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22/07/2020

Presentation of the second phase of the Spending Review

AIR^EF HIGHLIGHTS THE OPPORTUNITY COST OF TAX BENEFITS AND THE IMPORTANCE OF GUARANTEEING THEIR EFFECTIVENESS

- The Independent Authority for Fiscal Responsibility (AIR^EF) plans to review some of the 13 tax benefits analysed
- It suggests contextualising any changes to the tax benefits within the strategic planning of the public policies to which they relate, evaluating their effects ex-ante and their fulfilment ex-post
- Reforms carried out in the last decade in relation to Personal Income Tax (PIT) tax benefits that do not fulfil their objectives, such as social security, joint taxation or housing leasing, will continue
- It is suggested that a gradual and economic recovery-driven review of reduced VAT rates take place to improve their distributive efficiency. This review would have to be accompanied by expenditure policies aimed at protecting vulnerable groups and strategic sectors
- It proposes strengthening requirements to take advantage of the reduced Corporate Income Tax in SICAVs

Today, the Independent Authority for Fiscal Responsibility (AIR^EF) presented the first study of the second phase of the Spending Review, commissioned by the EU. This first study focuses on analysing 13 tax benefits, with a cost of 35,000 million, which represents 60% of the total existing benefits. In its evaluation, AIR^EF highlights the opportunity cost of tax benefits in terms of collection and the importance of ensuring that they effectively fulfil the objective for which they were created.

Tax benefits are fiscal policy instruments that pursue economic and social objectives through exemptions, reduced rates, reductions or deductions in their tax quotas that generate incentives or improvements in the income of natural and legal persons that, in general, entail a lower tax collection. In Spain, a significant part of expenditure policies are implemented through tax benefits, with a fiscal cost of 60,000 million euros.

13 tax benefits were analysed in this study, totalling a collection cost of 35,000 million euros, almost 60% of the total. The aim is to evaluate whether each benefit fulfils the

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objective for which it was created and if they cause any distortions that makes their reformulation advisable.

The study is carried out using microeconometric methodologies for evaluating public policies, as well as an extraordinary wealth of microdata from both administrative and survey sources, a combination of the two, and the collaboration of different institutions.

Generally, AIRef concludes that the creation or any modification of tax benefits should be contextualised within the strategic planning of the public policies to which they relate, in order to assess the effectiveness of the various instruments as a whole.

In addition, coordination between different levels of administration should be improved as well as, in particular, coordination on tax benefits and other state and regional instruments that pursue similar objectives, in order to achieve maximum effectiveness and efficiency.

Finally, the formulation and reforms of tax benefits, like all other public policies, must be accompanied by an ex-ante evaluation that allows the potential effects of the measures to be approximated before their adoption and by ex-post evaluations that measure the degree of fulfilment of the objectives they pursue and, whenever possible, the efficiency with which they are achieved.

Proposals

Within the analysis of each benefit, AIRef evaluates whether the economic policy instrument fulfils the objective for which it was created and, where appropriate, makes specific proposals for improvement.

Thus, in terms of the reduction in PIT for contributions to social security systems, AIRef concludes that the fiscal benefit does not achieve the objective of incentivising long-term savings and proposes its complete reformulation in a manner consistent with the recommendations agreed in the Toledo Pact on long-term complementary savings.

In joint taxation on PIT, designed to adapt the tax to the composition of household income, AIRef concludes that the fiscal benefit does achieve its objective by benefiting households that only have one income earner, but disincentivises women's labour participation. Thus, it proposes that its gradual abolition be accelerated and a transitional regime be established so as not to be detrimental to families who are less able to adapt their employment decisions to the new situation. In addition, AIRef believes that the negative effect that it will continue to have during the transitional regime should be offset with new incentives for women's labour participation that reduce the gender gap.

In the case of the reduction in PIT for housing leases, which aims to promote the supply of rental housing, AIRef concludes that the fiscal benefit has generated a significant increase in the declared rental supply, although the difference between the new housing



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offer and the income that emerges from the informal economy cannot be identified. In addition, the assessment identifies the increasing difficulty faced by low-income households in accessing housing, especially in large metropolitan areas. In this context, AIReF proposes reformulating the incentive by reorienting its design to facilitate vulnerable groups' access to rented housing, taking into account the more acute needs in metropolitan areas.

In terms of reduced VAT rates, designed to facilitate access to essential social, cultural or strategic goods and services, it is concluded that they fulfil the objective, but they do not do so efficiently in terms of distribution. AIReF therefore proposes that a gradual and economic recovery-driven review of the reduced rates take place to improve the distributive efficiency of the tax. The institution highlights how important it is for this review to take into account economic developments and protect affected groups and sectors. Therefore, in order to not be detrimental to lower-income households and avoid increasing inequality in the distribution of income, it is considered necessary to articulate both expenditure measures aimed at the most vulnerable groups that guarantee better access to these assets, as well as targeted plans for the promotion and improvement of the quality of the strategic sectors that are intended to be boosted through the fiscal benefit.

As for SICAVs' reduced rates, designed to promote collective and diversified investment, AIReF notes a high concentration of shares amongst a small number of shareholders that cast doubt on fulfilment of the investment's collective nature. In this sense, it proposes strengthening the requirements to improve the effective fulfilment of the investment's collective nature in the terms established in our regulations.

According to AIReF, the measures proposed in the Spending Review should form part of the necessary medium-term national fiscal strategy that allows a fiscal reorientation and guarantees Public Administrations' financial sustainability in a realistic and credible way.