

*Government Institute for Economic Research*

*VATT-Working Notes 38*

*Tax Expenditures in Finland*

*Helsinki 1998*

## **TAX EXPENDITURES IN FINLAND**

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<sup>1</sup> Appendix has not been acted upon by the Government; intended as background material for budget proposal

Translated by John Rogers and Andrew Lightfoot

## FOREWORD

This report, which is a reprint of Appendix 2 to the Government proposal for the 1999 State Budget, contains a description of public support given through the tax system, i.e. tax expenditures. The calculations were performed using VATT's TUJA model and MATURE database for personal taxation and agricultural taxation respectively, and other information sources. The tax expenditure calculations were performed by the following senior researchers: Heikki Viitamäki and Esko Mustonen (personal taxation), Timo Rauhanen (indirect taxation), Tuomo Heikkilä (agriculture and forestry) and Outi Kröger (company taxation). The report was prepared for publication by research assistant Sari Virtanen.

The report is published as a reprint in Finnish and English in the VATT-Working Notes series.

Helsinki, September 1998

GOVERNMENT INSTITUTE FOR ECONOMIC RESEARCH

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## TAX EXPENDITURES IN FINLAND

Support rendered by means of the tax system results from tax concessions granted in the normal tax system. The purpose of tax expenditures is to support the taxpayer or, indirectly, other actors in the economy. The principle applied in the tax expenditure calculations presented here are described in the Ministry of Finance's publication "Verotuet Suomessa" (1988)<sup>2</sup>. The calculations are published annually as an appendix to the State Budget Proposal. In the present publication, the most recent year covering all the forms of taxation is 1996.

The legislative changes in taxation enacted in 1996 did not significantly affect the overall level of tax expenditures. It remained at the level of approximately FIM 40 billion.

Analysed by spending category, most tax expenditure was directed at social security. Total expenditure in this category was FIM 17 billion. The largest individual tax expenditures - the pension income deduction in municipal taxation, the deduction of employees' statutory pension contributions and the tax exemption of child benefits - accounted for 70 per cent of tax expenditure in this category.

Housing and environment accounted for nearly FIM 11 billion of tax expenditures, consisting of the deduction of interest expenses on housing loans, the tax exemptions of housing benefits and both capital gains and imputed rent for owner-occupied dwellings.

Tax expenditure for industry and business decreased from the year 1995 and was totalling slightly under FIM 5 billion. The majority of tax expenditures, totalling FIM 3.2 billion, were granted on the basis of the provisions governing company depreciations.

Tax expenditure in respect of agriculture and forestry in 1996 did not change. It remained slightly under FIM 3 billion.

Value added tax was almost solely responsible for tax expenditure in respect of transport and communication. Total tax expenditure was FIM 1.8 billion.

Tables 1-4 summarize tax expenditures and transfer payments by spending category. Table 5 itemizes individual tax expenditures.

When considering the significance of the figures, it must be borne in mind that the discontinuance of tax expenditures does not necessarily increase tax revenues by a corresponding amount since tax expenditures affect prices and the behaviour of taxpayers.

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<sup>2</sup> Available only in Finnish, English summary.

Table 1. Economically significant tax expenditures by spending and tax category  
1995 - 1996, FIM million \*

	Income, wealth and related taxation		Taxation of business and agriculture		Indirect taxation	
	1995	1996	1995	1996	1995	1996
General administration	100	100	-	-	-	-
Public order	-	-	-	-	-	-
Defence	-	-	-	-	-	-
Education, science and culture	800	800	-	-	-	-
Social security	17300	17100	-	-	30	40
Health care	-	-	-	-	400	400
Housing and environment	10000	10800	-	-	-	-
Labour force	-	-	-	-	-	-
Agriculture and forestry	200	200	1200	1200	1400	1500
Transport and communication	200	200	-	-	1500	1500
Industry and business	1600	1600	3500	2900	300	300
Other expenditures	1100	800	-	-	-	-
Miscellaneous items	3700	3700	-	-	800	1000

\* Figures generally rounded to nearest 100 million. Tax penalties subtracted from tax expenditures.

Table 2. Economically significant tax expenditures by spending category and taxing body  
1995 - 1996, FIM million \*

	Central government		Other taxing bodies		Total	
	1995	1996	1995	1996	1995	1996
General administration	35	40	35	40	70	80
Public order	-	-	-	-	-	-
Defence	-	-	-	-	-	-
Education, science and culture	400	500	400	400	800	800
Social security	6000	5900	11300	11300	17300	17100
Health care	400	400	-	-	400	400
Housing and environment	2700	3100	7300	7700	10000	10800
Labour force	-	-	-	-	-	-
Agriculture and forestry	2000	2200	700	700	2700	2900
Transport and communication	1500	1600	100	100	1600	1700
Industry and business	4900	4400	500	400	5400	4800
Other expenditures	1100	800	-	-	1100	800
Miscellaneous items	2400	2600	2100	2100	4400	4600

\* Figures generally rounded to nearest 100 million. Tax penalties subtracted from tax expenditures.

Table 3. Economically significant tax expenditures in central government taxation and government transfer payments by spending category 1995 - 1996, FIM million \*

	Tax expenditures		Transfer payment		Change 96/95, %	
	1995	1996	1995	1996	Tax expenditures	Transfer payments
General administration	35	40	7300	7600	14	4
Public order						
Defence	400	500	19000	18800	0	-1
Education, science and culture						
Social security	6400	6300	48300	47500	-2	-2
Health care						
Housing and environment	2700	3100	4000	3200	15	-20
Labour force	-	-	9300	10600	-	14
Agriculture and forestry	2000	2200	14100	11300	10	-20
Transport and communication	1500	1600	1700	800	7	-53
Industry and business	4900	4400	5900	5500	-10	-7
Other expenditures	1100	800	6800	2900	-27	-57
Miscellaneous items	2400	2600	-	-	8	-

\* Figures generally rounded to nearest 100 million. Tax penalties subtracted from tax expenditures.

Table 4. Economically significant tax expenditures by spending and tax category 1993 - 1996, FIM million \*

	1993	1994	1995	1996
General administration	100	100	100	100
Public order	-	-	-	-
Defence	600	200	-	-
Education, science and culture	800	800	800	800
Social security	16400	16400	17300	17100
Health care	900	400	400	400
Housing and environment	12500	11100	10000	10800
Labour force	-	-	-	-
Agriculture and forestry	5700	5100	2700	2900
Transport and communication	4100	2400	1600	1700
Industry and business	3600	5400	5400	4800
Other expenditures	1100	1100	1100	800
Miscellaneous items	700	-1300	4400	4600

\* Figures generally rounded to nearest 100 million.  
Tax penalties subtracted from tax expenditures.



Table 5. Itemized breakdown of economically significant tax expenditures  
by spending and tax category 1993 - 1998

Explanation: \* = preliminary calculation, \*\* = forecast, - = nothing to report, .. = not estimable

Spending category	Tax expenditures, est. FIM million						Notes
Item	1993	1994	1995	1996	1997*	1998**	
<b>1. General administration</b>							
<i>Income, wealth and related taxation</i>							
1. Tax exemption of certain benefits received by foreign service and other employees	70	70	70	80	90	..	Order of magnitude.
2. Tax exemption of foreign-stationed specialists' salaries from UN organizations	..	..	..	..	..	..	Can not be estimated.
<b>2. Defence</b>							
<i>Indirect taxation</i>							
1. Exemption from turnover of certain foreign acquisitions for national defence	570	230	-	-	-	-	- Exemption from turnover tax based on exemption from customs duties. Eliminated 1994.
<b>3. Education, science and culture</b>							
<i>Income, wealth and related taxation</i>							
1. Tax exemption of non-profit organizations (excluding Evangelical Lutheran and Orthodox churches)	500	500	500	550	..	..	Order of magnitude.

Spending category Item	Tax expenditures, est. FIM million						Notes
	1993	1994	1995	1996	1997*	1998**	
2. Tax exemption of scholarships, etc.	200	160	100	90	90	100	Support in the form of tax exemptions for student aid and university scholarships. The student aid for university students became liable to taxation on July 1, 1992 and student aid for intermediate level students since July 1, 1994.
3. Student grant deduction in municipal taxation	80	140	190	190	170	160	
<b>4. Social security</b>							
<i>Income, wealth and related taxation</i>							
1. Tax exemption of national pension supplements, etc.	660	680	670	630	580	580	
2. Tax exemption of war injury compensation	460	450	440	420	400	380	
3. Tax exemption of social assistance payments	700	800	800	900	900	900	
4. Tax exemption of maintenance support	490	590	580	580	570	570	
5. Tax exemption of child benefits	2200	3850	3600	3300	3200	3200	The amount of child benefits was raised in 1994 in conjunction with the elimination of family deductions.

Spending category Item	Tax expenditures, est. FIM million						Notes
	1993	1994	1995	1996	1997*	1998**	
6. Tax exemption of front-veterans' pension	-	-	-	-	-	-	
7. Tax exemption of redundancy payments	250	160	100	90	80	80	
8. Child care deduction in central government taxation	400	-	-	-	-	-	- Eliminated 1994.
9. Pension income deduction in central government taxation	110	70	70	50	20	20	
10. Child deduction in municipal taxation	2800	-	-	-	-	-	- Eliminated 1994.
11. Single-parent deduction in municipal taxation	300	-	-	-	-	-	- Eliminated 1994.
12. Disability deduction in municipal taxation	180	200	190	170	160	160	
13. Pension income deduction in municipal taxation	4300	4300	4500	4200	4200	4200	Collection of the national pension contribution from pensioners increases the magnitude of tax expenditure since 1992.
14. Disability deduction in central government taxation	250	260	270	250	260	270	
15. Maintenance obligation deduction in central government taxation	20	20	30	30	30	30	
16. Deduction of employees' statutory pension contributions	2950	3000	3950	4700	4950	5300	

Spending category Item	Tax expenditures, est. FIM million						Notes
	1993	1994	1995	1996	1997*	1998**	
17. Deduction of employees' unemployment insurance contributions and unemployment fund contributions	300	2000	2050	1750	1800	1700	
<i>Indirect taxation</i>							
1. Refund of motor-vehicle tax to disabled persons	30	30	30	40	40	..	
<b>5. Health care</b>							
<i>Indirect taxation</i>							
1. Reduced VAT rate for medicines (12 %)	890	400	360	400	433	..	Order of magnitude. Before 1995 tax expenditure resulted from tax exemption of medicines.
<b>6. Housing and environment</b>							
<i>Income, wealth and related taxation</i>							
1. Tax exemption of capital gains on owner-occupied dwellings	2600	2500	2500	3000	3000	..	Order of magnitude. Calculation based on nominal sales proceeds of dwellings and acquisition cost deemed to be 50 per cent of sales proceeds. The capital income tax rate has been applied.
2. Tax exemption of housing support	950	1200	1200	1150	1100	1150	

Spending category Item	Tax expenditures, est. FIM million						Notes
	1993	1994	1995	1996	1997*	1998**	
3. Deduction for interest expense and for index and exchange rate losses (housing loans)	4100	3500	3200	2400	2200	2300	Includes additional interest deduction.
4. Partial tax exemption of imputed rent for owner-occupied dwellings	2600	3000	3100	4200	4500	..	Order of magnitude. Calculation based on State Housing Board dwelling valuations and assumed 3 % return. The taxation of imputed rent was eliminated in 1993 in conjunction with the adoption of the real estate tax. Since 1993 when calculating the tax expenditure, imputed rent has been treated as capital income. The real estate tax has not been deducted from the tax expenditure.
<i>Indirect taxation</i>							
1. Tax exemption of tap water	290	120	-	-	-	-	- Eliminated 1994.
2. Tax exemption of housing construction	2000	800	-	-	-	-	- Order of magnitude. Eliminated 1994.
<b>7. Agriculture and forestry</b>							
<i>Income, wealth and related taxation</i>							
1. Tax exemption of sales revenue from wild berries, mushrooms, etc.	10	20	20	20	20	..	Order of magnitude.

Spending category	Tax expenditures, est. FIM million						Notes
Item	1993	1994	1995	1996	1997*	1998**	
2. Agricultural adjustment deduction	-	-	150	150	140	140	Applies to 1995 - 1999.
<i>Farm income taxation</i>							
1. Tax exemption of own-use farm products	250	250	250	250	..	..	Order of magnitude.
2. Depreciation on machinery and equipment	-	-	10	10	..	..	
3. Depreciation on building acquisition expenses	50	60	40	30	..	..	Order of magnitude.
4. Tax exemption of values of logging	240	240	240	240	..	..	Order of magnitude.
5. Forestry fee deduction	50	50	50	50	..	..	Order of magnitude.
6. Tax exemption of damaged forest area	40	40	40	40	..	..	Order of magnitude.
7. Tax expenditure due to valuation of forestry on a net income basis	600	600	500	500	..	..	Order of magnitude.
8. Tax exemption of forestry subsidies	80	80	80	80	..	..	Order of magnitude.
9. Equalization reserve	..	..	..	..	..	..	
1.-9. Total tax expenditure	1310	1320	1210	1200	..	..	

Spending category	Tax expenditures, est. FIM million						Notes
Item	1993	1994	1995	1996	1997*	1998**	
<i>Indirect taxation</i>							
1. Turnover tax deductions for primary products							
- domestic consumption	4380	4200	-	-	-		- Gross reduction in foodstuff prices due to primary product deduction. Eliminated 1995.
- exports	710	710	-	-	-		- Export subsidies for agricultural products paid through turnover tax system. Eliminated 1995.
2. Hidden turnover tax (tax penalty) on agricultural production inputs							
- investments	-250	-440	-	-	-		- Non-deductible turnover
- other production inputs	-720	-900	-	-	-		- taxes on machinery, equipment and building investment, and other production inputs. Eliminated 1995.
3. Turnover tax exemption of compensation for price reduction	140	80	-	-	-		- Reduces compensation for price reduction in Budget by amount of tax expenditure. Eliminated 1994.
4. Reduced VAT rate for foodstuffs (17 %)	-	-	1350	1520	1650		.. Deductible since 1995. Order of magnitude.
Total turnover tax expenditure for foodstuffs (items 1 - 4)	4260	3650	1350	1520	1650		.. Hidden taxes netted out. Eliminated 1995.

Spending category Item	Tax expenditures, est. FIM million						Notes
	1993	1994	1995	1996	1997*	1998**	
<b>5. Turnover tax exemption of cattle feed</b>							
- agriculture	(570)	(600)	-	-	-	-	- Part due to tax exemption of cattle feed for agriculture in item 1. Eliminated 1995.
- other	90	90	-	-	-	-	
<b>6. Turnover tax exemption of fertilizers</b>							
- agriculture	(400)	(370)	-	-	-	-	- Figures for agriculture included in item 1. Eliminated 1995.
- other	30	30	-	-	-	-	
<b>8. Transport and communication</b>							
<i>Income, wealth and related taxation</i>							
1. Deduction for seamen's wages	150	180	170	180	180	180	
<i>Indirect taxation</i>							
1. Reduced VAT rate for conveyance of passengers (6 %)	2200	1000	560	690	750	..	Order of magnitude. Before 1995 tax expenditure resulted from tax exemption of conveyance of passengers.
2. Reduced VAT rate for TV licences (6 %)	-	-	190	160	170	..	Applies in respect of the compensation received from the State Radio Fund of Oy Yleisradio Ab.
3. Zero VAT rate for subscribed newspapers and other periodicals	610	650	570	540	580	..	Order of magnitude. Before 1995 tax expenditure resulted from tax exemption of newspapers and periodicals.



Spending category Item	Tax expenditures, est. FIM million						Notes
	1993	1994	1995	1996	1997*	1998**	
4. Tax exemption of land and water construction	1000	400	-	-	-	-	- Order of magnitude. Includes some work not related to transport and communication. Eliminated 1994.
5. Taxi owners' motor vehicle tax relief	120	120	130	140	140	..	.. Includes also estimated turnover tax relief.
<b>9. Industry and business</b>							
<i>Income, wealth and related taxation</i>							
1. Tax exemption of Regional Development Fund, TEKERA, Finnish Export Credit Ltd and EKOKEM	40	40	40	70	40	..	
2. Tax exemption of interest income from bonds, etc. for taxpayers with limited tax liability	1400	1500	1300	1300	1400	1400	Order of magnitude.
3. Tax exemption of income earned abroad	150	150	150	150	150	..	
4. Partner deduction	140	150	100	70	40	20	
<i>Taxation of business income</i>							
1. Extraordinary investment deduction for development regions	10	10	5	2	..	..	.. Deduction applies to investments made in 1989 at the latest.
2. Ice fee classification deduction	40	40	20	5	..	..	.. Order of magnitude.
3. Undervaluation of inventories	20	-	-	-	-	-	- Order of magnitude. Eliminated 1993. Transitional regulations apply to security-related and obligatory inventories in 1993.

Spending category Item	Tax expenditures, est. FIM million						Notes
	1993	1994	1995	1996	1997*	1998**	
4. Operating reserve	200	10	40	-20	..	..	Order of magnitude. Eliminated in 1993 except for self-employed persons and partnerships. 10 % reserve for corporations up to 1993.
5. Releasing of inventory and operating reserves	-1300	-	-	-	-	-	Order of magnitude. Part of inventory and operating reserves could be used to form transitional reserves allowing for indirect crediting to income like the investment reserve.
6. Investment reserve	-210	-260	-220	-280	..	..	Reserve entitlement removed in 1992. Restriction of depreciation entitlements reduces tax expenditure of previous years. Calculated on basis of true economic depreciation.
7. Vessel purchase reserve	20	-	-	-	-	-	Eliminated 1994.
8. Machinery and equipment depreciation	2000	2400	2800	3000	..	..	Order of magnitude.
9. Temporarily accelerated depreciation of productive investments	360	350	40	-	-	-	
10. Unrestricted development area depreciation	200	300	820	200	..	..	Order of magnitude.
11. Interim subsidy of industrial investments	-	7	5	-	-	-	
1.-11. Total tax expenditure	1340	2857	3510	2907	..	..	

Spending category Item	Tax expenditures, est. FIM million						Notes
	1993	1994	1995	1996	1997*	1998**	
<i>Indirect taxation</i>							
1. Turnover tax exemption for services (accommodations, beauty and health care, recreation, culture, etc.)	3500	1600	-	-	-	-	- Order of magnitude. Eliminated 1994.
2. Turnover tax exemption of workplace canteens	210	200	-	-	-	-	- Canteen and restaurant activities generally subject to turnover tax. Eliminated 1995.
3. Reduced VAT rate for film performances (12 %)	-	-	30	30	40	..	.. Deductible since 1995. Order of magnitude.
4. Reduced VAT rate for entertainment events etc. (6 %)	-	-	10	10	10	..	..
5. Reduced VAT rate for physical training services (12 %)	-	-	..	..	..	..	.. Can not be estimated.
6. Reduced VAT rate for books (12 %)	-	-	90	100	110	..	.. Deductible since 1995. Order of magnitude.
7. Reduced VAT rate for accomodation services (6 %)	-	-	160	160	180	..	.. Deductible since 1995. Order of magnitude.
8. Turnover tax exemption of domestic fuels and certain waste materials	300	350	-	-	-	-	- Eliminated 1995.
9. Turnover tax exemption of natural gas imports	250	280	-	-	-	-	- Eliminated 1995.
10. Hidden turnover tax (penalty) on exports	-3700	-1700	-	-	-	-	- Order of magnitude. Eliminated 1994.

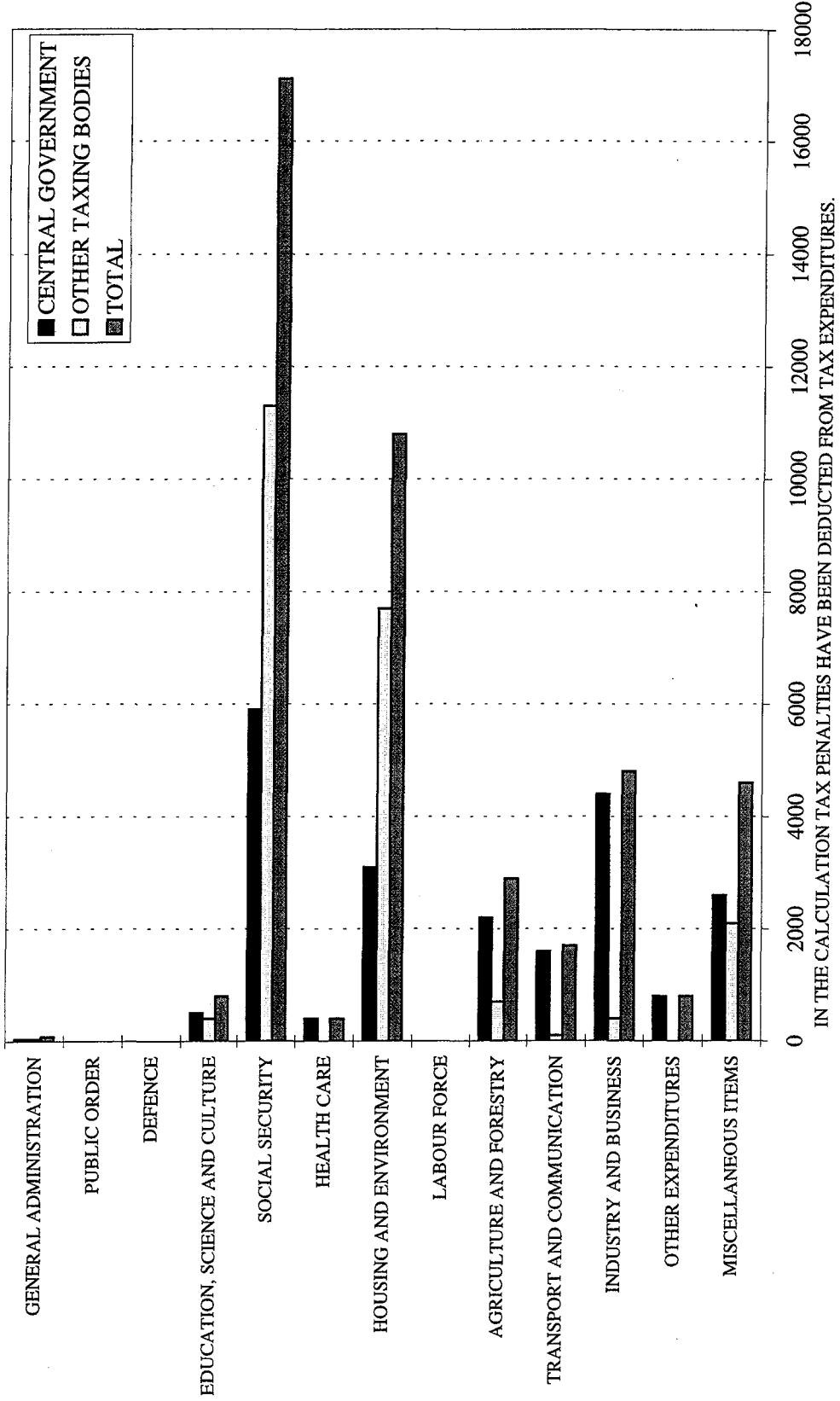
Spending category Item	Tax expenditures, est. FIM million						Notes
	1993	1994	1995	1996	1997*	1998**	
<b>10. Other expenditures</b>							
<i>Income, wealth and related taxation</i>							
1. Tax exemption of bonds and interest thereon	200	200	150	100	50	50	Tax exemption of interest income. Calculated using the final withholding tax rate on interest income.
2. Tax exemption of deposits and interest thereon	900	900	900	700	700	700	Tax exemption of interest income. Calculated using the final withholding tax rate on interest income.
<b>11. Miscellaneous items</b>							
<i>Income, wealth and related taxation</i>							
1. Tax exemption of personnel benefits	1000	1000	1000	1100	1200	1300	Order of magnitude.
2. Deduction of labour organization membership fees	1050	1050	1150	1200	1200	1200	
3. Deduction for interest payments, and index and foreign exchange losses (other than housing loans)	650	400	-	-	-	-	
4. Temporary earned income deduction for individuals with a small income in municipal taxation 1991-96	360	560	500	480	1600	1600	The rules of deduction changed 1994.
5. Partial tax exemption of emoluments in kind	1000	900	800	700	600	600	
6. Tax exemption of travel cost reimbursements in certain sectors	60	60	60	50	50	50	

Spending category Item	Tax expenditures, est. FIM million						Notes
	1993	1994	1995	1996	1997*	1998**	
7. Partial tax exemption of travel allowances	250	220	170	150	120	110	
<i>Indirect taxation</i>							
1. Turnover tax exemption of certain buildings	400	200	-	-	-	-	- Order of magnitude. Covers public and other activity not subject to turnover tax, such as bank and insurance offices. Eliminated 1994.
2. Lower average VAT rate for intermediate product inputs in public sector (21 %)	-	-	410	480	..	..	.. Deductible since 1995. Order of magnitude.
3. Lower average VAT rate for intermediate product inputs in private sector (21.5 %)	-	-	100	120	..	..	.. Deductible since 1995. Order of magnitude.
4. Turnover tax exemption of sales and import of trotting horses and pets	30	10	-	-	-	-	- Order of magnitude. Eliminated 1994.
5. Non-deductibility of turnover tax included in prices of transport and services (penalty)	-2800	-3700	-	-	-	-	- Order of magnitude. Eliminated 1994.
6. Non-deductibility of purchase price of telecommunications services (penalty)	-800	-900	-	-	-	-	- Order of magnitude. Eliminated 1994.
7. Limitation in deductibility of turnover tax inherent in investments, excluding agricultural investments (penalty)	-2600	-1800	-	-	-	-	- Order of magnitude. Only production-related investments and energy investments are deductible. Eliminated 1994.

Spending category Item	Tax expenditures, est. FIM million						Notes
	1993	1994	1995	1996	1997*	1998**	
8. Other types of non-deductibility of turnover tax (penalty)	-1900	-1200	-	-	-	-	- Order of magnitude. Eliminated 1994.
Total hidden turnover tax (items 5-8)	-8100	-7600	-	-	-	-	
of which							
- share related to domestic consumption	-4400	-5900	-	-	-	-	
- share related to exports	(-3700)	(-1700)	-	-	-	-	- Included in industry and other business tax expenditures.
9. Tax exemption on motor vehicles imported as personal effects when moving into Finland	270	250	250	350	250	..	Order of magnitude. Includes loss of tax revenue due to exemption of motor vehicles and motorcycles and loss of turnover tax revenue.

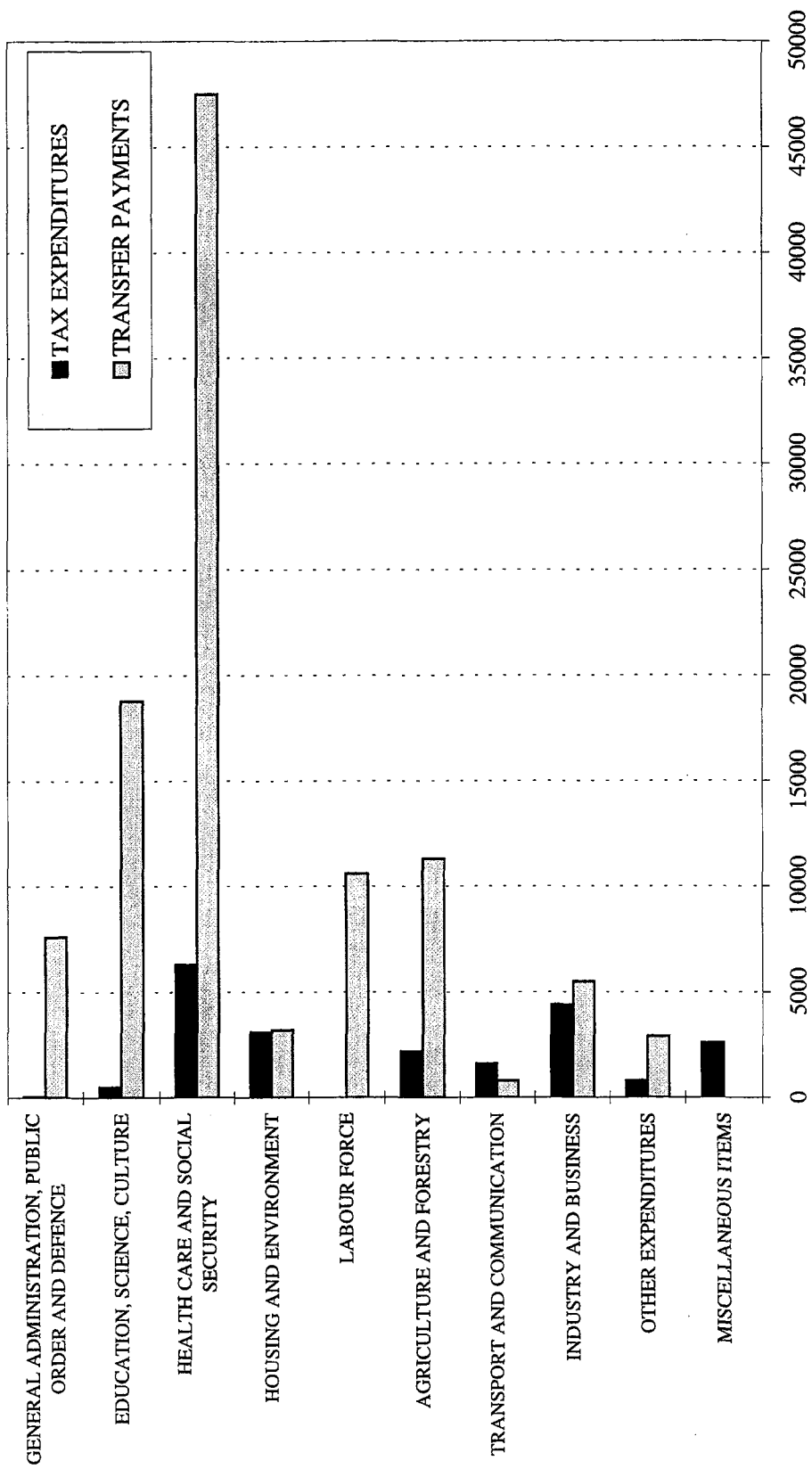


# TAX EXPENDITURES BY SPENDING CATEGORY AND TAXING BODY IN 1996, FIM MILL.





# CENTRAL GOVERNMENT TAX EXPENDITURES AND TRANSFER PAYMENTS BY SPENDING CATEGORY IN 1996, FIM MILL.



IN THE CALCULATION TAX PENALTIES HAVE BEEN DEDUCTED FROM TAX EXPENDITURES.

