

AmCham Tax Central Europe Conference:

a brief look at three factors of an effective tax system

“Taxes are what we pay for a civilized society...”

Oliver Wendell Holmes, 1927

Some might disagree with Mr. Holmes’ assertion, but no one can deny that taxes are what we pay for an organized government. Or that taxes are a tool to shift resources from private investment to public investment; in other words, to shift the intent of investment from private focus with possible public benefit to public focus with possible private benefit.

The goal of economic policy to find the balance between public and private investment that creates the greatest and widest level of prosperity a country can achieve. The goal of tax policy is find a way to finance that level of public investment without decreasing private investment below that optimal level. That involves three primary factors: 1) avoiding taxes that overly distort investment decisions, 2) achieving a high level of compliance on the lowest possible level of taxation, and 3) creating incentives for certain types of high value-added investments that help reduce the risk of those types of investment.

The first factor could be called tax balance. The more evenly taxes are distributed over different economic activities, the less likely companies will modify their investment decisions due to the added cost of taxation or due to their desire to avoid higher level of taxation (for instance, on labor). The ideal system would eliminate consideration of tax consequences from private investment decisions.

The second factor could be called tax fairness. For taxes to be fair, every person should pay the same tax for the same economic activity. Evading that tax creates not only the unfairness of one person paying their full share of tax while another does not, but leads to a second unfairness: in order to collect the full share of tax from those who intend to evade paying it, authorities have to build systems of compliance which increase the cost of taxes for not only the state, but also those who want to pay their full share. Everyone who evades taxes, therefore, contributes to a below optimal balance in the tax system.

The third factor could be called tax competitiveness. In order to generate wealth, each country strives to generate products and services that other countries will buy. Those products and services can either be a cheaper version of what is available in other countries or a better version that can sell for more. Better versions create bigger prosperity. Keeping a higher level of products and services require riskier investments into education and research. To help private investors offset the cost of those risks, countries can create tax incentives that encourage private investors to take the risk of such investments.

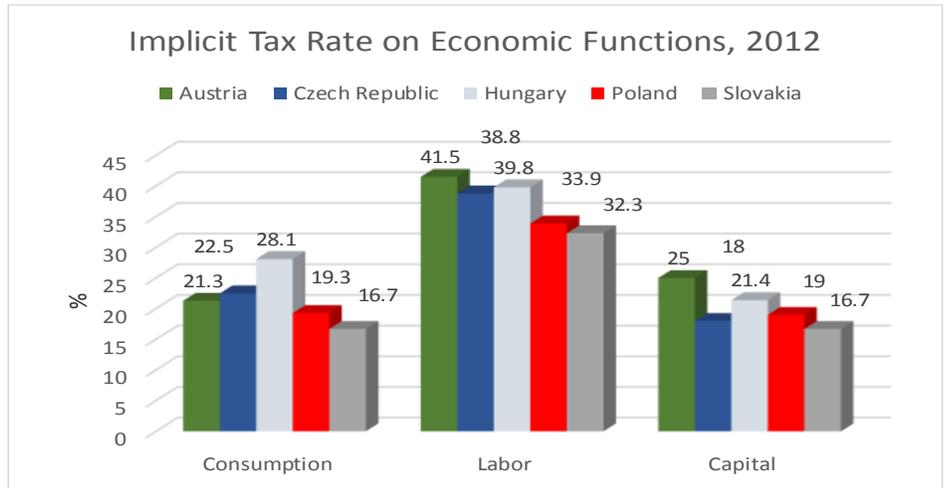
Over the next pages, we provide some international data on these three factors to put some perspective on how Central European countries conduct tax policy.



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Tax Balance

None of the three factors can be precisely measured and analysed by publicly available statistical indicators. To put a loose analytical frame on assessments of tax balance, three indicators have selected: implicit tax rates on economic functions, tax revenue by economic function as % GDP, and share of total taxes by economic function.



Implicit Tax Rate

source: Eurostat

The Czech Republic has an implicit tax rate that is higher than the EU average for consumption (+13%) and labor (+7%), and lower for capital (-23%). The trend since 2002 is an increase in consumption (+4.1%), and a decrease in labor (-2.5%) and capital (-3.3%).

Poland has implicit tax rates lower than the EU average for all three (consumption -3%, labor -6%, and capital -19%). The trend since 2002 is an increase in consumption (1.4%) and labor (+1.5%), and a decrease in capital (-3.4%).

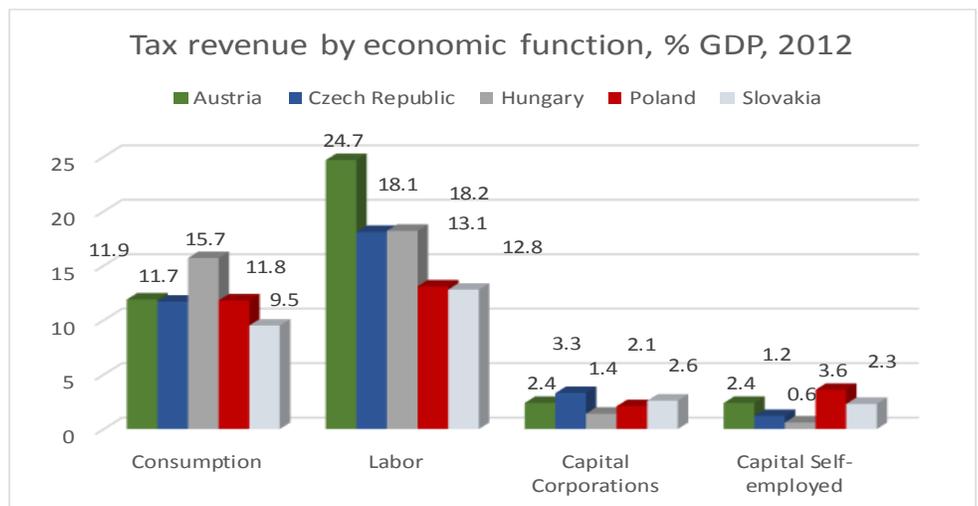
Austria is above EU average in all three (consumption +7%, labor +15%, and capital +7%). Hungary is above in consumption (+41%, the fourth highest rate in EU) and labor (+10%), and below in capital (-9%). Slovakia is below EU average in all three (consumption -16%, labor -11% and capital -29%).

Tax revenue by economic function as % GDP

The Czech Republic receives tax revenue (as a % GDP) above the EU average from taxes on consumption (+4%) and corporate capital (+27%), and below the EU average from labor (-10%) and the capital of the self-employed (-40%). The trend since 2002 is an increase in consumption (+2.1%), and a decrease in three: labor (-0.2%), capital of corporations (-0.9%), and capital of self-employed (-0.3%).

Poland receives above average tax revenue (as % GDP) from consumption (+5%) and capital of self-employed/households (+80%). Labor (-35%) and corporate capital (-19%) are below average. The trend since 2002 is an increase in capital of corporations (+0.1%), a decrease in consumption (-0.1%) and labor (-0.3%), and no change in capital of self-employed.

Austria is above EU average in consumption (+6%), labor (+23%) and capital of self-employed (+20%), and below average in capital of corporations. Hungary is above the EU average in consumption (+40%) and below average in labor (-9%), capital of corporations (-46%), and capital of self-employed (-70%). Slovakia is above average in the capital of the self-employed (+15%), at the EU average for capital of corporations, and below average for consumption (-15%) and labor (-36%).



source: Eurostat

% Total Tax Revenue

The Czech Republic receives a larger proportion of its tax revenue than the EU average from consumption (+17%), labor(+1%) and capital of corporations (+46%). Since 2002, the trend has been an increasing share from consumption (+11.7%) and a decreasing share from labor (-1.2%) as well as capital from corporations (-2.5%) and self-employed (-1.1%).

Poland also receives a greater share of tax revenue from consumption (+27%) and capital of corporations (+2%), but it receives more the twice the EU average from capital of self-employed (+224%). It receives significantly less than the EU average from labor (-21%). Since 2002, the proportion of tax revenue received from capital (both corporate and self-employed (+0.3%) has slightly increased, while the share from labor decreased (-0.7%). The share from consumption remained the same.

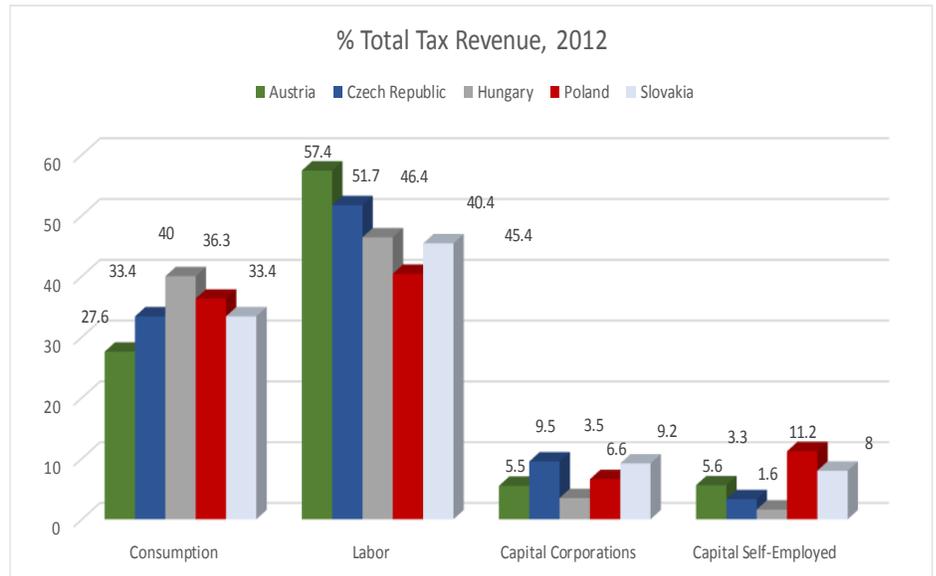
Austria receives a larger share of revenue from consumption (+0.9%) and labor (2.2%) than the EU average, a lower share from capital of self-employed (-0.9%), and the average from capital of corporations. Hungary collects a larger share of revenue from consumption (+3%) than the EU average, and a lower share from labor (-3.9%), capital of corporations (-2.6%) and capital of self-employed (-0.2%). Slovakia receives a larger share of revenue from consumption (+0.7%) than the EU average, and a lower share from labor (-0.4%), as well as capital of corporations (-0.6%), and the EU average from capital of the self-employed.

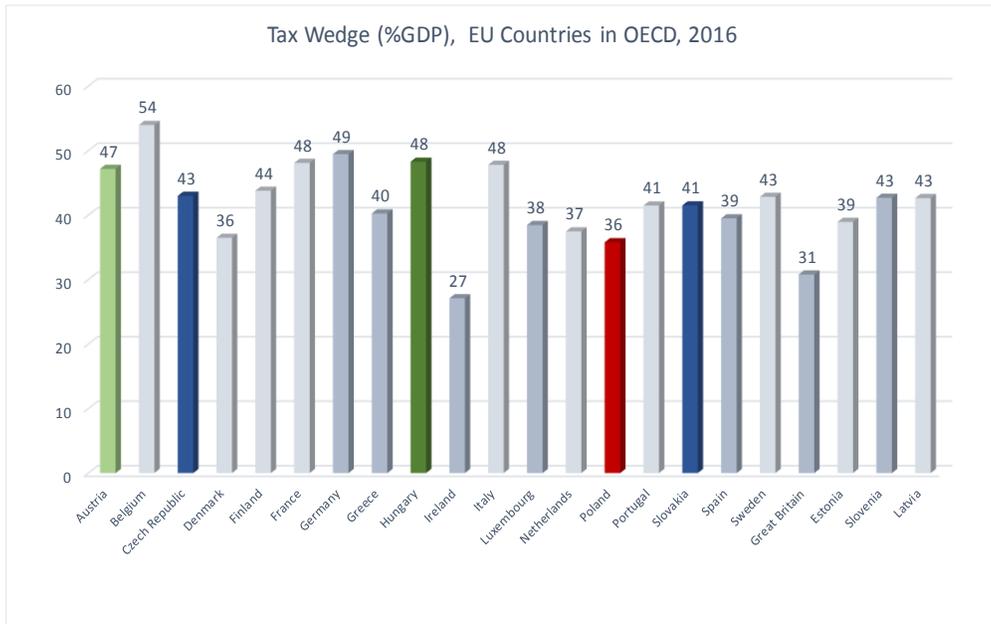
Summary for Czech Republic

In broad strokes, the Czech Republic levies taxes in a similar pattern to most EU countries. Consumption and capital are taxed at approximately the same level, and labor higher. The country is at the high end of how much money it collects as a percentage of GDP (see next page), and, like a majority of EU countries, the country has reduced their tax wedge since 2008.

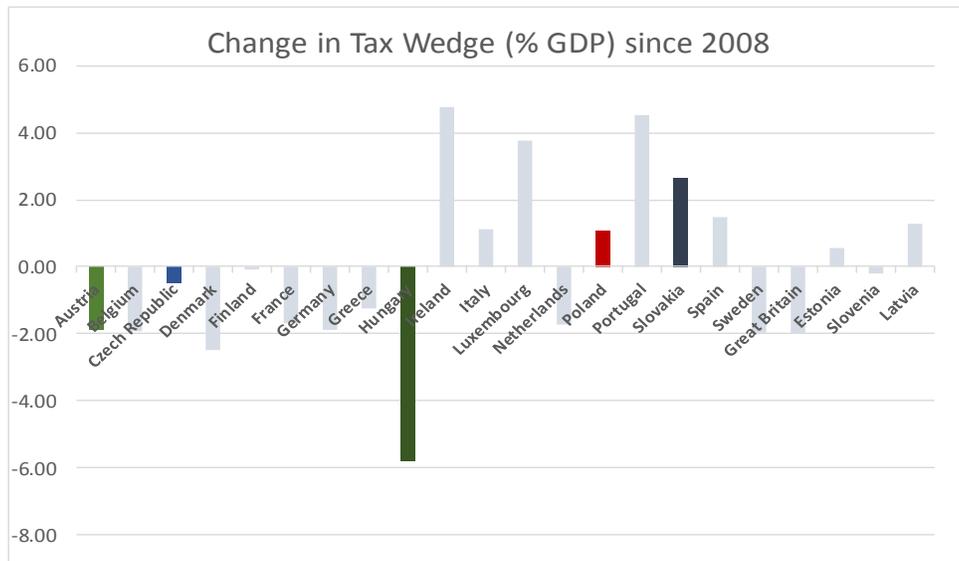
Summary for Poland

Outside of the Anglo-Saxon countries of the EU, Poland has one of the lowest percentages of tax collected to its GDP. The country’s pattern of collecting tax follows the EU, but the difference in tax rates between consumption, capital and labor is lower. Poland has increased the level of taxes collected as a %GDP since 2008.

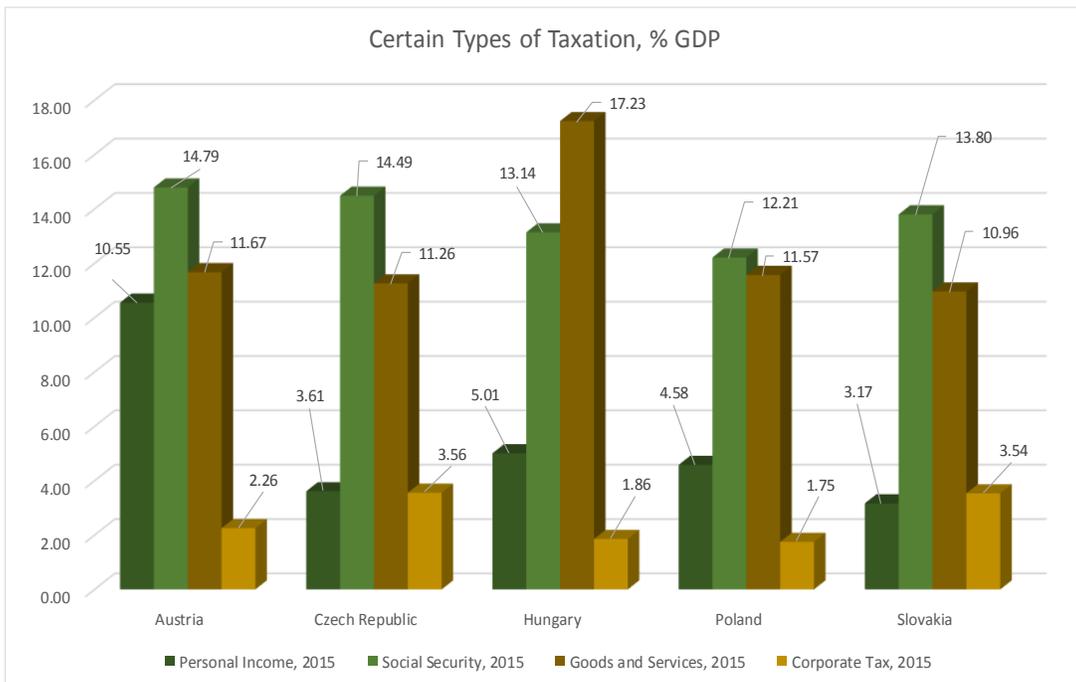




source: OECD



source: OECD



source: OECD

Tax Fairness

No international statistics could be identified that assesses evasion or the exact cost of tax compliance for either public authorities or taxpayers.

Evasion is not addressed in this section.

The only proxies for the cost of tax compliance are World Bank statistics which are proxies for the complexity of compliance. Complexity can indicate the cost. Therefore, as a rough estimate of the cost of compliance, the number of tax payments and the time needed to prepare taxes are employed. Evasion will not be assessed.

Since 2008, both the Czech Republic and Poland have decreased both the number of tax payments and the time to prepare taxes. The Czech Republic has achieved remarkable results in reducing the time to prepare and Poland has done the same with the number of payments.

Poland now has the second fewest number of tax payments in the EU (only Latvia, with 7, has fewer). In the Czech Republic, it now takes less than the EU average to prepare taxes, while taxpayers still spend more than the EU average in Poland.

| Efficiency of Collection, 2016 | Number of Payments | Trend since 2007 | Time to Prepare | Trend since 2007 |
|--------------------------------|--------------------|------------------|-----------------|------------------|
| Austria | 12 | 0 | 131 | -39 |
| Czech Republic | 8 | -4 | 234 | -525 |
| Hungary | 11 | -3 | 277 | -63 |
| Poland | 7 | -34 | 271 | -149 |
| Slovakia | 8 | -24 | 192 | -133 |



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Tax Competitiveness

Again, international statistics for how tax policy influences the value of exports could not be identified. As a proxy for it, Eurostat’s indicators of research spending will be used. Research spending by business enterprises is an indicator that companies are trying to differentiate their products through technological advantage rather than through price. Competitive tax policy, therefore, would result in a higher level of business enterprise spending on research.

in 2015, businesses in the Czech Republic spent 1.5% of the total business expenditure on research in the EU. Czech businesses spent 1.2 PPS for every 1 spent by other institutions (mainly government).

Polish businesses accounted for 2% of total business expenditure in the EU. They expended .9 PPS for every 1 PPS spent by other institutions.

| R&D Spending, PPS, 2015 | Total | Business Enterprise | Ratio Bus. Ent/Other | % Total EU Bus. Ent |
|-------------------------|-------|---------------------|----------------------|---------------------|
| Austria | 9,718 | 6,882 | 2.4 | 3.8% |
| Czech Republic | 5,128 | 2,785 | 1.2 | 1.5% |
| Hungary | 2,667 | 1,958 | 2.8 | 1.1% |
| Poland | 7,638 | 3,557 | 0.9 | 2.0% |
| Slovakia | 1,418 | 396 | 0.4 | 0.2% |

How does that compare to other EU countries? Germany, the powerhouse of research in Europe, has a business-to-other ratio of 2.1:1, and their businesses total 29% of all business research spending. Ireland has a 2.5:1 ratio. Finland has a 2:1 ratio.



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