends (Graph 4). The lower rate of losses, combined with the current legislation on loss deduction[3], and gradual economic recovery push the corporate income tax revenue expectations for 2021 upwards. The positive impulse is further extended to the rest of the forecast horizon through a gradual return of the effective tax rate to earlier levels.

Graph 3: Tax liability by firms for 2020



Source: IFP

Graph 4: Firms' losses in 2008 - 2020 (EUR billion)



Source: Income Tax Returns, IFP

[1] It is adjusted for the effects of legislation, since small and medium-sized firms with a turnover of up to EUR 100,000 were subject to a 15% tax rate in 2020, instead of 21%. Further, it is also analytically adjusted for the effects of a change in methodology recommended by Eurostat: non-applied tax losses for 2015-2018 in the amount of EUR 28 million, which were supposed to be reflected in 2019 through settlements, are instead included in 2020, as a change directly attributable to the pandemic.

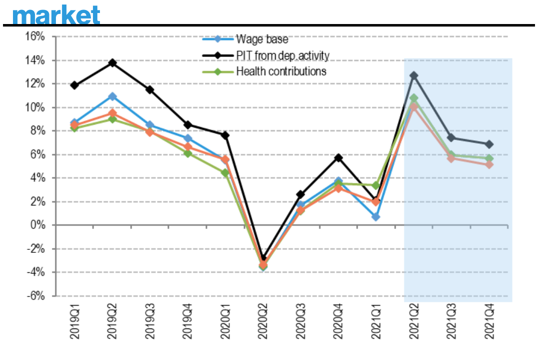
[2] Historical experience shows that tax returns filed as at the normal due date were mostly those with tax overpayment claims, while firms with a payable tax amount chose to postpone the filing. We did not see such a high increase in overpayment claims in 2020 as in the previous years. This topic is discussed in the Box at a greater detail.

[3] Starting from 2021, firms may deduct up to 50% of past losses from taxable profits.

Tax revenue will be driven by a stable labour market...

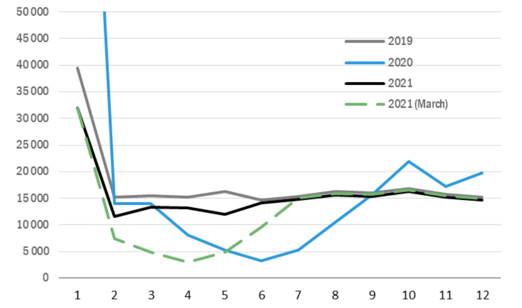
Recovery in the labour market in 2021 will generate higher tax revenue. Revenue from the personal income tax and social security contributions were driven by a stronger growth of wages. Promoted by the creation of new jobs, the positive trend is expected to continue in the second half of the year. However, the personal income tax from employment experienced relatively slow growth in the first quarter (Graph 5). This is attributed to the refund of overpaid tax to employees who were not working during the pandemic in 2020 (e.g. they were receiving home-nursing or sickness benefits) and, accordingly, could not deduct the full non-taxable amount. In the upcoming years, the expected higher indexation of the tax allowance will slightly reduce income tax revenues from employment. For social insurance contributions, we have additionally increased the forecast of delinquent contributions collected in 2021 since a reduction in revenue similar to 2020 has not been confirmed yet (Graph 6). The deferrement of contributions to2023 increases the revenues at the end of the horizon at the expense of 2021.

Graph 5: Year-on-year growth in the labour market



Source: IFP

Graph 6: Forecast of delinquent social insurance contributions (in EUR thousand)

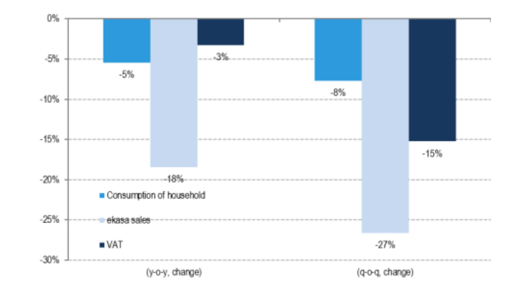


Source: IFP

... and a strong growth of household consumption

Neither VAT revenues nor household consumption dropped during the lockdown at the beginning of the year as markedly as *e-Kasa* data had suggested (Graph 7). The two-digit fall in VAT revenues experienced in January and February was made up by a strong growth in March. With the further recovery of household consumption foreseen for the second half of the year, VAT revenues will exceed the pre-pandemic level of 2019 by EUR 300 million[4]. The effective tax rate has remained approximately stable since 2019. The dramatic decrease in effective tax rate experienced in 2009 did not recur in 2020 (Graph 8). The reduction against the previous estimate is due only to a revision of the data on final household consumption and intermediate government consumption, which are not factors related to the collection efficiency. VAT will grow by 5% year-on-year, and this rate will also be retained in 2022 and 2023. Compared to the dynamics of the pre-pandemic years 2017 to 2019, the annual growth rate will be lower by about 8%[5].

Graph 7: Actual consumption of household, ekasa sales and VAT revenues for the first quarter



Source: IFP

Graph8: Effective tax rate remaining stable

Source: IFP

[4] A potential adverse risk factor for 2021 is the possible postponement of VAT revenues to be derived from the D4/R7 PPP, which is, for now, scheduled for the end of this year. But the postponement would not affect the budget balance as such since it would have an equal impact on the state's expenditure.

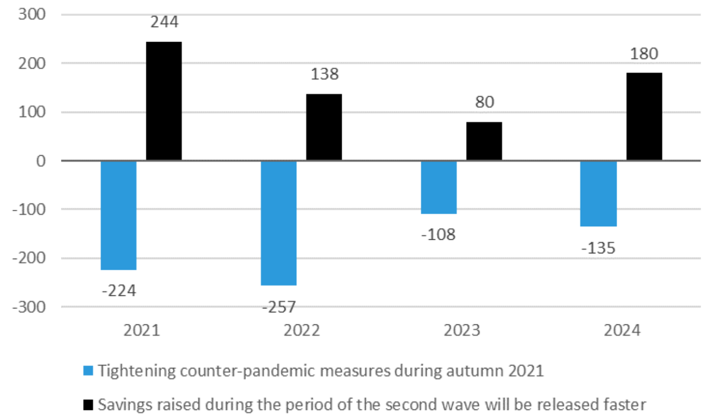
[5] The higher rate resulted from a higher, about 7% growth of consumption in the economy, and the rest is attributable to successful collection.

Alternative scenarios

We expect tightening counter-pandemic measures if the incidence of new cases increases at the end of the year and the subsequent impact on the current estimate of this year's tax revenues is EUR 220 million. The reduction in tax revenues would be due, in particular, to lower consumption in the retail, service and restaurant sectors. The losses would, however, be lower than those seen during the second wave. Tax revenues from income from employment will be cut by lower employment in services, although schools will remain open and the amount of home-care benefit payments will thus not rise.

As a positive forecast risk factor in the amount of EUR 240 million for 2021, savings raised during the period of the second wave are expected to be released faster (Graph 9). Higher revenues would be derived mainly from VAT and excise duties. The labour market will respond to the increased consumption with a delay, only in 2022.

Graph 9: Effect of the alternative macro-development scenarios on tax revenues (in EUR million)



Source: IFP

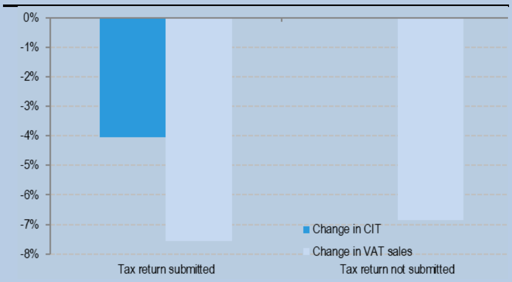
Box: Corporate tax estimates at times of uncertainty

Information gathered from the tax returns received so far from around 150 thousands businesses, out of the default total of over 260 thousand, indicates a substantial year-on-year cut in tax revenues. Nevertheless, the drop is still lower than expected. Our basic scenario assumes that the income of the remaining firms which have postponed their filings will be similar to those of the competitors in their sectors.

Deferring the filing of the tax return is a result of a firm's active decision. In the past years, the firms using the filing postponement option posed a positive risk: corporations expecting a negative tax and refund from the Financial Administration usually filed their tax returns earlier, while those supposed to make an additional tax payment usually put the filing off. The beginning of 2021, when the normal filing of tax returns was due, was rather specific because of the prolonged pandemic restrictions. Firms could have faced liquidity issues and thus decided to postpone the tax payment. The amounts of tax payable by them may be similar to those payable by the operators which have already filed their tax returns.

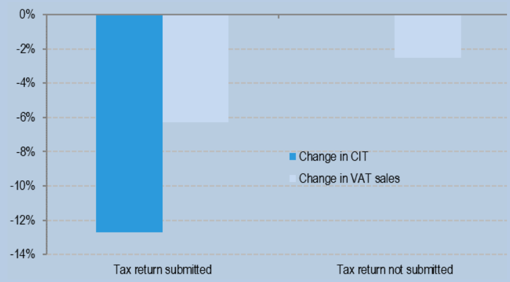
The corporate income tax estimate is associated with a higher degree of uncertainty. To reduce it, we have compared data for the firms that postponed their income tax return filing with the data taken from VAT returns for 2020. In addition to the tax amount as such, VAT returns also include information on the firms' revenues, and the latter is a good indicator of a firm's performance. For small and medium-sized firms that have filed their tax returns, the drop in revenues is lower than that of the operators which chose to use the postponement option. Early filers recorded a 6% loss of revenues in 2020, while firms that have not made the filing yet incurred only a 3% loss of revenues . Accordingly, it can reasonably be expected that small and medium-sized firms filing later will pay more than early filers. This is not quite the case for large companies. The drop in revenues is about the same for both early filers and firms postponing their filing (Graph 11). [6]

Graph 10: SMEs: Reduction in revenues and tax paid according to tax returns



Source: IFP

Graph 11: Large corporations: Reduction in revenues and tax paid



Source: IFP

Non-tax revenues

Emission trading

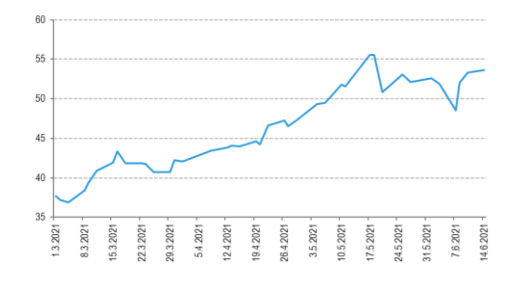
A higher price for emissions

Cash revenues from the sale of emission allowances have largely been affected by the withdrawal of allowances from the market. The European Commission decided to withdraw the allowances earmarked for sale in auctions in 2021 and 2022[7], and with the stable demand, this automatically led to an over 20% increase in prices in May (Graph 12). However, such a price increase has not made up for the reduction in the auction share on a cash basis.

Pollution estimates fine-tuned

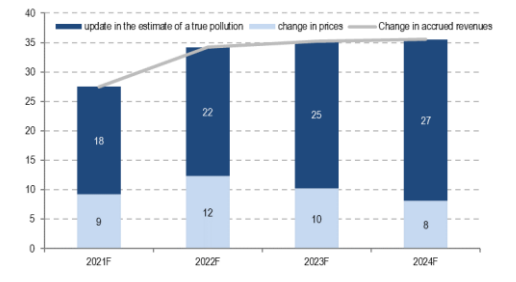
Accrued revenues are updated to reflect a change in the etimate of consumed allowances representing true pollution (Graph 13). The assumption regarding the stable consumption of allowances over the forecast horizon has been fine-tuned. The estimated quantity of pollution for 2021 is based on the individual data taken from the national emission allowance register and our assumption that the use of allowances would slightly rise in line with the economic recovery. As the key factor of accrued revenues, the growth of the use of allowances will not exceed the pre-crisis level of 2019. This assumption is based on the strong rise in prices which is supposed to push emissions down. For the remaining years, we suppose a gradual decrease in the use of allowances in ETS[8].

Graph 12: Strong growth of the price of emission allowances (EUR)



Source: Ministry of Environment of the SR, IFP

Graph 13: Change in accrued revenues (EUR million)



Source: Ministry of Environment of the SR, IFP

---

[6] Large economic operators may have various reasons for filing their tax returns later (beyond those provided in law), i.e. internal processes or a fiscal year other than calendar year.

[7] An assumption of similar withdrawal of allowances in 2022 is reflected across the entire forecast horizon, which is based on the historical experience of allowance withdrawal for the so-called Market Stability Reserve.

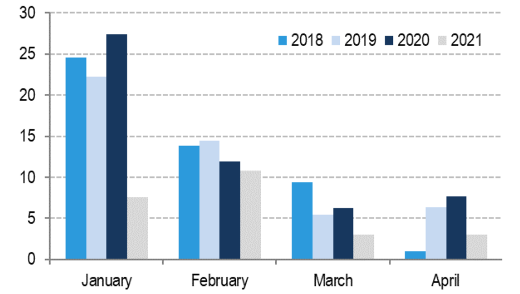
[8] 2.2% reduction in the actual use.

Toll revenues of the National Motorway Company (NDS)

Short-term reduction in NDS' revenues

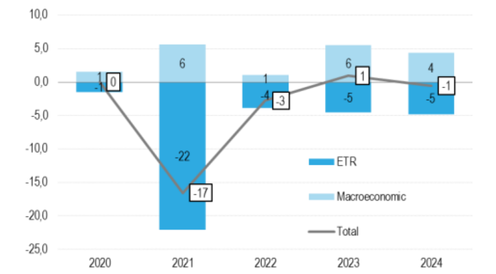
The negative trend in the sale of vignettes reduces the forecast revenues of NDS for 2021. While toll revenues are gradually restoring to their potential, we have noted a loss of vignette revenues[9]. We attribute the latter to two factors: Reduced mobility due to the lockdown at the beginning of the year could have caused a corresponding reduction in the demand for vignettes (Graph 14). The second factor is the transition from annual to 365-day vignettes. This could have made consumers to postpone the usual purchase of vignette from the beginning of the year to a later date. Vignette revenues in January were normally making 25% to 30% of total revenues. Our forecast reflects the expectation that the usual revenue timing will be restored in line with the gradual lifting of measures and the next years will not be affected by this effect (Graph 15). A negative risk factor is a major worsening of the pandemic situation at the end of the year.

Graph 14: Structure of monthly vignette revenues (EUR million)



Source: NDS, Ministry of Finance of the SR

Graph 15: Change in NDS' revenues compared to the March forecast (EUR million)



Source: NDS, Ministry of Finance of the SR

Further extension of the forecasts committees

Forecast increase of EUR 700 million

Further tax and non-tax revenues will be added to the September forecast. To improve the budgetary process, we plan forecasting the levy on gambling revenues and dividend revenues derived from the state-owned enterprises, totalling around EUR 700 million. The committee process ensures that the published forecasts are reviewed by experts and based on consistent macroeconomic assumptions[10].

In line with the Constitutional Act on Budget Responsibility, the Ministry of Finance of the Slovak Republic updates and publishes forecasts of tax and public health and social insurance contribution revenues. The forecasts were discussed at the session of the **Tax Revenue Forecasts Committee held on 24 June 2021. The Office of the Council for Budget Responsibility, NBS, Infostat, Tatrabanka, ČSOB, Slovenská sporiteľňa, UniCreditBank and VÚB see the forecast as realistic.**

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

For detailed data about the development of individual tax revenue items over the forecast horizon as well as a breakdown of the contributions of the factors to the forecast update and information underlying the data presented in the commentary refer to *UloziskoIFP.*

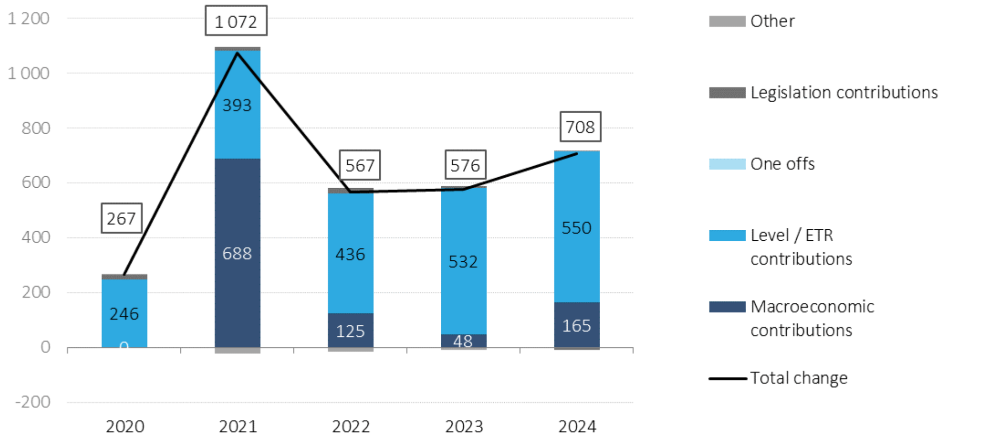
This document presents the views of the authors and the Institute for Financial Policy, which do not necessarily reflect the official positions of the Ministry of Finance of the Slovak Republic. The purpose of publishing analyses prepared by the Institute for Financial Policy (IFP) is to encourage and enhance professional and public debate on topical economic subjects. Therefore, any quotations of this text should refer to IFP (and not the MF SR) as the author of these views.

[9] We forecast so-called administrative charges for the National Motorway Company (NDS). They include mainly toll and vignette revenues.

[10] For more information refer to the IFP's tax commentary of March 2021

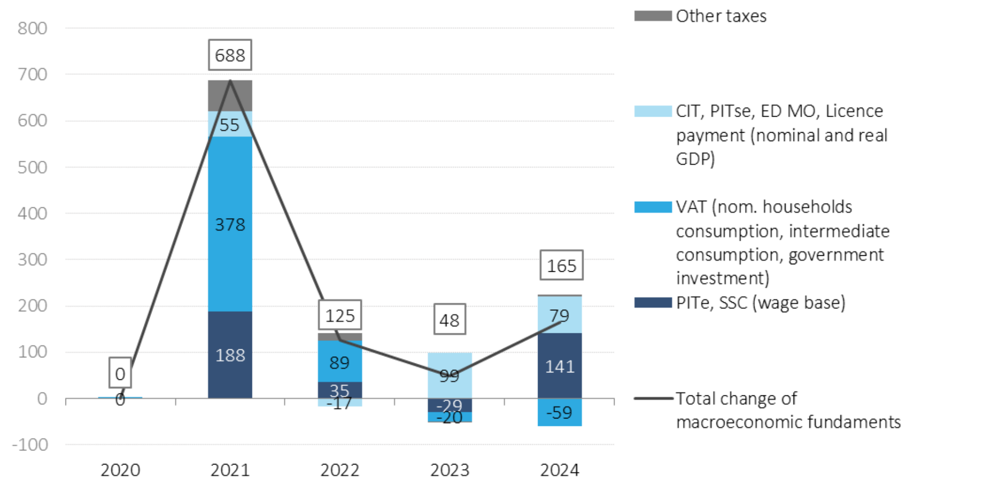
Annex

Graph A: Change of actual forecast compared to March 2021 (EUR mill.)



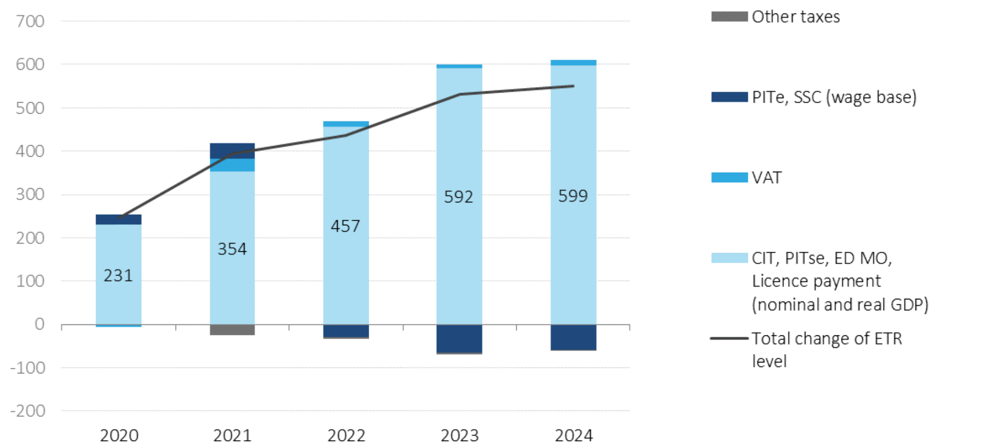
source: IFP

Graph B: Tax revenues update based on current macroeconomic forecast (EUR million)



source: IFP

Graph C: Tax revenues update based on changes in ETR (EUR million)



source: IFP

Table 1: Revised impact of the legislation introduced in the past, (difference compared to situation in March, ESA2010, EUR million)	2020	2021	2022	2023	2024
	17	**13**	**21**	**7**	**-11**
Changes in vehicle taxation	16	9	0	0	0
Lower VAT rate related to food stuff	0	4	-2	-4	-7
VAT tax base adjustments related to missing payments for goods or services	0	13	13	14	15
Updates in social contribution rate related to the 2nd pillar payments	0	6	-8	-14	-18
Deferrement of social contributions related to december 2020	0	-7	11	0	0
Postpoment of deadlines related to payment of social contributions	0	-14	5	14	0
Deferrement of social contributions in 2021	1	2	2	-2	0