# Tax justice in Southeast Europe – How to reduce inequalities?

# Slovenia

## Perception of taxes

A study of tax perceptions and morale from 2014 (Čokelc and Križman, 2014) reveals that majority of the people (65.7%) feel disadvantaged by having to pay the tax because they do not receive sufficient benefits from the state in comparison with their tax burden. Less than one third (31.9%) feel that the relation of taxes paid and benefits received from the state is fair. Majority of the interviewees (78%) believes that non-payment of taxes is a criminal offense, while some people believe it to be only a morally reprehensible act or insignificant offense. The perception changes with the age and education. While among the elderly it is mostly perceived as a criminal offense, in the younger age group (up to 25 years) it is often described as morally wrong. The respondents with a university education perceive non-payment of taxes as a criminal offence, while respondents with primary education tend to perceive it as insignificant offense.

Among the reasons for having a negative attitude towards the payment of taxes, the respondents list the following (Čokelc and Križman, 2014): actions and examples of government, public officers and public servants, the inefficiency of the legal system and worsened financial situation of the individual. The reasons for the deterioration of the tax morale are: tax system, which favours politicians, political sympathizers, tycoons and rich; irresponsible handling of taxes and financing areas, which should not be financed and unjust taxation. The key elements of shaping a more positive tax attitude and increasing the tax morale are: improving the work of the courts, good fiscal control, tax system that dissimulates tax evasion, better satisfaction with government services and improved actions and behaviour of the government and public officials.

Tax morality tends to be higher among employed people and elderly, but it is also related to grey economy (the higher the grey economy, the lower the tax morale), the tax system (the more just the system, the higher the morale), the transparency of allocation of budgetary resources (the more transparent allocation, the higher the tax morale) and control (the greater the control of the tax authority, the higher the morale) (Čokelc and Križman, 2014). Filipovič (2009) shows that the social norms are also an important factor: the more they are functional (desired), the higher is the tax morale. If we want to improve the tax morale, we need to influence the social norms.

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According to Malogorski (2004), the Slovenian tax authority is believed to be an establishment with good reputation among the Slovenes. Public gives it an average mark of 3,4 out of 5. The public has positive attitude towards the data collection and processing of the tax authority, as well as towards the efficiency of tax collection and objectivity (does not orient according to opinions of political parties). On the other hand, the people are not happy with the organisation of work of the tax authority and there is a belief that tax authorities are not economising with taxpayers money properly. The businesses believe that the regulations are not interpreted the same for all the taxpayers (Malogorski, 2004).

The available studies are giving hardly any or no indication on how the taxes are perceived by business, as cost or redistribution. Filipovič (2009) explored individual entrepreneurs and found out that entrepreneurs do not perceive the tax system as fair and objective; hence, they are more prone to tax dodging. Hauptman (2014) studied the attitudes of students of business and discovered that they find tax evasion ethical under certain conditions and in certain circumstances. The most important reason for justifying tax evasion is the unfairness of the tax system. However, the available literature gives no more indications on how the companies perceive the taxes, and neither there is indication on whether the businesses should pay the same level of taxes (relatively speaking) as individuals.

## Outline of the tax system

### Regulative framework and types of taxes

The regulative framework for taxation in Slovenia consists of five sets of legal acts (Ministry of Finance, 2017a):

a) general acts: Law on Tax Procedure, Law on Financial Administration and Law on the approval of tax accounts;
b) acts on direct taxes, such as Law on Income Tax Act, Law on Corporate Income or Law on Social Security Contributions;
c) acts on indirect taxes, such as Law on Value Added Tax, Law on Excise Duties or Law on financial services;
d) acts on taxation of property, inheritances and gifts, such as Law on inheritance and gifts, The Law on Citizens' Taxes or Law on Tax on bank assets; and
e) customs regulations.

The tax system consists of three main categories of taxes (Ministry of Finance, 2015):

- Direct taxes on income: Corporate Income Tax, Tonnage Tax, Personal Income Tax, Derivative Instruments Gains Tax, Contractual Work Tax, Social Security Contributions, Taxation of Winnings from Conventional Games of Chance, Gambling Tax and Concession Fee, Tax on Profits Due to Changes in Land Use
- Direct taxes on property: Inheritance and Gift Tax, Real Estate Tax, Water Vessel Tax, Circulation Tax
- Indirect taxes: Value Added Tax, Excise Duties, Insurance Contracts Tax, Tax on Transfer of Immovable Property, Motor Vehicle Tax, Financial Services Tax, Tax on Lottery Tickets, Customs Duties

The Financial Administration of the Republic of Slovenia collects all taxes, including customs duties, excise duties and value added tax on imports.

- Key taxes (SBC, 2017):
  Corporate tax on revenue: 19% Flat tax
- Tax relief: 100% for R&D investments; up to 40% for investments in equipment and long term

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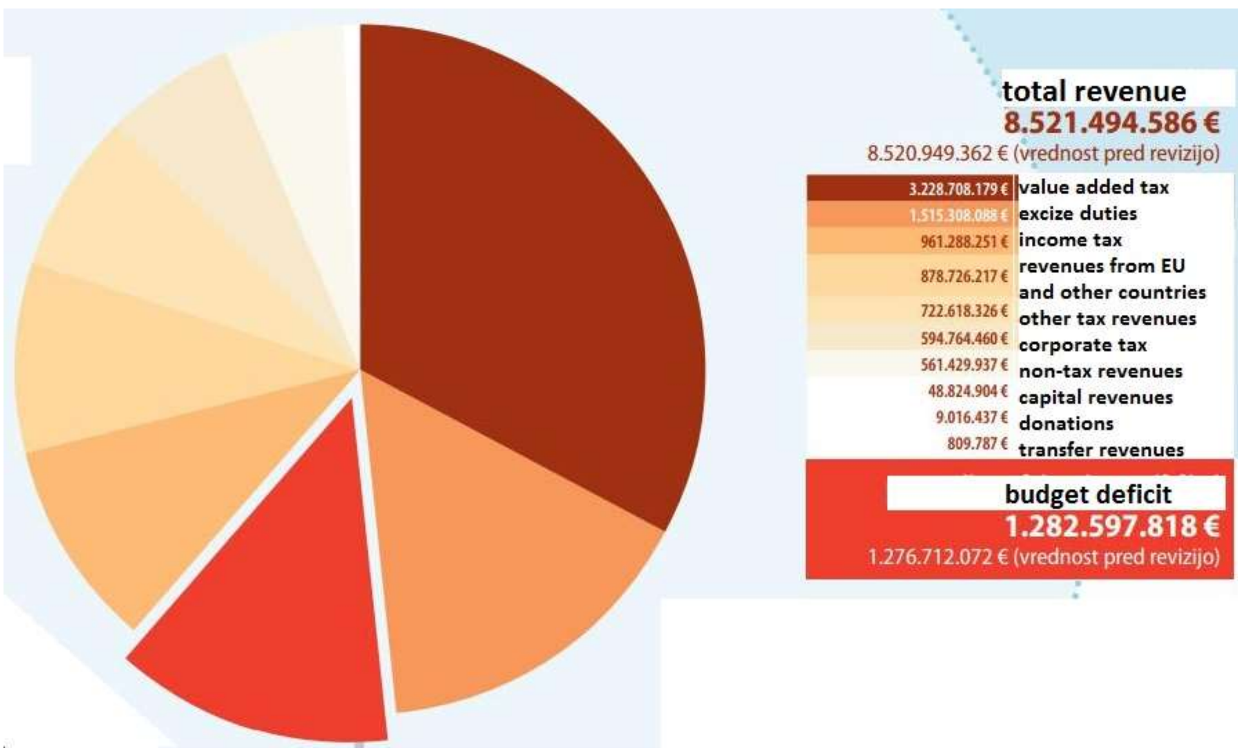
intangible assets

- Profit distribution: 0% on dividends paid to partners from EU Member States; 15% for other countries (depending on bilateral agreements)
- Tax on property income: 0 - 25% (depending on duration of possession)
- Value Added Tax: 22% – standard rate; 9.5% – reduced rate
- Wealth tax: 0%
- Tax on real estate sales: 2%
- Social contributions: 16.1% borne by the employer; 22.1% a borne by the employee
- Tax on salaries: Abolished in 2009
- Income tax for natural persons: Progressive tax: 16%, 27%, 34%, 39% and 50 %
- Tax deductions and reliefs: Corporate costs can be deducted up to 100%. The Slovenian Government offers tax relief and funding for businesses that create jobs.

### The structure of budget revenues and costs




Source: Court of Audit, 2016.

In comparison with the OECD countries, Slovenia shows several specifics in tax revenues (OECD, 2016):

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- substantially higher revenues from taxes on social security contributions,
- higher revenues from value added taxes,
- lower proportion of revenues from taxes on personal income, profits and gains; corporate income and gains and property.

Mencinger (2011) points out a few more specifics of Slovenia, as compared to the EU countries:

- share of indirect taxes is slightly higher in Slovenia than in the EU
- the share of direct taxes is lagging considerably behind the EU average, which speaks in favour of increasing the progressivity and raising the tax rate on profits
- in terms of contributions for social security, Slovenia is among the countries with the highest shares
- there is above-average expenditure for "good" activities (education, recreation, culture, health and social security) and below-average expenditure for "bad" activities (state administration, army, police and intervention in the economy).

Further specifics are pointed out in the Runaway taxes report (Za Zemiata et al, 2017):

- tax cuts on corporates and higher earners appear to simply shift the tax burden onto ordinary citizens
- there is a disproportionately large tax burden on goods and services when compared with the OECD average
- amount of corporate taxes as a percentage of GDP is considerably lower than the OECD average
- income taxes on individuals contribute more to the government's total tax take than taxes on corporate profits, so the businesses contribute less in taxes as a proportion of the total tax revenues of the government than the OECD average
- to compensate, much more tax revenues come from taxes on consumers, such as VAT, sales taxes and excise duties; the amount of tax revenue comprised of these taxes on consumption is higher than the OECD average

As it is visible from the table 1 below, the pensions and interest on public debt represent two large items on the cost side of the budget. The next key items are primary rail infrastructure, education costs, family transfers and road infrastructure.

Table 1: Budgetary costs 2015*

| | |
|---|---|
| Total | 9.804.092.404 |
| Ministry of finance | 3.256.394.886 |
| Pensions | 1.465.437.011 |
| Interest on public debt | 1.028.836.841 |
| Ministry of education, science and sport | 1.622.823.724 |
| Primary education | 718.639.325 |
| Higher education | 308.363.909 |
| General and vocational high schools | 284.012.593 |

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| | |
|---|---|
| Ministry of labour, family, social affairs and equal opportunities | 1.400.772.798 |
| Family transfers | 556.720.901 |
| Social support | 302.362.982 |
| Unemployment support | 201.529.782 |
| Ministry of infrastructure | 930.150.968 |
| Rail infrastructure | 719.284.601 |
| Road infrastructure | 513.818.663 |
| Ministry of environment and spacial planning | 493.467.135 |
| Water management | 260.786.681 |
| Ministry of agriculture, forestry and food | 398.098.930 |
| Agriculture - Measures for stabilisation of markets | 163.650.993 |
| Agriculture - Measures for development of the country side | 147.446.571 |
| Ministry of defence | 343.938.756 |
| General staff of the Slovene armed forces | 263.228.803 |
| Ministry of interior affairs | 316.775.613 |
| Police | 294.200.513 |
| Ministry of economic development and technology | 199.523.608 |
| Local development infrastructure | 43.437.769 |
| Ministry of culture | 159.440.307 |
| Programs for culture and media | 81.516.556 |
| Ministry of health | 103.022.199 |
| Secondary and tertiary health care | 59.762.249 |

* Please note that the key budget users and their key costs are presented to simplify the overview of the budgetary costs.

Source: Court of Audit, 2016

### Key challenges of the tax system

OECD (2014) lists several key challenges of the Slovene tax system. The first is to reduce tax rates on labour income. This should be done in a revenue-neutral manner and tax expenditures should be limited to off-set the reductions in labour income taxes. Slovenia could also consider shifting from flat-rate taxation of personal capital income to modestly progressive rates. The use of reduced VAT rates should be reconsidered, while at the same time investing to improve compliance and guard against fraud in VAT payment. OECD also recommends increasing tax rates on immovable property. Its tax revenues from taxes on property in 2012 were a mere 0.6% of GDP, one third of the OECD average. The statutory corporate income tax rate in Sloveniain 2014 was 17%, which was the second lowest in the OECD. Further cuts of this rate were planned, but further cuts would bring diminishing returns[1]. Challenge is to ensure that the tax base is sufficiently broad and neutral, while Slovenia should evaluate the success of targeted corporate income tax incentives. Slovenia should also consider aligning tax rates on different forms of energy as the current tax rates vary substantially across different forms of energy.

[1] In 2017 the rate was increased to 19% to off-set the change in personal income tax rates.

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Within Slovenia, a somewhat different set of challenges in the tax system is exposed. Božič (2017) highlights the need to improve the collection of taxes. To this end it is important to connect the different data sets and make them compatible. Another highlight is that the tax system needs to be de-bureaucratised. Prof. Škof (in Morozov, 2015) highlights the challenge of increasing the tax morale in Slovenia. People need to link the tax collection with the provision of services. This would lead to reducing the extent of grey economy, which is a long-term challenge. Another major challenge is the manner of reforming Slovene regulative framework for taxes: instead of solving problems one at the time, the regulatory framework needs a more comprehensive approach to reforms. In such manner, effects can be harnesses in the long-run.

In its analysis, OECD (2014) highlights several other public finance challenges that are relevant for Slovenia: the need for comprehensive pension system reform and reform of health care. Due to the ageing of Slovenia's population, the pension and health care costs are likely to significantly increase, posing a threat to the sustainability of public finance. OCED's Secretary General advises the Slovenian government to trigger a wide public debate on this important inter-generational question (Krebelj, 2015).

## Tax dodging

### Presence of tax dodging in Slovenia

Slovenia is a relatively small fish in the game of tax dodging, but it is not immune to the attempts of engaging in the game (Eurodad, 2015). Publicly available information shows that there is a number of Slovenian citizens involved in tax evasion through tax havens, which is damaging mostly for Slovenia. Inquiries about corporate tax dodging are so far either very rare or not available at all. Although there are companies operating in Slovenia or Slovenian companies mentioned in tax dodging scandals (LuxLeaks and Panama papers), there is no systematic study of affects for the Slovene budget.

Due to non-exploration of the issue, estimates of the extent of tax dodging in Slovenia are highly variable. Some estimates suggest about €50-75 billion being lost from Slovenia to tax havens (Kocbek, 2014), although they are described as exaggerated by the vice-governor of the Bank of Slovenia (Banjanac Lubej, 2014). The study of Global Financial Integrity from 2011 (Kar and Curcio, 2011) gives an estimate of 4.494 million USD (conservative estimate) to 5.834 million USD (high-end estimate) being lost due to tax dodging in Slovenia in the period 2000-2008.

Slovene Ministry of Finance or any other public office does not systematically assess the extent of tax dodging. The so called VAT gap is, however, one of the fields where estimates are done systematically. Here the estimates differ depending on the source, but tend to be less varied than the estimates of the total tax gap due to tax dodging. EU's VAT gap report estimates that the 2014 gap was about 280 million EUR (Taxud, 2015), whereas latest estimates show a VAT gap of about 8% or 430 million EUR in 2016 (Božič, 2017).

Further exploration of the amount of taxes lost to the Slovene budget due to tax dodging would be needed in order to get a clearer picture. International analyses show that tax dodging benefits multinational corporations (MNCs) disproportionately in comparison with small- and medium-sized enterprises (SMEs) (Eurodad, 2015). Use of assertive tax planning methods causes concern that the tax burden is not equally carried by the MNCs and SMEs. The former can benefit from aggressive tax planning through many jurisdictions, whereas the later cannot compete with such practices (Eurodad, 2013). Slovenia has recently (as of 1 January 2017) enabled conclusion of advance pricing agreements (Božič, 2017), one of the tools that can be used for aggressive tax planning (ATP). A study of EU member states from the perspective of ATP (European Commission, 2015) shows that Slovenia does not directly promote or prompt ATP structures, but it does show gaps because of lacking of rules aimed at counteracting the avoidance of tax. For example, Slovenia applies no test of beneficial ownership to exemptions or reductions of the withholding tax. Although the provision exists

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in the legislation, it is not being applied in practice. Tax deduction of interest does not link to the tax treatment in the creditor state and tax can be deducted for intra-group interest costs and royalty costs, which opens a possibility for ATP. Slovenia has no rules on controlled foreign corporations, although those can be effective tools for countering ATP. Also no general anti-avoidance rule can be identified. In spite of not actively opening possibility for ATP, Slovenia's regulations are not effectively blocking it either.

### Measures against tax dodging

In spite of not being tax-dodging proof, Slovenia has recently adopted some measures to prevent tax dodging.

Slovenia was among the first 31 countries to sign tax co-operation agreement enabling automatic sharing of country-by-country information (Ministry of Finance, 2016a). With the amendments of the Tax Procedure Act, which has been published in the Official Gazette on 5 October 2016, a country by country reporting obligation has now been implemented into the Slovene legislation and is in use as of January 2017 onwards (PWC, 2017).

The Slovene Law on Corporate Income has been amended to prevent abuse on the taxation of the hybrid financial mechanism ('hybrid loans') and from 2016 onwards, Slovenia has implemented an obligation for taxable persons to report cash turnover only through specific electronic cash registers ('tax cash registers'), providing for traceability of any modifications made and thus enabling a proper audit trail (PWC, 2016). The special zero tax rate for venture capital companies is abolished and recognition of expenses from depreciation of goodwill is no longer allowed (PWC, 2017).

Change of Law on prevention of money laundering increased the powers of the Office for Money Laundering Prevention, demanding that it collects and publishes information on all transfers exceeding the amount of 30,000 euros, which were carried out by Slovenian banks in the country or on behalf of individuals and legal entities domiciled in countries, where likelihood of money laundering or terrorist financing exists. The banks are also obliged to collect information regarding the beneficial owners and keep a record of that. A similar demand was introduced also by a change in the Law on integrity and prevention of corruption. According to this Act any public authority that wishes to make a contract with a value in excess of $ 10,000, must, before signing of the contract, obtain a statement of company's ownership structure (Eurodad, 2013).

## Tax competition / Race to the bottom

### Slovenia's race to the bottom

More and more countries are lowering corporate tax rates or giving tax incentives, both meaning attractive ways of avoiding taxes for companies. It is a race to the bottom, which opens a question for whom such race is beneficial. Also Slovenia hopes to attract foreign direct investments (FDI) in such manner.

Slovenian tax system offers a variety of tax reliefs (eVEM, 2017): investment in R&D (internal R&D activities, including the purchase of R&D equipment or R&D services); investment in equipment and intangible assets; employment; voluntary supplementary pension insurance; donations; and employment and investing in specific regions. When it comes to tax reliefs for R&D investments, the tax basis can be reduced by up to 100% of the investment. Unused relief can be transferred for 5 years. Relief for investments in R&D cannot be combined with tax reduction due to other investments. Relief for investment can reduce the tax basis by up to 40% of the invested amount, but not more than the tax basis itself. Also here the relief can be transferred for 5 years.

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Slovenia is using the lowering of the corporate income tax rate as one of the tools to attract business. In 2006, the corporate income tax rate amounted to 25% and then gradually declined to reach 17% in 2014. Such rate was significantly below the EU average, where the average tax rate at that time was almost 23% (Eurodad, 2015). In spite of the corporate tax rate being increased from 17% to 19% from 1 January 2017 onwards, this rate remains far from the average rate in the EU (PWC, 2017).

Slovenia has one free customs zone in port of Koper, where subjects operating in the zone are not liable for payment of customs duties, nor are they subject to other trade policy measures until goods are released into free circulation (Export, 2016). Slovenia also offers land sites designed for greenfield investments that have direct access to well-developed infrastructure, including highways and rail service. Municipalities and the state often subsidize infrastructure and land costs as incentives to increase employment opportunities (Export, 2016).

The total amount of various incentives (including incentives for families, employment, investments...), subsidies and support is estimated to be at the level of 1.5 billion EUR per year (Božič, 2017). In 2015, 15.794.379 EUR were spent from the state budget on stimulating foreign investments and openness of the economy (Court of Audit, 2016).

## Effects of the race to bottom

The effects of the incentives are to some extent studied, but the studies are not public (Božič, 2017). The assessment of the effects can differ: while the Chamber of commerce perceives very positive effects of the incentives, the Ministry of Finance might have a different perception (Božič, 2017). However, it would be beneficial to have publically accessible analysis of the results of tax incentives and reliefs in order to have an open debate on how effective those are. As it is a question of giving or not collecting public money, the effectiveness of reliefs and incentives should be publicly discussed.

Although it is perceived as an absolute truth, lowering corporate taxes might not lead to increased investments or employment. Companies might believe that reduced labour costs and a corresponding increase in capital will immediately be converted into technological modernization and increased employment, but the past and empirical data for other countries does not confirm it (Mencinger, 2011). Conversely, a larger share of gross profits in GDP in the EU is firmly connected to the lower share of expenditure on research and development (Mencinger, 2011). Similarly, Bole (2004) explains that empirical results do not corroborate significant effects of tax incentives on the increasing of employment. Besides negligible effects on investment, larger tax distortions and more difficult tax administration, absence of any effect on employment is additional argument for abandoning tax incentives at corporate income taxation (Bole, 2004).

According to Bole (2004), the low efficiency and the non-neutrality of tax incentives and a reduction in the tax base have traditionally been identified as weaknesses of tax incentives abroad. The empirical record shows that also in Slovenia the effectiveness of tax incentives in the field of corporate taxation is questionable. As Slovenia has low taxation on capital, compared with labour, the reduction in taxation of capital (through tax incentives) makes no sense (Bole, 2004).

According to the Slovenian Court of Accounts, FDI is not attracted only by favourable taxes; a stable business environment and a clear development strategy would have been more important factors for business to invite investments (Court of Audit, 2013).

All in all, the benefits of tax incentives seem to be questionable, while the costs appear not only in public spending, but also in reduced revenue for the public budget (the Runaway Taxes report (Za Zemiata et al, 2017) shows that major companies are not paying any tax due to using the incentive for R&R investments). There is poor publicly available evidence of what the benefits of tax reliefs are. Companies profit from numerous tax reliefs, which mean less income for the budget, but the benefits of these are dubious at best. Detailed studies lack or are not publicly available. What little evidence there is, empirical results do not indicate that tax incentives would have positive effects on the increasing of employment, while the effects on investment are negligible. It suggests that abandoning tax incentives at corporate income taxation would be a good move. Taking into consideration the above findings, it is possible to open the question on how much tax money is Slovenia losing by betting on tax incentives as the main attraction. Regular studying of the effects (cost-benefit analysis) of tax incentives and publishing of those could be a starting step in eliminating the race to the bottom.

## Progressive taxation

In the field of personal taxes and property taxes Slovenia is already familiar with progressive taxation. For 2017 the tax rates are the following (Ministry of finance, 2016b):

- For tax basis up to 8.021,34 EUR: 16%
- For tax basis of 8.021,34 EUR - 20.400,00 EUR: 1.283,41 EUR + 27% over 8.021,34 EUR
- For tax basis of 20.400,00 EUR - 48.000 EUR: 4.625,65 EUR + 34% over 20.400,00 EUR
- For tax basis of 48.000 EUR - 70.907,20: 14.009,65 EUR + 39% over 48.000,00 EUR
- For tax basis over 70.907,20 EUR: 22.943,46 + 50% over 70.907,20 EUR

However, the corporate income taxes are at the moment not progressive and neither are the taxes on income from capital investments or renting of real-estate. This is one field where, as also the findings from the previous section indicate, change could be introduced.

Another open issue is that due to progressive taxation, the citizens are burdened more than the companies (relatively speaking). There is a growing discrepancy between the relative level of taxation of individuals and companies. The companies pay less and less tax in relative terms (reduction of tax rates for profit of companies); the current statuary corporate income tax rate is 19%, while the effective tax rate is even lower due to the incentives. Although the companies use the same state services as the citizens, the later have to pay double as much tax in relative terms: the average rate of tax and contributions for citizens in 2016 was 34,99% (Ministry of Finance, 2017b).

## Expanding the social services

The issues of tax dodging and race to the bottom are inexplicably related to the question of what public services could be made available if those two challenges were addressed properly. The estimates of taxes lost due to tax dodging range from a bit less than 0,5 billion EUR to over 5 billion EUR, and even if we take the lower estimates, the addition to the public budget would be significant. Further investigation into the effects of tax incentives could probably result in finding out that more taxes could be collected or some of the public funding could be saved. A further exploration in progressive taxation in the field of corporate income and capital gains would also be interesting in terms of identifying possible budget revenues.

As Slovenia is irrepressibly approaching the increased pressure of aging population onto its pension and health care system, the listed steps could help to identify some resources for covering the increasing costs. Rather than limiting the pensions and social and health care, or opening possibilities for commercialisation in those sectors, which would lead to limiting the access to those services for the vulnerable parts of the population, Slovenia should look into making the corporations pay their fair share of taxes.

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## Recommendations for reforms for fair taxation

Some of the described challenges can only be addressed through cooperation with the international community, while some challenges will have to be addressed within the country. Whereas tax havens and other global tax avoidance schemes can only be addressed in close cooperation with other countries, reduction of corporate tax rates and offering of tax incentives is a domestic issue.

In the international efforts, Slovenia could contribute by actively supporting ambitious solutions for complete transparency of transactions of multinational companies, including public country by country reporting, which would enable Slovenia to receive data from multinational corporations on how much business and profit they actually make in Slovenia and around the world; demanding more transparency of beneficiary ownership of companies, including public availability of information; and supporting a global tax body under the auspices of the UN. Although Slovenia tends to be generally supportive of EU measures to tackle tax dodging, it should be more proactive in demanding more transparency, especially through public access to collected data and reports from companies. Often Slovenia takes a stand in the EU talks that the proposed measures are an administrative burden for the companies (Office of Government for Communication, 2016), which can be interpreted as blocking the progress of the negotiations. At the same time, Slovenia should not open doors for practices, such as advance price agreements, which can lead to companies paying lower taxes (two other open issues with advance price agreements are that the agreements are made before any operation takes place in the country and before any financial information is available and that advance pricing agreements are kept secret). It should also thoroughly study the real effects of tax reliefs (cost-benefit analysis). Only in such way can Slovenia start thinking about the real attractions it can offer to companies, rather than taking part in offering legally substantiated ways for companies to avoid paying taxes.

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