

# Personal taxes in the European Union

Tomáš Kozelský

EU Office of Česká spořitelna

**EU OFFICE**

Česká spořitelna, a.s.

Olbrachtova 1929/62

140 00 Praha 4

tel.: +420 956 718 012

fax: +420 224 641 301

[EU\\_office@csas.cz](mailto:EU_office@csas.cz)

<http://www.csas.cz/eu>

Jan Jedlička

+420 956 718 014

[jjedlicka@csas.cz](mailto:jjedlicka@csas.cz)

Iva Dlouhá

+420 956 718 015

[idlouha@csas.cz](mailto:idlouha@csas.cz)

Jana Majchráková

+420 956 718 012

[jmajchrakova@csas.cz](mailto:jmajchrakova@csas.cz)

Tomáš Kozelský

+420 956 718 013

[tkozelsky@csas.cz](mailto:tkozelsky@csas.cz)

## Introduction

Even if indirect taxes (VAT and consumer taxes) are regulated by EU directives, which became valid many years ago already, and rules are set regarding the amount and number of rates (although some EU states use a lot of exceptions), personal retirement taxes are not regulated by any European legislation or are affected only to a limited extent.

Individual EU states alone determine what final form individual income taxes will take, whether this concerns the number and amounts of individual tax rates, tax discounts, etc. Some states have imposed a flat tax, based on which they have set a single rate for all incomes, and other states have set several rates as well as municipal rates, various surcharges, etc. Even despite many variations of these systems, it is possible to identify a certain trend. Like with corporate taxes (referred to in Czech as "daň z příjmu právnických osob"), in the case of individual income taxes there is also an apparent gradual decrease in the highest average rates in the EU. Individual states are resorting to increasing indirect taxes and reducing direct taxes in an effort to reduce the financial burden for companies and reduce the cost of human labour.

## Development of individual income tax rates in Czech Republic

Individual income taxes have undergone many changes in the Czech Republic since 1993. The numbers and amounts of tax rates have changed, and tax bases have been adjusted. First the amounts changed for basic deductible items from the tax base, and then these were replaced by income tax discounts, etc. From 1993 to the end of 2007, the individual income tax rate in the Czech Republic was progressively fluctuating, which meant that limits were set, above which a higher tax rate was applied only to the portion of the pension that exceeded that particular limit.

From 1993 to 1995, the Czech Republic had six brackets, and in 1993 the so far highest rate of 47% was imposed from a base exceeding CZK 1.08 million. This highest rate was reduced in later years to 44% in 1994 and 43% in 1995. Then the number of brackets was reduced to five by 2000, and the highest rate was reduced to 40%. Therefore, in those years only the tax base amounts were changed. From 2000 to 2007, the number of brackets was reduced to four, and the amounts of the two lowest rates and tax bases were adjusted. From the end of 1993 to the end of 2005, deductible items from the tax base were used in the Czech Republic (the tax base consists of income following deduction of expenses) for these purposes:

- for the taxpayer,
- for each child in the household,
- for a spouse in a joint household with own income less than set in individual years,
- for a taxpayer who was a user of a partial or full disability pension,
- for a holder of a ZTP-P disability card
- for a tax payer up to age 26, who is studying to prepare for a future career.

Since 2006 (for a raised child already from 2005), instead of deductible items from the tax base, a tax discount has been applied (deducted from the resulting taxes, not from the tax base). Tax discounts are applied due to taking into consideration the taxpayer's social status.

As of 1 January 2008, the system of sliding progressive rates was changed to a single flat rate. That rate was set as 15%.

Due to the existence of deductible items and tax discounts, however, there is still a certain progressive approach. However, this at first glance simplification and rapid reduction has a typical "Czech flavour". Besides this change, a practically unknown new term, "super gross wage", was introduced.

**Development of Czech individual income tax rates from 1993-2007**

| Year       | Tax base (in CZK) |           | Tax (in CZK)      | From base exceeding in CZK |
|------------|-------------------|-----------|-------------------|----------------------------|
|            | from              | to        |                   |                            |
| 2006-2007  | 0                 | 121 200   | 12%               | -                          |
|            | 121 200           | 218 400   | 14 544 + 19%      | 121 200                    |
|            | 218 400           | 331 200   | 33 012 + 25%      | 218 400                    |
|            | 331 200           | and more  | 61 212 + 32%      | 331 200                    |
| 2001-2005  | 0                 | 109 200   | 15%               | -                          |
|            | 109 200           | 218 400   | 16 380 + 20%      | 109 200                    |
|            | 218 400           | 331 200   | 33 012 + 25%      | 218 400                    |
|            | 331 200           | and more  | 61 212 + 32%      | 331 200                    |
| 2000       | 0                 | 102 000   | 15%               | -                          |
|            | 102 000           | 204 000   | 15 300 + 20%      | 102 000                    |
|            | 204 000           | 312 000   | 35 700 + 25%      | 204 000                    |
|            | 312 000           | and more  | 62 700 + 32%      | 312 000                    |
| 1999       | 0                 | 102 000   | 15%               | -                          |
|            | 102 000           | 204 000   | 15 300 + 20%      | 102 000                    |
|            | 204 000           | 312 000   | 35 700 + 25%      | 204 000                    |
|            | 312 000           | 1 104 000 | 62 700 + 32%      | 312 000                    |
|            | 1 104 000         | and more  | 316 140 + 40%     | 1 104 000                  |
| 1998       | 0                 | 91 440    | 15%               | -                          |
|            | 91 440            | 183 000   | 13 716 + 20%      | 91 440                     |
|            | 183 000           | 274 200   | 32 028 + 25%      | 183 000                    |
|            | 274 200           | 822 600   | 54 828 + 32%      | 274 200                    |
|            | 822 600           | and more  | 230 316 + 40%     | 822 600                    |
| 1997       | 0                 | 84 000    | 15%               | -                          |
|            | 84 000            | 168 000   | 12 600 + 20%      | 84 000                     |
|            | 168 000           | 252 000   | 29 400 + 25%      | 168 000                    |
|            | 252 000           | 756 000   | 50 400 + 32%      | 252 000                    |
|            | 756 000           | and more  | 211 680 + 40%     | 756 000                    |
| 1996       | 0                 | 84 000    | 15%               | -                          |
|            | 84 000            | 144 000   | 12 600 + 20%      | 84 000                     |
|            | 144 000           | 204 000   | 24 600 + 25%      | 144 000                    |
|            | 204 000           | 564 000   | 39 600 + 32%      | 204 000                    |
|            | 564 000           | and more  | 154 800 + 40%     | 564 000                    |
| 1993-1995* | 0                 | 60 000    | 15%               | -                          |
|            | 60 000            | 120 000   | 9 000 + 20%       | 60 000                     |
|            | 120 000           | 180 000   | 21 000 + 25%      | 120 000                    |
|            | 180 000           | 540 000   | 36 000 + 32%      | 180 000                    |
|            | 564 000           | 1 080 000 | 151 200 + 40%     | 540 000                    |
|            | 1 080 000         | and more  | 367 200 + 43-47%* | 1 080 000                  |

Source: Legislation regarding individual income taxes, Note: \*the highest rate in 1993 was 47%; 1994 - 44%, 1995 - 43%

This term represents a gross wage increased by social security and health insurance, which the employer is required to pay for each employee.

The collective rate of mandatory premiums in 2008 was 35%, of which 9% was for health insurance and 26% was for social security.

Since 2009, this collective rate has been reduced to 34%, social security has been reduced from 26% to 25% (the amount of disability insurance dropped from 3.3% to 2.3%, retirement insurance remained at 21.5%, and the contribution to state employment policy remained at 1.2%). The set 15% rate from the super gross wages therefore represents 20.1% of the gross wages ( $15 \times 1.34$ ). In the conditions of 2008, this meant 20.25%.

So the current 15% rate is basically only a cosmetic adjustment of the actual individual income tax rate amounting to 20.1% of gross wages in the Czech Republic.

As of 1 January 2013, another change occurred in relation to individual income taxes in the Czech Republic. From the flat rate that we have had for five years, we have switched based to a system of sliding progressive rates. In the Czech Republic, the individual income tax is defined in Act No. 586/1992 Coll., on income taxes.

It is covered specifically in the first part of the Act (Sections 2 to 16), and the second part of the Act defines corporate income taxes. In individual paragraphs, individual particulars of the Act are defined, including details regarding individual income taxpayers, subjects of tax, tax relief, the tax base and more as well as regarding tax rates and solidarity contributions that increase them.

The introduction of a solidarity increase in Section 16a of the act on income taxes has created a new rate, which has transformed the flat rate valid from 2008 to 2012 to a sliding progressive system. The solidarity tax increase is 7% of the positive difference between:

- the sum of income included in the partial tax base pursuant to Section 6 of the act on income taxes and the partial tax base pursuant to Section 7 of the act on income taxes in the particular tax period, and
- 48 times the average wage determined based on the act governing premiums for social security.

This solidarity increase in taxes is calculated from an amount exceeding 48 times the average wage. For monthly expression, this represents a 7% solidarity tax from an amount above 4 times the average salary, which has been determined for 2013 as CZK 25,884. This determination is based on Labour Ministry Decree No. 324/2012 Coll., which sets:

- the amount of the general assessment base for 2011 as CZK 25,093,
- the amount of the recalculation coefficient for adjustment of the general assessment base for 2011 as 1.0315.

This method was used to determine the average salary for setting the calculation base in the amount of CZK 103,536 (25,093 \* 1.0315 = 25,884; 25,884 \* 4 = 103,536). From an amount exceeding the monthly income of CZK 103,536, a solidarity tax is also deducted at the rate of 7%.

Another change was the cancellation of the basic tax discount for the taxpayer among working pensioners (CZK 24,840), and the ceiling for health insurance was also abolished.

However, the current system is not expected to last long. As of 2015, the super gross wage is expected to be cancelled, and the individual income tax rate will be increased to 19%. The tax will then be calculated as the product of the tax base, reduced by the non-taxable portion of the tax base and by a deductible item from the tax base rounded down to whole hundreds of CZK and tax rates. The newly established solidarity 7% tax is also expected to be cancelled.

The development of the highest individual income tax rates has a declining trend not only in the Czech Republic, but also on average in the EU. While the average for the EU was just under 48% in 1995, this year it is just under 38%, which is 10% less.

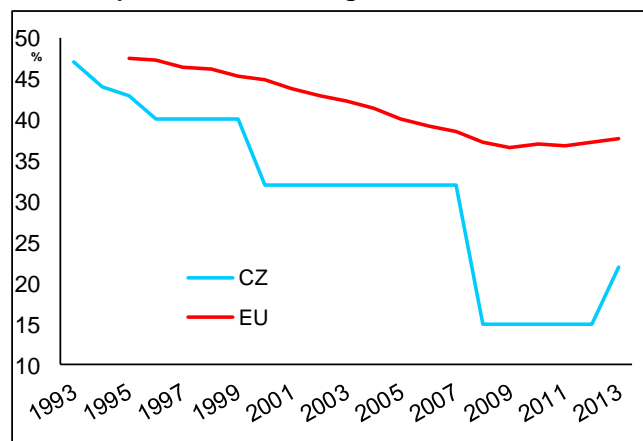
Some states (including the Czech Republic, where for 2013 the highest rate is 22% (15% + 7% solidarity tax) have resorted in recent years to increasing the highest rates of personal retirement taxes.

**Development of Czech individual income tax rates from 2008-2013**

| Year      | Tax rate    |
|-----------|-------------|
| 2013      | 15% + (7%)* |
| 2008-2012 | 15%         |

Source: Legislation regarding individual income taxes, note: \*solidarity increase of taxes by 7% of monthly income above 4 times the determined average monthly salary (CZK 25,884 in 2013), meaning CZK 103,536

**Development of the top individual income tax rates in the Czech Republic and on average in the EU-27**



Source: Eurostat

## Personal tax rates in the EU

The systems and development of rates and taxable income among individual income taxes are overseen by individual EU states. This corresponds both to the needs and setting of taxes in individual countries, and it is also a question of certain traditions. Therefore, the spectrum of individual income taxes is very wide, from relatively simple systems, in which states have implemented flat tax rates or in which they have several sliding progressive rates, to different taxation based on social status and the practice by certain states in adding to state rates municipal, church, solidarity and other fees.

A simplified overview is practically impossible, but we can evaluate individual systems in terms of their complexity and transparency or compare individual numbers and amounts of rates.

However, we can observe a certain trend in the EU among personal retirement taxes. It amounts to gradual reduction of the highest individual income tax rates. The highest rates have traditionally been in northern states. This is apparent from the data in the Eurostat document "Taxation trends in the European Union", according to which the rates were over 60% in 1995 and now are just over 50%.

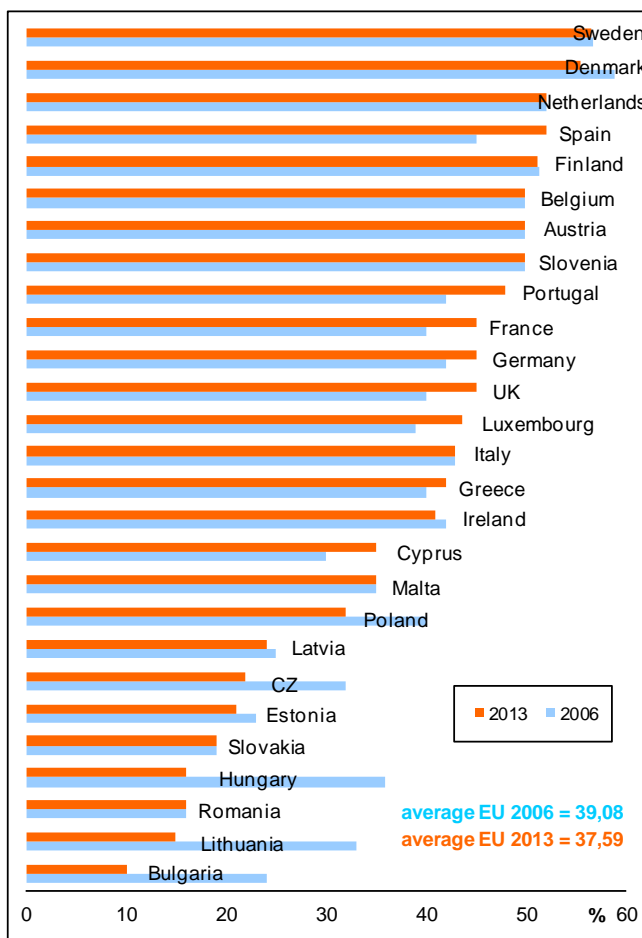
The largest reduction in rates of personal retirement taxes has occurred in former Communist countries in Eastern Europe, where today the rates are among the lowest and which also have the simplest systems (most have a flat tax).

The highest rates have fallen by more than 20% in the Czech Republic, Hungary, Romania and Slovakia. The clear winner in this respect is Bulgaria, which

today has a flat rate of 10%, although in 1996 it had the highest rate at 50%, which represents a reduction by an unbelievable 40%. Although most states have reduced their highest rates since 1995, Portugal, Greece and the UK have taken the opposite approach and have increased their highest individual income tax rates.

However, Malta and Austria have each maintained the same highest rate during the mentioned period of 1995-2013. Therefore, personal retirement tax rates in the EU vary greatly, from 10% in Bulgaria (Bulgaria and Cyprus each also have lowest corporate tax rate, 10%), 15% in Lithuania and rates exceeding 50% in Denmark, Belgium, Spain, the Netherlands and Portugal.

Development of the top individual income tax rates in the EU



Source: Eurostat

## Current individual income tax rates in the EU

We can divide the systems of individual income tax rates based on whether the states use a flat tax rate or a sliding progressive rate. Flat rates are used by:

- Bulgaria (10%)
- Estonia (21%)
- Latvia (24%)
- Lithuania (15%)
- Hungary (16%)
- Romania (16%)
- Slovakia (19%)

As early as last year, the Czech Republic was also in this category, but with the introduction of the 7% solidarity tax, it basically gained an additional rate and therefore returned to sliding progressive rates, which it had used until the end of 2007. These states not only have a relatively simplified system using only single flat rates, but they are also among the EU states that have the lowest rates and therefore a more advantageous system for taxpayers.

Five rates are most often used for sliding progressive rates. However, a certain extreme is Luxembourg, which has an unbelievable 19 rates. Also in Germany, there is a different annual taxable income for joint taxation of spouses along with a 5.5% solidarity surcharge. Other differences in individual systems can be created by taxpayers' social statuses. In Ireland, the amount of taxable income at the 20% rate differs depending on whether the taxpayer is single/widowed, whether he/she has children and whether spouses have only joint income or both have income.

### Personal tax rates in Luxembourg in 2013

| Taxable income (EUR) | Rate in % |
|----------------------|-----------|
| 0 - 11 265           | 0         |
| 11 266 - 13 173      | 8         |
| 13 174 - 15 081      | 10        |
| 15 082 - 16 989      | 12        |
| 16 990 - 18 897      | 14        |
| 18 898 - 20 805      | 16        |
| 20 806 - 22 713      | 18        |
| 22 714 - 24 621      | 20        |
| 24 622 - 26 529      | 22        |
| 26 530 - 28 437      | 24        |
| 28 438 - 30 345      | 26        |
| 30 346 - 32 253      | 28        |
| 32 254 - 34 161      | 30        |
| 34 162 - 36 069      | 32        |
| 36 070 - 37 977      | 34        |
| 37 978 - 39 885      | 36        |
| 39 886 - 41 793      | 38        |
| 41 794 - 100 000     | 39        |
| over 100 000         | 40        |

Source: web pages of Luxembourg's Ministry of Finance

### Personal tax rates in Malta

| Taxable income (EUR) |                           |   | Rate in % |
|----------------------|---------------------------|---|-----------|
| Individual           | Joint taxation of spouses | Parents caring for a studying child between the ages of 18 and 21 |           |
| 0 - 8 500            | 0 - 11 900                | 0 - 9 300   | 0         |
| 8 501 - 14 500       | 11 901 - 21 200           | 9 301 - 15 800  | 15        |
| 14 501 - 19 500      | 21 201 - 28 700           | 15 801 - 21 200   | 25        |
| 19 501 - 60 000      | 28 701 - 60 000           | 21 201 - 60 000   | 32        |
| over 60 000          | over 60 000               | over 60 000   | 35        |

Source: web pages of Malta's Ministry of Finance

**Personal tax rates in the EU in 2013**

| Country               | Tax rates in %                      |
|-----------------------|-------------------------------------|
| Belgium               | 25 / 30 / 40 / 45 / 50              |
| Bulgaria              | 10                                  |
| <b>Czech Republic</b> | <b>15 / 22</b>                      |
| Germany               | 0 / 14-42 / 42 / 45                 |
| Estonia               | 21                                  |
| Ireland               | 20 / 41                             |
| Greece                | 22 / 32 / 42                        |
| Spain                 | 24.75 / 30 / 40 / 47 / 49 / 51 / 52 |
| France                | 0 / 5.5 / 14 / 30 / 41 / 45         |
| Italy                 | 23 / 27 / 38 / 41 / 43              |
| Cyprus                | 0 / 20 / 25 / 30 / 35               |
| Latvia                | 24                                  |
| Lithuania             | 15                                  |
| Luxembourg            | 0 - 40*                             |
| Hungary               | 16                                  |
| Malta                 | 0 / 15 / 25 / 32 / 35               |
| The Netherlands       | 5.85 / 10.85 / 42 / 52**            |
| Austria               | 0 / 20.44 / 33.725 / 50             |
| Poland                | 18 / 32                             |
| Portugal              | 14.5 / 28.5 / 37 / 45 / 48          |
| Romania               | 16                                  |
| Slovenia              | 16 / 27 / 41 / 50                   |
| Slovakia              | 19                                  |
| Finland               | 6.5 / 17.5 / 21.5 / 29.75**         |
| Sweden                | 0 / 20 / 25**                       |
| UK                    | 20 / 40 / 45                        |

Note: \*Luxembourg has 19 rates; \*\*additional information in text

**Personal tax rates in France**

| Taxable income (EUR) | Rate in % |
|----------------------|-----------|
| do 5 963             | 0         |
| 5 964 - 11 896       | 5.5       |
| 11 897 - 26 420      | 14        |
| 26 421 - 70 830      | 30        |
| 70 831 - 150 000     | 41        |
| over 150 000         | 45        |

Source: web pages of France's Ministry of Finance

18% for income exceeding 1 million euros, which in combination with social contributions would have made the highest tax rate 75%. However, that proposal was rejected by the constitutional council. It is interesting that this particular proposal was rejected mainly due to a formal shortcoming, which would have created an unjust difference between households with the same income levels, but different income among individual members of the household.

A solidarity surcharge is also applied in Portugal, 2.5% for income above 80,000 euros, for which a 48% rate is applied, along with an additional 4% surcharge for a salary above 6,790 euros, meaning that the highest rate can be greater than 50%.

Malta has five individual income tax rates, but different amounts of taxable income:

- for individuals,
- joint taxation of spouses and
- for parents caring for a studying child between the ages of 18 and 21.

In the Netherlands, contributions for national social insurance are added to the first two rates (5.85% and 10.85%), and those contributions are divided into several categories (for more see J. Široký: Taxes in the EU Scandinavian countries are a separate chapter, and besides their national rates they also have municipal tax rates (Sweden approximately 29-34%), church taxes, etc. In Finland, these additional tax rates amount to 16 to 24%. The upper individual income tax rates in Scandinavian countries are among the highest in the EU.

Some states (including the Czech Republic) have taken certain steps in relation to individual income tax (and rates) only for a definite period, or they have already planned changes for later years. Slovenia has added an additional 50% rate for taxable annual income of more than 69,313 euros for 2013 and 2014. Malta intends to reduce its second highest 32% rate in 2014 to 29%, and it will only be 25% in 2015, which should reduce the number of rates to four. A recently discussed item in the media was a proposal to tax high incomes in France more, and the media mainly mentioned it in relation to actor Gérard Depardieu and his citizenship.

In France additional rates are already used for higher incomes,

- for an individual:
  - 3% of income between 250,000 and 500,000 euros,
  - 4% of income above 500,000 euros,
- for a couple:
  - 3% of income between 500,000 and 1 million euros,
  - 4% of income above 1 million euros,

but they also proposed an exceptional contribution of

## Importance of personal taxes in relation to overall taxation

Although a trend of reducing the lowest rates among certain EU states is apparent, the share of individual income tax in GDP and in overall taxation remains very high. Between 2000 and 2011, this share fell in the EU by one percent, but in some states it grew (Ireland, Spain, Luxembourg, the Netherlands and Portugal).

Individual income taxes remain a very important and large source of revenue for many states, in which the share of individual income taxes in GDP is more than 10% (Britain, Italy, Finland, Sweden, Belgium); in Denmark it is nearly 25%. From the point of view of overall taxation, personal retirement taxes have a very high share. In the states mentioned above, it is around one third, and in Denmark it is even just under half (in the Czech Republic, the share of individual income tax in overall taxation fell between 2000 and 2011 to 10.8%).

The share of personal tax income in 2000 and 2011

| Country               | % GDP      |            | % of total taxation |             |
|-----------------------|------------|------------|---------------------|-------------|
|                       | 2000       | 2011       | 2000                | 2011        |
| Belgium               | 13.2       | 12.3       | 29.4                | 28.2        |
| Bulgaria              | 4.0        | 2.9        | 12.7                | 10.5        |
| <b>Czech Republic</b> | <b>4.4</b> | <b>3.6</b> | <b>13.0</b>         | <b>10.8</b> |
| Denmark               | 25.6       | 24.3       | 51.9                | 50.9        |
| Germany               | 9.5        | 8.4        | 22.9                | 21.8        |
| Estonia               | 6.8        | 5.4        | 22.1                | 16.1        |
| Ireland               | 9.2        | 7.6        | 29.3                | 32.0        |
| Greece                | 5.0        | 4.3        | 14.4                | 14.6        |
| Spain                 | 6.7        | 7.4        | 19.6                | 23.7        |
| France                | 8.4        | 7.6        | 19.0                | 17.9        |
| Italy                 | 11.4       | 11.7       | 27.5                | 27.1        |
| Cyprus                | 3.7        | 4.2        | 12.2                | 11.9        |
| Latvia                | 5.6        | 6.2        | 18.8                | 20.3        |
| Lithuania             | 7.7        | 3.6        | 25.6                | 13.6        |
| Luxembourg            | 7.2        | 7.9        | 18.3                | 22.2        |
| Hungary               | 7.3        | 6.5        | 18.5                | 13.3        |
| Malta                 | 5.6        | 6.0        | 19.9                | 19.1        |
| The Netherlands       | 6.0        | 8.5        | 15.0                | 20.9        |
| Austria               | 10.0       | 9.7        | 23.3                | 23.2        |
| Poland                | 4.4        | 4.5        | 13.5                | 13.8        |
| Portugal              | 5.3        | 5.6        | 17.1                | 18.5        |
| Romania               | 3.5        | 3.3        | 11.4                | 11.8        |
| Slovenia              | 5.6        | 5.7        | 15.0                | 15.0        |
| Slovakia              | 3.4        | 2.3        | 9.9                 | 8.8         |
| Finland               | 14.5       | 12.5       | 30.6                | 29.4        |
| Sweden                | 18.1       | 15.7       | 35.2                | 33.8        |
| UK                    | 10.8       | 10.1       | 29.4                | 27.9        |
| <b>EU-27</b>          | <b>9.8</b> | <b>9.1</b> | <b>24.3</b>         | <b>23.5</b> |

Source: Taxation trends in the European Union, Eurostat

## Final summary

Individual income taxes are not very regulated in the EU, and their form is in the hands of individual states. The differences between systems in terms of the number and amount of rates, various exceptions and additional tax surcharges are wide ranging. However, a certain trend can be identified. In many EU states, the highest individual income tax rates are being gradually reduced (today the rate in the Czech Republic is much lower than it was in 1993, when the highest rate was 47%).

Some states (most former Communist countries in Central and Eastern Europe) have introduced a flat tax (which the Czech Republic had from 2008 to 2012).

These states are also among those that have a much lower rate than the highest rates in other (mainly northern) EU states. However, the advantageousness of the system for the taxpayer can only be determined based on the amount of rates. It is also necessary to monitor the taxable income to which the particular rate applies and other additional taxation (for example, Scandinavian countries have imposed various municipal, church and other taxes).

The tax area is very "lively" due to the implemented and planned changes in EU states (since 2013 a new solidarity tax has applied in the Czech Republic, and there is a plan to abolish the "super gross wage" and introduce a 19% rate). Time and possibly also the EU's future efforts to regulate these systems will demonstrate whether states will move towards simplification or attempt to combine additional exceptions and additional adjustments into individual income taxes.