



## Shifting Tax Burden from Labour to Property: the case of Latvia

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### 1. Introduction

- **Currently in Latvia:** relatively low tax burden on immovable property and high taxes on labour, especially on low wage earners (OECD, 2015);
- **We propose property and labour tax reforms that would:**
  - Reduce tax burden on low wage earners
  - Partly compensate foregone budget revenues with higher revenues from immovable property, and
  - Improve work incentives for low wage earners.

### 2. Methodology and data

- There is no existing empirical evidence on who bears tax burden on immovable property in Latvia and no existing national models that can be used to model property tax reforms;
- We use EUROMOD-LV extended with immovable property tax modelling;
- We use a **unique dataset** where EU-SILC 2012 database is matched with administrative data on immovable property.

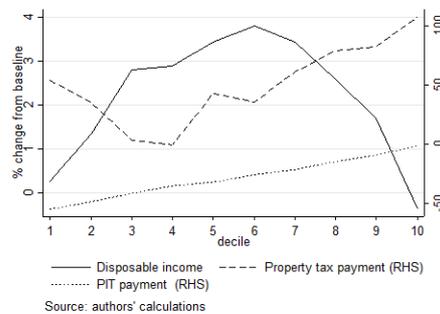
### 3. Policy challenges

- Low progressivity of the personal income tax, which is due to low tax allowances and flat tax rate;
- High METRs for low-wage earners, which is due to low tax allowances, income-based eligibility for the property tax discount and the way means-tested benefits are withdrawn when income rises (benefit recipients face 100% METRs);
- Property tax is regressive, which is mainly due to taxation of land: land constitute the main source of revenues and poor households have large possessions of cheap land.

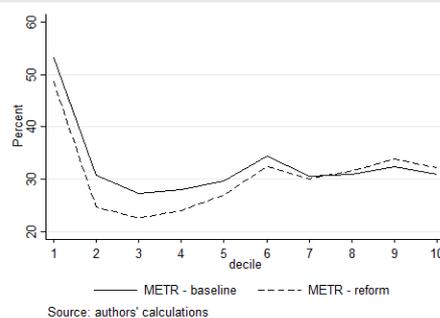
### 4. Main features of the proposed reforms

- **Personal income tax:**
  - differentiated progressive tax allowance;
  - progressive tax rate.
- **Property tax:**
  - raising tax rate, especially tax rate on land;
  - lowering tax brackets and linking the tax brackets to quantiles of distribution of property cadastral values;
  - provision of tax discounts to pensioner households;
  - eligibility for the tax discount on land is based on the price of land per m<sup>2</sup>, which introduces progressivity;
  - discounts based on income criterion are avoided as these kind of discounts create disincentives to work.

### 5. Main Results



Main beneficiaries of the reforms are in middle deciles of income distribution



The reforms improve work incentives at the bottom end, but further reforms of means-tested benefits are needed

	Baseline	Reform
Gini coefficient	35.47	35.05
S80/S20 ratio	6.016	6.001

Though not strongly, the proposed reforms reduce income inequality

Change in property tax revenues, %	Change in PIT revenues, %	Fiscal impact, mln EUR
59.0	-12.4	-106.5

The direct fiscal effect of the reforms is negative and most of the burden (80 mln EUR loss) is on local governments' budgets