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The Tax Reform 2009-10

The largest part of the tax reform 2009-10 has been carried forward into 2009 for reasons of cyclical stabilisation in the economic crisis. The thrust of the reform is a lowering of the wage and income tax burden. The reform consists of a modification of the tax rate schedule reducing tax revenues by € 2.3 billion, larger tax concessions for donations (€ 100 million), a family "package" (€ 510 million) and a company "package" exonerating income-tax-liable corporate earnings by € 150 million. When fully implemented, the implicit revenues foregone will amount to about € 3 billion or 1 percent of GDP. Including a number of tax cuts already introduced in 2008, government revenues in 2012 will be reduced by € 4.1 billion or 1.4 percent of GDP. The reform is estimated to raise GDP in 2010 by 0.6 percent and generate 10,900 additional jobs.

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Goals and options for a fundamental reform of the Austrian tax system

For a number of years, goals and options for a reform of the tax system have been the subject of lively debate in Austria, to which WIFO has contributed recently with the submission of a comprehensive study (*Aiginger et al.*, 2008). Apart from the long-term goals of a gradual decline in the overall tax burden, the compensation for fiscal drag and the role of the tax system for cyclical stabilisation, the study cited as major economic dimensions of taxation – and possible approaches towards a fundamental reform of the Austrian tax system – the following:

- creation of jobs (relief of tax burden on labour, shift of social security financing towards general tax revenues),
- promotion of economic growth and investment (support for higher qualification, education and training, research and development),
- promotion of higher energy efficiency (adjustment of the tax system towards environmental goals),
- support of distributive goals and of widespread formation of wealth (limiting the differences between high and low incomes/wealth),
- discharge of future government expenditure (taxation of "public bads", e.g., tobacco and alcohol; support to provision for old age, insurance, healthy work environment; adjustment of the tax system towards environmental goals),
- support for compatibility between work and family obligations, fight against poverty of families (relief for low-income families, reduction of cost of social care, promotion of child care facilities),
- streamlining of the tax system (simplification of the tax code, integration of income tax schedule and social security contributions).

Overview of the tax reform 2009-10 and other measures taken since 2008

In 2008, a number of measures were implemented, designed to exonerate disposable income of private households (Table 1):

- originally intended to offset the drag on purchasing power from high inflation in the early part of 2008 (cut of unemployment insurance contributions for low-income earners, increase in kilometric allowance and commuter allowance in the context of the "anti-inflation package" of spring 2008; cut in the VAT rate on pharmaceuticals, tax relief for overtime pay and daily allowances as part of the parliamentary decisions of 24 September 2008);

- subsequently as a means to stimulate private consumption (frontloading of cuts in wage and assessed income tax, of the "family package" and tax relief for donations and sponsoring as part of the first leg of the tax reform 2009) and private investment (possibility of accelerated depreciation of 30 percent of asset cost offered for two years within the framework of the "fiscal stimulus package II")[1] to cushion the severe recession. A smaller part of the relief measures will benefit companies directly ("corporate package 2010", accelerated depreciation).
- Finally, as of 1 August 2008, the inheritance and the gift tax were phased out as the government renounced to their reform to abide by constitutional requirements.

As one element of the cyclical stimulus measures to counter the adverse impact of the global economic and financial crisis on the domestic economy, the bulk of the tax reform planned for 2010 was carried forward into 2009. The first stage of the reform consists of a lowering of the tax scale for wage and assessed income tax to the tune of € 2.3 billion per year and a "family package" worth € 510 million[2]. In addition, donations have become tax-deductible retroactively as from 1 January 2009 as current operational or special expenses (up to 10 percent of earnings/income of the preceding year) not only for purposes of science, adult education, arts and culture and sports for the handicapped, but also for benevolent activities in the EU or the EEA, for development co-operation and for national or international aid in the case of natural disasters, implying revenue losses of € 100 million per year. Tax deductibility has also been increased for contributions to churches (by a doubling of the ceiling for special expenses to an annual € 200) with a budgetary cost of € 30 million per year, to be counter-financed by the phasing out of the preferential tax treatment of stock options.

In 2010, the "corporate package" will enter into force. It will replace the current tax allowance for re-invested earnings of unincorporated enterprises subject to simplified accounting rules with a tax allowance for all companies liable to income tax, causing an annual revenue shortfall of € 300 million. The tax allowance for business earnings will be raised from 10 percent to 13 percent and can henceforth be claimed for operational income from all sources. For earnings up to € 30,000 per year, their re-investment will no longer be required. In addition, the tax allowance for business fixed investment will be granted up to € 100,000 per year. At the same time, for purposes of partial counter-financing of the new "package", tax privileges for retained earnings[3] worth € 150 million will be abolished, such that taxable corporate income will be exonerated in net terms by € 150 million per year.

The exonerating measures referred to above (in the context of the anti-inflation "package", parliamentary decisions and "stimulus package II" as well as the phasing out of inheritance and gift tax) will rise to a total € 1,059 million by 2012. Overall, the tax reform 2009-10, when taking full effect as from 2012, will have a size of € 3,060 million or 1 percent of GDP, slightly below the 1.1 percent of GDP volume of the 2004-05 tax reform[4]. On the basis of the current distribution key for joint federal revenues among the territorial authorities, about two-thirds of the tax revenue shortfalls will fall on the central government (Bund), nearly 22 percent on the federal states (Länder) and some 12 percent on the local communities. All measures taken

[1] The accelerated depreciation allowance does not lead to revenues definitively foregone, but rather to a shift in tax liabilities over time; the expected shortfall of € 700 million overall in the years between 2010 and 2012 will be fully offset in subsequent years.

[2] The size of the different tax reform measures cited refers to the respective budgetary cost after full implementation (for some measures 2012 at the latest); for tax administration reasons (e.g., assessment process for income taxation) some measures have only a lagged budgetary effect such that the figures for short-term budgetary costs presented in Table 1partly differ from those after full implementation.

[3] This provision introduced with the tax reform 2004/05 is discussed in detail in *Breuss – Kaniovski – Schratzenstaller* (2004).

[4] For an analysis of the tax reform 2004-05 see *Breuss – Kaniovski – Schratzenstaller* (2004).

together will amount to an alleviation of the fiscal burden by € 4,119 million or 1.4 percent of GDP by 2012. Adding to this the cyclically-induced revenues foregone, the tax burden will fall from 43 percent of GDP in 2008 to 41.1 percent in 2012 (*Schratzenstaller,* 2009).

Table 1: Budgetary impact of the tax reform 2009-10 and of further relief measures since 2008

	2009	2010	2011	As from 2012 per year
	Million €			
First leg of tax reform 2009				
Cut in wage and income tax rates	−1,900	−2,300	−2,300	−2,300
Family package	− 235	− 488	− 510	− 510
Enhanced deductibility of donations	± 0	− 70	− 80	− 100
Enhanced deductibility of contributions to churches	± 0	− 30	− 30	− 30
Abolition of tax privilege for stock options	± 0	+ 30	+ 30	+ 30
Second leg of tax reform 2010 (corporate package)				
Increase in earnings tax allowance	± 0	± 0	− 250	− 300
Abolition of tax privilege for retained earnings	± 0	± 0	+ 140	+ 150
Overall size of tax reform 2009-10	*−2,135*	*−2,858*	*−3,000*	*−3,060*
As a percentage of GDP	*0.8*	*1.0*	*1.0*	*1.0*
Federal government (Bund)	−1,430	−1,915	−1,999	−2,039
States (Länder)	− 457	− 611	− 647	− 660
Municipalities	− 248	− 332	− 354	− 361
Further relief measures	*− 916*	*−1,167*	*−1,287*	*−1,059*
Cut in VAT for pharmaceuticals	− 270	− 289	− 309	− 331
Higher tax exemptions for overtime work and overnight stay allowances	− 138	− 150	− 150	− 150
Introduction of accelerated depreciation allowance		− 250	− 350	− 100
Cut in unemployment insurance contributions	− 288	− 288	− 288	− 288
Increase in kilometric and commuter allowance	− 50	− 20	− 20	− 20
Abolition of inheritance and gift tax	− 150	− 150	− 150	− 150
Higher subsidy for residential construction saving	− 20	− 20	− 20	− 20
Overall size of tax reform 2009-10 and further relief measures	*−3,051*	*−4,025*	*−4,287*	*−4,119*
As a percentage of GDP	*− 1.1*	*− 1.4*	*− 1.5*	*− 1.4*

Source: Federal Ministry of Finance, WIFO compilation. – . . . revenue decline, + . . . revenue increase.

Reform of the wage and income tax scale

The bulk of the tax cut is due to the modification of the wage and income tax scale which raises thresholds for the lowest and the highest tax brackets and lowers all tax rates except the top one (Table 2).

The bottom tax bracket of taxable income (basic allowance totally exempt from tax) has been lifted from € 10,000 to € 11,000. The threshold to the top marginal tax rate, at € 51,000 since 1989, has been raised to € 60,000. As a result of the increase in the basic tax allowance, the number of tax subjects exempt from tax goes up from 2.54 million (38.9 percent of all tax subjects) to 2.7 million (41.3 percent of all tax subjects), an increase by 160,000 persons or 6.3 percent. The number of taxpayers liable to the top marginal tax rate is reduced by 70,000 or 26 percent, edging down from 270,000 (4.1 percent of all tax subjects) to 200,000 (3.1 percent).

The Austrian wage and income tax scale exhibits four brackets of (constant) marginal tax rates. The bottom tax rate is zero. The tax reform has lowered the tax rate for the second bracket from 38$^1/_3$ percent to 36.5 percent, and for the third bracket marginally from 43.596 percent to 43.214 percent, while the top marginal tax rate remains at 50 percent (Figure 1).

In a comparison across Europe, the combination of a high tax-exempt basic allowance with a still high bottom marginal tax rate is eye-catching (Table 3). Beyond the ceiling of the tax-free range at € 11,000, incomes are in a first bracket taxed at 36.5 percent, compared with initial marginal tax rates of 24.3 percent on average for the EU 15 and of 21.6 percent on average for the EU 27. The Austrian system of wage-related taxes therefore features two important obstacles to leave the mini-job segment:

- Above the minimum income threshold of € 357.74 (gross) per month in 2009, the entire gross income is subject to regular social security contributions;
- Due to the high bottom marginal tax rate, taxable annual income to the extent exceeding € 11,000 (corresponding to a gross income of € 15,374) is subject to a tax of 36.5 percent.

Table 2: Income tax scale before and after the reform

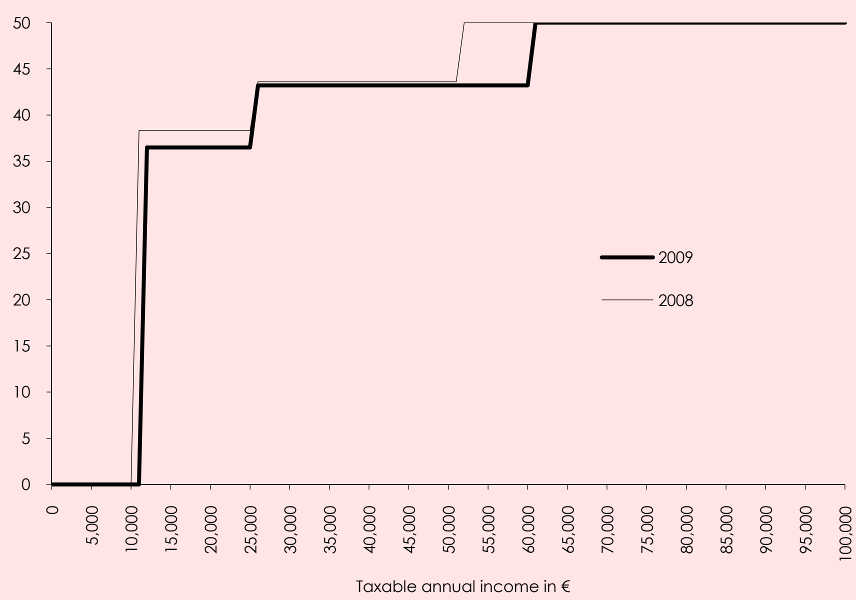
Taxable annual income	Gross annual income[1]	Tax rate	Number of cases	
In €	In €	Percent	In 1,000	Percentage shares
Income tax scale 2008				
0 to 10,000	0 to 14,252	0	2,540	38.9
10,001 to 25,000	14,253 to 35,874	38 $^1/_3$	2,580	39.5
25,001 to 51,000	35,875 to 68,433	43.596	1,145	17.5
From 51,001	From 68,434	50.0	270	4.1
Total			6,535	
Income tax scale 2009				
0 to 11,000	0 to 15,374	0	2,700	41.3
11,001 to 25,000	15,375 to 35,872	36.5	2,400	36.7
25,001 to 60,000	35,873 to 80,393	43.214	1,235	18.9
From 60,001	From 80,394	50.0	200	3.1
Total			6,535	

Source: Federal Ministry of Finance, WIFO compilation. – [1] Including supplementary payments; employees (white collar).

The sizeable marginal tax burden at the transition to a regular job liable to social security contributions, as well as the high marginal tax on low income discourage from leaving the segment of mini- and part-time jobs. This is of particular relevance for women who are over-represented in this segment of the labour market.

Figure 1: Marginal income tax rates

Taxation of amounts of € 100 exceeding the respective threshold in percent



Source: Federal Ministry of Finance; employees without employee and commuter tax credit.

Table 3: Bottom and top marginal income tax rates in a European comparison

2008

	Bottom marginal tax rate[1]	Basic tax allowance or zero tax rate ceiling	Top marginal tax rate	As from taxable income of . . .
	Percent	ĺn €	Percent	In €
Belgium	26.75	6,150[2]	53.5	32,860
Denmark	38.057	310	59.0	–[3]
Germany	15.0	7,664	47.48	250,000
Greece	15.0	10,500[2]	40.0	75,000
Spain	24.0	5,151	43.0	53,407
France	13.5	5,687	48.0	67,546
Ireland	20.0	1,830	41.0	35,400
Italy	24.15	–	44.15	75,000
Luxembourg	8.2	10,335[2]	38.95	36,570
The Netherlands	33.6	2,074	52.0	53,860
Austria[4]	*36.5*	*11,000*[2]	*50.0*	*60,000*
Portugal	10.5	234	42.0	62,546
Finland	27.1	12,399	50.1	62,000
Sweden central govt	51.6	34,769	56.6	52,344
Communities		1,279		
UK	20.0	7,610	40.0	43,880
EU 15	24.3		47.1	
Bulgaria	10.0	–	10.0	Flat Tax
Czech Republic	15.0	1,056[2])	15.0	Flat Tax
Estonia	21.0	1,726	21.0	Flat Tax
Cyprus	20.0	19,500	30.0	36,300
Latvia	25.0	1,365	25.0	Flat Tax
Lithuania	24.0	1,112	24.0	Flat Tax
Hungary	18.0	587[2])	40.0	7,333
Malta	15.0	8,150	35.0	19,000
Poland	19.0	180[2])	40.0	26,243
Romania	16.0	70	16.0	Flat Tax
Slovenia	16.0	2,960	41.0	14,375
Slovakia	19.0	3,249	19.0	Flat Tax
EU 27	21.6		37.8	

Source: *Federal Ministry of Finance* (2009). – [1] All government levels plus possible supplements. – [2] Tax credit instead of basic tax allowance or zero tax rate ceiling. – [3] Top marginal rate taking effect from different levels depending on composition of earnings. – [4] 2009.

The top marginal tax rate of 50 percent in Austria is close to the upper end of the international range. In the EU 15, Austria belongs to those six countries with top marginal tax rates of 50 percent and above (among the new EU member countries, Slovenia has the highest top marginal rate of 41 percent). The threshold for the top marginal rate of € 60,000 as from 2009 is equal or higher than in most other countries with high top marginal tax rates. However, for the wage tax the effective top marginal rate is only 43 percent and thus below the EU 15 average of around 47 percent, due to the preferential tax treatment of the 13th and 14th monthly salary[5] for dependent employees. Since income from capital (interest and dividends) is taxed in Austria at a flat rate of 25 percent and capital gains realised from private sales are tax-free after a speculative period[6], the nominal top marginal income tax rate of 50 percent is actually applied only for business earnings and for capital gains realised from sales within the speculative periods.

For the sake of higher transparency and simplicity of taxation and to facilitate international comparisons of the effective tax burden it would have been desirable if the tax reform 2009 would not have been confined to a tax cut but had provided for a

[5] One-seventh of a dependent employee's annual salary (i.e., the 13th and 14th monthly salary, "Sonderzahlungen"/supplementary payments) is taxed at a flat rate of 6 percent subject to an allowance of € 620.

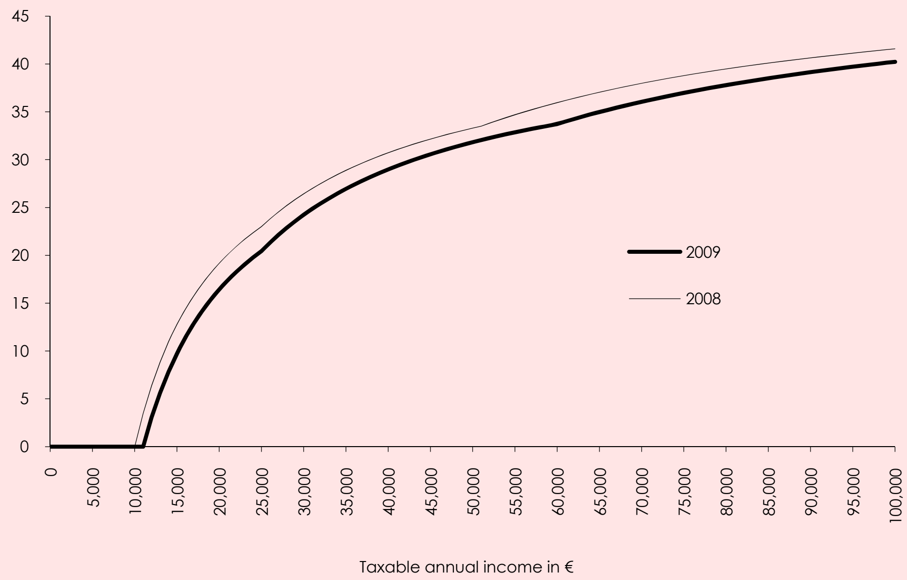
[6] Such speculative period is one year for financial assets and 10 years for real estate assets.

systemic reform (e.g., by cutting the tax relief for the 13th and 14th monthly salary coupled with a revenue-neutral lowering of marginal tax rates)[7].

The reform leads to lower average tax rates across the entire income range. As before, the average tax burden increases steeply beyond the basic tax allowance and becomes markedly flatter as from a taxable annual income of around € 35,000 (Figure 2).

Figure 2: Average income tax rates

Tax as percent of taxable income



Source: Federal Ministry of Finance; employees without employee and commuter tax credit.

The tax reduction in absolute terms increases with higher taxable income (Table 4, Figure 3). It amounts to € 148 per year for a taxable income of € 11,000, but already some € 400 for a taxable income of € 12,000. As from the top marginal rate threshold of € 60,000, the absolute tax relief is a constant € 1,350 per year. Relatively speaking, the exoneration is highest for low incomes, amounting to 3.3 percent for a taxable income of € 12,000, but only 1.4 percent for an income of € 51,000 and – because of the top threshold being raised – 2.2 percent for incomes between € 59,000 and € 62,000. For incomes above this ceiling, the relative relief diminishes gradually; thus, for a taxable income of € 100,000 it is around 1.3 percent.

The reform of the tax scale markedly increases the progressivity of the tax schedule (i.e., the ratio of marginal and average tax rate) for the lower income brackets (Table 5), where the lower average tax rate resulting from the higher basic allowance is only partly offset by the cut in the bottom marginal tax rate. Conversely, progressivity is somewhat reduced for incomes between € 52,000 and € 60,000 following the increase in the top marginal rate threshold.

As the tax schedule becomes more progressive in almost all income brackets, the revenue elasticity of wage and income tax increases (further). For the average income[8] (2008 € 21,830, 2009 € 22,336), the degree of progressivity (allowing for the employee and the commuter tax credit) rises from 1.98 to 2.19. Thus, an increase in the wage bill by 1 percent generates growth of wage tax revenues by 2.19 percent.

[7] Suggestions along these lines are presented in greater detail in *Aiginger et al.* (2008).

[8] Monthly gross wage and salary bill according to national accounts (ESA 95) per capita (i.e., per employment contract) including supplementary earnings; figure for 2009 estimated.

Table 4: Tax relief offered by the reform of the income tax scale

Employees benefiting from employee and commuter tax credit

Taxable annual income	Average tax rate		Tax due 2009 compared with 2008	
	2008	2009		
In €	As percent of income		As percent of income	In €
10,000	– 1,1	– 1.1	± 0.0	± 0
11,000	0,3	– 1.0	– 1.3	– 148
12,000	3,5	0.2	– 3.3	– 402
13,000	6,2	3.0	– 3.2	– 420
14,000	8,5	5.4	– 3.1	– 438
15,000	10,5	7.4	– 3.0	– 457
20,000	17,4	14.7	– 2.7	– 548
25,000	21,6	19.1	– 2.6	– 640
30,000	25,3	23.1	– 2.2	– 659
35,000	27,9	26.0	– 1.9	– 678
40,000	29,9	28.1	– 1.7	– 697
45,000	31,4	29.8	– 1.6	– 716
50,000	32,6	31.1	– 1.5	– 735
60,000	35,4	33.2	– 2.2	– 1,350
70,000	37,5	35.6	– 1.9	– 1,350
80,000	39,0	37.4	– 1.7	– 1,350
90,000	40,3	38.8	– 1.5	– 1,350
100,000	41,2	39.9	– 1.3	– 1,350

Source: Federal Ministry of Finance, WIFO calculations.

Figure 3: Tax relief for wage and income taxpayers 2009 vis-à-vis 2008

Source: Federal Ministry of Finance, WIFO calculations.

The residual income elasticity indicator gives an idea of the gain in income after tax as a result of a rise in taxable income. The higher the progressivity of the tax schedule, the lower is the residual income elasticity. A value below 1 suggests that the tax schedule is progressive, since an increase in taxable income by 1 percent yields a gain in after-tax income by less than 1 percent. Under the new income tax schedule 2009, the residual income elasticity is smallest for the lowest taxable incomes (0.64 for a taxable income of € 12,000; Table 6). It generally rises with income. At the transition points from one to the next marginal tax rate bracket, it drops each time, due to the jump in the marginal tax rate (from 0.78 for € 24,000 to 0.70 for € 25,000, and from 0.85 for € 59,000 to 0.75 for € 60,000), before heading up again with rising income. At an annual income of € 100,000, the residual income elasticity is 0.83.

Table 5: Progressivity of the income tax schedule

Taxable annual income	Ratio between marginal and average tax rate					
	Without employee and commuter tax credit			With employee and commuter tax credit		
In €	2008	2009	Difference 2008-09 in percentage points	2008	2009	Difference 2008-09 in percentage points
11,100	10.09	111.00	+ 100.91	55.50	– 36.83	– 92.33
12,000	6.00	12.00	+ 6.00	10.91	219.00	+ 208.09
13,000	4.33	6.50	+ 2.17	6.19	12.32	+ 6.13
14,000	3.50	4.67	+ 1.17	4.52	6.81	+ 2.30
15,000	3.00	3.75	+ 0.75	3.66	4.91	+ 1.25
20,000	2.00	2.22	+ 0.22	2.20	2.48	+ 0.29
25,000	1.67	1.79	+ 0.12	1.77	1.92	+ 0.14
26,000	1.83	2.03	+ 0.19	1.94	2.16	+ 0.22
30,000	1.65	1.78	+ 0.13	1.72	1.87	+ 0.15
40,000	1.42	1.49	+ 0.07	1.46	1.54	+ 0.08
50,000	1.31	1.36	+ 0.05	1.34	1.39	+ 0.05
52,000	1.48	1.34	– 0.14	1.51	1.37	– 0.14
60,000	1.39	1.28	– 0.11	1.41	1.30	– 0.11
61,000	1.38	1.47	+ 0.09	1.40	1.50	+ 0.09
80,000	1.27	1.32	+ 0.06	1.28	1.34	+ 0.06
100,000	1.20	1.24	+ 0.04	1.21	1.25	+ 0.04

Source: Federal Ministry of Finance, WIFO calculations.

The increase in progressivity generated by the tax reform is also reflected by the fact that the residual income elasticities of the 2009 schedule are slightly lower for almost all income brackets than those for the schedule in force up to 2008 (except for the income range from € 51,000 to € 60,000 for which the new marginal tax rate is lower because of the top income threshold having been raised).

Table 6: Residual income elasticities

Employees benefiting from employee and commuter tax credit

Taxable annual income	Gain in income after tax at an increase in taxable income by 1 percent	
	2008	2009
In €	Percent	
5,000	1.00	1.00
10,000	0.99	0.99
12,000	0.64	0.64
20,000	0.75	0.74
24,000	0.78	0.78
25,000	0.72	0.70
30,000	0.75	0.74
40,000	0.80	0.79
50,000	0.84	0.82
59,000	0.77	0.85
60,000	0.77	0.75
80,000	0.82	0.80
100,000	0.85	0.83

Source: Federal Ministry of Finance, WIFO calculations.

Public attention generally focuses also on the redistributive effects of a tax reform. These effects are assessed by the change in the net income after the implementation of the reform against a base year which in the present case is conveniently 2005, i.e., the year of the implementation of the second stage of the previous tax reform[9]. A tax reform has a progressive effect if the net income gains are higher for lower incomes than for higher ones, i.e., if they narrow with rising incomes. For the tax reform 2004-05, a progressive effect can be shown both for nominal and for real incomes (*Schratzenstaller – Wagener*, 2009).

[9] For the methodology see *Schratzenstaller – Wagener* (2009).

Judging by the respective gains in net nominal income (Table 7), the redistributive impact of the tax reform 2009-10 is not clear-cut. It is highest for low taxable incomes and declines with rising income. Due to the increase in the top marginal tax rate threshold from € 51,000 to € 60,000 the net income gain is much higher in this bracket, but narrows again beyond € 60,000. The same profile is conveyed by the gains in real net income (deflated by an overall price increase of 7.5 percent between 2005 and 2009).

Table 7: Redistributive effects of the tax reform 2009-10

Taxable income	Average tax rate		Difference in net income
	2005	2009	2005-2009
In €	Percent		Percent
10,000	0.0	0.0	+ 0.0
15,000	12.8	9.7	+ 3.5
20,000	19.2	16.4	+ 3.4
25,000	23.0	20.4	+ 3.3
30,000	26.4	24.2	+ 3.0
35,000	28.9	26.9	+ 2.7
40,000	30.7	29.0	+ 2.5
45,000	32.2	30.6	+ 2.3
50,000	33.3	31.8	+ 2.2
55,000	34.2	32.9	+ 2.1
60,000	36.0	33.7	+ 3.5
70,000	38.0	36.1	+ 3.1
80,000	39.5	37.8	+ 2.8
90,000	40.7	39.2	+ 2.5
100,000	41.6	40.2	+ 2.3
200,000	45.8	45.1	+ 1.2
400,000	47.9	47.6	+ 0.6
600,000	48.6	48.4	+ 0.4
800,000	48.9	48.8	+ 0.3
1,000,000	49.2	49.0	+ 0.3

Source: Federal Ministry of Finance, WIFO calculations. Average tax rate for tax scale without tax credits.

Table 8: Taxation of constant real incomes

Employees benefiting from employee and commuter tax credit

Taxable annual income	Deviation of average tax rate for corresponding real income	
2009	2005-2009	2008-09
In €	Percentage points	
10,000	+ 0.08	+ 0.01
11,000	+ 0.08	– 1.16
20,000	– 1.17	– 2.64
25,000	– 1.31	– 2.48
30,000	– 0.82	– 2.10
40,000	– 0.71	– 1.67
50,000	– 0.65	– 1.42
60,000	– 1.15	– 2.18
70,000	– 0.99	– 1.87
80,000	– 0.87	– 1.63
90,000	– 0.77	– 1.45
100,000	– 0.69	– 1.31

Source: Federal Ministry of Finance, WIFO calculations. + . . . fiscal drag not fully compensated, – . . . fiscal drag over-compensated.

In view of the bout of inflation prevailing until late summer 2008, public debate about the features of the tax reform 2009 gave heightened consideration to the aspect of fiscal drag[10] and to what extent it would be addressed by the tax reform. In real terms, the income tax burden is lowered only if average tax rates on nominal income of a given year are lower than average tax rates on the corresponding real

[10] "Fiscal drag" stands for the effect that taxpayers move to an income tax bracket with a higher marginal tax rate as a result of the adjustment of their market incomes to higher costs of living, their constant real incomes thus being taxed at a higher average tax rate.

income. To examine this issue, nominal incomes for the year of the tax reform are deflated by the consumer price index for a given base year. The present analysis uses 2005 (i.e., the year of the previous tax reform) and 2008 as base years. The comparison suggests that the tax reform 2009, unlike its predecessor of 2004-05, actually (over)compensates for fiscal drag related to the base years across the entire income range (Table 8), via the marked upward adjustment of both the basic tax allowance and the threshold to the top marginal tax rate. However, the higher revenue elasticity implied by the 2009 tax schedule will henceforth reinforce the fiscal drag effect, i.e., the increase in tax revenues only caused by inflation.

Family "package"

With the "family package", also implemented in 2009, direct or indirect monetary transfers for families with children have been newly introduced or increased by a total € 510 million (Table 9; *Festl – Lutz – Schratzenstaller,* 2009). The family tax credit was raised from € 50.90 to € 58.40 per child and month (with a budgetary impact of € 165 per year). The corresponding increase in the child support tax credit from € 25.50 to € 29.20 for the first, from € 38.20 to € 43.80 for the second and from € 50.90 to € 58.40 for each further child generates additional expenditure of € 10 million per year.

Table 9: Size of the "family package" 2009

	Million €
Increase in child tax credit	– 165
Adjustment of maintenance tax credit	– 10
Introduction of child tax allowance	– 165
Tax deductibility of child care cost	– 160
Introduction of a tax-free employer supplement to child care cost	– 10
Total	– 510

Source: Federal Ministry of Finance.

In addition, three instruments of family policy are being (re-)introduced: first, for each child a tax allowance of € 220 per year may be claimed (implicit annual revenue loss of € 165); if both parents can claim the tax allowance, each will be granted 60 percent of the total (€ 132 p.a., respectively). Second, cost of child care for children up to 10 years can be deducted from the tax base up to € 2,300 per year (without co-payment) as extraordinary expenses, if the care is administered in a childcare institution (nursery, kindergarten etc.) or by a pedagogically equivalent person (revenue shortfall of € 160 million per year). Third, employers may grant all or part of their staff a financial child care supplement exempt of tax and social charges of up to € 500 per year and child below the age of 10, provided that the child is taken care of in a childcare institution or by a pedagogically equivalent person (revenue shortfall of € 10 million per year).

The promotion of female employment is a declared aim of the family "package", to which the child tax allowance, the employer supplement to the child care cost and the tax deductibility of the latter should contribute. While due to its small amount the impact of the child tax allowance should be limited, the tax deductibility of child care cost will prove more effective since it reduces the opportunity cost of working women with children. However, the tax benefit does not require that both parents are working. Unlike the child tax credit that is granted to the eligible population as a flat amount independent from the income level, the child tax allowance and the tax deductibility of child care cost have a degressive impact in that the tax relief rises with income in absolute and relative terms. For low-income earners below the income tax threshold, child tax allowance and tax deductibility carry no financial advantage.

When judging on the family "package", two further aspects play a role. First, the introduction of yet other instruments still adds to the complexity of the existing array of family support measures. Second, the imbalance between benefits in cash and those in kind is enhanced at the expense of the latter. Against the size of the family "package", the additional spending planned by Bund and Länder on new childcare facilities of up to € 110 million per year[11] appears rather small, considering also the fact that the recently introduced 13th annual instalment of the family allowance will raise government spending by € 250 million each year. However, such criticism does not include the subsidy to and tax deductibility of child care cost since they, as earmarked monetary transfers, provided targeted support to the use of childcare facilities. While the shortage of available facilities currently constrains the effectiveness of both measures, they may provide an incentive for the creation of new capacity in the longer run.

Current taxation trends in Europe

Tax measures to cope with the crisis

In response to the financial and economic crisis, all EU member countries have also included tax measures in their fiscal stimulus programmes. In many cases, tax cuts were introduced in order to sustain private demand; some countries, however, increased certain taxes in order to help finance the cost of the crisis. Table 10 presents an overview of the tax measures adopted by EU member countries in the context of the crisis, which take effect partly in 2009 and partly in 2010. Information on the size of the measures is available only for 2009, hence the ratios to GDP quoted in Table 10 convey an incomplete picture. Altogether, 16 EU member countries cut the tax burden in 2009 (by between 0.1 percent of GDP in Denmark and Slovenia and 1.4 percent in Austria), in 10 countries it remained unchanged, and in Italy the tax burden increased by 0.2 percent of GDP.

Most EU member countries (22 in all) lower the income tax burden for private households through tax rate cuts and/or introduction or extension of tax concessions. Only few countries increase tax rates and/or abolish tax privileges. Tax reductions are often granted also to companies liable to income or corporate tax, almost exclusively in the form of tax privileges like more generous depreciation allowances, partly limited in time. No less than seven countries increase excise taxes (mostly on tobacco, alcohol and mineral oil). Eleven countries lower the indirect tax burden, mostly via a longer list of exemptions, in some cases with a time limit; only the United Kingdom has temporarily lowered the (VAT) tax rate. Nine countries alleviate social charges, normally via cuts in contribution rates; but as many as four countries proceed to higher social contributions.

In the EU 15, tax concessions are granted mainly for income tax on private households and companies, but also for corporate tax. In the new EU member countries, however, also consumption taxes play a bigger role, partly in the form of a cut in the standard sales tax rate and partly via an actual increase in excise taxes or in the standard sales tax.

Structural trends in tax systems

The contribution from consumption taxes to general government financing is in a slight downward trend in Austria as well as in the EU (Table 11). The respective share of 27.8 percent in Austria in 2007 was close to the EU-25 average and somewhat above the euro area average (26.7 percent). Special consumption taxes on tobacco and alcohol, accounting for 1.6 percent of total tax revenues (0.6 percentage points less than in 1995), play a relatively smaller and declining role in Austria. The share of environmental taxes has increased by 0.6 percentage points since 1995 in Austria, but declined on average in the EU. At 5.8 percent of total tax revenues in Austria, their share corresponds to the euro area average, but is below the EU-25 average of 6.2 percent.

The most significant difference in the tax structure between Austria and the EU average is in the areas of capital taxation (taxes on the stock, return and transactions of financial assets of companies and private households) and labour taxes. The latter claim an above-average share of 55.2 percent of total tax revenues in Austria, as

[11] Federal government subsidy of € 20 million p.a. for the expansion of childcare facilities in 2009 and 2010, to be topped by the same amount by the *Länder* (as agreed in the Revenue Sharing Act 2008). Additional spending of € 70 million per year up to 2014 for the introduction of a compulsory pre-school year free of charge, as agreed in the fiscal stimulus programmes.

compared with 48.8 percent in the EU 25 (in 2007) and 50.6 percent in the euro area; moreover the downward trend in the share of labour taxes has been much more pronounced abroad since 1995 than in Austria.

Table 10: Fiscal stimulus measures from the tax side in EU 27

	Income tax private households	Income tax companies	Corporate tax	Excise taxes	VAT	Social security contributions	Overall impact as a percentage of GDP[1]
Austria	3, 7	3, 8	8				− 1.4
Belgium	7, 8				7		− 0.2
Bulgaria	7	8	8				± 0.0
Cyprus			7		8		± 0.0
Czech Republic		7	7		7	3	− 0.5
Germany	3, 7	8	8				− 0.8
Denmark	3, 7, 8						− 0.1
Estonia	2, 6				5		± 0.0
Greece	1, 7						± 0.0
Spain	7	7	7			3	− 1.3
Finland	3, 7		7	1	7	3	− 1.1
France	3	7	7		7		− 0.3
Hungary	3				1, 8	3	± 0.0
Irleand	3	7	7	1	1, 8	1	− 0.2
Italy	5, 6, 7	7	1, 7	7		7	0.2
Lithuania	3, 7	8	1, 8	1	1, 5	1	± 0.0
Latvia	3, 7			1	1, 5		± 0.0
Luxembourg	3, 7		3				− 1.2
Malta	3				7		− 0.3
The Netherlands	7	7, 8	8			3	− 0.5
Poland	3	7	7				− 0.7
Portugal	7	7	3, 7		7		± 0.0
Romania	7, 8	7	7	1	7	1, 3	± 0.0
Sweden	3, 7		3, 5, 7			3	− 0.8
Slovenia		7	7	1			− 0.1
Slovakia	7	7	7			3	± 0.0
UK	1, 5, 7	7, 8	2, 7, 8	1	4	1	− 1.0
EU 27							
Decline	22 countries	16 countries	20 countries	1 country	11 countries	9 countries	
Increase	4 countries		3 countries	7 countries	5 countries	4 countries	− 0.6

Source: *European Commission* (2009A, 2009B), WIFO compilation. – 1 . . . permanent tax rate increase, 2 . . . temporary tax rate increase, 3 . . . permanent tax rate cut, 4 . . . temporary tax rate cut, 5 . . . permanent abolition or reduction of tax breaks, 6 . . . temporary abolition or reduction of tax breaks, 7 . . . permanent introduction or extension of tax breaks, 8 . . . temporary introduction or extension of tax breaks.

While the share of capital taxes has increased by 2.3 percentage points in Austria since 1995, it is at 17.1 percent markedly below the average for both the EU 25 (23.8 percent) and the euro area (23 percent). Furthermore, the European average has moved up much more since 1995 than the Austrian ratio. A large part of the deviation is explained by the minor and diminishing role of taxes on the stock of financial wealth in Austria (2007: 2.4 percent, –0.4 percentage points since 1995; EU 25: 7.3 percent, +0.8 percentage points; euro area 6.6 percent, +0.3 percentage points since 1995).

Table 11: Tax revenue structure in Austria compared with the EU average

	Austria	EU 25[1]	Euro area[1]	Austria	EU 25[1]	Euro area[1]
		2007			1995-2007	
	As percent of total taxes			Change in percentage points		
Tax base						
Consumption	27.8	27.7	26.7	− 0.2	− 0.8	− 0.7
Tobacco, alcohol	1.6	2.1	1.8	− 0.6	− 0.3	− 0.2
Environment	5.8	6.2	5.8	+ 0.6	− 0.8	− 1.0
Labour	55.2	48.8	50.6	− 2.0	− 3.8	− 3.4
Capital	17.1	23.8	23.0	+ 2.3	+ 4.7	+ 4.2
Stock of wealth	2.4	7.3	6.6	− 0.4	+ 0.8	+ 0.3

Source: *European Commission* (2009A). – [1] Weighted average.

However, the picture conveyed by differential tax revenue structures is incomplete without tax bases being included. Indeed, country-specific differences may relate not only to divergences in tax systems, but also to different tax bases. In order to control for that factor, effective (implicit) tax rates have been calculated which set tax revenues in relation to the respective tax base (Table 11).

The fact that these indicators show trends similar to those of tax revenue structures suggests that different tax bases are indeed exploited to a different degree across countries. Thus, the implicit tax rate on labour has increased steadily in Austria since the mid-1990s (by 2.5 percentage points between 1995 and 2007), to a ratio of 41 percent, above the EU 25 average of 36.6 percent and the euro area of 38.7 percent. For the EU 25, the ratio has edged down by 0.3 percentage points from 1995 to 2007, in the euro area it has gone up by 0.5 percentage points.

The implicit capital tax rate in Austria was 26.1 percent in 2007, unchanged from 1995, and below the euro area average (1995-2007 +6.8 percentage points to 32.1 percent) and the EU 25 average (34.2 percent, +7.9 percent). This indicator is difficult to interpret insofar as it relates all taxes on the stock, returns and transactions of financial assets (capital taxes) to profits and income from wealth earned world-wide by private households and companies. In order to identify long-term trends of this complex indicator, the European Commission calculates three sub-indicators: an implicit tax rate on capital gains and corporate earnings, one on earnings of incorporated enterprises, and one on income from capital and entrepreneurial activity for private households. These three sub-indicators performed differently for Austria over the period from 1995 to 2007.

Table 12: Implicit tax rates for Austria and the EU average

	Tax base											
	Consumption			Labour			Capital			Energy[1]		
	Austria	EU 25[2]	Euro area[2]	Austria	EU 25[2]	Euro area[2]	Austria	EU 25[2]	Euro area[2]	Austria	EU 25[2]	Euro area[2]
	Percent											
1995	20.5	20.0	19.4	38.5	36.9	38.2	26.1	26.3	25.3	128.8	171.2	178.1
1996	21.1	20.0	19.3	39.4	37.4	39.0	29.2	28.3	27.5	120.9	170.0	175.5
1997	22.1	20.0	19.4	40.7	37.4	39.5	29.3	29.4	28.2	141.4	175.5	176.1
1998	22.3	20.1	19.6	40.3	37.7	39.9	29.7	30.1	28.5	133.6	178.6	173.7
1999	22.8	20.5	20.1	40.5	37.5	39.7	28.3	32.6	30.6	139.1	189.8	184.4
2000	22.1	20.1	19.6	40.1	37.2	39.5	27.3	33.1	30.5	142.6	189.9	179.1
2001	22.1	19.6	19.2	40.6	36.8	39.1	35.8	31.3	28.5	146.3	183.3	174.3
2002	22.5	19.7	19.2	40.8	36.4	38.9	29.3	30.0	27.8	149.1	188.6	179.5
2003	22.2	19.6	19.1	40.8	36.6	38.9	28.3	29.2	27.8	148.2	185.7	181.5
2004	22.1	19.7	19.1	41.0	36.2	38.5	27.4	29.9	28.1	157.9	184.2	177.9
2005	21.7	19.7	19.2	40.8	36.3	38.4	24.2	31.2	28.9	150.3	178.7	172.7
2006	21.2	19.8	19.4	40.8	36.4	38.5	24.4	33.0	31.0	144.5	177.2	172.2
2007	21.6	20.0	19.6	41.0	36.6	38.7	26.1	34.2	32.1			
Change 1995-2007 in percentage points	1.1	0.0	0.2	2.5	– 0.3	0.5	0.0	7.9	6.8	15.7	6.0	– 5.9

Source: *European Commission* (2009A). Ratio of tax revenues per category to potential tax base. – [1]) change in euro. – [2]) weighted average. – [3]) energy taxes in € per ton of oil equivalent, deflated by the cumulated change in the consumer price index (base year 2000).

The implicit tax rate on income from capital and entrepreneurial activity, unlike the implicit capital tax rate, does not include taxes on the stock of wealth. Its increase in Austria from 21.1 percent in 1995 to 22.4 percent in 2007 therefore reflects the loss of importance of taxes on wealth. The implicit tax rate on capital and entrepreneurial income can in turn be decomposed into the implicit tax rates on earnings of incorporated enterprises on the one hand, and on those on capital and entrepreneurial income of private households, on the other. While the former increased from 23.6 percent to 24.8 percent, the latter decreased from 11.2 percent to 8.5 percent.

Energy also is taxed at a below-average degree in Austria. As measured by the relation between real energy tax revenues and final energy use (in euro per ton of oil equivalent), the implicit energy tax rate was higher in 2006 than in 1995, but declining in recent years. At € 144.5 per ton of oil equivalent in 2006, it was clearly below the average of the EU 25 (€ 177.2) and the euro area (€ 172.2).

Conclusions

The tax reform 2009-10 puts the emphasis on the lowering of the wage and income tax burden, targeting private households and earnings from employment. It also provides tax relief for families. Other measures, like tax breaks for donations or the corporate "package", play a rather minor role as part of the reform. Other goals of taxation which are often at the focus of systemic reform as referred to above are only partly achieved by the latest reform and the other tax relief measures taken in 2008. This is notably the case for structural macro-economic goals.

The adjustment of the tax scale compensates in a static perspective for fiscal drag; however, in a dynamic perspective, it exacerbates the problem by introducing a more progressive schedule in the lower and intermediate income brackets. The tax reform accounts for almost half of the GDP and employment effects of the fiscal stimulus measures taken by the federal government and the Länder. It thereby makes a major contribution towards countering the financial and economic crisis: without the tax reform, GDP in 2010 would be 0.6 percent lower (overall impact of the stimulus measures of Bund and Länder +1.4 percent), and employment by 10,900 lower (overall impact of government action +26,600; *Breuss – Kaniovski – Schratzenstaller*, 2009). The tax reform also includes elements for a better reconcilability of work and family obligations. Finally, the tax relief measures make for a reduction of the overall tax burden.

However, the latest adjustments neither make the tax system more environmentally friendly nor do they make it simpler, e.g., by integrating the income tax schedule with social contributions or by phasing out the preferential tax treatment of the 13th and 14th monthly salary. Nor were tax instruments used more actively to rein back "public bads" (e.g., activities with harmful individual and/or social consequences like tobacco and alcohol consumption or gambling). While the adjustment of the tax schedule strengthens its redistributive impact by conferring the relatively strongest tax relief to low incomes, it makes at the same time the schedule more progressive for the lower and middle income brackets. With the phasing out of the inheritance and the gift tax, the system no longer works towards correcting the unequal distribution of inter-generational transfer of wealth.

Moreover, the tax relief measures implied by the reform 2009-10 contribute little towards making the tax system more growth- and employment-friendly. Indeed, empirical analysis by the OECD (*Johansson et al.*, 2008) suggests that taxes on labour, which in Austria are high and rising, are among those with the most negative effect on growth and employment. Certain taxes on financial wealth, on the other hand, like those on real property or on inheritance and gifts, which are more neutral to growth and employment, are levied to a below-average degree or not at all (respectively no longer) in Austria. This structural imbalance is hardly corrected by the latest tax measures. Tax barriers to leave the segment of mini or part-time jobs remain high even after the cuts in the bottom marginal tax rate and the unemployment insurance contributions for low-income earners, and no major step has been taken to exonerate labour incomes of social charges or to shift social security financing towards general tax revenues.

A structural reform geared towards making the entire tax system conducive to higher growth and employment would have to further reduce the tax burden (including social security contributions) on labour, in particular for the low and middle-size incomes. For such a reform to be revenue-neutral, it may be counter-financed (apart from savings on the expenditure side) by the phasing out of tax exemptions that have become obsolete (e.g., tax privileges for hours worked overtime or the single-earner tax credit for couples without children). In addition, special consumption taxes on economically harmful activities or tax bases may be increased (e.g., energy and environmental resource consumption, tobacco and alcohol consumption, gambling); such taxes are not only more growth- and employment friendly, but also generate positive incentives for individual behaviour. Finally, the design of a growth- and employment-friendly tax system may rely on higher taxes on wealth (capital gains, real estate, inheritance, gifts) as a compensation for lower labour taxes.

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The Tax Reform 2009-10 – Summary

The tax reform of 2009-10 focuses on a reduction of the wage and income tax burden. It essentially comprises a reform of the tax schedule, measures to relieve families, an extension of the deductibility of donations as well as tax reductions for corporate earnings. However, the tax reform – as well as the other tax relief measures of the past year – makes only a partial step towards the structural macroeconomic objectives pursued through the tax system (or its reform).

The reform of the tax scale offsets fiscal drag. From a dynamic perspective, however, it exacerbates the problem by enhancing the progressivity of the tax schedule for lower and medium income brackets. The tax reform contributes substantially to fighting the current economic crisis: in its absence, GDP would be 0.6 percent lower in 2010 (the combined effect of Federal and State-level measures being 1.4 percent of GDP), and the number of employees would be 10,900 persons lower (the combined effect of Federal and State-level measures being 26,600 employees). In addition, the tax reform includes measures to improve the work-life balance of parents.

By contrast, the most recent fiscal measures do not help to make the tax system more environmentally friendly nor do they help to simplify it (e.g., by reducing the tax privilege for the 13th and 14th monthly wage). The potential of taxation to curb "public bads" (activities with negative individual or collective economic consequences) is not strengthened either. With respect to distributive objectives, the tax reform does provide the relatively strongest relief for the lower income brackets. However, it also exacerbates the progressivity of the tax schedule for lower and medium incomes. Due to the expiry of the inheritance tax and the gift tax there will be no correction of the unequal distribution of inherited wealth in the future.

In addition, the tax relief measures of the past year contribute little to making the tax system more growth and employment friendly. Taxes on wages which are of high and growing significance in Austria are among those tax categories which are most detrimental for growth and employment. By contrast, certain wealth taxes (such as real estate tax or gift and inheritance tax), which are considered relatively neutral with respect to growth and employment, are not tapped to the full potential or not levied at all (any more). This is hardly changed by the most recent tax measures. Even after the reduction of the bottom marginal tax rate as well as of unemployment insurance contributions for low incomes, the tax barriers to an increase of marginal and part-time employment remain high and no substantial progress has been made towards a decisive cutback of the tax burden on wages or, respectively, towards an increased tax financing of the social security system.

A structural reform which aims at making the whole tax system more growth and employment friendly would have to reduce taxes on wages (including social security contributions) further, especially for lower and medium incomes. Firstly, this would have to be financed (besides expenditure cuts) by the abolition of tax exemptions which have become obsolete (e.g., reducing the tax exemptions for overtime pay, abolition of the personal allowance for childless single earners). Secondly, an enhanced use of excise duties on activities or tax bases with negative externalities (energy use, consumption of alcohol and tobacco, gambling) would make sense. A certain expansion of wealth taxes (capital gains tax, real estate tax, inheritance tax and gift tax) could play a role in the design of a more growth and employment friendly tax system, too, if they are used to compensate for the reduction of taxes on wages.

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