TAX BENEFITS FOR INDIVIDUALS AND EXTENT OF THEIR USE IN ESTONIA DURING 2007-2009

Velda Buldas, Priit Sander, Mark Kantšukov
University of Tartu

Abstract

In this paper an overview of tax benefits granted by Estonian legal acts is given, and extent of tax benefits use by resident natural persons using the data from databases of Estonian Tax and Customs Board (ETCB) is analyzed. Also the possibility of tax benefits classification is considered and to whom and on which purposes stated tax benefits are addressed is analyzed. Research based on three years data shows that in Estonia tax benefits for individuals are widely used. On average uncollected amounts of tax due to tax benefits approximately equal 9% of the state budget revenues. Large amount of tax benefits is not a negative indicator *per se* but they aid distributed incomes to reach people who really need those benefits. In opposite case tax benefits are not reasoned but they rather create additional administrative workload. Talking about Estonian tax system roughly half of tax benefits is addresses to people who belong to low income stratum, at the same time remarkable proportion of benefits may be directed to middle-class and wealthy people.

Keywords: tax benefits, tax exemptions, tax system, Estonia

JEL Classification: D14, H2

Introduction

Tax benefits is one of the three possibilities how individuals, companies and other organizations can diminish their tax burden. Generally tax cutback possibilities can be divided into three:

1) Tax benefits contained in legal acts which state deliberately offers to diminish taxes payable (e.g. reduced tax rates for certain people or on certain goods, tax exemptions, increased tax exemptions for families with children, possibility to choose accounting method to calculate return on securities investments, investment account system for individuals);
2) Possibilities to diminish taxes that are not offered directly by the state but are enabled by tax system, considered in the literature as “tax optimization” (the possibility to choose income receiver and time or country of income, cost or sales accrual; additionally possibilities unintentionally written into law by legislators the use of which is in contradiction with the meaning of the law);
3) Tax evasions (actions that plainly are not in accordance with law, e.g. concealment of revenues, under-the-table pay etc.).

Among these three options, in the present article we consider the first one, i.e. the possibility to decrease taxes legally focusing in empirical part on the inquiry of tax liability diminishing opportunities for natural persons. We omit income tax benefits addressed to companies and self-employed persons, also tax benefits associated with implementation of reduced rate of value-added tax.

Surveys conducted during last two decades in OECD countries show that the gap between the rich and the poor has widened. Denmark and Sweden were able to maintain the smallest gap. Tax burden in Nordic countries is higher compared to other European countries, still collected tax revenues are transferred to lower income stratum of population decreasing by that the gap between rich and poor. (Pearson *et al.* 2008: 1, 2, 5) As tax collection is associated with administrative expenses, and expenses usually increase if tax system contains plenty of exemptions then these exemptions have to be well-weighed and directed. Without doubt tax benefits are exemptions that increase administrative work load and thus should foremost serve social purposes transferring incomes from high-earning individuals to low income people.

The aim of this paper is to give an analytical overview of Estonian tax system's benefits to resident natural persons. Extent of the use of benefits offered by the state is assessed using data from register of taxable persons, Bank of Estonia and KPMG.

The paper is structured as follows. In the first part reasons of tax benefits' implementation are discussed. In the second part of the paper possibilities of tax benefits classification are observed; in the third part extent of tax benefits use in Estonia is analyzed.

1. Reasons for implementation of tax benefits

Main objectives of public sector and taxation are allocation function, distribution function and stabilization function (Musgrave *et al.* 1987: 5). In taxation attention has to be paid who or what is subject to tax, how to tax, to what extent to tax, what is the effect on economic agents and processes, what the consequences are (Võrk *et al.* 2008: 10). In the late 1980s there was still a standpoint that tax system in general should be impartial and affected as little as possible by directed objectives. (Musgrave *et al.* 1987: 207)

At the same time, with strengthening economic integration of European countries junctions of taxation systems of member states is becoming more important. Changes in tax policy of one member state may have spillover effects on systems of other states; these changes may become a reason for implementation of tax benefits (Cnossen 2002: abstract). Mutual effects of tax systems in the EU may be both positive and negative, resulting in more efficient distribution of income (as well as opposite). (Cnossen 2002: 3).

The survey on poverty and inequality conducted in 30 OECD countries show that the gap between rich and poor people in most OECD countries has widened over the past 20 years. The rise in gap has taken place due to the rich improving their income vis-à-vis low-income and middle-income people. At the same time some part of this growing inequality may be explained by demographic changes – due to higher life expectancy and less children number of single-adult households increased substantially. The greater spread of lone parents has had a strong effect on inequality. (Pearson *et al.* 2008: 8)

Through taxes and various benefits governments play a big role in determining incomes and standards of living. In Nordic countries, taxes and benefits are of very important redistributive role. To a lesser extent system of taxes and benefits is redistributive in Korea and the United States. On average across OECD member states, income taxes and cash transfers reduce inequality by one third but positive impact of taxes and benefits on poverty and inequality has decreased in many OECD countries during last decade (Pearson *et al.* 2008: 5)

Thus trends emerged during last couple of decades in OECD countries refer to need to employ tax systems for income redistribution more than it was done before. Taking into account that a state should spend as little resources on tax administration as possible, then exceptions (benefits) in tax system should be reasoned and easy do administer. Basically, a state should collect as much tax revenues as it needs to sustainably carry its functions. However, it is not easy to predict future monetary needs. It is also possible to understand differently the idea of justice in the context of taxation.

Miron and Murphy (2001) argued that individuals' rights to social guarantees must occur only when they have worked for a certain period of time. In reality no direct relation between tax contribution and amount of benefits received exists, taxes paid by employed people are used to finance all the guarantees and benefits. (Miron, Murphy 2001: 2)

Leviner (2007) introduces in her paper the vision of a good tax system according to which higher tax burden should be carried by wealthier persons (Leviner 2007: 405). Because wealthier persons have control over the greater part of resources available rich people should actively participate in supporting society through carrying higher tax burden, taxes paid by wealthy people can be distributed to weaker members of the society, she concludes (Leviner 2007: 406). Whether to fully agree with Leviner's community-oriented rather than individual-centred view or not is the question itself; however, there is not point to channel benefits to persons who are prosperous enough.

In Estonia the Center for Policy Studies Praxis prepared a report on influences of tax policy: results of analysis show that e.g. non-increasing of basic exemption would increase income inequality (Võrk *et al.* 2008: 45). Increased basic exemption in case of second or next child has brought the biggest gain to a person with middle-income, deduction of housing loan interests, training expenses and student loans from taxable income has provided the biggest gain to people with higher income (Võrk *et al.* 2008: 51). Due to the fact that the survey was not conducted using declared data – microsimulation model ALAN was used instead – real data can yield slightly different result. Nevertheless, the survey gives a signal that tax benefits included in

Estonian tax system may not be justified – they are not to transfer income from wealthier to poorer, direction is rather opposite.

John Rawls wrote about justice (1999) that “Justice is the first virtue of social institutions, as truth is of systems of thought. A theory however elegant and economical must be rejected or revised if it is untrue; likewise laws and institutions no matter how efficient and well-arranged must be reformed or abolished if they are unjust.” (Leviner 2007: 408)

Recently in euro zone ideas on harmonization of tax systems and retirement age started to flow, one can recall so called competitiveness pact proposed by Germany and France. Objects of concern include inter alia low tax rates of several countries that cause high level of public debt to be paid up by other member states. There is debate on introduction of a minimum corporate tax rate and a higher retirement age, based on demography. (O’Donnel, Toyer 2011) It is still unclear whether harmonization shall cover also tax benefits.

2. Classification possibilities of tax benefits

There are many terms regarding tax benefits in the literature on taxation: one can discover various terms, e.g. “tax exemption”, “tax deduction”, “tax benefit”, “tax cut”, “tax rebates” and so on. It is very easy to get confused when trying to make difference between different benefits and their variations. In our paper we use “tax benefit” as a blanket term to refer to any kind of possibility guaranteed by law to decrease an individual tax liability. To make a distinction it is possible to separate tax benefits into following categories (Nalogovoe pravo 2000: 107, Tax Rebates and Benefits…):

- exemptions,
- deductions,
- reliefs.

Exemptions refer to excluding some objects or items from taxation. For instance, in Estonia some incomes of resident individuals are exempt from tax, income tax is not charged on them – these include inter alia scholarships and grants paid pursuant on law from the state budget, certain lottery prizes, benefits paid to victims of crime pursuant to law and other. (ITA § 19 (3)). Basic exemption of Estonian resident natural persons deductible from the income (1728 Euros) also falls into this category. Also payments to some groups of people and organizations may be exempt from tax charge (for instance, income tax is not charged on payments made to persons recruited for secret co-operations in surveillance activities according to Surveillance Act § 14).

Deductions refer to benefits aiming to decrease tax base. The most explicit example perhaps is that companies can deduct business costs from their sales revenue. For resident natural persons in Estonia it is possible to deduct e.g. housing loan interest from income received during the period of taxation (ITA § 25). There are other several deductions available to resident individuals in Estonia.

Depending on the influence on the results of taxation deductions can be limited (the amount of deductions are limited directly or indirectly) and unlimited (tax base can be decreased for a full amount of costs or expenses of a taxpayer). As an example, in Estonia an individual can deduct housing loan interest, training expenses, gifts and donations from his/her income received during the period of taxation in total amount up to 3 196 EUR but no more than 50% of the income adjusted for deductions related with business activities. (ITA § 28[2]).

Relief is the benefit associated with diminishing of tax rate or tax liability. Possibilities here include reduction of tax rate, diminishing tax liability, tax deferral or scheduling tax payments, tax credits, tax amnesty, return of and reckoning with previously paid tax. In case of reliefs benefits are provided directly in contrast to benefits provided by exemptions and deductions. Compared to other benefit schemes reliefs can better take into account taxpayer's wealth. If from exemptions and deductions the rich gain more then quantitatively equal relief saves higher portion of income for low-income taxpayer. (Nalogovoe pravo 2000: 108)

Tax benefits can be also classified consequently from the purpose of their imposition: for instance, benefits imposed on social purposes, benefits imposed to decrease administrative workload, benefits to promote savings or certain spheres of activity, and other.

3. Use extent of tax benefits for individuals in Estonia

Estonian taxation system contains in significant amount tax exemptions for individuals[1]. Chapter 4 of Estonian Income Tax Act considers tax exemptions from the income of a natural person resident. Among income tax exemption minimum tax-free income in amount of 1728 Euros to a natural person should be mentioned (ITA § 23). Additionally possibility of joint declaration for spouses is established (ITA § 44 (2)), according to which a nonearning spouse can additionally deduct income tax in amount of minimum tax-free income from family income. Parents raising children have the possibility to deduct additional minimum tax-free amount for every child starting from the second child (ITA § 23[1]). Income tax liability of an individual is decreased by schooling expenses (ITA § 26), interest payments on housing loan (ITA § 25) and donations (ITA § 27). Income tax on last three mentioned tax exemptions cannot exceed 3196 EUR a year per taxpayer or 50% of a taxpayer's taxable in Estonia income for the same period. Since January 1, 2011 it is not possible to deduct income tax from interest payments on student loans.

Since 2011 to postpone tax liability on capital gain individuals can use the system of investment account (ITA § 17[2]). Investment revenues on this account are not charged with income tax, the liability for individual occurs when sum of money withdrawn from investment account (for purposes other than purchase of financial

---

[1] It should be mentioned that in this paper we do not consider some types of tax benefits which are either difficult to estimate (e.g. joint declaration of income tax by spouses) or are slightly out of focus group (tax benefits associated with self-employed persons).

assets) exceeds the surplus of all the depositions made to that account. It should be mentioned that certain securities are not qualified for investment account system (e.g. securities of non-listed companies)[2].

Table 1. Income tax exemptions to individuals and extent of their use 2007 – 2009

Income tax exemptions to natural persons (Mio EUR)	**2007**	**2008**	**2009**	**Total**
Basic exemption	897.8	1 066.10	1 011.0	2 974.9
Increased basic exemption in event of pension	217.8	247.2	257.8	722.8
Increased basic exemption in case of two or more children	102.8	339.6	118.1	560.5
Housing loan interest	138.9	179	132.8	450.7
Training expenses	65.2	69.3	69.0	203.5
Funded pension (2nd pillar)	57.1	68.9	65.0	191.0
Funded pension (3rd pillar)	46.8	41.7	32.2	120.7
Unemployment insurance premiums	22.3	25.9	27.3	75.5
Student loan interest	7.3	7.6	7.9	22.8
Maintenance support	4.6	5.6	5.2	15.4
Trade union membership fees	3.3	3.8	3.5	10.6
Gifts and donations	2.6	2.7	3.0	8.3
Increased basic exemption in event of compensation for accident at work or occupational disease	0.9	0.9	0.9	2.7
Social security contributions paid in a foreign country	0.3	0.4	0.5	1.2
Total tax exemptions	**1 567.70**	**2 058.7**	**1 734.2**	**5 360.6**
Income tax collections in case of no exemptions	**344.9**	**432.3**	**364.1**	**1 141.3**
State tax revenues	**4 328.0**	**4 076.0**	**4 497.0**	**12 901.0**
Tax exemptions as a share of the state budget income	**7.97%**	**10.61%**	**8.10%**	**8.85%**

Source: Compiled by authors using data from Tax and Customs Board.

[2] Prior to 2011 an individual could choose between FIFO and weighted average method to calculate the cost basis of securities of the same class acquired at different times and different price; this applied to all the securities. With the introduction of investment account system the method of calculation of the cost basis of securities to which investment account system can be applied became irrelevant since it does not affect tax liability on capital gain. However, for other securities it is still possible to choose between FIFO and weighted average method (ITA § 38 (6)). Unfortunately there is no data available to authors regarding extent of use of this possibility.

Previously mentioned benefits determine remarkably lower level of tax proceeds to state. At the same time the state consciously has validated such benefits and gave up some portion of tax income. While not discussing reasons for validation of these benefits we try to estimate how significant waiver from income for the state is.

The data about the extent of the amount of uncollected revenue due to tax benefits for resident natural persons can be found on the homepage of Estonian Tax and Customs Board. Table 1 is compiled on the basis of data from income tax returns of individuals.

Presented data show that due to existing tax exemptions to natural persons the state gives up the amount of income tax equal to 8.85% of the state budget income on average. The only benefit abolished by the present time is the benefit on student loan interests but extent of its use is not big and thus the state does not get supplementary tax income from that. Fluctuations in tax benefit regarding two or more children are due to the fact that in 2008 increased basic exemption was provided from the first child.

Amount of used tax exemptions vary by exemption types, also the number of persons who used exemption is different. The following table 2 gives an overview of how extensive a particular tax exemption was. Also below in this chapter described tax exemptions were inserted into the table.

From the table 2 one can see that the most remarkable tax exemption per person was granted by tax exemptions related with pension and children (exemptions made on social purpose) followed by exemption related to social security contributions paid in a foreign country (tax exemption related with avoidance of double taxation). Next one, the basic exemption is a broad-base exemption to everyone (obviously people earning lower income win the most in this case, so this exemption can be defined as exemption implemented on social purpose); exemption on housing loan interest was apparently introduced to support young families.

In addition to tax exemptions presented in the last table tax exemption related to interest receivable is included in Income Tax Act. According to ITA § 17 (2) income tax is not charged on interest paid to natural persons by a credit institution which is a resident of a state which is a contracting party to the EEA Agreement or on interest paid through or on account of a permanent establishment of a non-resident credit institution located within a contracting party state[3]. It is difficult to estimate the amount of such a tax exemption using publicly available data as it is not know how big amounts of money and at which interest rates resident natural persons deposited outside of Estonia. The data on individuals' deposits in Estonian credit institutions is

[3] However, since 2011 according to ITA § 17 (3) this enactment does not apply to interests received by natural persons from investment deposits (structured deposits) – interests paid on these deposits depend partially or fully on the value of some underlying asset (equity index, currency etc.) or the change of the value. Prior to 2011 interest income on such instruments were tax-free.

available but it is not possible to calculate precise amount of interest income using available data only.

Table 2. Number of people who used particular tax exemptions 2007 – 2009, average annual amount of tax exemptions per person

Tax exemptions to natural persons	**2007**	**2008**	**2009**	**Annual average income tax gain per person (EUR)**
Increased basic exemption in event of pension	97 636	104 503	106 997	491.0
Increased basic exemption in case of two or more children	57 419	143 899	58 173	453.6
Social security contributions paid in a foreign country	177	193	197	421.3
Basic exemption	545 093	569 596	538 494	377.9
Housing loan interest	96 984	102 975	102 035	313.4
Maintenance support	3 970	4 063	3 635	277.1
Increased basic exemption in event of compensation for accident at work or occupational disease	1 362	1 323	1449	133.1
Training expenses	153 955	149 818	146 599	94.9
Funded pension (3rd pillar)	91 907	91 724	83 333	94.9
Dividends from contracting party state	416	422	343	56.1
Funded pension (2nd pillar)	296 441	310 403	323 752	43.1
Student loan interests	68 686	69 092	68 263	23.4
Gifts and donations	25 371	27 602	27 687	21.4
Trade union membership fees	45 142	43 843	41 301	17.0
Unemployment insurance premiums	407 681	412 239	447 257	12.5

Source: Income tax returns.

Estimate presented in this paper is based on statistics published on the website of the Bank of Estonia with some additional assumptions. Both resident and non-resident natural persons have deposited their money in Estonian commercial banks. The share of non-residents' deposits of total amount of deposits in Estonian credit institutions during 2007-2009 was in range of 5%-6%. In the following analysis it is assumed that this proportion is the same in the context of different terms and currencies. Analysis is complicated by the fact that a large part of private persons' deposits are on demand deposits (see the figure 1 below), interest rates on which the

Bank of Estonia does not disclose. As a rule, interest rates on deposits on demand deposits are very low[4].

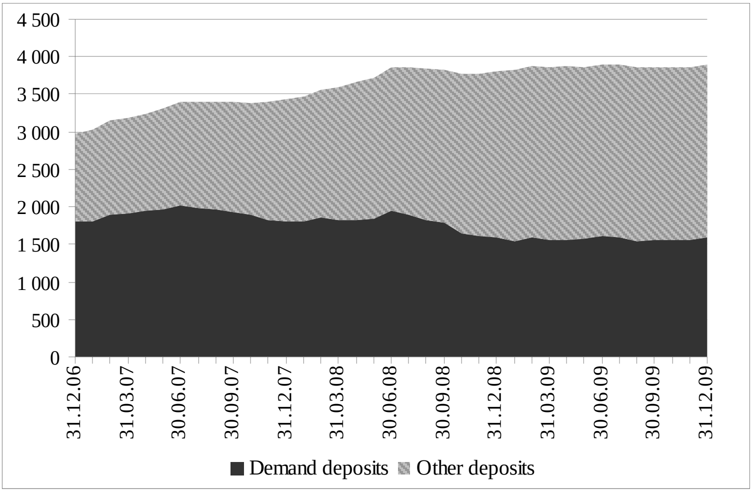

Figure 1. Deposits of private individuals in Estonian credit institutions 2007-2009 (Mio EUR). Source: compiled by authors based on data from the website of the Bank of Estonia.

When calculating interest received by resident natural persons, kroon-based and other currency based deposits were taken into account separately. For latter merely euro-based interest rate was applied because the information on distribution of deposits by currencies (EUR, USD, SEK etc.) was not available. The figure 2 gives an overview of the movement of kroon-based and euro-based interest rate during the given period.

To calculate interests received during the month under consideration an average monthly interest rate was applied to an average surplus of deposits at the beginning and at the end of a month, results were summed up by calendar years. In the following table 3 the estimate on interests received and tax benefit according to ITA § 17 (2) are presented (during years 2007 – 2009).

[4] In the present analysis interest rates applied to cash deposits on demand deposits are 0.25%, 0.2% and 0.15% for 2007, 2008 and 2009 respectively.

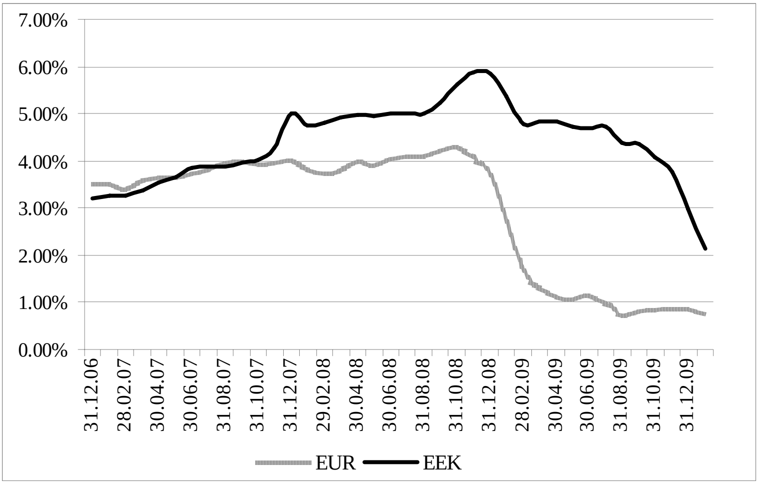

Figure 2. Interest rates on kroon-based and euro-based term deposits in Estonian credit institutions 2007 – 2009. Source: compiled by authors using data from the homepage of the Bank of Estonia[5].

Table 3. Effect of non-taxation of deposit interests (Mio EUR)

	2007	2008	2009	Total
Interest receivable by resident natural persons	52.2	86.6	69.7	208.5
The amount of tax exemption	11.0	18.2	14.6	43.8

Into tax benefits granted to resident natural persons by the state enactment of ITA § 18 (1^1) can be partly included. Generally, income tax is charged on all dividends and other profit distributions received by a resident natural person from a foreign legal person in monetary or non-monetary form. However, income tax on dividends shall not be charged in case income tax has been paid on the share of profit on the basis of which the dividends are paid or if income tax on the dividends has been withheld in a foreign country. This amendment entered into force since 01.01.2002 (RT I 2003, 88, 587); until that date aforementioned dividends were charged with income tax according to current tax rate in Estonia (RT I 1999, 101, 903).

As the basis for tax exemption is merely the fact of paying income tax in a foreign country, whereas income tax rate in a foreign country on dividends received or on the share of profit on the basis of which the dividends are paid does not matter, then thanks to this prescript total tax liability of an investor on dividends received from a

[5] kroon-based interest rate refers to interest rate applied to natural persons, euro-based interest rate is calculated on the basis of all euro deposits

foreign country may be lower compared to the situation where similar investment was made into shares of Estonian business entity.

According to the data from Bank of Estonia, direct and portfolio investments of Estonian residents (both of natural and legal persons) grew during 2003-2010 4.15 times reaching by the end of third quarter of 2010 8.51 bn Euros. As most of the investments abroad are made by legal persons the share of private persons is relatively small. In the following table 4 top-10 investment destination countries are listed (as of end of third quarter of 2010) with corporate income tax rates as of end of 2009.

Table 4. The amount of direct and portfolio investments made from Estonia into 10 primary investment destination countries with respective corporate income and dividend tax rates in these countries (as of 30.09.2010)

Destination country for investment	Total direct and portfolio investments (Mio EUR)	Share of total investment	Corporate income tax rate	Dividend tax rate
Lithuania	1 401.9	16.47%	20%	15%
Latvia	1 230.7	14.45%	15%	15%
France	732.1	8.60%	33.33%	15%
Cyprus	599.2	7.04%	10%	0%
Netherlands	574.7	6.75%	25.5%	15%
Finland	557.7	6.55%	28.59%	15%
Luxemburg	523.2	6.14%	26%	15%
Russia	355.7	4.18%	20%	15%
Italy	245.8	2.89%	31.4%	15% (5%)
Germany	241.8	2.84%	30.175% - 33.325%	15%
Other	2 051.7	24.10%	-	-

Source: Compiled by authors using data from the Bank of Estonia, Tax and Customs Board, and KPMG.

From preceding table it appears that among ten primary investment destination countries dividend taxation is more beneficial in Cyprus where on corporate level income tax of 10% has to be paid, no additional income tax is charged on dividends. In all other top-10 countries together corporate income tax and tax on dividends are higher than in Estonia. Thus, investors do not have any income tax advantage when investing into these countries.

On the basis of data from income tax returns natural persons in 2007 received from foreign countries dividends in amount of 1.04 Mio EUR, in 2008 1.56 Mio EUR and in 2009 2.34 Mio Eur. Number of persons received dividend income from foreign countries was during these years 416, 422 and 343 respectively. Taking into account proportions of investments and tax rates of corresponding countries it is possible to calculate approximate amount of income tax the state has given up. Considering share of investments made into Cyprus investors gained from income tax saving during particular years: in 2007 – 0.016 Mio EUR, in 2008 – 0.022 Mio EUR and in 2009 – 0.033 Mio EUR. That kind of tax benefit may appear considering countries out of top-10 but tax gains are small. At the same time the reason of this benefit is not transferring income to less secured people but rather to simplify administration, wealthier people are those who gain more from this tax benefit.

Table 5. Uncollected revenues of the state due to tax exemptions to natural persons 2007 – 2009

Tax exemptions to natural persons (Mio EUR)	2007	2008	2009	Total
Income tax from exemptions (table 3)	344.9	432.3	364.1	1 141.3
Tax exemption on interests received	11	18.2	14.6	43.8
Total tax exemptions	**355.9**	**450.5**	**378.7**	**1 185.1**
Share of exemptions from the state budget revenues	**8.22%**	**11.05%**	**8.42%**	**9.19%**

Source: Compiled by authors using data from Tax and Customs board.

In table 5 potential tax amounts are summarized that are left to natural persons because the state imposed miscellaneous tax exemptions for various reasons. At the current income tax system the state gives up in favor of natural persons around 9% of its tax revenues. The following table 6 provides evidence that money left in pockets of natural persons due to income tax exemptions roughly equals the amount of total collected income tax (income tax from both natural and legal persons).

From tax exemptions cited above there are exemptions with distinct social purpose: increased basic exemption in event of pension, increased basic exemption in case of two or more children, funded pension payments (2nd pillar), maintenance support and unemployment insurance premiums. Affording basic exemption to people with low income also serves social purpose but is not justified for all the persons. During the period under analysis income of below 6 391 EUR can be considered as low income. Such income was declared in 2007 by 271 356 persons, in 2008 by 246 376 persons and in 2009 by 254 574 persons. Taking into account the amount of exemptions mentioned above one can claim that in Estonia tax exemptions serve their social objective in extent of 48% (the amount of tax exemptions made for social purpose is presented in table 7, the amount of other tax exemptions is presented in table 8).

Table 6. Tax revenues in the state budget (thousand Euros)

Taxes	Actual 2007	Actual 2008	Actual 2009
Total state budget revenues	**5 240 481**	**5 476 278**	**5 423 247**
TAX REVENUES	**4 328 014**	**4 076 289**	**4 497 411**
Income tax	**566 922**	**410 772**	**542 912**
incl. natural persons income tax	305 926	154 462	276 654
incl. legal persons income tax	260 996	256 310	266 257
Social tax	**1 742 724**	**1 794 913**	**2 000 380**
Heavy goods vehicle tax	**4 197**	**3 544**	**4 034**
Tax on goods and services	**1 979 048**	**1 847 383**	**1 917 569**
Value added tax* **	**1 425 478**	**1 202 146**	**1 313 254**
Excises duties	**523 743**	**627 470**	**573 377**
incl. alcohol excise duty	147 863	160 401	155 564
incl. excise duty on tobacco	97 733	133 445	97 124
incl. fuel excise duty	278 228	311 625	300 202
incl. excise duty on packaging	-89	30	73
incl. excise duty on electricity	0	21 968	20 411
incl. other excise duties	8	1	3
Gambling tax	**29 827**	**17 768**	**30 938**
Customs duty	**35 122**	**1 258**	**2 078**

Source: Homepage of the Ministry of Finance.

Table 7. The amount of tax exemption with distinct social purpose 2007 – 2009 (Mio EUR)

Tax exemption	2 007	2 008	2 009	Total
Basic exemption	92.0	95.0	96.0	283.0
Increased basic exemption in event of pension	45.7	51.9	54.1	151.8
Increased basic exemption in event of compensation for accident at work or occupational disease	0.2	0,2	0.2	0.6
Increased basic exemption in case of two or more children	21.6	71.3	24.8	117.7
Maintenance support	1.0	1.2	1.1	3.2
Unemployment insurance premiums	13.7	14.6	14.5	42.7
Funded pension (2nd pillar)	1.5	1.6	1.7	4.8
Total	**175.7**	**235.7**	**192.4**	**603.8**

Table 8. The amount of tax exemptions made on non-social purpose during 2007 – 2009 (Mio EUR)

Tax exemption	**2 007**	**2 008**	**2 009**	**Total**
Basic exemption	97.0	129.0	116.0	342.0
Housing loan interests	29.2	37.6	27.9	94.7
Training expenses	13.7	14.6	14.5	42.8
Student loan interest	1.5	1.6	1.7	4.8
Trade union membership fees	0.7	0.8	0.7	2.2
Gifts and donations	0.5	0.6	0.6	1.7
Social security contribution paid in a foreign country	9.8	8.8	6.8	25.4
Interests received	11.0	18.2	14.6	43.8
Dividends from contracting party state	0	0	0	0
Funded pension (3rd pillar)	29.2	37.6	27.9	94.7
Total	**192.6**	**248.8**	**210.7**	**652.1**

Housing loan interest payment, training expenses, student loan interest payments, trade union membership fees, gifts and donations do not serve social purpose. One can reach the conclusion that 50% and 3196 EUR limit at these tax exemptions are favoring at leas on relative basis people with rather medium income, on absolute basis obviously middle class and wealthy people. Results of Praxis' analysis prove the same. Tax exemptions on dividends received from foreign countries, interests received and on funded pension payments (3rd pillar) are addressed plainly to wealthier persons. Analysis by Praxis also shows that some of these exemptions can be used by rather prosperous people. In total, exemptions that are not related with income distribution constituted on average 52% of all the exemptions during 2007 – 2009. From these benefits that do not have so distinct social purpose tax exemptions on student loan are cancelled, but their amount was catchpenny. At the same time OECD surveys conducted in Europe show that 18-20 year olds (i.e. people having demand for student loans) are socially one of the least secured stratum of population. So it is still an open question whether it is reasonable not to give tax exemption on student loan interests (7-8 million Euros a year) and still afford tax exemption on housing loan interests (130-180 million Euros a year in total).

One of the goals of tax system is distribution of incomes, and tax benefits should serve this objective. Recalling the statement of John Rawls presented earlier in the paper if it becomes evident that a system is unjust or does not serve the goals it should be remade.

Conclusions

Analysis of tax exemptions' use extent demonstrates that in Estonia annual tax exemptions for natural persons constitute on average 9.2% of the state budget tax revenues. Amount of tax exemptions for individuals are of the same magnitude as the amount of collected income tax. Tax benefits and tax-aided distributed cash flows are extensive in whole Europe, however tax benefits should be implemented purposefully and direction of tax-aided distributed cash flows should be from wealthier to socially less secured people.

Exceptions to the rule – i.e. different tax exemptions – generally require additional administrations expenses and thus must be reasoned. In some cases the aim of tax benefit implementation is diminishing of administrative workload (e.g. tax benefits imposed on dividends received from contracting party state).

In Estonia of tax benefits to individuals 52% are addressed to people earning average or high income. Hence incomes induced by tax benefits move rather in opposite way than in OECD countries in general; many tax benefits cannot be regarded as reasoned.

Acknowledgements: This article was prepared with financial support received from the Estonian Ministry of Education and Research (Target Financing SF0180037s08).

References

1. Act to Amend Income Tax Act, Social Tax Act and Land Tax Act, RT I 2003, 88, 587 (in Estonian) [https://www.riigiteataja.ee/akt/690814]
2. **Cnossen, S.** (2002) Tax Policy in the European Union: a Review of Issues and Options. Working Paper No. 758. Available at: [http://papers.ssrn.com/sol3/papers.cfm?abstract_id=340905]
3. Income Tax Act. Passed 15.12.1999, RT I 1999, 101, 903; amended 20.10.2010, RT I 18.11.2010 (in Estonian) [https://www.riigiteataja.ee/akt/78069]
4. International investment position [http://www.eestipank.info/dynamic/itp1/itp_report_1j.jsp?reference=653&className=EPSTAT1&lang=en]
5. KPMG's Corporate and Indirect Tax Rate Survey 2009 [http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/KPMG-Corporate-Indirect-Tax-Rate-Survey-2009.pdf]
6. **Leviner, S.** (2007) From Deontology to Practical Application: the vision of a good Society and Tax System. Available at: [http://papers.ssrn.com/sol3/papers.cfm?abstract_id=759005]
7. Ministry of Finance homepage. Cash basis revenues and expenditures of the state budget (in Estonian). [http://www.fin.ee/index.php?id=81725]. (02.01.2011)
8. **Miron, J. A., Murphy, K. M.** (2001) The False Promise of Social Security Privatization. [http://papers.ssrn.com/sol3/papers.cfm?abstract_id=270245]
9. **Musgrave, R. A., Musgrave, P., Bird, R.** (1987) Public finance in theory and practice. Canadian edition. Toronto: McGraw – Hill Ryerson, 768 p.
10. **O'Donnell, J., Toyer, J.** Paris, Berlin launch EU competitiveness pact. Reuters [http://www.reuters.com/article/2011/02/04/idINIndia-54665620110204] 04.02.2011

11. **Pearson, M., Förster, M., D’Ercole M. M.** (2008). Are we growing unequal? New evidence on changes in poverty and incomes over the past 20 years. OECD Publishing. [http://www.oecd.org/dataoecd/48/56/41494435.pdf]
12. Tax and Customs Board homepage. Press releases (in Estonian). [http://www.emta.ee/index.php?id=4006]
13. Tax Rebates and Benefits. Income Tax Department of India. [http://www.incometaxindia.gov.in/publications/7_Tax_Benefits_for_Pensioners/Chapter5.asp#TypesofTaxBenefits] 04.02.2011
14. **Võrk, A., Paulus, A., Poltimäe, H.** Maksupoliitika mõju leibkondade maksukoormuse jaotumisele. Tallinn, 2008, Praxis research, 100 lk. [http://www.fin.ee/doc.php?80820]
15. Nalogoe pravo: uchebnoe posobie. Pod redakciej S. G. Pepelyayeva. Moscow: FBK Press, 2000, 608 p.