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Own revenues in federations: tax powers, tax bases, tax rates and collection arrangements in five federal countries

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1. INTRODUCTION

The purpose of the paper is to examine the four classic aspects of revenue assignment in fiscally federal countries[2]: (a) how are the taxes from which subnational governments receive revenues determined, (b) how are the bases defined and shared, (c) how are the tax rates set, and (d) which level of government administers the taxes. For each issue, we frame the question using a principled approach, provide five examples of how it is done and assess when possible if there are preferable outcomes. This allows us to carry out the task assigned to us by the conference organizers that was to provide information of potential reḑSp004 e.0inax red,k assild,k asss

United States

The tax provisions of the Constitution have been subjected to numerous reviews by the courts over time[8]. On one hand section 8, clause 1 states that (the central government) *The Congress shall have Power to lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States*, while on the other section 9, clause 4 states that *No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.* Because of this clause and its interpretation by the Supreme Court, it was felt necessary to base the personal income tax on a constitutional amendment (XVI introduced in 1913): *The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration*[9].

States are prohibited from taxing international trade (section 10, clause 2) and inter-state trade through a judicial interpretation of the Commerce clause (section 8, clause 3). Thus in this case, the courts played a key role in broadening central government taxation with a key issue (similar to the case of Canada) being the interpretation of the term direct taxes.

2.3 An assessment

It is not feasible to assess if the two principles outlined above were used or not in the process that led to the tax sharing processes described above. But the answer for the older federations is most likely no, with issues of interpretation of imprecise terms such as direct taxes playing a greater role. In the more recent federation, political bargains with the macro dimensions dominating the discussions seem to have occurred.

Figure 1: **Relationship between levels of government and tax bases**

Level of government

Local	Intermediate (province, state…)	Central

progressivity. They fully control taxes such as amusement and gambling taxes and set the rates of the inheritance tax with some control over its base (Verdonck, 2010). Changes have been negotiated in 2011 but their implementation is not done as of February 2012.

Canada

Canadian provinces have access to own taxes such as the PIT, the CIT , VAT type (QST or HST) or retail sales taxes, as well as excises (tobacco, alcohol, fuel, ...), and payroll taxes. They can set the bases, the rates and collect them. In 2011:

- Nine provinces use the federal PIT income as their tax base and thus have the federal government collect it for them;
- Eight provinces have the federal government collect their CIT;
- Five[12] provinces use the Harmonized Sale Tax, a VAT with one rate split between Ottawa and the provinces with each province setting its own rate and the collection done at the federal level. Three provinces levy a RST, one (Québec) levies its own don11 1 0 TD..1266 Tw[Canadithe QST9x R)3.4(T)7.31(ere)]TJde

convention[15] the federal government pays such taxes. Also of interest is that Québec's VAT (QST) is levied on the sales price + the federal GST; thus a change in the GST rate directly affects QST revenues.

Table 1: Personal Income Tax (PIT) Revenues in Canada selected years 1947-2000

	Total PIT ($millions)	Federal % of PIT	% Federal in Québec	% Federal R.O.C. [b]	PIT as % GDP	% PIT ceded-ROC	% PIT ceded - Québec
1947[a]	660	100.0%	100.0%	100.0%	5.4%	5	5
1952	1,225	100.0%	100.0%	100.0%	5.5%	5	5
1954	1,309	98.1%	n/a	100.0%	5.6%	10	10
1957	1,676	97.6%	n/a	100.%	5.6%	10	10
1962	2,378	84.9%	83.5%	87.0%	6.2%	13	13
1967	5,112	71.4%	55.9%	75.8%	7.3%	28	52
1972	11,385	69.3%	50.7%	75.8%	10.3%	30	54
1977	23,656	60.4%	40.6%	69.0%	10.7%	39	55
1982	43,932	58.6%	38.1%	66.8%	11.6%	39	55
1987	70,333	59.3%	41.4%	66.0%	12.6%	39	55
1992	101,226	58.7%	43.0%	64.1%	14.5%	39	55
1997	120,956	60.6%	47.8%	64.5%	13.8%	39	55
2000	143,514	62.4%	48.4%	65.4%	13.6%	39	55

regressive personal income tax schedule put forward by the canton of Obwalden, precludes a declining tax rate schedule. Also, pursuant to article 129 of the Constitution, federal legislation that took effect in 1993 aimed at harmonizing the cantonal PITs, the cantons were given a transitory period of eight years to adapt their tax laws to the new standard set out in the federal law. A significant amount of tax harmonization was achieved at the end of 2000.[16].This harmonization means cantons must levy some taxes (article 2 of federal law: income and wealth taxes on individuals, profits and capital taxes on corporations); but since rates are not bound by a minimum, this is a weak constraint. Both the confederation and the cantons use a common tax base and a common list of tax exemptions/ deductions; however, the amount of each deduction/exemption is set independently by the confederation and each canton. There is no requirement for a harmonization of rates.

United States

American states can levy their own PIT and CIT as does the federal government; they also levy RST (VAT is not used) while the federal government does not levy a goods and services tax. They also levy various excises and payroll taxes. States collect their own taxes. There has never been federal collection of state taxes in the USA; for the PITs this was offered from 1972[17] to 1990[18] (see Stolz and Purdy, 1977) for a discussion of this proposal). The first state PIT and CIT were levied in 1911 in Wisconsin (Cordes and Juffras, 2012; Brunori, 2012).

3.3 An evaluation

One can distinguish here between the old (Canada, Switzerland, USA) and new (Belgium, Spain) federations. In the old federations, the distribution of tax powers does not respect the principles outlined above. In particular, the taxation of corporate income at the subnational level is not a recommended outcome. Attempts are made to mitigate this by using allocation formulas to attribute national profits between

the choice of tax bases and in tax administration can create complexity and administrative and compliance burdens.
In this part of the paper, we focus on the personal income tax since it is in our opinion, the best tax for subnational constituent units given the mobility of tax bases and the type of services they provide.

4.2 The practice for the PIT

Belgium
The personal income tax is federal, but a positive or negative piggy-back tax can be used by the Regions. The Flemish Region is the only one to have used that possibility, through a lump-sum reduction of €125, introduced in 2006 for the tax year of 2008 (2007 income) for taxpayers with market incomes above €5,500 and below €21,000. If this income was above €21,000 and below €22,500, then this non-refundable credit was reduced by 10 cents for each additional euro, and thus tapered off at €22,250.[19]

This lump-sum amount increased over time reaching a maximum of €300 for 2009. For 2010 incomes (2011 tax collection), it was reduced to €125 for incomes between €5,500 and €17,250 with a 10% reduction applying to incomes above €17,250 and thus tapering off at €18,500[20]. It has been abolished for income year 2011[21]. Two reasons appear to have motivated this: the need to reach budget equilibrium and the objection by the European Commission in October 2010 that such a reduction was discriminatory against non-resident workers. Rather than fight this, the lump-sum reduction was abolished[22].

There are also regional investment incentives[23]:

- The Win-Win loan from an individual to a Small or Medium Enterprise with both located in Flanders. The maximum loan is €50,000 for a maximum term of eight years; 2.5% of the loan (maximum €1,250) can be claimed as a credit against tax payable each year;
- Investments in the Caisse d'investisssement de Wallonie with an annual reduction in PIT of 3.10% of the amount of bonds purchased with a maximum purchase of €2,500 (5x500);
- Loans between individuals for housing renovations up to €25,000 in Flanders with a 2.5% annual tax credit and a maximum loan period of 30 years.

So, overall, Belgian regions make little use of their limited tax rate setting powers. On October 11th 2011 an agreement has been reached by the various political parties on the sixth institutional reform but it has yet to be adopted by the Parliament.[24] One chapter of the agreement is dedicated to the increase in tax autonomy for the Regions. The most important federal grant to the Regions is withdrawn while the federal income tax is reduced by an equivalent amount, leaving tax room (about 25% of the base) for the Regions that they will need to use to maintain revenues through a piggy-

[19] Moniteur Belge 26 09 2006 p 50043

back tax. Regions may differentiate tax rates across tax brackets, but their autonomy is limited in order to prevent tax competition. The progressivity of the federal income tax

7. effective progressivity measured by the ratio of the PIT for an income of \$200,000 / PIT for an income of \$5,000 does not vary much, being highest in the two distinct (non tax) societies of Québec (language) and BC (climate)[26];

8. for high income individuals, the highest tax burden is found in Québec and the lowest in Alberta; while for low income individuals, Manitoba has the highest and Alberta the lowest tax burden.

Table 2: Rates per bracket, progressivity of rates, income threshold for the 2nd and last bracket, and effective tax burden as % of income, provincial PITs, Canada, 2008

2008-Marginal tax rate (%) rate per bracket	First bracket	Second	Third	Fourth	Progressiv-ity highest/ lowest rate	Income threshold for 2nd bracket	Income threshold for top bracket	PIT for 25000$

Schwyz, Zug, and Obwalden, but the rate was more than 12% in Glarus, Geneva, and Neuchâtel.[28] One should note that this neglects communal taxation of income.
Cantons also differ greatly in the progressivity

APPENDIX - BASIC COMPARISON OF SIX FEDERAL STATES, 2008

	Australia	**Belgium**	**Canada**	**Spain**	**Switzerland**	**USA**
Population	21 015 690	10 516 660	33 316 000	44 310 870	7 583 861	304 228 300
Land mass	7 692 024	30 528	9 984 670	505 992	41 277	9 629 091
Density	2.73	344.49	3.34	87.57	183.73	31.59
GDP US$ PPP	831 247 090 050	377 861 664 400	1 300 243 994 930	1 434 159 454 650	329 853 279 130	14 369 400 000 000
GDP $ per capita PPP	39 553,64	35 929,82	39 027,61	32365,86	43494,11	47232,29
Largest SNG population	6 984 172 (New South Wales)	6 161 600 (Flanders)	12 936 296 (Ontario)	8 046 131 (Andalucia)	1 295 800 (Zurich)	36 756 666 (California)
Smallest SNG population	219 818 (Northern Territory)	1 048 491 (Brussels-Capital)	139 451 (Prince Edward Island)	311 773 (Rioja)	15 400 (Appenzel Rhodes-Intérior)	532 668 (Wyoming)
Population L/S	31.77	5.88	92.77	25.81	84.14	69.00
Highest SNG GDP pc*	48 724.35 (Northern Territory)	66 154.27[30] (Brussels-Capital)	65 819.43 (Alberta)	40937.53[1] (Madrid)	66 089.74 (Basel-City)	70 814.99 (Delaware)
Smallest SNG GDP pc*	30 179.53 (Tasmania)	24 864.21[1] (Wallonia)	26 945.06 (Prince Edward Island)	21 682.29[1] (Extremadura)	21 844.68 (Jura)	31 233.05 (Mississippi)
GDP L/S	1.61	2.66[1]	2.44	1.89[1]	3.03	2.27

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