ABOUT LABOR TAXATION IN EUROPEAN UNION. EVOLUTION AND CURRENT CHALLENGES

Nicoleta, MIHĂILĂ*[1]*, PhD,
Centre for Financial and Moneray Research "Victor Slăvescu"

Scopul principal al lucrării îl constituie analiza impozitării muncii în Uniunea Europeană în perioada 2007-2020, metodologia utilizată fiind de tip descriptiv, prin apelarea la surse bibliografice variate, cu preponderență din literatura de specialitate străină, precum și o metodologie de tip cantitativ, pentru prelucrarea și analiza datelor preluate din bazele de date internaționale (Eurostat, OECD). Avem în vedere analiza impozitării muncii la nivelul țărilor membre UE prin utilizarea celor doi indicatori, Taxa implicită de impozitare, respectiv Tax wedge, în perioada menționată, precum și unele provocări/tendințe curente privind munca și posibile măsuri fiscale în contextul crizei sanitare actuale, în vederea ajutorării persoanelor vulnerabile și a economiei în ansamblul ei.

Cuvinte cheie*: venituri din muncă, taxa implicită de impozitare, tax wedge, familie, măsuri fiscale*

Abstract. *The main purpose of the paper is the analysis of labor taxation in the European Union in 2007-2020, the methodology used being descriptive, by appealing to various bibliographic sources, mainly from foreign literature, and a quantitative methodology for processing and analysis of data taken from international databases (Eurostat, OECD). We consider the analysis of labor taxation at the level of EU member states by using the two indicators, Implicit tax rate (ITR), respectively Tax wedge, during the mentioned period, as well as some current challenges / trends on labor and possible fiscal measures in the context of the current health crisis, in order to help vulnerable persons/ families and the economy as a whole.*

Keywords*: labor income, implicit tax rate, tax wedge, family, tax measures*

Introduction

Labor taxation influences both the decision of each individual to work and with what norm (labor supply), and the employer's decision to hire, as they increase the cost of labor (labor demand). The supply of labor from certain categories of the population (low-skilled workers, young people, the elderly and people with a second source of income for the family) is particularly sensitive to taxes and contributions to the social security system.

In our paper we analyze labor taxation in the European Union in 2007-2020, in terms of two indicators, *Implicit Tax Rate* (ITR), calculated as the sum of income tax and social contributions of the employee and employer, respectively the *Tax wedge* indicator (EC, Taxation Trends 2021), defined as the sum of personal income taxes and employee and employer social security contributions net of family allowances, expressed as a percentage of total labour costs (the sum of the gross wage and the social security contributions paid by the employer).

The ITR on labour measures the burden from employed labour taxes and social security contributions, net of tax credits, allowances, exemptions and deductions, but excludes social benefits. It also integrates the effects of taxpayer behaviour, including non-compliance(EC, 2021). *The tax wedge* covers tax, social security contributions and social benefits, but does not cover all tax reliefs or all types of benefits, or the behavioural impacts of tax reforms. An advantage of the tax wedge is that it allows comparisons between those countries that help families through benefits and those that use the tax system to do so.

The paper presents the following objectives:

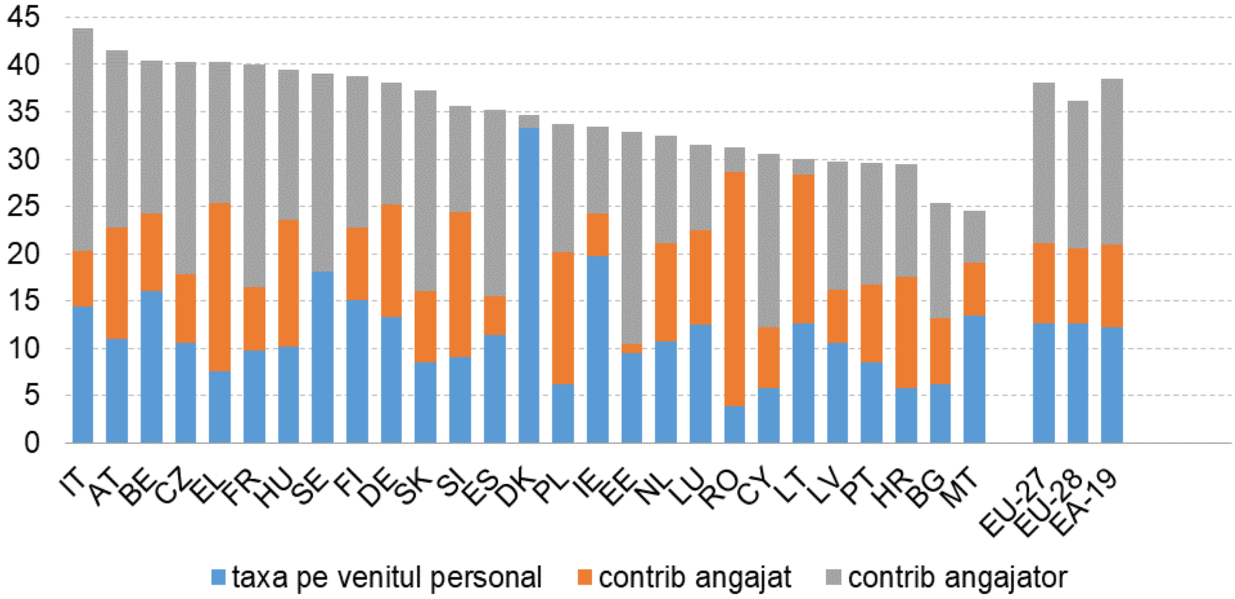
- Analysis of labor taxation in the European Union in the period 2007-2019, by using the implicit tax rate (ITR)
- Analysis of labor taxation in the European Union in 2020, by using the tax wedge indicator
- current challenges related to labor taxation and some tax measures to support vulnerable persons and the economy.

[1] © ***Nicoleta, MIHĂILĂ***, nicoleta.mihaila@icfm.ro

1. Analysis of labor taxation in the European Union in the period 2007-2019, by using the implicit tax rate (ITR)

The implicit tax rate on labor is defined as the sum of all direct and indirect taxes and social contributions of employees and employers levied on the income from employment divided by the total compensation of employees. It is calculated only for the employed labor force (thus excluding the tax burden on social transfers, including pensions).

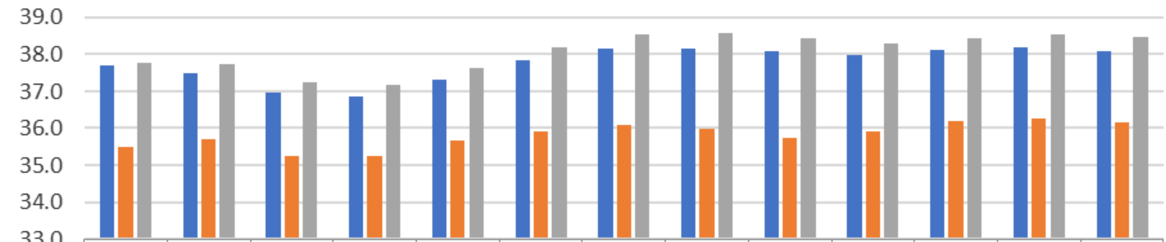
Figure no. 1 Implicit tax rate, by components, in 2019



Source: EC, Taxation Trends 2021 Report, https://ec.europa.eu/taxation_customs/business/economic-analysis-taxation/data-taxation_en

In 2019, from the point of view of the composition of the indicator, we notice that in developed countries the personal income taxation and the employer's contributions predominate (in Denmark the share of personal income taxation is significant). In Romania, employee contributions have the highest share. Taxes on labor (including social security contributions paid by both the employer and the employee) ranged from 25% in Bulgaria to 44% in Slovakia.

Figure no 2. ITR on labor in UE 28, UE 27 and UE 19 in the period 2007-2019



	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
EU-27	37.7	37.5	37.0	36.9	37.3	37.9	38.2	38.1	38.1	38.0	38.1	38.2	38.1
EU-28	35.5	35.7	35.3	35.2	35.7	35.9	36.1	36.0	35.7	35.9	36.2	36.3	36.2
EA-19	37.8	37.7	37.2	37.2	37.6	38.2	38.5	38.6	38.4	38.3	38.4	38.5	38.5

EU-27 EU-28 EA-19

Source: EC, Taxation Trends 2021Report, https://ec.europa.eu/taxation_customs/business/economic-analysis-taxation/data-taxation_en

The ITR on labor for EU-27 was 38,1% in 2019, compared to 38,1% in 2018, and 1,2 pp above the level reached in 2010. The ITR on labor for EU-27 is very close to the euro area rate (38,5% in 2018), but with a significant gap compared to the EU-28 (36,2%), due to low labor taxation in the UK (ITR on labor for UK of 25,2 % in 2019).

The level of the tax burden on labor varied substantially between Member States in 2019. The highest ITRs on labor are found in Austria (41,5% in 2018), Greece (40,3%) and Italy (43,8%), and the lowest in Bulgaria (25,4%), the United Kingdom (25,2%) and Malta (24,6%).

In the EU-27, most Member States recorded increases in the ITR on labor force between 2018 and 2019, with the highest increase in Cyprus (from 26,1% in 2018 to 30,6% in 2019), and the highest decrease in Lithuania (from 31,4% to 30%).

By components, at EU 27 level, we analyze the taxation of personal income and social contributions, of the employer and the employee, as shares in GDP, as well as in total fiscal revenues. In the area of personal income tax (PIT), most countries continue to reduce the tax burden on personal income, by reducing tax rates or tax bases, in order to support equity, especially for those with low and medium incomes. It should be noted that both personal income tax (PIT) and social security contributions (SSC) are essential sources of tax revenue in most (developed) countries.

The top PIT rate at the start of 2021 for the EU-27 (simple average) was 38,8 %, 0,1 pp higher than in 2020. It had fallen sharply from 44,8 % in 2000 to 37,9 % in 2011. Between 2011 and 2013, the average top rate increased to around 39 % and it has remained unchanged since 2013. The average rate for the euro area also increased slightly, to 43 %, in 2021. In 2021, Czechia introduced a top PIT rate of 23 %, which applies to taxable income exceeding the average wage by 48 times and replaces the solidarity surcharge. The tax rate is 15 % for the part of the taxable income up to the threshold. Croatia lowered its top rate by 7,1 pp, to 35,4 %. The top PIT rate varies substantially in the EU, ranging from 10 % in Bulgaria to more than 55 % in Denmark

In 2019, compared to 2018, the level of income from social contributions had several changes: the Netherlands, a decrease of 0,5 percentage points in 2019, Lithuania, a decrease of about 2 pp, in Latvia, increased by 0,5% pp , France, a decrease of 1,2% pp, in 2019. Romania recorded a level of 11,3% of GDP in 2019, surpassing Sweden (3,3,% - the lowest level), Norway, Malta, Ireland. We continue to rely on tax revenues from indirect taxation and social security contributions.

Most countries' personal income taxes have a progressive structure, which means that the tax rate paid by individuals increases as they earn higher wages. The highest rate of taxation paid by individuals differs significantly between European EU countries (as mentioned before).

For most governments, labor taxes (personal income tax, as well as employer and employee social security contributions) are the most important source of tax revenue, contributing to almost half of all income. A high tax burden on labor can become an obstacle in stimulating economic activity and increasing employment.Reducing taxes on personal income or social contributions of employees can lead to the stimulation of labor supply and create employment incentives, especially for those on low incomes, who feel any change in wages after tax. Reducing employers' social security contributions can help support job creation and improve the competitiveness of businesses.

However, the level of labor taxation depends very much on national preferences and the size of the social security system, which means that there is no optimal tax burden on labor. What is more important is the general tax structure and the distribution of the tax burden to the different income groups.

2. Analysis of the labor taxation in European Union, by using the "tax wedge" indicator, in 2020

The tax burden on labor in measured by "tax wedge" indicator in most countries and refers to the difference between an employer's cost of an employee and the employee's net disposable income. The wedge is determined by several factors: the amount of pretax income (referred to as "labor cost") of a worker, the taxes that apply to that income, and whether the taxpayer is filing as single or as a family (EC, 2021).

In many countries, taxes are progressive, which means that higher-income workers are taxed at higher rates. However, the average worker does not necessarily escape from being burdened by these taxes. It is also important to note that the tax burden on families is often lower than the burden on single, childless workers earning the same pretax income.

In general, countries with a higher tax wedge provide greater tax relief for families with children. According to "Taxing wages" Report (OECD, 2021), Belgium, Germany, Austria, and the Czech Republic, which had the first, second, third, and sixth-highest tax wedge for single workers without children, drop more than seven positions, ranking seventh, ninth, eleven and twentieth respectively once family relief is included.

The average tax burden among EU countries varies substantially. In 2020, a worker in Hungary faced a tax burden higher than that of a French worker (43,6% vs 16,5%). Also, about Hungary we must mention that it is the country with the highest tax burden on labor in present, but in time, more precisely, since the year 2000, has had the most notable decrease in its tax wedge, from 54,7 percent in 2000, to 43,6 percent in 2020. This is partially due to the introduction of a flat tax on income, which lowered the income tax burden relative to total labor costs. Additionally, Hungary reduced its payroll taxes relative to total labor costs. Sweden, Lithuania have also lowered their tax burden on labor substantially, with a reduction between 7,2 and 8.8 percentage points each.

In 2020, the average tax burden from income and payroll taxes for single taxpayers without children in EU countries was 31,3 % of total labor cost, compared to 32,2% the previous year. In general, countries with higher tax wedges provide greater tax relief for families with children, typically through targeted tax breaks that lower income taxes. While all European countries provide tax relief for families, its extent varies substantially across countries.

Between 2019 and 2020, the EU average tax burden decreased by 0,9 percentage points. The COVID-19 support measures were primarily designed to reduce the tax burden for families with children rather than that of a single taxpayer without children. Overall, the impact of COVID-19 measures was smaller than other policy changes and accounted for about one-fifth of the decrease in the average tax burden faced by a single average employee in 2020.

One way to measure targeted tax relief for families is to compare the tax burdens on labor of a *family with one earner and two children* and a *single worker without children*, both earning the same pretax income. Larger differences imply more extensive tax relief for families.

In the OECD European countries, a *family with one earner and two children* faced on average a tax burden of 28,3 % in 2020. The average tax burden of a *single worker without children* was 39,6 %, 11,3 pp higher than a family (Taxfoundation, 2021).

Poland had the largest disparity between the two tax wedges of all countries covered, with a 21,6 percentage-point difference between its 13,2 percent tax wedge for families and 34,8 percent tax wedge for single workers.

Table 1. Average tax wedge in some OECD European countries, 2020, % labor costs

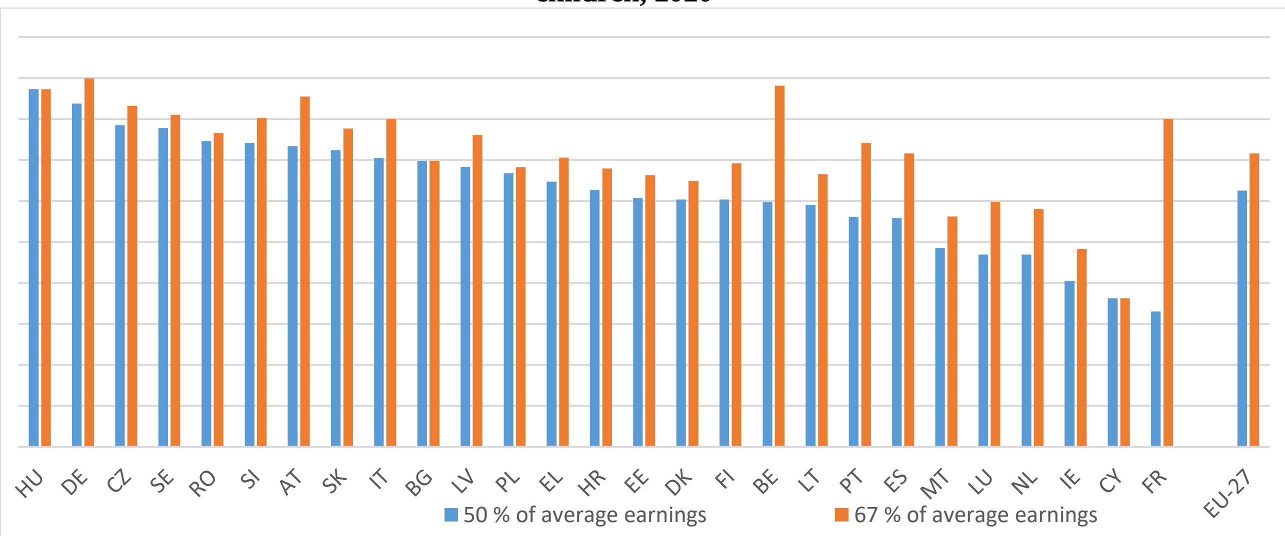
	Single person, no children	**One-earner married couple, 2 children**	**Percentage-point difference**
Austria	47.3%	32.0%	-15.3
Belgium	51.5%	34.9%	-16.7
Czech Republic	43.9%	26.1%	-17.8
Denmark	35.2%	25.1%	-10.1
Estonia	36.9%	26.8%	-10.1
Finland	41.2%	36.7%	-4.4
France	46.6%	37.9%	-8.8
Germany	49.0%	32.9%	-16.1
Greece	40.1%	37.1%	-3.0
Hungary	43.6%	30.1%	-13.5
Iceland	32.3%	18.6%	-13.7
Ireland	32.3%	16.1%	-16.2
Italy	46.0%	36.4%	-9.6
Latvia	41.8%	31.1%	-10.8
Lithuania	36.9%	20.1%	-16.8

Luxembourg	37.5%	16.3%	-21.3
Netherlands	36.4%	30.0%	-6.4
Norway	35.8%	32.2%	-3.6
Poland	34.8%	13.2%	-21.6
Portugal	41.3%	30.0%	-11.3
Slovak Republic	41.2%	30.1%	-11.1
Slovenia	42.9%	25.5%	-17.4
Spain	39.3%	33.9%	-5.4
Sweden	42.7%	37.5%	-5.2
Switzerland	22.1%	9.6%	-12.5
OECD Average	**39.6%**	**28.3%**	**-11.3**

source: OECD, Taxing wages 2021, https://stats.oecd.org/Index.aspx?DataSetCode=AWCOMP#

As noted before, the analysis of the ITR on labour gives a picture of the average tax burden on labour across all income classes. The tax wedge indicator, however, explores the burden of taxation across different categories of households (e.g. single, couple, family) and income levels (for exemple, workers on 50, 67 and 100 % of the average wage). For single persons, with no familiy, the tax burden is higher as the earnings are higher. In 2020, the highest tax wedge for a single worker with 67% of average earnings is in Belgium (44%), followed by Denmark (44%) and Hungary (43% of total labor costs). The lowest value is in Cyprus (18%) and Irland (24%).

Figure 3. Tax wedges for a single worker with 50% and 67% of average earnings, no children, 2020



Source: European Commission, DG Economic and Financial Affairs, Tax and Benefits

The average tax wedge in 2020 for workers with 50 % of average gross earnings was 31,3 % in the EU-27, having decreased 0,9 pp since 2019 and 2,6 pp since 2010.

In 2020, tax wedge rates for these low-income earners were above 40 % in Hungary and Germany, while they were below 20 % in France and Cyprus. In France, there is a considerable gap between the tax wedges at 50 % and 67 % of average earnings (23,5 pp).

In 2020, 19 Member States recorded a year-on-year fall in the tax wedge for single people on low incomes. France and Belgium showed the largest yearly declines (5,2 pp and 3,2 pp respectively). Yearly increases in the tax wedge, on the other hand, were few and modest. Romania showed the largest increase, 0,8 pp. France had the largest decrease since 2010 (17,6 pp), reaching in 2020 the lowest level in the EU for workers at 50 % of the average wage. In the decade running up to 2020, Malta registered the largest increase (5,4 pp), followed by Slovakia (4,4 pp).

3. Current challenges related to labor taxation

Even before the COVID-19 crisis, many economies were in a difficult situation. Labour markets across much of the developed world still had not fully recovered from the financial crisis of 2008–09, after which real-terms wage growth remained weak and millions were obliged to take low-paid, low-skill service-sector jobs to support household incomes. Many of these same people were working in the sectors worst affected by the pandemic: retail, hospitality, travel, leisure and the office supply chain—cleaners, security guards and takeaway food.

The reduced levels of business activity and low wages had already determined Governments in the developed world to provide huge ad hoc support for their economies, including funding highly disruptive lockdowns. Budget deficits have exploded, and millions of jobs are being shed, leading to a much less sustainable fiscal position.

As a response to the COVID-19 crisis, countries all over the world adopted fiscal packages in order to support businesses and households. Tax measures implemented are classified in the table above:

Table 2. Tax measures taken as a response to the pandemic

	relief	Recovery-orinted stimulus	Tax increases
Objectives of policies	Cushion the economic and social impacts of virus containment policies	Stimulate aggregate demand and investment	Finance part of the government response to the crisis
Main types of tax measures	- Tax deferrals - Tax filing extensions - Accelerated tax refunds - Loss-carry back provisions - Temporary tax waivers - Temporary tax rate reductions	- Tax incentives for investment - Reduced corporate or other business taxes - Tax incentives for employment - Temporary VAT rate reductions - Lower property transaction taxes - Lower property transaction taxes	- Increases in top personal income tax rates - Health excise tax increases - Environmental tax increases - Property tax increases - Business tax increases

Source: 2021 OECD Tax Policy Reform Questionnaire.

As regards the tax measures related to labor, Personal income taxes and social security contributions were used to provide relief to households and employers, but several countries also raised tax rates on high earners. Also, there were tax payment deferrals and other PIT administration measures- the most common type of measure related to labour taxes across countries has been the deferral of PIT and SSCs payments, extended or new personal income tax allowances and credits.

Other measures are targeted at individual taxpayers that were hit the hardest by the pandemic, including families with children, essential workers, and low-income households (for exemple, increased income tax allowances for households with children, for vulnerable individuals).

Other measure is related to reducing the tax burden of employers associated with salaries for the apprenticeship period, by partially financing their salaries from the unemployment fund or by financing lines from the structural funds addressed to the formation of human capital.

Thus, as unemployment rises and the income tax base gets smaller, authorities are tempted *to shift the burden of taxation towards consumption and corporate profits*. However, since taxing corporate profits is less economically efficient and potentially more damaging than taxing incomes (it might descourage investment), a solution is *the taxation of consumption* (increasing taxes on products and services that wealthier households are more likely to purchase, or VAT), or *increase the environment taxes*.

Also, *taxes on wealth and capital gains* are another option that has been put forward to address issues of wealth inequality and the need to create greater equity in tax systems. Any increase in capital gains taxes will inevitably involve imposing a greater burden on the people putting capital at risk during an economic crisis.

Depending on the regime, there may be opportunities to adjust rates and broaden the tax base or the mix of taxes. For example, in our oppinion, regimes that have relatively highincome tax rates but relatively lower VAT rates may see indirect taxes play an increasing role. Each country will do its own assessment.

4. Conclusions

According to official statistics, developed countries rely on the taxation of income and social contributions, taxes on goods and services or property taxes. It should be mentioned that income taxes negatively affect the economy, compared to consumption and property taxes.

Income taxes are usually progressive, the higher the personal income increases, the progressive tax is a beneficial solution for most governments in Europe because it creates fiscal equity (in this case the tax rate is charged according to gross salary) in exchange for a tax equality as in the case of the single tax rate (the single rate applies to any individual regardless of the salary he earns). Progressive taxation reduces economic disparities, which implies more social benefits.

In the paper we analyzed the taxation of labor in the European Union, by using the indicators Implicit Tax Rate and Tax Wedge. In the area of personal income tax, most countries continue to reduce the tax burden on personal income, by reducing tax rates or tax bases, in order to support equity, especially for those with low and medium incomes. It should be noted that both personal income tax and social security contributions are essential sources of tax revenue in most (developed) countries.

Also, between 2019 and 2020, the EU average tax burden decreased by 0,9 percentage points. The COVID-19 support measures were primarily designed to reduce the tax burden for families with children rather than that of a single taxpayer without children. Overall, the impact of COVID-19 measures was smaller than other policy changes and accounted for about one-fifth of the decrease in the average tax burden faced by a single average employee in 2020.

In present, the pandemic has a semnificative impact on taxation; most countries had a significant decline in their average tax-to-GDP ratio in 2020 and direct international financial support and debt relief was and will be necessary in order to restart the mobilization of revenues and to regain growth (Țibulcă, I.L., 2021).

In order to help the vulnerable families, authorities adopted tax policies aiming to supporting wages, through funding job creation and helping retrain workers for new jobs, and improving structural conditions for low-wage workers. Fiscal stimulus packages, particularly income support measures, continue to be necessary to protect households and businesses and to boost aggregate demand (ILO, 2021).

There are needed measures to support sectors that have been hit the hardest, measures to assist businesses (especially micro, small and medium sized enterprises), workers and jobseekers to adjust to the post-COVID-19 economy, including employment services, active labour market programmes and skilling initiatives, all adapted to the new realities.

Against a backdrop of structural change and persisting deficits, the social dialogue with employers and workers organizations will help to reshape trajectories to meet longer-term goals and promote the transition to a more inclusive, fair and sustainable economy.

Also, there must be a shift from labor taxation to taxation of consumption, wealth and capital gains or environmental taxation.

References:

1. Enache, C., 2021, “Sources of Government Revenue in the OECD,” Tax Foundation, https://www.taxfoundation.org/publications/sources-of-government-revenue-in-the-oecd/.
2. Țibulcă, I.L., 2021, The impact of the COVID-19 pandemic on tax revenues in the EU, Economic Research-Ekonomska Istraživanja, DOI: 10.1080/1331677X.2021.1954967
3. European Commission, Taxation and Customs Union, 2021, Taxation trends in the European Union
4. ILO, 2021, ILO Monitor: COVID-19 and the world of work. Seventh edition
5. OECD, Taxing Wages 2021
6. OECD, 2021, Tax Policy Reform Questionnaire
7. Taxfoundation, 2021, A Comparison of the Tax Burden on Labor in the OECD
8. *** https://www.oecd-ilibrary.org/sites/9e2dbb95-en/index.html?itemId=/content/component/9e2dbb95-en#section-d1e2066
9. *** https://stats.oecd.org/Index.aspx?DataSetCode=AWCOMP#