Efling - Trade Union

Kjarafréttir

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From 1994 to 2018, the tax burden on high incomes and the wealthy was greatly reduced, while it was increased for low and middle incomes, most for the lowest paid. This greatly increased the burdens on low-income workers and pensioners. Their incomes had been free of income taxes from 1988 to 2001, but the minimum wage and the lowest pensions are now seeing at least 60,000kr in income and municipal taxes each month, even though the amount isn't enough to live off.

Those who have large capital incomes enjoy significant tax benefits, which means that the highest-earning 1%, which gets about 2.5 million a month or more (with capital gains being the greater part), the tax burden is lower than for those earning 750,000 to 2.4 million a month. This high-income group has a similar tax burden as those with 650,000 to 700,000kr a month. This is very unjust.

Those who have high capital gains also do not pay municipal taxes. This is highly unusual. Taxes on company profits are also very low in Iceland and tax evasion high compared to other countries.

Here are some means to mend this.

The tax system favours the highest paid and prays on those who have less

From the beginning of the nineties, the income tax burden has been shifted from the higher incomes to the lower, most to the lowest. Image 1 shows the numbers for the highest-earning 1% and the lowest-earning 10%, annually from 1992 to 2019. This development was especially pronounced from 1994 to 2005.

The tax burden of high and low earners 1992-2019

% of gross wages in annual direct taxation

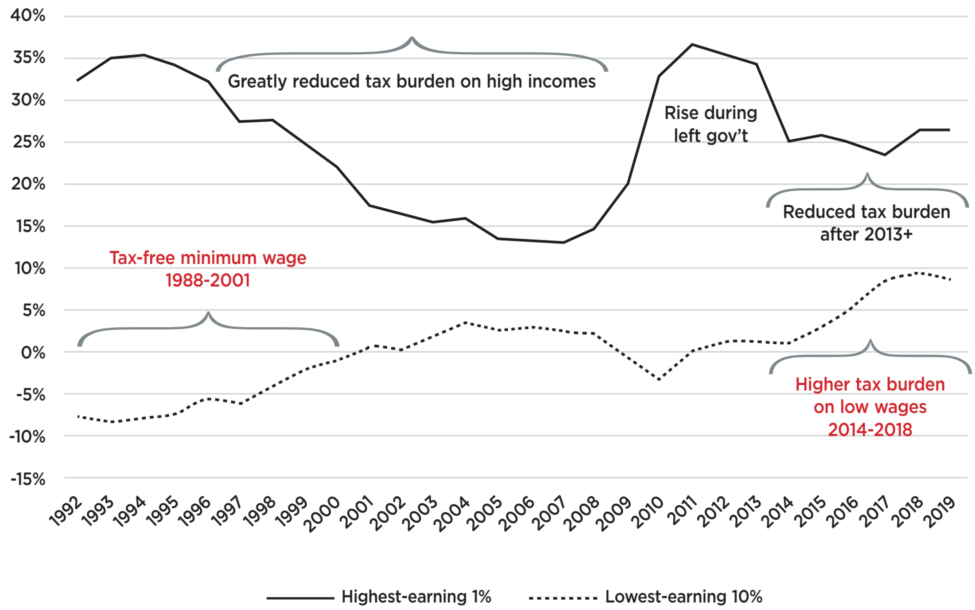

Image 1 The tax burden of the highest and lowest incomes, 1992 to 2019. Combined income tax and capital gains tax as a % of gross income, before taxes. Source: Icelandic tax office.

After the 2008 crash, the left-wing government raised the taxes on the highest incomes back to around the 1994 level. The tax burden of the lowest group, on the other hand, dropped slightly in 2009-2010, and then remained level until 2013. After a new Independence Party-Progressive Party coalition took power in 2013, the top tax rates were lowered again, from about 35% to 25-26%. From 2014-2018, the tax burden of the lowest paid was again raised significantly, from about 1% to about 10%.

The difference in the tax burden of the lowest and the highest incomes was much greater in the beginning of this period, and during the term of the left-wing government (2009-2013), than at its end. The weight of taxation has thus shifted from the higher paid to the lower paid. This is a big transformation and unusual in comparison with neighbouring states.

Another interesting fact about the image is that at the start of the period until 2001, the lowest-paid 10% paid no tax. This applied to the **lowest labour market pay rate** at the time, **the average old-age pension** and **most disability pensions**. All these low income groups paid no income tax, which helped them in making ends meet. As shown in the Efling economic analysis no. 4, *Low-wage households running at a loss*, their position would be completely different today if they didn't have to pay at least 60,000kr income tax off a wage that's barely high enough to live off. The same applied to a large group of old-age pensioners and most of the disabled. This tax burden transfer from the higher paid to the lower paid has therefore been a most unfortunate development, which needs to be fixed.

In relation to the 2019 collective agreements, the government agreed to lower taxes on lower incomes by about 10,000kr a month, tapering off at higher incomes. This happened and the changes went into effect in 2020 and 2021. This was a sea change in the tax policy taht had been in operation since 1994, except for the years of the left-wing government in 2009-2013. It was an important gain. But in light of the taxation of the lowest wages today, it is clear that a bigger step is needed on this road to get a good result for people on lower incomes.

The distribution of the tax burden

Image 2 shows the proportional direct taxation of different income groups according to 2019 tax returns, from the lower end of the income scale to the higher. It is the actual judgement on the tax burden of individuals, what they in fact paid in directly levied taxes (combined income taxes, capital gains taxes and wealth taxes). These are, in other words, the "final returns" from the tax office, not a hypothetical calculation. This image says a lot about the distribution of the tax burden and about how capital gains enjoy special tax concessions.

Here, we can see how rapidly the margin rises on the lower end (the left side), even at low incomes. When people get between 350,000 and 399,000kr in gross monthly wages, the tax burden is already 20%, and then rapidly rises. This slope was much gentler between 1990 and 1995, as shown in the report Sanngjörn dreifing skattbyrðar, by Stefán Ólafsson and Indriði H. Þorláksson, from 2019. After the tax burden reaches about 30% for people earning between 1,350,000 and 1,399,000kr a month, a different story begins. It doesn't continue rising as it did lower in the income scale, but stays around 30-32%. A progressive tax system would continue raising the burden as incomes rise - also above 1,399,000kr. Why doesn't that happen?

It happens because above 1 million in gross income, capital gains become an ever larger share of the taxpayer's income. They continue increasing their share as incomes reach 2 million and more. Since the effective taxation of capital gains is so much lower than that of wages and pensions, as shown by a line in the image, the effective tax burden stops rising for the higher incomes, as capital gains become an ever larger share of incomes. That's why the tax rate stagnates at 30-32%.

Tax burden of all taxpayers, by income brackets (%)

Direct taxation as a % of gross income before tax and capital gains tax

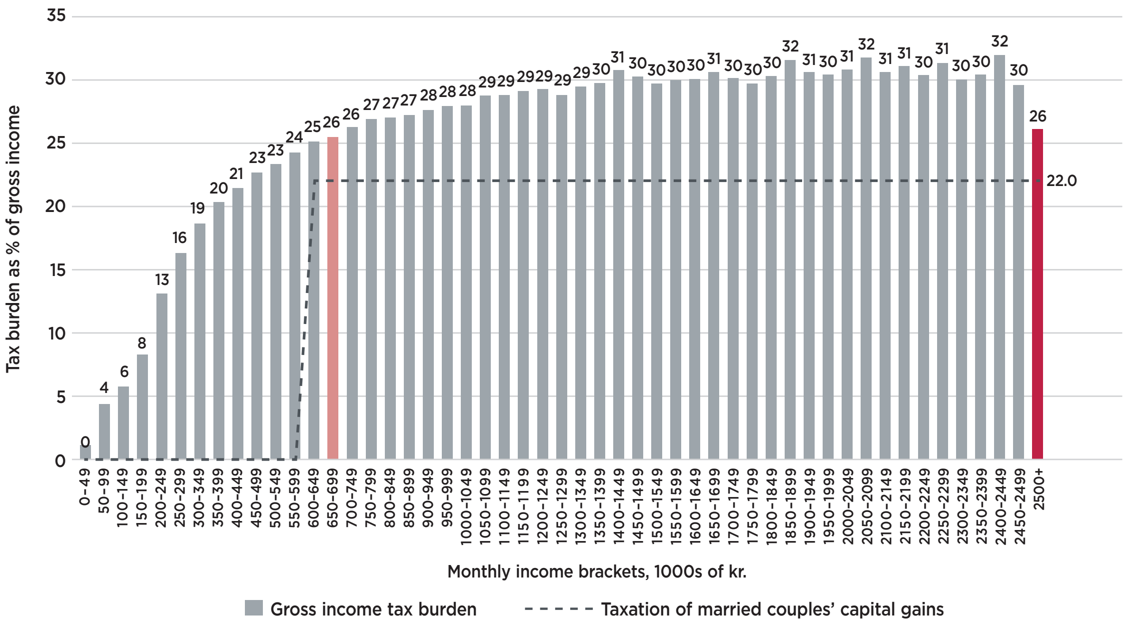

Image 2 Effective taxation of different income groups (50,000kr between groups). Combined income tax and capital gains tax as a % of total income. All taxpayers according to 2019 tax returns. Special report by Statistics Iceland for Efling.

Then, when gross income reaches 2.5 million a month, the tax burden drops sharply from 32% to 26%. This happens because the top 1% (which is roughly the group of people with 2.5 million a month or more) gets most of their income in the form of capital gains, which are taxed at under 22% (for amounts in excess of 300,000 for individuals and 600,000 for married couples). Capital gains are mutually taxed for married couples, so they get their first 600,000kr a month tax free. The capital income decreases the total tax bill of the highest earners.

The effective tax rate of the richest 1% becomes only 26%, similar to that of people earning between 650,000 and 690,000kr a month in gross wages (the pink column). Their tax burden is similar to that of the people sweeping their floors, at their relatively low wages.

This is a direct consequence of the relatively low capital gains tax rate. These are the benefits which the finance minister and the Chamber of Commerce have tried to hide with their verbal gymnastics about alleged double taxation of capital gains. Let's look at this in more detail.

The minister's financial tax distortions

Bjarni Benediktsson, minister of finance, recently said in an interview in Morgunblaðið (August 31) that "the discussion about capital gains taxation often ends in error, since people forget that companies pay a 20% income tax before dividends are paid out". He permits himself to add the companies' income tax to the capital gains tax levied on individuals (20% + 22%) and claims that individuals' capital gains taxes are nearly double what they actually are.

In this way, Bjarni tries to maintain that capital gains taxes are similar to the taxation of regular wages. This is a distortion, not a fact. The Chamber of Commerce and the right-wing press have long whipped this pony to confuse the discourse on taxation.

The claim about twofold taxation of capital gains, and about capital gains taxation being similar to taxation of regular wages, is a wrong as it can be. There are many reasons for this. Let's look at a few of them.

1. Companies and individuals are separate entities, each subject to its own tax. They each pay for their use of society's infrastructure.
2. If it was right to add a company's tax rate to that of individuals receiving income form the company (via regular wages or capital income), then of course the same should apply to the workers.
3. In this way, one could add the payroll tax (6.35%) and pension dues (11.5%), levied on companies, to the workers' tax burden. That's close to 18% added to the companies' wage bill for workers. Without this tax, companies could of course pay workers higher wages. Thus the finance minister's message on the tax burden of capital income being similar to regular wages is for the birds..
4. One could of course go all the way and count the companies' income tax (20%) as part of the workers' tax burden, as the minister and the Chamber of Commerce do for capital gains. If this tax wasn't levied, the company could obviously pay workers higher wages.
5. One might then compare the taxation of capital gains and regular wages as follows: **capital gains tax** (22%+20%); **income tax:** bracket 1: 31.45%; bracket 2: 37.95%; bracket 3: 46.25%. Each bracket should then be added to the 6.35% payroll tax, the 11.5% paid to pension funds, and finally the 20% company income tax (37.85% in all). The sum of the capital gains tax rates would then be about 42%, but for regular wages the tax rate would be between 69.3% to 84.1% - if the erroneous arguments of the minister and the Chamber of Commerce were carried to their logical conclusion. This demonstrates the absurdity of their position.
6. Further, the minister is only speaking to the taxation of dividends, but this erroneous idea makes even less sense when speaking about the profits made from selling shares and other assets, which in recent years has been the greater part of capital gains. The arguments are an even worse fit for the taxation of income from interest and rent, which are also counted as capital gains. Those who rent out two extra flats get, to take an example, half of their rental income tax-free (the tax rate in that case is only 11%, not 22%).

This should make clear to all what trickery is involved in saying the capital gains tax rate is higher than 22% (above the tax-free limit), only meant to justify the enormous benefits being afforded to those with extensive income from capital, namely the highest paid and wealthiest people.

Are company owners in Iceland overtaxed?

In the abovementioned interview, Bjarni Benediktsson, the minister of finance, also said, referring to the alleged double taxation of capital incomes (refuted above), that "those who run companies pay higher taxes than is often said to be the case".

Let's look at this more closely.

If we take the minister's word and combine the company's income tax and the taxation of dividends (even though this makes no sense) we can compare this to a similarly combined taxation in other Western societies. This is done in Image 3.

The gray columns show the capital gains tax rate, the black columns represent the combined taxation of dividends and company profits.

Iceland is at the lower end of both scales. The other Nordic countries levy 30 to 42% taxes on capital income, as opposed to 22% in Iceland. It has sometimes be claimed that this difference is justified because the tax here is levied on nominal income, while it's levied on real income abroad. This doesn't matter much at a low level of inflation. Last year, however, the government introduced a special tax-free allowance on capital gains to counteract this difference (up to 600,000kr for married couples). The image shows clearly that the taxation of capital gains is at a very low rate in Iceland compared with other Western nations.

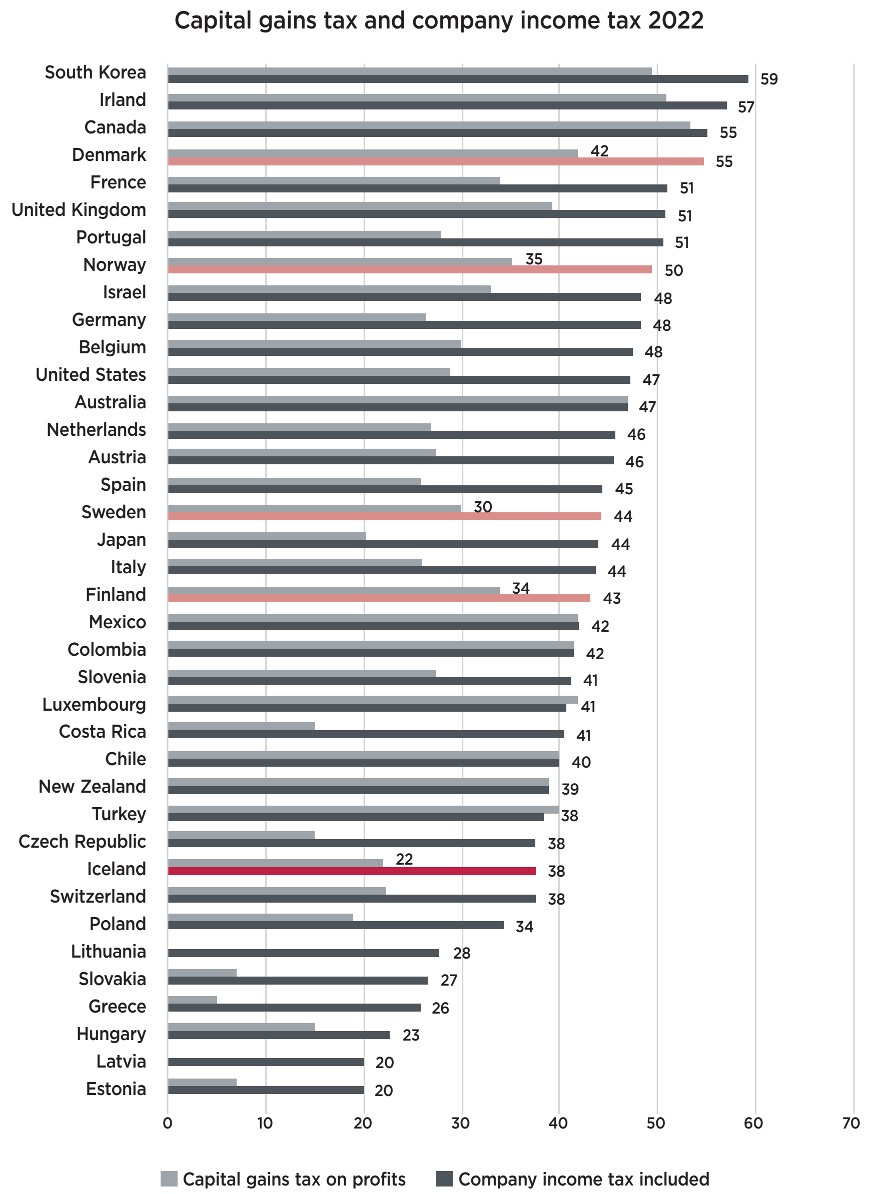

Image 3 Taxation of profits and dividends in 2022, according to OECD estimates. Taxation is given in percentages.

Looking at the black columns, Iceland has a combined tax rate of company profits and dividends of 38% while the other Nordic nations are between 43% (Finland) and 55% (Denmark). Iceland is ninth lowest out of 38. This must be considered a very modest tax burden for company owners in Iceland.

Ireland is an interesting case study. Representatives of companies and owners of capital in Iceland have long looked to Ireland as a model in terms of the taxation of company profits. In Ireland it's very low, but instead, the capital gains tax rate is around 52%. Take note of that - 52%. Here, the taxation of both items combined is at a very low rate (38%) and much lower than in Ireland (57%).

The same can be said about South Korea, Canada, Denmark, France, Britain, Norway and Germany. All these countries and many more levy much higher taxes on company owners.

The picture is clear.

The tax burden of company owners and capitalists is low in Iceland, compared with other countries.

The tax burden of high income groups is also low, as shown above. But the tax burden of the lowest paid is relatively high here, as shown in the report ***Sanngjörn dreifing skattbyrðar***. This must be changed.

Great cuts in income transfers to working households

Finally, we'll show how income transfers to working people's households have been drastically reduced between 1992 and 2020, i.e. combined child benefits and interest relief. These transfers are paid for by the income tax system and are deducted from the income and municipal tax. When they are cut in real terms, this leads to a higher tax rate, especially for the lower and middle income families.

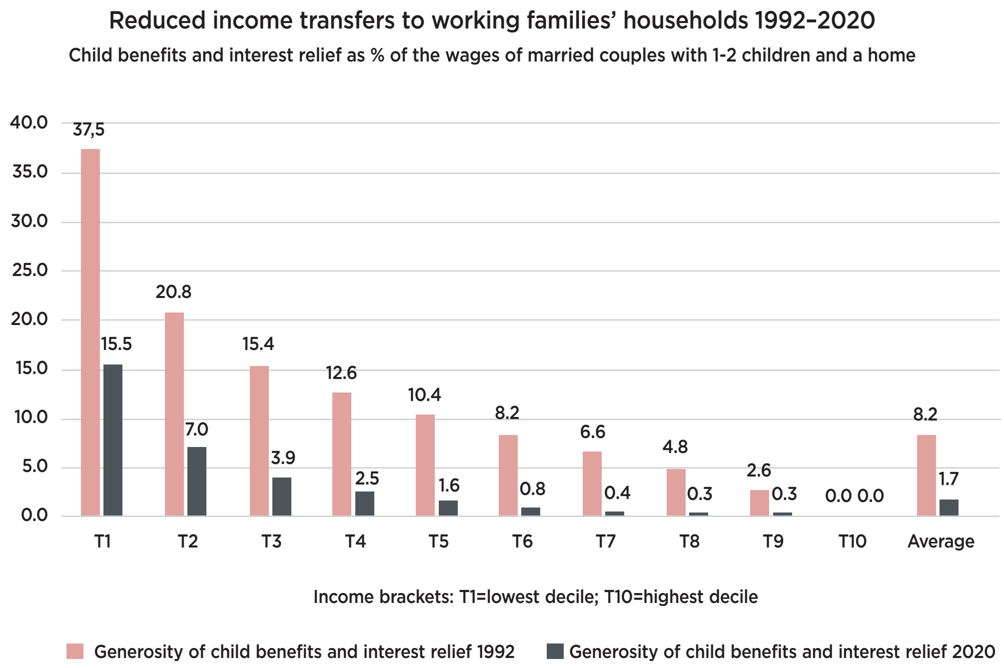

Image 4 Child benefits and interest relief as a % of wages for a married couple with 1-2 children and a home, 1992 and 2020. Source: Prime ministry's Income history (Tekjusaga).

The generosity of child benefits and interest relief is shown as a proportion of families' wages in ten equally large groups, from the lowest (T1) to the highest (T10). The light columns are for the year 1992, dark for 2020.

The change is clear. The generosity of these transfers to working families has been greatly reduced. It has plunged from an average of 8.2% of wages to 1.7%, more than three quarters. The lowest income group saw the transfers go from 37.5% of their wages to 15.5%, and the second-lowest group from 20.8% to 7%. The greatest difference is due to the reduction in interest relief. By these means, the government has greatly cramped the condition of families, which is also seen in their higher tax burden, especially for the lower and middle income groups.

What needs to be done

To correct the fairness deficit in the income tax system, the following must be done:

- Reduce the taxation of the lowest incomes by at least 15,000 to 20,000 a month.
- At the same time, taxes on the highest incomes must be raised so it becomes comparable to that in neighbouring European states.
- The taxation of capital income must be comparable to the taxation of wages and pensions.
- Tax evasion must be reduced, as shown in the report *Sanngjörn dreifing skattbyrðar*.
- It is also in order to increase the fees on the use of natural resources in fishing and elsewhere.
- A wealth tax would be desirable on assets in excess of a moderate home, which could amount to 10-15 billion a year.
- A windfall tax on the enormous profits of banks and companies which made huge gains during the pandemic, as other neighbouring countries have done.
- These changes to the taxation of high incomes, capital gains, large assets and natural resource use would make up for a lower tax on low incomes, and then some. The remainder should be used to improve the welfare system.
- Improved tax inspections could gain the state large sums in addition, to strengthen societal infrastructure, both socially and economically.

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