Effects of a Shift from Income Deductions to Tax Credits
— A Study on the Impact of Income Tax Reform in the Netherlands —*

Yuka Shiba
Associate Professor, Faculty of Law, Tokoha University

Abstract

As the Netherlands has faced problems such as increased social security costs, it has expanded the taxation base by adopting a flatter income tax system. Through tax reforms, seeking to unify social insurance premiums and taxes, the Netherlands shifted partly from income deductions to tax credits to expand the taxation base. In the tax reform of 2001, introduction of tax credits was effective to some degree in improving the labor participation rate for women and the employment situation. After the tax reform of 2001, the significance of encouraging people to work has been emphasized. However, as the fiscal condition deteriorated after the Lehman Shock, tax credits have been reformed from the perspective of expanding the tax base, in addition, there is a trend of reducing tax credits for high-income earners. The Netherlands’ tax credit system may provide clues to a solution to the problem of the regressivity that is inherent in the consumption taxation as part of the integrated reform of social security and tax systems in Japan.

Keywords: income tax, tax credits, tax reform, the Netherlands

I. Introduction

Nowadays, the burden placed on social security due to the declining birthrate and aging population is increasing in developed countries. Therefore, keeping public finances sustainable is an important agenda in developed countries.

In this aging society, governments need to restore certain important functions of personal income tax items while also increasing the role of consumption taxes. It is possible to achieve a subsistence level of income security by using not only progressive income tax rates, but also personal deductions and other personal exemptions along with a negative income tax. Therefore, it has been suggested that income tax systems must contribute to the enhancement of social security and the redistribution of wealth (Kaneko, 2014).

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A global trend in recent years is for governments to expand their tax bases and to reduce the progression in income tax rates, and to flatten their tax rates. At the same time, they have moved from tax deductions to tax credits.

In the Netherlands in the early 1980s, there were major problems regarding public finances, the tax burden, labor costs, increasing unemployment, and the intensification of the trade union movement (Nagasaka, 2001). In order to overcome this so-called Dutch disease, the government, businesses, and labor unions collaborated in 1983 to construct the Wassenaar Agreement. Goals were established for each of these groups. The government aimed for “tax cuts and reductions in government spending,” the trade unions focused on “acceptance of wage restraint,” and business aimed at “creating jobs.” As a result, in 1999 the unemployment rate had dropped to 3%, and finances were also balanced (Van Oorschot, 2002; Bovenberg, et al., 2001). This has been called the “miracle of the Netherlands.”

Further steps were to come. In the early 1990s, the Netherlands reformed its income tax rate system by integrating social security contributions into the income tax rate. In 2001, the Income Tax Act (Wet inkomstenbelasting 2001, IB) was amended to introduce a box system, as well as to apply a proportional tax rate to capital income. The tax rate on earned income was reduced and the tax base of the income tax was expanded. Several income deductions were converted into tax credits. The working tax credit was increased with the aim of promoting employment (Shiba, 2011).

In the Netherlands, problems such as the increase in social security costs, high unemployment, and the budget deficit (Mizushima, 2003; Kapteyn & Vos 1999) were mitigated in the short term. However, after the Lehman shock of 2008, they began to get worse again. Nonetheless, the Netherlands has maintained its strategy of expanding the tax base with flattening the income tax rate. This paper focuses on the effects of the change from tax deductions to tax credits in the Netherlands.

The shift from tax deductions to tax credits is not only related to the income tax base, but is also closely related to the income tax rate. Moreover, the income tax rate is also related to consumption taxation. First, we consider the discussion of flattening income tax rate in the Netherlands. Second, we consider how consumption taxes have been affected by the flattening of the income tax rate, with special attention given to the burden of energy taxes on individuals. Third, we consider how the tax credits were designed while the tax base was expanded due to the reduction in the income tax rates. Fourth, we will investigate the effect of the 2001 tax reform on the economy and tax revenue. Finally, we consider some implications from the Netherlands for the Japanese tax system.

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1 In the Netherlands, there is much discussion about the “flat tax.” This refers to a flattening of the progressive tax rate, not to a consumption-type income tax.

2 According to Ogose (1998), the number of long-term unemployed was not reduced. The number of recipients of disability insurance continued to grow. This had been a hidden problem of unemployment; people who retired early tended to use wage-related disability benefits to be paid into retirement rather than using unemployment insurance (WW).
II. Flattening of the income tax rate

II-1. The need for simplification of income tax

In the 1980s, when the top rate of income tax in the Netherlands was 72%, problems of tax avoidance occurred. Since both the progressive tax rate and wealth tax were levied on capital income, the taxation was criticized as unduly heavy. As various methods were used to avoid taxes, tax law became more complicated in order to contain tax avoidance. Therefore, simplification of the tax system was strongly demanded (Van Mierlo, 1991).

In 1990, a tax reform called the Oort operation was enacted. The Oort operation was intended to simplify the tax system. The basic tax exemption was reduced, the deductibility of the social insurance premiums was abolished in order to broaden the tax base, and the top income tax rate was reduced from 72% to 60% (Caminada & Goudswaard, 1997).

The number of tax brackets was reduced from nine to three: the tax rate structure of income tax was (rates 1990) 35.2% in the first bracket (of which social insurance premiums accounted for 28.2%), 50% in the second bracket, and 60% in the third bracket with wealth tax imposed in addition to the progressive tax rate on capital income. In the late 1990s, distortions such as dividends and interest affected the treatment of capital income. This caused tax avoidance, such as the transferring of capital abroad. By the end of 1990s, again, it became necessary to expand the tax base and reduce the income tax rates.

II-2. The debate over the flat tax in the Netherlands

Many countries have adopted increasing statutory tax rates with income. Under such a progressive structure, vertical inequity can be reduced. However, it is also asserted that the resulting high marginal tax rate will discourage entrepreneurship, reduce citizens’ willingness to work, devalue the investment of taxpayers, and cause tax avoidance. Therefore, it has been concluded that flattening the tax bracket rates or creating a proportional rate is preferable to a progressive rate.

In the discussion of a flat expenditure tax, the tax base of an individual consists of limited to wages, salary, and pension benefits. A proportional tax rate is adopted, meaning that the marginal tax rate does not increase as income increases (Hall & Rabushka, 1996). It is believed that a flat tax will not reduce citizens’ willingness to work and that it will increase the labor supply. However, it is not limited to expenditure tax. Applying a low marginal tax rate for an income tax to a wide tax base means that additional income can be obtained by additional work, and thus willingness to work increases. Applying a high marginal rate to a narrow tax base is thought to negatively impact growth.

In the Netherlands, the idea of applying a proportional tax rate to earned income has been put forward by politicians as well as researchers (Hemels, 2013). Because a high marginal tax rate causes distortions in savings behavior and labor supply, as well as tax evasion. On the other hand, compared to a proportional tax rate, a progressive tax rate is desirable based
on the principle of ability to pay (Herwaarden & De Kam, 1983).

In “Tax system in the 21st Century,” a consultative committee of the Ministry of Finance concluded that applying a proportional tax rate to earned income is not efficient and is not essential for the purpose of simplifying a system. From an international point of view, to expand the tax base, a lower income tax rate has been proposed (Tweede Kamer der Staten-Generaal, 1997).

II-3. Changes in the tax rate on earned income

In the 2001 tax reform, the box system was introduced to the income tax. After this reform taxpayers can no longer deduct capital losses from taxable income. The income for taxes in Box 1 (IB chapter 3) includes not only earned income, such as salary, pension, and business income, but also a fixed proportion of housing wealth.

A progressive tax rate is applied to the income in Box 1. The lowest tax rate was reduced from 33.9 to 32.35%, the tax rate for the second bracket from 37.95 to 37.6%, the tax rate in the third bracket from 50 to 42%, and the highest tax rate was reduced from 60 to 52% (rates 2001).

The tax rates for high earners were reduced greatly. Because of the introduction of the working tax credit, it was thought that the benefits of the tax reform were more evenly spread (Groot, & Van der Veen, 2006).

The progressive tax rate is applied to Box 1, while a proportional tax rate is applied to Box 2 (25%, income from substantial interests, in short: shareholdings of 5% or more) or Box 3 (30%, income from savings and investments). There is still room for the tax arbitration, but by flattening the tax rate, such arbitration was expected to be reduced.

Social insurance contribution rates and income tax rates were integrated by the Oort operations in 1990; the lowest tax rate in the Netherlands is still high as compared to international standards. The bases of the two categories became equal, and the same definition of income was to be used for both (Bakirtzi, et al., 2011).

However, the nature of social insurance and tax has not necessarily been integrated, as the Income Tax Act defines (gecombineerd heffingspercentage, IB Art. 8.1) the integrated tax rate. Until 2006, UWV (Dutch Workers Insurance Agency) collected social security contributions, whereas the tax agency collected income taxes. The two collection procedures are now integrated into one, and the collection is performed by the tax agency. As a result, the withholding obligation of employers has been simplified. The concept of uniting wages was fulfilled by the Social Security Finance Act (Wet financiering sociale verzekeringen), but nonetheless it was criticized from the field of social security (Bakirtzi, et al., 2011).

Under the Social Insurance Finance Act, information about employees is provided to the agency through the tax withholding agent. After being collected by the tax office, social employee insurance contributions are transferred to the fund. In this way, the character of social insurance contributions is distinguished from that of taxes (Pieters, 2006). Only general social insurance contributions for the national old age pension (AOW), the survivor’s
pension (ANW), and the special medical expenses insurance system (AWBZ) are integrated with income tax.

The pension system in the Netherlands consists of three pillars. The first pillar consists of the national old age pension. Pensioners can receive the benefit as a basic pension amount of 70% of the legal minimum wage (this figure applies to unmarried citizens. For couples, the pension amount is 50% per person in total 100%). If they have been residing or working in the Netherlands in the 50 years before they received the pension (2% is built up every year). The second pillar consists of collective pension schemes which are operated by either corporate pension funds, industry-wide pension funds, pension funds for independent professionals such as dentists and medical specialists, or regular insurance companies. The third pillar is private pension savings (which are tax favored up to a certain amount).

Like the AOW, the survivor's pension (ANW) is a National Insurance. The survivors' benefit is for men and women whose spouse or partner has died, and also provides a right to a benefit for children who have lost their parent(s). It is paid in accordance with certain conditions, such as the presence or absence of a child (under 18 years of age) and the individual’s date of birth (Sasaki, 2012).

There are two systems of medical insurance in the Netherlands. One is a special medical expenses insurance system (AWBZ), and the other consists of health insurance plans for all residents of the Netherlands (ZVW) (Oka, 1996). Each resident is automatically subscribed to the special medical expenses insurance system (AWBZ) and the health insurance system (ZVW). The annual premium of the health insurance system is 7.75% of the salary of the employee (2013) plus an individual premium levied by the insurance company. The upper limit for income is 50,853 euros, and the annual premium is limited to 3,941 euros (2013), the individual premium is not limited. Annual premiums are collected from employers (Oomori, 2012).

People aged 65 years or more receiving the old age pension, do not pay premium for the old age pension.

The tax budget of 2013, due to a budget deficit reduction, expanded the bracket and raised the lowest taxable rate of income tax from 1.95 to 5.85%. In addition, the tax rate of the second bracket was increased from 10.8 to 10.85%. There was no change in the top tax rate. The burden was extended to high-income earners by the reduction of the tax credit. In 2014, the tax rate of the first bracket was lowered to 5.1% (Table 1) and the tax credit for higher income earners was further reduced (as of 2016 the working tax credit will be 0 for earners of an income over EUR 110,000), which is in fact a hidden increase in the highest tax rate, a wish of left wing politicians.
II-4. Changes in capital income taxation

In the Netherlands, the concept of source income applied under the old personal income tax Act 1964. This is the idea that income can be taxed only if it is generated from a source, such as an employment contract, a business, and capital.

The Income Tax Act has traditionally distinguished between capital income and business income. Income resulting from a business is taxed, including capital gains. Capital gains are not taxed if the asset is not used for business; moreover, until the 2001 tax reform, interest could be fully deducted (Vording & Lubbers, 2006).

In the 2001 tax reform, profits from a substantial shareholding (which is a shareholding of at least 5% of a certain class of shares of a company resident in or outside of the Netherlands) were taxed in Box 2. Both capital gains and dividends are taxed at a rate of 25% in Box 2. It should be noted that, as a part of a 2014 economic stimulus package, incomes of up to 250,000 euros in Box 2 were taxed at a rate of 22% in 2014 (temporarily reduced rate).

On the other hand, it was decided that income from savings and investments would be taxed in Box 3. Income from savings and investments is determined by calculating 4% of the value of an individual’s assets minus all liabilities (except for assets and liabilities taxed in box 1 and 2) insofar as this net value exceed an exempted amount (EUR 21,139 in 2014) and is taxed by the proportional tax rate of 30% in Box 3. This tax replaced the wealth tax that was abolished in 2001. It is not possible to deduct the interest from the capital income in Box 3, because capital income is deemed income. In addition, imputed income from the residential

**Table 1. Tax rate of Income tax (2014)**

<table>
<thead>
<tr>
<th>Income (€)</th>
<th>Income tax rate</th>
<th>AOW</th>
<th>ANW</th>
<th>AWBZ</th>
<th>Social security contributions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 65 years old</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0–19,645</td>
<td>5.10%</td>
<td>17.90%</td>
<td>0.60%</td>
<td>12.65%</td>
<td>31.15%</td>
<td>36.25%</td>
</tr>
<tr>
<td>19,645–33,363</td>
<td>10.85%</td>
<td>17.90%</td>
<td>0.60%</td>
<td>12.65%</td>
<td>31.15%</td>
<td>42%</td>
</tr>
<tr>
<td>33,363–56,531</td>
<td>42%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>42%</td>
</tr>
<tr>
<td>Above 56,531</td>
<td>52%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>52%</td>
</tr>
<tr>
<td>Over 65 years old</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0–19,645</td>
<td>5.10%</td>
<td>0.60%</td>
<td>12.65%</td>
<td></td>
<td>13.25%</td>
<td>18.35%</td>
</tr>
<tr>
<td>19,645–33,363</td>
<td>10.85%</td>
<td>0.60%</td>
<td>12.65%</td>
<td></td>
<td>13.25%</td>
<td>24.10%</td>
</tr>
<tr>
<td>33,363–56,531</td>
<td>42%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>42%</td>
</tr>
<tr>
<td>Above 56,531</td>
<td>52%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>52%</td>
</tr>
</tbody>
</table>

property is taxed in Box 1. The capital gains from the residential property are not taxed in Box 3. Other real estate, such as a holiday home, is included in Box 3.

Income in Box 3 is defined as “income from savings, investment.” The taxable assets in Box 3 are (1) immovable, (2) direct or indirect rights on real estate, (3) investment property (household personal property is excluded), (4) rights on movables, (5) non-business property (including money), and (6) other valuable property. Specific assets are savings, listed equity and unlisted stocks, bonds, and real estate (other than principal residence). Assets that produce income in Box 1 or Box 2 are excluded. The movables which are not investments but are designated for personal use or consumption are not taxed. Deemed income is only taken into account when the difference between assets and liabilities exceeds a fixed amount (heffingvrij vermorgen 21,139 euros in 2014, [IB Art. 5.1]). Income in Box 3 is always 0 or more, as negative income is impossible because of this rule.

The basic exemption of Box 3 varies every year, taking into account the inflation rate. In addition, person with a partner for income tax purposes can transfer his basis exemption to his partner, for example if the partner exceeds the exemption and the transferring partner cannot fully use the exemption. For taxpayers over the age of 65, the basic exemption is somewhat higher to 27,984 euros in 2014.

In the Netherlands, some argue that capital gains should be included in the tax base (Jacobs, 2013). It has been suggested that since the capital gain has previously been excluded from the tax base, including it into the tax base would be difficult in practice. As described above, in Box 3 a relatively high basic exemption is still permitted and there is no capital gains tax. Also, second pillar pension savings are excluded from Box 3, further narrowing the tax base for capital taxation. As a result, the tax base of capital income is quite narrow in the Netherlands. Because the proportional rate is applied to capital income, there is a problem of equity in Box 3.

III. Impact on consumption taxation by the flattening of the income tax rate

III-1. From income taxation to consumption taxation

The reduction in the tax on labor is to be financed by reductions in total public expenditure and by increases in indirect taxes, such as VAT and environmental levies (Caminada, 2001).

Tax revenue from energy tax and VAT was intended to be allocated to the flattening of the income tax rate because energy tax and VAT could provide stable revenue. The standard VAT rate was 16% in 1980, 20% in 1988, decreased to 17.5% in the early 1990s, and then increased to 19% in the 2001 tax reform. Furthermore, it increased to 21% in 2012.

III-2. Energy tax

In 1996, under the environmental tax law, an energy tax was introduced. Small-scale consumers such as households were taxed for their energy use (e.g., use of electricity or
The Regulatory Energy Tax on small-scale energy consumption was not primarily intended to generate tax revenue, but rather as an incentive environmental tax for energy savings. However, as of 2004 the name of the tax became Energy Tax (Energie Belasting) and since then it was primarily intended to raise revenue. The revenue from environment-related taxes, which was 1.86 billion guilders before the introduction of the Regulatory Energy Tax, has increased about 2-fold to 3.76 billion guilders. It has since been used for income tax cuts.

Tax revenue from the Regulatory Energy Tax was used to reduce social insurance contribution (0.19%), increase the tax credit for the self-employed, raise the basic exemption and the basic exemption for the elderly, reduce the income tax rate (0.6%), and reduce the corporation tax rate (3%) (European Environment Agency, 2005). With the tax reform of 2001, the rate of the Regulatory Energy Tax was raised to a large extent by recycling the tax revenue; a reduction was made to the income tax rates.

The environmental tax reform recycled the tax revenue of environment-related taxes in order to cut the rates of social insurance premiums and income taxes while ensuring the neutrality of tax revenue. According to the double dividend hypothesis, which has been cited as theoretical support for environmental tax reform, increasing taxes on energy and resources can lower the cost of labor and the unemployment rate.

Regarding the introduction of the Regulatory Energy Tax in the Netherlands, it is possible to view it as an environmental tax reform because of the use of revenue from environment-related taxes to cut income taxes. While the “Green Tax Committee Second Report” focused on the positive impact on the environment due to the transition to environmental taxes, the “Green Tax Committee Third Report” addressed the ability to cut income tax with the financial resources from the energy tax (Kogels, 2010; Vermeend & Vaart, 1998; The Dutch Green Tax Commission, 1998).

Due to the EU’s Energy Tax Directive (2003/96/EC), the Regulatory Energy Tax was transformed into an energy tax in 2004. Taxation of energy other than coal was regulated as a separate excise tax. Taxable energy, with respect to the energy tax, is the amount of electricity and natural gas consumed. Energy tax is levied on the sale of electricity and natural gas through the connection between the supply of electricity, natural gas and consumers.

Energy-intensive enterprises are exempt from energy tax; a low tax rate is applied to users of large amounts of natural gas and electricity, such as large factories (Speck & Jikova, 2009). This is because energy tax entails the risk of competitiveness. The tax rate of energy tax is regressive: the tax rate decreases as the consumption of energy increases. This is, of course, not in line with the environmental idea which was originally at the basis of the tax. In addition, the tax rate is amended every year by taking into account the inflation rate. In other words, energy tax contains a mechanism by which it depends on the consumption of natural gas). Instead of taxing for carbon content, the energy tax requires citizens to pay for their energy consumption. Therefore, the energy tax is not an environmental tax in a narrow sense.
electricity and gas in the household (Table 2).

IV. Broadening of the tax base due to the flattening of the income tax rate

IV-1. Transition from tax deductions to tax credits

Under the Oort operation in 1990, 8% of income (maximum 2,086 guilders (1994)), as well as commuting expenses and certain other expenses, could be deducted from income. The amount of the basic allowance was 6,074 guilders, but if the spouse received no income, it was possible to transfer the basic exemption (Te Spenke, 1995). Between 1990 and 1998, the basic allowance was raised gradually, partly because of the impact of inflation, from 4,568 guilders to 8,617 guilders. This caused a shrinking of the tax base.

In the Oort operations, some limits were placed on the costs of business, and social insurance premium deductions were also abolished.

In the tax reform 2001, deductions were further reduced. Employees can no longer deduct any costs except for a small deduction (not real costs) if they travel to their work with public transport. Furthermore, some, but not all personal (not income related) deductions were transformed from an income deduction to a tax credit. Tax credits include living expenses for

### Table 2. Tax rate of Energy tax (2014 and 2013)

<table>
<thead>
<tr>
<th>Natural Gas (m³)</th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>0–170,000</td>
<td>0.1894</td>
<td>0.1862</td>
</tr>
<tr>
<td>170,000–1 mln.</td>
<td>0.0446</td>
<td>0.0439</td>
</tr>
<tr>
<td>1 mln–10 mln.</td>
<td>0.0163</td>
<td>0.0160</td>
</tr>
<tr>
<td>Over 10 mln.</td>
<td>0.0117</td>
<td>0.0115</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Electricity (kWh)</th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>0–10,000</td>
<td>0.1185</td>
<td>0.1165</td>
</tr>
<tr>
<td>10,000–50,000</td>
<td>0.0431</td>
<td>0.0424</td>
</tr>
<tr>
<td>50,000–10 mln.</td>
<td>0.0115</td>
<td>0.0113</td>
</tr>
<tr>
<td>Over 10 mln.(non-business)</td>
<td>0.0010</td>
<td>0.0010</td>
</tr>
<tr>
<td>Over 10 mln.(business)</td>
<td>0.0005</td>
<td>0.0005</td>
</tr>
</tbody>
</table>

child support (under the age of 21), high medical costs, and cost of home leave for people with disabilities under the age of 21, cost of education (for self), donation costs (De Kam, 2011). However, several income deductions for personal (not income related) costs still exist, such as gift deduction, deductions for monument owners, for alimony to an ex-spouse, for special health care costs and education.

Through the Oort operations, income tax rates were reduced. However, there was a drawback which high-income earners would benefit more than low-income people as a result of the income tax deduction.

Some proposals were raised regarding how to expand the tax base of the income tax. The first was maintaining tax allowances, the second was the partial transition to the tax credit for personal allowances, and the third was a repeal of the basic exemption. Income tax deduction was advantageous for high-income earners but had few benefits for low-income earners; therefore, the transition to tax credit has been conducted in light of what was learned from income tax deduction (Sillevis & Van Kempen, 2011).

Other purposes of the transition to the tax credit were to strengthen the redistribution function (instead of flattening the tax rate), to apply economic incentives to work, and to provide income compensation for people with disabilities and for older people.

Seven deductions were abolished in the 2001 tax reform, while 12 new tax credits were introduced. These were the general tax credit (algemene heffingskorting), the working tax credit (arbeidskorting), the child tax credit (kinderkorting), the additional child tax credit (aanjullende kinderkorting), the combination tax credit (combinatiekorting), the single parent tax credit (aanjullende-ouderkorting), the additional single parent tax credit (alleenstaande-ouderkorting), the elderly tax credit (ouderenkorting), the single elderly tax credit (aanjullende ouderenkorting), and the young disabled tax credit (jonggehandicaptenkorting).

Two investment tax credits were introduced: the venture capital investment tax credit (korting voorbeleggingen in durfkapitaal) and the social investment credit (korting voormaatschappelijke beleggingen) (Klootwijk, 2001).

Tax credits were revised every year. As of 2014 the general tax credit and the working tax credit are reduced (in some cases to 0) for higher income earners. Most of tax credits are for the purpose of promotion of employment (Table 3).
Table 3. Maximum Tax credits (2014)

<table>
<thead>
<tr>
<th>Tax Credit Description</th>
<th>Less than 65 years old</th>
<th>Over 66 years old</th>
</tr>
</thead>
<tbody>
<tr>
<td>General tax credit (algemene heffingskorting)</td>
<td>€2,103</td>
<td>€1,065</td>
</tr>
<tr>
<td>Working tax credit (arbeidskorting)</td>
<td>€2,097</td>
<td>€1,062</td>
</tr>
<tr>
<td>Deferred retirement tax credit (werkbonus)</td>
<td>€1,119</td>
<td></td>
</tr>
<tr>
<td>Early retirement temporary tax credit (tijdelijke heffingskorting voor VUT en prepensioen)</td>
<td>€121</td>
<td></td>
</tr>
<tr>
<td>Reserve tax credit (levensloopverlofkorting)</td>
<td>€205</td>
<td></td>
</tr>
<tr>
<td>Income-related combination tax (inkomensafhankelijke combinatiekorting)</td>
<td>€2,133</td>
<td>€1,080</td>
</tr>
<tr>
<td>Parental leave tax credit (ouderschapsverlofkorting)</td>
<td>€4.29/hour</td>
<td></td>
</tr>
<tr>
<td>Single parent tax credit (alleenstaande-ouderkorting)</td>
<td>€947</td>
<td>€480</td>
</tr>
<tr>
<td>Additional single-parent credit (aanvulling op de alleenstaande-ouderkorting)</td>
<td>€1,319</td>
<td>€668</td>
</tr>
<tr>
<td>Young disabled tax credit (jonggehandicaptenkorting)</td>
<td>€708</td>
<td></td>
</tr>
<tr>
<td>Elderly tax credit (ouderenkorting)</td>
<td>€1,032</td>
<td></td>
</tr>
<tr>
<td>Elderly tax credit (ouderenkorting bij een inkomen) above €35,450</td>
<td></td>
<td>€150</td>
</tr>
<tr>
<td>Single elderly tax credit (alleenstaande ouderenkorting)</td>
<td></td>
<td>€429</td>
</tr>
<tr>
<td>Green tax credit (korting groene beleggingen)</td>
<td>0.007</td>
<td>0.007</td>
</tr>
</tbody>
</table>

(Source) http://www.hr-kiosk.nl/hoofdstuk/tabellen/heffingskortingen-tabellen
IV-2. General tax credit (Algemene heffingskorting)

In the 1994 general election, the Green Party (Groen Links) announced a plan to turn the personal exemption into a small refundable tax credit. However, from the standpoint of basic income, it was argued that a small refundable tax credit was of little value, and that the value would apply only to working people (Groot & Veen, 2006).

The general tax credit (IB Art. 8.10) was introduced in 2001. The amount of the general tax credit was constant regardless of income until 2013.

Beginning in 2014, the amount of the general tax credit is partly phased-out in the second and the third bracket in Box 1. The general tax credit for those over 65 years of age in 2014 is a maximum of 1,065 euros (693 euros for incomes of more than 56,495 euros), but for those under the age of 65 it is a maximum of 2,103 euros (Table 3). In 2015, the general tax credit for high-income earners of more than 120,000 euros will be zero, and so will that for high-income earners of more than 90,000 euros in 2016 (Figure 1).

The reason for this is that the labor party, which became part of the government, wanted to increase the burden on higher earning persons. However, it was feared that an increase of

Figure 1. General tax credit (2013–2017)

(Source) http://www.rijksfinancien.nl/belastingplan-2014/S_1171_MemorievanToelichting154/S_1175_4Maatregelenregeerakkoor158/a1008_Algemene-heffingskorting
(Note) Data for 2017 is approximately the same as that for 2016 but is not displayed.
the 52% tax rate or introducing a new, higher top rate would harm the Netherlands as a place for international business. For that reason the increase of the tax rate was hidden by lowering the general tax credit and the working tax credit, resulting in an effective raise of the marginal burden on higher incomes. It is possible that the reductions will be softened (The tax budget 2015 which was published on 16 September 2014, http://www.rijksoverheid.nl/onderwerpen/belastingplan-2015).

The basic exemption for a spouse with no income was transferrable to the main breadwinner under the personal income tax Act 1964. With the general tax credit, it is also possible to transfer the tax credit of a tax partner with low (or zero) income (Bosch & Van der Klaauw, 2012).

With the introduction of a general tax credit, the tax burden of taxpayers who had a partner with no income became less. Therefore, the general tax credit discourages the employment of tax partners of high income earners. This was regarded an unfair system (Niessen, et al., 2011). In 2009, the transferability of the tax credit to one’s partner by a low-income partner was set to be phased out over a period of 15 years, by making it impossible to transfer the tax credit by a partner who was born after 1972 and by a yearly reduction of the amount which can be transferred by partners born before 1972.

**IV-3. Working tax credit (Arbeidskorting)**

Prior to the 2001 tax reform, salary earners were able to deduct 12% of their salaried income from earned income (up to 1,465 euros (2000)). There were two problems with the earned income deduction. One was that high-income earners received more benefits than low-wage workers. The other was that a nonworking spouse could take advantage of the earned income deduction, and thus incentives for partners to find work were small.

In the tax reform of 2001, earned income deduction was converted to working tax credit (IB Art. 8.11). The maximum amount (920 euros) of working tax credit was applied to the minimum salary level (annually 15,117 euros). The working tax credit is independent of the tax rate. It was thought that it would become an incentive for unemployed spouses to find work.

On the other hand, there was no phasing out (decreasing) of the working tax credit (Figure 2). This was because taxpayers who face being phased out could avoid negative incentives (Gradus & Julsing, 2001). Rather, without regard to the participation decision in labor, employees with high-incomes were able to benefit from the tax cuts through the working tax credit. Thus, phasing out (decreasing) has been introduced into the working tax credit, because of financial deficit.

The working tax credit for high-income earners has been reduced to 550 euros. In addition, in 2016, the working tax credit for high-income earners is expected to be zero (Figure 3). However, it might be that this is changed again under the budget 2015. The

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3 Most countries that have adopted the working tax credit have a working credit with a phase-out for middle and higher income.
Figure 2. Working tax credit (2001)


Figure 3. Working tax credit (2013–2017)

(Source) http://www.rijksgroting.nl/2014/voorbereiding/groting,kst186878.html
working tax credit for low-income earners will have a two-step phasing-in. This is expected
to give an incentive to work for part-time female workers who make the minimum wage or
less.

The labor participation rate in the Netherlands in 2011 was 77%, which was higher than
the EU average (69%). Potential workers were estimated at about 2.4 million people (23%).
Therefore the Income Tax Commission (Commissie inkomsten belasting en toeslagen)
recommended an increase in the amount of working tax credit for low- and middle-income
earners. In the tax budget of 2013, the working tax credit for low-income earners was
increased to 1,723 euros.

In the tax budget of 2014, the lowest tax rate was reduced, but the working tax credit was
increased to 2,097 euros to promote employment (Table 4). The maximum working tax credit
for those over the age of 65 is 1,062 euros.

IV-4. Encouragement of early retirement and tax credits

In the Netherlands in the early 1980s, early retirement was encouraged in order to reduce
the unemployment rate of young workers. The early retirement system (Vervroegde Uit
treding) was introduced in many industrial sectors. Because the population in the Netherlands
is aging rapidly, the Dutch social partners have agreed that incentives for early retirement
need to be reduced. The Life Course Savings Plan (Levensloopregeling), which discourages
eyearly retirement, was implemented in 2006 (Euwals, de Mooij, & van Vuuren, 2009). Prior to
the introduction of the Life Course Savings Plan, the reserve tax credit (Levensloopverlofkorting) was introduced as a financial measure in 2004. This was abolished

<table>
<thead>
<tr>
<th>Labor income</th>
<th>Working tax credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Above</td>
<td>No more than</td>
</tr>
<tr>
<td>-</td>
<td>€8,913</td>
</tr>
<tr>
<td>€8,913</td>
<td>€19,248</td>
</tr>
<tr>
<td>€19,248</td>
<td>€40,721</td>
</tr>
<tr>
<td>€40,721</td>
<td>€83,971</td>
</tr>
<tr>
<td>€83,971</td>
<td>-</td>
</tr>
</tbody>
</table>

(Source) http://www.belastingdienst.nl/wps/wcm/connect/bldcontentnl/belastingdienst/prive/inkomstenbelasting/heffingskortingen/boxen_tarieven/heffingskortingen/arbeidskorting/arbeidskorting

in 2011, but taxpayers with a reserve balance of a certain maximum amount can deduct the amount of the reserve tax credit (205 euros as of 2014).

Because of an increase in social security costs in the Netherlands, the retirement age will be raised to 66 years of age in 2018 (and 67 years of age in 2021). As a transitional scheme for people who are not able to meet the retirement age, the working tax credit, called the deferred retirement tax credit (doorwerkbonus), was introduced in 2009. This tax credit applies to workers aged 62–67 who do not retire from work. For a taxpayer whose annual gross income was from 9,295 euros to 57,166 euros in 2012, it was possible to receive a tax credit from 1% to 8.5% of income depending on the age (2012). By the working tax credit, the employment rate for ages 60 to 64 had been estimated to be a 0.6% increase. According to research conducted in 2013, the retirement of the elderly was delayed by 19 months on average because of the introduction of the working tax credit (Da Silva Soca, 2013).

The deferred retirement tax credit (IB Art. 8.12) was reorganized in 2013. It is possible to receive a tax credit of 1,119 euros for ages 60–64 (if the salary income is up to 120% of the legal minimum wage). After 2015, it is expected that the largest amount of deferred retirement tax credit will increase to 3,300 euros. If the earned income is more than 33,694 euros, then the deferred retirement tax credit will be reduced to zero.

In 2013, the early retirement temporary tax credit (tijdelijke heffingskorting) was introduced, which applies to early retirees. Because they have not reached the retirement age, social insurance premiums are withheld. The maximum early retirement temporary tax credit is 121 euros (2014).

IV-5. Encouragement for households with children

From 1980 to the first half of the 1990s in the Netherlands, part-time employment was encouraged (Ogose, 1998) with the diversification of flexibility labor policy in the labor market and the working style. While the tax credits used for the encouragement of part-time employment, several other incentives such as benefits, the child allowance (kinderbijslag), the child budget (kindegebonden), and the child care allowance (kinderopvangtoeslag) have been used for the child care support system. The child allowance is a benefit that reduces the difference in income between households. The child budget is related to income that helps parents from low-income or middle-income families. In addition, the child care allowance is a benefit for the amount spent on formal childcare facilities. The purpose of the child care allowance is for parents with children in preschool and in elementary school to be able to obtain both work and childcare.

On the other hand, in Box 1, it is possible to deduct expenses for children (aftrek levensonderhoud kinderen). If a taxpayer has paid more than 30% of the cost of dependents of a child (from 6 years of age to 21 years of age), then it is possible to deduct 295 euros to 355 euros in three months. In Box 3, parents could claim an exemption for their children (kindertoeslag vrijstelling, 2,779 euros per child); however, the exemption was abolished in 2012 in order to simplify the child allowances.
The tax reform of 2001 introduced new tax credits for parents to encourage working and parenting. The child tax credit was applied if the combined income of a married couple with a child under the age of 12 did not exceed 54,501 euros. The additional child tax credit for dependents was applied if the combined income of a married couple with a child under the age of 12 did not exceed 27,251 euros. The purpose of these tax credits was to reduce poverty, but they were abolished in 2006 (Dijk, 2012).

The combination tax credit (currently called: income dependent combination tax credit IB Art. 8.14a) was intended to encourage employment by giving credits to child-rearing households as financial incentives. This tax credit aimed to encourage working and child-rearing. Parents with a child under the age of 12 can receive the credit. The maximum combination tax credit is dependent on income and amounts to a maximum of 2,133 euros for 2014 (Table 5, Figure 4). This tax credit also applies to high-income earners.

The additional combination tax credit for widows (or widowers) with low incomes was introduced in 2004. In 2009, however, it was integrated into the combination tax credit with income limitations (Dijk, 2012).

The additional single parent tax credit was introduced to encourage the labor participation of single parents with children under the age of 16. The tax credit amounted to 1,319 euros; however, it was reorganized in 2011, and the single parent tax credit amounts to 947 euros for 2014 (IB Art. 8.15).

In addition, to be able to encourage both working and parenting, the parental leave tax credit (ouderschapsverlofkorting) (IB Art. 8.14b) was introduced. If parents with children less than eight years of age meet certain conditions, they can benefit from compensation, which is multiplied by 4.29 euros from the time of parental leave.

As a result of the introduction of the tax credits in the tax reform in 2001, the probability of employment increased, especially for women in the low and middle education categories in particular. Due to the tax reform, the probability of female employment in the low and middle education categories increased. In addition, the magnitude of the effect of the estimation results of the “after-tax hourly wage limit” on women in the low and middle education categories was greater (Bosch, & van der Klaauw, 2012).

Moreover, because of the tax reform, the amount of labor for women increased, and the average working hours in a week for women increased by 0.37 hours. The extensive (participation) margin increased the amount of working women as a result of the tax reform (financial incentives), whereas the intensive (hours per week per worker) margin did not increase the amount of labor of every woman (Bosch, & van der Klaauw, 2012).

It should be noted that in the Netherlands, the treatment of part-time workers is equivalent to the treatment of full-time workers, and the rate of part-time workers (the proportion of part-time workers to total workers is over more than 35%) is the highest among OECD countries (Kenjou, 2006).

In 2001, the age limit of a child for the additional single parent tax credit was 12 years of age. In order to enable parents (or single parents) to obtain employment, the age limit was raised to 15 in 2002. As a result, the labor participation rate of widows with a child from 12 – 15 rose from 1.7 to 2% (Bettendorf, Folmery, & Jongen, 20114).

<table>
<thead>
<tr>
<th>Labor income</th>
<th>No more than</th>
<th>Income-related combination tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Above</td>
<td>€4,814</td>
<td>0</td>
</tr>
<tr>
<td>€4,814</td>
<td>€32,539</td>
<td>€1,024 + 4% × (Labor income - €4,814)</td>
</tr>
<tr>
<td>€32,539</td>
<td>-</td>
<td>€2,133</td>
</tr>
</tbody>
</table>

The tax reform led to a significant increase in the number of women working (extensive margin), but did not have a significant effect on the hours worked per employed woman (intensive margin) (Bosch & Van der Klaauw, 2012).

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**IV-6. Compensatory income tax credit**

The allowance for people with disabilities was changed to the young disabled tax credit in the tax reform of 2001. The young disabled tax credit amounts to 708 euros for 2014 (IB Art. 8.16a).

The elderly deduction was changed to the elderly tax credit in the tax reform of 2001. The elderly tax credit can be claimed by an elderly person who is 65 at the end of the calendar year with an accumulated income of no more than €35,450 (2013). The elderly tax credit amounts to 1,032 euros (IB Art. 8.17). If the income is more than €35,450, then the elderly tax credit is a maximum of 150 euros. Furthermore, if an elderly person is single, then the single elderly tax credit can be claimed. The single elderly tax credit amounts to 429 euros (IB Art. 8.18).

**IV-7. Procedures for the tax credit and the problem of illegal refunds**

The national old-age pension and income tax (AOW), the survivor’s pension (ANW), and the special medical expenses insurance system (AWBZ) are subject to a refund of the tax credit. The tax credit in the Netherlands is based on a combined tax credit that is a combined contribution of social security and income tax. This means that the function of...
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The total amount of the tax credit is deducted pro rata from three social insurance premiums and the income tax (gecombineerde heffingskorting), and the total amount of the tax credit cannot be deducted for more than the total amount of the three social insurance premiums and income tax. Therefore, the tax credits in the Netherlands are tax credits without refunds. This is regarded a problem by several politicians as it means that people with a very low income do not benefit from the tax credits (the cashing problem). For this reason allowances, direct subsidies for people in certain circumstances, such as renting a house with a low income, using child care or for health insurance premiums because of a low income (62% of all Dutch households receives such an allowance) are paid.

Employees can apply certain tax credits through the withholding of wage tax on their monthly wages and all tax payers can ask for an advance return of tax, the benefits of the tax credits can be obtained without waiting for the personal income tax return; however, if the credits are not withheld, it is possible to deduct through the personal income tax return.

Each resident of the Netherlands has a citizen number (Burger Service Nummer, BSN). This number is also used for tax purposes. Tax payers must file a yearly tax return in an automated system using their digital signature, called DigiD, after which the tax agency establishes the tax assessment. However, since a few years, it is possible (not obligatory) to use a tax return which has partly been filled in by the tax agency.

**IV-8. Tax credits and redistribution**

In the shift of the flattening of the income tax rate, the general tax credit has functions as redistribution for low-income people in the Netherlands. But it is possible even for laborers with relatively high wages to claim the maximum tax credit (Detragiache, 2001). Therefore, under the financial crisis, this is changing as the general tax credit and the working tax credit are reduced to zero for higher income earners.
IV-9. Is the tax base broadened by the transition to tax credits?

The earned income tax allowance ((forfaitaire) arbeidskosten) in 2000 was about 5% of taxable income. After its abolition in 2001, due to the tax credits, people who have less income, such as students and widows/widowers, people who earn minimum wage and have children, and pensioners do not need pay income tax nor social insurance contributions.

Furthermore, the social insurance rate has decreased. The tax credits have been applied to the social insurance rate since the tax reform of 2001. Funding for the elderly pension (AOW), the survivor’s pension (ANW), and the special medical expenses security system (AWBZ) has been insufficient (Bakirtzi, et al., 2011).

In addition, the following problems remain.

First, in terms of tax expenditures, tax credits will be reformed because it is a factor of narrowing the tax base (Hemels, 2013). It has been suggested that some of the tax credits with no reasonable grounds for their policies should be abolished for the reduction of the tax rate of income tax. For example, the additional single parents tax credit was reorganized in 2011, and were planned to be abolished in 2015.

Next, the general tax credit and the working tax credit for high-income earners will be abolished. Not because there was no fading out period, but because there was a financial crisis and the labor party wanted to tax high income groups more. But if these tax credits were to be abolished, the financial burden of high-income earners will increase considerably.

In addition, currently in the Netherlands, if a tax partner cannot use the tax credit on their own taxes, he/she can transfer the unused tax credit to his/her tax partner if he or she was born before 1972 (Kamakura, 2009). Moreover, before the tax reform of 2001, it was possible to transfer the amount of the spouse’s basic exemption even though the basic exemption only applied to individuals. The transferable tax credit would narrow the tax base; therefore, the tax payer with a low income cannot transfer his/her tax credit to his/her tax partner if he/she was born after 1972 and can only transfer a decreasing part if he/she was born before 1972 amounting to 0 in the future.

Finally, tax credits are used for tax policy. While some tax credits increase the effect of the policy as a labor tax credit, other tax credits are used as a tool in politics (Dijk, 2012). Because it is easy to introduce new tax credits to promote some policies, the tax system has become complicated.

Therefore, it can be concluded that the transition to the tax credits has not broadened the income tax base significantly.

V. Impact of the 2001 tax reform

V-1. The purpose of the 2001 tax reform

The intention of the tax reform of 2001 was to reduce the tax burden on earned income by broadening the tax base of the income tax and flattening the income tax rate. Another aim
of the tax reform of 2001 was financial stabilization through an expansion of employment and economic growth. In the following sections, the effects of the tax reform of 2001 are examined.

**V-2. Impact on employment**

After the Oort operation in 1990, employees instead of employers have paid the general social security contribution with the exception of disability insurance and non-medical insurance. The amount of social security contribution, which employees paid in 1995, increased to up to 11.7% of the GDP (Abrate, 2004). Employees paid 20.35% and employers paid 26.15% of the cost of the social security contribution of wages. These percentages of wages were the highest of the OECD countries in 1994 (Mizushima, 2003). It has been proposed that a lower tax burden on earned income and reducing the tax rate of income tax and social security contributions. Since several years, only employers pay the employee social security insurance premiums as the premiums to be paid by employees have been set at 0%.

In the Netherlands, social security contributions as well as income taxes were high in comparison with other countries. Income tax reform was required because the tax burden on earned income led to a reduction in international competitiveness.

As a result of lowering social security contributions and income tax rates in the tax reform of 2001, the rate of labor costs was 36% in the Netherlands for the period of 2001–2011, but it was basically equal to the average of the EU Member States (CPB, 2012). Therefore, it can be deduced that the tax reform of 2001 could reduce the tax burden on earned income.

On the other hand, the unemployment rate was over 7% in 1995 and fell to 6.6% in 1996 and 2.5% in 2001; however, it rose to 4% in 2003 (Albers & Langedijk, 2004). The effect of tax reform on the unemployment rate is unclear. Regarding the decline in the unemployment rate, not only the income tax rate but also other economic factors work strongly. Further verification is necessary.

**V-3. Impact on economic growth and households**

In the late 1990s, the real economic growth rate in the Netherlands was 3.7% on average, which was high compared with the 2.7 percent average of the EU countries, but economic growth in the Netherlands dropped sharply to 1.9% in 2001 (World Economic Outlook Databases).

There were two impacts on households: one on consumption, and the other on savings. Regarding the impact on consumption, the expansion of consumption was expected to be associated with an increase of disposable income of households because of the tax reform of 2001. At the same time, the tax rate of the regulatory energy tax and the VAT rate were raised in the tax reform of 2001.
In 2001, income tax was reduced and the tax rate of VAT was raised, so the disposable income expansion did not affect household consumption. But the consumption growth rate decreased from 4 to 1.4% in the spring of 2001 (CPB, 2005).

In addition, the household saving rate was 1% in the year 2000, and it rose to 2% in 2001. Tax cuts led to an increase in the savings rate because after mid-2000, the stock market declined. In order to fill the loss of assets, people increased their savings (CPB, 2005).

V-4. Budget deficit

In the Netherlands, the proportion of tax revenue to GDP was 39.6% in 2000, 37.7% in 2002, 38.7% in 2007, 38.2% in 2009, 38.9 % in 2010, 38.6% in 2011 and 39.0 in 2012 (Figure 7). It is relatively stable in comparison with other OECD countries (Revenue Statistics country note for The Netherlands). Government deficit as a percentage of GDP decreased in 2002, but it rose in 2003 and decreased again after the Lehman shock, when it greatly decreased to −5.58% in 2009. Government deficit as a percentage of GDP in 2012 was −4% (Figure 5).

For the period of 1999–2004, the scale of the economic activity (GDP) of tax revenue changed in three ways. First, before the tax reform of 2001, the revenue of social insurance premiums was more than 15% of the GDP, and in 2004, it decreased to 14%. Second, in 2000, the ratio of indirect taxes to GDP was 12.5%, but after the tax reform, it slightly increased to 13% in 2004. Third, the ratio of direct taxes to GDP was 12% before the 2001 tax reform, but in 2004, it decreased to 11% (Figure 6).
Figure 5. Government deficit/surplus as a percentage of GDP (2002–2012)


Figure 6. Revenue of Tax and Social security contribution

(Source) "Breder, lager, eenvoudiger? Een evaluatie van de belastingherziening 2001" (November 2005), p.187, Figure 5.5.2.
V-5. Impact on the redistribution of income

The flattening of the income tax rate may have impacted the redistribution of income. There could be problems with the box system, which applies different tax rates to capital income and earned income. In terms of equity and the ability to tax principle, the box system has some problems. However, the after-tax Gini coefficient in the Netherlands after the tax reform of 2001 created a gradual decreasing trend in 2005, but it rose to 0.295 once in 2006. Since then, it has remained at the low level similar to before the tax reform of 2001 (Table 6).

The redistribution effect of the tax lowered the Gini coefficients to 0.132 in 2000 and 0.144 in 2006. The redistribution effect in the Netherlands was relatively great until 2006.

Table 6. Gini coefficient

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2003</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gini</td>
<td>0.292</td>
<td>0.284</td>
<td>0.28</td>
<td>0.295</td>
<td>0.286</td>
<td>0.283</td>
<td>0.288</td>
<td></td>
</tr>
<tr>
<td>Gini before taxes and transfers</td>
<td>0.424</td>
<td>0.424</td>
<td>0.424</td>
<td>0.43</td>
<td>0.417</td>
<td>0.417</td>
<td>0.424</td>
<td></td>
</tr>
</tbody>
</table>

(Source) OECD STAT.

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According to an interview with Professor Arie Rijkers of Tilburg University (March 2013), from the point of view of the data of the Gini coefficient, the tax system has recently become unfair; in particular, the proportional tax rate of capital income in Box 3 has become a problem in the Netherlands.
Through two major reform operations in 1990 and 2001, the expansion of employment has been achieved, but unfairness has also increased (Salverda, et al., 2013). On the other hand, some argue that the redistribution of income has increased since 2001. In particular, the state pension and pensions have achieved a greater reduction of income inequality (Caminada et al., 2014).

V-6. The problem of the tax base

The interest deduction related to residential real estate in Box 1 creates a narrow tax base and a lower tax rate. Along with the recession, it was a factor that put pressure on tax revenue, which was mitigated somewhat by the low interest rates. In the Netherlands, the effective tax rate combined with the social insurance premiums and income tax rate is high, and interest deduction of residential real estate was also a cause of the real estate bubble (Figure 8) (Hemmelgarn, et al., 2011).

People prefer to invest in home ownership as a usable deduction of interest in Box 1. In fact, the prices of housing became 2.5 times greater between 1995 and 2008. The neutrality of the selection of assets was distorted. In this respect, the tax reform of 2001 was not successful (Brys, 2005). It must be noted that since the 2008 crisis, housing prices have declined sharply.

Figure 8. Effective average tax rates on owner-occupation
(personal income tax)


V-7. Direction of the income tax rate in the future

Since 1990, the Netherlands consistently has reduced income tax rates, broadened the tax base of the income tax, and shifted to consumption taxation in tax reform. In the future, it is possible to apply a proportional tax rate on capital income and earned income. It was argued that the suitable proportional rate was 33.2% in a 1990s study (Caminada & Goudswaard, 1997).

In a recent study, it was shown to be possible to introduce a proportional tax rate of 37 – 38% if people over age 65 pay social insurance premiums, the interest deduction for residential real estate of individuals is abolished, and the general tax credit is raised (De Vos, 2012).

V-8. Summary
V-7. Direction of the income tax rate in the future

Since 1990, the Netherlands consistently has reduced income tax rates, broadened the tax base of the income tax. In the future, it is possible to apply a proportional tax rate on capital income and earned income. It was argued that the suitable proportional rate was 33.2% in a 1990s study (Caminada & Goudswaard, 1997).

In a recent study, it was shown to be possible to introduce a proportional tax rate of 37–38% if people over age 65 pay social insurance premiums, the interest deduction for residential real estate of individuals is abolished, and the general tax credit is raised (De Vos, 2012).

V-8. Summary

Since 2001, the proportion of social insurance premiums to GDP decreased significantly, and the deviation of the percentage of the GDP of direct and indirect taxes increased. From 2001 to 2004, the tax had shifted from income to consumption.

As household consumption fell, economic growth in the Netherlands fell sharply in 2001; however, the redistribution effect of the Netherlands was relatively high until 2006. There was an effect on the after-tax distribution of income from the tax reform of 2001. The unemployment rate improved in the short-term, but it eventually became higher. As mentioned in section IV, due to the revision of the tax credit, employment was encouraged for women in low and middle education categories.

Labor demand declined significantly due to the recession that triggered the collapse of Lehman Brothers in 2008. Incentives from the working tax credit did not work. The working tax credit for low and middle income earners was increased to promote employment. And the working tax credit for high-income earners has been reduced due to financial crisis.

Despite of tax reform of 2001, stabilizing the financial system had not been achieved in the short term; however, from 2005 to 2008 the financial condition of the Netherlands had stabilized. In comparison with the EU members in 2013, the financial condition of the Netherlands was relatively elaborate. One of the reasons is the narrow tax base with high marginal tax rates.

VI. Conclusion of the implications from the Netherlands

Should we implement a new tax credit in Japan? Most developed countries in which the burden of social security increases face a challenge to keep public finances sustainable. At the same time, in terms of social security, it becomes an important policy issue to grant tax incentives for taxpayers to encourage employment.

In the Netherlands, many income deductions still exist next to tax credits and are linked to the ability to pay idea. Also most tax credits are linked to the ability to pay idea. But some tax credits have been used for incentives for employment policy.
In Japan, it is necessary to deal with the expansion of the generation gap due to the changes in the social structure and a significant deterioration of the fiscal situation.

In the “2010 Tax Reform Outline” (Cabinet decision December 22, 2009), the Japanese government indicated that it wanted to recover the income redistribution as well as the integration of the social security system. It said that a shift from income deductions to tax credits with refunds for personal income taxes was necessary.

Japan faces a financial burden because of the aging population, so the introduction of the tax credits has been studied regarding social security. Under the progressive tax rate structure, the tax burden of high-income earners is greatly reduced by the tax deductions in income taxes. It is possible to redistribute income using the tax revenue by reducing the income deductions for the tax credit. Furthermore, the integral adjustment of the burden of social security contribution for low-income taxpayers is possible through the refundable tax credit.

In considering the role of income tax in the future of Japan, the design of the tax system of the Netherlands would be helpful.

The biggest difference between the Netherlands and Japan is the structure of the income tax rate. For the income tax rate in Japan, it is necessary to take into account not only income taxes but also inhabitant taxes (local taxes). In the Netherlands, there is no tax corresponding to Japan’s inhabitant tax, but the lowest tax rate is as high as the tax rate of income tax and the social insurance premiums are integrated. Therefore, in the Netherlands, the income effect of the tax credit is significant, and the incentive effects for low-income taxpayers are also significant.

In Japan, it is possible to replace the income deductions with the tax credits under the condition that the income tax rate is relatively low, but the incentive effect of the tax credits would be limited. To replace the income deductions with the tax credits, a drastic reform of the integration of social insurance premium and income tax is required. In addition, even though the tax credits are refundable, it is necessary to prevent illegal refunds (Nakazato, 2009).

Given the differences described, consider the transition from income deductions to tax credits in Japan using the Netherlands as an example. It is conceivable that a transition from income deductions to the tax credits would mitigate the regressive consumption tax (Morinobu, 2010). Although the general tax credit in the Netherlands is not explicitly in response to the shift to consumption taxation, the burden of VAT and energy tax is much higher. Therefore, it seems that the effect of relieving the regression of consumption tax is considered. Even the tax credits without refund have led to a lack of social security funds in the Netherlands, and it would be beneficial to design refundable tax credits carefully so as to prevent a similar scenario in Japan.

On the other hand, in transferring the general tax credit, the credit should be carefully transferred from low-income partners to high-income partners. In the Netherlands, because transferring the tax credit to the partner is considered to narrow the tax base and to discourage employment, it has been decided to be gradually diminished. Therefore, transferring the general tax credit from the partner with less income to the other partner will no longer be an...
The working tax credit is effective in encouraging employment in the Netherlands. The introduction of the working tax credit could be considered to be an incentive to work for full-time homemakers in Japan (Morinobu, 2010). A transition to the working tax credit by abolishing the marital deduction will likely promote employment for full-time homemakers; however, the biggest problem is that such an incentive will not have an effect during a recession or economic downturn.

It is also worth considering the shift from the child deduction to the child tax credit in Japan to facilitate childcare support (Morinobu, 2010). In the Netherlands, the main purpose of the child tax credit is to encourage employment. For childcare support, a variety of family structures must be considered. Therefore, the tax system will be a complicated system, as it is in the Netherlands.

After all, tax credits are the same as the income deductions in terms of the ability to pay taxes for the individuals. As the tax base will not inevitably broaden due to the transfer of the tax credits, it would not be expected to have a large effect on tax revenue. Therefore, in order to shift to tax credits in Japan, it may be necessary to develop effective policies for social security and employment (Yoshimura, 2009).

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