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Higher wages play the first fiddle

Forecast of tax revenues and social contributions for 2018 to 2022 (February 2019)

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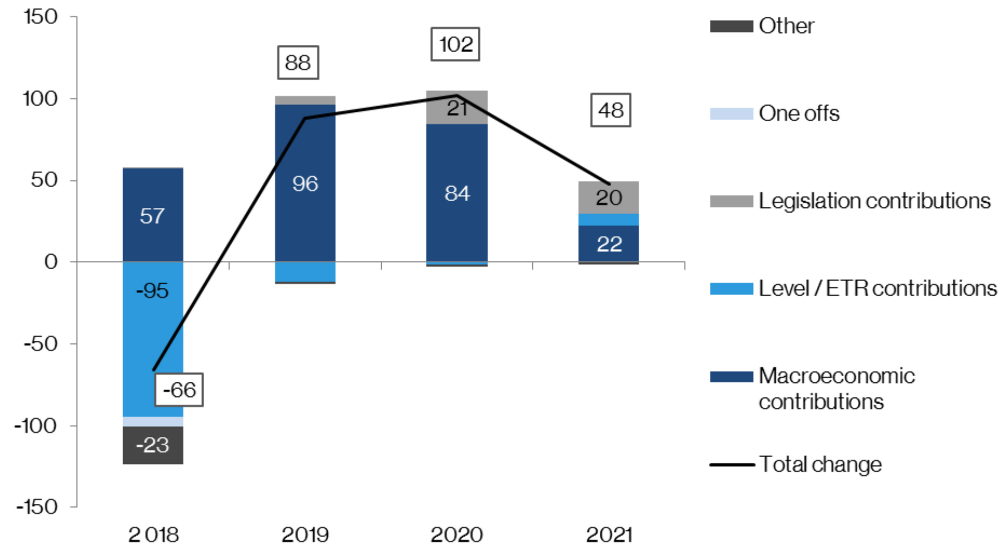
The current forecast estimates slightly higher tax revenues for 2019 – 2022. Last year's estimate was decreased by EUR 66 mill. (0.07% GDP) due to actual tax developments. Over the whole horizon, the stronger wage growth is positively contributing towards higher revenues. On the contrary, new legislation reduces the yield somewhat.

Positive contribution of economic development fades over time

In February, we increased the forecast of tax and social security revenues for the next three years between EUR 88 mill. and EUR 48 mill., respectively (Graph 1). These changes are mainly due to positive developments on the labor market. The new legislation in the form of changing the eligibility for the 13th salary exemptions reduces overall revenues, but this drop is offset by revisions in impact of previously adopted legislative measures. The effective tax rates (ETR) estimates for 2018 are lower compared to the previous ones due to observed tax collection developments.

Graph 1: Changes to the forecast of tax revenue and social contributions, compared to December 2018 (in EUR mill.)

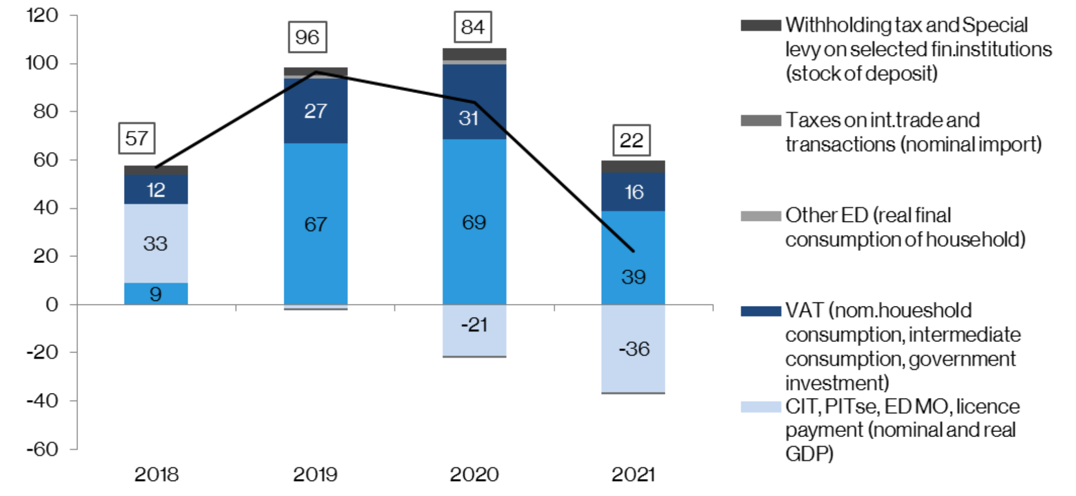


source: IFP, UloziskoIFP

Labor market key driver of tax revenues

Improvements in the macroeconomic environment, particularly dynamic wage growth, increases tax revenues throughout the forecast horizon (Graph 2). Macroeconomic developments boost tax revenue by EUR 96 mill. in 2019, by EUR 84 mill. in 2020, and by EUR 22 mill. in 2021. The smaller positive contribution in 2021 is due to weaker GDP growth. Compared to the previous macroeconomic forecast, we expect a higher wage bill in each year. A stronger labor market will also impact household consumption, which is the underlying macroeconomic basis for VAT revenues.

Graph 2: Impact of the macroeconomic forecast on the tax estimates[1] (in EUR mill.)

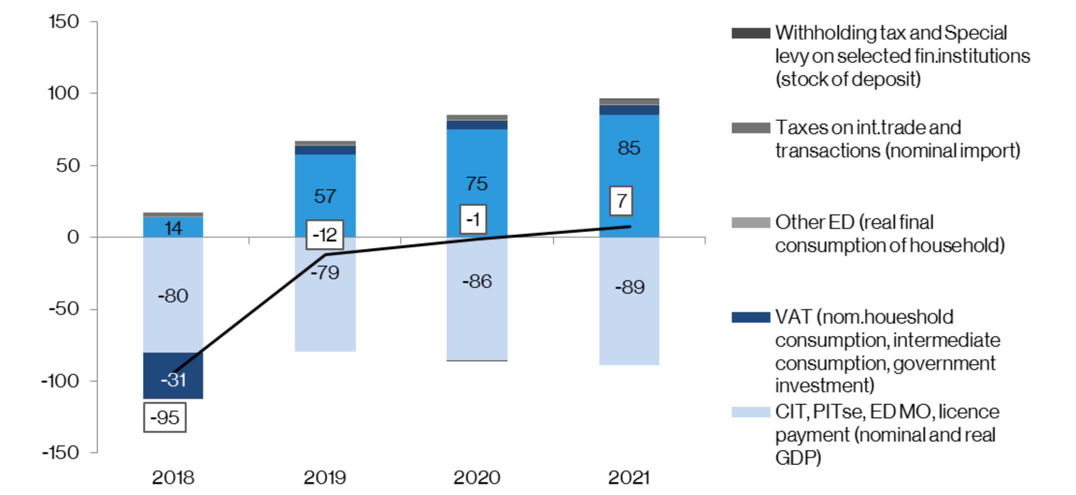


source: IFP, **UloziskoIFP**

weaker ETR in 2018 is only partially carried-forward

The impact of effective tax rates in 2018 is not fully carried-over into the following years, due to the compensating effects of PIT (Graph 3). Based on the weaker than projected VAT receipts in the end of the year 2018, ETR estimates have been revised slightly downwards. The negative contribution of the corporate tax stems from the fact that the macroeconomic base does not fully capture the development of this tax.[2] An opposite trend is observed for personal income tax, as the PIT forecast reflects a long term situation, in which revenues grow above the macroeconomic basis.

Graph 3: Impact of changes to effective tax collection (ETR) on tax forecasts (in EUR mill.)



Source: IFP, **UloziskoIFP**

Updated legislative measures

Overall legislation has a broadly neutral stance (Table 1). The forecast takes into account the easing of the conditions for the 13th salary, which the Parliament approved in January[3]. The estimated negative impact on revenues amounts to EUR 29 mill. For 2019

[1] Taxes are organized into individual categories, based on which macroeconomic aggregate has the most significant impact on them. SD = excise duties, DPFOpod = PIT enterpr., DPFOzč = PIT dependant activity, SD MO = excise duty on mineral oils, SO= Social Contributions, ZO= Healthcare contributions.
[2] Macroeconomic base for CIT is GDP without compensation of employees, rather than profitability of companies.
[3] The original legislative act required that in order to qualify for the tax benefit the 13th and 14th salary have to be above the level of an individual employee's average salary. The amendment relaxes this as the 13th salary only has to be above 500 euros from 2019 onwards.

we slightly increased the forecast of revenues from the levy on retail business chains and we also revised the impact of 13th and 14th salary.

Measures	2018	2019	2020	2021
1. New legislation	**0**	**-29**	**-30**	**-50**
13th and 14th salary (January 2019)	0	-29	-30	-50
2. Revised legislation	**1**	**34**	**51**	**70**
3=1+2. Total legislative effect	**1**	**5**	**21**	**20**

*Source: IFP, **UloziskoIFP***

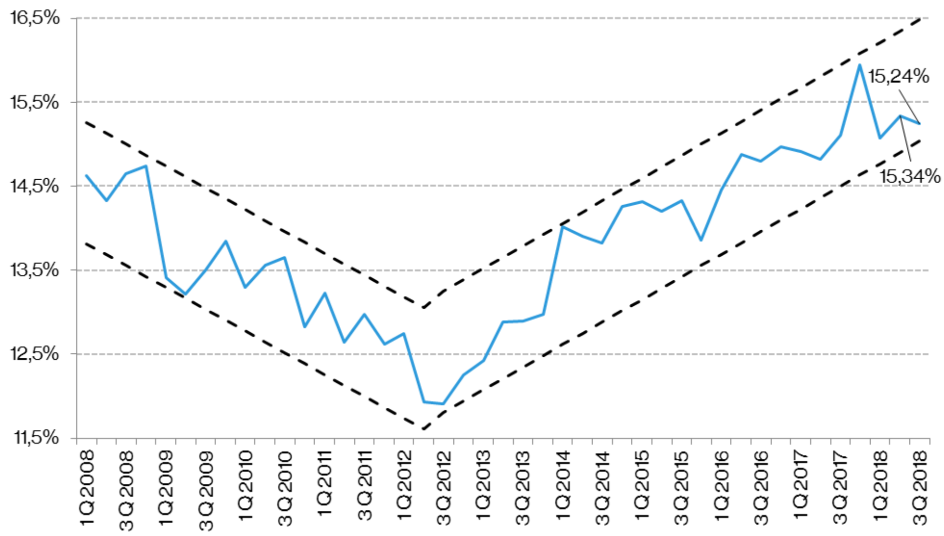
Corporate taxes are being revised downwards

Overall revenues from corporate taxes has been revised down, compared to December's forecast. Despite stronger economic growth in 2018, we retain estimates of profitability for 2018 at 2.9%. Following a weaker economic growth from 2019 onwards, the accrual CIT revenues grow slower. The negative effect on corporate tax collection also stems from higher projected revenues from the levy on retail business chains.

Stable effectivness of VAT collection

We have increased VAT collections projection, driven mainly by stronger household consumption on the back of stable effective tax rate. Based on actual developments by the end of the year, VAT collection was adjusted downwards. For the coming years, we are using ETR from the third quarter of 2018, which was at 15.24% (Graph 4).[4] VAT growth is supported by stronger macroeconomic fundamentals in 2018 – more specifically higher intermediate consumption and governmental investments. Revised household consumption is also upbeat and contributes in 2019. A positive risk persists due to the planned implementation of online cashiers to the eKasa Financial Administration portal.

Graph 4: Effective tax rates of VAT (%)



*Source: IFP, **UloziskoIFP***

PIT revenue detached from the wage bill

Stronger labor market continues to boost higher taxes and social contributions from labor. After a strong first half of 2018, social and healthcare contributions grew in line with the wage bill increases in the third quarter. However, the impact of annual settlement of healthcare contributions exceeded previous projection. As a result, we are

[4] Considering significant revisions by ŠUSR (Statistical Office SR) to macroeconomic bases, ETR historical figures have also changed.

forecasting the growth of future contributions in line with the macroeconomic base. PIT revenues from employees surpass wage bill growth and our previous expectations. Based on the analysis of individual tax returns over the past years, we have raised the effect of the fiscal drag above the performance of the labor market for all the forecast years.

Excise taxes are mainly driven by mineral oils development

Compared to December's forecast, the total estimate of excise taxes has been revised down, particularly for mineral oil (MO). Weaker than expected collection on MO at the end of 2018 resulted in a declining ETR, which is thus carried forward. Excise tax returns from tobacco products remain roughly in line with the December forecasts. Other excise taxes are approximately in line with previous estimates and economic growth.

The Ministry of Finance of the Slovak Republic, in accordance with the Constitutional Act on Budget Responsibility, updates and publishes the forecasts of tax and social security contribution revenues. These forecasts were discussed at the meeting of **Tax Forecast Committee (VpDP), February 07, 2019**. The Bureau of Budgetary Responsibility Council (KRRZ), NBS, Infostat, SLSP, Tatrabanka, ČSOB and UniCreditBank have indicated the forecast to be realistic.

More on tax forecasts as well as underlying materials can be found at **IFP web page** in the Economic Forecasts section ⇨ "**tax forecasts**"

Detailed data on the development of individual tax revenues on the forecast horizon, as well as the breakdown of the contributions of individual factors to the update of the forecast, or the underlying data for the individual data in the policy brief are available at **UloziskoIFP**