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Annual Report on Taxation 2021

3 Recently implemented tax reforms

This chapter complements the analysis included in Chapter 2 by focusing on the most recent tax policy reforms and crisis measures. It consists of two sections.

Section 3.1. presents the reforms Member States introduced or announced in the months prior to the onset of the COVID-19 pandemic[1]. These are grouped according to which of the tax priorities presented in the first two chapters of this report they contributed to most. The information in this section is based on the tax reform tables included in the Taxation Trends Report (European Commission, 2020a). In some cases, this information is complemented with data from other sources, such as information provided by Member States in their national reform programmes and stability or convergence programmes[2]. These sources are referenced in footnotes. While comprehensive, the list of reforms is non-exhaustive.

Section 3.2. concludes the chapter by looking at the tax measures introduced by Member States during 2020 in response to the COVID-19 pandemic. It takes stock of the numerous tax measures introduced by Member States, based on a variety of sources including information provided by Member States to the Commission and the OECD's overview of tax policy measures taken so far in response to the pandemic[3].

3.1 Tax reforms introduced or announced prior to the pandemic

3.1.1 Reforms affecting innovation and productivity

Corporate tax rates (CITs) continue to show a decreasing trend. The average top statutory CIT rate (including surcharges) in the EU fell slightly from 21.9% in 2019 to 21.5% in 2020. The decrease was due to reforms in Belgium (top rate was reduced from 29.6% to 25%), France (reduced from 34.4% to 32%), and Greece (reduced from 28% to 24%). Further cuts were announced in France (progressive decrease 32% in 2020 to 28.4% in 2021 and 25.8% in 2022) and the Netherlands (decrease of the top rate from 25% in 2020 to 21.7% in 2021). No Member State increased its headline CIT rate in 2020. However, some Member States introduced new taxes on certain company profits. For example, Denmark raised the level of tax on companies' residual profits and Lithuania introduced a top up of 5% (i.e. additional to the general rate) on the CIT rate applied to the taxable profits of credit institutions.

Several Member States introduced new tax measures to stimulate investment. For example, Hungary increased the upper threshold of its tax allowance for angel investments.

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(1) Specifically, it covers reforms announced or implemented between June 2019 and March 2020. For an analysis of reforms in previous years, see previous editions of this report (European Commission, 2018a; European Commission, 2017a; European Commission, 2016; European Commission, 2020).

(2) For more information, see: https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/european-semester-timeline/national-reform-programmes-and-stability-or-convergence-programmes_en.

(3) For more information on the OECD's overview, see: https://www.oecd.org/tax/tax-policy/#d.en.194478.

Slovakia extended the carry-forward period for eligible micro taxpayers and Italy introduced a new allowance for investments in innovative and intangible assets.

A number of Member States apply allowance for corporate equity (ACE) schemes to address the corporate debt bias[4]. Belgium, Cyprus, Malta, Poland, and Portugal continued to apply these schemes. Furthermore, Italy re-introduced an ACE scheme for 2019 and Austria intends to re-introduce an ACE as early as 2021.

Several Member States introduced measures to incentivise R&D investment. Germany introduced its first R&D tax credit to complement its direct support measures. Italy replaced its old R&D tax credit with a new tax credit that supports the green transition and investments in innovative technologies. Slovakia increased the amount of its R&D tax deduction. Ireland increased its R&D tax credit to provide extra support to micro- and small companies, subject to State aid approval. Sweden increased its tax relief on the total social security contributions paid by companies in relation to the employment of individuals who work in R&D from 10% to 20%.

Member States continued to implement reforms embracing digitalisation and simplifying the remittance of taxes. Spain and Italy have introduced pre-completed VAT returns in 2020. To make it easier for taxpayers to declare their incomes, Bulgaria introduced an option for individuals to use pre-filled annual tax returns.

3.1.2 Reforms affecting the environment and health

In 2020, a number of Member States implemented environment-related tax measures. Sweden introduced a tax on plastic carrier bags and Italy put in place a new consumption tax on plastic packaging materials (EUR 0.45 per kilogram). Latvia abolished the existing tax exemption for disposable tableware and accessories made of plastics.

In the field of vehicle and fuel taxation, adjustments were introduced in several Member States. Latvia raised excise duties for gas oil (diesel fuel) by 7.2% and introduced a pollution tax on vehicles. Bulgaria introduced a vehicle tax based on the category of vehicles and their environmental impacts. Ireland introduced tax benefits for electric vehicles and Finland increased its tax rates on transport fuels. To incentivise more sustainable forms of travel, Germany reduced the VAT rate on long-distance rail travel from 19% to 7%, and increased its aviation tax rate. Luxembourg increased its excise duties on gasoil and petrol.

Other environmental taxes were also implemented in 2019 and 2020. Spain increased its excise duty rates on hydrocarbon and Sweden introduced a tax on waste incineration. Estonia applied a 25% increase on the excise rate for natural gas, and Latvia increased its tax rate on several activities (sand, greenhouse gas emission and coal). The Netherlands increased the tax rate on natural gas and will introduce an additional CO_2 tax in 2021. Lithuania increased its excise duty rate for diesel used in agricultural activities by 7.1% from EUR 56 to EUR 60 per 1000 litre.

As regards health-related taxes, many Member States (Czechia, Denmark, Estonia, Finland, Ireland, Lithuania, Hungary, the Netherlands, Portugal, Romania and Slovenia) raised their excise duties on tobacco products. Only Finland and Lithuania raised their excise duty rates on alcoholic beverages. Conversely, as part of a reform to foster the growth of entrepreneurship, Denmark reduced its excise duties on certain alcoholic drinks (wine, alcopops) and Estonia decreased its excise duty rates on beer and fermented beverages with less than 6% alcohol. Other measures in the field of health taxation include an increase of excise duty rates on sugary beverages, with several Member States (Ireland, Finland, Italy, Poland, Portugal) increasing their rates to disincentivise their consumption.

[4] See Section 2.1.2.

3.1.3 Reforms affecting tax avoidance, evasion and fraud

Member States continued the fight against tax avoidance, evasion and fraud in 2019-2020, complementing EU action. Measures span from strengthening enforcement and tax collection to facilitating compliance and improving the legal framework against tax avoidance practices.

In 2019-2020, several reforms aimed to combat tax fraud and evasion. Bulgaria introduced an obligation for authorised warehousekeepers to use video surveillance systems and monitor all processes taking place in tax warehouses, where energy, ethyl alcohol and tobacco products are produced or stored. Italy tightened the rules for CIT and personal income tax (PIT) liability offsets, and its obligation to file direct tax returns electronically before offsetting the tax liability was extended to amounts exceeding EUR 5 000. Cyprus announced in October 2020 that it was suspending its Cyprus investment programme, which granted full Cypriot citizenship to wealthy individuals who invested EUR 2.2 million into the country and met certain other requirements.

Some countries introduced measures to strengthen VAT compliance. Czechia increased the rates of its tax lottery(5) and measures to encourage consumers to register purchase receipts in order to reduce the shadow economy. To fight the shadow economy, Latvia now enables the state revenue service to inform businesses regarding their suppliers or clients risks to avoid them being unintentionally involved in their counterparties' illegal activities. Latvia also introduced a tax lottery from July 2019. Poland put into place an online cash register system (to be introduced gradually) to automatically and in real time upload information regarding each registered VAT transaction and thus control whether VAT is correctly accounted for. This will reduce the compliance burden and tackle the shadow economy by increasing the transparency of VAT settlements and facilitating tax inspections.

On top of the implementation of the Anti-Tax Avoidance Directive, several countries took specific measures to reinforce their tax system against aggressive tax planning practices. As from January 2021, the Netherlands introduced withholding taxes on interest and royalty flows to low-tax jurisdictions and in the event of abusive tax arrangements. Moreover, the Netherlands tabled a thin capitalisation rule for banks and insurance companies, whereby interest paid on corporate debt in excess of 92% of total assets will not be deductible for tax purposes. Ireland amended its Real Estate Investment Trust framework to ensure an appropriate level of tax collection from the regime. More specifically, the proceeds from the disposal of a rental property will be subject to dividend withholding tax upon distribution. For the Irish Real Estate Fund (IREF), Ireland introduced limitations on interest expenses based on debt-to-property cost and on an income-to-interest ratio. Furthermore, an amendment was made to the calculation of the amount on which IREF tax is levied to ensure that any gains which are reflected in the market value of the unit, but which are not reflected in the accounts of the IREF, are subject to IREF tax. Ireland has also changed the clawbacks provision of its capital allowance for intangible assets. For intangible assets acquired after 22 October 2020, balancing charges(6) will apply regardless of the period of detention of these assets, aligning Ireland with the rules in other jurisdictions.

Some Member States reinforced their transfer pricing rules to fight ATP. Ireland modernised its transfer pricing rules including the incorporation of the OECD 2017 transfer pricing guidelines into Irish legislation and the extension of rules to cover cross-border non-trading, and material capital transactions. Poland passed a reform on transfer pricing regulation, which also incorporated the OECD's 2017 guidelines**.**

(5) Cash registers in shops must provide special receipts with a unique lottery code, and these are then entered into a regular lottery for consumers. The objective of this measure is to encourage consumers to insist on all transactions being properly recorded in the electronic cash registers and being offered a receipt.

(6) Balancing charges (also referred to as 'clawbacks') apply when an asset for which capital allowances have been claimed is sold for more than its accounting value, a value which incorporates the capital allowance deductions already incurred.

3.1.4 Reforms affecting redistribution and social fairness

A modest number of reforms were made to PIT and SSC systems, to cut rates, adjust tax brackets or achieve simplification. For example, Slovenia increased the thresholds of individual tax brackets and reduced the PIT rate applied in the second and third PIT tax brackets. Hungary merged four separate elements related to employees' social security contributions into a single social security contribution from July 2020. Lithuania increased the amount of income exempt from PIT, changed the income threshold at which the second PIT bracket is applied, and further lowered the ceiling for SSC contributions.

A number of measures to reduce the tax wedge on labour were put in place, to boost the net incomes of lower income workers and families and in some cases encourage labour supply. For example, Greece revised the basis for calculating PIT liabilities and reduced the social security contributions for full-time employees by 0.9pp with effect from June 2020. The government has announced a further reduction by 3pp in 2021. In Poland, on top of a tax exemption for younger workers, since October 2019 the first income tax rate was reduced from 18% to 17%. The tax-deductible costs for employees were also increased. Lithuania increased the income tax allowance from EUR 350 per month to EUR 400 per month, effective from July 2020. Italy reduced the tax wedge for dependent workers: for income up to EUR 28 000 per year, an allowance of EUR 600 was given for the last six months of 2020, which became an annual EUR 1 200 from 2021. Lower allowances are envisaged for higher incomes, up to EUR 40 000. This measure replaces a previous rebate ('bonus Renzi') on income between EUR 8 000 and EUR 26 600. In Belgium (Flanders region), from 2021 an 'employment bonus' will increase the net salaries of workers whose gross monthly salary does not exceed EUR 1 700 by at least EUR 50 per month. The bonus is intended to address unemployment and activity traps and gradually decreases to zero for people with a gross monthly salary of at least EUR 2 500. France reduced the PIT rate in the first bracket from 14% to 11% and adjusted the tax relief mechanism ('décote') to smooth the onset of the application of PIT. Malta increased the differentiated non-taxable minimum income to EUR 300 per month and increased the highest margin to which the maximum PIT amount is applied. Austria increased the maximum SSC reimbursement for low-income earners from EUR 400 to EUR 700. Finland increased a number of PIT allowances and deductions while proceeding with the gradual reduction and removal of the tax deductibility of mortgage interest payments. Croatia implemented a reduction in PIT liability by 100% for under-25s and by 50% for people from 26 to 30 years of age for annual salaries under HRK 360 000. Hungary introduced an exemption from PIT for women with four or more children. Estonia increased the supplementary basic PIT allowance from the third child from EUR 1 848 to EUR 3 048 per year.

The long-term trend of decreasing top marginal tax rates continued, driven by large reductions in a few Member States. The simple average of top personal income tax (PIT) rates at the start of 2020 in the EU was 38.7%, 0.5 pp lower than in 2019, although this masks a very large range from a minimum of 10% in Bulgaria to more than 55% in Denmark. In 2020, significant falls in the top PIT rate were introduced in Ireland (a drop of 8pp from 48% to 40%) and Sweden abolished its surcharge on high incomes, bringing the top PIT rate down 4.9pp from 57.2% to 52.3%. The Netherlands accelerated the introduction of its two-bracket PIT schedule (the old system had three brackets) by introducing it in 2020 rather than in 2021 as had previously been envisaged. As part of this reform, the highest PIT applicable fell from 51.75% in 2019 to 49.5% in 2020. In Greece, the PIT rate on the highest income bracket for business, employment and farming income above EUR 40 001 was reduced to 44% from 2020. In contrast, Lithuania increased its top PIT rate by 5pp, although at 32% it is still substantially below the EU average. Finland extended the application of the temporary highest income bracket of the progressive income tax scale until the end of 2023.

A number of Member States legislated special treatment for certain types of income, or schemes targeting particular groups. Sweden increased the reduction in SSC applied to people working in roles related to R&D, and also introduced reduced SSCs for people entering the labour market. Poland lowered the amount of SSC that micro-entrepreneurs with modest annual revenue have to pay. The Netherlands began to implement a gradual reduction in the tax deduction for unincorporated self-employed people from EUR 7 280 in 2019 to EUR 5 000 in 2028. Malta introduced a fixed PIT rate on overtime. Ireland increased the maximum amount of the earned income tax credit for the self-employed and unincorporated businesses by EUR 150 to EUR 1 500.

Changes to consumption taxes were generally relatively minor. No Member States changed their standard VAT rate, although national standard VAT rates vary significantly from a low of 17% in Luxembourg to a high of 27% in Hungary. The VAT base therefore remained relatively stable until the onset of crisis measures, although some recent changes have been made in recognition of the growth of online media, or to support tourism-related industries. Slovenia lowered the rate applied to electronic publications to 9.5% and the rate on printed media and books to an additional reduced rate of 5%. The Netherlands also brought electronic publications like e-books and electronic newspapers into the reduced VAT rate. In Hungary, VAT on accommodation services was reduced from 18% to 5%. In Croatia, the reduced VAT rate of 13% was extended to food served in restaurants, and to revenue related to music copyright. Romania reduced the VAT rate applied to ecological agriculture and traditional products from 9% to 5%. Germany reduced the VAT rate on long-distance rail travel from 19% to 7%. Poland applied a new matrix of VAT rates that lowered the VAT rate applied to some goods and services while raising it on others. Greece expanded the range of goods and services to which the reduced VAT rate of 13% is applied and lowered the VAT rate on gas and electricity to 6%.

3.2 Tax measures introduced in response to the COVID-19 crisis

3.2.1 General policy response in the EU

2020 was marked by a deep health crisis, which affected the whole globe and had significant economic and social consequences. The highly infectious COVID-19 virus resulted in lockdown measures to protect people's health and to support health systems' ability to respond. As a result, EU countries experienced economic shocks to both aggregate demand and supply, where business activity, investment, private consumption, exports and imports were significantly reduced or limited in all Member States – although some Member States were hit harder than others due to their economic structure (e.g. those more dependent on tourism or services) and degree of openness.

The latest Commission forecast projects that the EU economy contracted by 7.4% in 2020 and will grow by around 4.1% in 2021 and 3% in 2022[7]. As a result of the COVID-19 pandemic, economic activity in the EU suffered a severe shock in the first half of 2020. A rebound followed in the third quarter as containment measures were gradually lifted, but the resurgence of the pandemic resulted in new public health measures in Autumn, with additional economic disruption. Unemployment rates (from 6.5% in third quarter 2019 to 7.4% in third quarter 2020[8]) and the aggregated government deficit at EU level (from just 0.6% of GDP in 2019 to around 8.4% in 2020) are also forecasted to have increased. Projections over the forecast horizon are subject to a high degree of uncertainty and risks and much may now depend on the deployment of vaccines and more effective diagnostic and treatment as well as substantial financial support to the economies concerned, notably via the NextGenerationEU and the ECB monetary support. Despite the disruption, it is important to note that employment has dropped much less in terms of persons employed than GDP thanks to the various measures implemented, while the drop in hours worked was of similar magnitude to that for GDP for the EU. Certain sectors and companies in certain industries (e.g. those providing digital services) may have been fairly protected or actually benefitted from the pandemic situation.

The urgency of the situation pushed Member States to take quick, uncoordinated action at the start of the crisis. Nevertheless, tax measures adopted by Member States seem similar in several aspects, most likely due to the fact that they faced similar shocks. Their main objective was to provide much needed liquidity to cash-strapped companies and households. These measures had a key role to play in cushioning the impact of the containment measures introduced by Member States to protect health.

The Commission supported the Member States' measures, and quickly acted to facilitate crisis response measures in the areas in which it has competence. Besides the suspension

[7] See: https://ec.europa.eu/info/sites/info/files/economy-finance/ip136_en_2.pdf

[8] Eurostat UNE_RT_Q, extracted on 24/03/2021

of Stability and Growth Pact fiscal rules and the SURE program[9] to maintain employment, it notably adopted a temporary framework[10] to enable Member States to use the full flexibility envisaged under State aid rules to support their economies in the context of the COVID-19 outbreak. It also published a decision[11] helping Member States affected by the COVID-19 pandemic to temporarily suspend customs duties and VAT on protective equipment, testing kits and medical devices such as ventilators. Since the outbreak of the crisis, the Commission postponed the application of two EU taxation measures to take account of the difficulties that businesses and Member States are currently facing: the entry into application of the VAT e-commerce package was delayed by 6 months (to 1 July 2021) and certain deadlines for filling and exchanging information under the Directive on Administrative Cooperation (DAC) were deferred by three months. Finally, the Commission adopted an ambitious new tax package of measures to ensure that EU tax policy supports Europe's economic recovery and long-term growth[12].

In its March 2020 Communication, the Commission stressed the need for a coordinated economic response to the COVID-19 crisis[13], including that Member States should implement targeted fiscal measures to support sectors and areas that face disruption of production or sales and are therefore affected by a liquidity squeeze, in particular SMEs. As regards taxation, those measures could entail, e.g.: deferred payment of corporate taxes; social security contributions and VAT; advancement of government payments and arrears; tax rebates; direct financial support; and tax incentives to support companies, and especially SMEs, access to public markets by incentivising SME research and market making activity as well as vehicles for long-term investment in listed and unlisted SMEs (e.g. European Long Term Investment Funds - ELTIFs). When Member States introduce tax measures, it is important that they ensure coordination with other policy areas, such as health care, trade, social and labour market policies. Overall, as this section describes, many Member States have introduced such measures quickly after the onset of the crisis.

Without the strong initial support actions, prolonged containment and mitigation measures would have had a much more negative impact on businesses and households[14]. This could have had significantly increased unemployment and decreased disposable income, while harming the production structure of businesses. The initial measures to support businesses and households were important for cushioning the immediate impact of the crisis and remain crucial for safeguarding the capacity of economies to rebound as soon as the crisis abates.

While these measures represented a significant budgetary cost in the short-term, the cost of inaction would have been much higher. For example, inaction could have resulted in even the most robust health care systems being overwhelmed, and as a result could have had a more adverse impact on public health.

The Commission has set out strategic guidance for the implementation of the recovery and resilience facility in its 2021 annual sustainable growth strategy[15] (ASGS). The facility is the key recovery instrument at the heart of NextGenerationEU[16] and will help the EU emerge from the current crisis stronger and more resilient. It will provide an unprecedented EUR 672.5 billion of loans and grants in frontloaded financial support for the crucial first years of the recovery. Under the facility, Member States are encouraged to modernise their tax administration, fight tax abuse, simplify their tax systems and make them more efficient. Moreover, Member

[9] See: https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/financial-assistance-eu/funding-mechanisms-and-facilities/sure_en

[10] See: (C(2020) 1863) and its amendments C(2020) 2215, C(2020) 3156 and C(2020) 7127.

[11] Commission Decision (EU) 2020/491.

[12] See: https://ec.europa.eu/taxation_customs/general-information-taxation/eu-tax-policy-strategy/package-fair-and-simple-taxation_en

[13] COM(2020) 112 final: https://ec.europa.eu/info/sites/info/files/communication-coordinated-economic-response-covid19-march-2020_en.pdf.

[14] For more information, see Almeida et al. (2020) : https://ec.europa.eu/jrc/sites/jrcsh/files/jrc121598.pdf

[15] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020DC0575&from=EN.

[16] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020DC0456&from=EN.

States should address challenges identified in the country-specific recommendations of the European Semester process, as highlighted in the recently issued guidance[17].

Guidance on Recovery and Resilience Plans encourage Member States to plan for reforms, which can 'bring budgetary savings (such as some pension reforms or the removal of environmentally harmful national subsidies), or increase the revenue potential in the medium to long-run (as a second-round effect from fostering a more efficient, digital and sustainable economy with a higher potential output, lower structural unemployment, increased labour force participation or higher innovation capacity), or from a combination of all these effects. For instance, shifting away from labour taxation into well-designed environmental taxation, with due consideration to possible distributional effects, has the potential to stimulate employment, change behaviour towards more sustainable consumption and production and to help the EU and Member States achieve their environmental and climate objectives.'

3.2.2. Tax measures to support businesses and households

Member States' tax responses were broadly similar, with the main objective of alleviating economic pressure on businesses and households, notably by providing additional time for dealing with tax affairs. Providing additional time for dealing with tax affairs can be implemented quickly and easily, provides sizeable relief to businesses and households, and limits the costs in the long run, as taxes should eventually be recovered once the economy bounces back. Member States are currently re-assessing the continuously evolving situation and are adapting their tax policies and administration measures accordingly.

The most pressing issue faced by Member States has been to ensure continuous cash flow to businesses and households. Because of the crisis, many businesses have been forced to stop or significantly reduce their activity, triggering urgent liquidity issues. If not dealt with in time, liquidity issues may transform into a solvency crisis and eventually bankruptcies – which could have a possible domino effect. Even once government gradually started to ease lockdown measures imposed on businesses, their capacity to resume their activity has been severely constrained, notably because of the continuous physical distancing measures, the moral impact that has kept some customers away and the damage to supply chains. A liquidity crisis also makes it harder for businesses to continue paying wages, putting many jobs at risk and creating financial hardship for households. According to Eurostat, the number of employed individuals fell by 5 million between the second quarter of 2019 and second quarter of 2020.

All Member States have taken tax measures to protect business cash flows, notably through tax deferrals. Such deferrals have been introduced for CIT, PIT, property tax, VAT, and SSCs. Deferral or temporary suspension of SSC payments for employers can also help businesses keep their employees. A few Member States (Czechia, Poland and Slovakia) have introduced changes to the tax treatment of losses (i.e. carry forward and backward provisions). These have often been accompanied by extended tax-filing deadlines (e.g. Austria, Belgium, Finland and Luxembourg). In many Member States, the COVID-19 outbreak fell within the period in which income tax return filing and payments were due. Pushing out deadlines by several weeks or months has given businesses needed breathing space.

Some Member States went further than deferrals and extended deadlines, introducing tax cuts for businesses. These cuts were introduced for a variety of tax categories, but often focused on those that are usually not affected by economic cycles or that would constitute an unfair extra-burden for businesses with heavy revenue losses. For instance, Croatia introduced partial or complete exemption from profit tax, income tax and contributions for companies that cannot – or very limitedly – do business. Hungary decreased its social contribution by 2 percentage points from July 2020 onward. Other examples include Spain's reduction of instalment payments for corporation taxes paid by certain eligible SMEs and of income tax paid by certain self-employed people. As the tax relief is not recovered, these measures have been generally more targeted – often to SMEs – in order to limit their budgetary impact.

[17] SWD(2021) 12 final: https://ec.europa.eu/info/sites/info/files/document_travail_service_part1_v2_en.pdf

A number of Member States have introduced more flexibility for tax debt repayment. This has notably taken the form of easier access to and extension of debt payment plans (Belgium, Finland, France, Hungary, Lithuania and the Netherlands), suspension of debt recovery (Belgium, Cyprus, France, Germany, Greece, Hungary, Ireland, Italy, Lithuania, Malta, Romania and Spain) and suppression of all penalties for late tax payments. While it appeared crucial that Member States provide flexibility on a large scale, this also carries some risks, notably the support of businesses that were non-viable and experience structural payment difficulties independently of the COVID-19 crisis.

Quicker processing and acceleration of tax refunds or reimbursements (VAT and other taxes) are also having a positive effect on business cash flows. Belgium, France, Greece, Ireland, Latvia, Lithuania and Romania have introduced such accelerated processes. However, the risk of tax fraud has also likely increased during the COVID-19 outbreak(18): accelerated payments may also imply reduced verification (e.g., Greece does not require tax audits for refunds up to EUR 30 000). Furthermore, there might be instances of taxpayers committing fraud to maximise the amount of tax and non-tax (COVID-19) benefits they receive.

Other tax measures in response to the COVID-19 crisis have focused on healthcare systems and medical equipment. Some Member States (e.g. the Netherlands, Poland and Portugal) have introduced measures aimed at facilitating the import of medical supplies, such as the removal of tax and customs duties on imported medical supplies to fight the pandemic. The Commission has also allowed Member States to exempt the sales of COVID-19 vaccines and testing kits to hospitals and medical practitioners from VAT(19).

Measures have also been introduced to stimulate investment in the health sector(20). Preferential tax treatment, such as the full or partial deductibility for CIT and PIT purposes of donations made to healthcare institutions, has been implemented in certain Member States (e.g. Belgium, Italy). Other similar measures include tools to safeguard the VAT deduction on items donated by businesses to healthcare institutions (e.g. Belgium, Slovenia).

(18) See: http://www.oecd.org/coronavirus/policy-responses/tax-administration-privacy-disclosure-and-fraud-risks-related-to-covid-19-950d8ed2/.

(19) For more information, see: https://ec.europa.eu/commission/presscorner/detail/en/IP_20_2299.

(20) 'Tax Policy Reforms 2020', OECD (2020): https://www.oecd-ilibrary.org/docserver/7af51916-en.pdf?expires=1603107887&id=id&accname=oid031827&checksum=FB91680A6FE47E1CD60662D6D094F441.

TABLE 7 HEAT MAP – TYPE OF TAX MEASURES TAKEN BY MEMBER STATES

	Personal Income taxes	Corporate Income taxes	Social Security Contributions	Property taxes	VAT	Other consumption taxes	Other
Austria	■	■			■	■	■
Belgium	■	■	■	■	■		■
Bulgaria	■	■		■	■		■
Croatia	■	■			■		
Cyprus	■		■		■		
Czechia	■	■			■		■
Denmark		■					■
Estonia			■				■
EU					■		
Finland		■			■		
France	■	■	■		■		■
Germany	■	■	■		■		■
Greece	■		■	■	■		■
Hungary		■	■		■	■	■
Ireland	■		■	■	■		■
Italy	■	■	■	■	■	■	■
Latvia	■				■		
Lithuania	■	■					■
Luxembourg	■	■			■		■
Malta		■			■	■	■
Netherlands	■	■	■		■		■
Poland	■	■	■	■	■		■
Portugal	■	■	■		■		■
Romania		■				■	■
Slovakia	■	■	■				■
Slovenia			■		■		■
Spain	■	■	■	■	■	■	■
Sweden	■	■	■		■		■

Source: OECD - http://www.oecd.org/ctp/tax-policy/

4 CRAFTING AN EFFECTIVE TAX POLICY RESPONSE TO THE COVID-19 PANDEMIC

Tax policy is an essential part of the policy response to the economic, social and fiscal challenges that the EU faces in the wake of the pandemic. The pandemic has had a severe impact on the economies and public finances of all EU Member States. In the short term, there is a need to maintain the temporary stimulus and support measures set out in Section 3.2 until the pandemic has been contained and the associated social and economic restrictions can be removed. In the medium term, tax policy has a part to play in facilitating a strong economic recovery and minimising 'scarring' effects on workers and businesses, while supporting the low carbon and digital transitions. Tax policy will also have a role in returning public finances to a sustainable path, while taking into account the principles behind a fair, efficient tax system (Chapter 1) and specific national situations and policy mixes (Chapter 2 and Sections 3.1 and 3.2). In this chapter, the reform options available to Member States are assessed around the same four themes as detailed in Chapter 2: i) investment and productivity; ii) environmental sustainability; iii) fighting tax abuse; and iv) creating jobs and reducing inequalities.

An agenda to create a more efficient, sustainable and fairer tax system calls for coordinated action as well as national reforms. Tax policies within the EU are largely set nationally and have not been subject to much harmonisation. However, collective and cross-border action has been and is being taken, in particular to reduce opportunities for tax fraud and evasion and to combat aggressive tax planning. Coordinated action at the EU level is increasingly necessary to tackle common challenges such as those emphasised by the COVID-19 pandemic. In many cases, coordinated solutions can ensure the competitiveness and sustainability of the EU economy and the sustainability of the EU tax base as a whole, while addressing tax avoidance more effectively, which in turn helps prevent criminals from making use of the EU financial system.

The EU has taken decisive action to support Member States in delivering the investment and reforms needed to promote a strong and sustainable economic recovery and secure fiscal sustainability. NextGenerationEU (NGEU), including its main instrument, the recovery and resilience facility (RRF), has boosted market confidence and launched a coordinated effort to restart economic growth and strengthen economic and social resilience. The implementation of well-designed policies in the context of NGEU and the RRF will support Member States in embarking on growth-enhancing reforms and increase the level and quality of investments, consistent with the objectives of building resilience and driving forward the twin green and digital transitions. The annual sustainable growth strategy[21], which promotes these objectives, put forward seven flagship initiatives that call for coordinated investment and reform across the EU. National reform challenges identified in the 2019 and 2020 country-specific recommendations (CSRs) should be addressed in the context of the RRF. The priorities set out in the CSRs for individual Member States include the fight against tax evasion, improving tax administration, tackling tax avoidance, reducing the tax burden on labour, and broadening tax bases. More broadly, the published guidance on the recovery and resilience plans that each Member State must produce to access RRF funding sets out the investments and reforms that can be funded through the RRF in more detail[22], encompassing elements related to the four themes around which this chapter is based.

[21] COM/2020/575 final.

[22] See: https://ec.europa.eu/info/business-economy-euro/recovery-coronavirus/recovery-and-resilience-facility_en

4.1 Fostering innovation and productivity

The pandemic has temporarily curtailed economic activity and reduced or diverted investment. As set out in the Commission's Autumn 2020 economic forecast and Winter 2021 interim economic forecast, there is some uncertainty about the European economy's recovery path, and the economies of many Member States are unlikely to fully recover the GDP losses seen in 2020 until at least 2022. As well as the temporary halt of activity in some sectors while lockdown measures were in place, social distancing measures also reduce the productivity of labour and capital across many other parts of the economy for as long as such measures are in place. GDP has fallen further than hours worked. For example, where hospitality venues or transport services have been able to continue operating it has often been at a much-reduced capacity and with much-reduced customer demand. Staff time and investment spending has been diverted to the short-term imperative for adaptations to meet social distancing requirements, rather than future growth and innovation. On a more positive note, an enforced move to remote working across large parts of the economy has worked better than many initially feared.

The COVID-19 crisis looks set to have a more lasting effect on productivity, investment and the structure of national economies, and this can be mitigated by appropriate policy responses. Both economic activity and public finances are likely to bounce back, though not fully, once COVID-19 is under control and temporary restrictions are removed. The medium- to long-term effects of the COVID-19 crisis risk hampering global investment, productivity and potential growth in the years to come. There is a looming threat of insolvencies, elevated unemployment and disruptions in global supply chains. The experience of the past recessions and economic crises, including the global financial crisis, shows that there can be persistent or even permanent negative "scarring" effects on workers, the capital stock, innovation and productivity in the wake of a severe economic shock. Workers unlucky enough to start their careers in a recession may experience lower earnings than other cohorts for a decade or longer, and those who lose jobs in shrinking sectors during recessions can also suffer considerably. Waves of insolvencies or permanent behavioural changes in the wake of the pandemic could render much of the existing capital stock obsolete, while economic uncertainty and weak balance sheets will both tend to reduce firms' desire and capacity to invest, expand, and take risks. As discussed above, NextGenerationEU (NGEU), and in particular the recovery and resilience facility (RRF), are designed to reboot investment and innovation across the EU, while limiting potential scarring effects. Tax policy also has an important role to play in mitigating persistent economic impacts, though the nature of the support needed will gradually shift from providing crisis support to existing firms and workers towards encouraging investment and the movement of workers and capital into new and growing sectors and firms, and securing fiscal sustainability.

In the short term, fiscal support measures should be withdrawn carefully to safeguard the prospects of businesses that will remain viable in the normalised post-pandemic economy. As set out in Section 3.2, in 2020 Member States primarily introduced new tax measures to increase cash flow to taxpayers that were hit the hardest by the pandemic, including SMEs. As the pandemic effects have persisted into 2021, many have increasingly graded the level of support provided to the severity of the impact of remaining economic and social restrictions within a given sector or region. It will be important to give businesses certainty as to how and when support will be withdrawn once there is a greater degree of clarity on the path out of the pandemic and associated social and economic restrictions. For firms that are still suffering drastically reduced revenue, targeted tax reductions and holidays should continue to be considered as part of coherent support packages, which can also include direct cash transfers and moratoria on debt repayments. The fact that the COVID-19 pandemic has persisted into 2021 poses a particular challenge in relation to tax payments due in 2020, which were deferred rather than cancelled, as detailed in Section 3.2. Businesses should not be asked to pay back taxes until their operating conditions have returned to something close to normal. Given how severe the impact of the prolonged nature of the restrictions has been on many firms' balance sheets, in some cases it may ultimately be necessary to consider permanently cancelling some tax payments that were initially only deferred, though this should be done carefully given the potential implications for fairness and competition.

In the longer term, tax policies should support economic change and dynamism. Supporting jobs in firms that are unlikely to ever recover to financial health could slow the reallocation of employment towards high-performance firms and sectors, hindering productivity and the economic recovery[23]. The accelerated impetus to the development and adoption of the digital economy that resulted from social distancing measures has some positive implications for innovation and its diffusion. The tax system can support and respond to this, as detailed below, complementing the focus of direct investment through economic recovery and renewal programmes including the RRF on shifting resources into growth sectors of the future.

Member States could consider implementing certain tax measures to support investment by firms that have been affected by the pandemic, and discourage future over-indebtedness. Many firms entered the pandemic with elevated debt, which has increased the risk that the revenue losses suffered during the pandemic pushes them into insolvency, or at least leaves them as financially impaired 'zombie firms'. This has further highlighted the problematic nature of the persisting pro-debt bias of tax rules. On average, the cost of capital of equity is still materially higher than the cost of capital of debt. Addressing this would make it less costly for companies to raise equity, encourage investment through equity as a complementary source of debt financing and thus contribute to the much needed re-equitisation of European firms. Allowing an enhanced depreciation for eligible companies (i.e. those hit hardest by the pandemic) would advance depreciation allowances and hence support investment and improve cash flow. Member States could also (temporarily) raise tax revenue from the companies that benefitted from the current crisis and shift towards the taxation of economic rents. They could also consider making additional options available to companies for offsetting losses. Changes to the treatment of losses, for example by making carry-forward provisions more generous, might help start-ups, which take longer to become profitable. Addressing the corporate debt bias may also be relevant in light of the current crisis as it would both reduce corporate debt levels and decrease equity costs for in particular young and innovative companies, which often have no access to external debt financing.

Tax policy can support future growth by fostering investment and productivity, but it also needs to safeguard fiscal sustainability. While most other tax bases should recover broadly in line with GDP, the large scale of private losses and debt incurred during the crisis will also depress corporate tax revenue in the years to come. Public deficits and debt have spiked in nearly all Member States, and the accelerating costs of ageing will gradually worsen Member States' underlying fiscal positions. Within this challenging context, Member States need to try to find a balance between collecting enough taxes to provide public services and safeguard the sustainability of public finances (which is also important to give firms the confidence to invest) and ensuring that the current fiscal climate is sufficiently conducive to positive investment and firms making hiring decisions.

Support for R&D can be most cost-effective by focusing on front-end support, either through deductions at the level of the R&D investments or direct cash support. Member States could consider better stimulating investment in innovation by moving away from back-end R&D deductions (deductions from R&D income), in particular away from 'patent boxes' (which do not promote R&D as they reward the location of intangible assets in a jurisdiction and may still allow ATP). Member States should focus on well-designed R&D tax incentives, which can more directly stimulate R&D activities. In the current circumstances, where many firms' revenue, profitability and balance sheets have taken a heavy hit as a result of the COVID-19 pandemic, there is a strengthened case for the (possibly temporary) use of 'cashback' type incentives for R&D and other investment and innovation activity. This is to minimise the risk that incentives based on tax reductions are weakened during an exceptional period when usually-profitable firms may have limited tax bills to be reduced.

Other specific tax measures to stimulate investment and innovation in the longer-term should be used carefully and sparingly to maximise their cost effectiveness. Permanent reductions of corporate tax rates that aim to encourage investment could fuel a race to the bottom and hamper other objectives such as tax fairness, especially in a context where corporate tax rates and revenue have often been declining relative to other tax bases and many Member States face significant fiscal challenges. Measures to support new investment and R&D by reducing its net cost (e.g. tax credits and tax deductions) should focus on targeted actions to encourage investment into a more digital and green economy. Tax measures should be used when they are more appropriate and cost-effective than other potential policy levers (such as subsidies, regulation or publicly delivered research). There is evidence that the impact of tax incentives is more positive if it is

[23] See OECD (2020), *Job retention schemes during the COVID-19 lockdown and beyond'. OECD Policy Responses to Coronavirus (COVID-19)*, October 3.

possible to focus them on young and innovative companies, as opposed to incentives available to all companies or SMEs. In the current context, Member States may see a stronger case for supporting young 'green' companies. At the same time, it is important that newly introduced tax measures comply with best practices to avoid possible drawbacks such as threshold effects and tax avoidance opportunities. Member States may also benefit from withdrawing existing measures if there is evidence that they have had negative unintended effects.

A simpler and clearer tax system will reduce the effort that goes into tax compliance, as will tax digitalisation. The growth of remote working as a result of social distancing measures and other social and economic changes brought on by the COVID-19 crisis has given an extra impulse to the process of digitalisation. It has also sharpened the challenge, due to the need to facilitate the uptake of, and monitor, a range of crisis measures to support businesses and households, and to respond to indications that the tax gap may have got larger during the pandemic. It is therefore important for tax administrations to step up their digitalisation efforts to use this window of opportunity to facilitate tax compliance, improve customer service and relieve the administrative burden on taxpayers, including by providing easily accessible and clear information on their government websites. The Commission has highlighted the digitalisation of tax administrations as a priority area for investment and reform in the context of the recovery and resilience facility[24]. The extent to which the tax system acts as a barrier to economic efficiency is minimised by providing tax certainty and keeping tax laws stable where possible. Where changes are needed, for example to simplify and clarify the application of tax rules to the fast-evolving collaborative and informal economy, it is beneficial to consult taxpayers. The Commission strongly supports simplification measures both in direct and indirect tax areas. Further improvements to the efficiency of withholding tax (WHT) procedures for EU cross-border securities income flows would ease the administrative and compliance burden and also improve the functioning of the Single Market.

4.2 Ensuring a sustainable recovery

The Commission wants to harness the potential of green growth to promote the European recovery from the pandemic, supporting both producers and consumers to reduce greenhouse gas emissions and make better informed choices. Environmental taxes deliver on many fronts (see Section 2.3 of this report). If properly designed, such taxes can help offset the costs of the environmental transition in a socially just manner and encourage investment in clean and innovative solutions.

The green transition that we had already planned with the European Green Deal has become our roadmap for a green and inclusive recovery. Against this backdrop, and considering the double role of environmental taxes for raising revenue and incentivising behavioural change, policy recommendations on 'green' taxation are expected to play a key role in the recovery.

Member States could consider introducing or increasing environmental taxes in a context of broader based fiscal reforms and in particular in the following cases:

- when implementation of measures to reach environmental and climate targets is lagging behind (the policy recommendation should focus on the specific area where there is a lack of progress);
- if environment costs are not sufficiently internalised;
- when there is evidence of environmentally harmful subsidies;
- when there is a general need for improving fiscal consolidation, as environmental taxes are considered to be less distortive and generally growth-friendly; and
- to compensate for the loss of revenue in case of a need to reduce taxes elsewhere (e.g. to promote growth, reduce unemployment, or correct inequalities).

[24] See for example European Commission (2020[x], *Recovery and Resilience Plans - Example of component of reforms and investments - A public administration fit for the future*, October, https://ec.europa.eu/info/sites/info/files/component_public_administration.pdf.

When proposing recommendations for an increased use of environmental taxes, the possible negative impacts on competitiveness and social inequalities should also be considered. Member States should therefore be encouraged to consider accompanying measures, such as: investments in energy efficiency and renewable energy infrastructure (to address possible impacts on competitiveness); transfers to low-income households; reductions in labour taxation (though this would not help inactive households such as pensioners), or; investment in public goods, such as public transport (to address possible negative redistributive impacts)[25].

A well-designed tax system plays an important role in supporting the green transition. The use of taxation as a policy instrument will help to reach climate neutrality by 2050 as well as the other environmental objectives of the European Green Deal. In this respect, initiatives such as the review of the Energy Taxation Directive (ETD) and the establishment of a carbon border adjustment mechanism (CBAM) are part of the European Green Deal.

The Commission is currently reviewing the ETD. It has been over 17 years since the **ETD**[26] was adopted. It is now necessary to bring it back in line with today's reality, ensuring that it gives price signals that support the EU's recovery goals and climate ambitions by aligning the taxation of energy products to EU climate objectives, namely by contributing to phasing out fossil fuel subsidies and re-establishing the harmonisation objective.

The EU is ready to lead on climate global ambitions but cannot run the race alone. Therefore, the Commission will propose a carbon border adjustment mechanism (CBAM) on selected sectors[27]. The CBAM's main objective is to address climate change, and to incentivise low-carbon production processes across the world. The CBAM will also provide protection against risks of carbon leakage, where production is either transferred from the EU to other countries with lower emission reduction ambitions, or where EU products are replaced by more carbon-intensive imports. If the carbon leakage risk materialises, the EU's ambitious climate policies would be undermined. A CBAM would ensure that the price of imports reflects more accurately their carbon content. The precise design of the measure is currently being assessed. However, it will be designed to comply with the World Trade Organization rules and other international obligations of the EU.

4.3 Fighting tax fraud, evasion and abuse to help fund the recovery

The crisis and its demands on public finances compound the need for Member States to secure tax revenue in a smart and sustainable manner. Intensifying the fight against tax fraud, evasion and avoidance is one of the most obvious ways to achieve this without imposing undue burden on those hit hardest by the crisis. Much progress has already been made in the past few years in the fight against tax abuse (European Commission, 2020c), but the work is far from over. EU tax policies have to ensure that everyone, from individuals to corporations, pays their fair share.

Tackling tax abuse will protect the level playing field for companies – large and small – that operate in the Single Market, thereby strengthening the resilience and competitiveness of the EU economy. In parallel, we need to break down unnecessary tax obstacles and make it easier for companies to innovate, invest and grow in the EU. To respond to this challenge, on 20 July 2020 the Commission published a tax package to ensure that EU tax policy supports Europe's economic recovery and long-term growth[28]. It notably includes a

[25] Such investments could fit into the Recovery and Resilience Facility, see: https://ec.europa.eu/info/business-economy-euro/recovery-coronavirus/recovery-and-resilience-facility_en

[26] For more information on the ETD, see: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12227-Revision-of-the-Energy-Tax-Directive.

[27] For more information, see: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12228-Carbon-Border-Adjustment-Mechanism.

[28] See: https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1334

legislative proposal to improve tax transparency, a tax action plan for fair and simple taxation that supports the recovery strategy and a Communication on tax good governance. The package is built on the twin pillars of fairness and simplicity. It seeks to boost tax fairness by intensifying the fight against tax abuse, curbing unfair tax competition and increasing tax transparency. In parallel, it focusses on simplifying tax rules and procedures, to improve the environment for businesses across the EU.

The legislative proposal[29], amending the directive on administrative cooperation[30], will introduce once adopted an automatic exchange of information between Member States' tax administrations for income/revenue generated by sellers on digital platforms and strengthen administrative cooperation by clarifying existing rules. It will help tax administrations verify that those who earn money through digital platforms pay the appropriate share of taxes.

The tax action plan presents 25 actions the Commission will put forward between 2020 and 2024. These actions will reinforce detection of tax abuse and make life easier for honest taxpayers, by removing obstacles at every step, from registration to reporting, payment, verification and dispute resolution. Among the relevant actions to fight tax abuse are:

- a proposal to amend the VAT Directive with the objective of moving towards a single EU VAT registration to provide services and/or sell goods anywhere in the EU;
- a pilot project to assess which digital solution(s) can be used and how, to ensure better exploitation of data, create new digital services for taxpayers and better support the work of tax administrations at EU level;
- a recommendation for improving the Member States' mutual assistance on recovering unpaid taxes;
- a legislative initiative introducing a common, standardised, EU-wide system for withholding tax relief at source, accompanied by an exchange of information and cooperation mechanism among tax administrations;
- a possible legislative initiative amending Council Regulation (EU) No 904/201046 to ensure that Eurofisc has a true EU capability to fight against VAT fraud in cross-border transactions;
- securing VAT through automatic exchange of verifications of cross-border transactions.

The Communication on Tax Good Governance proposes four main initiatives:

- a reform of the Code of Conduct on Business Taxation;
- a review of the EU list of non-cooperative jurisdictions (NCJs) for tax purposes;
- reinforcement of the EU's tax good governance rules regarding EU funds and defensive measures vis-à-vis listed countries;
- additional support for partner countries in the area of tax good governance.

The Communication confirms the need to cover a scope beyond preferential tax regimes, widen the application of the listing criteria, monitor cleared jurisdictions thoroughly to prevent backtracking and adopt efficient defensive measures for all Member States. Furthermore, the Commission actively participates in international discussions taking place in the Organisation for Economic Co-operation and Development concerning the reform of the corporate taxation framework, including a revision of the right to tax notably for the digital economy and the implementation of a minimum effective taxation of multinational enterprise's profits. In parallel, the European Council has mandated the Commission to table a proposal for a digital levy as a potential new own resource in the first half of 2021. The exact design of this potential own resource is still to be determined and the Commission is exploring various options.

[29] COM(2020) 314 final.

[30] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation, OJ L 64, 11.3.2011, p. 1.

4.4 Supporting employment and help tackling inequality

In the wake of the COVID-19 pandemic, it will be critical to support the creation of new jobs, including for workers who may need to find a new line of work in the changed post-COVID economy. The extensive use of crisis support measures, including short-term working schemes and furlough, has limited the rise in unemployment across the EU to date. However, average unemployment in the EU is forecast to rise from 6.7% in 2019 to 8.6% in 2021, and labour market participation has also fallen(31). The brunt of the employment adjustment has been borne by the most vulnerable categories of workers, such as those on temporary contracts, to whom furlough schemes often did not apply(32), or those in low-wage low-skilled occupations. Employment losses have been largest in countries such as Spain, where the share of temporary contracts is highest. Higher paid and skilled occupations are also more likely to be ones where extensive use of remote working is more feasible and where activity and employment have been less affected by social distancing measures(33). If hospitality and tourism do not fully recover, fewer lower-skilled workers will be demanded in these sectors than before at the same time as opportunities open up in growth industries. It is therefore very important to support, re-skill, and re-employ people previously employed in sectors which may not recover fully, and to ensure that the tax-benefit and pension systems facilitate workers' ability to make such transitions.

Member States with low employment rates and a high tax burden on labour could consider focusing labour tax cuts on groups whose labour supply is the most responsive and those facing the biggest challenges in gaining and maintaining employment. In a difficult fiscal context, it is appropriate to focus labour tax cuts on groups facing the greatest unemployment challenges and precarious work conditions (e.g. the low-paid, the youth and long-term unemployed), rather than expensive across the board generic tax reductions. Targeting reductions to the tax wedge of low-paid workers could also be a way to support the demand for lower skilled workers in a difficult post-COVID-19 labour market while maintaining those individuals' net income. Temporary hiring incentives could be appropriate to accelerate the re-employment of workers who have lost or will lose their job as a result of the COVID-19 pandemic. There is also scope to consider and encourage the role of entrepreneurship in supporting social mobility, including by temporarily maintaining support through the tax-benefit system for unemployed workers wishing to move into self-employment or start a business but who may have limited capital or savings. It also remains important to seek to remove or amend features of the tax system that create high marginal tax rates for second earners, for example by tapering the withdrawal of income-related child tax credits, and moving from joint to individual taxation for couples.

As the COVID-19 crisis appears to have exacerbated existing social and economic inequalities, this only strengthens the case for tax-benefit system measures to alleviate poverty and promote inclusion. Employment is an important route out of poverty and social exclusion. A loss of labour income has exacerbated existing economic and social issues, despite temporarily higher levels of cash and in-kind support to households put in place in some Member States to alleviate hardship. Additional relevant measure to mitigate inequalities of income, wealth and opportunity include strengthening the progressivity of personal income taxes or mitigating wealth inequality and supporting equality of opportunity by increasing the progressivity of the overall tax mix, including by taxing wealth transmission, individuals' capital income and property. Reducing the tax burden (both the tax wedge itself and tax compliance costs) on low-paid workers and self-employed people with modest incomes can also help reduce the size of the informal economy and ensure that all workers are paying social insurance contributions and commensurately have access to payments from the social security as and when they require these.

(31) European Commission, *European Economic Forecast Autumn 2020*, https://ec.europa.eu/info/sites/info/files/autumn_20_forecast.pdf

(32) European Commission, *Proposal for a Joint Employment Report 2021*, https://ec.europa.eu/social/main.jsp?langId=en&catId=89&newsId=9834&furtherNews=yes.

(33) See Bartik, A., Z. Cullen, E. Glaeser, M. Luca and C. Stanton (2020), *What Jobs are Being Done at Home During the Covid-19 Crisis? Evidence from Firm-Level Surveys*, NBER Working Paper No. 27422, June.

Glossary

Aggressive tax planning consists of taxpayers reducing their tax liability through arrangements that may be legal but are in contradiction with the intent of the law.

Allowance for corporate equity (ACE) is a corporate tax arrangement whereby interest payments and a defined return on equity can be deducted from the corporate income tax base. It moves the system closer to financing neutrality between debt and equity at corporate level.

Allowance for growth and investment (AGI) is also a corporate tax arrangement whereby interest payments and a return on equity can be deducted from the corporate income tax base. It also moves the system closer to financing neutrality between debt and equity at the corporate level. However, it goes further than ACE, because it removes tax avoidance by cascading the benefits (the funds injected in a group benefit from deductibility only once), uses an incremental system based on a moving reference year and allows for negative allowances.

The **at-risk-of-poverty rate** (AROP) is defined as the percentage of the population living in households where the equivalised disposable income was below 60% of median equivalised income after social transfers.

The **persistent at-risk-of-poverty rate** is defined as the percentage of the population living in households where the equivalised disposable income was below the 'at risk of poverty' threshold for the current year and at least 2 of the preceding 3 years.

Business angel is a knowledgeable private individual, usually with business experience, who directly invests part of their personal assets in new and growing unquoted businesses. Besides capital, business angels provide business management experience.

Comprehensive business income tax (CBIT) is a type of corporate tax where neither interest payments nor the return on equity can be deducted from corporate profits, and are thus fully taxed at the normal CIT rate. It equalises the tax treatment of debt and equity finance at corporate level.

Controlled foreign companies attribute a proportion of their income to a resident controlling shareholder and tax that shareholder for that income if certain conditions are met (usually the tax rate in the foreign country must be lower than a set percentage of the tax rate in the country applying the 'CFC charge').

Direct taxes are defined as current taxes on income and wealth plus capital taxes including taxes such as inheritance or gift taxes. Income tax is a subcategory that includes personal income tax (PIT) and corporate income tax (CIT), along with capital gains taxes.

Effective average tax rate (EATR) is a tax rate calculated based on the nominal tax rate and the definition of the tax base. In particular, it is based on total investment income.

Effective marginal tax rate (EMTR) is a tax rate calculated based on the combination of the nominal (i.e. statutory) tax rate and the definition of the tax base (i.e. taxable profit). In particular, it is based on additional investment income.

Environmental taxes include taxes on energy, transport, pollution and resources (excluding VAT, which is levied on all products). **Energy taxes** include taxes on energy products and electricity used for transport (e.g. petrol and diesel) and stationary purposes (e.g. fuel oils, natural gas, coal and electricity). **Transport taxes** include taxes on the ownership and use of motor vehicles, and taxes on other transport equipment such as planes and on related transport services, e.g. duties on charter or scheduled flights. **Pollution taxes** include taxes on measured or estimated emissions to air (except taxes on CO_2 emissions) and water, on the management of solid waste and on noise. **Resource taxes** include any taxes linked to the extraction or use of a natural resource (e.g. taxes on licence fees paid for hunting and fishing rights)[34].

[34] This definition is based on (European Commission, 2013).

European Semester is the annual cycle of economic policy coordination in the EU. The Commission analyses Member States' budgetary, structural and investment policies, provides proposals for Council recommendations to each Member State and monitors their implementation.

Feebates are a system of charges and rebates whereby energy-efficient or environmentally friendly practices are rewarded while failure to adhere to such practices is penalised.

Health taxes(35) are imposed on products that have a negative public health impact (e.g. taxes on tobacco, alcohol, sugar-sweetened beverages, fossil fuels). These taxes result in healthier populations and generate revenues for the budget even in the presence of illicit trade/evasion. These are progressive measures which benefit low-income populations relatively more, once health care costs and health burden are taken into account.

Implicit tax rate on consumption is defined as all consumption taxes divided by:

- the final consumption expenditure of private households on the economic territory (domestic concept)
- intermediate consumption and social transfer in kind by the government and Non Profit Institutions Serving Households (NPISH).

Inactivity trap measures the financial incentive for an inactive person not entitled to unemployment benefits (but potentially receiving other benefits, such as social assistance) to move from inactivity to paid employment. It is defined as the rate at which the additional gross income of such a transition is taxed.

Indirect tax is a tax levied on a material or legal event of an accidental or temporary nature and on a (legal or natural) person that can often be an intermediate and not the person responsible for the event (hence the indirect character of the tax), e.g. VAT, import levies, excise duties.

Low-wage trap measures the financial incentive to increase a low level of earnings by working additional hours. It is defined as the rate at which the additional gross income of such a move is taxed.

Social security contributions are mandatory contributions paid by employers and employees into a social insurance scheme set up to cover pensions, healthcare and other welfare provisions.

Tax avoidance is the arrangement of a taxpayer's affairs in a way that is intended to reduce his/her tax liability and that (although the arrangement may be strictly legal) is usually in contradiction with the intent of the law it purports to follow (OECD glossary of tax terms).

Tax evasion generally involves illegal arrangements whereby liability to tax is hidden or ignored, i.e. the taxpayer pays less tax than they are legally obliged to pay by hiding income or information from the tax authorities.

Tax fraud is a form of deliberate evasion of tax that is generally punishable under criminal law. It includes situations in which deliberately false statements are submitted or fake documents are produced.

Tax wedge on labour is the difference between wage costs to the employer of a worker and the amount of net income that the worker receives, expressed as a proportion of the overall wage costs. The difference arises as a result of taxes, including PIT and compulsory SSCs.

Thin capitalisation rules restrict the deductibility of interest payments made by corporations with excessive debtto--equity ratios(36).

VAT gap is the difference between VAT revenue actually collected by the government and the theoretical net VAT liability for the economy as a whole, under the country's current VAT system.

(35) This definition is based on: https://www.who.int/health-topics/health-taxes#tab=tab_1

(36) Adapted from Arnold & McIntyre (2002).

The latter is estimated by identifying the categories of expenditure that give rise to irrecoverable VAT and applying the appropriate VAT rates to estimated expenditure in the various categories.

Venture capital is investment in unquoted companies by firms who, acting as principals, manage individual, institutional or in-house money. In the EU, the main financing stages are early-stage (covering seed and start-up financing) and expansion. Strictly defined, venture capital is a subset of private equity. To offset the high risk involved, the investor expects a higher than average return on investment.

Withholding tax is a tax on income imposed at source. A third party is charged with deducting the tax from certain kinds of payment and remitting that amount to the government. Withholding taxes are found in practically all tax systems and are widely used for dividends, interest, royalties and similar tax payments. The rates of withholding tax are frequently reduced by tax treaties.

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Annex

Choice of indicators

The indicators used in this *Annual Report on Taxation* are taken from various sources. They are useful in identifying areas in which policies could be improved, but the results always need to be interpreted alongside in-depth country analysis before any conclusions on appropriate policies can be drawn. This type of in-depth analysis is beyond the scope of this report, but is carried out as part of the European Semester.

The report does not claim to be comprehensive and inevitably other indicators could have been used. Factors taken into account in the choice of indicators include completeness (where possible, data cover all 27 Member States), clarity and reliability. Choosing indicators is a particular challenge in certain areas, e.g. it is by definition difficult to estimate how much money is lost to tax fraud, evasion and avoidance. Despite the measurement challenges, this report looks at indicators that are generally considered relevant and can improve our understanding of the size or relevance of the features or phenomena in question.

Where available and relevant, EU-27 averages are presented alongside country-specific data. This is intended to help readers understand the relative levels in different Member States and should not be interpreted as suggesting that the EU average represents an ideal level.

Box A.1. To go further

Taxation trends in the European Union[37]

Taxation Trends in the European Union presents taxation data and information for the EU Member States, Iceland and Norway. The latest edition of the report (the 2020 edition) is divided into four sections:

- **Part 1** 'Development of the overall tax revenue in the European Union' provides an analysis of developments in the EU, outlining with graphs and tables the main trends in taxation indicators at EU level.
- **Part 2** 'National tax systems' presents, for each of the 30 countries covered in the report:
  - a summary table of the country's tax revenue covering different types of tax revenue, implicit tax rates (ITRs) and payable tax credits;
  - the latest tax reforms announced, legislated or implemented during the calendar year 2019.
- The detailed statistical annex in **Part 3** (Annex A) includes national accounts data sets (direct and indirect taxes, social contributions, etc.), by level of government (central, state, local, social security funds and EU institutions) and by economic function (consumption, capital, labour taxes), as well as energy, environmental and property taxes and ITRs.
- The methodological annex in **Part 4** (Annex B) provides detailed guidance on the methodology used for all calculations carried out to prepare the document.

Taxes in Europe database[38]

The *Taxes in Europe* database is the European Commission's online information tool covering the main taxes in force in the EU Member States. The system contains information on around 650 taxes, as provided to the Commission by the Ministries of Finance of the Member States. Access is free for all users.

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(37) For more information see https://ec.europa.eu/taxation_customs/business/economic-analysis-taxation/taxation-trends-eu-union_en.

(38) For more information, see: https://ec.europa.eu/taxation_customs/economic-analysis-taxation/taxes-europe-database-tedb_en.

State aid

Member States must ensure that their tax measures comply with EU State aid rules and notify the Commission of all relevant measures not covered by the General Block Exemption Regulation[39] and the *De Minimis* Regulation[40]. This report is without prejudice to the Commission's possible State aid assessment of national tax measures.

[39] Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (OJ L 187, 26.6.2014, p. 1).

[40] Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid (OJ L 352, 24.12.2013, p. 1).

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