



# PUBLIC EXPENDITURE EVALUATION 2019

STUDY

TAX BENEFITS

EXECUTIVE SUMMARY





The Independent Authority for Fiscal Responsibility (AIReF by its Spanish acronym) was created with the mission of ensuring strict compliance with the budgetary stability and financial sustainability principles set out in Article 135 of the Spanish Constitution.

**AIReF Contact:**

C/José Abascal, 2, 2º planta. 28003 Madrid,  
+34 910 100 599

[Info@airef.es](mailto:Info@airef.es)

[www.airef.es](http://www.airef.es)

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# EXECUTIVE SUMMARY

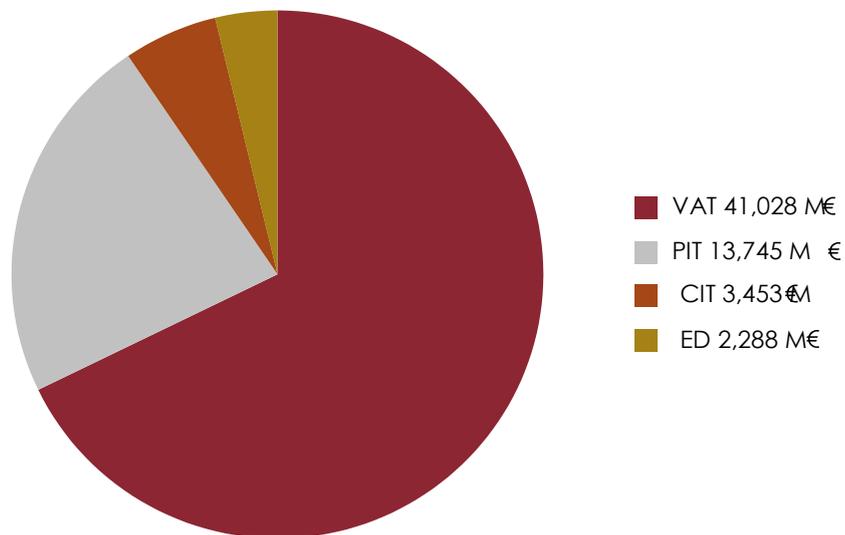
Tax Benefits are policy instruments that pursue established economic and social objectives through exemptions, reduced rates, reductions or deductions in tax quotas that generate incentives or improvements in the income of natural and legal persons that, in general, entail a lower tax collection.

In Spain, a significant part of expenditure policies are implemented through tax benefits. As a total, these amount to close to 60 billion euros (5% of GDP) and cover a wide spectrum of policies related to the promotion of employment, provision of social services, pension complementation, housing policy, the promotion of research, health, education, culture, access to basic goods and services, and the protection of strategic sectors and the environment.

The purpose of this study is to evaluate part of these tax benefits in order to determine whether they meet the objectives for which they were created and to determine whether their existence is associated with some type of externality or distortion that means that they should be reformulated. The study does not discuss the relevance or adequacy of the economic policy objectives that each tax benefit pursues.

The quantitative importance of tax benefits has decreased by 1.2% of GDP since 2010, mainly due to the disappearance of Personal Income Tax (PIT) reductions and deductions and, in particular, the abolition, through a transitional regime, of the deduction for purchasing a habitual residence that amounted to around 0.6% of GDP. During that same period, the tax benefits of Value Added Tax (VAT) and Excise Duties (ED) have remained constant in terms of Gross Domestic Product (GDP), and those related to Corporate Income Tax (CIT) have decreased slightly. In particular, those relating to VAT continue to assume a high fiscal cost of around 41 billion euros (two-thirds of the total), much higher than the European average.

FIGURE 1. DISTRIBUTION OF THE COLLECTIVE COST OF ALL TAX BENEFITS BY TAX FIGURES, 2018



Source: Own calculations from the *Tax benefits Report*.

Tax benefits are a common element in the tax structure of many countries, although they are very heterogeneous at the international level, which makes comparing them very technically challenging. This is due to both differences in the design and delimitation of instruments used to establish the tax benefits between countries and the heterogeneity in the methodologies for quantifying their impact and effectiveness. Moreover, the differences in the cost of tax benefits between countries do not provide much information about the importance of their respective policies in a specific area. It must be noted that a country may not have any tax benefits to promote, for example, the supply of rental housing, but in turn may dedicate a significant amount of resources to that objective through direct transfers.

This report evaluates 13 tax benefits, with a total cost of approximately 35 billion euros, representing 60% of the total fiscal cost of all existing tax benefits.

TABLE 1. TAX BENEFITS ANALYSED AND THEIR FISCAL COST (IN MILLIONS OF EUROS) IN 2016

Tax benefit	Cost
Reduction for joint taxation	2,393
Reduction for contributions to social welfare systems	1,643
Reduction for earnings from work	1,139
Reduction for housing rental	1,039
Deduction for donations	469
Social deductions (maternity, large family, disability)	1,708
<b>Total PIT (61% of the total)</b>	<b>8,391</b>
Reduced rates: 4% and 10%	17,787
VAT exemption: health and education	3,457
VAT exemption: financial services	2,777
Diesel/Gasoline tax difference	1,162
<b>Total VAT and ED, households only (58% of the total)</b>	<b>25,183</b>
Reduced rates	323
Deduction for R&D&i	244
Deduction for donations	107
<b>Total of CIT (20% of the total)</b>	<b>674</b>
<b>Total tax benefits analysed (57% of the total)</b>	<b>34,248</b>

The results are supported by a set of administrative and survey data whose wealth and completeness is unprecedented in such a study on tax benefits. This makes it possible to have information on millions of anonymised tax data relating to tax returns on PIT, IS and VAT, both in its cross-sectional dimension and in panel data. This information refers to the Regions under the common tax regime in relation to PIT and CIT and to the State as a whole in relation to VAT. The regional treasuries of Navarre and the Basque Country have not provided information, so it has not been possible to assess these territories' tax benefits. In addition, information is completed by unprecedented cross-referencing of the Instituto Nacional de Estadística (National Statistics Institute) Household Budget Survey and Innovation in Companies Survey with tax data from the PIT and the CIT. This merger of administrative records and surveys has been carried out under the strictest confidentiality criteria. Finally, this study also has new information from the Agencia Estatal de Administración Tributaria (Spanish Tax Agency - AEAT) regarding the net wealth of the respondents and all

their components (real assets, financial assets and liabilities), which has made it possible to carry out a progressivity analysis on some occasions, not only in terms of income, but also wealth. In short, a set of microdata that exceeds 700 million records and over 15,000 analysed variables. This report's evaluation of tax benefits is based on the use of standard microeconomic quantitative methodologies in the evaluation of public policies. In particular, elasticity estimation methodologies are combined with econometric impact analyses for the evaluation of public policies and the development of fiscal microsimulation tools.

The evaluation's conclusions and proposals are summarised below, divided into those that are common to all tax benefits and those specific to the incentives of each tax figure.

## GENERAL CONCLUSIONS AND PROPOSALS

<p>COMPREHENSIVE PUBLIC EXPENDITURE PLANNING</p>	<p><b>The creation or any modification of tax benefits should take place within the strategic planning of the public policies to which they are related</b>, so that the effectiveness of the different instruments as a whole can be assessed and the efficiency of different alternatives to achieve the proposed objective can be compared.</p>
<p>ADMINISTRATIVE COORDINATION</p>	<p><b>Coordination between different levels of the Administration and, in particular, in relation to those tax benefits and other state and regional economic policy instruments that pursue similar objectives, should be improved</b> in order to most effectively and efficiently meet the general needs of the population as a whole and the particular needs of each territory.</p>
<p>EX ANTE AND EX POST EVALUATION</p>	<p><b>The formulation and reforms of tax benefits</b>, like all other public policies, <b>must be accompanied by an ex ante evaluation</b> 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.</p>

## PIT TAX BENEFITS

### 1. Reduction for joint taxation (marriage modality)

DEFINITION	€3,400 for married couples who choose to make a single declaration.
COST (million €)	2,393
INEQUALITY	Neutral.
OBJECTIVE	Adapt the progressive tax to the composition of household income.
COMPLIANCE WITH OBJECTIVE	<b>YES</b> , although it generates a disincentive to the second income earner's labour participation, which in practice largely affects women, thus accentuating the Spanish economy's gender gap problems.
PROPOSALS	Accelerate its gradual abolition by <b>establishing a transitional regime</b> so as not to be detrimental to families less able to adapt their employment decisions to the new situation. Offset the negative effect that the tax benefit will continue to have with <b>new incentives for women's labour participation</b> that reduce the gender gap.

### 2. Reduction for contributions to social welfare systems

DEFINITION	Up to € 8,000 for contributions to pension plans (tax deferral).
COST (million €)	1,643 (tax deferral: 450)
INEQUALITY	Regressive.
OBJECTIVE	Encourage long-term savings as a complement to the public pension system.
COMPLIANCE WITH OBJECTIVE	<b>NO</b> . The evaluation shows that the tax incentive may be negative for a wide range of savers once the taxation of retirement benefits, pension plan fees and the inter-temporal preference rate are taken into account.
PROPOSALS	<b>Complete reformulation of the tax benefit</b> in a manner consistent with the recommendations agreed in the Toledo Pact on long-term complementary savings.

### 3. Reduction for earnings from work

DEFINITION	Up to €5,565 for obtaining work income for declarants with a work income of less than €16,825.
COST (million €)	1,139 (€9,000 million if the deductible expenditure of €2,000 is considered).
INEQUALITY	Progressive.
OBJECTIVE	Promote the labour supply of low incomes.
COMPLIANCE WITH OBJECTIVE	<b>YES</b> , mainly in the number of people (extensive margin).

PROPOSALS	<b>Harmonisation and coordination of all existing incentives</b> that seek to promote the supply of work, avoiding overlaps and duplications and, in particular, with future incentives for the use of the Minimum Living Income (MLI)
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#### 4. Reduction for housing rental

DEFINITION	60% of the net income obtained from the rental of habitual residence.
COST (million €)	1,039
INEQUALITY	Regressive.
OBJECTIVE	Promote the supply of rental housing.
COMPLIANCE WITH OBJECTIVE	<b>YES</b> , although the difference between the new housing offer and the incomes that emerge from the informal economy cannot be determined. In addition, <b>the assessment identifies the increasing difficulty faced by low-income households in accessing housing</b> , especially in large metropolitan areas.
PROPOSALS	<b>Reformulate the incentive by reorienting its design to facilitate access to rent for vulnerable groups</b> , taking into account the more acute needs in metropolitan areas. This can be done, for example, by modulating the intensity of the incentive based on the housing rental index by census section of the <i>Ministerio de Transportes, Movilidad y Agenda Urbana</i> (Ministry of Transport, Mobility and the Urban Agenda) or registration as social rental housing.

#### 5. Deduction for donations

DEFINITION	75% of the donation for the first 150 euros and 30% for the rest.
COST (million €)	469
INEQUALITY	Neutral.
OBJECTIVE	Promote the financing of the third sector.
COMPLIANCE WITH OBJECTIVE	<b>INCONCLUSIVE</b> , no direct causal relationship is identified between the tax benefit and the recent progress of donations, although analysis through surveys at the European level shows that the tax incentive is one of the five main factors that positively influence the decision to make donations.

#### 6. Social deductions (maternity, large family, disability)

DEFINITION	Negative tax of up to €1,200 for mothers with children under 3 years of age, large and taxpaying families with people with disabilities.
COST (million €)	1,708 (44% for the deduction for maternity, 36% for the deduction for a large family, and 20% for the deduction for dependent disabled people)
INEQUALITY	Progressive.

OBJECTIVE	Promote births, the inclusion of people with disabilities and reduce the gender gap.
COMPLIANCE WITH OBJECTIVE	<b>YES</b> , a positive, small and significant effect both on the birth rate and on the labour participation of women with children under 3 years of age.

## TAX BENEFITS FOR VAT AND ST

### 7. Reduced rates: 4% (super-reduced / 10% reduced)

DEFINITION	Lower than usual (21%) tax rates for the consumption of basic goods and services or for their social, cultural or strategic nature.
COST (million €)	17,786 (super-reduced rate: 5,323; reduced rate: 12,463)
INEQUALITY	Progressive, although it depends on each product.
OBJECTIVE	Facilitate access to essential social, cultural or strategic goods and services.
COMPLIANCE WITH OBJECTIVE	<p><b>YES, although it does not meet the objective efficiently from a distributional point of view.</b></p> <p><b>By lowering consumption taxes, reduced rates benefit higher incomes</b>, which are the ones that spend the most. This effect is accentuated in those items of expenditure at reduced rates that are most consumed by high-income households (restaurants, tourist packages, hotels, books, gardening...).</p> <p>Furthermore, the <b>evaluation highlights distributional inefficiency when comparing reduced rates with other expenditure policies that are</b> more focused on specific groups or sectors and that manage to reduce inequality much more than reduced rates using fewer public resources.</p> <p><b>Lastly, the existence of a high proportion of expenditure at reduced rates</b> explains the lower VAT collection in Spain compared to our European partners.</p>
PROPOSALS	<p><b>Gradual revision, accompanied by the recovery of the economy, of the reduced VAT rates to improve the distributive efficiency of the tax</b> in relation to those goods currently taxed at reduced rates that are mainly consumed by high-income earners.</p> <p>To avoid being detrimental to lower-income households and avoid increasing inequality in the distribution of income, it is necessary to articulate both <b>expenditure measures aimed at the most vulnerable groups</b> that guarantee better access to these assets, as well as <b>targeted plans for the promotion and improvement of the quality of the strategic sectors</b> that are intended to be favoured through the tax benefit.</p>

## 8. VAT exemptions for health and education services

DEFINITION	Possibility of not taxing education and private healthcare.
COST (million €)	3,457
INEQUALITY	Neutral.
OBJECTIVE	Reduce prices to facilitate access to education and health, and decongest the public system.
COMPLIANCE WITH OBJECTIVE	<b>INCONCLUSIVE.</b> If the exemption is lifted, the higher revenue obtained by the State as VAT could be offset by a higher cost of providing the service via the public system. Results subject to the heterogeneous range of elasticities that have been found in the estimation.

## 9. VAT exemptions for financial services

DEFINITION	Possibility of not taxing financial services.
COST (million €)	2,777
INEQUALITY	--
OBJECTIVE	Reduce the cost of financing homes and businesses.
COMPLIANCE WITH OBJECTIVE	<b>YES,</b> lifting the exemption would increase prices, as a consequence of the greater tax burden on financial products for households, and would not affect companies as they could deduct the supported VAT.

## 10. Tax difference in the ED between diesel and gasoline (non-professional use)

DEFINITION	Difference of €93.69 per 1,000 litres in taxation in favour of diesel
COST (million €)	1,162
INEQUALITY	Neutral.
OBJECTIVE	Favour diesel to reduce the cost of transport and for environmental reasons.
COMPLIANCE WITH OBJECTIVE	<b>Yes.</b>
PROPOSALS	<b>Update taxation in accordance with the new environmental policy standards and objectives</b> (e.g., set a price for the emissions of each Kg of CO <sub>2</sub> and NO <sub>2</sub> )

## CIT TAX BENEFITS

### 11. Reduced rates in CIT for SICAVs and SOCIMIs

DEFINITION	Reduced tax rates of 1% and 0% respectively in the Corporate Income Tax.
COST (million €)	323
OBJECTIVE	SICAVs: Promote collective and diversified investment. SOCIMIs: Promote real estate investment.
COMPLIANCE WITH OBJECTIVE	<b>INCONCLUSIVE</b> , although, despite the reinforced requirements existing in Spanish regulations (having a minimum number of one hundred shareholders), a high concentration of investment in SICAVs is detected in the hands of a limited number of shareholders that cast doubt over the investment's collective nature.
PROPOSALS	SICAVs: <b>reinforce the requirements to improve effective compliance with the collective nature of the investment in the terms provided in our regulations</b> (e.g., set a maximum limit for participation per shareholder).

### 12. Deduction for donations in CIT

DEFINITION	35% of the donation with a limit.
COST (million €)	107
OBJECTIVE	Promote the financing of the third sector.
COMPLIANCE WITH OBJECTIVE	<b>INCONCLUSIVE</b> , no direct causal relationship is identified between the tax benefit and the recent progress of donations, although analysis through surveys at the European level shows that the tax incentive is one of the five main factors that positively influence the decision to make donations.



José Abascal, 2-4, 2.ª planta  
28003 Madrid  
+34 910 100 599  
info@airef.es  
www.airef.es