

5 The Tax Treatment of Capital Income: European Union and Countries in Transition*

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Abstract

This paper deals with the tax treatment of specific categories of income from capital – income from interests on savings deposits and bonds, dividends and capital gains in the old Europe, some countries in transition and in the Republic of Croatia. The aim of the paper is to provide, in rather simple manner, the insight into the type of taxation of these categories of capital income (e.g. taxation by applying a special kind of tax on capital income or inclusion of capital income in the total taxable income), the level of the statutory tax rates and key features of the capital income taxation, so as to enable the comparison of the tax treatment of capital income in Croatia and in the neighbouring countries. Very important issues related to the theoretical background and principles on which the taxation of interest income, dividend income and income from capital gains is based are beyond the ambition of this paper and are, thus, left for some other research study.

Keywords: taxation, capital income, tax harmonisation

JEL classification: H2, H24

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1 Introduction

Every country has its unique tax system, but in analysing the features and impact of the tax systems, as well as in designing or redesigning these tax systems, domestic practice is frequently compared with the solutions in other countries. Since Croatia's immediate economic and geographic neighbourhood is the European Union and Central, South and East European countries, the research of tax systems in these countries and analyses of their development in time are of a particular interest.

The aim of this paper is to compare tax systems of the countries in the Croatia's neighbourhood and to identify general characteristics and differences among them, as well as to examine the extent to which the Croatian tax system is similar to tax regimes in other countries. Since it is almost impossible to summarise in one place and compare all the features of the tax systems in a group of countries, this paper is focused only on comparing the method of tax treatment of various types of capital income in two groups of countries, encompassing the old EU Member States and some European transition countries¹. In addition, the comparison mainly relates only to the current status², rather than to the changes in the tax systems over time.

Capital income or income from investments is considered to be an income earned by natural persons through their passive investments, i.e. an income earned with no active participation in income creation or in managing business venture. The concept opposite to capital income, which is also referred to as the passive income, is employment income, or active income (IBFD, 1996). Capital income includes income from immovable property, dividends, interest on bank deposits and bonds, rentals receivable under operating leases, etc. The paper discusses tax treatment of the following forms of income - interest on bank deposits and bonds, dividends and capital gains. Tax treatment of capital income is mostly analysed from the perspective of a resident natural person. International aspects of capital income

1 In addition to 15 old EU Member States, certain aspects of the tax systems in 11 European transition countries are also analysed in this paper - Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania (except for interest taxation), Hungary, Poland, Romania, Slovakia, Slovenia and Croatia.

2 For all the countries, except for Croatia, the data relate to the end-2004 period, while for Croatia, the data relating to 2005 are reported.

taxation are discussed only in the case of tax treatment of income from interest on savings deposits, since in the taxation of income from interest on savings deposits serious problems arise, concerning the unequal treatment of interest payable to residents and non-residents. In view of the relevance of this issue, a separate chapter is also dedicated to harmonisation of taxation of income from interest on savings deposits in the European Union. Finally, on the basis of a comparison of the tax treatment of the selected forms of capital income in the observed countries, the final conclusions are made.

2 Tax Treatment of Interest on Bank Deposits

The tax treatment of interest on bank deposits in the EU Member States and in European transition countries varies to a great extent. In general, there are four main types of tax treatment of interest on deposits in these countries, as follows:

- taxation by levying a final withholding tax,
- taxation within an annual taxation of income,
- taxation by levying a withholding tax first and then within the annual taxation of income,
- interest income tax exemption.

In the largest number of the old EU Member States, interests on deposits are treated by levying withholding tax, which is considered a final tax, and interest income is not included in the annual tax return. Interests are treated in this manner in eight old EU Member States - Austria, Belgium, Finland, France, Greece, Italy, Portugal and Sweden. In five of these countries (Austria, Belgium, France, Greece and Portugal), taxpayers are entitled to opt for the tax already withheld used as a prepayment i.e. to be included in the annual income tax return and a standard income tax liability to be applied to interest income. The tax rates on income from deposit interest, however, range from 15 to 30 percent.

The two old EU Member States, Denmark and Luxembourg, include interest income in the taxable income, applying the income tax rate that corresponds to the overall level of income. In the Netherlands, income is classified into three

different categories, to which three different tax rates are assigned. One of these tax rates is applied to interest income.

In four old EU Members States (Germany, Ireland, Spain and United Kingdom), withholding tax is levied on interest first, and withholding tax is considered as an advance payment of the final interest income tax. In the annual tax return, withholding tax paid is included in the total annual income tax to which the income tax rate is applied.

Income from interest on deposit is not exempt from income tax in any of the old EU Member States, although in most of the countries non-residents pay either interest income tax at a lower rate or at a zero rate, in accordance with the double taxation avoidance agreements. In transition countries, the situation is different. In Slovenia, Hungary and Croatia interest is, as income of natural persons, exempt from income tax for all types of savings, and in Bulgaria, Latvia and Estonia interest income is also not subject to income tax for the majority of the common types of savings. Out of ten selected European transition countries, including Croatia, seven countries that tax interest on bank deposits, levy the final withholding tax.

It may be assumed that a significantly reduced tax burden, as regards interest on savings, in transition countries is a consequence of an attempt to simplify the tax system to the largest extent possible, but it could also be a result of a desire to stimulate savings and decrease need for capital imports as much as possible³.

In the old EU Member States, the analyses point to a downward trend in tax burden of interest income - in 2004 it amounted to 34 percent in 15 EU Member States, with a standard deviation of 11.1, while according to Gorter and de Mooij (2001) in 2000, the average tax rate on interest stood at 36.7 percent (standard deviation amounting to 14), and in 1990 at 45.9 percent (standard deviation amounting to 11.4). An overview of the interest income tax treatment in the old EU Member States is given in Table 1, and a summary of the interest income tax treatment in 10 selected transition countries is shown in Table 2. However, it

3 For common reasons for allowing tax incentives for savings, see Banks (1996). An overview of the theoretical and empirical studies of interdependence between savings and taxation is provided by Robson (1995) and Bernheim (1999).

should be noted that in a large number of countries there are differences in the tax treatment of different savings instruments, which are not elaborated and shown in more detail in the table, but may, nevertheless, significantly influence the decisions of the persons concerning their choice of savings instruments. Unequal tax treatment of income from various types of savings is present in France, in particular.

3 Tax Treatment of Interest on Bonds and Dividends

Interests on bonds are, in a large number of countries, treated the same as interests on deposits, and the same method is usually applied to the calculation of bond interest income tax as to deposit interest income tax. In some countries, corporate and government bonds are treated differently, government bonds enjoying a more favourable tax treatment. Taxation of dividends is equal to the bond taxation, or they are partially tax-exempt, in order to mitigate a double taxation of income from investment in shares – first, at the company level, and the second time, at the shareholders' level.

Tables 3 and 4 show a statutory tax rate, applied to corporate and government bonds and to dividends in the old EU Member States and in some European transition countries.

It should be noted that in the case of the old EU Member States, interests on corporate bonds have equal tax treatment to interests on bank deposits, except in Greece, Italy and Portugal, where higher tax rates are levied on interests on bank deposits. As regards transition countries, in Bulgaria and the Czech Republic corporate bonds are subject to higher tax rates compared to interest on bank deposits.

Table 1. Tax Treatment of Interest on Deposits in old EU Member States				
	Tax rate residents ¹	Tax rate non-residents	Taxation method	
			Note	
Austria	25%	0-25%	FWT	- possibility of choosing a standard income tax rate or a reduced rate, if these rates are lower than the withholding tax rate
Belgium	15%	0-15%	FWT	- exemption in the amount of EUR 1,500 of interest on "regular" bank deposits
Denmark	59%	30%	IT	- possibility of including the withholding tax on interest
Finland	29%	0-25%	FWT	- exemption for child's savings account (up to DKK 3,000 annually)
France	25%	0-25%	FWT	- the base is reduced by the costs of earning interest
				- certain types of interest are exempt
				- taxpayers may choose the tax treatment within the income tax
				- in the case of individual types of investments, the tax treatment within the income tax is applied, the highest marginal rate being 48.09%
Germany	44.31%	0-25%	IWT	- interests, in principle, are not subject to withholding tax, although in case of individual types of investments withholding tax is levied
Greece	20%	0-10%	FWT	- withholding tax at a rate of 20% may be included in the final income tax
				- tax rate of 15% on interests on euro deposits and deposits in Postal savings bank
Ireland	42%	0-15%	IWT	- there is tax relief on individual types of savings – final withholding tax at a rate of 25% is levied on them and a tax credit worth 25% of investment amount is permitted
Italy	27%	0-30%	FWT	- different tax treatment of interest relative to the source
Luxembourg	38.95%	0-15%	IT	- the base is reduced by the costs of earning interest
				- interest income tax exemption up to EUR 1,500
				- tax relief on investment in housing savings schemes
Netherlands	30%	0-25%	"third category" IT	- tax base is the imputed return on savings and investments of 4%
				- tax allowance of EUR 17,600 from the tax base
Portugal	40%	0-15%	IWT	- withholding tax on interest in the amount of 15% is included in the income tax liability
Spain	45%	0-15%	IWT	- withholding tax on interest in the amount of 15% is included in the income tax liability
Sweden	30%	0%	FWT	
United Kingdom	40%	0-25%	IWT	- withholding tax on interest in the amount of 20% is included in the income tax liability
				- interests on special savings accounts are tax-exempt, and tax allowance on deposits with National Savings Bank

Note: ¹ If a progressive income taxation is applied, the highest marginal tax rates are indicated.

Legend: FWT = final withholding tax; IT = taxation within income tax; IWT = withholding tax is included in the annual income tax.

Source: IBFD (2004a); Guide to European Taxation Volume VI: Taxation of Individuals in Europe, Amsterdam (loose leaf) (as at 20 November 2004).

Table 2. Tax Treatment of Interest on Deposits in Transition Countries

	Tax rate residents	Tax rate non-residents	Taxation method	Note
Bulgaria	0%	0% / 15%	FWT	- a large portion of interest on deposit is tax-exempt
Croatia	0%	0%	-	- withholding tax of 35% is paid on interest on the basis of granted loans and credits
Czech Republic	15%	the same as for residents	FWT	
Estonia	0% / 26%	0% / 26%	FWT	- interests paid by credit institutions with a registered office in EU are tax-exempt
Hungary	0%	0%	-	
Latvia	0% / 25%	the same as for residents	FWT	- interests paid by credit institutions with a registered office in Latvia are tax-exempt
Poland	20%	20%	FWT	- exemptions relate to interest on investments before 1 December 2001
Romania	0% / 1%	10%	FWT	- interests on current accounts, term deposits and savings instruments of Romanian banks are tax exempt
Slovakia	19%	the same as for residents	FWT	
Slovenia	0%	0%-15%	FWT	- withholding tax of 25% is paid on interest on the basis of granted loans and credits, which is included in the tax liability

Legend: FWT = final withholding tax

Source: IBFD (2004b): Guide to European Taxation Volume V: Taxation & Investment in Central and East European Countries, Amsterdam (loose leaf) (as at 20 November 2004), Income Tax Act (Official Gazette 177/04).

Table 3. Tax Treatment of Interest on Corporate and Government Bonds and Dividends in EU Member States				
	Corporate bonds tax rate ¹	Government bonds tax rate ¹	Dividends tax rate ¹	Note to dividends taxation
Austria	25%	25%	25%	- dividends of new shares in domestic manufacturing companies are tax-exempt
Belgium	15%	15%	15% / 25%	- reduced rate is applied to shares issued after 1994 (under certain conditions)
Denmark	59%	59%	28% / 43%	- higher rate is applied if shares income exceeds DKK 42,400
Finland	29%	29%	29%	- there is certain tax relief
France	15 + 10%	15 + 10%	48.09% + 10%	- only half of the dividends is subject to taxation - social taxes are additionally levied on dividends and bonds (at a rate of 10%) - there is a tax-free allowance
Germany	44.31%	44.31%	44.31%	- only ½ of dividends is subject to taxation
Greece	0%	0%	0%	- no tax is levied on dividends at the shareholders' level
Ireland	42%	42%	42%	- threshold for exemption is EUR 5,210
Italy	12.5%	12.5%	12.5%	- in the case of qualified companies, progressive income tax is levied on dividends (the highest marginal rate being 45%) and 60% of dividends is tax-exempt
Luxembourg	38.95%	0%	38.95%	- permitted tax-exemption for 50% of dividends, plus an exemption of EUR 1,500
Netherlands	30%	30%	25% / 30%	- tax base is the imputed return on savings and investments of 4% - tax allowance of EUR 19,252 from the tax base - lower tax rate is applied if there is a significant share in ownership
Portugal	20%	25%	40%	-permitted tax-exemption in the amount of 50% of dividends
Spain	45%	45%	45%	- imputed tax credit amounts to 40% of dividends
Sweden	30%	30%	30%	- limited exemption for dividends of small and medium-sized companies is permitted
United Kingdom	40%	40%	32.5%	- imputed tax credit amounts to 1/9 percent of dividends

Note: ¹ If a progressive income taxation is applied, the highest marginal tax rates are indicated.

Source: IBFD (2004a): Guide to European Taxation Volume VI: Taxation of Individuals in Europe, Amsterdam (loose leaf) (as at 20 November 2004).

Table 4. Tax Treatment of Interest on Corporate and Government Bonds and Dividends in Transition Countries			
	Corporate bonds tax rate	Government bonds tax rate	Dividends tax rate
Bulgaria	20%	0%	15%
Croatia¹	0%	0%	0%
Czech Republic	25%	0%	25%
Estonia	26%	26%	0%
Hungary	0%	0%	20% / 30.5%
Latvia	25%	0%	0%
Lithuania	15%	0%	15% / 33%
Poland	20%	0%	19%
Romania	1%	1%	5%
Slovakia	19%	19%	0%
Slovenia	0%	0%	50%

Note: ¹ As of 1 January 2005, until end-2004, dividends tax rate stood at 15%.

Source: IBFD (2004b); Guide to European Taxation Volume V: Taxation & Investment in Central and East European Countries, Amsterdam (loose leaf) and IBFD (2004a); Guide to Taxation of Individuals in Europe, Amsterdam (loose leaf) (as at 20 November 2004), Income Tax Act (Official Gazette 177/04).

In the old EU-Member States, the treatment of corporate and government bonds is similar, except in Luxembourg, where certain zero-coupon government bonds are tax-exempt. In contrast, a considerably large number of transition countries, provide for a more favourable tax relief on government bonds, compared to the corporate bonds - Bulgaria, the Czech Republic, Latvia, Lithuania and Poland. In all these countries, the interest on government bonds is completely tax-exempt. Differences in tax regimes with respect to government bonds in these two groups of countries may be accounted for by a greater need of the governments in transition countries for financing debt and by their inherited preference for the government sector⁴.

4 Harmonisation in the Field of Taxation of Income from Interest on Saving Deposit in the EU

Taxation of income from interest on savings deposits of natural persons in the European Union is still not subject to harmonisation, although a partial regulation has been achieved by the introduction of the Directive on Taxation of Savings Income in the Form of Interest Payments. The Savings Directive⁵ was adopted only in 2003 and it entered into force as at 1 July 2005, although the preparation of regulations, which would bring about a certain degree of tax harmonisation in this area, began as early as in the 1960ies (Oravec, 2002). The attempts for the tax harmonisation to encompass taxation of income from savings interest result from the fact that the existing principle of interest taxation is the principle of the country of residence, which is violated by the fact that tax authorities may assess interest yield only in the country, but not abroad. Consequently, depositors take out savings in other countries and do not report return on these savings in the country of residence, which results in a loss of potential tax revenues for the home countries, as well as in a flight of capital (Härtel, 2000).

⁴ *Explanation of the unfavourable impact of government securities tax exemption on efficiency and fairness in distribution may be found in Norregaard (1997).*

⁵ *Council Directive 2003/48/EC of 3 June 2003 on Taxation of Savings Income in the Form of Interest Payments was published in the Official Journal of the European Union, 26 June 2003.*

taxable. The Directive, therefore, does not require the Member States to harmonise the manner of taxation or the amount of tax burden relating to interest income.

5 Tax Treatment of Capital Gains

All old EU Member States have some form of capital gains taxation⁶ in place, either in the form of a special tax on capital gains or within the framework of income tax. In this paper we will examine both types of capital gains taxation, and that for capital gains on all types of assets whose realised gains are taxable. Table 5 gives a clear overview of the basic elements of capital gains taxation in those countries. As shown in the Table, although all the selected countries have some form of capital gains taxation, the manner of taxation and the level of capital gains taxation in those countries differ greatly⁷.

The selected countries can be classified into two groups: those that tax capital gains together with other forms of income and countries which apply a special tax on capital gains. In nine old EU Member States (Austria, Denmark, Finland, Germany, Italy, Luxembourg, Portugal, Spain and Sweden) capital gains are integrated in total taxable income and taxed at progressive tax rates in accordance with the statutory tax rate. In two Scandinavian countries with the so-called dual income taxation⁸ capital gains are added to income from capital and are subject to capital income tax. In the remaining six old EU Member States (Belgium, France, Greece, Ireland, The Netherlands, and the United Kingdom) there is a special tax rate for capital gains.

Depending on the type of assets, tax rates levied on capital gains can differ within a single country in the same way as they do between different countries. Assuming that in countries in which capital gains are taxed by progressive income tax rates,

⁶ *Capital gain is the difference between the purchase price and the selling price of asset (IBFD, 1996).*

⁷ *For details concerning capital gains taxation pattern, see Messere (1993). For the effects of capital gains taxation on efficacy, income, capital gains realisation, propensity to assume risks, savings and investments, the price of assets, prosperity, portfolio structure and distribution, see e.g. Auten (1999), Zodrow (1995), Sandmo (1985) and Poterba (2001).*

⁸ *For the reasons for the introduction and the characteristics of the dual system of taxation, see Hamaekers (2003).*

Table 5. Taxation of Capital Gains in Old EU Member States

	Type of taxation	Rates ⁽¹⁾	Different treatment of short-term and long-term gains	Threshold	Adjustment for inflation	Capital loss deduction	Roll-over relief
Austria	IIT	½ of the average rate applied to tax base, max. 50%	yes	no	no	no	yes, under certain conditions
Belgium ²	S	16.5 / 33%	yes	no	no	no	no
Denmark	IIT	59%	yes	yes	no	yes	no
Finland	ICIT	29% (28% since 2005)	no	yes	no	no	no
France	S	26%	yes	yes	no	no	no
Germany	IIT	47.48%	yes	yes	no	no	no
Greece ³	S	5 / 20%	no	no	no	no	no
Ireland ⁴	S	20 / 40%	no	yes	yes	yes, from capital gains	yes
Italy ⁵	IIT	12.5 / 45%	no	no	no	no	no
Luxembourg	IIT	38%	yes	yes	yes	yes, from speculative gains	
Netherlands	S	25%	no	no	no	yes, from same category income	no
Portugal	IIT	40%	yes	no	yes, in case of real estate		yes
Spain	IIT	45%	yes	no	no	no	yes
Sweden	ICIT	30%	yes	yes		yes, with different rates for different types of assets	yes
United Kingdom	S	40%	yes	yes	no	no	yes

Notes:

⁽¹⁾ In case of progressive taxation of income, the highest marginal tax rates are given.

⁽²⁾ Belgium - the reduced tax rate of 16.5 percent applies to any sale of a significant share (over 25 percent) in a domestic corporation, foreign corporation and to long-term capital gains on the sale of real estate. Other taxable capital gains are subject to a higher, 33 percent rate.

⁽³⁾ Greece - the reduced tax rate of 5 percent applies to capital gains on the sale of unlisted shares. Other taxable capital gains are subject to a higher, 20 percent rate.

⁽⁴⁾ Ireland - capital gains on the sale of undeveloped land are subject to a 40 percent taxation. The standard capital gains tax rate is 20 percent.

⁽⁵⁾ Italy - the standard capital gains tax is 12.5 percent. Gains on the sale of shares, share-like financial instruments and holdings in domestic companies and partnerships are subject to a 40 percent tax rate after a 60 percent tax exemption.

Legend: IIT = included in income taxation; ICIT = included in capital income taxation; S = special tax

Source: IBFD (2004a): *Guide to European Taxation Volume VI: Taxation of Individuals in Europe, Amsterdam (loose leaf) (balance as at 20 November 2004)*; IBFD (2004c): *European Tax Handbook, Amsterdam*

Table 6. Tax Treatment of Capital Gains as Regards the Type of Assets in Old EU Member States	
	EXEMPT ASSETS
Austria	<p>TAXABLE ASSETS</p> <ul style="list-style-type: none"> - business assets - real estate < 10 years - land < 15 years, the base reduced between years 5 - 15 - other assets (and securities) < 1 year - shares constituting a qualified substantial shareholding - company liquidation gains or gains on repayment of shareholders' stakes <p>EXEMPT ASSETS</p> <ul style="list-style-type: none"> - real estate serving as the principle residence in the last two years - real estate > 10 years - land > 15 years - other assets (and securities) > 1 year - bonds issued by a domestic debtor
Belgium	<ul style="list-style-type: none"> - business assets - undeveloped assets < 5 years - portfolio sold to a foreign legal person
Denmark	<ul style="list-style-type: none"> - shares < 3 years - other unlisted shares whose value exceeds DKK 133,700 - intellectual property
Finland	
France	<ul style="list-style-type: none"> - business assets and business portfolios - real estate - movable property except furniture, motor vehicles and household appliances
Germany	<ul style="list-style-type: none"> - business assets - real estate < 10 years - movable property, including shares and bonds < 1 year - withdrawing assets from business - real estate < 10 years, other assets < 1 year - derivative transactions, contractual period < 1 year
Greece	<ul style="list-style-type: none"> - business assets - unlisted shares - shares in partnerships or limited liability companies - goodwill or registered trademark - assets which are not exempt
Ireland	<ul style="list-style-type: none"> - large number of exemptions - real estate serving as taxpayer's principle residence

Table 6. continued

	TAXABLE ASSETS	EXEMPT ASSETS
Italy	<ul style="list-style-type: none"> - business assets - land - real estate < 5 years - shares in companies and partnerships - securities - derivative instruments 	<ul style="list-style-type: none"> - real estate > 5 years
Luxembourg	<ul style="list-style-type: none"> - business assets - real estate < 2 years - movable property < 6 months - substantial shareholding 	<ul style="list-style-type: none"> - bonds issued by domestic residents
Netherlands	<ul style="list-style-type: none"> - substantial shareholding 	
Portugal	<ul style="list-style-type: none"> - real estate (only 50%) - intellectual and industrial property (50%) - shares, bonds < 1 year 	<ul style="list-style-type: none"> - tangible assets of an individual entrepreneur, if profits are reinvested in similar assets in the following 3 years - real estate serving as taxpayer's principle residence, if total profit is invested in the acquisition of the same assets within 2 years
Spain	<ul style="list-style-type: none"> - assets < 1 year 	<ul style="list-style-type: none"> - real estate serving as taxpayer's principle residence, if total profit is invested in the acquisition of the same assets within 2 years
Sweden	<ul style="list-style-type: none"> - private assets intended for dwelling (2/3 of capital gains) - real estate intended for business activity of the taxpayer (90% of capital gains) 	
United Kingdom	<ul style="list-style-type: none"> - assets not exempt 	<ul style="list-style-type: none"> - under certain defined conditions, various forms of assets may be exempt (e.g. tangible movable property below a certain value, zero or reduced coupon bonds, motor vehicles, principle residence, etc.) and deferral for various types of assets

Source: IBFD (2004a): *Guide to European Taxation, Volume VI: Taxation of Individuals in Europe, Amsterdam (loose leaf) (as at 20 November 2004); IBFD (2004c): European Tax Handbook, Amsterdam.*

It can be concluded that business assets and short-term capital gains on the sale of real estate and securities and stakes are the most commonly taxed items, while items exempt from taxes are usually capital gains on the sale of real estate used as a principle residence and long-term capital gains on the sale of real estate, securities and stakes. In some countries, such as for instance in Belgium and the Netherlands, capital gains tax is levied only on a limited number of very specific types of assets, so for all practical purposes it can be claimed that capital gains tax does not exist in those countries.

Although it could be argued that, in view of numerous capital gains tax exemptions in the old EU Member States and different tax rates on capital gains on different types of assets in some countries, tax legislation creates significant non-neutrality between capital gains on different types of assets, comparisons in time point to a progress towards greater neutrality (Journard, 2001). The introduction of a dual system of income taxation in the Scandinavian countries has contributed to equality in tax treatment of capital gains on different types of assets, even in tax treatment of different types of capital income. Still, it is obvious that in formulating capital gains taxation, the authorities are not governed by the principles of assets neutrality and equality in tax treatment of different types of assets, but by fiscal and political objectives, irrespective of the mentioned principles. In the area of capital gains taxation in the EU, there is currently no initiative aimed at harmonisation and no essential changes can be expected to take place in this area any time soon.

The selected eleven transition countries are also familiar with the concept of capital gains taxation. In Lithuania, Poland and Romania capital gains are subject to a special tax, while in other countries they are subject to integrated taxation together with other forms of income. Generally, capital gains in Hungary are taxed as income, but almost all types of capital gains are subject to a uniform flat rate.

As shown in Table 7, which gives an outline of the basic characteristics of capital gains taxation in transition economies, capital gains tax rates differ greatly among countries, ranging from 1 percent in Romania to 50 percent in Slovenia. In most transition countries, however, capital gains tax stands at around 20 percent.

Unlike the old EU Member States which as a rule allow certain degree of tax exemptions, among transition countries only Hungary and Lithuania envisage tax exemptions for capital gains up to a certain threshold value. Tax base inflation adjustment is permitted in Bulgaria, Slovenia and Croatia, while capital loss deduction is permitted in Slovenia to the amount of capital gains and in Croatia, provided capital gains are taxed within the framework of income tax and as such, capital losses reduce the tax base. Roll-over relief is allowed in Hungary and in Poland.

Table 8 shows the types of assets which are subject to capital gains tax obligation, as well as assets exempt from this type of tax obligation in transition economies. Compared with the old EU Member States, it would appear that fewer assets generate income which is subject to capital gains tax, and that there are fewer exemptions. This somewhat simpler and more neutral taxation of capital gains in the transition economies might be due to the fact that capital gains tax policy in these countries is less burdened with tradition, compared with the old EU Member States.

Table 7. Taxation of Capital Gains in Transition Economies

	Type of taxation	Rates ⁽¹⁾	Different treatment of short-term and long-term gains	Threshold	Adjustment for inflation	Capital loss deduction	Roll-over relief
Bulgaria	IIT	29%	yes	no	yes	no	no
Croatia ²	IIT	15% / 25% or 20%	yes	no	yes	yes	yes
Czech Republic	IIT	32%	yes	no	no	no	no
Estonia	IIT	26% in 2004, 24% in 2005, 22% in 2006 and 20% as of 2007	yes	no	no	no	no
Latvia	IIT	25%	yes	no	no	no	no
Lithuania	S	15%	yes	yes	no	no	no
Hungary ³	IIT/S	20% / 45%	yes	yes	no	no	yes, in case of real estate
Poland ⁴	S	10% / 19%	yes	no	no	no	yes, in case of real estate
Romania	S	1%	no	no	no	no	no
Slovakia	IIT	19%	yes	no	no	no	no
Slovenia ⁵	IIT	50%	yes	no	yes	yes, from gains	no

Legend: IIT = included in income taxation; ICIT = included in capital income taxation; S = special tax

¹⁾ In case of countries in which progressive taxation of income is used for capital gains taxation, the highest marginal tax rates are given.

²⁾ In Croatia, a lower 15 percent tax rate of is levied, after deduction, on income on receipts from distribution or option to purchase own shares, while any income on the sale of real estate and property rights is subject to a 25 percent tax rate as of 1 January 2005. Until end-2004, the tax rate on income on the sale of assets and property rights stood at 35 percent. Income on the sale of real estate is tax exempt if the real estate in question was used for dwelling purposes by the taxpayer or maintained members of his/her immediate family and in case the real estate or property right in question was sold after three years from the date of its acquisition - indicating that there is a different tax treatment in place for short-term and long-term gains. The 20 percent rate is used if the taxpayer chooses to pay profit tax. Here, capital gains taxation is considered to be taxation of any gain on the change in the price of assets, irrespective of the fact whether the legislation refers to such income as capital income or property or property rights income.

³⁾ In Hungary, a uniform 20 percent rate is applied to the majority of capital gains.

⁴⁾ In Poland a lower tax rate of 10 percent is used to tax gains on the sale of movable property, real estate and property rights in case the sale takes place within 5 years from the date of purchase, while a higher, 19 percent rate is used to tax capital gains on the sale of shares and other securities.

⁵⁾ In Slovenia, capital gains are taxed first at the rate of 30%, with this tax being included in the final tax obligation.

Source: IBFD (2004b): Guide to European Taxation Volume V: Taxation & Investment in Central and East European Countries, Amsterdam (loose leaf) (as at: 20 November 2004), Income Tax Act (Official Gazette 177/04).

Table 8. Tax Treatment of Capital Gains with Regard to the Type of Assets in Transition Economies	
TAXABLE ASSETS	EXEMPT ASSETS
Bulgaria	<ul style="list-style-type: none"> - shares listed on the Bulgarian Stock Exchange - basic > 3 years of use or > 5 years of ownership
Croatia ¹	<ul style="list-style-type: none"> - real estate used for dwelling by the taxpayer or by maintained members of his/her immediate family - real estate or property right sold after 3 years from the date of acquisition - sale of real estate and property rights between spouses, etc.
Czech Republic	<ul style="list-style-type: none"> - motor vehicles, aeroplanes, and ships < 1 year - real estate < 5 years - securities, shares, stakes in joint-stock companies < 6 years - stakes in other companies < 5 years - assets not exempt
Estonia	<ul style="list-style-type: none"> - motor vehicles, aeroplanes and ships > 1 year - real estate > 5 years - securities, shares, stakes in joint-stock companies > 6 years - stakes in other companies > 5 years - sale of own apartment - country house > 2 years - various restitution programs - movable property used by the taxpayer for own purposes - shares and other securities, real estate > 1 year
Latvia	<ul style="list-style-type: none"> - real estate < 1 year
Lithuania	<ul style="list-style-type: none"> - property including shares
Hungary	<ul style="list-style-type: none"> - real estate - securities - movable property - withdrawal of entrepreneurial assets
Poland	<ul style="list-style-type: none"> - shares and other securities - real estate, property rights, and movable property < 5 years
Romania	<ul style="list-style-type: none"> - shares of joint-stock companies and stakes in limited liability companies and futures contracts
Slovakia	<ul style="list-style-type: none"> - housing serving as taxpayer's residence < 2 years - other assets < 5 years
Slovenia	<ul style="list-style-type: none"> - real estate, shares and stakes < 3 years

Source: IBFD (2004b): *Guide to European Taxation Volume V: Taxation & Investment in Central and East European Countries, Amsterdam (loose leaf) (balance as at 20 November 2004), Income Tax Act (Official Gazette 177/04).*

Note: ¹ Status after 1 January 2005.

6 Concluding Remarks

In the preceding chapters simple comparisons are given of the basic legislative provisions in connection with the taxation of income from interest, dividends and capital gains in the old EU Member States and several transition countries. To avoid unnecessary complication of the comparisons given, no attempt was made in general to examine theoretical concepts on which taxation systems in the reference countries are based. Nevertheless, even a simple comparison may lead up to some conclusions.

As regards taxation of income from interest on savings deposits, the old EU Member States clearly tend to tax this source of income with relatively high rates, ranging from 15 to 59 percent. However, in an effort not to discourage savings, many of these countries allow for certain tax exemptions and tax reliefs for certain types of savings. By contrast, the transition countries are trying, as much as possible, to exempt savings income from taxation and tax mainly savings income earned in foreign banks.

The old EU Member States tend to treat similarly income from corporate and government bonds, with the rates of taxation on interest on bonds being equal or lower than those on income from interest on savings deposits. Transition countries, on the other hand, impose higher taxes on corporate bonds than on income from interest on savings deposits, though these rates are generally still lower than those found in the old EU Member States. Government bonds are mainly tax exempt in these countries.

Taxes on dividends in the old EU Member States are equal or lower than taxes levied on bonds, which can be explained by the efforts of these countries to mitigate double taxation of dividends. In the transition countries, taxes on dividends are as a rule lower than in the old EU Member States, with not a few of them providing for a full tax exemption for dividends.

The largest diversity can be found in capital gains taxation, both in terms of the level of taxation, the form of taxation and the treatment of capital gains on different types of assets. Differences in capital gains taxation are particularly large in the "old" Europe, probably attributable to traditionally different taxation

practices in each of these countries. Taxation of capital gains in transition countries is much more uniform and there is a smaller number of the types of assets which are subject to this type of taxation in these countries.

Croatia stands out as a country with a particularly lenient capital income tax policy; income from interest on savings deposits is fully tax exempt and so are dividends and bond yields, with only few types of assets being subject to capital gains taxation. However, when compared with other transition countries, such tax treatment of capital gains is not unusual. It should be noted that on the European Union level there are no regulations that would require harmonisation of tax burden for this type of taxes.

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