

**TAX SYSTEM AND REFORMS IN EUROPE:
THE NETHERLANDS**

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TAX SYSTEM AND REFORMS IN EUROPE: THE NETHERLANDS

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Abstract

This paper aims at discussing the main features of Netherlands tax system, its recent reforms and those underway. It is part of a wider research on European taxation, carried on at this Department, under the direction of L. Bernardi and P. Profeta, and the supervision of V. Tanzi. The Dutch system has been involved in radical changes especially in the field of the social security and the taxation of capital, and further modifications are planned. The present work describes the structure and the economic effects of such a system, with a particular attention to the distribution of the burden among the different productive factors. The comparison of the characteristics of the Netherlands' taxation with the other European frameworks will offer the possibility to give an interpretation of its peculiarities. This is particularly interesting considering the claim of harmonisation of fiscal systems among the EU countries. We will try a general evaluation of the reforms in progress and of the future perspectives.

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1. Introduction, contents and main conclusions

This paper analyses the tax system of the Netherlands and its recent evolution. The Netherlands has a relatively small-scale, but very open economy. At the end of the 90s, the financial health of the Government sector, in terms of the Maastricht parameters, allowed a substantial reduction of the tax burden, together with a structural modification of the fiscal system. The reforms currently in progress aim at stimulating employment opportunities and strengthening the Netherlands' economic structure and international competitive edge. The social security system is under substantial revision and the sources of financing for the Government have been radically changed since the 70s. The taxation of capital has some features that characterize the Dutch system with respect to the other industrialised countries, and make the Netherlands an attractive location for business operating on an international scale.

The work is organised as follows. In section 2 we analyze the evolution of the fiscal revenue structure and compare it with the other European countries. The overall tax burden was one of the highest in the Union in the early 90s, but more recently this trend was reverted. The high share of social contributions, in particular the ones charged to employees, has always been a characteristic of the system, but recently a substantial revision of social security is in progress. This probably means a re-classification of the Dutch model, from the classical Rhineland model towards a system with many features typical of the Anglo-Saxon model. Revenues from direct taxation, which were the main sources of tax revenues in 70s and 80s, progressively shifted to indirect taxation.

Section 3 is devoted to the explanation of the main taxes. The personal income tax (PIT) was revised in 2001 with the new Income Tax Act, which lowered the tax rates and involved many changes in the assessment base. We will explore details of the personal deductions allowed and the favourable conditions for the self-employed. Both social security contributions and taxation of financial activities are collected within the PIT. However, returns from savings and investments are no longer taxed with progressive rates, and are now taxed with a 30 percent flat rate on the base of assumed yield of 4 percent on personally held assets. The classical system of taxation of dividends (double taxation, at corporate and personal level) provides a complex framework for the taxation of different activities. As concerns the corporation tax (CT), the participation exemption ensures that CT is levied only once on the profit obtained within a group.

After this description of the structure of the fiscal system, we will move to the analysis of its economic implication. Therefore, Section 4 provides some useful indicators to understand the consequences in terms of equity and effective distribution of the tax burden among the different factors (labour, consumption and capital). The labour was heavily taxed and shifting away from this charge was one of the goals of the reform process begun in the 90s. The data on the implicit tax rate

on labour relative to 1997 was still 5 percentage points above the European average, but the difference has been significantly reduced, considering that it was 12 percent in 1993, and that the more recently taken measures should further reduce this value. On the contrary, the tax burden on consumption is augmenting. A peculiarity of the Dutch system stems from the weight given to environmental levies, and the attention given to the issues of pollution and road traffic regulation.

Perhaps the main difference between the Netherlands and the other European countries lies in the taxation of capital. The implicit tax rate is 5 percentage points lower than the average and the taxation at the level of corporation is one of the lowest in the Union. This data confirms the Netherlands power of attracting business. Moreover, the new system of taxation of financial activities has many effects in terms of neutrality between the investment choices.

Finally, in section 5 we focus on reforms, their economic goals, and their coherence to the suggestions of OECD and EU. In particular, the reduction of tax wedge on labour and the reform of social security with the attempt to favour new opportunities of work are the answers to the policy problems related to the low participation rates of older workers and workers with few marketable skills. The goal of the Government is also that of ensuring that the Netherlands remains attractive to businesses, through the indication of Oecd concerning the harmonisation of the international taxation on corporations. Moreover, the reduction of the overall tax burden is still in progress and only in the next years an evaluation of its effects on the economic activities will be possible.

2. The structure of the system and its development from the '70s

2.1 The current structure of taxation and social security contributions

During the second half of 90s, the government balance showed a continuous reduction of the net borrowing (4.2 percent of GDP in 1995), and this indicator finally turned to a net lending in 1999 (0.4 percent). This result was achieved mainly because of a lower level of expenditure. The most important components of the latter are final consumption expenditure (23 percent), social transfer not in kind (12.5 percent) and interest payments (4.5 percent). Indeed, the overall tax burden in the Netherlands amounted to 46.7 percent of GDP in 1999 (data by Eurostat, see Table 1) and it is characterised by a high amount of social contributions. In fact, more than 40 percent of total fiscal revenues are raised via social contributions (only Germany and France rely to a greater extent on this source of financing). Social contributions are collected as a share of the first two brackets of the personal income tax¹ and they are mainly charged on the employees (9.5 percent of GDP, against

¹ 29,40 percent of the first 27,000 Euro. See also section 3.1, which concerns the personal income tax.

6.4 percent paid by employers). A relevant share is also collected from the self-employed labour (3.5 percent).

Within the tax revenues, the greater source of financing is represented by indirect taxes, which constantly increased their weighting during the years and now they account for more than 14 percent of GDP. More than half of these revenues are financed by the value added tax (VAT), but also environmental taxes play an important role. Direct taxes represent less than 30 percent of total revenues, and they are characterised by a low share charged on the individual or household income and a relatively high share collected through the corporation tax. More specifically, revenues from PIT represent only 6.5 percent of GDP, while those from CT amount to 4.6 percent of GDP, a high value compared to the other industrialised countries. This is probably a consequence of the power of the Netherlands in attracting investments, and to the high share of corporate business in enterprises.

At the administrative level, local Government raises only 2 percent of total fiscal revenues, perhaps because the Netherlands is a relatively small and homogeneous country. Within the municipal taxes, the most important is property tax, which is paid by both users and owners on the value of that property.

However, as we will see more in detail in the next sections, the new tax system introduced from January 2001 involves many changes both in the level and the structure of taxation. In fact, the wide-ranging fiscal reform which entered into force on 1 January 2001 is leading to a significant decrease in revenues from income tax and social security contributions that is only partly offset by the increase in indirect taxes, such as VAT and environmental levies. The reform lowered the basic rates of income taxation, in order to stimulate the economy and employment opportunities. The lower taxation on income from employment, together with a shift from direct to indirect taxation, strengthens the Netherlands' economic structure and its international competitive edge. In fact, the Dutch tax system has many features, which make the Netherlands an attractive location for businesses operating on an international scale.

2.2 Developments of the system from 1970 to 2000

The total fiscal burden grew fast in the 1970s, like in many other European countries, boosted by a great increase in direct taxes and in social contributions. In the 1980s and 90s total revenues stabilised their level, though they showed a slight tendency to rise, reaching a maximum of 48.6 percent of GDP in 1993. Recently, the trend was inverted. In particular, the weight of direct taxes significantly decreased between 1993 and 1995 owing to the so-called “AAW-schuif”. Looking at table 1, it can be noted that it is mainly due to the reduction in the share of the personal income tax.

It accounted for 11.6 percent in 1980 and it was very high if compared with the European mean, where now it has slowed down to 6.5 percent. On the contrary, the indirect taxes, which accounted for less than one quarter of total taxation in 1975, constantly increased their share. In more recent years, the shift from direct to indirect taxation is evident, and clearly it has many implications in terms of losses of the redistribution effects of taxation.

Social contributions have always represented a high share of revenues, but what has changed most dramatically over the years is their distribution between employees and employers. Until 1989 the division was roughly equal. Then, with the “Oort operation”, contributions for exceptional medical expenses and disability were levied on the employees instead of the employers (employees are awarded a compensation payment on top of the gross wage). For this reason, the employees’ contributions reached 11.7 percent of GDP in 1995. In 1998 a new rescaling occurred, and so a quota of employees’ contributions shifted to the employers’, even if the first remain very high if compared to the Union’s average. The substantial changes in social security system, which occurred in the last 15 years, will be analysed in more detail in Section 5.2.

Local governments, even if collecting only a little share of revenues, constantly obtained an increasing share of funds through the year (now about 2 percent of GDP).

2.3 A comparative view with the European average

In the early 1990s the tax burden in the Netherlands was one of the highest in the Union. In recent years it has become closer to the middle range of the member States. However the 1999 level is still three-percentage points above the Union’s average². This is mainly the result of a high amount of social contributions. If one considers only the tax revenues, they are clearly below the middle range of European countries.

Analysing the structure of tax revenues, PIT gives a particularly low contribution if compared to other countries, accounting only for 15 percent of total taxation. On the contrary, the level of revenues from corporate income tax is relatively high and reaches 10 percent of total taxation, partly as a consequence of the high share of corporate business in enterprises. The Dutch Tax Department has always recognised that the tax system should not hinder the international expansion of business, and recent international studies have confirmed that the Netherlands score well as an investment location. Another peculiarity of the Netherlands’ system concerns the weight of environmental taxes, from which the Government raises almost 10 percent of its tax revenues. The

² It should be noted that the Eurostat data concerning the Netherlands seems to be a little high if compared with other sources of data like Oecd, which placed the Netherlands closer to the middle range of the other European countries.

level of pollution taxes (numerous special levies in connection with water pollution, waste disposal, sewerage charges) is the highest in the Union.

As concerns the four models of tax system historically developed in Europe (Bernardi, in this book, par. 3), the Netherlands' system is not easily fitted in. Perhaps we could say that with the reform in progress involving a reduction of the overall tax burden and social contributions, it is moving away from the Rhineland model, assuming some characteristics that place the system nearer to the British model.

3. Some quantitative and institutional features of main taxes³

3.1 The Personal Income Tax - PIT

Under the present Income Tax Act, residents are liable for income tax on their worldwide income⁴. The beneficiary is the State. The basis of assessment is composed by three categories, so-called "boxes" of taxable income:

- Box 1: taxable income from work and home. They consist of business profits with a number of additions or deductions plus net income from work, certain periodical payments, home, and personal liabilities, which are received back. Taxation is levied at a progressive rate (see Table 2). As we have already seen, the first two brackets consist of both tax and social contribution, whilst the other two rates consist solely of taxes⁵;
- Box 2: taxable income from substantial interests. They consist of dividends and capital gains when the taxpayer holds, solely or with his or her partner, directly or indirectly, at least 5 percent of the capital of the company⁶. Tax rate is 25 percent;
- Box 3: taxable income from savings and investments, e.g. bank savings, second home, stock, bonds, based on the assumption that the taxpayer has a (annual) return of 4 percent on his or her capital. The rate applied is 30 percent.

In this Section we will focus on the general principles of PIT and on revenues from box 1, whereas the details on the taxation of financial activities (i.e. box 2 and 3) will be described in Section 3.3. Personal circumstances are taken into account when making the assessment of the amount of tax to be paid. As a result, taxable income is the income less the deductible losses. Personal deductions are set off primarily against taxable income from box 1. They will be set off

³ The contents of this section are mainly based on works by European Commission (2001) and Ministry of Finance (2001).

⁴ Non-residents are taxed only on the income from a limited number of sources in the Netherlands, established by a double taxation convention.

⁵ People aged 65 and over are no longer liable for several social security contributions, and so they pay a first rate of 14,45% and a second rate of 19,70%, which consist solely of taxes.

⁶ So the shareholder is supposed to have a substantial interest in a company if he holds at least 5% of it.

against taxable income respectively from boxes 3 and 2 if there is still a portion left. The tax-free allowance amounts to 3.800 €.

People pay tax individually as far as possible. Therefore partners pay tax on their own income and can only use their own deductible items. Some income and deductible items are joint (for example the ones relating to the living expenses for children up to 27 years old). As a peculiarity of the system, there is not a ‘wife deduction’, but the *partner* status offers a series of advantages. First, there is the eligibility for a number of business-related facilities. For example, when one spouse assists the other in the latter’s business, the entrepreneur qualifies for a deduction from income (assisting-spouse deduction), the amount of which depends on the extent to which the entrepreneur is assisted in this way⁷. Second, they have the option of allocating the yield assessment base for the investment yield tax (Box 3) and the joint elements of income to both partners at their discretion. Furthermore, there are possibilities to increase the others tax credits depending on the total joint incomes of the partners (e.g. supplementary child rebate).⁸

TAB 2. *Structure and parameters of PIT in the Netherlands - 2001 - Values in € - Box 1*

Brackets	Marginal Rates	Mean Rates	Dependent Labour	Self Employment	Partner	Sons
Up to 14.870	32.35 (29.4)*	32.35	Tax credit of 920 €	Tax credit of 920 €	Assisting spouse deduction	Expenses for the care of each child up to 13 years old are deductible up to 8.800 €
14.870 – 27.009	37.6 (29.4)*	33.9		Relief of 5.993 € for profits up to 11.775 € that falls progressively to 2.893 € for profits up to 50.065 €	Increases to other tax credits	
27.009 – 46.309	42	36.6		12% of profits may be deducted and added to the old age reserve		Further credits are allowed for children under 27 living at home
More than 46.309	52					Further credits are conditional to the status of partner or employed.

* Quota of social contributions

Note: Mean rates are calculated at the middle of any brackets

The amount of tax owed is calculated by applying the appropriate tax rate. The result is reduced by one or more tax credits. Everyone benefits from a general tax credit, which amounts to 1.576 €. Additional credits are available depending on personal circumstances. For individuals with income from current employment the credit is increased by a minimum of 920 €. For taxpayers with

⁷ Income earned by one spouse in assisting the other in the latter’s business is attributed to the latter unless both spouses request that the income accruing to the assisting spouse be attributed to the latter, and the income amounts to at least 5.000 €.

⁸ Meussen (2000)

children under 27 living at home, single parents and elderly persons, there are further credits. Table 2 summarises the main circumstances that allow special fiscal consideration, which often have to be considered together.

The profits (box 1) should be determined according to sound business practice and consistent accounting methods. The concept of sound business practice has been developed mainly in case law. For example, unrealised losses may be taken into account, while unrealised profits may be ignored. Losses may be offset against the taxable income of the three preceding years (carry back) and against taxable income of the following eight years (carry forward). There are many different forms of tax relief concerning investment, research and development (which means qualified work) and self-employed persons. In particular, there is an investment allowance with respect to investments in business assets of up to 261.000 €, ⁹ with particular attention to investments in energy saving projects and the so-called “environmental investments”. Self-employed resident taxpayers are allowed to offset a certain percentage of their profits towards the provision of a pension scheme (old-age reserve).

Income tax has two advance levies, which are the tax on wages (deducted at source by the employer) and the dividend tax (deducted at source by the paying company).

3.2 Corporation Tax - CT

Corporation tax is levied on companies established in the Netherlands (resident taxpayers) and on certain companies not established in the Netherlands, which receive income from the Netherlands (non-resident taxpayer). The main types of companies referred to in the Corporation Tax Act are the public companies (NV) and private companies with limited liabilities (BV). The beneficiary is the State and there are two tax rates: 30 percent for the first 22.689 €, and 35 percent for the remainder.

CT is levied on the taxable amount, which is the taxable profit made by the company less the deductible losses. The determination of company taxable profits corresponds largely to the one subject to the personal income tax (sound business practice). Rules concerning investment and their promotion are similar to the ones for the PIT. Table 3 summarises the basis of assessment for the CT in the Netherlands. The basic principle is that all expenses associated with business operations

⁹ Investments are divided into nine bands, with the percentage of the allowance declining as the investment increases. For investments of up to 30.000 € the allowance is 25 percent.

are tax-deductible. Some restrictions concern mixed expenses, which are business expenses with a private element¹⁰.

An important feature of corporation tax is the participation exemption, applicable to both domestic and foreign shareholding, which ensures that corporation tax is levied only once on the profit obtained within a group. This means that a company receiving dividends does not have to pay corporation tax on these dividends since the company distributing the dividends has already paid the tax. The main features of this scheme are the following: all gains from shareholdings are exempted, the costs associated with a shareholding are not deductible¹¹, and losses arising from liquidation of the company are only deductible under certain conditions. A shareholding is deemed to exist if the taxpayer holds at least 5 percent of the shares in a subsidiary.

TAB. 3 *The basis of Corporation Tax in the Netherlands*

<i>PROFITS ITEM</i>	<i>ASSESSMENT</i>	<i>LOSSES ITEM</i>	<i>ASSESSMENT</i>
General principle	Unrealised profit may be ignored	General principle	Unrealised losses may be taken into consideration
Stocks	Valuation based on cost, unless the market value is significantly lower. Value determined using Fifo or Lifo	Depreciation	The linear method is generally used, but accelerated depreciation is permitted for certain fixed assets (e.g. environmentally friendly fixed assets)
Capital gains & dividends	All gains from shareholdings are exempted	Passive interests	Deductible, with some limits concerning interests and other charges on intercompany loans.
		Losses	Carry back (3 years) and carry forward (all years to come)

Under certain conditions a parent company may form a fiscal unity with one or more subsidiaries. For CT purposes, this means that the subsidiaries are deemed to have been absorbed by the parent company, and as a result, losses of companies belonging to the unit can be set off against profits from another company. This type of consolidation can occur only if a parent company holds 100 percent of the shares in its subsidiary.

Another special feature concerns the investment institutions that can be required to pay CT at 0 percent. The purpose of this system is to ensure equal treatment for persons investing in investment

¹⁰ Limitations are tighter for companies with one or more persons holding a substantial interest in the company who also work for the company. An option consists in treating as non-deductible a fixed amount of 1.500 € for each person with a substantial interest working for the company.

¹¹ An exception is made when the taxpayer is able to show that the costs are conducive to making domestic taxable profits. In practice, the main non-deductible costs are those of financing the participation.

institutions and persons who invest directly. An investment institution does not qualify for the participation exemption.

3.3 Taxation of income from financial capital

The Netherlands represents a classical system of taxation, as distributed dividends are taxed twice, both at the corporate and at the personal level. At the personal level, the dividend tax is collected as an advance levy on PIT. As already seen in section 3.1, the law makes a great difference between dividends and capital gains earned when the taxpayer has a substantial interest in the company (corresponding to box 2) and other financial revenues (box 3). In the first case, dividends and capital gains derived from the sales of shares are taxed at a proportional rate of 25 percent within the income tax. In the case of capital losses, 25 percent of those losses may be offset against the tax, which would otherwise be due.

In the second case, taxation on income from savings and investments is based on the assumption that people will have a taxable return of 4 percent on their net capital. This is the main change introduced by the reform on income tax since January 2001. The current level of return (for example interest, dividend, capital gains or losses) is not relevant at all. Net capital is determined as the average net capital during the calendar year¹². Only capital available for savings and investment is taken into account. Therefore capital invested in someone's own company or in a substantial interest is not considered here¹³. Each person is entitled to a tax-free capital threshold of 17.600 €, and for each child under 18, the threshold is raised by 2.349 €.

Considering the Dutch classical system, Table 4 provides a picture of the taxation on the different assets.

The tax on presumptive capital income is levied at 30 percent, and so it is equal to a net wealth tax levied at a rate of 1.2 percent. Expressed as a percentage of the effective return, however, the tax liability differs between assets, depending on the actual return (the higher the actual return becomes, the lower is the tax expressed as a percentage of that return). This tax has replaced the pre-existing system, which involved a tax on net wealth levied at a rate of 0.7 percent and a progressive tax on actual personal capital income. In fact, dividends and other capital income were taxed at the usual progressively rates (those of box 1). Only certain earnings were taxed at proportional rates varying from 10 percent to a maximum of 45 percent, to be applied only where income exceeded the first

¹² It is obtained by calculating the mean between the capital owned on January 1 and December 31.

¹³ Examples of assets taxed under box 3 are: bank and saving accounts, a second home, stocks and other shares, endowment insurance policy which is not linked to an owner-occupied dwelling.

income band, fixed at 6.800 €. The most important category was represented by the incomes from substantial interest in a company, taxed at the same present rate of 25 percent.¹⁴

TAB. 4 *Taxation of different type of returns in the Netherlands*

<i>TYPE OF RETURN</i>	<i>TAX</i>
Return on equity, including capital gains, invested in proprietorships.	Taxation on an ex-post basis, at progressive rates (box 1 of PIT)
Return on equity, including capital gains, invested in closely held corporations (income from substantial interests).	Taxation on an ex-post basis, at proportional rates: - 35 percent at the corporate level; - 25 percent at the personal level (box. 2 of PIT)
Return on equity, including capital gains, invested in publicly held corporations	Taxation on an ex-post basis at the corporate level (35 percent) and on an ex-ante basis at the personal level (box 3 of PIT, i.e. 30 percent on an assumed yield of 4 percent). In this second case, capital gains are not specifically taxed, but however they are included on the assumed yield.
Return on individually held assets, such as deposits, bonds, debt claims, and real estate	Taxation on an ex-ante basis, at proportional rates (box 3 of PIT).
Owner-occupied property	Taxation on an ex-ante basis, at progressive rates (box 1 of PIT). The assumed yield is 0.8 percent instead of 4 percent.
Return on savings held in pension funds	Not taxed ¹⁵

3.4 Value Added Tax-VAT

VAT is levied at each stage in the chain of production and distribution of goods and services. Taxable persons are persons conducting a business, who are defined as those who conduct independent business, including natural persons, corporate bodies, associations, and partnerships. Every taxable person is liable for VAT on his or her turnover (the output tax), from which the VAT charged on expenses and investments (the input tax) may be deducted. There are four taxable activities:

- Supplies of goods in the Netherlands, interpreted in its broader sense (goods are all physical objects, but also include electricity, heating, cooling);
- Supplies of services in the Netherlands;
- Acquisition of goods by an entrepreneur or legal body in the course of his/its businesses;

¹⁴ More in details, the rates were the following:

-45% in the case of certain types of profit and income, like profits made when a business is sold ;

-25% in the case of income from a substantial interest in a company;

-20% in the case of profits deemed to be made on an entrepreneur's death;

-10% in the case of bonus shares obtained when an officially quoted limited company issues new capital.

¹⁵ Actually, pension payouts are taxable, but pension contributions are deductible, and depending on the different tax rates, the return on pension savings is in fact subsidised through the tax system (Cnossen and Bovenberg, 2001).

- Importation of goods.

Several types of transactions are exempt from VAT, that means tax for the transactions should not be charged, and prepaid VAT cannot be deducted. Exemptions apply to transactions such as the transfer or rental of immovable property (with certain exceptions), certain supplies of services by banks, insurance companies, postal services and medical services, and the activities of youth organisations, sports clubs, non-profit-making institutions of a social or cultural nature, (most) education, composing and writing. Special arrangements are provided for sole traders and the agricultural sector.

The standard rate is 19 percent. A reduced rate of 6 percent applies to the supply, import and acquisition of goods and services mentioned in Annex 1 to the VAT Act. In general, it refers to goods and services that can be regarded as necessities (mainly foodstuffs and medicines). A rate of 0 percent applies to goods exported by an entrepreneur to non-EU countries.

3.5 Excise duties and other minor taxes

Excise duties are levied on the ultimate use or consumption of mineral oils, beer, wine, other alcoholic products and tobacco products. Like VAT, the duty is included in the price consumers pay for these goods, and the manufacturers and the wholesalers remit the tax. The largest contribution to the treasury comes from the excise duty levied on mineral oils (about 70 percent of revenues from excise duties and 6 percent of total tax revenues in the Netherlands).

Excise duty legislation in the Netherlands is fully in accordance with the EU Council Directives on harmonising excise duties in the internal market of the European Union. Since the EU excise duty system came into force in the Netherlands on 1 January 1993, indirect taxes on products other than mineral oil, tobacco and alcohol are admissible only insofar as they do not give rise to border formalities in trade between Member States. In this context, consumer taxes on non-alcoholic beverages, and tobacco products for non-smoking purposes still exist in the Netherlands.

Several taxes in the Netherlands are levied for environmental purposes, as last amended by the Law of 14 December 2000 on environmental taxes. The fuel tax is levied on mineral oils (together with excise duty), coal, and natural gas. Other taxes are charged on the extraction of fresh groundwater, on the supply of tap water, on the disposal of waste to establishments operating dumps and incinerators. The regulatory energy tax is levied on the consumption of natural gas, electricity and mineral oil products when used as substitutes for gas by domestic users or commercial establishments.

4. The fiscal burden

4.1 The distribution of taxation charge

A first idea about the distribution of taxation charge according to economic functions is given in table 5. The labour is the most heavily taxed factor and raises more than 50 percent of the total taxation. In particular, the charge to employed labour is very high, given the minimum burden on self-employed labour also showing a decreasing trend. On the contrary, taxation on capital shows an increasing trend, almost aligned with the European trend. However, it is composed primarily of non-allocable incomes and wealth, whereas the typical kind of capital, real and monetary, gives a small contribution to total taxes, particularly from the returns on monetary capital (only 0.5 percent of GDP). A peculiarity of the Netherlands system concerns the weight of environmental taxes, from which the Government raises almost 10 percent of its tax revenues. The level of pollution taxes (numerous special levies in connection with water pollution, waste disposal, and sewerage charges) constantly increases and it is the highest in the Union (almost 1 percent of GDP).

TAB. 5 *Structure of taxation according to the economic function as % of GDP*

	1970	1975	1980	1985	1990	1995	1997
<i>Consumption</i>	9,8	9,8	10,8	10,9	10,9	11,2	11,4
<i>Labour</i>	22,9	28,4	29,2	28,7	27,7	27,0	25,5
Employed	18,9	25,1	26,7	26,5	25,8	25,0	23,9
Self-employed	4,0	3,4	2,5	2,1	1,8	2,0	1,6
<i>Capital, of which</i>	4,7	5,3	5,9	5,9	6,6	7,0	8,8
Real estate & capital	0,8	0,8	1,3	1,4	1,5	1,9	2,1
Monetary capital	0,4	0,3	0,3	0,4	0,5	0,3	0,5
<i>Environment</i>	2,5	2,4	2,5	2,6	3,1	4,1	4,3
Energy	1,4	1,2	1,0	0,9	1,2	1,8	2,0
Transport	0,9	0,9	1,0	1,2	1,3	1,5	1,5
Pollution	0,2	0,3	0,5	0,5	0,6	0,8	0,8

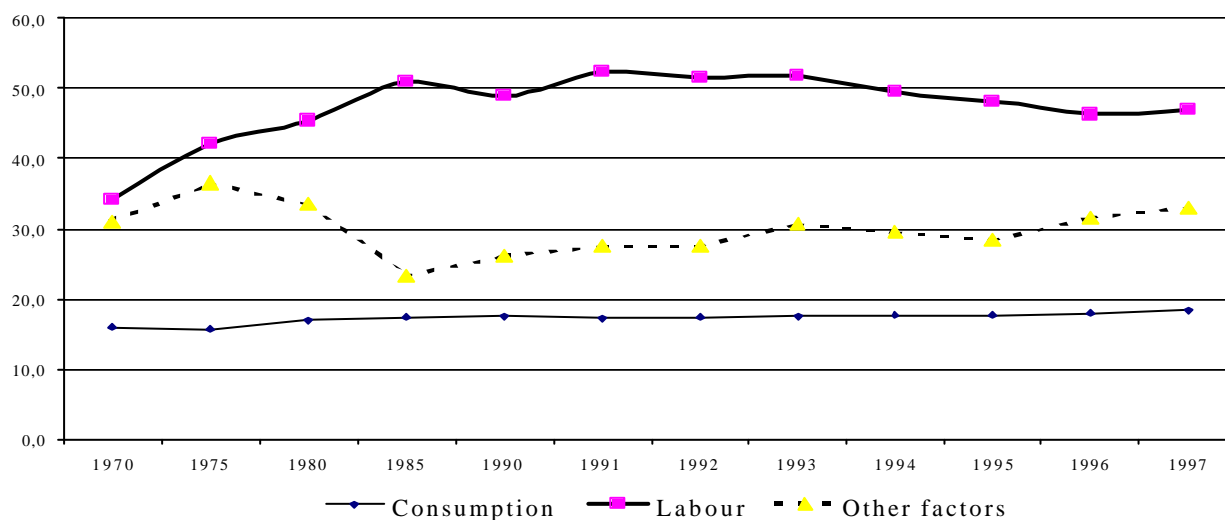
Source: Eurostat, 2000. 1997 is the most recent available data.

Implicit tax rates well summarise the data on distribution of fiscal burden among factors, permitting a wider analysis and comparison with the international trends. The trends of these indicators in the Netherlands from 1970 to 1997 are shown in Fig. 1: they relate to labour, consumption, and other factors (i.e. gross operating surplus).

The implicit tax rate on employed labour has always been the highest one and it grew significantly during the 1970s, as a consequence of the marked increases in social contributions. It reached 50.9 percent in 1985 and then remained more or less constant until 1993. In 1993, when direct taxes began to decrease, it started to slow down and in 1997 the level of the labour implicit tax rate was 46.9 percent. If one compares this indicator with the European average, it can be argued that the level of taxation on labour in the Netherlands has always been higher than the European average. However, the difference between the Netherlands and the middle range of the other countries was significantly reduced in recent years, falling from 12 percent in 1993 to only 5 percent in 1997.

Regarding consumption, the implicit tax rate has shown a moderate upward trend, increasing by two percentage points. This increase does not correspond to the trend of the other European countries. As a consequence, while in 1970 the implicit tax rate in the Netherlands was only a bit higher than the European mean (16.1 against 15.2), in 1997 the gap reached almost 4 percentage points (18.2 against 14.5).

Fig. 1 Implicit Tax rates



The average level of the implicit tax rate of the other factors of production, taxation on capital and self-employed labour, was around 31 percent in 1970, a level higher than the European average. However, after reaching a peak in 1975, it started to go down, following reduction in corporation tax revenues and showing a trend seemingly opposite to the other European countries. From 1985, when the level was at 23.4 percent, the trend was reverted and started to increase up to 33 percent in 1997, but it is still 5 percentage points lower than the middle range of other European countries.

Another important feature of a fiscal system concerns the goal of reducing inequality among people. This is mainly pursued through the PIT. The redistributive effects of PIT in the Netherlands, estimated as the difference between the Gini index on gross and net incomes, was 3.3 percent in 1992. This is the data shown in a comparative analysis of twelve Oecd countries (Wagstaff and others, 1999), and it is in line with the other analysed countries. This value can be decomposed between the effect of average rate (15 percent) and that of progressivity (Kakwani index equal to 19.8 percent): both the values put the Netherlands in a middle position.

Since the weight of revenues from PIT on the total fiscal revenues significantly decreased from 1992 up to now¹⁶, it may be argued that a recalculation of the redistributive effects with recent data should give a lower result. It is however more difficult to make conjectures about the progressivity index. Even if the maximum rate was reduced from 60 percent to 52 percent, the present PIT has one more bracket, and taxation burden on the poorest incomes has been lowered. Moreover, an accurate evaluation of the redistributive effects should also take into account social security contributions and the whole fiscal system.

With the new Income Tax Act, the Netherlands follows the international trend to create a system with a broader base and lower rates. However, an interesting simulation for the Netherlands (Caminada and Goudswaard, 2001) shows that a flat rate individual income tax has a low impact on the redistributive effects as overall tax progressivity is mainly caused by the fixed personal exemption.

4.2 Tax wedges on labour and corporate taxation

Joumard (2001) provides an estimation of the average tax wedge on labour for the year 2000. In the Netherlands the level is around 45 percent, aligned with the European mean. It is characterised by low impact of the personal income tax, whereas the employee's social security contributions play a fundamental role. The indicator slightly decreased during the last ten years, and it should be expected to drop further due to the recent reduction of social contributions and the shift from direct to indirect taxation. The marginal tax wedge is one of the highest in the union (near 60 percent) and despite progressively nominal income tax schedules; the marginal wedge is very high even at the lower end of the wage scale. This is one of the reasons why the Netherlands traditionally shows a low participation rate, though in the 1980-90s, there was a great increase in the number of persons employed and in the total hours worked. In fact, employment (in person) grew at an annual rate of 1.4 percent, especially thanks to a rapid population growth and the gradual catching up of low female labour-force participation rate to the European average. However the boom of these years is

ahead, and, as underlined by OECD (Economic Survey of Netherlands, 2002), improving the functioning of the labour market should remain a high short and medium term priority. In this respect the large pool of “inactives”, i.e. working-age benefit recipients not seeking a job, remains a weak point of the Netherlands economy.

Moving to the tax wedge in corporate taxation, the “all-in” statutory rate on corporations is at 35 percent, and it corresponds to the corporate income tax rate¹⁷, as there are no surcharges and no other taxes are imposed on corporate profits. However, to have a more precise assessment of the tax burden charged on corporations, effective rates should be analysed. Joumard (2001) reports an estimate of the “backward looking” effective rate of corporate taxation, which takes into account the allowances granted from fiscal legislation. However, the average level, from only 1990 to 1996, in the Netherlands was a few points under the statutory rate (31.80 percent).

The “forward looking” approach considers *ex ante* a hypothetical investment project and it is based on the calculation of the EMTR (for the marginal project) and the EATR (effective average tax rate). According to the calculation in Giannini and Maggiulli (2001), in 1999 both marginal and average effective tax rate were at the same level of statutory rate in the case of equity finance (not distinguished between new equity and retained earnings). This is not a surprise, considering the legislative framework where no depreciation is allowed for financial assets, dividends are not deductible and there are no specific allowances for retained earnings. The picture is different when one considers the case of debt finance. In this case, due to the deductibility of interests from the tax base, the EMTR turns out to be a negative result (as in most European countries) and the EATR is just above 20 percent. These results are similar to those shown in the work of Baker and McKenzie (1999), that estimate the weighted average EMTR at the level of 23 percent. The authors also provide an estimate of the impact of the investment incentives (accelerated depreciation), which reduced the EMTR by about five percentage points.

In the same work analysis is not only carried out at corporate level, but also takes into account taxation at the level of shareholders. In this case, the weighted average EMTR comes up to 57 percent, and shows the advantage of financing the activity with retained earnings with respect to the other sources of financing. It must be considered that the Dutch tax system provides an example of the “classical system”, under which distributed profits are taxed separately at corporation level (under the corporation tax) and at shareholder level (under the income tax). Until the recent reform, carried in the new Income Tax Act of 2001, the statutory combined corporate and personal income tax wedge on distributed profits for resident top earner individuals was at 74 percent, the highest

¹⁶ As we saw in Section 2, revenues from PIT represent now less than 15% of total fiscal revenues. They were 11.5% of GDP in 1992, whereas they were less than 7% in 2000.

¹⁷ Since 2000, profits up to € 22,686 are taxed at a lower rate of 30%.

level in the OECD, as shown in Joumard (2001)¹⁸. After the reform, the classical system is maintained, but capital personal income is now taxed at lower proportional rates¹⁹.

Neutrality considerations and the effect of the new capital income tax are analysed by Cnossen and Bovenberg (2001). The previous income tax regime encouraged publicly held corporations to finance their investments through profit retention rather than debt. Now the high personal income tax rate on actual nominal interest income is replaced by a low 30 percent rate on a presumptive return of only 4 percent. The calculation shown in Cnossen and Bovenberg (2001) confirms that the presumptive capital income tax has reversed the privileged position of retained profits versus debt. Another interesting consideration concerns the comparison between retained profits and new shares. While the old regime favoured financing through retained profits²⁰, the presumptive capital income tax does not depend on the form in which the return on equity is enjoyed (dividend or capital gain), and so the decision to distribute profits is no longer being distorted.

4.3 Taxation by levels of government and fiscal federalism

The Netherlands has no strong intermediate levels of government and a small share of total fiscal revenues are collected by Local government (1.9 percent of GDP in 1999 according to Eurostat, 1.4 according to OECD). However this share is not insignificant, especially if one considers that it has constantly increased over the years (it was just one third in 1970). According to the OECD classification, in the Netherlands there are two main sources of finance for Local government: taxes on property and taxes on use of goods, or on permission to use goods or perform activities.

Property taxes are the most important revenue source for the municipalities and raise more than 60 percent of local revenues. The tax is paid by both users and owners on the market value of that property and municipalities are free to establish the tax rates. Allures and others (2001) carried out a study about the partisan influence on local tax burden. Using data regarding Dutch local property taxes in 1996, they show that municipalities with a council dominated by left wing parties have a higher tax burden, whereas larger coalitions have lower levels of taxation.

However the most dynamic source of financing seems to rely on the taxes on use (these revenues recently increased to 0.5 percent of GDP in 1999), which consist mainly of environmental taxes and other levies connected with road and parking utilisation. The increasing attention given to

¹⁸ The top rate of income tax was at 60 percent, so the calculation is as follows: $35\% + 60\% (100-35)$.

¹⁹ For dividends from participation of at least 5% (substantial interest) the rate has not changed, as they were already taxed at the rate of 25%, and the calculation is as follows: $35\% + 25\% (100-35) = 51,25\%$. The other dividends and capital gains are taxed at 30% on a presumptive base. See section 3.3 for more details.

²⁰ The net dividend that shareholders forego, considering the high personal income tax rate to pay, was lower than the cost of new equity.

upgrading the quality of the physical environment and to the protection of some resources like water can represent a great opportunity for the financing of local bodies.

4.4 A comparative view with the European average

The indicators of fiscal burden provide a picture of the features of the Netherlands taxation system, compared to the EU average.

First, all indicators reveal that labour, and in particular employed labour, is heavily taxed if compared to the other European (and also non European) systems. As seen in section 4.1, in 1997 the implicit tax rate was still 5 percentage points higher than the European average, even if it has slowed down in recent years. Tax wedge on labour (in particular the marginal one) is higher than the mean, mainly because of the high level of employee's social contributions. The major consequence is relatively low participation rates and working hours, though the unemployment rate is one of the lowest in the Union. A peculiarity of the Dutch system, however, relates to the self-employed, that are charged a relatively low share of taxes (1.6 percent of GDP, with respect to the EU average of 2.3 percent, with an opposite trend during the years in the Netherlands and in Europe).

The taxation on consumption shows a slight but constantly increasing trend and its implicit tax rate is now almost 4 percentage points above the European average. This data reflects the trend in indirect taxation, whose returns now exceed those from direct taxation. The further shift from direct taxes and social contributions to indirect taxation involved by the 2001 reform should result in a further increase of taxation on consumption, whereas it should keep the taxation on labour near (or under) the European average.

Perhaps the most important difference between the Netherlands and the other European countries depends upon the taxation of capital. The implicit tax rate is 5 percentage points lower than the average and taxation at the level of corporation is one of the lowest in the Union. However it should also be remembered that the Dutch is a classical system, and so the distributed profits are taxed twice. The new Income Tax Act of 2001 also involves the introduction of a presumptive capital income tax, which is unique in the industrialised world.

As concerns the redistributive impact of income tax (and of the whole fiscal system), the available data put the Dutch system in a middle range position among European countries. Nevertheless, the data refers to the early 1990s, and as we have seen, in the last ten years fundamental changes have occurred in the system, first of all PIT now provides a lower share of Government revenues, one of the lowest in the Union.

5. Tax reforms in the '90s and those currently planned

5.1 A quick glance at the budget and the general economic environment

After the 1993 recession, the Dutch macroeconomic performance was buoyant, and real GDP grew by at least 3 percent each year since 1995 (with a peak of 4.3 percent in 1998). 2000 was no exception to this trend since growth reached 3.5 percent, supported by buoyant private consumption and, in contrast with 1999, by exports that also proved extremely dynamic.

Private consumption was probably the main engine of growth in the Dutch economy and it was first fuelled by the rapid increase in employment. Employment increased by about 2.5 percent a year in the period 1995-2000, whereas unemployment continued to fall, albeit at an increasingly slower pace, from 6.8 percent in 1994 to 2.8 in 2000 and 2.4 in 2001. Private consumption was also boosted by the tax cuts operated in recent years and by accelerating wage increases (in particular from 1997) which probably brought fifteen years of wage moderation to an end²¹.

The Government sector fully benefited from the positive economic trend. In 2000, revenue exceeded expenditure generating a surplus of 2.2 percent of the GDP²². The Government debt ratio fell by more than 7 percentage points of GDP in 2000, decreasing from 63.1 percent in 1999 to 56 percent. It is expected to fall below 50 percent in 2002, with a further reduction of the expenditure for interests. This context allows a substantial reduction of the tax burden without the necessity of cutting the primary expenditure. In fact, the wide-ranging fiscal reform which entered into force on 1 January 2001 is leading to a significant decrease in revenues from income tax and social security contributions that is only partly offset by the increase in indirect taxes, such as VAT and environmental levies. Accordingly, the general government surplus should decline and vanish in 2002 (European Commission, economic forecasts, spring 2002).

However the peak of the growth cycle is now clearly behind. Investment proved less dynamic than expected and seemed to remain stagnant in the 3rd and 4th quarters of 2000. While GDP growth exceeded 4 percent in annual terms in the first half of 2000, it slowed to about 3 percent in the second, and according to preliminary estimates, it fell down to 1.1 percent in 2001. Exports felt the effects of the slowdown in international trade and the impact of the deterioration of competitiveness in recent years, no longer compensated by the depreciation of the Euro. The slowing down of GDP growth is due to the crisis of investments but also to a deceleration of private consumption.

Forecasts for 2002 and 2003 indicate a slight recovery, with the GDP growing by 1.5 percent and 2.7 percent respectively. The main engine of growth in the Dutch economy will probably

²¹ This increase partly reflected the labour productivity growth but it somewhat arose the real unit labour cost, affecting the competitiveness of the Dutch economy.

²² The primary surplus was 6.1 percent of GDP (3.9% was the expenditure for interests).

remain private consumption, boosted by a very solid increase in households disposable income (about 10 percent in nominal terms and 6 percent in real terms) amplified by the effects produced by reduction in Income taxes and social security contributions implemented at the beginning of 2001. However, the unemployment rate, now certainly close to a frictional level, should invert the tendency and slightly increase (up to 3.5 percent in 2003). Nevertheless, higher employment is expected to result essentially from a higher activity rate, which, despite climbing significantly in recent years, is still relatively low in international terms.

It can be argued that the recovery of the Dutch economy will also depend upon the positive effects on private activity expected from the new tax system. In the meantime, the economic environment will have an influence on the level of tax revenues and consequently on the Government surplus or deficit. The situation of the Government sector, which in the past has allowed a policy of reduction of the tax burden, will represent either an opportunity or a constraint in the deciding of future tax policies.

5.2 Tax reforms in the '90s

As already seen, in early 1990s the tax burden in the Netherlands was one of the highest in the Union. Now the situation has changed, due to a series of reforms, which involve substantial tax reduction, permitted by a favourable economic environment. In this paragraph we will try to summarise the main changes of the structure of the Dutch fiscal system.

A first fundamental characteristic concerns the social security model. As noted by Bolkenstein (2000) in the early 1990s the Dutch model (or the so-called Polder model) clearly fitted like a variant of the Rhineland model, a regulated market economy with a comprehensive system of social security and with harmonious relations between social partners²³. The symbol of such a system was probably the wage moderation facilitated by the so-called Wassenaar agreement between employers and the union in 1982. However, at a certain point the Dutch came to the conclusion that their initially strongly centralised model resulted in slow adaptation and low flexibility. That was the time of the Dutch recession in the early 90s. Therefore, the model was adjusted: there is currently less emphasis on consensus building and much more on the achievement of concrete policy goals. From the 1990s up to now, some distinctive features implied a certain convergence towards the Anglo-Saxon Model²⁴. The most important reforms focused on the disability insurance and on sickness benefits.

²³ Generally speaking, in such a system, the participants in the economic process try to achieve a harmony of interests pursuing a sustainable, stable and continuous economic growth and a high level of employment.

²⁴ Bolkenstein (2000) also underlines that many measures were taken without a harmonious agreement between the different social parts (in contrast with the Rhineland model). For example, one should remember the reduction of the tax

The level of social protection benefits was very generous, and the lack of incentives for the low-skilled workers to take a job is evident when one considers that in 1995 there were 82 social security beneficiaries for each 100 active persons²⁵. Officially 13 percent of the working population was disabled and this number is obviously too high, making the Netherlands the unhealthiest place in north-western Europe, whilst having the highest life expectancy²⁶. Bovenberg (2000) distinguishes in the welfare state reform two combined strategies:

- The first aimed at fighting moral hazard through a more efficient administration of social benefits, preserving as much as possible the European legacy of solidarity.
- The second, which can be identified with the Anglo-Saxon approach, focused on reducing the level of public insurance and widening the income gap between the working and non-working.

The goal of the progressive reforms made in the 90s is certainly to increase the activity rate of the population, reducing benefits and tightening the criteria for eligibility. In this sense there is also a reduction of social security contributions for workers aged above 65. The privatisation of the sickness insurance contributed to a marked reduction in the problem of sickness absenteeism. The health system has been involved in reforms since 1988, and the goal, not yet achieved, is a universal compulsory insurance within a regulated competition framework (Mapelli, 2000).

The stimulation of employment opportunity and the reduction of the tax burden on labour have clearly been pursued during the last 10 years, not only through the reduction of social security contributions. From 1993 direct taxation has been progressively shifted towards the indirect taxation. Tax rates on personal income have been reduced. With the new Income Tax Act introduced since January 2001, the top rate is now at 52 percent, against the previous 60 percent; the intermediate rate slowed down from 50 to 42 percent; the lower rate from 33.9 to 32.25 percent. The level of taxation is very low especially if one considers that at the lower bracket only 2.85 percent consists of taxes (before the reform it was 4.5 percent), while the remainder are social contributions. With the new tax rates, all across the board from high to a very low income, net income after tax increases by 2.1 percent up to 9.7 percent (Meussen, 2000). Moreover, the reform introduced an employment tax credit to employees and the self-employed of up to 920 Euro, and the minimum level of exempted income was increased. The tax burden has been partially shifted towards consumption, with the increase of the standard VAT rate from 17.5 to 19 percent, and with

burden, the policy to stop matching any increase in wages with an equal increase in minimum social benefits, the decentralisation of collective bargaining agreements, the privatisation of health insurance and the reduction of benefits for the disabled.

²⁵ Source: CPB (1998).

²⁶ This data can be explained by many features that made the Dutch system of disability insurance unique. For example, only the degree of disablement was relevant and not its origin, whereas in other OECD countries less generous benefits are provided if the impairment is not job related. Another peculiarity was that those persons who were only partly disabled were entitled to full disability benefits if the labour-market situation did not allow them to find a job.

a progressively increasing relevance of the environmental levies. The Netherlands is clearly devoted to promoting sustainable economic development (“greening”) and they are one of the most advanced countries in promoting such a policy within the European Union.

A peculiarity of the tax system concerns the taxation of the financial activities (see also section 3.3) that are taxed in Box II and III of the PIT. The tax treatment of profits from substantial business interests changed dramatically with effect from 1 January 1997. As of this date, not only capital gains on shares belonging to a substantial interest are characterised as profits from substantial business interests (gains on disposal), but also the regular income, such as dividend income. The tax rate was raised from 20 to 25 percent, in order to fight the phenomenon of the closely-held corporation set up to avoid the high personal income tax rates²⁷. Moreover, a fictitious wage was imputed to manager-shareholders that could previously transform their labour income into capital income without limit. Under the Income Tax Act 2001, this system has been largely left intact in Box II²⁸.

The most important change concerns the tax levied on income from savings and investments. Under previous legislation, income actually received in a year, such as rental income, dividends from listed shares, interest on savings accounts, etc., were taxed at progressive rates and capital gains were not taxed. Instead, from January 2001 a fixed assumed yield of 4 percent is calculated each year on the value of assets held. This income is taxed at a flat rate of 30 percent. It is clear that if the effective return exceeds the assumed 4 percent yield, the excess is not taxed at all. As a consequence, in Corporation Income Tax Act it has been implemented a 20 percent CT surcharge on certain excessive dividends distributed during the period from 2001 through 2005. Another important feature of the new tax system regards the Dutch real estate owned by foreign entities, which will always be considered to be a permanent establishment and so the related capital gains will be subject to tax.

The presumptive capital income tax has several implications in terms of neutrality considerations of investment choices (Cnossen and Bovenberg, 2001):

- It reverses the privileged position of retained profits versus debt, the latter becoming a more attractive source of finance
- It raises the costs of equity finance in owner-occupied housing and proprietorships, and worsens the discrimination of equity with respect to debt, because the tax on equity income at the corporate level is no longer offset by the exemption of capital gains at the personal level;

²⁷ In fact business form was greatly favoured over proprietorship, because current profits were taxed at the corporation tax rate of 35 percent, while deferred profit distributions attracted 20 percent tax, instead of progressive income tax-rate.

²⁸ The original proposals included an increase of the tax rate for substantial business interests to 30 percent, but at the end the tax rate has been maintained at 25 percent

- It eliminates the distortion in the choice between financing with retained profits and new shares. Issuing new shares is no longer less attractive and this should shift equity capital from mature corporations, which generate retained profits, to new growing corporations, which have to rely on the external capital market to attract equity.

However, though the tax incentive to borrow vanishes, tax arbitrage is still possible considering the different tax rates in the various boxes. By excluding owner-occupied housing, equity in closely held corporations and proprietorships and pension wealth, the presumptive capital income tax features only a relatively small base.

5.3 Tax reforms currently planned

Reforms caused substantial changes in the taxation structure. How does the Netherlands fit in the international scenario of reforms with respect to the suggestions of OECD and EU? When one considers the demand for harmonisation of fiscal systems within the European Union, it mainly concerns the field of indirect taxes, while there is a less pressing need in the domain of personal income tax and social contributions. In fact substantial differences in indirect taxation can create an immediate obstacle to the free movement of goods and the free supply of services within the internal market. Indeed, a significant degree of harmonisation in this direction has already taken place.

The most controversial problem seems to be the tax competition within companies and corporations, particularly the avoidance of harmful competition. The Netherlands has engaged in a fruitful dialogue with other member states resulting in the adjustment of its ruling practice to internationally accepted OECD standards. Tax reform 2001 may have an impact on the Netherlands' tax position on foreign companies (Van der Stok and Sunderman, 2001). Previously, foreign companies that held Dutch real estate that was no part of the assets of a business were taxed only on income derived from the real estate, while there were no taxes on capital gains realised. Now real estate held by foreign companies is deemed to form part of a Dutch business, and so it is subject to both income and capital gains tax in the Netherlands. However, the most fundamental change in the new Income Tax Act is probably the taxation of income from savings and investments (Box III). Especially in an international perspective, the taxation of an assumed investment yield is something of a curiosity, being unique in the industrialised world. In the Netherlands some scholars have argued that this takes the Netherlands, as far as taxation is concerned, back to a system familiar in the nineteenth century. On the other hand, although the Netherlands do not have a capital gains tax, some of the specific measures mean that many assets have been taken out of Box III and situated in Box I (making assets available), thus effectively leading to a partial introduction of a

capital gains tax (Meussen, 2001). However, the small tax base distorts economic choices and harms efforts to co-ordinate capital income taxes within the European Union. Cnossen and Bovenberg (2001) evaluate the alternatives to the presumptive capital income tax and they conclude that the effective and neutral taxation of capital income could best be ensured through a combination of the following:

- A mark-to-market tax on the returns from easy to value financial products (i.e. the base of taxation for these products should be the annual accretion of wealth measured in real terms);
- A capital gains tax on the returns from hard to value real estate and small business.

The current fiscal policy in the Netherlands is certainly coherent with the suggestion of shifting tax burden away from labour (both Joumard, 2001 and OECD, 2001). This policy has been pursued both reducing social contributions and increasing indirect taxes like VAT and environmental levies, and it is devoted to reduce the tax wedge and favour new opportunities of work. The main issue of reforming social security is still open, as the major remaining policy problems concern the low participation rates of older workers and of workers with few marketable skills. Benefit recipients still seem to have very limited access to work, and this is reflected in the high share of the long-term unemployed in overall unemployment. The official unemployment figure substantially underestimates the overall level of inactivity in the Netherlands, because of the high share of hidden unemployment. Despite progress over the recent years, more reforms remain necessary, as stressed in the Government agenda. More in detail, the 2002 tax plan includes five bills dealing with²⁹:

- Labour market and incomes policy;
- Economic infrastructure;
- Nature, environment and transport;
- Review of inheritance and gift tax, VAT measures, arrangements for artists and sportsmen, and other changes;
- Social security legislation.

The bills will result in a total tax cut of EUR 1.3 billion (around 0.3 percent of GDP), continuing the policy of reduction of total tax burden. A substantial proportion of this will be used to promote employment, and measures will also be taken to strengthen the economic structure and policy on nature, environment and transport. To tackle current labour market problems, the government will introduce a large number of tax measures to encourage job seekers and promote labour participation. These measures should also increase acceptance of taxes and social insurance contributions and reduce the number of people on benefit. To promote labour participation, the government will introduce a tax credit for certain benefit claimants who find work and other people

²⁹ Press release, 2001 (www.minfin.nl)

re-entering the labour market. The tax credit, a maximum of EUR 2,723, will be paid to taxpayers only once, over a period of three years. In certain conditions, it may be awarded to claimants who find work or to people who have had no income or a very low income for two calendar years. The government intends to grant the employers of people re-entering the labour market a reduction of EUR 700 in tax and social insurance remittances. It also wants to promote labour participation by keeping people in the labour market longer, and is planning to introduce a package of tax incentives for employees over the age of 58.

Tackling the poverty trap has been an essential part of government policy for some time. It is important to make paid work more attractive if the labour market is to function properly, as the poverty trap can deter people from seeking paid work. Proposals to further reduce the poverty trap include increasing the employed person's tax credit and increasing the child tax credit while abolishing child allowances under the Housing Benefit Act.

The government believes that company taxes need to be reduced to ensure that the Netherlands remain attractive to businesses. One proposal is to reduce corporation tax by 0.5 percentage points to 34.5 percent. This structural tax cut will give an extra boost to the business environment in the Netherlands. Though the suggestions of Oecd mainly concern the co-ordination in the base assessment of CT and not the tax rates, this proposal certainly remains in the field of fair tax competition.

The 2002 tax plan will continue with the "greening". Despite many years of environmental policies, many policy goals have still not been achieved. It appears that in formulating environmental policy goals, policymakers have paid insufficient attention to the issue of how to realise these goals having a tendency to be too optimistic about the effects of the adopted measures³⁰. However the proposals deal with the continuation of lowering and "greening" of vehicle taxes begun last year. Motor vehicle tax for cars that can use LPG will be reduced by 6.5 percent. In addition, excise duty on low-sulphur petrol and LPG will be temporarily reduced by 1.36 Euro cents as from 1 October. The government will also encourage people to buy fuel-efficient cars. Depending on how economical a car is, some of the motor vehicle tax paid by the buyer will be refunded.

Alongside marriage, other forms of cohabitation have become commonplace in recent decades. This makes it necessary to modernise inheritance and gift tax. The 2002 tax plan proposes a general exemption from inheritance and gift tax for partners; the definition of 'partner' will be broadened.

Changes to the VAT system are also proposed. For instance, VAT on domestic air tickets will be changed to the high rate and VAT for sports centres will be changed to the low rate.

³⁰ CPB (2001)

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