

Merging the Administrations of Social Security Contribution and Taxation

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Foreword

On behalf of the European Institute for Social Security, we are pleased to present this report “Merging the administrations of social security contribution and taxation” by Effrosyni Bakirtzi, Prof. Paul Schoukens and Prof. Danny Pieters*. The findings of this research project have been presented at the 12th IBM International Social Security Forum on 4th and 5th October 2010 in Vienna, Austria.

As it has been discussed in the aforementioned Forum, nothing is stable in social security and, thus, the social security structures and financing mechanisms are constantly evolving. Therefore, governments may need to adapt these structures and mechanisms to the new circumstances, especially those arising after the recent economic downturn. Still remains the question how we can move forward in social security with efficiency and effectiveness with regard to the financing of the social security schemes. An answer to this question could be the far more reaching form of cooperation between social security administration and tax authority in the collection of the social security contributions; this close form of cooperation is the merger of the administrations of social security contributions and taxation.

The present report studies the collection systems of five different European countries and gives an overview of the lessons learned from the different practices adopted in this field. These conclusions may help trigger awareness in this particular area of collecting social security contributions. The report may also give an insight for further changes in the national collecting systems of other countries.

When a change like the merger of the collection functions is implemented in a country, one should always keep in mind the objectives of such a change and put emphasis on the successful cooperation between the administrations and the cost efficiency and effectiveness of the new system. Of course, equally important is to invest both on people and structures during the implementation of the merger in the collecting system of taxes and social security contributions.

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Executive summary

Although taxes and social security contributions are considered as different systems that serve different purposes, there is often a tendency to merge the collection of both levies and transfer this competency into the hands of one administrative body. It is argued that merging the administrations of social security contributions and taxation can provide considerable simplification and increase the compliance to the payment obligations. The present report summarizes the meaning of the merged collection systems, the process towards this merged collection of taxes and social security contributions and the advantages and disadvantages of such a collection system. This is done in order to give an insight of the situation governing the merged collection in different countries and help the reader evaluate the consequences of the adoption of such a merged collection system.

Research summary

The document is focusing primarily on the financing of the social security systems from social security contributions, either these are traditional employee's, employer's and self-employed person's contributions or alternative forms of financing; the financing of social security via general taxation is excluded from the present research.

The paper also covers one of the aspects of the integration, coordination and interaction between social security and tax authorities in a number of European countries; that is the merger of both the functions of the collection of taxes and the collection of social security contributions into the hands of one institution. The countries selected for this research were:

- countries with a longer standing record with regard to the merger, i.e. the United Kingdom and the Netherlands;
- countries in transition to market economies, such as Hungary and Estonia; and
- countries with a partial merging of collection functions, such as Italy.

This increased interaction between tax and social security administrations is due to the fact that they seem to have many common functions which can be merged for the purposes of simplification of procedures and cost elimination.

As explained in the first chapter of the present report, a merger of the administrations of social security contribution and taxation is a form of centralization of the collection system either by merging procedures or by merging institutions. The level of merging depends upon the number of administrative functions brought together during the transfer of the collection of social security contributions to the tax administration.

Structure of the report

The structure of this report is described in details in chapter 2. In brief, we can mention that the report is divided into two thematic parts. The first part (chapter 3) examines the past and current situation of the merged collection system in five different countries maintaining a common structure for all the countries examined. The second part (chapters 4-7) gives an overview of some conclusions drawn on the typology and functioning of the merged collection system as well as the obstacles encountered and the benefits expected by merging social security and tax collection administrations.

Summary of country reports

Estonia

Estonia has recently undergone important changes in the field of social security. Therefore, the redevelopment of the social security contribution collection system was considered necessary for the sustainability of the social security system. One way for achieving this was the merger of tax and social security contribution collection; the merger took place in 1999 with the introduction of the so-called “social tax” collected by the tax authority.

In Estonia pension and health insurance schemes are financed by the so-called “social tax” - a kind of social security contribution containing different components for the different social security schemes; unemployment benefits are funded by the compulsory unemployment insurance contributions. A funded supplementary old-age pension scheme was introduced only in 2001. All the social security contributions are collected by the Estonian tax authority which also performs controlling functions with regard to the payment compliance of both taxes and social security contributions. Upon collecting both the levies, the Estonian tax authority accounts and maintains separate records for all the levies. The taxpayers/contributors are identified through their private identification number or a commercial registration number. Personal accounts can be accessed through an online system. The employers have to submit monthly reports with all the information on the amounts paid whilst the self-employed persons have to make such reports and payments on a quarterly or annual basis. There are different kinds of records kept with regard to taxes and social security contributions: individual and separate records. The funds collected are immediately kept separated and transferred periodically to the competent social security fund either directly or via the State Treasury. The tax authority is responsible for processing the information submitted and the data are then transmitted to the competent social security administration.

Some of the obstacles encountered during and after the merger in Estonia can be summarized to the following:

- implications to the registering, calculating and recording systems caused by the implementation of new procedures and the introduction of new forms, especially with regard to the second pillar social security contributions (introduction of a *unified tax declaration* for withholding income tax and social security contributions since January 1999),
- human resources and IT related problems, and
- communication issues.

As benefits of the merger in Estonia were reported:

- the creation of a more efficient administration system,
- the reduction of the administrative burdens for the employers,
- the smoother introduction of the mandatory funded pension and unemployment insurance schemes, and
- the decrease of cases of social security contribution fraud.

Hungary

The merger was a result of the major social security changes that took place in Hungary towards the end of 1990's; there was a pension reform with the introduction of the three pillar social security system. The financing of the social security system in Hungary today is based mainly on contributions, but some schemes are also co-financed by the taxes. The competent authority for the collection of both taxes and social security contributions is the tax authority. The merger of the collection system was completed in 2001.

The Hungarian tax authority collects both the levies as aggregate amounts on a regular basis without making any distinction or split upon the collection. There are two numbers required for the identification of the payers: a social security identification number for the contributors and a tax identification number for the taxpayers. The contributions are assessed, deducted and paid by employers and entrepreneurs to the so-called "accounts" of the tax authority; a declaration is made on their returns. The revenues collected are transferred to the competent social security funds via the State Treasury. There are two kinds of records kept: records of the declarations, payments and enforcement for both the levies maintained by the tax authority and records on pension and health insurance register maintained by the social security administrations. The data exchange is limited as the tax authority discloses the data to the social security administration with the use of tax identification codes of the insured persons concerned. The tax administration is also competent for the control of the social security contribution payment which is performed together with the social security inspectorate; the latter has only limited enforcement powers in this field.

Some of the obstacles encountered during and after the merger in Hungary can be summarized to the following:

- in the beginning of the merger the tax administration showed limited attention towards the specific needs of social security contribution collection, and
- the reforms were upheld by legislation not yet adopted and updated.

As disadvantages of the merged collection system were reported the facts that:

- there is no precise information on the calculation basis of social security contributions and amounts actually paid for the social security administration because the collection is made in aggregate amounts (not always the same amount is used for the calculation of tax and social security contributions), and
- there are gaps in record keeping due to the lack of a unified identifying number for contributors.

Some of the benefits of the merged collection system in Hungary were identified as the following:

- simplified administrative procedures were created for the employers,
- the overall collection procedure was more efficient,
- there were stricter means of collection enforcement, and
- there was higher compliance with the social security contribution payment obligations.

Italy

Most of the revenues of the social security schemes in Italy come from the payment of social security contributions from the different categories of employees. The social security contributions - presenting a wide variety - are paid together with the taxes with the use of a unified payment form. Thus, currently there is no unified collecting authority in Italy as the taxes are collected by the tax administration and the social security contributions by the competent social security administration; the parallel collection system is maintained in this aspect. The merger in Italy is at an early stage and only a procedural merger took place in 2010 regarding the unified payment form implemented for both the levies as well as the establishment of common intermediaries - such banks and post offices - where the payment of both the levies can occur.

The social security contributions are completely distinguished from the taxes in Italy. Payment is done on a unified payment form where there is a specific reference to all types and amounts of taxes and social security contributions in separate sections of the form. Payment is also done to common intermediaries which are - among others - banks, post-offices and so on. The revenues are kept separated electronically and the transfer of data is realized through the data management structure of the Ministry of Finances.

Another aspect which is merged in the collection procedure of social security contributions and taxes in Italy is the collection of overdue payments. One administrative body - for example "Equitalia" - is competent for the collection of both taxes and social security contributions that are overdue charging a fee for these services. This body has also access to the necessary data in order to complete the collection of the overdue social security contributions and taxes.

The benefits expected from this procedural merger in Italy are the following:

- simplification of the payment procedures with the use of unified payment forms,
- decrease of expenses related to the collection as less administrative personnel is required for the collection of the levies,
- effective combat of tax and social security contribution evasion due to the common collecting intermediaries, and
- elimination of duplicate operations with regard to the overdue taxes and social security contributions because of the merged collecting authorities pursuing overdue payments.

As the merger of tax and social security contribution collection in Italy is currently at an early stage, it was too early to report any obstacles or disadvantages of the merger.

The Netherlands

The social security system in the Netherlands is mainly financed by income-related social security contributions paid by the insured persons and the employers. The Dutch tax authority is the administration which is competent for the social security contribution collection together with the taxes since 2006. The merger of the administrations of social security contribution and tax collection began in 1990 and it was completed in 2006. An exception to this rule constitutes the competency of another administration to collect voluntary social security contributions: this administration is the Dutch Social Insurance Bank.

When the social security contributions are collected with the taxes, they can not be individualized as the payment is unified on the pay slip. The levy and the collection of taxes and social security contributions are made according to the taxation law rules. The identification of contributors is realized via a unified personal identification number - the so-called *Burgerservicenummer*. The concept of wage in the law on the financing of the social security schemes has been harmonized with the definition of wage in the taxation law for the facilitation of the merged collection system. The employer declares and pays each month to the tax authority the social security contributions which are directly withheld from the salary of the employee. Both the levies upon collection are kept together until the competent authority transfers them directly to the social security funds. The data on the payments are interchanged freely; however, there is appropriate data protection level as only competent persons can process and access this kind of information. The control of the payments is performed by the tax authority with the cooperation of the Dutch Social Insurance Bank and another special administrative body which is called Social Intelligence and Investigation Service; all these administrations can jointly declare a person liable for not paying his/her contributions.

The only obstacles reported during and after the merger in the Netherlands were some performance practices on behalf of the tax administration which did not manage to take into consideration the nature and purpose of the social security contributions collected.

Some disadvantages of the merged collection system in the Netherlands were:

- the vulnerability of the operation system due to the massive processes, the large flows of information, the transfer of data and the transfer of personnel, and
- data failures in the insurance file administration.

Some of the benefits of the merged collection system were identified as the following:

- levying and collecting social security contributions were simplified,
- the administrative burdens on employers were reduced,
- the implementation costs for the government were reduced,
- the contradictory decisions within the administrative bodies have decreased.

From a general point of view, the transition to the merged collection system was welcomed positively in the Netherlands. The taxation and social security rules were harmonized and the collection procedure became more efficient.

The United Kingdom

The United Kingdom is a country with a longer standing record in the field of merging the administration of social security contribution and taxation. In this country a compulsory contributory scheme financed by social security contributions is complemented by a range of non-contributory measures which are financed by general taxation.

The merged collection system for both levies was a recommendation of the Taylor report which concerned the modernization of Britain's tax and benefit system. The preparations for the merger started in the early 1990s, but it was only until 1999 that the responsibility for the social security contribution management and operations was transferred to the tax authority.

Before the implementation of the merger a "joint working initiative" was adopted; this initiative was designed to facilitate a fully coordinated tax and social security contribution service. It was also advised that this "joint working initiative" has put the foundations of the merged collection system. According to the testimonial of the national experts, a key to success for the first phase of the merger was managing of the human resources change associated with the merger.

The authority competent for the collection of social security contributions in the United Kingdom is the National Insurance Contributions Office - the so-called "NICO" - which is a department of the tax administration. Apart from the collection of social security contributions, this collecting authority works closely with other departments of the tax authority and maintains strong links with the social security administration. The collecting authority supplies information to other administrations by using the "National Insurance recording System" where the social security contributions of all UK residents and some non-residents are being recorded. The contributors are identified with the use of a unique personal reference number - called the "National Insurance Number". This number acts as a reference for the whole social security system. There are two sets of records maintained within the collecting authority: the National Insurance accounts and the individual National Insurance accounts. Finally, the collecting authority is competent for the control and recovery of overdue payments through the merged compliance processes and compliance teams for social security contributions and taxes.

An issue reported to pose impediments to the smooth implementation of the merger was the fact that there were different legal frameworks governing the areas of taxes and social security contributions; these legal frameworks were difficult to integrate. Moreover, the relationship of the merged collection administration to the retained social security administration had to be handled as the social security administration tended to drift apart. With the "joint working initiative" the participation of the social security administration could be more rebalanced.

A disadvantage of the merged collection system in the United Kingdom was the limited attention that the tax authority could show towards the special nature and purpose of the social security contributions.

Some of the benefits of the merged collection system were identified as the following:

- the elimination of duplicate operations in the accounting, reporting and collecting procedure,
- the harmonization and simplification of taxation and social security rules as a result of the administrative changes due to the merger, and
- the possibility to reinvest personnel in new programs achieving efficiency savings.

Conclusions in summary

According to literature overview in this subject and the findings of the present research, the main administrative functions that are related to the collection of social security contributions and taxes are the following:

- the registration requirement, with a possible existence of a unique identifying number,
- the accounting and reporting function,
- the collection of social security contributions and taxes,
- the maintenance of individual records,
- the controlling function over the collection process,
- the settlement of claims, and
- the transfer of social security contribution revenues to the competent social security funds.

In relation to the main administrative functions related to the collection procedure, the benefits of the administrative practices adopted in a merged collection system of taxes and social security contributions can be summarized in the following way:

<i>Administrative functions of the collection system</i>	<i>Some practices adopted by the merged system</i>	<i>Some benefits of this merged approach</i>
Registration of contributors	Creation of a unique identification system for social security and taxation (e.g. social-fiscal number)	<ul style="list-style-type: none"> ▪ simplification and facilitation of the collection procedure ▪ streamlined collection of social security contributions and taxes ▪ discouragement of contribution evasion
Accounting and reporting	<ul style="list-style-type: none"> ▪ administration of levies through one tax return (unified tax declarations) ▪ harmonization of the concept of wage for taxation and social security contribution purposes ▪ extensive use of IT systems and e-government practices 	<ul style="list-style-type: none"> ▪ elimination of duplicate operations during the accounting and reporting procedure for taxes and social security contributions ▪ avoidance of mistakes on the calculation of levies ▪ minimizing the administrative burdens for payers ▪ frequent up-dates and better keeping of the data records ▪ more efficient control of the payments ▪ creation of appropriate databases for certification of compliance and accrual of benefit rights
Collection	Unified payment form	<ul style="list-style-type: none"> ▪ simplification of payment procedures ▪ elimination of duplicate payment operations ▪ better compliance with the social security contribution payment

		obligations
		<ul style="list-style-type: none"> ▪ more rapid and safer collection and distribution of funds and data
Control	<ul style="list-style-type: none"> ▪ cross checking data for consistency ▪ incorporation of data in electronic databases ▪ use of appropriate IT systems ▪ enforcement powers granted to the collection agency 	<ul style="list-style-type: none"> ▪ facilitation of identification or errors and misreporting ▪ more effective enforcement procedures ▪ increase of revenues due to higher compliance ▪ combat of social security fraud
Transfer of the collected revenues	<ul style="list-style-type: none"> ▪ frequent transfers of revenues ▪ transfers via the national banks or state treasuries ▪ compensation payments for delays in transfers by employers, banks or collection agencies (in case of liability for the delay) 	<ul style="list-style-type: none"> ▪ increase of the speed of transfers of social security contributions and relevant data to the competent social security funds ▪ timely transfer of funds

While designing the merger, one should take into consideration some of the potential challenges regarding this transfer of collecting functions to one administrative body, such as:

- the merger could be seen as a takeover of the social security administration by the tax authority;
- the tax authority could show limited respect towards the special needs of the social security system;
- there may be difficulties in making a distinction between employees and self-employed persons as regards the status of a person for tax and social security purposes (for example a person can be considered sometimes as an employee for taxation purposes and as a self-employed person for social security purposes or even in the case of multiple occupations);
- there may be differences in defining income as calculation basis for social security contributions and taxes;
- there may also be different calculation periods for social security contributions and taxes;
- the employee's and employer's partition to the social security contributions may cause problems to the collection of the taxes,
- there can be different rates of the levies when accomplishing an integration of rates; and
- there may be issues regarding the protection of personal data when designing data exchange systems or when the data are interchanged.

Finally, when implementing the merger, some other factors should be considered as well. The appropriate legal and administrative environment for such a merged collection system should be created. Moreover, national legislation should be amended and a number of projects should be organized by the administration in order to lay the foundations for the merger (e.g. creating more understanding for a well-organized collection structure, establishment of efficient collaboration within the administration, creating of working groups, etc.). Finally, the national taxation and social security legislation should be harmonized as far as the collection procedure is concerned.

To sum up, there may be an impact on the existing facilities and the administrative personnel when merging the administrations of social security contributions and taxation. In addition, the taxation and social security rules can be lead to a certain degree of harmonization and the core collection processes can be made common for taxes and social security contributions. What is more, the collection system can operate in a more efficient way and the mandatory social security schemes can be introduced smoothly. Furthermore, the governmental administrative costs can be lowered and the competencies of the authorities can be more distinct. The compliance system can be also more effective.

The following points are ascertained from this report:

- the merging of the administration of social security contribution and taxation can be a cost-effective and efficient system,
- the administrative burdens on the administration and the employers or insured persons can be greatly reduced,
- the collection procedure can be facilitated by the use of new technologies, and
- the stricter control and enforcement procedures will result in higher contribution compliance which will safeguard the sustainability of the social security systems.

1. Introduction

1.1 Preliminary research note

During the past twenty years there have been many changes and reforms in the field of social security throughout Europe. These reforms have resulted in the creation of new forms of social security systems which further required the reorganization and modernization of the collection system of social security contributions in several countries; this was necessary in order to achieve a satisfactory level of social security contribution revenues. A successful and without deficits financing of the new social security systems became a priority for most of the countries; this became the inspiration of the idea for the creation of merged collection systems as opposed to the parallel collection systems of social security contributions and taxes.

First of all, let us make a distinction between the existing collection systems in order to understand better the role of the merged collection system for taxes and social security contributions. In some countries a parallel system¹ is in force: social security institutions and tax authorities collect social security contributions and taxes in strictly separate ways using distinct systems and potentially with systems based on fundamentally different architectures. In some other countries we encounter a merged system² where the social security contribution and tax collection responsibility is merged into the hands of a single revenue administration. Last but not least, there is also a partially merged system³ where tax authorities collect social security contributions for some social security programs or specific groups of people (e.g., self-employed), but not for all. According to a Working Paper of the International Monetary Fund⁴ there has been a trend for the convergence of some parallel collection systems into merged ones, but there appear to be no cases of reverse conversion into a parallel collection system.

In the present research we are going to investigate the meaning of the merged collection systems adopted by five countries, the process of the said merger of the social security contribution and tax collection functions as well as the advantages and disadvantages of this collection system. It is important to give an overview of the

¹ According to the OECD (working paper “Tax Administration in OECD and selected Non-OECD Countries”, Comparative Information Series 2008, p. 29), the OECD countries that have parallel collection systems are Austria, Belgium, the Czech Republic, Denmark, France, Germany, Greece, Japan, Korea, Luxemburg, Mexico, Poland, Portugal, the Slovak Republic, Spain, Switzerland, and Turkey, and some of the selected Non-OECD countries are Chile, Cyprus, Malaysia, Singapore and South Africa. In some papers the parallel system is also referred to as “dual” or “decentralized” systems.

² According to the OECD (working paper “Tax Administration in OECD and selected Non-OECD Countries”, Comparative Information Series 2008, p. 29), the OECD countries that have merged collection systems are Canada, Finland, Hungary, Iceland, Ireland, Italy, Netherlands, Norway, Sweden, UK, USA, and some of the selected Non-OECD countries are Argentina, Bulgaria, China, Estonia, Latvia, Malta, Romania and Slovenia. In some papers the merged system is also referred to as “unified”, “integrated” or “centralized” systems.

³ That was the case for example in the Netherlands before 2006 where the social security contributions for the general social security schemes were collected by the tax authority while the social security contributions for the employee insurance schemes were still collected by the social security administration.

⁴ Paper on Integrating a Unified Revenue Administration for Tax and Social Contribution Collections: Experiences of Central and Eastern European Countries, 2004, IMF Fiscal Affairs Department.

collection systems in each of the countries in question and to further draw some conclusions regarding their different typologies of merger as well as the effects of adopting such social security contribution collection methods in the context of legal, economic and administrative surroundings. The differences between merged and parallel collection systems, the case of an integrated levy of social security contributions and taxes usually in the form of a tax⁵, as well as the relationship between social security contributions and social security benefits fall outside the scope of the present research.

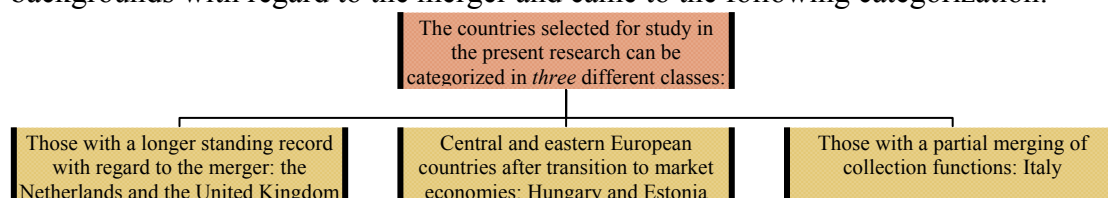
The purpose of our research is to give an insight of the general situation governing the merged collection of social security contributions and taxes in the hands of one administrative authority in five different countries. This can provide assistance to policy makers in order to better understand the historical, legal, sociological and economic aspects of this system and to evaluate the consequences of the adoption of such a merged collection system. The countries selected for the purposes of this research are all countries with a relatively short-term implementation background of the merged collection functions.

Finally, this research is closely related to and is building further upon the conclusions of the former study of the European Institute of Social Security (EISS)⁶ with the cooperation of the IBM Center for the Business of Government, “Cooperation Between Social Security and Tax Agencies in Europe”⁷ focusing, however, on examples of the most far reaching form of approximation of social security (contribution collection) and taxation.

1.2 Scope of the research

In our previous study in 2005 “Cooperation Between Social Security and Tax Agencies in Europe”⁸, we have analyzed the degree of integration, coordination and interaction between social security and tax authorities in several European countries examining a variety of administrative arrangements. Building further upon this study, this report will describe in a more detailed way one of the aspects of the above mentioned cooperation: the merger of both the functions of the collection of social security contributions and the collection of taxes into the hands of one institution.

Therefore, for the purposes of this research we chose some countries with different backgrounds with regard to the merger and came to the following categorization:



⁵ Some countries have adopted another approach with regard to the relationship of taxes and social security contributions: these countries have introduced an integrated levy of taxes and social security contributions which is collected by one competent authority, usually the tax authority.

⁶ Official website: <http://eiss.be/>.

⁷ Available online from the IBM Center for the Business of Government website: <http://www.businessofgovernment.org/report/cooperation-between-social-security-and-tax-agencies-europe>.

⁸ Ibid.

1.3 Key concepts for the purposes of the research

In order to examine the situation uniformly in the different countries in question, this report uses general - external to the countries - concepts rather than national ones. This way the report can be easily understood by the reader and, therefore, it can provide a liaised view to the stakeholders in order to evaluate more efficiently the given situation in the different countries examined herein.

Before we proceed with the description of the key concepts of our research, allow us to clarify that our research is focusing primarily on the financing of the social security systems from social security contributions, either these are the traditional employee's, employer's and self-employed person's contributions⁹ or they constitute alternative forms of financing such as general social security contributions levied on income. The aspect of financing social assistance and compensation plans from the general budget via taxation is excluded from the present research unless the amounts of revenues collected are earmarked and identifiable for social security purposes.

More specifically, the present report will examine in detail the collection arrangements of the above described levies which have been more or less recently transferred from the competent social security administrations to the national tax authorities while the social security contributions are kept distinct from the other national taxes.

For the purposes of our research, the following key definitions are provided:

Social security/insurance means any program that provides benefits on the basis of solidarity or supplements incomes to persons and households whose incomes are inadequate due to illness, unemployment, retirement, or due to other factors such as family size¹⁰.

Social security contribution is the levy on incomes which finances either exclusively or partially - together with state contributions - the different social security schemes in a given country¹¹.

Taxes are compulsory contributions to the state budget levied either directly on the taxpayer, or indirectly through tax on purchases of goods and services and through various kinds of duties; taxes paid to the local or regional authorities are included in this concept as well.

Social security contributions are to be distinguished from taxes; in that case the contributions (either on a primary or secondary level) will be transferred into a

⁹ However, there are persons classified as “not employed” or “professionally non-active” who have to pay social security contributions as well. For example, individuals receiving an income replacement (e.g. pensioners paying for healthcare) or all citizens residents in a country paying for a general social insurance program (such as in the Netherlands) have to contribute to social security.

¹⁰ Zaglmayer, B., Schoukens, P., Pieters, D., Cooperation between social security and tax agencies in Europe, IBM Center for The Business of Government, April 2005. Available online from the IBM Center for the Business of Government website: <http://www.businessofgovernment.org/report/cooperation-between-social-security-and-tax-agencies-europe>.

¹¹ These include pension, health care, unemployment insurance contributions, etc.

separate social security fund. The transfer of the social security contributions collected by the tax authority into a separate social security fund is made on a primary level when the funds are transferred directly to the social security funds and on a secondary level when the funds are transferred first to a general national account and are at a later stage separated and transferred to the social security funds¹². This happens unless the merger of social security contribution and tax collection leads to an integration of the contributions into the overall tax revenues.

However, we are aware that such a distinction presents several difficulties which are confirmed by a great controversy in the contemporary literature regarding the character of social security contributions as opposed to the character of taxes. As a matter of fact, the OECD treats social security contributions as “taxes” and, therefore, includes them in its compilation of tax burden statistics¹³. On the other hand, social security experts exclude the taxation nature of social security contributions because there is a linkage between the collected contributions and the scheme and benefits paid from the scheme as the contributions aim exclusively at financing the social security system.

Another important key concept that we need to clarify in our research is the meaning of the *employer’s social security contributions* versus *the employee’s social security contributions*. In the social insurance system for employees, one does indeed distinguish between employers’ and employees’ contributions. The employers’ contribution is usually calculated in terms of a percentage of the employee’s nominal wage (i.e. his/her wage before deduction of the employee’s contribution and the wage tax); employees’ contributions are also calculated in terms of this wage¹⁴. However, this distinction is usually just an artificial labeling on the contributions because the employer withholds from the source the employee contributions; this has no impact on the payment technique and collection arrangements of the social security contributions that are collected together with taxes¹⁵.

1.4 Administration of social security/ administration of taxation: where do they entail?

Social security authority/administration/institution is the national administrative agency (or agencies) responsible for the management of the social security records, data and funds and in certain cases responsible for the payment of benefits in a country.

Tax authority/administration is the national administrative agency competent for the collection of taxes and the management of tax records, data and funds.

¹² See further Hungary and France.

¹³ A contribution to a social security fund is a tax if there is a requirement to make payments either to state funds or to state regulated funds from which there is an obligation to pay social security benefits. This reflects the OECD working definition of a tax in its Revenue Statistics, published annually.

¹⁴ Pieters, D., *Social Security, An Introduction to the Basic Principles*, Kluwer Law International, 2006, p. 102.

¹⁵ *Ibid.*, pp. 101 et seq.

The previous research project of the European Institute of Social Security in cooperation with the IBM Center for the Business of Government¹⁶ has shown that there has already been considerable interaction between tax and social security administrations with regard to the collection of financial means for the social security systems; this increased interaction between these two authorities is due to the fact that they seem to have many common functions. In the present research we are going to examine the way that some of the administrative functions of the social security authorities are transferred to the tax authority which has to undertake now new competencies in this field. The following functions can be distinguished:

Administrative functions/operations constituting diverse aspects of the merged collection process of social security contributions and taxes can be identified in seven different levels¹⁷:

- Registration of payers
- Accounting and reporting of the payments
- Collection of social security contributions and taxes
- Verification of registration, social security contribution and tax payment and audit
- Maintenance of records of account on different levels
- Settlement of claims
- Transfer of social security contribution revenues to the competent social security funds together with the relevant collection data

1.5 Merger/Unification/Integration

A merger¹⁸ of tax and social security operations with regard to the collection of social security contributions is a form of centralization of the collection system; this can occur in many different ways depending on the levies to be centralized (taxes and social security contributions), on the agency responsible for collection, and on the existence of collecting intermediaries. Centralization can result from merging procedures, such as the unification of payment forms for income taxes and social security contributions or the integration of the rates of both the levies; it can also result from merging institutions such as the design of a new centralized structure for

¹⁶ Zaglmayer, B., Schoukens, P., Pieters, D., Cooperation between social security and tax agencies in Europe, IBM Center for The Business of Government, April 2005.

¹⁷ Ross, S., Common issues of social security and taxation systems, in Interactions of social security and tax systems, ISSA and OECD, 1997, p. 19. Please note that we have used some of the concepts of the administrative functions for a contributory social insurance scheme described by McGillivray, W.R., Administrative issues in the implementation of social security reforms, in Interactions of social security and tax systems, ISSA and OECD, 1997, p. 60, and Anusic, Z. International experience in consolidated social contributions and tax collection, reporting and administration, WB, ECSHD, 2005 (available online:

http://info.worldbank.org/etools/docs/library/238288/Anusic_CollectionUnification.pdf).

¹⁸ The terms “unification”, “integration” and “consolidation” are also quite frequently encountered in the literature and have the same meaning with the merger. In this report, we are going to use the term merger for describing this administrative change in the collection of social security contributions and taxes.

social security contribution and tax collection or the merger of two already existing institutions.

The concept of *merger* has to be distinguished from the concept of *integration* of taxes and social security contributions as the latter one refers to the creation of one integrated levy, usually with the character of a tax, for both social security contributions and taxes.

In view of the aforementioned clarifications, the level of merging the collecting administration of social security contributions and taxes depends highly on the number of administrative functions relating to the collection of social security contributions that are merged - in other words transferred - from the social security administration to the tax authority.

1.6 Research question

To sum up, this project is going to describe the way that five countries, i.e. Estonia, Hungary, Italy, the Netherlands and the United Kingdom, have realized the merging of the social security contribution collection and taxation. We are going to describe which of the administrative functions and what kind of institutions have been merged, which steps have been taken towards the realization of such a merger and what are the advantages and disadvantages of this merged collection system.

The findings of this report are based on international and national literature on this particular subject, references to national legislation as well as the actual experiences of the five countries under examination. The information regarding the country experiences were acquired by the use of questionnaires of common reference sent to national experts and public administrators and a limited number of interviews with public administrators. The questionnaires were consisting of open forma questions and they were divided in three parts: the first part was describing the present situation in a country, the second part concerned the process towards the merger and the third and last part regarded the evaluation of the merged collection system.

2. Structure of the report

2.1 General

The report can be divided in two main parts. The *first part* (chapter 3) describes the past and current situation concerning the transfer of the collection of social security contributions from the social security administrations to the tax authorities in five different countries, i.e. Estonia, Hungary, Italy, the Netherlands and the United Kingdom. A common descriptive structure is maintained for all the countries involved; an overview of the systems at issue is further presented. For the compilation of the country descriptions questionnaires completed by national experts were used and the information thereby acquired has been integrated into the results of the research together with additional information from international and national literature review.

In the *second part* of the report (chapters 4-7), we draw some conclusions regarding the typology and functioning of a merged collection system for social security contributions and taxes as well as the obstacles encountered and the benefits expected by merging social security and tax collection administrations. Moreover, we examine the interactions between the social security contributions and taxes with regard to the collection issue on a comparative basis. This was accomplished by focusing on the process and motivation of the merging of social security contribution and tax collection and the different degrees of merging identified in the five countries in question.

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3. Country reports

3.1 Estonia

3.1.1 Introduction

Estonia is a former Soviet republic and one of the new member states of the European Union. This country seems to be an interesting case for our research for several reasons. One of them is that it has recently undergone important changes in the field of social security. These changes were the result of the country's accession to the European Union and the effort to reach the Western European standards and economic growth. Moreover, the pension reform of the 1990's introduced a three-pillar pension system with a fully funded second pillar pension scheme¹⁹. Finally, Estonia appears to be an interesting example of a country focusing on e-government introducing the e-government principles to the social security sector as well.

The Estonian social security system consists of:

- pension social security schemes granting benefits for old age, survivorship and permanent incapacity for work,
- health social security schemes providing health care and benefits/income in case of loss of earnings due to sickness, maternity or caring for a sick dependant,
- schemes for family benefits and social benefits for disabled persons.

Social assistance is seen as a part of the social welfare policy.

3.1.2 Financing of social security

In Estonia the pension and health insurance schemes are financed by the so called "social tax" - *sotsiaalmaks*, which is a kind of social security contribution paid by employers, self-employed and the State. The "social tax" is financing both in-kind and cash sickness and maternity benefits²⁰, pension for work incapacity, old age pension and survivors' pension. The employment injuries and occupational diseases are co-financed by the "social tax", the general taxation and employer's civil liability.

Apart from the so-called "social tax", there are also compulsory unemployment insurance contributions paid by employees and employers (as of January 2002); in addition, contributions financing the funded supplementary old-age pensions²¹ are paid by the employees and the State's share to the "social tax"²².

The family allowances, the survivor's national pension and the old-age and invalidity pension supplements are purely state-financed from the general taxation. As for the

¹⁹ Further information about the three pillar pension system in Estonia can be found at the website of the Estonian Pension Center: <http://www.pensionikeskus.ee/?lang=en>.

²⁰ Maternity benefits are financed by the "social tax" except for the so-called "parent's salary" (an one and a half year-long social security benefit granted to the mother or the father of the child) which is financed from the general state budget.

²¹ This is part of the fully funded second pillar pension scheme.

²² This is paid by employers.

long-term care, there is no single, separate scheme and the benefits in kind are financed from the general taxation together with the local authorities.

In relation to the general taxes, the social security contributions in Estonia are completely separate and distinguished from the personal or corporate income taxes. The collection of the social security contributions can be done in three different forms of payments: the “social tax”, the payment for funded supplementary old-age pension and the payment for the unemployment insurance benefit.

The “social tax” has been established by the Social Tax Act passed on the 13th December 2000 and entered into force on the 1st January 2001. The “social tax” has the following definition:

“Social tax” is a financial obligation which is imposed on taxpayers to obtain revenue required for pension insurance and state health insurance and which is subject to performance pursuant to the procedure, in the amount and during the terms prescribed by this Act²³.

In light of the aforementioned definition, we come to the conclusion that the “social tax” and the personal and corporate income taxes are not integrated levies, but they are distinguished on the grounds of the purposes for which they are collected.

Despite the fact that the new legislation provides for the integration of the formerly autonomous social insurance budgets with the state budget, the earmarked nature of “social tax” has been maintained and revenues from “social tax” are held strictly separate from other state revenues. This is mainly due to the provisions of the Pension Insurance Act as revenues from the pension insurance component within the “social tax” cannot be used for any other purpose except for the payment of state pensions²⁴. Hence the integration is merely of a technical nature.

The social security contributions for a funded supplementary old-age pension scheme were first introduced by the Funded Pensions Act which is effective since the 12th September 2001 and the subsequent regulations of the government and the Minister of Finance. In addition to the Funded Pensions Act, the Guarantee Fund Act²⁵, the Investment Funds Act and amendments to the Estonian Central Register of Securities Act²⁶ are also relevant to the implementation of the second pillar scheme. The second pillar addresses only the risk of old age; it does not provide pensions for risks of disability and survivorship. Participation is compulsory for new entrants to the labour force beginning in 2002 whereas participation is voluntary for the rest of the workers.

After the pension reform, the redistribution function of “social tax” has been redefined²⁷ in a sense that the component of the “social tax” destined for the pension

²³ Article 1 of the Estonian Social Tax Act. Estonian Legislation in English website: <http://www.legaltext.ee/indexen.htm>.

²⁴ See the Estonian Social Pension Insurance Act.

²⁵ This Act was passed on the 20th February 2002.

²⁶ This Act was adopted on the 12th September 2001.

²⁷ See table 15, Pension Reform in the Baltic States, Pension reform in Estonia, 2006, ILO (Leppik and Vork), p. 73.

insurance was divided further to a first pillar social security contribution component and a second pillar social security contribution component²⁸. An individual contribution from the gross wage - a social security contribution for the funded supplementary old-age pension scheme - is added to the component of the “social tax” for the second pillar social security fund.

In 2002 the Unemployment Insurance Act has introduced the unemployment insurance scheme. This scheme covers an employee in case of becoming unemployed, in case of collective closing or insolvency of the employer and in case of collective redundancies²⁹. The unemployment insurance contribution is paid partly by the insured persons and partly by the employers.

The persons liable to pay social security contributions are identified as the resident legal persons, natural persons, non-residents who have a permanent establishment in Estonia as well as state, rural municipality and city authorities³⁰. More specifically, employers are responsible to pay “social tax” on behalf of their employees. The unemployment insurance contribution is paid by the insured persons and the employers³¹. The self-employed persons - as defined in the Social Tax Act - pay “social tax” on their business income whereas the central government pays it on behalf of certain social groups (usually the Estonian National Social Insurance Board is the competent authority for this purpose)³², and the Unemployment Insurance Fund pays it on behalf of the registered unemployed.

3.1.3 Collection methods

According to the definitions used in the Estonian Taxation Act, “social taxes” are considered as state taxes and the provisions of the aforementioned Act concerning taxes apply also to the “social taxes”, the contributions to funded pensions as well as the unemployment insurance contributions unless otherwise provided in the relevant Acts.

The role of the Estonian Tax Authority: The so-called “social tax” and the other social security contributions together with the other taxes are collected by a single tax administration which is called the Estonian Tax and Customs Board, *Maksu- ja Tolliamet*³³. This is an administrative agency within the area of competency of the Ministry of Finance, which has a managing function, exercises state supervision and applies the enforcement powers of the state on the basis and to the extent prescribed

²⁸ Before the introduction of the second pillar, the component of the social tax destined for the financing of the pension insurance was not divided.

²⁹ EUROMOD Country Report Estonia (EE) 2005, Silja Luepsik, Alari Paulus, Andres Vork, April 2008. Available from: http://www.praxis.ee/fileadmin/tarmo/Projektid/Too-ja_Sotsiaalpoliitika/I-CUE/Estonian_2005_tax-benefit_system.pdf.

³⁰ Article 4 of the Estonian Social Tax Act.

³¹ See the Estonian Unemployment Insurance Act which is in force since 2002.

³² The cases for which the state pays social tax concern a list of persons among which are parents with a child up to 3 years of age who are on parental leave or are receiving a child-care fee pursuant to the Family Benefits Act, conscripts in compulsory military service, persons providing care for disabled child or disabled adult or receiving a caregivers’ allowance pursuant to the Social Benefits for Disabled Act, persons with disabilities working in enterprises listed by the Minister of Social Affairs, non-working spouses of diplomats working in a foreign representation and non working persons who participated in the clean up of the Chernobyl nuclear disaster (article 6 of the Estonian Social Tax Act).

³³ Official website of the Estonian Tax and Customs Board: <http://www.emta.ee/index.php?id=12219>.

by law³⁴. There are not separate departments within the tax authority competent for the collection of the taxes and social security contributions because the tax authority is organized according to the functions performed and not in relation to the revenues collected.

The “social tax” is paid on wages and remuneration paid to employees³⁵. The current rate for its calculation is 33% (20% for pension insurance and 13% for health insurance)³⁶. However, if the employee is participating in the funded pension insurance scheme (2nd pillar pension scheme), then 4% out of the above mentioned 20% is shifted from the state pension insurance scheme to the private pension insurance scheme of the second pillar and an additional 2% contribution from gross wage will be paid by the employee³⁷. The 2% employee contribution to the funded supplementary old-age pension insurance is withheld by the employer and transferred together with “social tax” to the tax authority which has to identify all participants of the second pillar. The information provided by the employers are double checked by the Central Register of Securities as there are different contribution rates for different employees of the same employer, depending on whether the person has joined the second pillar or not³⁸.

According to the official gateway to Estonia³⁹, about 590.000 people - around 86% of the labour force - had joined the second pillar funded pension plan as of October 2009. However, due to the global economic downturn and the difficult financial situation of Estonia, the state contributions to funded pensions have been temporarily suspended for a certain period of time (from July 2009 until 31st December 2010). It is scheduled that in 2011 the contribution system will resume on a 1+2% basis, and then at the beginning of 2012 the initial 2+4% system - as described above - will be fully restored.

In cases of persons receiving unemployment benefits, some categories of dependant spouses and persons receiving social benefits granted on the basis of the Social Welfare Act⁴⁰, the rate of “social tax” is differentiated from the aforementioned rate and it is set to the 13% of the taxable amount.

Self-employed persons pay their own social security contributions, consisting of pension and health insurance contributions. The basis of the contribution calculation is the net business income up to an amount equal to 15 official minimum monthly salaries⁴¹. Most cases involving people who are otherwise insured (e.g. pensioners)

³⁴ Article 1 of the Statutes of the Estonian Tax and Customs Board Adopted by Regulation No. 29 the Minister of Finance of October 6th, 2008 (RTL1 2008, 84, 1168), entered into force on December 1st, 2008.

³⁵ According to article 2 of the Social Tax Act.

³⁶ See article 7 of the Estonian Social Tax Act.

³⁷ I-CUE Feasibility Study, Estonia (2005 Tax-Benefit System), August 2006. Available from: http://www.praxis.ee/fileadmin/tarmo/Projektid/Too-ja_Sotsiaalpoliitika/I-CUE/EUROMOD_Estonian_report_2005.pdf.

³⁸ See Table 4, Tax base comparison for selected taxes and contribution payments, I-CUE feasibility Study, Estonia (2005 Tax-Benefit System), August 2006, p. 48.

³⁹ Source: Official Gateway to Estonia: <http://estonia.eu/about-estonia/society/pension-system-in-estonia.html>.

⁴⁰ According to article 23.

⁴¹ The minimum monthly salary is currently EEK 4,350 or EUR 278.

are usually exempt from the minimum liability. With multiple employers or if a self-employed person is a part-time employee and a part-time self-employed person, only one minimum “social tax” obligation is applied. Social security contributions are deductible for income tax purposes only for corporate/business income.

As far as the second pillar is concerned, during the first two years after the reform, it was not allowed to pay the funded supplementary old-age pension insurance contributions on the income from self-employment for administrative and technical reasons rather than political. One of these technical reasons was the different taxable period for employees and self-employed (for the first ones the taxable period is one calendar month and for the latter ones the taxable period is one calendar year); another reason was the procedure of making quarterly advance payments of “social tax” by self-employed persons. Only in 2004 it was allowed to accumulate second pillar pension for self-employed persons as for employees.

Unemployment insurance contributions: The unemployment insurance contributions must be paid by employers and employees, on any monetary employment income of the employees; therefore, it is levied on wages and other remuneration paid to employees, with the exception of some benefits⁴². Contributions are also due on the payments made to an individual under a service contract, unless the individual is registered with the commercial register or with the tax authorities as a self-employed. Contributions are equally due in respect of non-resident employees working in Estonia. Non-monetary employment income and fees paid to the members of management and supervisory boards are not included in the contribution calculation base. The employer’s contribution is levied at a rate of 1.4%⁴³. The employee’s contribution is levied at a rate of 2.8%. This contribution is withheld by the employer⁴⁴.

Calculation basis of the social security contributions: The social security contribution calculation method is the same with the personal income tax calculation method. As a matter of fact, withholding income tax and social security contributions on wages has the same tax base in principle, with the exception of the order in which these are calculated (see the figure below). The rates’ brackets are set by the law, but the government makes the appropriate decisions which will be the precise applicable rates. This decision is made according to the actual labor market situation needs.

⁴² More specifically:

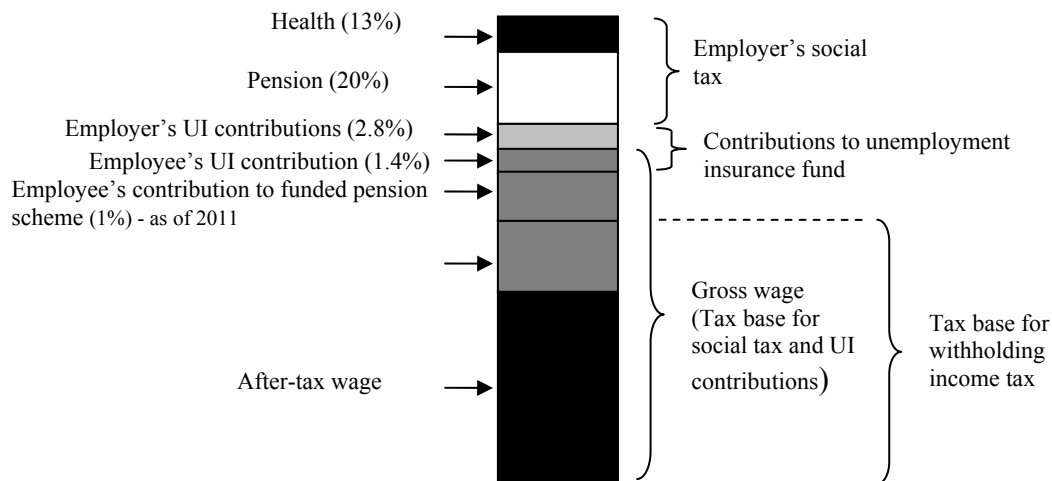
- on benefits paid upon the termination of an employment contract,
- on wages and other remuneration paid to public servants,
- except for benefits paid upon release from service and remuneration paid to private persons on the basis of contracts for services, authorization agreements or contracts under the law of obligations entered into for the provision of other services, not on business income of a self-employed person.

⁴³ European Tax Handbook on line 2010, available from:

<http://ip-online.ibfd.org/kbase/?search=N%3d3339+3>.

⁴⁴ Ibid.

Figure: Structure of wage taxes, 2010⁴⁵



When the tax authority collects the personal or corporate income tax, the “social tax” and the unemployment insurance contributions - although all these levies are collected as a unified payment - there is a clear distinction made by individualizing each of the payments in the tax return depending on the tax type, the taxpayer and the insured person. These all are accounted for separately; they all have separate records. Furthermore, “social tax” which has one record - at the beginning - is then separated at a later stage into two components (one for health insurance and one for pension insurance).

The contributors have full access to their personal prepayment accounts administered by the tax administration in an *online system*. From these personal accounts, the necessary amounts are then automatically used to cover the individualized tax and social security obligations as declared by the insured person (or assessed by the tax administration in a case of an audit) upon the payment deadline.

The employer has to report the salary of his or her employees by the tenth day of the calendar month following the month of payment by using electronic forms, where taxes for each employee are shown, one row for each person, and different columns for the different levies, i.e. the income tax, the “social tax”, the contributions to the funded pension scheme and the unemployment insurance contributions. This means that the “social tax” and the other social security contributions calculated in the tax return have to be paid on a monthly basis to the tax administration by the same date of the reporting (the deadline for the declaration and the payment of the social security contributions is the tenth day of the month following the month of wage payment); thus the taxable period for the social security contributions is one calendar month.

For the self-employed persons, the payment of the “social tax” and the mandatory pension contributions is made once a year by October 1st, according to the declared business income. Most of the self employed persons though have to make quarterly

⁴⁵ Source: EUROMOD Country Report Estonia (EE) 2005, Silja Luepsik, Alari Paulus, Andres Vork, April 2008, p. 50. The report is available from: http://www.praxis.ee/fileadmin/tarmo/Projektid/Too-ja_Sotsiaalpoliitika/I-CUE/Estonian_2005_tax-benefit_system.pdf. The graphic was adapted to the rates of taxes and social security contributions that were valid during the drafting of this report.

“social tax” payments in advance which shall be calculated for the final liability which shall be determined on the basis of the yearly tax return.

Table: Overview of the frequency of the declaration and payment of social security contributions and taxes for employers and self-employed persons in Estonia

	<i>Employers</i>	<i>Self-employed persons</i>
Taxable period	One calendar month	One calendar year
Payment	On a monthly basis	Once a year or quarterly in advance
Frequency	On a monthly basis	Once a year or quarterly in advance
Declaration/report of taxes and social security contributions paid	10 th day of the calendar month after the month of the salary payment	By October 1 st of each year

Transfer of revenues: The funds collected are immediately kept separated and they are transferred periodically (per month) at the end of the collecting procedure either directly to the respective social security administrations or via the State Treasury. More specifically, the “social tax” is transferred to the state budget by the tax authority via private banks; there is also a special agreement regulating the data transmission. Then, the amounts are redirected *within fifteen working days* after the receipt partly to the Estonian Health Insurance Fund⁴⁶ and partly to the Estonian National Social Insurance Board⁴⁷, which are responsible for the redistribution of funds. The corresponding part of the amount of the Estonian National Social Insurance Board financing the state pensions is reported to be kept in the State Treasury.

With regard to the second pillar contributions, the Estonian Tax and Customs Board used to supplement the 2% contribution with 4 percentage points from the “social tax” and transfer the total contribution (6%) *within fifteen working days* after the receipt to the bank account of the Estonian Central Depository for Securities (ECDS). The ECDS plays a key role to the administration of the second pillar having the following responsibilities:

- keeping account of the subscriptions to the funded pensions,
- calculating the number of pension fund units,
- recording all the relevant information - for example contributions paid, pension fund units acquired, payments made, funds replaced - and
- transferring the total contribution to the custodian bank of the fund management company⁴⁸.

However, this financing has been temporality suspended due to the economic downturn and the contribution system will be resumed in 2011 on a 1+2% basis and at the beginning of 2012 the initial 2+4% will be fully restored.

⁴⁶ *Haigekassa* – Official website of the Estonian Health Insurance Fund: <http://www.haigekassa.ee/>.

⁴⁷ *Sotsiaalkindlustusamet* - Official website of the Estonian National Social Insurance Board: <http://www.ensib.ee/?lang=en>.

⁴⁸ The registration to the ECDS is made through the website: <https://www.e-register.ee/en>. The maintainer of Estonian Central Register of Securities is the Estonian CSD (ECSD). Estonian CSD is a public limited company, which was established in 1994 and operates under the name “AS Eesti Väärtpaberikeskus”. The 100% owner of Estonian CSD is Tallinn Stock Exchange. The ECDS is the main register of the state, which administers share registers of all joint stock companies (aktsiaselts) operating in Estonia and all securities and pension accounts opened in Estonia. The register also includes other electronic securities (shares of private limited companies, bonds, etc.) and securities transactions history.

The unemployment insurance contribution is collected by the Estonian Tax and Customs Board, but it is directed *within fifteen working days* after the receipt to the Estonian Unemployment Insurance Fund⁴⁹. The competent authority for the administration of the unemployment insurance scheme was the National Labour Market Board which is now merged to the Unemployment Insurance Fund. The payment of such contributions is not applicable to self-employed persons and members of the managing or controlling bodies of legal entities.

As for the administration costs for the collection work of the tax authority, these are covered by the State budget and no additional fee is charged for the administration of the collection of the social security contributions.

3.1.4 Record-keeping and data exchanges

Identification of contributors: All persons who possess either a private identification number as administered by the Population Register or a commercial registration number as administered by the Commercial Register can submit tax returns. No separate registration is needed for the purposes of paying the taxes or social security contributions. As it is the tax authority that collects both the amounts and the data, the debtors are identified without additional formalities.

Only in the case of not possessing any registration in Estonia - for example a non-resident short-term employer - the registration may be done by the tax authorities. Private identification and commercial registration codes are used state-wide by all public and many private institutions for most identification and data dissemination purposes eliminating most of the needs for separate registrations.

The Estonian Taxation Act⁵⁰ provides for a register of the taxable persons. This state register as defined in the Databases Act is established by the government and it is being maintained in order to ensure the performance of the functions imposed on tax authorities by law. Among the information to be entered in the register are the data related to the social security contribution status of a person. These are described in the following table.

Types of personal data to be entered in the state register

Information to be entered in the state register regarding persons that:

- Are insurable on the basis of the Social Tax Act
- Are insured or paying unemployment insurance contributions (Unemployment Insurance Act)
- Liable persons, persons making contributions and withholding agents for contributions of the Funded Pensions Act.

Moreover, a *separate record* shall be kept in the register of the taxable persons concerning the financial rights and obligations of each taxable person arising from the relevant taxation regulations. *Individual records* for each person are kept for all taxes;

⁴⁹ *Töötukassa* - Official website of the Estonian Unemployment Insurance Fund: <http://www.tootukassa.ee/?lang=en>.

⁵⁰ In article 17. Source: <http://www.legaltext.ee/en/andmebaas/ava.asp?m=022>.

this is the reason why the employers have to perform the *individual registration* of “social tax” paid on behalf of their employees. This individual recording started on January 1999, whereas the new benefit rules were to be applied in the beginning of 2000. All these data are transmitted to the Estonian National Social Insurance Board by the tax authority after the latter one has received the respective monthly reports⁵¹.

The Estonian tax authority is responsible for processing the information which will be entered in and obtained from the register pursuant to the procedure provided for in the statutes of the register. These statutes are approved by the Government of the Estonian Republic in accordance with the provisions of the Taxation Act⁵² as well as the Social Tax Act.

It is reported that the information between government entities and quasi-government institutions are transferred electronically, through a common interoperability network; there is a direct electronic link between tax administration and the social security institutions⁵³. This means that the data relating to accounting and collecting of tax and social security contributions is freely interchanged via electronic means within the different departments of the collecting administration, i.e. the tax authority, and between all respective public and private institutions within the limits of their authority and in compliance with the tax secrecy provisions; for example, no mandatory pension payments information is given to the Unemployment Insurance Fund, as this is not in line with their scope of its duties. Moreover, all the information leading to a better administration of the social security contributions is exchanged on an ad hoc basis: e.g. the unemployment agency running across an unofficial employment case of an officially registered unemployed person.

As for the second pillar pension scheme, the Estonian Central Depository for Securities (ECDS) - a public limited company established in 1994 - is the main register of the state which administers the pension accounts opened in Estonia. This agency plays a key role to the administration of the second pillar social security contributions as it was analyzed in the previous section⁵⁴.

3.1.5 Control and recovery of overdue payments

The Estonian Tax and Customs Board is responsible for the collection of taxes and social security contributions. Apart from this collecting competency, though, the tax administration is authorized to perform controlling functions, pursue payments in arrears and investigate the undeclared or under-reported earnings.

Further supervision is exercised by the Ministry of Social Affairs⁵⁵ which is responsible for the general management and supervision of the social security schemes. Moreover, the Estonian National Social Insurance Board⁵⁶ is responsible for

⁵¹ With regard to the record keeping and the interchange of data, according to the Estonian State Pension Insurance Act, the State Pension Insurance Board Register was established as a structural unit of the Estonian National Social Insurance Board, with the aim to record data on insured persons including the amounts of social tax paid on their behalf.

⁵² Articles 27-30 thereof.

⁵³ The relevant databases are interlinked.

⁵⁴ See section 3.1.3 on the Collection methods.

⁵⁵ Official website of the Estonian Ministry of Social Affairs: <http://www.sm.ee>.

⁵⁶ Official website of the Estonian National Social Insurance Board: <http://www.ensib.ee>.

the overall planning and coordination whereas the regional pension offices are responsible for the administration at a local level.

With regard to the mandatory individual accounts, the Ministry of Finance⁵⁷ supervises the Financial Supervisory Authority and the Registrar of the Estonian Central Depository of Securities (ECDS). The Financial Supervisory Authority⁵⁸ then supervises financial services providers, including pension management companies and life insurance companies⁵⁹.

3.1.6 The merger process

Initially, the adoption of a Social Tax Act in 1990 changed the financing of the state pension insurance system by introducing a “social tax” of 20% of the gross wage to be paid by employers. This Social Tax Act was adopted on September 12th, 1990, and entered into force on January 1st, 1991.

During the transition period 1993-1999, the state pension system was administered by the Estonian National Social Insurance Board (ENSIB) which was a state social security administrative agency operating under the auspices of the Estonian Ministry of Social Affairs. Until December 31st, 1993, there were two different so-called “social taxes” besides the income tax: the health insurance tax and the “social tax” - the latter one was for the financing of the state pensions. However, since January 1st, 1994, the health insurance tax was integrated with the “social tax”, although these two were still collected and declared separately. Regional health insurance funds and pension boards monitored and checked the companies on their own⁶⁰.

Before January 1st, 1999, an employer had three different obligations:

- first, he had to withhold income tax;
- second, he had to pay the health insurance part of the “social tax” to the central Estonian Health Insurance Fund⁶¹; and,
- third, he had to pay the pension insurance part of the “social tax” to the Estonian National Social Insurance Board.

Each of the aforementioned payments required different declarations although the tax base for the calculation of all these payments was the same.

As of January 1st, 1999, the collection of the “social tax” has been transferred to the tax administration and a *unified tax declaration* for withholding income tax and “social tax” has been implemented since then. At the same time, the dates for the payment of “social tax” by employers have changed. Due to the transition to these changed payment dates, there was no deadline for the payment of “social tax” in January 1999 and, consequently, “social tax” was paid by employers for only 11 months in 1999.

⁵⁷ Official website of the Estonian Ministry of Finance: <http://www.fi.ee>.

⁵⁸ Official website of the Estonian Financial Supervisory Authority: <http://www.fi.ee>.

⁵⁹ For further information see the report of the Social Security Programs Throughout the World on Estonia: <http://www.ssa.gov/policy/docs/progdsc/ssptw/2008-2009/europe/estonia.pdf>.

⁶⁰ Consult the website: <http://www.maksumaksjad.ee/modules/smartsection/item.php?itemid=648>.

⁶¹ *Eesti Haigekassa*.

The Social Tax Act has maintained the rate of “social tax” unchanged; however, it has introduced a significant change in the method of tax and social security contribution collection, i.e. the unification of the collecting function of both the levies under the competency of the tax administration.

The employers have to pay the total rate of “social tax” to the tax authority accounts. Under the new arrangement, it is the tax authority and not the employer that transfers one part of the “social tax” to the account of the pension insurance fund and another part to the health insurance fund. It is worth noting that the accounts of the pension insurance scheme are administrated by the National Social Insurance Board whereas the health insurance revenues are managed separately by the Health Insurance Fund.

Previously the employers used to calculate and pay “social tax” on the total wage without providing any information on individual earnings. After the introduction of the Social Tax Act, employers are now required to provide data on the specific amount of “social tax” paid on behalf of each insured person.

Moreover, the new arrangement has brought several changes in order to cope with the transfer of the collection function. Some information systems had to be adjusted and new tax return forms had to be designed. In addition, the dates for tax reporting and the payment dates were arranged in a way to coincide and there has been an agreement on the methods of information and funds exchange, as well as on the retrospective treatment of erroneous data.

Table: Comparison of the old and new rules after the pension reform for the first pillar⁶²

Social security rules	Until 1999	Starting with 1999–2000
Collection of pension insurance part of “social tax”	Pension offices	Tax Office
Payment and declaration of “social tax” by employers	Paid on total payroll, no individual registration of wage data	Amounts of “social tax” indicated separately for each employee
Target pensionable age	65 for men, 60 for women to be reached by 2007	65 for both genders, to be reached by 2026 ⁶³
Acquisition of pension rights	On the basis of years of service	On the basis of “social tax” paid
Old-age pension formula	Flat-rate base, variation on the basis of length-of-service	Flat-rate base, variation on the basis of “social tax” paid over the full career
Increase of pensions	Ad hoc political decisions	Indexation (from 2002)
The key principle of the first pillar	Macro-level defined-contribution: the rate of “social tax” was fixed (at 20 percent of gross wages), the level of pensions depended on the resulting revenues	Defined-benefit principle: initial benefits determined by the amounts of “social tax” paid, pension adjustments and total expenditures determined by the index

⁶² Source: Table 6, Pension Reform in the Baltic States, Pension reform in Estonia, 2006, ILO (Leppik and Vork), p. 69. As adapted to the raise in Estonia’s retirement age to 65 years by the year 2026.

⁶³ Amendment to the State Pension Insurance Act passed on April 7th, 2010. Source: <http://www.president.ee/en/speeches/statements.php?gid=137641>.

The unification of the social security contribution and tax collection in Estonia was a consequence of the implementation of a pension reform.

Some of the motives⁶⁴ for the pension reform were:

- the increase in the total number of pensioners due to the 1991 broadening of pension coverage and abolition of the qualification period for disability pensions (during the years 1992-93),
- the fact that pension expenditures exceeded revenues in two years, i.e. 1996 and 1999 because of the political attempts to attract pensioner voters by the pension increases (during the period 1992-2000), and
- the charges in the “social tax” collection procedure caused the exceeding of the pension expenditures over the “social tax” revenues⁶⁵.

Before 1999 “social tax” was not individualized as it was just a lump-sum tax on wages; however, since 1999 it was additionally tagged to concrete persons and this information was collected and stored centrally, because pension insurance coefficients began partially to depend on the exact amount of “social tax” paid on behalf of those persons⁶⁶. “Social tax” remained legally still the obligation of an employer. In principle the “social tax” has remained unchanged since 2001 and the tax rates of the “social tax” have been unchanged since 1992⁶⁷.

In addition, due to the similarities of the calculation base used for “social tax” and income tax, both of them could be administered through one tax return. This was financially expedient for the state and led to a lesser administrative burden for the payers. In 2002 the Unemployment Insurance scheme was introduced, as well as the funded pension scheme, but as they used the same tax base as “social tax”, their collection was also assigned to the tax authority.

Another driver for the merger of social security and tax collection in the hands of the tax authority was the previous merger of the three previous administrations that were competent for the collection of the social security contributions and taxes. Furthermore, all the tax declarations and reporting requirements were unified and gradually transferred into the internet in order to reduce the administrative burden of the tax administration and hoping for synergy effects from joined IT. Finally, the tax audit could be more effective with the unification of the collection of all the social security contributions and taxes and the respective evasion could be now easily controlled.

Before, during and after the implementation of the merger no transfers or significant dismissals of personnel were reported. Likewise, the tax administration personnel increased only marginally. A structural change was introduced with the centralization of local revenue accounting departments of the tax administration; as a result, the necessary human resources were made available. At the same time, enormous work was undertaken to call upon the largest taxpayers to give up paper reporting in favor of electronic data exchange, which in turn made more resources available as well. Nearly 100 employees of the Social Security Fund (about 16% of their staff) were

⁶⁴ For further information see Leppik, L. and Vork, A., Pension Reform in the Baltic States, Pension reform in Estonia, 2006, ILO.

⁶⁵ By over 750 million EEK (in 1999).

⁶⁶ Formally not “paid”, but “declared” by the employer.

⁶⁷ 20% for pension insurance and 13% health insurance.

able to engage in other activities within the Fund. No further changes as well as no new institutions or mergers of any kind were reported.

Obstacles encountered during and after the merging process: During the merging process there have been some temporary problems, such as

- implications to the registering, calculating and recording systems caused by the implementation of new procedures and forms, especially with regard to the second pillar social security contributions (introduction of a *unified tax declaration* for withholding income tax and social security contributions since January 1999),
- some other human resource and IT-related problems, and
- PR and communication issues.

These are common problems encountered during any reform process.

However, some practical problems came up with regard to the second pillar contributions. Due to the higher contributions entailed in the participation at the second pillar, the employers were required to know whether particular employees have joined the second pillar or not, when they were making the declaration and when they were withholding or transferring taxes and contributions to the tax authority. In case of mistakes in the tax declaration or wrong calculation of contributions, the issue had to be settled before the second-pillar contributions were transferred from the tax authority to the Estonian Central Depository for Securities (ECDS). In regular cases, the tax administration had to control the data within 15 working days in order to match the individual additional contribution with the 4 percentage points from “social tax” paid by the employer, and to transfer the total second pillar contribution to the ECDS⁶⁸.

It was reported that there has been no significant criticism against this merger because this process was understandable and well justifiable by the stakeholders. Only the social security administration was against the reform for quite a long time. In addition, according to publications of several newspapers, major stakeholders favored the “social tax” to be collected by the tax authority. Labour unions, employer’s associations and the government supported the introduction of the uniform “social tax” and its allocation to the tax authority to administer. Labour unions have raised objections to other aspects of the pension and health insurance reform.

At the moment there are no discussions about major changes in this field as the system is quite merged with the rest of the tax administration. However, there are some voices heard which support the idea that “social tax” and income tax could become integrated into one income tax with different parts assigned for different purposes. These voices, though, do not seem to receive much support.

Consequences of the merged collection system: The merger of the administrative functions of social security and taxation with regard to the collection of social security contributions has resulted in a more efficient administration system and a greater convenience for the payers by reducing the administrative burden of the employers. This merger also allowed the smoother introduction of the mandatory funded pension

⁶⁸ Note that the 2+4% formula is not in force at the moment, but it will resume on a 1+2% basis in 2011 and the initial 2+4% system will be restored by 2012.

and unemployment insurance schemes in 2002 and contributed substantially to the decrease of the cases of social security contribution arrears and evasion.

Moreover, the tax administration has currently more obligations that were taken from the regional health insurance boards and pension boards; the latter can now focus on their main activities as they do not have to deal with the collection of the social security contributions anymore. Furthermore, the tax authority was motivated to transfer all its activities on the internet by adopting all kinds of electronic tax declaration forms and so on.

Finally, good practices have been developed in the second pillar pension schemes. The tax authority and the Estonian Central Depository for Securities have established a good cooperation with regard to solving problems of wrong calculation of contributions by the employer's accountants; as explained above, the participation at the second pillar entailed a higher contribution rate and the employees participating at the second pillar had to be distinguished by the non-participating employees. Moreover, the employers were trained on the correct calculation method of the contributions; in addition, more user-friendly methods of data transfer were introduced: the employers were able to check whether their employees participate in the second pillar over the internet, by entering the ID-number of the employee.

Table: Summary of the merged administrative arrangements for social security contribution and tax collection in Estonia

Collecting authority	Estonian Tax and Customs Board
Collecting method	The social security contributions are collected together with the taxes as a single payment
Applicability of taxation rules	Yes, the provisions of the Estonian Taxation Act are applicable unless otherwise provided in the relevant Acts
Relationship of social security contributions with taxes	They are not integrated levies, but distinguished on the grounds of the purposes for which they are collected
Declaration and payments of social security contributions and taxes	Performed by employers and self-employed persons
Records' maintenance	By employers and tax administration (state register)
Identification of insured persons for payment purposes	Via a commercial registration or personal ID code/number
Electronic declaration of payments	Mainly use of e-forms (paper forms also existing)
Calculation basis for social security contributions	Taxable income
Deductibility of social security contributions for corporate income purposes	Yes
Transfer of funds collected	<ul style="list-style-type: none"> ▪ "Social tax" is transferred to the state budget by the tax authority via private banks. Then it is redirected partly to the Health Insurance Fund and partly to the Estonian National Social Insurance Board ▪ The unemployment insurance contributions are directed to the Estonian Unemployment Insurance Fund
Control and recovery of overdue payments	Performed by the tax authority
Levels of record keeping	<ul style="list-style-type: none"> ▪ State register maintained by the tax authority ▪ Individual/personal records kept in the state register in an online system
Data exchange between tax and social security administration	Free electronic data exchange within the different departments of the collecting administration/ limited data exchange between tax authority and other administrative authorities
Obstacles during and after the merger	<ul style="list-style-type: none"> ▪ Implications to the registering, calculating and recording systems caused by the implementation of new procedures and forms ▪ Human resources and IT related problems ▪ Communication issues
Disadvantages of the merged collection	None reported
Benefits of the merger	<ul style="list-style-type: none"> ▪ More efficient administration system ▪ Reduction of administrative burdens for employers ▪ Smoother introduction of the mandatory funded pension and unemployment insurance schemes ▪ Decrease of cases of social security contribution evasion

3.2 Hungary

3.2.1 Introduction

In Hungary - one of the four Visegrad countries⁶⁹ - the introduction of the three pillar social security system triggered major social security changes towards the end of the 1990s. This reform was prepared by the Ministry of Finance with the direct participation of the World Bank officials⁷⁰ and it was introduced in 1998. The said reform has, thus, resulted in basic changes in the compulsory pension system: the former common Pay-As-You-Go system has been partially privatized, giving way to a mixed, two-pillar system in the framework of the compulsory pension system which is now financed by compulsory social security contributions. A third pillar was introduced in 1993 which was financed by voluntary social security contributions.

These changes have also influenced the contribution collection system as the collection of social security contributions was now regarded of high importance: *“the obligation to enter the social security system and the performance of social security contribution payment obligation determine the eligibility of insured persons to receive social security benefits”*⁷¹. This is even more the case for the pension scheme. Before we proceed to the description of the merger, we will give some general information on the social security system in Hungary.

Three basic forms of social security can be identified in Hungary:

- the social insurance schemes which cover the risks of sickness, maternity, health care, labour accidents and professional diseases, work incapacity, old age and survivorship and which are financed in principle from contributions,
- the social assistance scheme which is financed from taxes, either central taxes collected by the tax authority or local taxes collected by certain departments of local governments, and
- the universal scheme which provides benefits that are not otherwise granted.

Figure: *Basic forms of social security in Hungary*



⁶⁹ The Visegrad Cooperation is a sub-regional cooperative arrangement in Europe established after the political changes of 1989. The other three members of this cooperation are the Czech Republic, Poland and Slovakia. More information on the Visegrad Cooperation you can find at: <http://www.visegradgroup.eu/main.php?folderID=1082&articleID=4055&ctag=articlelist&iid=1>.

⁷⁰ Pension Reform in Central and Eastern Europe, vol.1, Restructuring with Privatization: Case studies of Hungary and Poland, edited by Elaine Fultz, ILO Central and Eastern European Team, 2002, p. 14.

⁷¹ According to Section 2 of the Hungarian Act LXXX of 1997 on the eligibility for social security benefits and private pensions and the funding of these services.

Within the social insurances there is the pension insurance component (old age, survivorship, incapacity for work) and the health insurance component (national health care insurance and medical care) which further includes benefits in kind and cash benefits.

3.2.2 Financing of social security

In Hungary we encounter the traditional four social security branches (old-age, health care, unemployment and family benefits) and the complementary social assistance system⁷². The financing principle of these systems is based mainly on contributions in practically all sectors of the social security system - with the exception of the social assistance benefits which are financed by taxes. Moreover, in case of deficits in the distinct social security funds, these deficits are covered by the general taxation.

There are also some social security schemes that are co-financed from taxes. Firstly, the schemes that are co-financed by social security contributions and taxes in Hungary are the health care schemes, i.e. the sickness and maternity schemes, either for in kind benefits or cash benefits. The most important source of public expenditure is made up of health insurance contributions paid by employers, employees and self-employed and a flat rate tax paid by employers. Moreover, the central budget makes contributions for several social welfare benefits, provides support and reimburses specific expenditures⁷³. The third party in the public financing of the health care is the local self-government which mostly contributes by arranging for health services delivery as an owner of healthcare facilities.

Furthermore, the first pillar old-age and survivors social security schemes as well as the invalidity social security schemes are also co-financed by taxes and social security contributions. These are Pay-As-You-Go contributions paid by insured persons and employers. In 2007 it was reported that 75% of the first pillar mandatory state pensions were financed by contributions and 25% by the state budget from taxes because of the lack of sufficient contributions in the existing Pay-As-You-Go system⁷⁴.

The second pillar old-age and survivors social security schemes as well as the unemployment insurance scheme are financed exclusively from social security contributions. The employment injuries' and occupational diseases' social security schemes are co-financed by both the levies while family allowances are financed from the taxes. There is no discrete long-term care system reported in Hungary.

⁷² MISSOC – Info 2/2007: Financing social protection:
http://ec.europa.eu/employment_social/missoc/2007/02/2007_2_mg_en.pdf.

⁷³ The most important support is the making up for losses in the Health Insurance Fund as well as the payment of the operation of health care facilities that the state owns.

⁷⁴ MISSOC – Info 2/2007: Financing social protection:
http://ec.europa.eu/employment_social/missoc/2007/02/2007_2_mg_en.pdf.

Table: Overview of the sources of financing social security in Hungary

<i>Schemes financed by social security contributions</i>	<i>Schemes co-financed by social security contributions and taxes</i>	<i>Schemes financed by taxes</i>
Second pillar old-age and survivors social security schemes	Health care schemes (sickness and maternity, for cash and in kind benefits)	Family allowances
Unemployment insurance schemes	First pillar old-age and survivors social insurance schemes	
Sickness benefit scheme	Invalidity social insurance schemes	
	Employment injuries and occupational diseases scheme	

Please note here that the Hungarian Government is currently preparing the introduction of some changes in the financing system of the social security schemes; these changes are most probable to take place in January 2011.

In order to ensure sufficient financial cover for the benefits provided under the social security system, it is important that the insured persons as well as the employers fulfill their obligations with regard to the social security contribution payment. According to the Hungarian Act⁷⁵, there are two basic types of social security contributions that can be identified in Hungary.

The first are the compulsory social security contributions which are paid by the insured persons as they are specified in the provisions of the aforementioned law. These compulsory social security contributions include both pension⁷⁶ (the second pillar private pension membership fee as well) and health care insurance contributions⁷⁷ (both in kind and in money), sickness benefit contributions⁷⁸, health services contributions and early retirement pension contributions⁷⁹. There is also a compulsory flat-rate contribution per month towards the expenses of work accident-related social security services⁸⁰ that has to be paid by companies with employees engaged in supplementary activities⁸¹ or by private entrepreneurs considered to be engaged in such activities.

In addition, there are the contributions for financing institutions promoting employment and providing for the unemployed paid to the Labour Market Fund - *Munkaerőpiaci Alap Irányító Testülete* which was set up after the merging of several previously independent funds⁸². These contributions are paid by the employers, the employees as well as the self-employed persons. Apart from the regular contributions we can also find included fixed-sum rehabilitation contributions which

⁷⁵ Act LXXX of 1997 on the eligibility for social security benefits and private pensions and the funding of these services.

⁷⁶ These are called *Nyugdíj járulék*.

⁷⁷ Known as *Egészségbiztosítási járulék*.

⁷⁸ *Táppénz-hozzájárulás*. These contributions are paid by employers and they are equal to one third of the short-term sickness cash benefit disbursed to any insured person during the period in which the person is incapable of work or undergoing treatment in a hospital (clinic).

⁷⁹ Section 4 par. L of the Hungarian Act LXXX of 1997.

⁸⁰ For the coverage of the employment injuries and occupational diseases.

⁸¹ As supplementary activities are meant the entrepreneurial or self-employed activities performed by old-age pensioners or surviving spouses reaching the retirement age.

⁸² Solidarity Fund of the Unemployed, Employment Fund, Vocational Training Fund, Rehabilitation Fund and Wage Guarantee Fund.

are paid in principle by economic organizations employing more than 20 employees⁸³, and vocational training contributions; in addition, subsidies from the central budget, other revenues from payments made to the Labour Market Fund from fines, interests and so on, and EU projects also finance the unemployment benefit scheme.

The second basic type of social security contributions are the voluntary social security contributions paid by persons that enter into an agreement on the provision of social security services including persons residing in the territory of Hungary who are not subject to social insurance liability, but who wish to become entitled to health provisions or pensions through their voluntary participation in the system⁸⁴.

In the present report we will not analyze the financing of the social assistance schemes regulated by the Hungarian Act on Social Administration as these schemes are financed by the state budget and not by social security contributions.

3.2.3 Collection methods

The role of the Hungarian Tax Authority: The social security contributions and taxes are both collected by the tax authority which is the Hungarian Tax and Financial Control Administration - *Adó- és Pénzügyi Ellenőrzési Hivatal* (APEH)⁸⁵. This authority is responsible for the collection, recordkeeping and supervision of the social security contribution payments along with taxes. More specifically, the Hungarian tax authority:

- carries out checks and legal proceedings,
- assesses the social security contributions collected,
- keeps records of contribution obligations, payments and debts; and
- imposes fines related to payment and declaration of contributions or even initiating legal action in serious cases of breach of legal obligations.

The taxes and the social security contributions are collected on a regular basis as aggregate amounts. It was reported that there is generally no distinction or split upon collection. However, the monthly social security contribution-tax return form⁸⁶ is the starting point in calculating the aggregate amounts due to the different state budget funds. The amounts are described in details depending on the tax or social security contribution type in the social security contribution-tax return form.

However, there is a distinction between benefits and services covered from general taxation, i.e. from the state budget (benefits connected with the citizens' rights according to the Hungarian legal system, such as family allowances, flat-rate maternity grants and child care grants) and those benefits covered from social security

⁸³ This contribution is paid if the ratio of the disabled employees does not reach 5% of the total number of the employees. See International Encyclopedia of Laws, Social Security Law - Suppl. 28 (March 1999), Hungary, Czucz, O., p. 81.

⁸⁴ International Encyclopedia of Laws, Social Security Law - Suppl. 28 (March 1999), Hungary, Czucz, O., p. 64.

⁸⁵ Tax authority is defined as the APEH's regionally competent organizations (with its main and local branches which are the regional directorates having territorial competencies) according to the provisions of the Act on Personal Income Tax (hereinafter referred to as PIA). APEH's official website: <http://en.apeh.hu/>.

⁸⁶ This form has detailed information of the social security contribution and personal income tax on a personal level.

contributions from employers and employees (social security benefits). Public social assistance is paid partly from the central budget and partly from the local governments' own budget.

Furthermore, we have identified an interaction between social security contribution and taxation rules. In fact, it was reported that the occasional applicability of the taxation rules in the social security contribution collection procedure is laid down in the relevant Hungarian law⁸⁷ unless otherwise provided.

According to the reports of Hungarian experts in economics and public finance, the social security contributions are quite similar to the direct taxes; however, there is a difference existing between the two. Direct taxes are not directly tied to the services offered in return whereas social contributions payments constitute a form of insurance with entitlements to certain services (e.g. pension, unemployment benefit or family support)⁸⁸. In the present report it is argued that the social security contributions do not constitute a form of taxes even though these are collected by the tax authorities. As a matter of fact, taxes are completely distinguished from the social security contributions. And the reason for this distinction in the Hungarian legal system is the fact that taxes and social security contributions have different legal backgrounds, i.e. there are different acts regulating each one of them⁸⁹. This differentiation of legal backgrounds and acts is reported to be caused by the actual structure of the Hungarian state budget.

Identification of contributors: The contributors to the pension and health insurance schemes are identified through a social security identification number. On the other hand, the tax administration uses a tax identification number for the individuals. This way the tax administration requires both identification numbers in the tax returns on the individual social security contribution data upon the collection of both levies. This means that there is not a unique identifying number used by both administrations, i.e. the tax and social security authority.

Every insured person⁹⁰ and his/her employers have to declare and pay regularly the social security contributions to the tax authority. That is employers and employees as well as joint and private companies and entrepreneurs have to pay contributions both to the pension and health insurance fund via the competent tax authority. In practice employers make the payments and self-employed persons act as employers and pay the contributions for themselves. An additional obligation of the employers is the

⁸⁷ Act LXXX of 1997.

⁸⁸ See Hungarian Working Paper in Public Finance – Hungarian Ministry of Finance, The efficiency of the Hungarian Tax System, April 2008.

Source: http://www.tatk.elte.hu/index.php?option=com_content&task=view&id=441&Itemid=598.

⁸⁹ E.g. taxes are regulated by the Act CXVII of 1995 on Personal Income Tax whereas social security contributions are regulated by the Act on the Eligibility for Social Security Benefits and Private Pensions and the Funding for These Services, the Act on Mandatory Health Insurance, the Social Security Pension Benefits Act and the Act on Family Allowance and Family Subsidies.

⁹⁰ According to section 5 of the Act LXXX of 1997, an insured person is a person engaged in employment under contract, a cooperative member, a student attending vocational schools under apprenticeship agreement, a self-employed not engaged in auxiliary activities, a business partner, a person performing work for remuneration in any work-related relationship, ecclesiastical personnel and small-scale agricultural producers.

maintenance of a register of the insured persons as well as records concerning the data of the insured persons⁹¹.

A distinction should be made between the insured persons who have chosen to remain in the first pillar and those who belong to the multi-pillar pension scheme as the rate of the contributions is different for the two categories of insured persons.

Moreover, there is another category of insured persons who pay social security contributions. These are the ones voluntarily insured as they are not subject to an insurance obligation, but they wish to become entitled to health provisions or pensions through their voluntary participation in the system. In practice this group of persons also includes those who do not acquire social insurance periods automatically - that is without paying contributions - during the period of receiving child-care allowance or during the years of study in an institution of higher education.

The collection of the contributions is merged and falls within the responsibility of the tax authority. The employers have to assess the amount of social security contributions payable on the income paid to the insured person for the current month which comprises part of the contribution base. Then they have to deduct the contributions which the insured person is liable to pay. The amount of the monthly contribution (including the pension membership fees) assessed has to be declared electronically with the use of e-forms⁹² since 2006 and it has to be paid to the tax authority each month by the 12th day of the following month⁹³.

The same is required for the self-employed persons with the exception of those self-employed who are taxed under the provisions of a simplified business tax⁹⁴ system; they have to make the payments according to the provisions of the Act on this simplified business tax. In general, as far as the self-employed persons are concerned, employer and employed are the one and the same person and the law requires them to meet the same criteria concerning the payment and declaration obligations, but only with some differences with regard to the frequency of payments and information provision in order to simplify their tasks. Moreover, the small-scale agricultural producers have the obligation to make the relevant declaration by the 12th day of the month that follows the quarter in question; that is on a quarterly basis.

Therefore, social security contributions are assessed, deducted and paid by the employers and entrepreneurs to the so-called “accounts” of the tax authority and shall be declared in their own returns. It is noteworthy that the term “account” is dated back since the time that only the employer had a current account with the social insurance institution - this explains the use of the term “*contribution account holder*” or “*account holder*” to refer to the employer as a social security contribution payer⁹⁵. Employees are not contribution account holders.

⁹¹ Section 46 of the Act LXXX of 1997.

⁹² These electronic forms of tax returns have to include all the individual contribution details on a monthly basis.

⁹³ In accordance with section 50 of the Act LXXX of 1997.

⁹⁴ The so-called “E.V.A.”.

⁹⁵ Account holders are the employers and all the self-employed as defined in the paper *Collection of Pension Contributions: Trends, Issues, and Problems in Central and Eastern Europe*, ILO Publications 2004, pp. 126 et seq.

In addition to the declaration obligation, the employer has to inform the insured person in writing on the amount of social security contributions that the employer has paid, the amount of the health and pension insurance contributions (membership fees) deducted from the insured person's wages and the amount of contribution refunded (transferred) due to overpayment. All the tasks associated with the remitting and reporting of the contributions are carried out by the account holder who is the employer. The employee only has to "withstand" the deduction of the contributions from his earnings⁹⁶.

According to the ILO country report on Hungary concerning the collection of pension contributions⁹⁷, the tasks of the employers can be summarized in the following table:

Table: Tasks of employers identified in the Hungarian social security contribution collection system.

<i>Tasks performed by the employers</i>	
Accounting of the contributions owed	Calculation of the social security contributions owed, according to the calculation rates on the wage of the employee
Deduction of the employee's contribution	Deduction of each employee's social security contribution
Withholding of the employer's partition	Matching the employee's social security contribution with their own contribution on the specific worker's behalf
Payment of the contributions	Total up the contributions for all their employees and then pay them to the tax administration
Reporting	Preparation and submission of a report (return) on each payment to the tax authority in the prescribed format ⁹⁸
Record-keeping	Maintenance of a record on each of their employees so that the social security administration ⁹⁹ can easily determine the pension rights that the employees accrue while working for that employer
Yearly reporting	Preparation of a yearly report on the entitlement accrual of each employee and sending it to the social security administration ¹⁰⁰

Calculation basis of social security contributions: In principle the taxable income serves as a calculation basis for the social security contributions. However, there are some exceptions regarding this general rule. For example social security contributions are not paid on the income from social security benefits approved and paid by the employer as well as social benefits payable by an entity other than the employer. Moreover, the contributions will be calculated in a different way than wages on some

⁹⁶ See Figure 1 of the paper Collection of Pension Contributions: Trends, Issues, and Problems in Central and Eastern Europe, ILO Publications 2004, p. 129.

⁹⁷ Ibid. pp. 128-132.

⁹⁸ The amounts paid as well as the employees are not individualized in this report. Only details of payments to public schemes and not to private pension funds are included.

⁹⁹ That is the Central Administration of the National Pension Insurance (CANPI).

¹⁰⁰ CANPI.

benefits in cash or in kind; for example, on the part of membership fees that are paid by the employer on a monthly basis into a voluntary mutual insurance fund for the benefit of the member¹⁰¹ and in the case of students pursuing full-time studies in an institution of higher education, on the remuneration received from the said institution¹⁰². Note that the calculation basis for taxes and social security contributions is going to change as of January 2011.

The social security contributions are levied, generally, on gross aggregate income deriving from employment and benefits in kind¹⁰³. Employees and self-employed persons have to pay health insurance and pension insurance contributions which are generally levied on the gross employment income, income from independent personal services and benefits in kind. The daily ceiling under the mandatory pension schemes is HUF 20,420 for 2010¹⁰⁴ whereas no ceiling applies to the health insurance. No social security contributions are, however, payable on royalties and social allowances and no ceilings apply thereto.

In detail, the applicable rates for the calculation of the social security contributions are categorized as follows:

Table: Applicable rates for the calculation of the social security contributions in Hungary - 2010 (Source Hungarian Tax and Customs Administration – APEH)¹⁰⁵

<i>Types of social security contribution</i>	<i>Rate (on the gross aggregate income)</i>
Pension insurance:	
Employers' pension insurance contributions of the first pillar	24%
Employee's pension insurance contributions if only insured in the first pillar	9.5%
Employee's pension insurance contributions if insured in the first and second pillar	1.5%
Employee's second pillar social security contributions (the so-called private pension fund membership fee)	8%

¹⁰¹ These voluntary pension fund contributions are considered as benefit in kind according to the Hungarian Act on the Personal Income Tax.

¹⁰² In accordance with section 18 as combined with section 21 of the Act LXXX of 1997. In case of such benefits in kind or in cash, these would be taxed differently than wages.

¹⁰³ As taxable income is meant: i) the income paid in employment relationship (including members of parliament), public service and civil service relationships, public prosecutor and judge relationships, justice administration relationship, official foster parents relationship, ii) the income of regular members of the Hungarian Army, public order enforcement bodies and national civil security services; income of contracted members of the Hungarian Army, the Border Guard, iii) the income of voluntary army reserve in service, iv) the income of persons in apprentice employment relationship, v) the income of members of cooperatives with active personal involvement, vi) the income of pupils enrolled in vocational school training with pupil employment contract, vii) the income of recipients of job search allowances, viii) the income of the self-employed who are not receiving pension on their own right, ix) the income of people in other gainful activities with active personal involvement (e.g. contract based temporary relationships, helping family members etc.) receiving payment which attains 30% of the monthly amount of the national minimum wage, x) the income of clergymen excepting pensioners, xi) the income of small scale agricultural producers (except of pensioners), and xii) the income of elected and managing officers of business corporations, foundations, NGOs etc. with income attaining 30% of the monthly amount of the national minimum wage.

¹⁰⁴ HUF 7,453,300 per year.

¹⁰⁵ The social security contribution rates for 2010 are available at: http://en.apeh.hu/taxation/social_security_contributions.html.

Employee's social security contributions for those who voluntarily contribute to a supplementary private pension scheme	up to 10%
Health insurance and unemployment:	
Employers' health insurance and labour market contributions	3% (after January 1 st , 2010)
Employer's health care tax	Flat rate (repealed as from January 2010)
Employee's health insurance and labour market contributions	7,5% (after the January 1 st , 2010)
Early retirement pensions:	
Employer's early retirement social security contribution	13%
Employment injuries and occupational diseases:	
Employer's or self-employed social security contribution towards the expenses of work-related social security services (if engaged in supplementary activities)	Flat-rate
Special contributions:	
Employer's sickness benefit Contribution	1/3 of the short-term sickness cash benefit
Vocational training contribution	1,5%

In addition to the social security contributions, a flat-rate health tax charge was payable by employers and other payers of income after it has been assessed on those items of income that are not subject to the social security contributions, but are included in the aggregate taxable base or they are taxed as benefits in kind. However, as from 1 January 2010, the application of the health tax is repealed. Individuals are also subject to a 14% health care tax charge on certain items of income if the health insurance contribution paid by the individual's employer is less than HUF 450,000 for each individual in the current year¹⁰⁶.

Moreover, the employer is subject to an early retirement insurance contribution which amounts to 13% of the gross - before taxation - wages, income. However, the 25% of the early retirement insurance contribution is covered from the central budget which means that there is only a 9.75% payment liability for the employer.

As a rule, the employer's social security contributions and charges are deductible for corporate income tax purposes.

Transfer of revenues: After the collection of the levies, the tax authority transfers the social security contributions to the first pillar social security pension scheme (old-age and survivors' pension) via the Treasury; more specifically, the tax authority makes the transfer to the Health Insurance Fund and the Pension Insurance Fund every month. The contributions for the second pillar insurance scheme are further diverted from the Pension Insurance Fund to the private pension funds. No fee is charged regarding the administrative assistance - cooperation between the governmental organizations.

¹⁰⁶ In such a case, the individual has to supplement the amount paid by the employer up to the amount of HUF 450,000, provided that he receives items of income that are subject to the health care tax charge, i.e. income withdrawn from the entrepreneurial income, income from securities lending, dividends and the entrepreneurial dividend base, capital gains and income from the lease of immovable property if it exceeds HUF 1 million per year.

As for the second pillar, Hungary has opted for a merged approach as well, because contributions are paid from the employers to the tax authority and then they are transferred to the pension funds.

It was also reported that the contributions paid in favor of persons who were eligible for only health care, had to be transferred directly to the regional health insurance funds. For example this is the case for persons receiving maternity benefits, unemployment allowance, or other social benefits.

3.2.4 Record-keeping and data exchanges

There are three different registers connected with the payment of the social security contributions.

On a first level, we find:

- the records of the social security contribution declarations, payment and enforcement which are maintained by the tax authority.

On a second level, there is:

- a pension insurance register maintained by the social security administration¹⁰⁷ with the authority to manage the pension insurance fund and administer social insurance benefits through its local branches¹⁰⁸, and
- the health insurance register maintained by another social security administration¹⁰⁹.

As far as the employers' individual record keeping is concerned, there is a provision in a Parliamentary Act¹¹⁰ that provides for a detailed reporting of employers to both the social security administrations of the first and second pillar social security schemes. However, in practice the application of this obligation has been postponed and until the present day there has been no public record of individual contributions in Hungary.

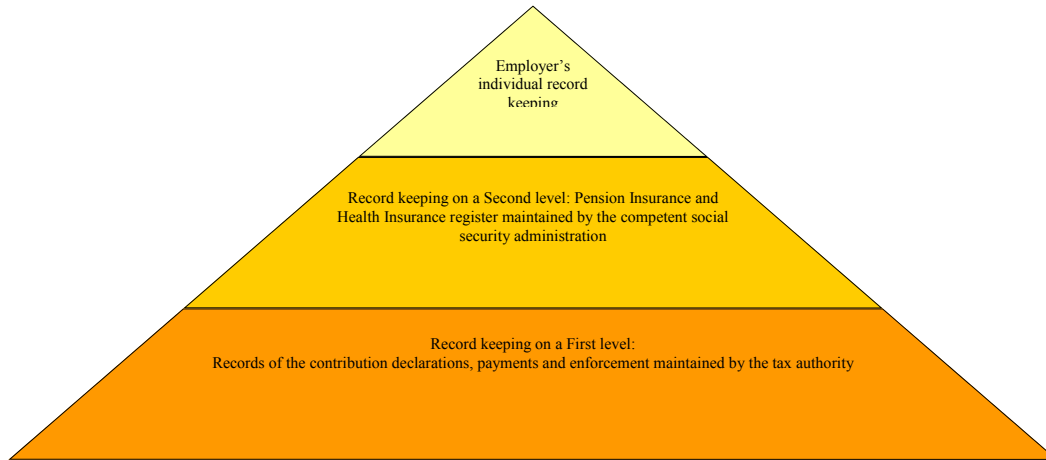
¹⁰⁷ The Central Administration of National Pension Insurance: <http://www.onyf.hu>.

¹⁰⁸ For further information see the report of the Social Security Programs Throughout the World on Hungary available from: <http://www.ssa.gov/policy/docs/progdsc/ssptw/2008-2009/europe/hungary.pdf>.

¹⁰⁹ The National Health Insurance Fund: <http://www.oep.hu>.

¹¹⁰ No. LXXX of 1997.

Figure: Record keeping arrangements in the Hungarian social security contribution and tax collection system



All these registers and records contain the data and information supplied by employers and insured persons under statutory requirement, indicating the income for each insured person as a base for social security contributions, the amount of the contributions paid by or deducted from the insured persons, the duration of the insurance relationships and the information necessary for granting benefits to the insured persons.

The access to the data related to social security contribution collection and data related to tax collection is strictly determined by the locality and the actual office process of the collecting tax authority; this access is also limited by certain access authorization rules. For example, if a taxpayer changes its seat, all of his payment history will be accessed by the actually competent regional directorate and authorized personnel thereafter. The aforementioned data, though, are not freely interchanged between social security institutions and the tax authority.

Furthermore, with regard to pension contributions, two institutions are responsible for the data keeping tasks after the collection is performed: on the one hand, the tax authority where the payments are actually done and, on the other hand, the social security administration¹¹¹ which keeps records of the employee's entitlement accruals¹¹². These data are interchanged according to the above described procedure.

More specifically, in order to prevent any unauthorized use of social security benefits and for determining the amount of the benefits, the tax authority discloses the relevant data with the *tax identification codes* of the insured persons indicated. The social security administration then collates the data received from these records with the data from its own records by applying the client codes and communicates the tax identification code of persons drawing benefits without eligibility to the tax authority. With the new social security contribution and tax return form which was introduced in 2006, the pension and health insurance fund have a direct access to the payment information on an individual level. This means that the social security administration

¹¹¹ This is the so-called CANPI administrative authority.

¹¹² Collection of Pension Contributions: Trends, Issues, and Problems in Central and Eastern Europe, ILO Publications 2004.

has information on whether an insured person abides by his/her social security contribution obligations; there are no data on the individual amounts actually paid for each insured person. The tax authority has also a direct feedback from funds in case of benefits without eligibility.

The current system of separate organizations - one for collecting social security contributions and one for paying benefits - requires regular data reconciliation and coordination because there are several ways that someone can change his/her insurance status. For this reason it is reported that the new electronic filling system and the electronic verification of eligibility in Hungary provide immediate and detailed data to all three competent administrations. Therefore, the inaccuracies and differences in the records have been reduced to the minimum level.

3.2.5 Control and recovery of overdue payments

The primary control of the contribution payment is carried out by the tax authority which is further supervised by the Ministry of Finance¹¹³ and the State Audit Office of Hungary¹¹⁴ as far as the pension insurance is concerned, by the Ministry of Health¹¹⁵ as far as the health insurance is concerned and the Ministry for National Economy¹¹⁶ regarding the unemployment insurance scheme. The Ministry of Social Affairs and Labor¹¹⁷ has a general supervision of the social security schemes whereas authorized private pension fund administrators administer the individual accounts and the Ministry of Finance supervises the individual accounts¹¹⁸.

Moreover, the tax authority exercises official power against contribution payers who are reluctant or deny fulfilling their obligation to pay the social security contributions. This means that beyond its power to assess and collect contributions, payments and debts, the tax administration has the additional authority to initiate legal action in serious cases of breach of legal obligations.

The social security controllers have the right to perform on-spot controls, but their competence in this field is limited as they can only report the fraud or social security contribution evasion to the tax authority or the police, but they do not possess any right to impose immediate sanctions. For the efficient detection of infringements and frauds, it has been reported that there are frequent joint controls performed by the social security administration and the tax authority.

As for the control of the social benefits payment, this lies within the competency of the granting social security administration, but the overpayments are to be collected by the tax authority.

¹¹³ Official website of the Hungarian Ministry of Finance: <http://www.p-m.hu>.

¹¹⁴ For more information on the State Audit Office of Hungary visit: <http://www.asz.hu>.

¹¹⁵ Official website of the Hungarian Ministry of Health: <http://www.eum.hu/english>.

¹¹⁶ For further details on the Hungarian Ministry for National Economy see: <http://www.ngm.gov.hu/en>.

¹¹⁷ Official website of the Hungarian Ministry of Social Affairs and Labor: <http://www.szmum.gov.hu>.

¹¹⁸ <http://www.ssa.gov/policy/docs/progdesc/ssptw/2008-2009/europe/hungary.pdf>.

3.2.6 *The merger process*

In 1992 the Social Insurance Fund was divided in a Pension Insurance Fund and a Health Insurance Fund. Until that time it was the responsibility of the Central Administration of National Social Insurance¹¹⁹ to collect contributions. After the aforementioned division in 1992, the Central Administration of National Health Insurance¹²⁰ Fund was placed in charge of all contribution collections until 1999. The Pension Insurance Fund was separate from the state budget and had an elected self-governing Body responsible to the Parliament. Similar to the latter was the Health Insurance Fund having a self-governing body as well, with the aim - among other duties - of financing health-care institutions and distributing pay sick. The financial burden of non-pension-type benefits has been transferred gradually from the Pension Insurance Fund to the central state budget¹²¹.

The responsibility of all the contribution collection-related tasks has been shifted to the tax authority in 1999 by a Parliamentary Act¹²². More specifically, all contribution payments and information returns had to be directed to the tax authority as from January 1st, 2001. Moreover, the tax authority had the additional obligation to restructure the social security contribution accounts. Thus, every account holder received a new account.

The tax authority has taken over the premises, infrastructure, personnel, databases and the balances in accounts related to them from the social security administration. In 2000, the relatively independent social security contribution directorates¹²³ of the tax authority were ceased and fully integrated into the organization of the tax authority¹²⁴.

Furthermore, the Pension and Health Insurance Funds were no longer self-governing bodies as their role has been taken over by one of the political state secretaries of the Prime Minister's Office. However, in the case of the unemployment system, self-government is still in operation with the National Employment Council, the Governing Body of Labour Market Fund and the County Labour Councils¹²⁵.

The merger of the social security contribution and tax authority was completed in January 1st, 2001. The Tax and Financial Control Administration (APEH)¹²⁶ has been the main institution involved in the collection of both levies. A new period has also started in 2006 when the electronic forms for the tax returns were introduced.

¹¹⁹ This was also called CANSI.

¹²⁰ Usually referred to as CANHI.

¹²¹ Collection of Pension Contributions: Trends, Issues, and Problems in Central and Eastern Europe, ILO Publications 2004, pp. 141 et seq.

¹²² Act No. LXIV of 1999.

¹²³ These relatively independent contribution directorates of the tax authority were responsible for reaching individual agreements with contribution payers on the amount of their outstanding debt and to cancel late charges and fines if the contribution payer could verify payment.

¹²⁴ Collection of Pension Contributions: Trends, Issues, and Problems in Central and Eastern Europe, ILO Publications 2004, pp. 146 et seq.

¹²⁵ Collection of Pension Contributions: Trends, Issues, and Problems in Central and Eastern Europe, ILO Publications 2004, pp. 141 et seq.

¹²⁶ See article Tine Stanovnik, Contribution compliance in central and eastern European countries: Some relevant issues, *International Social Security Review*, vol. 57, 4/2004, p. 60.

Hungary has merged most aspects of the contribution collection for the first and second pillar pension and health care systems presenting a manifold experience which is reflecting the continuing difficulties in modernizing the collection administration. It has been reported that, while good progress has been made, there are still few deficiencies in compliance, record keeping, and coordination.

One of the basic reasons for the merging of the administration of the social security contribution and tax collection was the targeted increase of the efficiency in the contribution collection, the simplification of the collection procedure and the reduction of the expenses. Before the merger there was also a powerful restriction on cross-checking between tax and social security contribution because of a prohibition enforced by the constitutional court in order to protect citizens' privacy. Therefore, there were many difficulties in the provision of information by employers to a central agency¹²⁷.

Moreover, in the early 1990's there was a great increase in the number of accounts handled by the health insurance institute. The collection agency was unable to cope with such a rapid increase and the IT used was also insufficient. Consequently, the development of a new system was more than necessary. However, several delays have impeded the introduction of such a system¹²⁸.

What is more, until 1992, social security administration for pensions had only limited authority relating to the overdue contributions; it could only send a payment request as, on the contrary, only the tax authority could use stricter means of collection or otherwise legal action had to be initiated. Then, in 1992, the Parliament enacted a legislation giving the health insurance institute the authority to recover debts through direct collection by the seizure of liquid assets and collection enforcement by confiscation and sale of physical assets. This way the collection agency has been granted the authority to withdraw funds from a firm's bank account without the firm's prior authorization. Nevertheless, many of the firms that time were operating on a cash basis and, as a result, there was limited value of the aforementioned authority. This is the reason why an additional authority for collection enforcement such as the tax administration was further required¹²⁹.

Obstacles encountered during and after the merger: According the experiences of the national experts, one of the main obstacles encountered was the limited attention on behalf of the tax administration towards the social security contribution collection needs compared to the collection of other levies such as the VAT or the income tax. Moreover, as another obstacle encountered during the merger was mentioned the old legislative provisions which continuously needed to be amended and modernized in order to meet the requirements of the merged collection system.

The national experts participating in the present report have mentioned that there has been no significant opposition to this merger because the tax and social security contribution payment obligations have been greatly simplified by the merger. It has

¹²⁷ See WB Discussion Paper on Collecting and Transferring Pension Contributions, 1999, p.23.

¹²⁸ As from 1998 there was a new IT system which was accessed by an authorization to the entire database independently from the locality.

¹²⁹ Collection of Pension Contributions: Trends, Issues, and Problems in Central and Eastern Europe, ILO Publications 2004, p. 142.

also been reported that no further merger procedure regarding the collection of both the levies is expected or foreseen in the near future.

Consequences of the merged collection system: One of the negative effects of the merger is that the social security institutions had no direct information anymore about the calculation basis of the social security contributions and the actually paid amounts. There has been no unified identifying number for the taxpayers and contributors used by the tax authority which has created gaps in the record keeping especially with regard to the non-paying persons. Especially with the numerous tax types, it became difficult to control the funds with large revenues. This problem had to be resolved with the regular data reconciliation of the health and pension social security authorities and the tax administration which is not always a successful procedure.

On the other hand, it was reported that this merger had a lot of positive effects in the collection procedure and administration of the social security contributions. Indeed, the collection procedure has proved to be more efficient especially with regard to the overdue payments as the tax authority can use stricter means of collection enforcement. In addition, the tax authority can perform a more efficient control on the payment of the contributions and, as a result, there is higher compliance with the social security contribution payment obligation. Finally, the employers can use a simplified procedure via a “*single window*” approach in order to fulfill all their obligations.

Table: Summary of the merged administrative arrangements for social security contribution and tax collection in Hungary

Collecting authority	Hungarian Tax and Financial Control Administration
Collecting method	The social security contributions and taxes are collected as aggregate amounts
Applicability of taxation rules	Yes, if there is no contrary provision in the Hungarian social security law
Relationship of social security contributions with taxes	They are distinguished from one another because they have different legal backgrounds due to the structure of the state budget
Declaration and payments of social security contributions and taxes	Performed by insured persons and their employers as well as companies and self-employed persons
Records' maintenance	By employers (in the so-called "accounts")
Identification of insured persons for payment purposes	Via a social security identification number plus a tax identification number
Electronic declaration of payments	Use of e-forms
Calculation basis for social security contributions	Taxable income with some exceptions
Deductibility of social security contributions for corporate income purposes	Yes
Transfer of funds collected	<ul style="list-style-type: none"> ▪ Transfer to the first pillar social security scheme via the treasury ▪ Second pillar contributions are further diverted from the first pillar pension fund to the private funds
Control and recovery of overdue payments	<ul style="list-style-type: none"> ▪ Primary control performed by tax authority ▪ Social security controllers have limited competencies in this field
Levels of record keeping	<ul style="list-style-type: none"> ▪ Records of the contribution declarations, payments and enforcement maintained by the tax authority ▪ Pension and health insurance register maintained by the competent social security administrations ▪ Individual record keeping (not applicable in practice)
Data exchange between tax and social security administration	Limited only with the use of tax identification codes (the so-called client codes)
Obstacles during and after the merger	<ul style="list-style-type: none"> ▪ Limited attention from tax administration towards social security contribution collection ▪ Requirement of amendments to old legislative regulations
Disadvantages of the merged collection	<ul style="list-style-type: none"> ▪ No direct information on the calculation basis of social security contributions and amounts actually paid for the social security administration ▪ Gaps in record keeping due to the lack of a unified identifying number for contributors
Benefits of the merger	<ul style="list-style-type: none"> ▪ Simplified procedures for employers ▪ More efficient collection procedure ▪ Stricter means of collection enforcement ▪ Higher compliance with the social security contribution payment obligations

3.3 Italy

3.3.1 Introduction

Italy is one of the southern European countries where the idea of a merger of the collection of the social security contributions and taxes is quite recent and currently at an initial stage. This is because a certain degree of complexity is encountered in all the Italian social security schemes. It is also a fact that most of the revenue of the social security schemes comes from the payment of the social security contributions by categories of workers¹³⁰; this makes the effective collection of the social security contributions very important for the financing of the different social security schemes. There is also a considerable contribution from the State, which, over the last few years, has become gradually even more significant.

In general, the Italian social security system makes a distinction between social assistance - *assistenza sociale*¹³¹ - which is financed by the taxes, and social insurance - *previdenza sociale*¹³² - which is financed primarily by social security contributions. Social insurance schemes in Italy cover a loss of income from work as a result of sickness, maternity and tuberculosis, and involuntary unemployment, as well as pensions' invalidity benefits and incapacity to work, survivors' pensions and old age pensions. Industrial injuries and occupational diseases are the subject of a separate insurance scheme. Finally, there is a national health service as well¹³³.

3.3.2 Financing of social security

Due to the complexity of the Italian social security system there is a vast typology of contributions that are financing the different social security schemes. This is also caused by the fact that there is a variety of social security contribution rates which are fragmented because they refer to individual production sectors depending on the activity pursued, the number of the employees, the location of the company, the classification of the insured as workers, employees, professionals or directors. In addition to these rates, there are further sub-rates for each category of social security contributions set according to the economic evaluation (for example there is support for the less wealthy sectors) or the pressure exercised by the different interest groups¹³⁴.

In an effort to provide a general overview of the basic types of social security contributions, we can distinguish the obligatory social security contributions¹³⁵, the

¹³⁰ MISSOC – Info 2/2007: Financing social protection

(Source: http://ec.europa.eu/employment_social/missoc/2007/02/2007_2_it_en.pdf).

¹³¹ Social assistance provides for the social protection of the citizen's actual interests without the prerequisite that a risk will come up. See del Giudice, F., Mariani, F., Solombrino, M., *Legislazione e previdenza sociale*, XIX Edizione, Edizioni Giuridiche Simone, 2004, p. 227.

¹³² Social insurance is defined as the social security legislation which aims at the protection of the employee (and the members of his family) from the risks of disability or loss of the ability to work caused by predetermined situations (natural or related to work). See *ibid.* p. 268.

¹³³ Pieters, D., *The social security systems of the Member States of the European Union*, 2002, Intersentia, p. 205.

¹³⁴ Pessi, R., *Lezioni di diritto della previdenza sociale*, sesta edizione, CEDAM, 2008, p. 351.

¹³⁵ The compulsory social security contributions -*contributi obbligatori*- are the contributions paid by the employer on behalf of the employees that are working for him/her. See del Giudice, F., Mariani, F.,

so-called “redeemed” social security contributions¹³⁶ (redemptions), the employers’ imputed social security contributions¹³⁷ and the voluntary social security contributions (for the voluntary continuation of social security contribution payments)¹³⁸, the additional social security contributions (pension supplements)¹³⁹ and the social solidarity contributions. Furthermore, we can distinguish the contributions paid by the employees and the employers with regard to the risks of maternity and sickness, invalidity, old age and death (including the special solidarity contribution which varies in accordance to whether the employer is involved in industry or trade and it is due by persons involved in the richer productive branches in favor of less wealthy sectors). Some categories of employers pay lower contributions for the branches of family allowances and old age.

With regard to the insurance scheme for professional risks, employers pay contributions depending on the degree of risk within their branch of industry. The National Health Insurance Service is financed by contributions from the sickness insurance fund and from contributions from the regions, provinces and municipalities. Some pensioners also pay a contribution for the National Health Service while for those who voluntarily affiliated to the National Health Service, special rates apply¹⁴⁰.

The social security contributions are collected together with the taxes with the use of a unified payment form - *modello di pagamento unificato*; so the merger in Italy is an administrative one having a mere procedural nature. There are different opinions in Italy, some of which argue that this procedural merger can not qualify as a merger of the administrations. However, the idea of merging the social security contribution and tax collection has already been introduced and it is nowadays more and more supported according to the experiences of the national experts.

3.3.3 Collection methods

The role of the Italian tax authority: Currently there is not a unified administration authority competent for the collection of both social security contributions and taxes in Italy as the taxes are collected by the tax administration - *Agenzia delle Entrate* - and the social security contributions are collected by the competent social security

Solombrino, M., *Legislazione e previdenza sociale*, XIX Edizione, Edizioni Giuridiche Simone, 2004, p. 304.

¹³⁶ These are the so-called *contributi da riscatto* paid by the employee in order to cover -from the social security point of view- periods which were not covered by the payments of social security contributions. See *ibid.*, p. 306.

¹³⁷ The so-called *contributi figurativi* are paid by the employer on behalf of the employee without the partition of the employee, for covering periods when the insured person was not able to work for reasons independent of his/her will to work. See *ibid.* p. 308.

¹³⁸ These contributions - *contributi volontari* - are paid directly by the insured person who has stopped working and has obtained the authorization from the social security administration to continue paying on a voluntary basis the social security contributions in order to retain his/her rights arising from the social insurance or to become entitled to pension rights. See *ibid.* p. 311.

¹³⁹ These contributions - *contributi integrativi* or *complementari* - are financing a mandatory or voluntary pension scheme which generally provides additional retirement income to the statutory pension schemes. See also Persiani, M., *La previdenza complementare*, CEDAM, 2008.

¹⁴⁰ Pieters, D. *The social security systems of the Member States of the European Union*, 2002, p. 221.

institutions (INPS¹⁴¹, INAIL¹⁴², ENPALS¹⁴³, INPDAI¹⁴⁴ and so on).

However, in the field of social security and tax collection Italy has introduced a different system which indicates a procedural merger to a certain extent of the collection administration of taxes and social security contributions by using a unique payment form which is common for both taxes and social security contributions (Form F24). As a matter of fact, after February, 16th, 2010 this unified module of payment - *modello di pagamento unificato* - is used for the payment of all kind of taxes and social security contributions. This so-called F24 tax form is used for the collection of all kind of taxes, VAT, local taxes, social security contributions, and interest owed from installment in payments as well as payments according to adjustment notices, judicial settlement or liquidation or formal control of the statements.

While defining the nature of the social security contributions, we have encountered some discussions about the qualification of the social security contributions as contributions or special levies or even taxes¹⁴⁵. The supporters of the opinion that the social security contributions are taxes, claim that the State makes a significant intervention in the legal system of social security and, thus, social protection corresponds to the direct and immediate satisfaction of the public interest. However, the Italian Constitutional Court has continuously excluded that the social security contributions have a tax nature because they aim exclusively at the financing of the social security system¹⁴⁶.

Therefore, in Italy social security contributions are completely distinguished from personal and corporate income taxes. This means that they are not integrated levies as they constitute a completely separate payment with regard to the other taxes collected and there is also no interaction between the two levies.

Consequently, when taxes and social security contributions are collected, a clear distinction is made on the F24 Module because it is explicitly explained in the form which amount corresponds to the taxes paid and which corresponds to the social security contributions paid. However, the total amount owed for both the taxes and the social security contributions is paid by the insured persons as a sum by using this unified form of payment to a common intermediary competent for the collection of both taxes and social security contributions.

In other words, contributions are collected by means of special forms which are also used for the taxes, or paying-in slips depending on the kind of contributions. The unified tax form F24 allows the payment of both taxes and social security

¹⁴¹ The National Social Insurance Institute (INPS -*Istituto Nazionale della Previdenza Sociale*). Official website: <http://www.inps.it>.

¹⁴² The National Employment Accident Insurance Institute (INAIL -*Istituto Nazionale per l'Assicurazione contro gli Infortuni sul Lavoro*). Official website: <http://www.inail.it>.

¹⁴³ The National Insurance and Assistance Office for Workers in the Entertainment business (ENPALS -*Ente Nazionale di Previdenza e di Assistenza per i Lavoratori dello Spettacolo*). Official website: <http://www.enpals.it>.

¹⁴⁴ The National Social Security Institution for Supervisory Staff in Industry (INPDAI -*Istituto Nazionale di Previdenza dei Dirigenti di Aziende Industriali*).

¹⁴⁵ Persiani, M., *Diritto della Previdenza Sociale*, Padova, 2003, pp.87 et seq.

¹⁴⁶ Pessi, R., *Lezioni di Diritto della Previdenza Sociale*, sesta edizione, 2008, pp. 343 et seq.

contributions at common intermediaries such as the post offices or the authorized banks or the collection agents - *agenti della riscossione* - either in cash or by using a debit card PagoBANCOMAT or a POSTAMAT/POSTEPAY card (connected to a current account of a postal office) or by bank or postal checks or postal money order. According to the guidelines for completing the Form F24, the types and the amounts due for taxes, social security contributions, local taxes etc, must be identified in the separate sections of this form by using the appropriate codes and then the payment of the total sum is made to the competent bank or post office. The collecting banks or post offices transfer the sums to a special national account where the details of each amount owed to every administrative authority can be easily identified.

In case there is a shortage of the amounts to cover the payment of the check or no funds at all, the payment is considered not to have taken place and, therefore, the contributions become overdue.

In the case of non-fulfillment of the social security contribution obligation, the social security authority asks some entities to proceed to the collection of the overdue payments. These collecting entities, one of which is “Equitalia” (51% of the public capital owned by the tax authority - *Agenzia delle Entrate* and 49% by INPS) or other entities (where the Ministry of Treasury has a share), use injunction proceedings for the collection of the social security contributions and taxes that have not been paid and they charge a fee for this collection procedure. Since the 1st October 2006, the forced collection of overdue taxes and social security contributions has been assigned to one institution named “*Equitalia s.p.a.*” (already *Riscossione s.p.a.*)¹⁴⁷.

As a result, one can argue that a kind of merger of tax and social security administration authorities can also be recognized for Italy due to the transfer of the collection functions for the overdue payments of both taxes and social security contributions in the hands of the aforementioned administrative body.

The persons liable to pay obligatory contributions are employers, employees, self-employed persons, and exceptionally some other categories, e.g. a client of a freelance professional, who has the obligation to contribute to the social security system for the professional with a contribution quota related to the value of the service received¹⁴⁸.

The contribution obligation is usually shared between employees and employers with the latter ones paying a higher proportion. There are, however, some cases that the contributions are exclusively owed by the employer; this occurs in the case of insurance against industrial accidents and professional diseases (competent authority for the collection of these contributions is the Italian National Institute against Industrial Injuries (I.N.A.I.L.)).

Identification of contributors: The insured persons are identified through a unique identifying number called “*codice fiscale*”; this number is used to identify the citizens in all transactions with the Italian public administration and organizations. Furthermore, the registration at the competent social security authorities is taking place automatically. These enrollments are called *ruoli* and they are sent

¹⁴⁷ According to article 3 of the law decree 203/2005 as modified by the law 248/2005.

¹⁴⁸ International Encyclopedia of Laws, Social Security Law, Suppl. 69 (November 2009), Italy, Renga, S., p. 38.

automatically to “Equitalia” - the collecting authority for the collection of overdue contributions - every two weeks in order to perform the forced collection of the contributions that are not paid.

Calculation basis of the social security contributions: We can distinguish various types of contributions transferred to finance the Italian social security system. These are the obligatory contributions, the voluntary contributions, some additional contributions and social solidarity contributions. The calculation basis for the social security contributions is usually the taxable income, although some exceptions may apply, such as the exemption of some wage items from the income used as a calculation basis for the social security contributions.

The total amount of contributions is normally established by the interested social security bodies with decisions to be approved by ministerial decrees. Ordinary contribution rates are depending upon the categories of the workers. There are different factors that must be taken into consideration in order to calculate the contribution rates. One of these factors is the nature of the activity of a company; commercial and craft companies pay lower contributions than industrial companies. Other determining factors are to which commodity sector the company belongs, the number of employees, the grade of employees (rates for workers are the highest and those for executives the lowest), the location of the company (areas considered depressed have lower contribution rates).

The amount of social security contributions depends on the type and size of the business and the rank of the employee. The aggregate contributions range from approximately 40% to approximately 45% of the aggregate remuneration accrued in the relevant year. The aggregate contributions are normally borne by the employer for 80% to 85% of their amount; the rest is borne by the employee and must be withheld by the employer. Social security contributions are deductible for corporate income tax purposes¹⁴⁹. There is also the case that the contributions are based on the employee's presumed income and they are not proportional to remunerations.

The income that is taken as a basis for the calculation of social security contributions or the so-called “taxable pay”, is conventionally established by the law. There are two concepts in Italy concerning the income that is taxable for social security purposes. One is provided for in a law of 1969¹⁵⁰ which concerns incomes acquired up to January 1998 and considers as taxable income “*all that the employee receives from the employer in money or in kind, gross of any deduction, dependent upon the employment relationship*”, and the other was introduced by a law in 1997, after the pension reform of 1995, which is valid for incomes accruing after January 1998 onward; then it was established that the taxable base for social security purposes coincides with the income coming from employment subject to individual income tax¹⁵¹.

As for the ceiling of wages according to which the social security contributions are calculated, one can argue that in principle contributions are levied upon unlimited

¹⁴⁹ European Tax Handbook online 2010, available from: <http://ip-online.ibfd.org/kbase/?search=N%3d3339+3>.

¹⁵⁰ According to article 12 of the Act No. 153 of 1969.

¹⁵¹ Article 6 of the Legislative Decree No. 314 of 1997.

wages. However, since the pension reform in 1995, contributions for the new pensions are only applicable up to an upper limit. For the amount of wage that exceeds this limit, no contributions are due and, consequently, this is not taken into account for the calculation of the pension. A minimal wage for contribution has also been introduced. In order to calculate the employee's income it is to be considered that the law provides that the employee's pay shall meet the minimum wages requirements¹⁵² which are reviewed every year in order to keep pace with the cost of living by the social security administration (INPS). If the contributions are paid on an amount lower than the minimum threshold established by law, such contributions will be considered as referring to a proportionally reduced period of time. A maximum contributions threshold is also provided for¹⁵³.

The aggregate contributions are normally borne by the employer from 80% to 85% of their amount; the rest is borne by the employee and must be withheld by the employer. Finally, social security contributions are deductible for corporate income tax purposes¹⁵⁴.

The employees' social security contributions¹⁵⁵ are withheld from the employee's salaries and they are payable partly by the employer and partly by the employee on a monthly basis to the INPS¹⁵⁶ using the F24 tax form. The employee's partition to the payable contributions is in general approximately 10% of the total gross salary, depending on the type and size of the business and the rank of the employee¹⁵⁷.

Employers have to withhold social security contributions¹⁵⁸ due by the employee (part of the social security contributions for the employee is due directly by the employer). The contributions are levied directly from the pay envelop and they are paid partly by the employer and partly by the employee on a monthly basis to the INPS¹⁵⁹ using the F24 tax form.

A system of social insurance covering old-age, survivorship and health insurance is also in operation for taxpayers engaged in a business or profession. The amount of social security contributions for self-employed and non-employed persons¹⁶⁰ varies according to earnings¹⁶¹ including the self-employed or family business's annual income and it is levied at the percentage which is provided for at that time¹⁶². There are minimum and maximum contribution requirements envisaged by law and the contribution payments are also made through the F24 tax form.

¹⁵² This amounted to 171.03 Euros per week in 2006.

¹⁵³ In 2006 all individuals had to pay contributions on an income of up to 85,478.00 a year while no contributions were levied on amounts over this threshold.

¹⁵⁴ European Tax Handbook online 2010, available from: <http://ip-online.ibfd.org/kbase/?search=N%3d33339+3>.

¹⁵⁵ *Contributi sociali a carico del lavoratore*.

¹⁵⁶ Or the other competent social security administration.

¹⁵⁷ European Tax Handbook online 2010, available from: <http://ip-online.ibfd.org/kbase/?search=N%3d33339+3>.

¹⁵⁸ *Contributi sociali a carico del datore di lavoro*.

¹⁵⁹ Or the other competent social security administration.

¹⁶⁰ *Contributi sociali a carico dei lavoratori autonomi*.

¹⁶¹ European Tax Handbook online 2010, available from: <http://ip-online.ibfd.org/kbase/?search=N%3d33339+3>.

¹⁶² For workers up to 21 years old a lower rate applies.

Transfer of revenues: As far as the ordinary social security contributions and taxes are concerned, these are all dealt with separately and kept separated electronically once they are collected by the use of the tax form F24. According to article 17 of the law decree 241/1997, taxes, social security contributions due to INPS and other amounts owed to the state, the regions, or other social security contributions, are subject to the unified payments which have to be made the same day that the relative statement is submitted.

After the fourth working day following the date of receipt of the F24 tax form, the banks or the postal offices where the payment has been made, calculate the paid amounts. Then they assign each one of them to the respective institutions and transfer them to the State Treasury within a unique special national account. These intermediaries also transfer the conclusive data for every authority within the aforementioned period to the data management structure of the Ministry of Finances which is called SOGEI¹⁶³.

Furthermore, within the first working day following the transfer of the amounts by the banks and the post offices and the receipt of the conclusive data, the competent department of the tax authority verifies that the intermediaries' actions are in time and correct and that the transfers made are correct as well; it also divides on a daily basis the amounts that correspond to each one of the administrations making the relevant transfers through the National Bank of Italy - *Banca d' Italia* keeping under consideration any payments made by the contributors. Within the following working day the National Bank of Italy has to credit all the amounts from the special national account to the specific accounts of the different recipients according to the data transmitted by the data management agency called SOGEI. Since February, 15th, 2010 the National Bank of Italy instead of transferring the amounts to the 211 different accounts of the several social security administration establishments, transfers daily all the amounts to a unique account of the provincial treasury of Rome to which the Directorate General of the social security administration¹⁶⁴ has access.

Currently INPS is in the phase of special accounting; this means that there are amounts exclusively relevant to contributions included and amounts relevant to taxes excluded from the accounting.

There are separate units in the administration dealing with the social security contributions and the taxes. Therefore, it can be noted that the parallel collection system is maintained in this aspect. As far as the overdue payments are concerned, these are dealt with by a new administrative authority which is called "Equitalia" which is competent for the collection of overdue social security contributions and taxes.

For the normal contributions and taxes, there is no fee collected, but for the collection of overdue payments the collecting agency of "Equitalia" or any other competent collecting entity by the law maintains a percentage of the collected amount as a fee for its services, the so called *aggio* (premium) which is a collecting commission currently equal to 9%.

¹⁶³ For more information you can visit:

<http://www.sogei.it/flex/cm/pages/ServeBLOB.php/L/EN/IDPagina/1>.

¹⁶⁴ That is the National Social Insurance Institute (INPS -*Istituto Nazionale della Previdenza Sociale*).

3.3.4 Record-keeping and data exchanges

The collecting agency of overdue payments, “Equitalia”, has access to data from the tax authority as well as from public and private entities. Indeed, with the creation of this new agency (“Equitalia”), the exchange of information between the social security administration and the tax authority is the rule (in the past it was an exception due to the bureaucratic problems faced by these authorities) and all the data regarding the personal profiles of the insured persons, their income and fiscal declarations, their assets and their social security contributions paid are now freely interchangeable between the two agencies as well as with the new agency “Equitalia” or other collecting entities which have signed agreements for the data exchange. This data exchange is only performed for the purposes of collecting the overdue social security contributions.

3.3.5 Control and recovery of overdue payments

The Ministry of Labor and Social Security¹⁶⁵ and Ministry of Economy and Finance¹⁶⁶ provide general supervision. The social security administration (INPS) supervision inspectors provide specific supervision with regard the collection of the social security contributions.

There is also data sharing between the Ministry of Labor and Social Security and the *Guardia di Finanza* which is a police force aiming at tackling the financial offences. In general, the National Social Insurance Institute (INPS) administers the mandatory national program through its branch offices and administers a number of special programs for certain categories of insured workers¹⁶⁷.

The collection of the overdue payments is assigned to collecting entities. As it is mentioned before, one of these entities is “Equitalia”¹⁶⁸ which uses injunction proceedings for the collection of the social security contributions and taxes that have not been paid and charges a fee for this collection procedure. Since the October 1st, 2006, the forced collection of overdue taxes and social security contributions has been assigned to one institution named “*Equitalia s.p.a.*” (already *Riscossione s.p.a.*)¹⁶⁹.

3.3.6 The merger process

In Italy, the parallel collection system of taxes and social security contributions has been maintained and the payment procedure has been converted to a merged collection system with the use of the unified payment form F24. This was the result of the reengineering of the collection and payment activities which have been launched during 2009 in order to simplify the operations and the corresponding control of the financial flows of the INPS.

¹⁶⁵ The official website of the Italian Ministry of Labor and Social Security: <http://www.lavoro.gov.it>.

¹⁶⁶ The official website of the Italian Ministry of Economy and Finance: <http://www.tesoro.it>.

¹⁶⁷ For further information see the report of the Social Security Programs Throughout the World on Italy: <http://www.ssa.gov/policy/docs/progdsc/ssptw/2008-2009/europe/italy.pdf>.

¹⁶⁸ 51% of the public capital owned by the tax authority - *Agenzia delle Entrate* and 49% by the social security administration INPS.

¹⁶⁹ According to article 3 of the law decree 203/2005 as modified by the law 248/2005.

Furthermore, the adequacy of collection of overdue taxes and social security contributions has long been a major issue in Italy, which has recently been addressed. There has been, indeed, a creation of a new authority in Italy, “Equitalia” or Riscossione S.p.a.¹⁷⁰; the tax authority holds 51% of its shares and the INPS 49%. This authority has the responsibility to collect all the overdue taxes including the social security contributions since October 1st, 2006¹⁷¹.

Now there are two conventions between the Agenzia delle Entrate and the INPS concerning the payment of social security contributions via the form F24 - *modello di pagamento unificato* - and one for the realization of the norms established in the relevant national law decree¹⁷².

Consequences of the merged collection system: Although there has been a long-term collaboration between the two authorities - the social security administration and the tax authority who have been exchanging data - this exchange of data was not very extensive and there were always the problems of the bureaucracy in the transfer of the necessary data and the exchange of information. Therefore, it was important to introduce a merger of social security contributions and tax collection for the smoother circulation of data flows.

Since the social security administration and the tax authority have signed on December 12th, 2008 the convention on the data sharing in order to combat the social security contribution evasion, it was estimated that 100 billion Euros more were going to be collected per annum as a result of the evasion combat.

Furthermore, the use of a unified form for the collection of both taxes and social security contributions aimed at simplifying the payment procedures and the reduction of the expenses. According to an internal document¹⁷³ of the social security administration, it is established that since February 16th, 2010, the merging of the collection of the social security contribution collection has begun with the use of the unified tax form F24.

A new administrative authority has been created for the collection of both taxes and social security contributions that are overdue. The main reason underlying the creation of this unified collection of overdue taxes and social security contributions by “Equitalia s.p.a.” (already Riscossione s.p.a.) has been the high rate of social security contribution evasion which Italy has been experiencing during the past years.

Among the good practices adopted during this merger we can identify the professional training of the employees of the social security administration who became familiar with the new collection procedure and the exchange of data after the introduction of the unified form. This training is usually regulated by agreements adopted by both the agencies on a local level¹⁷⁴.

¹⁷⁰ For more details you can visit: <http://www.riscossionespa.it/equitalia/opencms/>.

¹⁷¹ According to the article 3 of the law decree no. 203 dated on 30 September 2005, as amended by the law 248/2-12-2005.

¹⁷² No. 112/25-6-2008 as amended by the law 133/6-8-2008.

¹⁷³ No. 19/15-2-2010 of the INPS.

¹⁷⁴ See Convenzione tra l' Agenzia delle Entrate e l' INPS per la Formazione e l' Aggiornamento Professionale (Prot. N. 8703/2008).

No other changes with regard to the human resources/personnel or administration facilities were reported to take place because of this merger as well as no reactions towards this collection merger.

Finally, the data exchange agreement on December 26th, 2008, between the social security administration and the tax authority was signed some time after the merger of the tax and social security contribution collection for overdue payments in the hands of the collecting agency “Equitalia”; this agreement has duration of three years with the possibility of renewal. Some of the advantages of this agreement in the area of data exchange are the elimination of the duplicate operations, a more efficient administrative organization and the doubling of the control activities with the use of the same human resources in order to minimize the social security contribution and fiscal losses. There are no further steps or plans foreseen in the near future regarding the merger of the social security contribution and tax collection.

Table: Summary of the merged administrative arrangements for social security contribution and tax collection in Italy

Collecting authority	Taxes collected by tax authority and social security contributions by the social security administration
Collecting method	Use of a unique payment form common for both taxes and social security contributions
Applicability of taxation rules	As the parallel collection system is maintained, the taxation rules cannot be applicable to the social security contribution collection
Relationship of social security contributions with taxes	Completely distinguished from one another and there is no interaction between them
Declaration and payments of social security contributions and taxes	Regularly by employers
Records' maintenance	Separate for social security contributions by the social security administration and for taxes by the tax authority
Identification of insured persons for payment purposes	Unique identifying number
Electronic declaration of payments	Yes
Calculation basis for social security contributions	Usually the same for both levies, though some exceptions may apply
Deductibility of social security contributions for corporate income purposes	Yes
Transfer of funds collected	The revenues are kept separated electronically once they are collected
Control and recovery of overdue payments	For taxes by the tax authority and for social security contributions by the social security administration. Only for overdue payments there is one collecting authority
Levels of record keeping	Separate for each of the levies
Data exchange between tax and social security administration	Only for overdue payments, the collecting authority has access to the relevant data
Obstacles during and after the merger	None reported as the merger is at an initial stage
Disadvantages of the merged collection	<ul style="list-style-type: none"> ▪ Extensive exchange of data between the administrations
Benefits of the merger	<ul style="list-style-type: none"> ▪ Effective combat of social security contribution and tax evasion ▪ Simplification of payment procedures and reduction of expenses ▪ Elimination of duplicate operations for overdue payments

3.4 Netherlands

3.4.1 Introduction

The law currently regulating the collection of social security contributions in the Netherlands, is called the “Act on financing social insurance” (Wfsv)¹⁷⁵ dated on 16/12/2004. This law determines:

- the persons liable to pay social security contributions,
- the nature of each contribution,
- the collection process of the contributions by the tax administration, and
- the administration of the funds collected.

In this paper we are going to make further reference to the specific provisions of this law in the respective subsections of the present chapter.

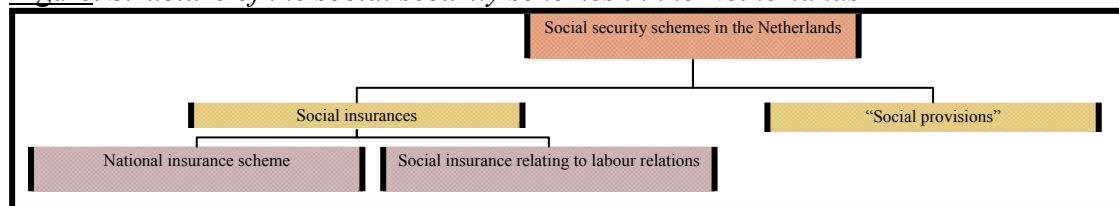
Before we proceed to the analysis of the individual aspects of the merger of the administrations of social security contribution and taxation, let us explain briefly the way the two types of social security schemes are organized in the Netherlands: social insurances and “social provisions”¹⁷⁶.

The social insurances are being mainly financed by the social security contributions whereas the “social provisions” are financed from the central budget¹⁷⁷. More specifically, the social insurance scheme is further divided into:

- a national insurance scheme (old age and survivors pension, child benefits, health care and exceptional medical expenses) which covers all the people residing in the country and is financed by means of contributions, and
- a social insurance scheme related to labour relations (employee benefit schemes, such as unemployment, sickness and disability benefits) which concerns all the employees either they work in the private or market sector or in the public sector and is financed by contributions directly charged to the employers or deducted from the employee’s wages¹⁷⁸.

It is also worth mentioning that there is no specific social security scheme for employment injury and occupational diseases in the Netherlands.

Figure: Structure of the social security schemes in the Netherlands



¹⁷⁵ *Wet financiering sociale verzekeringen.*

¹⁷⁶ “Social provisions” is the term used in the Netherlands for defining the social assistance schemes.

¹⁷⁷ Social assistance schemes covering all the residents for the risks of old age, welfare, health care etc (such as Work and Social Assistance Act (WWB), Act on Income Provisions for Older or Partially Disabled Unemployed Persons (IOAW), Act on Income Provisions for Older or Partially Disabled Formerly Self-employed Persons (IOAZ), Provisions for the Disabled Act (WVG), Work and Artistic Income Act (WWIK), General Child Benefit Act (AKW), Work and Employment Support for Disabled (Wajong), Supplementary Benefits Act (TW)) which are financed by the general budget. See also Pieters, D., *The social security systems of the Member States of the European Union, 2002*, Intersentia, p. 247.

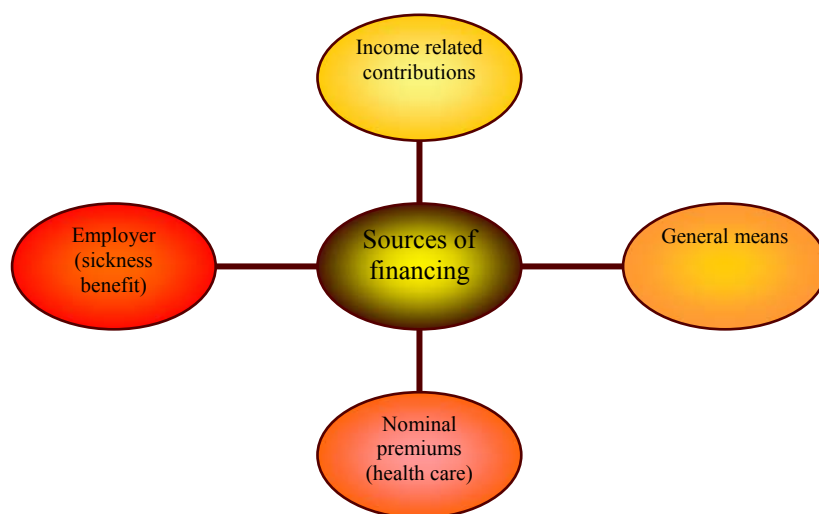
¹⁷⁸ See MISSOC – Info 2/2007: Financing social protection (the Netherlands): http://ec.europa.eu/employment_social/missoc/2007/02/2007_2_nl_en.pdf.

All the above provisions regard the public system of social security while there are also quasi-mandatory, funded occupational pension schemes which provide supplementary benefits related to previous income together with the basic pension; the latter one provides protection against poverty in old age. It has been argued that this combined public-private approach to pension provision is considered to be fairly resistant to all kinds of demographic and financial shocks that can affect the public pension systems elsewhere in Europe as the risk of old age is shared between the state and the social partners¹⁷⁹.

3.4.2 Financing of social security

The social security schemes in the Netherlands are financed by different sources. The first source consists of income-related contributions that need to be paid by the insured persons as well as by the employers. The second source consists of general means and, in the case of the Health Insurance Act (Zvw)¹⁸⁰ there is a third source of financing: the “nominal premiums”¹⁸¹. The employer can also be identified as a fourth source of financing because he or she is to pay to the employee 70% of the earned salary during the first two years of sickness. In the present report we are going to examine only the first source of financing of the social security schemes in the Netherlands, i.e. the social security contributions.

Figure: *Different sources of financing social security schemes in the Netherlands*



The social security contributions in the Netherlands can be regarded as *levies on a taxable income deriving from employment and home ownership* (Box 1 income¹⁸²)

¹⁷⁹ Haverland, M., Another Dutch Miracle? Explaining Dutch and German pension trajectories, JESP, 2001, pp. 308-323.

¹⁸⁰ *Zorgverzekeringswet*.

¹⁸¹ The persons insured under the Health Insurance Act also have to pay a “nominal premium” to their health care social security administration.

¹⁸² In general, there are three types of taxable income identified for income tax purposes which are categorized into three boxes; Box 1: taxable income from employment and home ownership; Box 2: income from a substantial interest; Box 3: income from savings and investment.

and they are distinguished from personal or corporate income taxes. They are collected as a single sum with the salaries tax¹⁸³.

It is worth mentioning here that the social insurance schemes in the Netherlands, either the employee or the national social insurance schemes, are financed from contributions and only some of the social insurance schemes are partially financed by the national government¹⁸⁴. Furthermore, a small part of the social security scheme for exceptional medical expenses (AWBZ) is financed by own contributions¹⁸⁵.

There are two categories of insurance schemes and each of them has the respective subcategories of social security contributions. The following table offers an overview of the existing types of social security contributions and the corresponding social security schemes.

¹⁸³ Ministerie van Sociale Zaken en Werkgelegenheid, A short survey of the Social Security in the Netherlands, overview on January 1st, 2010, p. 5.

¹⁸⁴ For example, there is the BIKK (Bijdragen In de Kosten van de Korting) which was introduced in 2001 and works as a compensation for the old-age pension (AOW), surviving relatives pension (Anw) and exceptional medical expenses (AWBZ) funds, and there are the state contributions (rijksbijdragen) which are only financing the AOW funds being annually determined and sometimes the Ministry of Public Health, Welfare and Sport sets some state contributions for the AWBZ funds, too. The difference between the BIKK and the state contributions (rijksbijdragen) is that the former are calculated through a formula.

¹⁸⁵ *Eigen bijdragen*.

Table: Overview of the existing types of social security contributions and the corresponding social security schemes.

<i>Types of social security contributions</i>	<i>Risks covered</i>	<i>Social security schemes</i>	<i>Persons covered</i>	<i>Payers</i>	<i>Collecting authority</i>
National Insurance Schemes¹⁸⁶					
Old-age pension contributions (AOW)	Old age	General Old Age Pensions Act - <i>Algemene Ouderdomswet</i> (AOW)	All residents between 15-65 years old and people subject to the Dutch tax on wages ¹⁸⁷	All residents between 15-65 years old earning an income or receive income related to work (unemployment or disability benefit)	Tax authority
Survivor's pension contributions (ANW)	Death	General Surviving Relatives Act - <i>Nabestaandenwet</i> (ANW)	All residents over 15 years-old and people subject to the Dutch tax on wages	All residents between 15-65 years old earning an income or receive income related to work (unemployment or disability benefit)	Tax authority
Contributions for the special medical expenses (AWBZ)	Exceptional Medical Expenses	General Act for the Exceptional Medical Expenses - <i>Algemene Wet Bijzondere Ziektekosten</i> (AWBZ)	All residents	All residents between 15-65 years old earning an income or receive income related to work (unemployment or disability benefit)	Tax authority
General means (no contributions)	Child benefits	General Child Benefits Act – <i>Algemene Kinderbijslagwet</i> (AKW)	All residents	All residents (via the general means)	
Health care contributions ¹⁸⁸ for benefits in kind	Sickness and maternity	Health Insurance Act – <i>Zorgverzekeringswet</i> (Zvw)	All residents	All residents between 15-65 years old earning an income or receive income related to work (unemployment or disability benefit) or pension	Tax authority
Employee benefits schemes					
Health care contributions for cash benefits ¹⁸⁹	Sickness and maternity	Sickness Benefits Act – <i>Ziektewet</i> (ZW)	Employees	Employers	Tax authority

¹⁸⁶ See tables of Ministerie van Sociale Zaken en Werkgelegenheid, A short survey of the Social Security in the Netherlands, overview on 1st January 2010, p. 5.

¹⁸⁷ As well as non-residents who work in the Netherlands and consequently pay tax on wages.

¹⁸⁸ The persons insured under the Health Insurance Act also have to pay a “nominal premium” to their health care insurer.

¹⁸⁹ WW *premies*.

Disability contributions: three components: basic, differentiated and uniform contributions ¹⁹⁰	Disability	Work and Income according to Labour Capacity Act – <i>Wet werk en inkomen naar arbeidsvermogen</i> (WIA) ¹⁹¹	Employees	Employers	Tax authority
Unemployment benefit contribution: 2 components ¹⁹²	Unemployment	Unemployment Insurance Act – <i>Werkloosheidswet</i> (WW)	Employees	Employers	Tax authority
Mandatory social insurance schemes					
Old-age pension contributions	Old-age		Voluntary insured persons	Voluntary insured persons	Social security administration ¹⁹³
Survivor's pension contributions	Death		Voluntary insured persons	Voluntary insured persons	Social security administration ¹⁹⁴

¹⁹⁰ The basic contributions finance the Disability Basic Fund which is controlled and administered by the National Social Insurance Contribution, while the differentiated contributions (WGA) finance the Disability Differentiated Fund which is controlled and administered by the Employee Insurance Implementing Body (Uwv) and which was introduced in January 1st, 1998. The third component is the uniform standard contribution.

¹⁹¹ This Act has replaced the Disability Insurance Act (WAO) on 29th December 2005 for persons who were sick after January 1st, 2004.

¹⁹² One is paid to the General Unemployment Fund (*Algemeen werkloosheidsfonds*, Awf) and the other is paid to the social security agency's Redundancy Payment Fund (*Wachtgeldfonds*, Wgf) which is the unemployment benefit fund of the economical sector to which the employer belongs.

¹⁹³ More specifically, the Dutch Social Insurance Bank (SVB).

¹⁹⁴ Ibid.

3.4.3 Collection methods

The role of the Dutch tax authority: The Dutch Tax and Customs Administration - *Belastingdienst*¹⁹⁵ is the collecting authority of social security contributions for the old age pensions¹⁹⁶, the survivors' pensions¹⁹⁷ and the special medical expenses¹⁹⁸ together with the income tax and the tax on wages since 1990; the responsibility for the collection of social security contributions for the employees' insurance schemes is transferred to the tax authority since 2006.

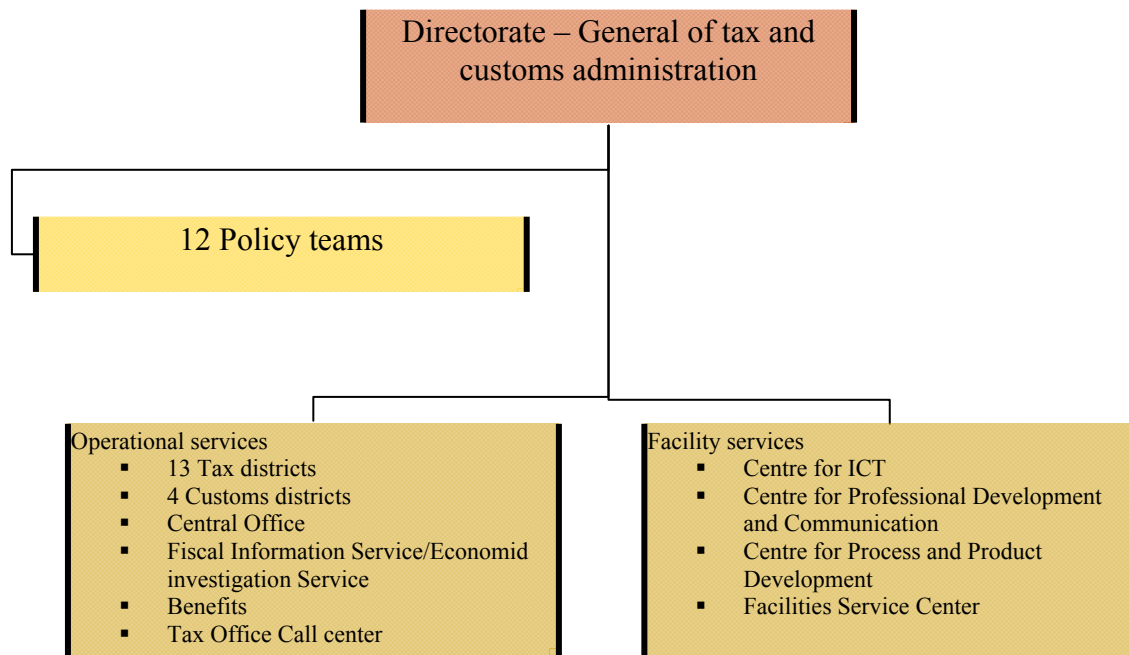
More than 30,000 staff members of the Dutch tax authority are responsible for levying and collecting taxes and social security contributions. According to the data given by the Dutch tax authority, each year this administration processes the tax returns of 6 million private individuals and 1.1 million entrepreneurs¹⁹⁹ as well as pays out provisional refunds and benefits that are available to households towards the costs of childcare, rent or health care.

Schematically, the organization of the tax authority which is part of the Ministry of Finance has the following structure:

Figure: Organizational structure of the Dutch tax administration

(Source: Official website of the Dutch tax authority:

http://www.belastingdienst.nl/organisatie/en/tax/tax-01.html#P5_781)



Since 2009 the tax authority uses a new system for the collection of taxes and social security contributions. This is called Enterprise Tax Management System (ETM) and

¹⁹⁵ Official website of the Dutch tax authority: <http://www.belastingdienst.nl/>. In accordance with article 57 of Wfsv.

¹⁹⁶ AOW.

¹⁹⁷ ANW.

¹⁹⁸ AWBZ.

¹⁹⁹ Source: <http://www.belastingdienst.nl/organisatie/en/tax/>.

it was reported to have led to the dismissal of nearly 600 employees in order to further reduce the operational and administrative costs in the collection process.

Besides the merged social security contribution and tax collection by the tax authority, it is the responsibility of the Social Insurance Bank - *Sociale Verzekeringsbank* (SVB)²⁰⁰ - to collect some of the social security contributions; these are only the social security contributions for the old age pensions and the survivors' pensions for those that are voluntary insured. Usually these concern people who leave the Netherlands for a longer time to work or live abroad and the relevant mandatory contributions correspond to a very small amount in respect to the total contributions paid to the social security schemes in the Netherlands²⁰¹. The Social Insurance Bank - a legal entity established under public law operating with a system of regional offices - has as main task to administer the general insurance scheme for the risks of old age, death and dependent children (child allowances).

When the social security contributions are collected, they cannot be individualized anymore from the taxes. That is because the payment of the taxes and the social security contributions is unified on the pay slip. The amount paid corresponding to the taxes can not be distinguished from the amount paid for the social security contributions.

Application of taxation law rules: Due to the effect of the Act on the financing of social insurance schemes dated on January 2006, the levy and the collection of the social security contributions is made according to the rules of the taxation law. The tax administration usually forwards a provisional assessment²⁰² to the person liable to pay social security contributions; if this person is subject to pay tax on wages, the national insurance contributions are levied in accordance with the regulations that apply to the collection of tax on wages. In case that the person liable to pay social security contribution receives an assessment, the contributions that have been withheld will be deducted in the final assessment²⁰³ which shows that the person concerned will receive a refund or will eventually have to pay an additional amount.

Furthermore, the “*insured person*” is liable to pay contributions for the national insurance schemes²⁰⁴. We can find in each one of the national insurance schemes the definition of the insured persons: these are either residents or persons that are not residents, but are subject to the Dutch Law on Wages on the grounds that they are employed in the Netherlands. The insured persons must be between the age of 15 and 65. There can be exceptions to the above rule when the Government sets other criteria by a general Decree extending or restricting the group of insured persons²⁰⁵.

²⁰⁰ Official website of the Social Insurance Bank: <http://www.svb.nl>.

²⁰¹ For further information see the report Sol-Bronk M., Vleeming H., Premies, rijksbijdragen en BIKK, Sociale Verzekeringsbank, available at: http://www.svb.nl/Images/conferentie2009_09113_financieele_stromingen.pdf.

²⁰² A provisional tax assessment is based on the income earned in the previous year while tax is owed in that year.

²⁰³ International Encyclopedia of Laws, Social Security Law - Suppl. 66 (December 2008), The Netherlands, Pennings, F., p.44.

²⁰⁴ According to article 6 of the Social Insurance Schemes Financing Act (Wfsv).

²⁰⁵ This authority is given to the Government by the law itself taking always in consideration the obligations that derive from international treaties and EU regulations.

In addition, persons who are compulsory insured for the Exceptional Medical Expenses scheme²⁰⁶ are also compulsory insured for health care (ZVW - Health Insurance Act)²⁰⁷.

As far as the employee insurance schemes are concerned, these are regulated by the Unemployment Insurance Act²⁰⁸, the Sickness Benefits Act²⁰⁹ and the Law Relating to Insurance against Incapacity for Work (WAO²¹⁰ and WIA²¹¹) and they are financed by contributions. There is no separate contribution for the Sickness Benefits Act anymore after the introduction of the obligation on behalf of the employers to continue to pay wages in case of sickness. An insured person according to the provisions of the above mentioned laws is an employee who is a natural person, under the age of 65, and is employed in the private or the public sector²¹².

Identification of contributors: The identification of the insured persons that pay the social security contributions is made by a unique personal identification number which is now called *Burgerservicenummer* (BSN)²¹³; this is the successor of the pre-existing social fiscal number²¹⁴ (“SOFI” number) as it was defined in the general taxation law²¹⁵. In case that the BSN is not known, then the formerly valid SOFI number is being used instead. The *Burgerservicenummer* is issued to everyone registered in the Personal Records Database of a municipality²¹⁶. It is required when starting a job, opening a bank account, using the health care system, applying for benefits, buying a car and announcing a change of address.

To sum up, the tax administration collects the contributions the same way as the collection of income tax and tax on wages. This means that if the liable person fails to fulfill his or her obligation, the tax authority is then authorized to take necessary measures.

Calculation basis for social security contributions: The income that is taken into account as a calculation basis for taxes is the same as the one for the calculation of the social security contributions, i.e. the wage or the income of the insured persons. The *concept of wage* in the law on financing social insurance schemes (Wfsv) is *harmonized* with the description of the wage concept in the Tax on Wages Act. This

²⁰⁶ AWBZ.

²⁰⁷ International Encyclopedia of Laws, Social Security Law - Suppl. 66 (December 2008), The Netherlands, Pennings, F., pp.40 et seq.

²⁰⁸ *Werkloosheidswet*.

²⁰⁹ *Ziektewet*.

²¹⁰ *Wet op de Arbeidsongeschiktheidsverzekering*.

²¹¹ *Wet Inkomen naar Arbeidsvermogen*.

²¹² International Encyclopedia of Laws, Social Security Law - Suppl. 66 (December 2008), The Netherlands, Pennings, F., p.45.

²¹³ This is a kind of personal identification number. More information in Dutch at:

http://www.belastingdienst.nl/particulier/bsn_sofinummer/ and <http://www.burgerservicenummer.nl/>. In English: http://www.burgerservicenummer.nl/veelgestelde_vragen/english_faq.

In addition see Zwenne, G-J., Bolle, P.E. and Duthler, A.W., Privacyregulering, belastingheffing en sociale zekerheid, in Berkvens, J.M.A. and Prins, J.E.J., Privacyregulering in theorie en praktijk, Kluwer, 2007.

²¹⁴ *Sociaal-fiscaal nummer*. See art. 33b of the Work and Income Implementation Structure Act (*Wet Structuur Uitvoeringsorganisatie Werk en Inkomen*).

²¹⁵ *Algemene wet inzake rijksbelastingen*. This is provided for in article 1 of the law on the financing of the social insurance schemes (Wfsv).

²¹⁶ *Gemeentelijke Basisadministratie persoonsgegevens* (GBA).

regulation aims at facilitating as much as possible the tasks of employers who have to deduct both contributions and tax on wages and then make the relevant payments to the tax authority.

As for the *contribution rates*, these are annually set by the Minister of the Social Affairs and Employment, the Minister of Public Health, Welfare and Sports or the competent administrative body and they are the same for the whole country with the exception of some schemes where the rates vary according to the risk (unemployment, invalidity) in the branch of industry or the individual enterprise. The Employee Insurance Implementing Body²¹⁷ (UWV) determines the level of the contributions to be paid to the unemployment funds.

The contributions for the employed, which the *employers* pay on the total gross salaries of the employees, including directors (not being majority stakeholders) for the year 2010 are the following:

Table: Calculation rates of the employers' social security contributions (2010)²¹⁸

<i>Type of social security contribution</i>	<i>Rate (%)</i>	<i>Maximum base (EUR)</i>
Income dependable health insurance (ZVW)	7.05	33,189
Disability Insurance (WIA):		
- fixed general contribution	5.70	48,715
- disability insurance surcharge	0.07	48,715
- WGA - work resumption premium	0.59	48,715
Unemployment Insurance (AWF):		
- general contributions of unemployment insurance (AWf)	4.20	32,011
- WW - Average redundancy contribution	1.48	32,011
KO - Child care contribution	0.34	32,011

In general, employers pay their own contributions as well as the employees' contributions deducting them from the wages.

There are also the national social security contributions forming part of the lowest two income tax rates (see the table below on the taxable income in the Netherlands²¹⁹). The social security contributions on employment income are payable by employees; these contributions are calculated on gross salaries, less pension premiums withheld

²¹⁷ *Uitvoeringsinstituut werknemersverzekeringen.*

²¹⁸ For the expected calculation rates for 2011 see Juninota UWV-fondsen 2010-2011: http://www.uwv.nl/Images/Juninota%20financiele%20ontwikkeling%20UWV-fondsen%202010-2011_tcm26-243580.pdf.

²¹⁹ Source European Tax Handbook online: http://ip-online.ibfd.org/collections/gthb/html/gthb_nl_s_001.html#gthb_nl_s_1.9.1.

from the salary and payments to the savings accounts (Box 1 income²²⁰). The rates for the calculation of social security contributions have been integrated with the rates for the calculation of the taxes²²¹.

Table: Taxable income in the Netherlands – 2010 (Box 1)²²²

Source: European Tax Handbook online²²³

Taxable income EUR (Box 1)		Maximum tax EUR	Rate (%)
up to	18,218	6,093	33.45
18,218 -	32,738	12,184	41.95
32,738	54,367	21,268	42
over	54,367		52

The contributions for the employed, which are all levied on the *employee*, are:

Table: Calculation rates of the employees' social security contributions (2010)

Type of social security contribution	Calculation rate (%)
Old-age pension contribution (AOW)	17.90
Survivor's pension contribution (ANW)	1.10
Exceptional Medical Expenses contribution (AWBZ)	12.15

In the Healthcare Insurance Act, the healthcare insurers determine the amount of fixed (nominal) healthcare contribution themselves and the monthly contribution can therefore differ per insurer. No contribution is required for children under the age of 18 years old. In addition to the contribution to the health insurer, an income-related contribution is paid to the government which is automatically withheld from the wages or the benefit granted by the employer or the benefits' agency and it is, also, at great extent reimbursed by them.

²²⁰ Box 1 regards the income from wages and ownership, while Box 2 concerns income from substantial shareholdings and Box 3 income from savings and investment.

²²¹ Williams, D., Legal and Institutional aspects of social security and taxation reforms, in Interactions of social security and tax systems, OECD and ISSA, 1997, p. 40.

²²² The 33.45% (first bracket) and 41.95% (second bracket) rates include, respectively, 2.30% and 10.80% income tax, the remaining 31.15% in both cases being national social security contributions. For individuals older than 64, the first two brackets are taxed at 15.55% and 24.05%, respectively (both rates include 13.25% national social security contributions). The 42% (third bracket) and 52% (fourth bracket) rates do not include any national social security contributions.

The national social security contributions should be distinguished from the employee social security contributions, the former being imposed on all types of income falling under Box 1, the latter being withheld only from salaries.

²²³ European Tax Handbook online, available from:

http://ip-online.ibfd.org/collections/gthb/html/gthb_nl_s_001.html#gthb_nl_s_1.9.1.

For the Exceptional Medical Expenses Act (AWBZ) which is a social security scheme that insures people against the risk of exceptional medical expenses that can not be insured on an individual basis, the contribution is income-related and is withheld from wages or benefits by the employer or the benefits agency respectively.

The general insurance schemes are paid for by the individuals insured under these schemes while the employees pay them via their employers.

Self-employed persons have to pay an income-dependent contribution for health insurance. The health insurance contribution for self-employed (*ZVW-zelfst.*) is levied at a given rate on net business profits up to certain ceiling. The contribution is deductible for income tax purposes only to the extent it exceeds, together with medical expenses, the threshold for the medical expense deduction. The self-employed are liable for the contributions for the disability scheme for the self-employed²²⁴.

Transfer of revenues: The social security contributions and the taxes after being collected by the tax administration, are kept together until the Ministry of Finance transfers directly the respective funds to the social security administrations which are competent for the management of the funds received from contributions.

More specifically, the contributions regarding the General Exceptional Medical Expenses and the health care are transferred to the Health Care Insurance Board (CVZ)²²⁵. Moreover, the contributions for the employee insurance schemes are transferred to the Employee Insurance Implementing Body while the national insurance scheme contributions are transferred to the Social Insurance Bank (SVB)²²⁶. Consequently, the social security contributions - although they cannot be individualized from the taxes at the time they are collected - are reported to be dealt with *separately* after the collection, i.e. regarding the transferring of data and funds. The tax authority does not charge any kind of fee for the collection of the social security contributions²²⁷.

3.4.4 Record-keeping and data exchanges

The employer declares and pays each month to the tax authority the social security contributions which are directly withheld from the salary of the employee. Therefore, the employer has to keep records for each individual employee and make the relevant monthly declaration to the tax administration. The employer also has the responsibility to calculate the exact amount of the contributions that are to be paid. In case of errors, the responsibility belongs to the employer. The above mentioned declaration shall include not only individual data, but also the collective data concerning the total wages within the company which are kept by the tax administration. The individual data are transferred to the insurance policy administration of the Employee Insurance Implementing Body (UWV).

²²⁴ European Tax Handbook online, available from:
<http://ip-online.ibfd.org/kbase/?search=N%3d3339+3>.

²²⁵ *College voor Zorgverzekeringen*.

²²⁶ International Encyclopedia of Laws, Social Security Law - Suppl. 66 (December 2008), The Netherlands, Pennings, F., p.44.

²²⁷ According to the answers to the questionnaire provided by the national experts.

The tax administration and the social security authorities interchange freely the data concerning the social security contribution payment including also information required for the determination of the right to benefits of the social insurance schemes, such as the duration and type of employment, paid wages and employee social security contributions.

This data exchange is covered by the Work and Income Implementation Structure Act²²⁸ according to which the competent social security administration must ensure the establishment and the proper functioning of the administration. There are two kinds of information included in the central data bank of the social security administration (UWV): on the one hand, information about the insured person's social security (such as data about the insured person, his employer, type of employment) and, on the other hand, data from a virtual database known as "Fi-base" (such as information on taxable income, contributions for general insurance schemes and social tax number)²²⁹.

All these data are coming from the tax declarations on tax returns by the employers via the tax administration, in the insurance file administration system²³⁰. The tax administration then delivers the data to the social security administration²³¹ to register the data in the insurance file administration system which then in turn uses the information to establish the entitlement to benefits - such as unemployment, sickness and incapacity to work. There are also other institutions that can use the aforementioned data, for example the tax administration, the National Health Services and the statistics agency²³².

It is reported that there is the appropriate data protection with regard to this process as only the competent persons within these authorities are eligible to have access and process the aforementioned data.

3.4.5 Control and recovery of overdue payments

The Inspection Service for Work and Income²³³ provides general supervision of contributions and cash benefits regarding the old age, disability and survivors and supervision of the cash benefits for sickness, maternity, unemployment, and family allowances²³⁴. Other important work processes include fraud detection and the supervision of the import, export and transit of goods.

In addition to the aforementioned agency, there is a special division of the Ministry of Social Affairs and Employment which is performing control on social security contribution fraud, the so-called Social Intelligence and Investigation Service

²²⁸ *Wet Structuur Uitvoeringsorganisatie Werk en Inkomen*. Available at:

<http://www.st-ab.nl/wetsuwi.htm>.

²²⁹ See article 33 of the Work and Income Implementation Structure Act (*Wet Structuur Uitvoeringsorganisatie Werk en Inkomen*).

²³⁰ *Polisadministratie*: This is a summary of data of several public institutions, not just fiscal data.

²³¹ The Employee Insurance Implementing Body (UWV).

²³² See article section 5.2 of the Work and Income Implementation Structure Act (*Wet Structuur Uitvoeringsorganisatie Werk en Inkomen*).

²³³ *Inspectie Werk en Inkomen*, website: <http://www.iwiweb.nl>.

²³⁴ For further information see the report of the Social Security Programs Throughout the World on the Netherlands: <http://www.ssa.gov/policy/docs/progdesc/ssptw/2008-2009/europe/netherlands.pdf>.

(SIOD²³⁵); this administrative body together with the tax authority and the Social Insurance Bank (SVB) has the competency to declare a person liable for not paying his/her contributions for the AOW; this finding may result in the reduction of his/her pension by 2% for each year that the person is found to be liable.

3.4.6 *The merger process*

In the Netherlands, the collection of the social security contributions has been merged with the collection of the taxes in the 1990s. As for the employee insurance contributions, their collection has been simplified first in the 1990s by unifying multiple industry-based insurance agencies, and then in the 2000s by merging the collection of employee insurance contributions and taxes.

By the early 1990s there were 19 Industrial Insurance Associations, 13 of which were yielding their administrative competencies to a joint body called the Joint Administration Office (GAK) while another 3 were assigning their authorities to a joint body called the Joint Implementation Office (GUO). Consequently, at that time there were five main agencies which were administering the employee insurance schemes.

In 1995, aiming to change the management of social security and move it from the industrial self-organization to politics, the government created a Social Security Supervisory Board (called CTSV) consisting of three independent government - appointed members having no ties to employers or trade union interests. In 1997 an additional tripartite supervisory body, the National Social Insurance Institute (LISV), was created and the Industrial Insurance Associations were abolished, although at the administrative level they mainly continued with a formal status as social insurance implementation bodies (called UVIs) working under contract to the National Social Insurance Institute (LISV). This institute was responsible for the assessment of the right to benefits, the collection of the social security contributions and the payment of the unemployment and disability benefits.

Between 2000 and 2002 the five social insurance implementation bodies and the National Social Insurance Institute were merged into a single Employee Insurance Implementing Body (UWV), responsible for the collection of employee insurance contributions; this administration had also some other competencies, such as assessing the right to benefits and paying the unemployment and disability benefits.

The Social Insurance Bank (SVB) administered the public pension benefits, child benefits and benefits for surviving relatives. The Ministry of Social Affairs and Employment exercised supervision through its Work and Income Inspectorate²³⁶. Finally, the social partners, traditionally involved closely with the administration of the social security, were kept at a greater distance²³⁷.

²³⁵ *Sociale Inlichtingen en Opsporingsdienst*. Website: <http://www.siod.nl/content/view/22/42/>.

²³⁶ This supervision used to be conducted by the Social Insurance Supervision Board (CTSV).

²³⁷ De Gier, E., de Swaan, A., Ooijens, M., Dutch welfare reform in an expanding Europe, 2004, Het Spinhuis Publisher, p. 24.

More specifically, the old age pension contributions (AOW) were not initially merged in the tax system. It was after the introduction of the Oort-legislation²³⁸ that the social security contribution system has been merged fully with the tax collection system, but the benefits were kept separated from the system altogether. In 1989 the Oort Committee has drafted a report about the changes that should have been implemented in the tax collection system in order to simplify the wage and income taxes. Indeed, in January 1st, 1990 the proposals of the above mentioned committee have been consolidated in the so-called Oort-legislation - *Oort-wetgeving*.

Some of the regulations adopted concerned provisions regarding the merged collection of income taxes and social security contributions. Due to this merged collection system, the compulsory income ceiling of social security contributions was lowered and, consequently, the calculation basis for the social security contributions has also decreased. In order to face this deficit problem, the old-age (AOW) and survivors' pension (AWW) contribution percentage has increased, and there has been a change in the calculation basis of the exceptional medical expenses (AWBZ) contributions which were formerly calculated on the basis of the old-age and survivors' pension contributions. Today the exceptional medical expenses (AWBZ) contributions are being calculated on the basis of the income; they are also paid directly by the insured person and not by the employer. However, the circle of persons liable to pay the exceptional medical expenses (AWBZ) contributions is still defined in the Healthcare Insurance Act (ZVW) and not in the Act on the financing of the social insurances (Wfsv)²³⁹.

Furthermore, the tax reform of 2001 aimed at broadening the contribution calculation basis, lowering the tax pressure on work, promoting the employment, the emancipation and economic independency, the sustainable economic development and, finally, simplifying the tax system. The box system - *heffingskortingen* - in the taxation was introduced and the tax free amounts have been replaced by the tax credits. As a result, the tax benefits to the old-age (AOW), surviving relatives (Anw) and exceptional medical expenses (AWBZ) funds have been lowered and in order to compensate these funds, the government introduced the state contribution called the *Bikk*²⁴⁰.

Driven by a continuing government wish to reduce the administrative burden on employers and simplify the operation of social insurance schemes, preparations for the integration of the collection of employee insurance contributions and taxes began in 2004. The process has been completed on January 1st, 2006.

Before the aforementioned date there was a differentiated collection method in force with regard to the social security contributions for the employee insurance schemes. The Employee Insurance Implementing Body - UWV²⁴¹ - was responsible for the levying and collecting the employee social security contributions whereas the tax

²³⁸ In 1989 the systems of income tax and social insurance contributions were reformed. The most important element of the said reform was the merging of tax and social security contributions into the taxation scheme.

²³⁹ Noordam, F.M., Klosse, S., *Socialezekerheidsrecht*, Kluwer, 2008, p. 476.

²⁴⁰ *Bijdrage In de Kosten van de Kortingen*.

²⁴¹ Official website of the Employee Insurance Implementing Body – UWV:
<http://www.uwv.nl/overuwv/over-UWV/wie-en-wat-is-UWV/profiel/index.aspx>.

administration was responsible in the area of the rest of the social security contributions. However, after January 1st, 2006, the employers have no longer been required to file separate returns for social insurance contributions and taxes because the tax authority is now competent for the collection of all the social security contributions, including those for the financing of the employee insurance schemes²⁴². Moreover, the department of the tax authority responsible for the collection of the social security contributions became part of the tax administration located in the premises of the latter. In addition, about 800 persons of the staff of the social security administration UWV responsible for the task of the contribution collection have been transferred to the tax authority²⁴³.

One of the main objectives of the Oort Committee was the simplification of the legislation regarding the collection procedure of taxes and social security contributions. Before the Oort-legislation - that is until 1990 - the calculation base for taxes and social security contributions was different. As a result, there were many difficulties in the calculation and collection of the social security contributions especially for the employers and the tax administration as well. After the Oort-legislation was adopted, the calculation basis has become the same for both the social security contributions and the taxes. Moreover, the exceptional medical expenses (AWBZ) contribution calculation base is no longer the old-age (AOW) and survivors' pension (AWW) contributions, but the income of the insured person. Consequently, the basic reason for the merger of the social security contribution and tax collection with the above mentioned regulations was the demand for cost efficiency for both the benefit administration and the individual employers.

Obstacles encountered during and after the merger: From a general point of view, the transition to the merged collection of social security contributions and taxes has been welcomed positively. However, there have been some objections with regard to the wage concept for the payroll tax. More specifically, it was argued that the wage concept of payroll tax ignores the special function of the wage concept in the employee insurance schemes, namely the basis for the calculation of the social security benefits.

Another serious concern was that the performance practices of the tax administration did not take into consideration the special nature and purpose of the social security contributions; namely, the tax authority had to take into account that the employee insurance does not only contain a collecting element, but there is also a distributing element involved.

Consequences of the merged collection system: According to the IMF, the most difficult implementation issue of the merger in the Netherlands was the transfer of the employer's share of social security contributions to the employee's share with a compensating increase in wages. This transfer was designed in order to establish one base for the new combined levy and equal circumstances between employed and self-employed persons. The idea of having a one-time transfer with compensation on a certain date was rejected as it might have increased social security burden on employees in the future. Therefore, there has been a compromise with a temporary

²⁴² See "The Unification of the Social Insurance Contribution Collection System in Korea", OECD Social Employment and Migration Working Papers No.55, 2007, pp. 51-52.

²⁴³ Ibid. pp. 51-52.

solution, according to which the transition period for the transfer and the compensation would be based on the current contribution rate for the year in question²⁴⁴.

Moreover, the merger has led to massive processes, large flows of information, transfer of data and the transfer of a large number of staff from the social security administration²⁴⁵ to the tax authority which has made the operation vulnerable in many senses. In addition, there have been failures in the insurance file administration, such as lack of data or incorrect data.

According to the Report of the Dutch Court of Audit - *Rekenkamer*²⁴⁶ - regarding the risks of the merger of tax and social security contributions collection in 2006, it has been recognized that transferring the collection of employee insurance contributions from the social security administration (UWV) to the tax authority was going to entail few risks. This was justified on the grounds that there would have been no fundamental change in the system. Therefore, it was proposed that some conditions should have been met so that the transfer would be smooth. More specifically, the measures should have been taken before 2006 in order to ensure the reliability of the social security administration of the UWV; furthermore, the Ministry of Finance should have further worked out the audit policy and agreements should have been made on performance indicators and the exchange of information between the bodies concerned and the House of Representatives. The Court of Audit has carried out this investigation at the request of the House of Representatives²⁴⁷; however, we do not have information to what extent these recommendations have been taken into consideration and have been implemented or not.

Overall, the merger of social security contribution and tax collection resulted in a simplification of levying and collecting social security contributions, a reduction of the administrative burdens on employers, a reduction of the implementation cost for the government, a higher level of efficiency in the collection process, the harmonization to a certain extent of rules and the decrease of the contradictory decisions within the public administration.

²⁴⁴ IMF Working Paper, The Pay-As-You-Earn Tax on Wages - Options for Developing Countries and Countries in Transition, 1994, p. 12.

²⁴⁵ The Employee Insurance Implementing Body (UWV).

²⁴⁶ "Collection of employee insurance contributions" published on May 26th, 2005.

²⁴⁷ See:

http://www.courtofaudit.com/english/News/Audits/Introductions/2005/05/Collection_of_employee_insurance_contributions.

Table: Summary of the merged administrative arrangements for social security contribution and tax collection in the Netherlands

Collecting authority	The Dutch Tax and Customs Administration. Collection of voluntary social security contributions by the Social Insurance Bank
Collecting method	Social security contributions are collected as a single sum with the wage tax
Applicability of taxation rules	Yes
Relationship of social security contributions with taxes	Social security contributions are distinguished from personal or corporate income taxes
Declaration and payments of social security contributions and taxes	Performed by insured persons and their employers as well as self-employed persons
Records' maintenance	By the employer for each individual employee
Identification of insured persons for payment purposes	Via a personal identification number which is now called " <i>Burgerservicenummer</i> " (BSN), the successor of the pre-existing social fiscal number (" <i>SOFI</i> " number)
Electronic declaration of payments	Use of e-forms (not applicable for people living in the Netherlands part of the year)
Calculation basis for social security contributions	Taxable income deriving from employment and ownership
Deductibility of contributions for corporate income purposes	Not reported
Transfer of funds collected	<ul style="list-style-type: none"> ▪ Transfer of Exceptional Medical Expenses and health care contributions to the fund of the Health Insurance Board ▪ Transfer of employee insurance scheme contributions to the Employee Insurance Implementing Body ▪ Transfer of the national insurance scheme contributions to the Social Insurance Bank
Control and recovery of overdue payments	<ul style="list-style-type: none"> ▪ General supervision of contributions by the Inspection Service for Work and Income ▪ Special supervision on social security fraud by the Social Intelligence and Investigation Service
Levels of record keeping	<ul style="list-style-type: none"> ▪ Records kept by the employer for each individual employee ▪ Records maintained by the tax authority ▪ Records kept by the competent social security administrations
Data exchange between tax and social security administration	Free data exchange of social security contribution payment and information on the right to benefits, the duration and type of employment and paid wages
Obstacles during and after the merger	Performance practices of the tax administration did not take into consideration the nature and purpose of the social security contributions
Disadvantages of the merged collection	<ul style="list-style-type: none"> ▪ Vulnerability of the operation system due to the massive processes, the large flows of information, the transfer of data and the transfer of personnel ▪ Data failures in the insurance file administration
Benefits of the merger	<ul style="list-style-type: none"> ▪ Simplification of levying and collecting social security contributions ▪ Reduction of administrative burdens on employers ▪ Reduction of implementation costs for the government ▪ Higher level of efficiency in the collection process ▪ Harmonization of rules ▪ Decrease of contradictory decisions within the administrative bodies

3.5 *The United Kingdom*

3.5.1 *Introduction*

The United Kingdom is a country that shows a long standing record in the field of merging social security contribution and taxation administration. Therefore, it is interesting to present the most significant changes that have been implemented in the social security contribution collection system in this particular country. Moreover, we are going to focus on the lessons learned from this merger of social security contribution and tax collection in order to give an overview of the best practices adopted and the possible problems encountered during this merger.

3.5.2 *Financing of social security*

In the United Kingdom a universal contributory social security system was introduced in 1948 on the basis of a plan put forward in the 1942 Beveridge report with flat-rate benefits and contributions. In due course, though, the contributions became based on a percentage of earnings instead of being flat-rate and the basic principle of Pay-As-You-Go financing remained. The social security contributions became largely earnings related in 1975. An Order is presented to the Parliament proposing the social security contribution rates for the next fiscal year and the earnings ranges to which the rates will apply²⁴⁸.

According to the report of the EU's Mutual Information System on Social Protection (MISSOC) on the financing of social protection²⁴⁹, the United Kingdom has a comprehensive state administered cash benefit scheme which covers the entire population²⁵⁰. A compulsory contributory scheme is complemented by a range of non-contributory measures²⁵¹ which are financed from general taxation - from the so-called Consolidated Fund administered by Her Majesty's Revenue & Customs (HMRC). The compulsory social security scheme - the so-called National Insurance scheme - provides protection against sickness, unemployment, widowhood and old age; the benefits for these schemes are funded entirely from the National Insurance Fund²⁵².

The financing of contributory benefits is made through the National Insurance Contributions (NICs); these are administered by the National Insurance Contributions Office (NICO) - a department of Her Majesty's Revenue & Customs (HMRC) - on behalf of the Department for Work & Pensions (DWP)²⁵³. NICO collects a very small proportion of the NICs - Class 2 social security contributions and Class 3 voluntary

²⁴⁸ For further details over the financing of the social security pension in the UK, see the ISSA report of Daykin, C., Financing of pension schemes, Experience of the United Kingdom, 2008, p. 1.

²⁴⁹ This report is available from:

http://ec.europa.eu/employment_social/missoc/2007/02/2007_2_uk_en.pdf.

²⁵⁰ Although there are separate social security systems for Great Britain and Northern Ireland, both systems are generally described to provide a single system of social security in the United Kingdom.

²⁵¹ For example benefits for disability and industrial injury or disease, and universal child benefits.

²⁵² Besides the social security contributions, the National Insurance Fund is financed by investment income. The National Insurance Fund has no borrowing powers according to the MISSOC report.

²⁵³ This is the Government department responsible for providing contributory benefits. Official website: <http://www.dwp.gov.uk/>. In Northern Ireland the competent authority is called Department for Social Development.

social security contributions- and administers certain National Insurance credits²⁵⁴. The bulk of the NICs are collected through the banking system by the tax administration (HMRC). Insured persons pay a single (or global) contribution covering all the contributory benefits²⁵⁵ credited into the National Insurance Fund. Since 1948, a proportion of the social security contributions have been allocated to the health care scheme - the so-called National Health Service (NHS)²⁵⁶- and this was increased in 2003.

The costs of the social security benefits are currently borne by six different classes of social security contributions levied on the insured persons and the employers:

- Class 1 paid by employees.
- Class 1A paid by employers who provide certain directors and employees with benefits in kind.
- Class 1B paid by employers who enter into a Pay-As-You-Earn Settlement Agreement with the tax administration for tax purposes.
- Class 2 (compulsory) paid by self-employed persons.
- Class 3 (mandatory) that give entitlement to bereavement benefits and retirement pensions; and
- Class 4 paid by self-employed persons when their profits exceed a prescribed limit²⁵⁷.

Only three of the above six types of social security contributions count towards benefit entitlement. Moreover, the type paid depends on whether a person is an employee, self-employed or paying contributions voluntarily to make up gaps in their contribution records.

The persons involved in the collection of taxes and social security contributions are:

- Employers who calculate and collect the amounts to be paid by deducting them from the employees' wages;
- The Government which has a responsibility for the overall public finances; and
- Individuals - employees, self-employed and pensioners - who are the end users of the collection system, paying taxes and social security contributions and drawing support from contributory benefits²⁵⁸.

²⁵⁴ National Insurance (NI) credits are awarded to persons who are ill or unemployed and registered as looking for work. This is done in order to help protect the entitlement of these persons to certain benefits, such as the State Pension (the State Pension in the UK has two parts – the Basic Pension and the Additional Pension).

²⁵⁵ Except for the unemployment benefit in case of self-employed persons.

²⁵⁶ The National Health Service is mostly financed by the general budget.

²⁵⁷ For more information see the MISSOC report Info 2/2007: Financing social protection, and Wikeley, Ogus & Barendt's, *The law of social security*, Butterworths, LexisNexis™, 5th edition, 2002, pp. 96 et seq.

3.5.3 Collection methods

Role of the National Insurance Contributions Office (NICO): The NICO department is responsible for the collection of certain types of social security contributions²⁵⁹ and the administration of the rest²⁶⁰ as part of the tax authority's wider Personal Tax Team²⁶¹. NICO also deals with refunds, underpayments and resolves queries with national insurance (NI) records arising from validation checks. This administrative authority works closely with the Local Services, Large Business Office, Share Pensions Saving Schemes Office and all the National Business Streams of the tax authority and maintains strong links with the social security administration in delivering services and looking after shared customers. The collecting department (NICO) is also supplying information to other Government Agencies for benefit claims and other purposes by using the National Insurance Recording System (NIRS2)²⁶².

The statistics of this collecting administration are quite impressive as this administrative authority on an annual basis:

- maintains over 70 million social security accounts and updates 40 million of them,
- registers 1.4 million social security contributors,
- registers 700,000 self-employed persons,
- processes over 55 million end of year returns,
- deals with 14.1 million items of work by post,
- maintains 5.7 million Personal Pension accounts,
- accounts for £98 billion social security contributions, and
- handles approximately 4 million telephone calls²⁶³.

Since 1999 the responsibility for the social security contribution management and operations was transferred to the tax authority which has now a total responsibility for social security contributions including records maintenance. The social security administration retained only the task of calculating the entitlement rights and paying the benefits. Therefore, the merger of the social security contribution collection in the United Kingdom was completed in 1999 when the so-called "Contributions Agency"

²⁵⁸ Review of income tax and national insurance alignment: an evidence based assessment, HM Treasury, October 2007, p. 9.

²⁵⁹ Class 2 and Class 3 social security contributions.

²⁶⁰ Which are collected by the tax authority (HMRC).

²⁶¹ For more information visit the official website of the National Insurance Contributions Agency of the HMRC: <http://www.hmrc.gov.uk/nic/aboutus.htm>.

²⁶² National Insurance Contributions for all UK residents and some non-residents are recorded using the NIRS2 computer software package. For further information on this recording system, see below paragraph 3.5.4 on the record keeping and data-exchanges.

²⁶³ According to the presentation of Mr. Ian McDonald, Director of the UK National Insurance Contributions Office (NICO) on the Operational Context and Challenges of the National Insurance Administration in the UK, International Seminar on Priority Challenges in Pension Administration, jointly organized by MHLW/ISSA/PIE, January 20-22, 2010, Tokyo (Japan).

moved from the social security administration into the tax authority²⁶⁴. In addition, with the Tax Credits Act 2002, the responsibility for the payment of child benefit and guardian's allowance was transferred to the tax authority as well.

The merger of social security and tax collection was a recommendation of the Taylor report²⁶⁵ which evaluated proposals to improve work incentives, cut red tape and encourage job creation. One of his recommendations was the move of the "Contributions Agency" to the tax authority, transferring the related national insurance contribution policy functions and contribution collection responsibility²⁶⁶.

The main objective of the merger was to reduce the administrative burden on business resulting from interfacing with both the tax authority and social security administration concerning income tax and social security contributions, whilst preserving the significant differences between both systems. Such burdens have been identified at two different stages:

- activity during the year, including calculation, assessment, error correction, recording, etc, and
- activity at the end of the year, including reporting/submitting information on cash and non-cash earnings and tax and social security contribution deductions²⁶⁷.

The audit inspection as a duplication of effort was reported as a driver for the merger as well.

Calculation basis of social security contributions: The taxes and social security contributions can be calculated either manually or through automated payroll processes. Usually the employers use payroll software, calculators on the HMRC CD-ROM²⁶⁸ or outsource their payroll activity. After the calculation of the social security contributions, the employer deducts and pays them to the tax authority either monthly or quarterly together with the employer's share of social security contributions and the Pay-As-You-Earn income tax. Each year an employer has to file a statutory annual return by 19 May²⁶⁹ comprising a summary return and individual returns regarding each employee. In any case a system of Pay-As-You-Earn tax codes and tables and a system of social security tables is very important²⁷⁰.

²⁶⁴ See Social Security Contributions (Transfer of Functions etc) Act 1999.

²⁶⁵ See Taylor, M., Work Incentives: A report by Martin Taylor, The Modernization of Britain's Tax and Benefit System No. 2, HM Treasury, 1998.

²⁶⁶ Review of income tax and national insurance alignment: an evidence based assessment, HM Treasury, October 2007, p. 10.

²⁶⁷ Ibid. p. 13.

²⁶⁸ This is the so-called "employers' CD-ROM" which is provided by the tax authority to the employers and contains guidance, tables and calculators for the calculation of taxes and social security contributions.

²⁶⁹ This statutory annual return is known as the Employer End of Year Return or Employers Scheme.

²⁷⁰ More details on the calculating process of taxes and social security contributions can be obtained in the Review of income tax and national insurance alignment: an evidence based assessment, HM Treasury, October 2007, pp. 14 et seq.

The following table gives a brief overview of the rates of social security contributions imposed on the weekly earnings of employees²⁷¹:

Weekly earnings	% of earnings
Employees' social security contributions (2010-2011)	
Below £97	Nil
Between £97 and £110	Nil contribution deduction, but the earnings count for contributory benefit purposes
£110 to £844	11% of £110 to £844 ²⁷²
Over £844 (Upper Earnings Limit)	1% of all earnings over £844
Employers' social security contributions (2010-2011)	
Below £110	Nil
£110 to £844	12.8%
Over £844	12.8%

As far as the calculation basis is concerned, "earnings" for social security contribution purposes is defined as "any remuneration or profit derived from an employment. This covers some benefits in kind and expense allowances as well as certain statutory payments, sickness payments, payments for restrictive covenants and gains arising from shares and share options schemes"²⁷³.

The self-employed pay the social security contributions at a fixed flat rate every week. These are the Class 2 social security contributions and they are collected by the collecting authority (NICO) which is a department of the tax authority. The payment can be made either by monthly direct debit from a bank account or the individual will be billed every 13 weeks. The same process is applied for voluntary contributions (Class 3) which are paid by persons that are not liable to pay any compulsory contributions, but they need to fill in the gaps in their social security records in order to improve the amount of basic State Pension. The payment of these social security contributions can also be made for the full year by cheque directly to the collecting authority.

3.5.4 Record-keeping and data exchanges

Identification of contributors: The identification of the contributors is made through a unique personal reference number which is called National Insurance Number (NINO) -hereinafter referred to as social security number. When a child is born and a child benefit claim is made, then a Child reference number is allocated to the newborn child. After the child reaches the age of 15 years 9 months this Child reference number is reclassified as a National Insurance Number and a plastic card is sent to the child by the tax authority. As for persons who were not born in the United Kingdom, such as migrant workers or students coming to the UK, another process is provided:

²⁷¹ For more information you can visit the HMRC official website on a detailed overview of the current social security contribution rates: <http://www.hmrc.gov.uk/rates/nic.htm>.

²⁷² If the employee participates in i) an employer-sponsored pension scheme or ii) a personal pension plan, which contract the employee out of the State Earnings Related Pension Scheme (SERPS), the 11% rate is replaced by a rate of 9.4%.

²⁷³ See Adam, S. and Loutzenhiser, G, Integrating Income Tax and National Insurance: An Interim Report, Institute For Fiscal Studies, WP21/07.

the allocation of the social security number is made upon application to the social security administration (DWP), but the tax authority is also involved in this process.

This social security number makes sure that the payments of social security contributions and taxes are properly recorded on the personal accounts. Moreover, this number acts as a reference number for the whole social security system because the entitlement to state benefits depends on the social security contribution records. This social security number can be used by the tax authority (HMRC), the employer, the social security administration (Department for Work & Pensions), the local council (for Housing Benefits) and the Student Loan Company (for student loans)²⁷⁴.

The National Insurance Recording System was subject to several changes through the years until it reached its final merged form today. From 1948 until 1975 there were paper based records for each individual. Later on - in 1975 - the records have been computerized at the same time as the merger of the collection of social security contributions with taxes. However, this was made on a separate IT system to tax records. In 1997, the original National Insurance Recording System (NIRS) was replaced with the NIRS2 as the first one was aging and did not support future business and legislative changes.

Finally, in June 2009 the National Insurance and Pay-As-You-Earn (PAYE) Service (NPS) introduced one single IT system which contained individual National Insurance records - hereinafter referred to as social security records²⁷⁵ - together with tax records. Moving from paper to automation was a challenge as social security contributions paid are matched with the correct individual social security record and this way the appropriate level of compliance and controls could be ensured.

Individuals' payments through national insurance contributions are underpinned by the "contributory principle"²⁷⁶: that individuals contribute to the scheme while in work and receive financial support while out of work, whether through illness or unemployment or in retirement²⁷⁷. A business usually operates either a weekly or monthly payroll which calculates and withholds the tax and social security contributions. Both levies deducted from the employees' wages are paid to the tax authority each month; for smaller businesses, the payment of tax and social security contributions can be made quarterly. At the end of the tax year, the employer has to make a statutory annual return²⁷⁸ to the tax authority setting out payments to employees and deductions made from the payments. This return includes a summary

²⁷⁴ For more information you can visit the website of the HMRC: <http://www.hmrc.gov.uk/ni/intro/basics.htm>.

²⁷⁵ We do this for the purposes of our report as explained in the first part of this paper in order to facilitate the reader in better understanding the situation uniformly in all the countries examined.

²⁷⁶ For more information on the role of the "contributory principle", see Dilnot, A.W., Kay, J.A. and Morris, C.N., *The reform of Social Security*, Oxford University Press, 1984, Creedy, J. and Disney, R., *Social Insurance in Transition: An Economic Analysis*, Oxford University Press, 1985, Bennett, F., *Social Insurance – Reform or Abolition?* Commission on Social Justice, IPPR, 1993, House of Commons Social Security Committee, *The Contributory Principle*, Fifth Report, 1999-00, London, HMSO, 2000, and Hills, J., *Inclusion or Insurance? National Insurance and the future of the contributory principle*, Centre for Analysis of Social Exclusion Paper 68, 2003.

²⁷⁷ Review of income tax and national insurance alignment: an evidence based assessment, HM Treasury, October 2007, p. 7.

²⁷⁸ This is known as Employer End of Year Return or Employers Scheme.

return as well as individual returns which contain details of employee's pay and social security contributions paid. These individual returns are posted to the individual social security record. At the same time, the employer has to provide the same information to each employee.

For individuals, these payments need to be recorded over their whole working life as they provide access to contributory benefits. Entitlement to these benefits, for the individual and their dependants and/or spouse, is determined by the number of qualifying years that an individual has built up through the payment of contributions during their working life. All payments of social insurance contributions are entered for each individual on their social security record or account and the social security administration uses this to determine the amount of benefit that is payable to each individual who makes a claim. The National Insurance Contributions Office (NICO) - hereinafter referred to as the collecting department- maintains two sets of records concerning the social security contributions collected:

- the National Insurance accounts, and
- the individual National Insurance accounts.

3.5.5 Control and recovery of overdue payments

The control and recovery of overdue payments is made by the tax authority. There are four different stages of control in the British collection system.

- At a *first* stage, with the electronic processing, the new recording system²⁷⁹ performs automatic checks on the annual statutory returns and rejects information for a variety of reasons²⁸⁰. When the social security contributions fail these automatic checks, they are returned to the employer for correction electronically without the need for human intervention, before being posted onto an individual's record.
- At a *second* stage, there is a control when the individual NI returns are linked to the NI record.
- At a *third* stage, the recording system sends automatically letters known as "Deficiency Notes" informing the persons that a specific tax year is not a qualifying year for basic State Pension purposes.
- At a *fourth* and final stage, there is a ratio check designed to identify when the social security contribution information is not within the ratios expected and a compatibility check which identifies when the social security contribution information appear wrong when compared to designatory data on the individual's record²⁸¹.

²⁷⁹ This is called National Insurance and Pay-As-You-Earn System (NPS).

²⁸⁰ These tests of the recording system consist of feasibility tests, minimum and maximum total contributions (MTC) tests and earnings tests.

²⁸¹ See paper from the presentation of Mr. Ian McDonald, Director of the UK National Insurance Contributions Office (NICO) on the Operational Context and Challenges of the National Insurance Administration in the UK, International Seminar on Priority Challenges in Pension Administration, jointly organized by MHLW/ISSA/PIE, January 20-22, 2010, Tokyo (Japan). Available from: <http://cis.ier.hit-u.ac.jp/Japanese/society/conference1001/mcdonald-paper.pdf>.

In general, the compliance processes and compliance teams for taxes and social security contributions have been merged; the consolidated teams pay consolidated visits to the businesses concerned in order to perform controls and recover overdue payments. This way a more efficient compliance system was created requiring less expenses and occupying less offices.

3.5.6 *The merger process*

Before 1999, a number of reforms have contributed to the unity of administration of social security contributions and taxes. In the beginning there were three independent insurance schemes (i.e. unemployment, health and widow's, orphans' and old-age pensions) and each insured person had to maintain two different insurance records. Since 1946 the three schemes were replaced by a single National Insurance System and an independent industrial injuries scheme has also been added²⁸².

From 1948 until 1975 the Department of Work & Pensions (DWP) - hereinafter referred to as social security administration - was responsible for the collection of the National Insurance Contributions (NICs) - hereinafter referred to as social insurance contributions - and the management of the social security contribution operations. In 1973-1975 the legislation simplified the administration by combining the social security contribution process with that of the income tax assessment²⁸³. Since 1975 the social security contributions were collected with taxes for employees on the same form²⁸⁴ by the Inland Revenue (now Her Majesty's Revenue & Customs (HMRC) - hereinafter referred to as tax authority - and they were both reported on a single document. This was a single form - the so-called "end of the year return"²⁸⁵ - which was common for taxes and social security contributions. The data from this form were introduced in the recording system of the tax authority and then broadcasted to the tax system and the social security system. The social security contributions management and operations responsibility stayed with the social security administration. As a result, the collection of social security contributions and taxes was merged without their operational management to be integrated. The revenues from the social security contributions were earmarked for the National Insurance Fund out of which payments for the contributory benefits were made²⁸⁶.

In 1990 a separate social security contributions agency - the so-called "Contributions Agency" - was set up within the social security administration in order to focus on the social security contributions. Contribution records have been maintained in Newcastle since 1948; individual contribution records started to be maintained by the "Contributions Agency" at Longbenton in Newcastle²⁸⁷. Late 1995's the "Contri-

²⁸² See Wikeley, Ogus & Barendt's, *The law of social security*, Butterworths, LexisNexis™, 5th edition, 2002, p. 93.

²⁸³ Ibid.

²⁸⁴ This form was submitted by the employers at the end of the year.

²⁸⁵ These are the reports of earnings, tax and social security contributions, student loans, statutory payments and contracting out scheme details at the end of each tax year made by employers to the tax authority.

²⁸⁶ The payments of all other benefits are met from the so-called Consolidated Fund which is financed by the tax authority and is the government's general bank account at the Bank of England from which most government spending comes. As far as the industrial injury benefits are concerned, these used to be classified as contributory, but since 1990 they are met out of the general taxation.

²⁸⁷ See Harris, N., *Social security law in context*, Oxford University Press, 2000.

butions Agency” initiated a program to upgrade the overall National Insurance Recording System. However, several problems have come up during the computerization projects because of systems failings (delays in dealing with claims for contributory benefits and rebates as well as consequential need for compensation payments). Despite the problems encountered, that initial recording system was reported to constitute a great assistance in the future implementation of the merger.

Prior to the implementation of the merger, the two departments (tax authority and the so-called “Contributions Agency”) had been working together closely under the “*joint working initiative*”²⁸⁸ which has been announced in 1995. This initiative was designed to facilitate a fully coordinated tax and social security contribution service. More specifically, the tax authority and the “Contributions Agency” had set up a joint team with a joint approach to the different merger issues.

For example one of the initiatives of this team was to provide guidance to the employers by sending the so-called “employers’ CD-ROM”²⁸⁹ explaining the whole procedure. Another initiative was to coordinate the compliance activity. An external overseer of the joint team as well as a program manager had been appointed in order to facilitate the works of this initiative and ensure the smooth operation of the project. The only obstacle to the operations of this joint working initiative was the occasional tensions present when two different organizations are involved which led to the limited success of this initiative. However, this joint working initiative was reported to be of great importance because it had put the foundations of the merger of social security contribution and tax collection.

The initial focus of the merger was to bring together the various administrative functions into single merged entities under the tax authority. The range of the administrative functions included in this merger ranged from all the head office functions (e.g. finance, human resources, etc.) to all the operations concerning the provision of services to the contributors, such as registration and identification of the contributors, the accounting and reporting of the social security contributions, the collection and control over the payments as well as the settlement of claims for overdue social security contributions. All the aforementioned tasks are performed together with the like tasks destined for the tax collection. An emphasis has been put on compliance issues as the financing of the social security schemes is of high importance for the sustainability of the social security system in the United Kingdom. It goes without saying that the merger focused on the creation of a fully functional and operationally efficient executive units.

The changes were initially focused in the area of customer service, especially customer services to business.

²⁸⁸ See Griffith, S. and Thomas, A., BMRB International Limited, The Qualitative Workshop, Evaluation of the Contributions Agency and Inland Revenue Joint Working Initiative, A study carried out on behalf of the Department of Social Security, May 1998.

²⁸⁹ This refers to a CD-ROM provided by the tax authority to employers which contains full guidance, tables and calculators for operating specific payroll functions including tax and social security contribution obligations.

In particular,

- merging compliance processes and compliance teams so that businesses would receive single consolidated visits. The different compliance teams for tax and social security contributions were brought together aiming at the creation of a more efficient compliance system which would be costing less and would occupy fewer offices. Targets -rather than collection incentives- were set for the personnel so as to achieve the efficiency compliance goals, and
- merging customer support teams for both programs, such as the teams that provide help workshops for businesses.

Head Office functions were also merged in a structured and timely program. As for the IT structures, it was reported that there was no such system available for the “Contributions Agency”; for example, there was limited access to IT in 1999. It was only since 2000-2001 that there was access to IT structures for all the employees. At the moment, the social security contribution collection for self-employed persons is greatly facilitated by the existence of one department. However, the merger of IT structures was seen as a task for later years and has been handled as IT systems have reached the end of their natural life. More particularly, the social security administration has proceeded to the redevelopment of the website and the tax authority has taken on a different supplier. All the above, though, were not a direct impact of the merger, rather the beginning of a new era in the use of IT systems in the social security contribution collection.

The key to success in the first phase of the merger was managing the human resources change associated with the merger. A holistic approach was adopted by bringing together policy and operational people from the “Contributions Agency” and the tax authority creating joint working teams which dealt with the separate merger issues. Moreover, it was critical that the staff of both administrations saw the change as a merger rather than a takeover. This was achieved in a number of ways:

- Establishing a culture of open collaborative work based on mutual trust.
- Creating merger teams with equal participation in key roles from both organizations. These jointly headed and not single lead teams worked on different strands of the merger, such as finance implementation and so on.
- Establishing a range of communication channels and maintaining regular communication with the personnel (even when there was no change to communicate - people still wanted to know what areas were being looked at and the progress made and this open, detailed approach allayed potential fears). This has been achieved by providing opportunities for discussion and written communication as back-up for these discussions. Furthermore, the adopted communication strategy included some communication products - for example, the publishing of a magazine - in order to suit the merger message. The IT restructuring was not part of the initial program, because the existence of two departments was impeding the creation of a merged IT system. As a matter of fact, the IT was not so developed and only after the merger of the administrations it was possible to proceed to the merger of the IT system as well.

The merger program was guided by three basic elements:

- The principle of a so-called “safe landing”; everything needed to continue to work effectively from day one. This included a variety of changes from legal to banking details.
- A published Blueprint for the merger which set out the guidelines on which functions should go in the merged tax authority. The basic argument of this Blueprint was that the collection of social security contributions should be totally merged with the tax collection.
- A program of work for the merger starting from day one and targeted to delivering early wins. This standard program activity included the creation of joint teams and a joint program office with the equal participation of the tax authority and the “Contributions Agency” officials.

In addition to these elements, some other factors played a key role following this merger. More specifically, some other administrative functions had to be regulated in order to meet the demands of the merged collection system. One of these functions was the exchange of information within the administrative authorities; the privacy of personal data became of great importance as the information given, for example, to the police authorities became more and more stringent after the merger.

It was important to recognize that the different tax collection regimes under the new Inland Revenue

- Income Tax (and Customs since 2005)
- VAT
- Social Security Contributions

are all based on different legislative frameworks. The focus on the merger was therefore NOT about legislative reform but about administrative procedures. The e-forms were introduced in 2004; the integration of the IT structures subsequently took place in a major upgrade of PAYE & social security contributions (NICs) systems in 2009-2010; this was greatly facilitated by the merged collection system because of the assignment of the collection competency to one department. The overall implementation of the original merger was reported to be remarkably smooth as the managers involved sought out people for their teams with a collaborative culture.

The most critical success factor, however, was handling the change management of the staff. It was important to recognize that the personnel of both administrations had different cultures, and that a new culture needed to be created which captured the best of both.

In summary, the four key critical success factors were:

- Managing the human resources change.
- Understanding the implication of the different legal frameworks.
- Ensuring that changes did not affect the day-to-day administration and that everything continued to work.
- Delivering early benefits, especially those related to merging services and making them more effective for customers. As a matter of fact, the platform of the merger provided for the elimination of duplicate operations; the core processes are now common for both tax and social security contributions.

The merger of social security contribution and tax collection continues today and there are always new opportunities for increased efficiency. This case study highlights the importance of viewing mergers and collaboration as a people based activity, driven by strong operational management. The change program needs to focus on improving services for customers and delivering benefits in a structured roadmap. It is critical to deliver early wins, maintaining the best of today and delivering new services over a period of time.

Consequences of the merged collection system: First of all, the existence of two departments dealing with the social security contributions resulted in the existence of two sets of rules regarding the guidance, reporting and compliance operations. With the merger, the collection of taxes and social security contributions stayed within one administrative department and all the duplicate operations have been eliminated. Consequently, the employers together with the administration were released from the heavy administrative burden of performing duplicate operations.

Furthermore, the tax and social security rules have been harmonized and simplified in order to meet the demands of the merger. The merger was focused initially on the administrative side of the collection. The pressures to bring together tax and social security rules came afterwards²⁹⁰. These pressures concerned mainly the differences noted in the calculation and recording procedure of both levies. For example, it was claimed that the different calculation periods and bases for tax and social security contributions should be aligned for a more efficient collection procedure²⁹¹. The same works for the recording of the taxes and social security contributions by the employers as well as the change of employment during the year. Some of these differences between taxes and social security contributions can create extra work for the employers. Another problem can come up in case of different outcomes for individuals, such as the treatment of multiple jobs.

²⁹⁰ Review of income tax and national insurance alignment: an evidence based assessment, HM Treasury, October 2007.

²⁹¹ The calculation of due taxes is made on an annual basis whereas the calculation of due social security contributions is made on a monthly or weekly basis. Moreover, the calculation basis for taxes is the total annual income whilst the calculation basis for social security contributions is the earnings from employment or profits from self-employment. For further information on this discussion see the Review of income tax and national insurance alignment: an evidence based assessment, HM Treasury, October 2007.

The merger of employer compliance enabled a reduction in personnel which could be reinvested in new programs, such as tax credits²⁹². This has enabled the tax authority to accommodate new functions whilst still achieving efficiency savings. The tax and social security contributions were brought into one collection system with single transactions. With regard to identity fraud, the tax authority is reported to work closely with the social security administration.

As far as the facilities are concerned, the “Contributions Agency” had launched the Newcastle Estate Development Project in 1998 before the transfer of the social security contribution collection to the tax authority. After the merger of the social security contribution and tax collection, the NICO collecting administration took over the completion of redeveloping the premises in Longbenton, Newcastle.

Obstacles encountered during and after the merging process: One area of potential pitfalls with regard to the merged social security contribution and tax collection was around the legal frameworks governing the two areas. The tax authority was controlled by an Act of Parliament while the “Contribution Agency” was managed through ministerial control. These two regimes are difficult to integrate as agencies under ministerial control often evolve to include out of scope activities. Bringing these under a formal Parliamentary Act needed some critical attention.

Another potential pitfall that needed attention was the relationship of the merged “Contributions Agency” to the retained social security administration. This was handled formally with new relationship management created between the two organizations which were documented with formal service level agreements. Although in the past the social security administration tended to drift apart, now the participation of the social security administration is more rebalanced due to the joint working initiatives which established new relationships between the two organizations. This new relationship management received positive feedback from both departments.

²⁹² Tax credits are payments made by the government. These payments are made to persons responsible for at least one child or young person who normally lives with them (Child Tax Credit) or payments to persons that work, but are on a low income (Working Tax Credit). More information about the tax credits in the UK is available from:
<http://www.hmrc.gov.uk/taxcredits/start/who-qualifies/what-are-taxcredits.htm>.

Table: Summary of the merged administrative arrangements for social security contribution and tax collection in the United Kingdom

Collecting authority	National Insurance Contributions Office (NICO) and the tax authority (Her Majesty's Revenue & Customs)
Collecting method	The social security contributions are collected with the taxes
Applicability of taxation rules	Yes, because of the merged collecting authority NICO that is part of the tax authority
Relationship of social security contributions with taxes	Social security contributions are distinguished from the personal or corporate income taxes
Declaration and payments of social security contributions and taxes	Performed by the employers and the self-employed persons
Records' maintenance	By the NICO (National Insurance Accounts) and the employers
Identification of insured persons for payment purposes	Via a unique personal reference number called National Insurance Number
Electronic declaration of payments	Use of e-forms introduced in 2004
Calculation basis for social security contributions	Any remuneration or profit derived from an employment
Deductibility of social security contributions for corporate income purposes	Yes (not deductible for income tax)
Transfer of funds collected	No transfer of funds is required as the revenues are credited directly to the National Insurance Fund
Control and recovery of overdue payments	Merged compliance processes and compliance teams for both tax and social security contributions
Levels of record keeping	<ul style="list-style-type: none"> ▪ National Insurance accounts ▪ Individual National Insurance accounts ▪ Records kept by employers
Data exchange between tax and social security administration	The collecting authority provides information to other Government Agencies for benefit claims and other purposes through the National Insurance Recording System (NIRS2)
Obstacles during and after the merger	<ul style="list-style-type: none"> ▪ Different legal frameworks governing the two areas ▪ The relationship of the merged collection administration to the retained social security administration
Disadvantages of the merged collection	Limited attention to the special needs of the social security schemes on behalf of the tax authority
Benefits of the merger	<ul style="list-style-type: none"> ▪ Elimination of duplicate operations ▪ Harmonization and simplification of tax and social security rules ▪ Reinvestment of the personnel in new programs

4. The distinct social security administration functions

4.1 Reforms leading to the merger

According to the experiences of the five countries examined in the present report, it can be argued that the merging of the social security contribution and tax collection administration in a given country can be usually interrelated with the introduction of a social security or tax reform.

This was the case in Estonia and Hungary, for example, where social security reforms were introduced when the two countries were in transition from a centrally planned economic system to a market economy²⁹³; before these reforms the two countries were not focusing on the collection of social security contributions and, as a result, their capacity to perform the collection was rather weak. Therefore, as their economies changed and developed, the reforms of the social security system were followed by a subsequent reform of the administration which would contribute to a smoother implementation of the new system. This latter administrative reform boiled eventually down to the merging of social security contribution and tax collection administration.

Another interesting case was the tax reform in the Netherlands where a common calculation basis for both taxes and social security contributions was required in order to simplify and harmonize the social security contribution and taxation rules. This particular necessity has emerged principally from the difficulties encountered in the calculation and collection of social security contributions; therefore, the merger of social security contribution and tax collection administration aimed at introducing a more simplified and understandable collection system.

As for the United Kingdom, the merger of the administrations of tax and social security contributions was a recommendation of the so-called “Taylor report”²⁹⁴ which evaluated proposals to improve the social security system through providing work incentives and on a long term employment opportunity for everyone. These recommendations should be viewed as part of the wider context of tax and benefit reforms in the United Kingdom.

Finally, in Italy, the merger of the tax and social security contribution collection is currently at a quite early stage. The initiative to merge the tax and social security contribution administration has been launched during the year 2009; this initiative aimed at simplifying the operations and control of the financial flows of the Italian social security administration.

²⁹³ The social security tax is a common characteristic of countries with economies in transition according to the IMF report on the Tax Law Design and Drafting (volume 1; International Monetary Fund: 1996; Victor Thuronyi, ed.), Chapter 11, Social Security Taxation, p. 2. In these countries social security taxation is the most important single source of public revenues.

²⁹⁴ See Taylor, M., Work Incentives: A report by Martin Taylor, The Modernization of Britain’s Tax and Benefit System No. 2, HM Treasury, 1998.

4.2 Administrative structure of the social security contribution and tax collection

First of all, a key factor in the creation of a scheme's contribution structure is whether there is to be one global contribution to all schemes of funded social security²⁹⁵ or separate contributions for each separate scheme of social protection²⁹⁶. This is usually determined by the institutional structure of the social security system; an IMF report supports that, if different funds or institutions are responsible for the different elements of social security, there is strong pressure to provide different contributions to each institution²⁹⁷. Therefore, according to the IMF paper on the tax law design and drafting, the social security funds should be closely coordinated at the time of the collection no matter how the funds are distributed once collected.

There can be further a distinction between contributions treated as a series of separate contributions and those treated as a single payment to be made by the contributor although consisting of separate amounts for different funds. This is the case in the Netherlands where there are different kinds of contributions payable to the different social security schemes which are though treated as a single payment by the collecting authority. Another system applies to the social security contributions in the United Kingdom where the costs of the social security benefits are borne by six different classes of social security contributions levied on the insured persons and the employers; each class of contributions provides financing for the entirety of the social security schemes.

All the aforementioned elements must be seriously taken into consideration when organizing a common collection process for both social security contributions and taxes.

Of course the global collection of social security contributions and taxes as parallel levies based on the same source of income by one administrative authority could simplify the collection arrangements; however, it is usually the case that different underlying systems of finance remain to apply to each branch even after the merger. For this purpose, separate accounts of income and expenditure must be maintained for each branch - either social security funds or taxation - and the contributions and other funds allocated to each branch must also be separately recorded. As a result, there can be some record keeping implications due to the special needs of the financing systems for each branch.

²⁹⁵ This is the case in the United Kingdom although a part of the global contribution is transferred to help fund health costs.

²⁹⁶ In Estonia there is a separate contribution for the unemployment insurance scheme. In Hungary, Italy and the Netherlands there are separate contributions for each social security scheme.

²⁹⁷ Tax Law Design and Drafting (volume 1; International Monetary Fund: 1996; Victor Thuronyi, ed.), Chapter 11, Social Security Taxation, pp. 9-10.

Table: Overview of the elements of the administrative structures of social security and taxation that could have an impact on the merging of the collection system

<i>Some elements of the administrative structure with an impact on the merging of the collection system</i>	
1.	Different systems of financing the taxation and the social security system;
2.	One global contribution or separate contributions existing for the social security schemes;
3.	Treatment of contributions after payment as a series of separate contributions or as a single payment consisting of separate amounts for different funds; and
4.	Separation of accounts of income and expenditure as well as separation of records for each branch.

4.3 Administrative functions relating to the collection

According to an ISSA publication on the interactions of social security and tax systems²⁹⁸, the merged collection of social security contributions and taxes touches upon more than one administrative functions²⁹⁹. This is due to the fact that the collecting administration has to perform a number of several other tasks rather than just receiving the payment; this is done in order to ensure the correctness and fulfillment of these payments. It can be argued that the number of these administrative functions merged in a national system can be an indicator defining the degree of merging of the collection in this country. A brief description of these functions is illustrated in the following section. Moreover, on the basis of the functions merged in each of the countries examined, we are going to present an overview of the degree of merger in each country according to the experiences reported in this field³⁰⁰.

4.3.1 Registration

According to the aforementioned ISSA and WB publication³⁰¹ as well as the findings of our research, the first of the administrative functions related to the merged collection system, concerns the registration of the persons liable to pay social security contributions. Moreover, our research showed that problems concerning the identification and registration of contributors were quite common to the countries that have introduced the merger of the collection procedures.

These problems arise from the fact that there is usually a distinction between persons liable to pay social security contributions and taxpayers; persons liable to pay social security contributions are not always people with a professional income (or even an

²⁹⁸ See Ross, S., Common issues of social security and taxation systems, in Interactions of social security and tax systems, ISSA and OECD, 1997, pp. 19 et seq.

²⁹⁹ It is argued in a WB report that some of the business processes included in the social security programs can be merged with the tax administration. For further information see Anusic, Z. International experience in consolidated social contributions and tax collection, reporting and administration, WB, ECSHD, 2005, pp. 4 et. seq. (available online: http://info.worldbank.org/etools/docs/library/238288/Anusic_CollectionUnification.pdf).

³⁰⁰ This is presented in the table on page 103 of the present report.

³⁰¹ Interactions of social security and tax systems, ISSA and OECD, 1997.

income replacement), which are employers, employees and self-employed persons, but also the general population without a professional income that, in some cases, has to pay social security contributions on the grounds of residing in a certain country. This is highly dependable on whether there is a general social security scheme covering all the residents in a country, such as in the Netherlands.

Moreover, the personal income for taxpayers does not always include the social security contributions paid or the income coming from social security schemes. In Estonia, for example, it was reported that the tax calculation basis does not include the social security contributions. On the other hand, in the Netherlands the concept of wage for social security purposes is harmonized with the concept of wage for tax purposes.

This distinction between contributors and taxpayers as a rule requires several arrangements in order to identify the persons liable to pay social security contributions in the merged collection system and overcome the related problems. Such an arrangement was reported in Estonia with the introduction of a state register of taxable persons where information on the social security status of a person was also included and, thus, the identification of taxpayers and contributors was facilitated. However, such arrangements could entail some risks as to the validity of some registrations because there can be difficulties in updating all the data included in the state register.

In some of the countries examined, the insured person is identified without a specific social or tax registration number, but on the basis of the personal ID number. In Estonia, for example, the contributors are identified without a specific social or tax registration number because there is a state register for all the taxpayers and contributors in order to ensure the performance of the functions imposed on tax authorities by law; there are also individual records for each and every person. As for the self employed persons in Estonia, there is no registration requirement under the condition that they are registered in commercial registers or they have personal identification codes.

On the other hand, in some other countries, like in Italy and the Netherlands, the identification of those liable to pay social security contributions and taxes is made through a social-fiscal number; this is also called social security number ("National Insurance Number") in the United Kingdom, but is used in the same way as the social-fiscal number. There is also the case that two different identification numbers apply: one for taxation and one for social security. This is the case in Hungary where two identification numbers are required when the taxes and social security contributions are collected.

Unique identifying number: More specifically, the registration of the contributors/taxpayers in a merged collection system can be further facilitated by the assignment of a unique identifying number for the purposes of social security contribution and tax collection to enterprises and individuals. Moreover, this can be combined with the creation of master files³⁰² or registration systems for

³⁰² These master files are similar to the ones used in the taxation field.

contributors/taxpayers where basic data can be recorded and stored³⁰³. In accordance to the responses of national experts participating in our research, the prior computerization of all the registration data and records concerning either taxes or social security contributions is advisable in order to achieve a smooth implementation of the unique identifying number.

We can find examples of unique identifying numbers in Italy, the Netherlands and the United Kingdom; in the first two countries there is a social-fiscal number used for identifying the persons liable to pay social security contributions and taxes and in the latter country there is a unique personal reference number serving the same purpose and additionally making sure that social security contributions and taxes are properly recorded on the personal accounts.

4.3.2 Accounting and reporting

At this point, it is worth mentioning another function related to the collection of taxes and social security contributions which, however, is not assigned to the administration, but to the employers and the self-employed persons. We are referring to the accounting and reporting of social security contributions and taxes levied on the income of the debtors; this accounting has to be performed by the employers and the self-employed persons so that the payment of the levies can follow. Therefore, the aforementioned calculation of the due social security contributions and taxes with the consequent report filling is an administrative burden for the persons obliged to pay the levies to the competent collecting authority.

However, the merger as such does not facilitate this procedure. This is due to the fact that the elimination of the administrative burdens is highly dependable on the degree of the merger realized. As we will see further in the benefits section, a merger can facilitate the accounting and reporting of social security contributions and taxes under the condition that it eliminates the duplicate operations for the employers and self-employed persons.

Some examples could shed some light on the particularities of the accounting and reporting function in a merged collection system. In Estonia, the employer has to account, report and pay on a monthly basis the social security contributions and the taxes to the tax authority; this is done with the use of electronic forms where taxes and social security contributions are indicated for each employee: one row for each person and different columns for the different levies paid. Moreover, in the United Kingdom the businesses are supplied with an “employers' CD-ROM” which provides guidance and assists the employers with the calculation and reporting of both taxes and social security contributions. Finally, in Hungary the social security contributions together with the taxes are being assessed, deducted and paid by the employers and the self-employed persons to the so-called “accounts” of the tax authority and are then declared in their own tax returns.

³⁰³ Ross, S., Common issues of social security and taxation systems, in *Interactions of social security and tax systems*, ISSA and OECD, 1997, p.20.

4.3.3 Collection of social security contributions and taxes

Based on the experiences of the five countries examined and international literature³⁰⁴, a third administrative function connected with the merger issue is the collection of social security contributions and taxes as such. The collection can be performed with the use of unified payment forms where the types and amounts of taxes and social security contributions are identified in the pay slip. These unified forms can be submitted to the competent collecting agency or intermediary. For example in Italy the unified payment forms are submitted to the common intermediary (competent banks or post offices). Moreover, the use of electronic papers (e-forms) via the internet is very common. All these unified forms and e-forms can eliminate the use of multiple paper-filling and promote the role of e-government in the country where they are implemented. The use of electronic forms was reported to be quite extensive in Estonia, the Netherlands and the United Kingdom.

The collection operation as such can result in some secondary functions as well. For example, notices to the debtors can be generated, visitations to payers can be organized and linkages to banks or other financial institutions providing information and assistance can be established. A quite important example is the case of the United Kingdom. During the merging process, common compliance teams and compliance procedures for tax and social security contributions were promoted; as a result, after the implementation of merger, it was not very difficult to introduce the common visitations practice without creating the impression that the tax authority is taking over the responsibilities of the social security administration.

Furthermore, the efficiency of the merged collection can be based -in principle- on the level of harmonization of social security and tax laws. In other words, it could be preferred if the definition of the wages, the timing of the declarations and the withholding of the levies are common both for taxes and social security contributions. This way the techniques may eventually become even simpler and, consequently, the merged system can be a successful one.

An indicative case of such coordination is the Netherlands where a harmonized concept of wage exists for levying both the social security contributions and the taxes. However, as the Italian experience shows, sometimes it is not necessary to harmonize everything in order to achieve greater contribution compliance, but harmonizing only some aspects of the collection procedure may also prove quite sufficient for achieving the same goal.

4.3.4 Control of the collection process

Another administrative function of the merged collection process –according to the analysis of the steps in contribution collection in an ISSA and OECD publication³⁰⁵- is the verification/enforcement of the registration, the contributions and other legislative or regulatory provisions. This function has many sub-functions each one of which is -according to the experiences of the five countries- very important for the completion of the whole collection procedure.

³⁰⁴ Interactions of social security and tax systems, ISSA and OECD, 1997.

³⁰⁵ Ibid. pp. 53 et seq.

One of these sub-functions is the return processing which helps identifying the non-payers or the delinquent accounts, leads to the set up of targeted procedures against non-payers and provides guidance to the selection of payers for audit. In the Netherlands declaring a person liable for not paying social security contributions is reported as a competency of a special administrative body (called "Social Intelligence and Investigation Service") which works together with the tax authority and the Social Insurance Bank, the social security administration. In Italy, the social security administration performs the returns processing; when there are cases of persons breaching their social security contribution payment obligations, the collection of the overdue payments is then assigned to collecting entities, such as "Equitalia" or other private collecting agencies³⁰⁶. These entities use injunction proceedings for the collection of the social security contributions and taxes that have not been paid; for this collection procedure they charge a fee.

Moreover, some other very important sub-functions are the audit and the establishment of techniques for identifying under-reporting. In Estonia the tax authority has the assignment to investigate the undeclared or under-reported earnings. On the other hand, in Hungary the social security controllers have the right to perform on-spot controls, but their competence is quite limited as they only report fraud to the tax authority or the police and they can not impose sanctions. In order to detect efficiently infringements and frauds, there are frequent joint controls performed by the social security administration and the tax authority. In the British collection system the compliance processes and compliance teams for both taxes and social security contributions have been merged; thus, consolidated teams pay consolidated visits to businesses for control and recovery of overdue payments.

Previous research in this field³⁰⁷ showed that a mere collaboration between tax and social security administrations can be sufficient, but with the merged approach this cooperation with regard to the audit and compliance processes could be further facilitated.

4.3.5 Individual and general records

On the basis of international literature³⁰⁸ and our findings, a further administrative function related to the merger is the maintenance of individual and general records for both taxes and social security contributions. These records are based on harmonized data collected for both levies which are available to the social security administration and the tax authority.

An illustrative example of such records are the public records of individual contributions kept by the Estonian tax authority for all the levies collected; this individual recording was launched in January 1999 and contributed greatly to granting benefits smoothly because of the efficient and timely exchange of data concerning the payments.

³⁰⁶ See section 3.3.5 for further information.

³⁰⁷ See Zaglmayer, B., Schoukens, P., Pieters, D., Cooperation between social security and tax agencies in Europe, IBM Center for The Business of Government, April 2005.

³⁰⁸ Ross, S., Common issues of social security and taxation systems, in Interactions of social security and tax systems, ISSA and OECD, 1997, pp. 19 et seq. and Anusic, Z. International experience in consolidated social contributions and tax collection, reporting and administration, WB, ECSHD, 2005.

A similar approach is followed in the United Kingdom. In June 2009 the National Insurance and Pay-As-You-Earn (PAYE) Service - known as NPS, part of the tax administration - introduced one single IT system which contained individual social security records together with tax records. Moreover, in order to grant access to contributory benefits, the National Insurance Contributions Office (NICO) - a department of the tax authority as well - maintains two sets of records for the social security contributions: the National Insurance Accounts and the individual National Insurance Accounts; in the latter accounts information deriving from individual returns are recorded (in particular details on employee's pay and social security contributions paid).

In Hungary a public record of individual contributions was meant to be in force. However, it was reported that this measure could not be implemented in practice, although provided for by the law, due to the introduction of the second pillar social security scheme in the country which required a more complex individual record-keeping. This record keeping issue was due to the fact that it has been difficult to identify the contributors to the second pillar scheme - as the identification of the contributors is not automatic - and, therefore, no individual records could be kept³⁰⁹.

It is important for the merged collection system that the data maintained are correct, complete, accurate, up-to-date, uniform and readily accessible. With regard to the collection of data, several privacy issues may arise, such as the confidentiality of numbers assigned to businesses and individuals for the record keeping purposes. Therefore, the data exchange between the social security administration and the tax authority is an issue requiring special attention in the merged collection system.

Italy is an interesting case as the data concerning the personal profiles of the insured persons, their income, their fiscal declarations, their assets and social security contributions paid are accessible by the collecting authority of overdue payments in accordance with data exchange agreements signed between the administrations. In the Netherlands, data which come from the tax declarations on tax returns including information on a person's social security status and the levies paid are recorded in the central bank of the social security administration; these data can be used according to the provisions of the relevant Dutch law³¹⁰ regulating the establishment and the proper functioning of the administration. It was reported though that only the competent persons within the competent administrative authorities were eligible to have access and process these information according to the principles of the personal data protection.

4.3.6 Settlement of claims

An additional administrative function in connection with the collection procedure is the operation of the settlement of claims. This is greatly relevant to the enforcement competencies of the collecting authority. In order to ensure the compliance of the debtors with their obligations concerning social security contribution and tax payment, the collecting authority may be authorized to impose penalties or even become involved in dispute resolution or judicial appeals. In Estonia, for example, the tax

³⁰⁹ For more information see the Hungarian country report included in the 3rd chapter of the present paper.

³¹⁰ Work and Income Implementation Structure Act.

authority which is the collecting authority pursues the payments in arrears and in Hungary the tax administration exercises official powers against contributors that are reluctant or deny fulfilling their obligation with regard to the payment of social security contributions. In Italy the settlement of claims is assigned to special collecting entities which initiate legal proceedings charging a fee for their services.

4.3.7 Transfer of social security contribution revenues

At last but not least, our research showed that in some countries the administrative function that constitutes a special characteristic of the merged collection system is the transfer of the social security contribution revenues; this is performed by the collecting authority towards the competent social security funds accompanied by the transfer of the relevant data to the social security administration. When collected, the taxes and social security contributions are kept together in most cases until the social security contribution revenues are further transferred to the social security funds. If there are common intermediaries in the collection process, then these are responsible to perform the transfer of the revenues to the competent social security and taxation funds. In case of delayed transfers by the common intermediaries, there may be an obligation to compensation if a liability for such a delay can be established.

Based on the experiences of the five countries examined in the present report, we can argue that the transfer performed by the tax authority or the common intermediaries can be made in several ways:

- directly to the first pillar social security administration on a monthly basis; after that the second pillar contributions are transferred further from the first pillar social security administration to the private insurance fund (Hungary);
- the social security contributions collected are transferred to the competent social security administration via the State Treasury (Estonia);
- in a similar way, taxes and social security contributions collected by the competent banks or post offices - acting as common collecting intermediaries - are transferred to a special national account (within the State Treasury) where the details of each amount owed to every administrative authority can be easily identified. Then the amounts are dealt with and kept separated electronically (Italy); and
- the social security contribution revenues are directed immediately to the social security funds without the intermediation of the State Treasury where the collecting administration - the National Insurance Contributions Office, department of the tax authority - transfers the collected revenues to the National Insurance Fund; this is not done via the Consolidated (Revenue) Fund (United Kingdom).

On the basis of the above descriptions and the functions merged in each of the countries examined, we can present an overview of the degree of merger in each country according to the experiences reported in this field.

Table: Comparative table showing the merger of administrative functions with regard to the collection of social security contributions and taxes in the countries examined

Merged administrative functions	Estonia	Hungary	Italy	Netherlands	United Kingdom
Primary administrative functions					
Registration:					
- unique identifying number	✓		✓	✓	✓
Accounting and reporting:					
- paper forms	✓	✓	✓	✓	✓
- e-forms	✓	✓		✓	✓
Collection:					
- unified payment form	✓	✓	✓	✓	✓
- intermediaries			✓		
Secondary administrative functions					
Verification of registration, contributions and other provisions:					
- returns processing	✓			✓	✓
- audit	✓	✓		✓	✓
- identification of under-reporting or non-reporting	✓	✓		✓	✓
Individual records	✓			✓	✓
General records	✓	✓			✓
Settlement of claims	✓	✓	✓	✓	✓
Transfer of social security contribution revenues to the competent social security funds with the relevant data	✓	✓	✓	✓	

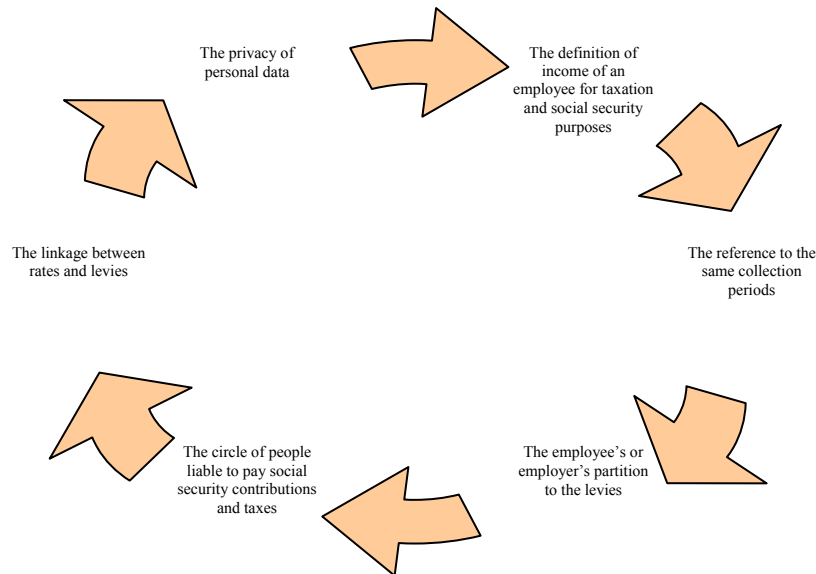
For the purposes of our research, we have characterized the tasks of registration, accounting, reporting and collection as primary administrative functions because they are performed at the first stage of the collection procedure. The verification of registration and contributions, the record-keeping, the settlement of claims and the transfer of the revenues are defined as secondary administrative functions because they are carried out at a later stage of the collection procedure.

After having identified and described the merged administrative functions in each country, we will now proceed to the examination of the design and the implementation of the merger according to secondary literature sources combined with the results of our research regarding the experiences of the five countries in question.

4.4 Design of the merger

When making the necessary administrative arrangements for the transfer of the social security contribution collection function to the tax administration or even for merging one of the aforementioned administrative functions, it is advisable to keep in mind some key elements. According to international literature in this field³¹¹, these are in principle the elements concerning the revenue base, but also touch upon other aspects, such as the privacy of personal data.

Figure: *Overview of some elements to be taken into consideration when designing the merger*



4.4.1 Persons liable to pay social security contributions and taxes

First of all, it is important to examine whether the social security contributions and the taxes are paid by the same or different groups of people. Key concept for this element is the definition of the status of a person as employee or self-employed. This happens because traditional employment patterns tend to break down more and more while more flexible working relationships are being promoted instead. Therefore, nowadays it has become even more difficult to distinguish between employees and self-employed persons; it is also quite frequent that one person is considered as an employee for taxation purposes and as a self-employed person for social security purposes. This can result in confusion with regard to the status of a worker as well as in contradictory decisions within the different administrations.

The situation is different in each of the five countries examined. We found out that the definition of a person's status as employee or self-employed depends highly on the national legislation and case law concerning this issue in each of the countries in

³¹¹ Williams, D., *Legal and Institutional aspects of social security and taxation reforms*, in *Interactions of social security and tax systems*, OECD and ISSA, 1997, pp. 29 et seq. and Barrand, P., Ross, S. and Harrison, G., *IMF Working Paper, Integrating a Unified Administration for Tax and Social Contribution Collections: Experiences of Central and Eastern European Countries*, 2004, pp.20 et seq..

question³¹². Moreover, the existence of different sets of rules and techniques in order to determine which persons are liable to pay social security contributions and taxes creates an additional difficulty in this area.

4.4.2 Definition of income

The social security contributions can be either flat-rate contributions or income-related contributions. When the social security schemes are financed from flat-rate social security contributions, the definition of income can not have an impact on the operations of a merged collection system. On the contrary, when the social security schemes are financed from income-related social security contributions, then defining income can create several issues with regard to the merger of social security and tax collection administration.

Usually the definition of earnings for income tax purposes is different from the relevant definition for social security contribution purposes. In some cases the calculation basis for the social security contributions is the taxable income and in other cases the calculation basis is the income determined by other means; sometimes not all parts of income are taken into account and there can be different deductions. There is even the case that the contributions are calculated on the basis of the risk related (at a generalized level of risk).

In most cases the taxable income - as determined by the national legislation- is the calculation basis for the social security contributions - like for example in Estonia - although some exceptions from this rule may apply (this is the case in Italy and Hungary).

Moreover, the concept of wage for the purposes of social security contribution calculation can be harmonized with the description of the wage concept in the taxation law in order to facilitate the collection process. As a matter of fact, in the Netherlands, the wage concept for the calculation of social security contributions is harmonized with the wage concept for taxation purposes. However, the social security contributions calculation basis includes only the income from wages and ownership and it is differentiated from the overall taxable income, whereas other sources of income are excluded; the tax calculation basis includes these other sources of income in the Netherlands.

Thus, the differences in defining the income as calculation basis for taxes and social security contributions can result in different record keeping for each employee as well as different returns for the employers; these are known as “duplicate operations”. In order to overcome this impediment, it would be helpful to link the social security contribution legislation to the legislation on the income tax on earnings; it is, therefore, argued that linking the social security legislation to the income tax on earnings was more or less common for most of the countries examined in the present paper.

³¹² More information over the problematic regarding the distinction between employees and self-employed in the UK, see Williams, D., Legal and institutional aspects of social security and taxation reforms, in Interactions of social security and taxation, ISSA and OECD, 1997, pp. 31-32.

4.4.3 Same calculation periods

Furthermore, referring to the same periods for the calculation of social security contributions and taxes can prove to be quite helpful for designing and further implementing the merger process. In most of the countries examined, the calculation period for the social security contributions was one month whereas the taxable period was one year. In addition, there were different calculation periods of social security contributions for self-employed persons and employees; these different calculation periods were further reported to create an additional burden in the merged collection system.

Therefore, if uniform timing rules with regard to social security contributions and taxes are to be adopted, then we could identify a possible advantage, especially because in that case the same basis for the collection of both levies can be used. This can be simplifying the accounting and record-keeping operations carried out by the employers as there will be no more duplicate operations for paying and reporting the taxes and social security contributions³¹³.

4.4.4 Employer's and employee's share to the levies

Another issue that could be taken into consideration while designing the merger of a country's collection administration is the partition of the employee and the employer to the levies³¹⁴. The question that arises is whether the burden of contribution payment liability falls on the employer or the employee. In some countries it is evenly shared between the employer and the employee being collected half from each; in some other countries most of the burden is imposed either on the employer³¹⁵ or on the employee³¹⁶. The employer usually withholds the employee's partition from his/her wage and then pays it with his/her own partition to the competent collecting authority. We were not able to identify a consistent pattern regarding the share of the contribution burden between the employer and the individual through our research.

However, as it is mentioned in the introduction³¹⁷, the employee's and employer's share to social security contributions must be distinguished from the payment method of taxes and social security contributions. This is important because the employee's and employer's share to social security contributions cannot influence the final payment made³¹⁸.

The liability for overdue payments can also be different for taxes and social security contributions. In a merged collection system for both taxes and social security contributions this differentiation could be a matter having negative consequences on the merged collection of overdue payments. Therefore, mainstreaming liability which

³¹³ For more information see Williams, D., *Legal and institutional aspects of social security and taxation reforms*, in *Interactions of social security and taxation*, ISSA and OECD, 1997, pp. 36-37.

³¹⁴ *Ibid.* pp. 38-39.

³¹⁵ In Hungary nearly all the burden and in Estonia and Italy the larger part of it is imposed on the employer.

³¹⁶ In the UK the employee is liable to pay the social security contributions.

³¹⁷ For further clarifications on this matter see section 1.3 of the present report.

³¹⁸ Pieters, D., *Social Security, An Introduction to the Basic Principles*, Kluwer Law International, 2006, pp. 101 et seq.

is different for taxes and social security contributions should be considered when designing the merged collection system.

4.4.5 Rates of the levies

While designing the merger of the collection of both levies, a linkage between rates and levies could be established. This is for example the case in the Netherlands which has one of the most merged collection systems; most employees pay a high rate of social security contributions to which a low rate of income tax is added³¹⁹. For example, the lower-paid workers pay far more in social security contributions than in income tax³²⁰. This is in practice an integration of the rates of both levies: an approach not followed by many countries.

4.4.6 Privacy of personal data

The privacy of personal data is an issue that is crucial while creating a merged collection system. This happens because the use of information technology, on the one hand, makes the data collection and record keeping easier, but, on the other hand, the personal data of taxpayers/contributors can be often at stake because they may be accessed by non-competent authorities. For example, the establishment of a central databank³²¹ could be useful in order to guarantee the smooth operation of the collection system; however, privacy protection issues may come up³²².

Some conclusive remarks regarding the design of the system before the implementation of the merger:

- The difficulty to distinguish between employees and self-employed persons should be dealt with.
- Differences in defining income as calculation basis for social security contributions and taxes should be eliminated.
- Calculation periods for social security contributions and taxes should be harmonized.
- It is not essential that employee's and employer's partition to the social security contributions are taken into consideration.
- Linking rates and levies could be useful for accomplishing a greater merger (integration of rates).
- Protection of personal data should become a priority when designing data exchange systems.

³¹⁹ Williams, D., Legal and institutional aspects of social security and taxation reforms, in Interactions of social security and taxation, ISSA and OECD, 1997.

³²⁰ The same applies in France according to the IMF paper on the Tax Law Design and Drafting (volume 1; International Monetary Fund: 1996; Victor Thuronyi, ed.), Chapter 11, Social Security Taxation, p. 3⁹.

³²¹ This is the case of the central databank at the Employee's Insurance Implementing Body – UWV in the Netherlands.

³²² For further information see Zwenne, G-J., Bolle, P.E. and Duthler, A.W., Privacyregulering, belastingheffing en sociale zekerheid, in Berkvens, J.M.A. and Prins, J.E.J., Privacyregulering in theorie en praktijk, Kluwer, 2007, and Report on the Protection of privacy and social security, EISS (upcoming).

4.5 Implementation of the merger

The merger of social security contribution and tax collection is usually achieved through the implementation of a reform of one or several administrative arrangements for the said collection. This reform, though, must be examined within the context of the overall administrative structures of social security and tax administrations and not as a separate part because of the interoperability of the social security administrations and tax authorities.

4.5.1 Creation of appropriate environment

First of all, it is important to create the appropriate legal and administrative environment for such a merger³²³. This means that the new collecting agency, i.e. the tax authority, has to be prepared to take on the new responsibilities for all the different aspects of the collection of the social security contributions; this can be succeeded with a previous assessment of the readiness of the tax administration to take on this competency. If the tax administration is modernized and well-structured with trained personnel and effective management, then the transition to the merged system can be achieved successfully with lower administrative costs.

Very enlightening is the experience of the United Kingdom in this field. During the merger process it was important that the personnel of the tax and social security administrations saw the change as a merger rather than a takeover. In particular the "joint working initiative" established a culture of open collaborative work based on mutual trust between the two administrations. Moreover, a merger team from both organizations having equal participation in key roles was created; these teams were jointly headed and worked on different strands of the merger. Finally, a range of communication channels was established and regular communication was maintained with the personnel.

In view of creating the appropriate administrative environment for the merger, it can also be useful if the personnel of the tax authority are trained to respect the specific needs of the social security contributions. This way, there will not be limited attention of the tax authority towards the social security contributions especially because the payment of these levies creates entitlement to benefits and does not have just a general financing scope.

4.5.2 Preliminary steps before the implementation

According to the IMF working paper on integrating a unified revenue administration for tax and social contribution collections, it is essential that some preliminary steps before the implementation of the merger are followed³²⁴. Some of these steps are identified as follows:

³²³ Barrand, P., Ross, S. and Harrison, G., IMF Working Paper, Integrating a Unified Administration for Tax and Social Contribution Collections: Experiences of Central and Eastern European Countries, 2004, pp.16 et seq.

³²⁴ Ibid. p. 18.

- The government and the different agencies must understand the need for a well-organized collection structure.
- Amendments to the national legislation and the diverse administrative responsibilities may also be required for introducing such a change in the collecting arrangements.
- The administrative authorities must establish an efficient collaboration with each other because the merger itself presupposes the effective cooperation between the competent authorities.
- A working group of officials or experts in the field may be needed in order to design, organize and manage the implementation process.
- It would be also very helpful to opt for a project schedule which has to be monitored and respected as well as some transitional measures to a smoother introduction of the new collection system.

4.5.3 Harmonization of the national legislation

In certain cases the harmonization of the national legislation could be considered. For example, the legislation regulating the tax and social security rates, the definition of the income, the coverage and definition of the contributors, the definition of payments for social security contributions, the judicial proceedings and the enforcement methods. The Netherlands, for example, managed to harmonize successfully the national legislation on taxation and social security contributions; this was accomplished with the harmonized concept of wage for tax and social security contribution purposes. This harmonization was aiming at the simplification of the legislation regarding the collection procedure of taxes and social security contributions.

Moreover, the legislation concerning some other issues such as the data collection, the enforcement of payments and the exchange of information by the tax authority, could be consistent with the legislation governing the collection of tax payments³²⁵. This would probably facilitate the operations of the merged collection system.

To conclude, we can support that the overriding objective of the merger of tax and social security contribution collection is to achieve the best possible revenue collection performance and, therefore, contribute to the long-term sustainability of the social insurance schemes.

³²⁵ Ibid, pp. 20-22.

5. The benefits of merging social security and tax collection administrations

Since the 1990s several institutions and international organizations have been supporting the idea of merging social security contribution and tax collection. One of these institutions is the International Monetary Fund which in 1994 has published a report³²⁶ suggesting that the social security contribution collection could be combined with the withholding of tax on income and the collection of both taxes and social security contributions could be assigned to the tax administration. The reasoning of this suggestion lied in the thought that the merger of tax and social security contribution collection should be regarded as an urgent matter for countries in transition to market economies³²⁷ with good prospects for administrative savings. However, the benefits from the merged collection system are important not only for the countries in transition, but also for the countries with market economies.

It has been argued that many of the benefits from the merged collection system derive in principle from the merger of the procedures of social security contribution and tax collection rather than from the merger of the institutions as such³²⁸. This is why we are going to analyze the benefits of the merged collection system with regard to each of the administrative functions that constitute diverse aspects of the merged collection process.

5.1 Registration

In a merged collection system there is usually a unique identification system for social security and taxation purposes. This means that the merger could contribute to the elimination of the multiple identification methods usually used; these are for example national identification numbers, internal numbers generated by regional offices, tax identification numbers and so forth. These different identification numbers can probably cause confusion to the administration during the collection procedure.

With the merged collection system these different identification methods have been replaced by one unified identification system for both social security contribution and tax payment obligations. This was the case in Estonia where a register of taxable persons is provided for by the law and this register includes information on taxable persons as well as insured persons³²⁹. In Italy and the Netherlands, the insured and taxable persons are identified automatically with the use of a single social-fiscal number³³⁰.

When the different identification methods are eliminated, then the collection procedure can be simplified and facilitated. A streamlined collection procedure can be

³²⁶ IMF Working Paper, The Pay-As-You-Earn Tax on Wages – Options for Developing Countries and Countries in Transition, September 1994.

³²⁷ More specifically the report analyzes the situation in Central and Eastern European countries where the failure to collect social security contributions deprived pension schemes of resources needed to meet their obligations.

³²⁸ Rofman, R., Demarco, G., Collecting and Transferring Pension Contributions, Social Protection Discussion Paper No. 9907, The World Bank, 1999, p. 16.

³²⁹ These include the persons that pay the so-called “social tax”, unemployment insurance contributions and contributions to the second pillar funded pension scheme.

³³⁰ In Italy it is called “codice fiscale” and in the Netherlands the former “social-fiscaal nummer” (“SOFI” number) and now called *Burgerservicenummer* (BSN).

developed. The contribution evasion by employers and employees can be further discouraged.

5.2 Accounting and reporting

The *accounting* of the taxes and social security contributions on wages is usually part of the activities carried out by the employers when they are making the payment of the wages. When the calculation basis for taxes is different from the calculation basis for the social security contributions, then there can be implications with regard to the accounting and, thus, duplicate operations may pose obstacles to the smooth collection procedure. This is the reason why most of the countries that have introduced the merged collection system, have also tried to ensure a close identity between earnings for income tax purposes and earnings for social security contribution purposes. This way the accounting and reporting procedure can be enhanced by avoiding possible mistakes upon the calculation of the levies and promoting the payment compliance.

Estonia is a good example in this field. This country has introduced the same method for calculating social security contributions and personal income tax. Only the order that these levies are calculated is different. Due to the similarities in the calculation basis, both the levies can be easily administered through one tax return. This was financially expedient for the state and a smaller administrative burden for the payers.

In Hungary, the taxable income serves in principle as the calculation basis for social security contributions with some exceptions (concerning, for example, the income from social security benefits). In the Netherlands, the concept of wage for social security contribution purposes is harmonized with the wage concept for the taxation purposes. In Italy, there is a distinction between the income accrued prior to a certain period³³¹ which is not harmonized for social security and taxation purposes and the one accrued after that period when the same calculation basis for both social security contributions and taxes is established.

It goes without saying that the keeping of different sets of records for each employee and different returns to the two authorities (cost problem for duplicate operations as well as two teams of officials for the audit of the employer's records) has been eliminated. This way the legal, administrative and compliance burdens of collecting two parallel payments from employees are being minimized.

The accounting task where employers calculate and deduct the levies from the employees' income, is followed by the transfer of the funds to the collecting authority and the preparation and submission of a report (return) on these payments to the tax authority.

³³¹ This relates to the income accrued until January 1998. This distinction was introduced by the pension reform of 1995.

In Estonia before the merger the employer had to make three different payments and declarations regarding the payments:

- one for the income tax to the tax authority,
- one for the health insurance part of the “social tax” to the competent health insurance agency, and
- one for the pension insurance part of the “social tax” to the competent pension insurance agency.

After the merger of the social security contribution and tax collection in 1999, the procedure was greatly simplified as the employer was required to make only one single payment for all the levies together using a unified tax declaration.

Another important element of the reporting activity is the *frequency of reporting*. In a merged collection system reporting is made on a monthly basis instead of a six-month or yearly basis. In Estonia, for example, the dates for the payment of “social tax” by the employers have changed with the merger of the social security contribution and tax collection. Data for monthly payments are transferred from the employers to the collecting authority on a monthly basis in several countries³³². This is a way to keep the data up-dated in shorter periods of time which can ensure a better record-keeping and control of the payments as well as an efficient and in-time transfer of the corresponding funds by the collecting authority to the competent social security institutions that manage those funds.

Finally, merging the social security contribution and tax collection system has introduced the use of *new IT systems as well as the implementation of e-government* in the field of social security contribution collection. Especially, some new IT systems have facilitated the employer’s reporting task because these reports are filed and stored in electronic format rather than in a paper format. In the United Kingdom the tax administration provides the so-called “employers CD-ROM” which contains guidance and information on the accounting of both taxes and social security contributions.

More in general, in Estonia e-government is very popular for the everyday transactions with the public administration; more specifically all the tax declarations and reporting requirements have been unified and gradually transferred into the internet in order to achieve synergy effects from the joined use of IT. In Italy the interactions of the insured persons with the social security institutions take place principally with the use of the IT systems within the broader environment of the digital era³³³.

Finally, the use of technology has facilitated the creation of the appropriate databases for the certification of compliance and accrual of benefit rights. Moreover, in order to meet the requirements of the use of the new IT systems, it was also necessary to

³³² In Estonia on the 10th day of the following month when the payment was made and in Hungary on the 12th day of the following month when the payment was made. In the Netherlands the employer has to make the payment declaration to the tax authority on a monthly basis as well.

³³³ This is for example the internet platform of the Italian National Institute for Social Security (INPS): <http://www.inps.it/>.

provide training to the administrative personnel as well as the employers who can now perform more effectively their reporting and record-keeping activities. This practice was reported to be extensively used during the merger process in the United Kingdom. It goes without saying that after the merger the reporting procedure is much faster and simplified in principle and the employers are released from the heavy burden of filing paper forms and performing duplicate reporting procedures.

5.3 Collection

The merging of social security contribution and tax collection can lead to the simplification of the payment procedures. This is due to the fact that the introduction of a unified payment form eliminates the need for complex and duplicate declarations to multiple administrative collection agencies which has been a burden for both the administration and the employers. These duplicate operations were discouraging compliance and making it impossible to cross-check the several reports because of the differences. In addition, through this operational merger the collection and distribution of both funds and data is more rapid and much safer.

Last but not least, the collection of social security contributions with income taxes could make it difficult to pay the one without paying the other and, as a result, the decision to evade social security contributions must be considered with the evasion of income tax payments³³⁴.

5.4 Control

With the merged system the risk of having inadequate and unsound information relating to the collection of taxes and social security contributions is much lower; this happens because the errors and misreporting can be better identified due to the cross-checking of data for consistency and the incorporation of these data in electronic databases.

Moreover, information technology systems including computerization and telecommunication networks are promoted and reliable systems for generating “alarms” when there is social security contribution evasion, are designed and further implemented. Therefore, the issue of overdue contributions is dealt with more effectively as the doubling of control activities with the use of the same resources can minimize to a great extent the contribution losses (as reported in Estonia and Italy) and thus increase the revenues for the social security schemes reinforcing their financial sustainability.

In addition, more efficient enforcement procedures and reduction of the administrative and compliance cost of the collection are achieved in different ways. The audit and overall compliance control is carried out by the tax authority which is also the collecting authority (such as in Hungary, Estonia and the United Kingdom) or even by a separate authority with the competency to perform checks with regard to the social security contribution fraud (such the separate authority that exists in the Netherlands). These functional collection organizations can send notices quickly in case of non-

³³⁴ Bailey, C., Turner, J., Strategies to Reduce Contribution Evasion in Social Security Financing, World Development, Vol. 29, No. 2, pp. 385-393, 2001.

payment or underpayment and audits and enforcement collection mechanisms can follow up in case that the notices for payment are ignored.

As a result, the enforcement powers granted to the collection agency help increase the compliance and reduce the social security contribution fraud. That is because the previous limited authority of the social security administrations with regard to the enforcement of payments has not been enough to ensure compliance with the social security contribution payment obligations. Due to the increased social security contribution evasion, it was necessary to make the control on the payment fulfillment more effective and enforce the overdue payments more efficiently (especially in Estonia and Italy). The merged collecting administration with enforcement authority can, therefore, contribute significantly to combating social security fraud and ensuring the smooth financing of the social security schemes.

5.5 Transfer of the collected revenues

With the merged collection system, the speed of the transfers of the social security contribution revenues to the competent social security funds together with the relevant data can be increased. The reason is that the transfers are made on a monthly basis³³⁵ and usually not longer than a few days from the payment until they are credited to the competent accounts.

For example in Italy, the amounts collected by the competent banks and post offices are transferred within the first working day following the payment to the tax authority which verifies that the payments are correct and made within the prescribed time. Then the tax authority makes the transfers via the National Bank of Italy³³⁶ which credits all the amounts to the specified social security funds. In Estonia the revenues are redirected to the social security funds via private banks within fifteen working days after their receipt.

What is more, there can be a possibility of compensation payment for delays in transfers which are caused by employers, banks or collection agencies if they are responsible for such a delay. This compensation is payable usually automatically, based on prevailing interest rates; the contributors should, however, be informed of any compensation paid.

5.6 Overall

The merged collection system is reported to be more cost-effective and efficient than the decentralized one; as a matter of fact, the countries examined in the present research have reported that they are not considering the possibility of returning to the decentralized collection system. The administrative burden for social security institutions, tax authorities and employers is further reduced and the use of new technologies has greatly facilitated the collection procedure. Moreover, the control and enforcement procedures have contributed to higher contribution compliance which is very important for the viability of the social security systems in a country.

³³⁵ In Hungary the social security contributions are transferred every month from the tax authority to the competent social security funds.

³³⁶ Banca d' Italia.

Last but not least, it is useful to determine a number of factors which can contribute to the strengthening of the benefits from the merged collection system. First of all, the financial intermediation has to be strong with enforcement powers in order to ensure the efficient collection of the due social security contributions. Secondly, the use and availability of information technology is very important so as to enjoy the benefits of the merged collection. Thirdly, the collecting agency selected should be effective and well-organized in order to perform the increased duties assigned to it. Finally, the administrative authorities and in general the public organizations have to show a degree of flexibility in embracing those changes³³⁷.

<i>Overall benefits of the merged collection system as identified in the countries under examination</i>	
1.	Cost-effective and efficient system
2.	Reduction of administrative burdens for social security institutions, tax authorities and employers
3.	Facilitation of the collection procedure through the use of new technologies
4.	Higher contribution compliance due to stricter control and enforcement procedures

³³⁷ Rofman, R., Demarco, G., Collecting and Transferring Pension Contributions, Social Protection Discussion Paper No. 9907, The World Bank, 1999, p. 31.

6. Consequences of the merger in general

6.1 Impact of the merger on existing facilities and administrative personnel

The merger of social security contribution and tax collection has usually an impact on the administration -personnel and facilities- of the countries where the changes are implemented. In Estonia and Hungary, for example, there has been an increase of the tax administration personnel in order to cope with the increased competencies of the tax authority. A further transfer of employees of the social security administration to other departments within the same administration authority took place in Estonia. The centralization of the local revenue accounting departments resulted in the availability of more human resources and enormous work was undertaken for the promotion of the electronic reporting by the largest employers.

In Hungary the tax administration had relatively independent contribution directorates with the authority to reach individual agreements with contribution payers on the amount of their outstanding debt and to cancel late charges and fines if the contribution payer could verify payment; these directorates have been ceased with the merger and they have been fully integrated into the general organization of the tax authority. The latter was reported to have taken from the social security administrations the premises, infrastructure, personnel, database and balances in accounts related to them.

In the Netherlands it was necessary to transfer personnel to the tax authority while a number of employees have been dismissed because of the introduction of a new system for the collection of taxes and social security contributions. In the United Kingdom another approach was adopted: the tax authority established a new department called National Insurance Contributions Office which replaced the “Contributions Agency” - part of the social security administration. The new administration took over the premises of its predecessor; however, the merger was not seen as a takeover of the social security administration. There was also a reduction in personnel which could though be reinvested in new programs.

As for the overdue payments it was reported that, e.g. in Italy, a new administrative authority has been created without, however, any further changes of the human resources or the administration facilities of any other administrative authority.

6.2 Simplification and harmonization of tax and social security rules

The merger has contributed greatly to the simplification and harmonization -to a certain extent- of the tax and social security rules. As a result, most of the examined countries have achieved a more efficient administrative system of collection and control because of the merged collection system. An illustrative example is the United Kingdom where the merger initially focused on the administrative side of the collection and the pressures to bring together tax and social security rules came afterwards. In addition, the Dutch experience showed that the harmonization of taxation and social security rules could also decrease the errors in the accounting and reporting of the levies as well as the contradictory decisions within the public administration.

6.3 Commonality of core processes

The procedures followed by the employers have been further simplified because the use of common definitions of earnings for tax and social security contribution purposes - either in law or in practice - provided solutions in some practical problems that existed before the merger, such as the keeping of different sets of records for each employee and different returns to the two authorities. There have also been cost problems for duplicate operations as well as the need of two teams of officials for the audit of the employer's records. The problem was even bigger for smaller employers without trained staff and facilities automation.

Therefore, it can be argued that the elimination of duplicate operations has lifted a great burden from the employers' obligations, especially in countries like Italy and the Netherlands. In the United Kingdom there were merged compliance teams for taxes and social security contributions in order to pay consolidated visits to the businesses; their aim was to create a more efficient compliance system which would be costing less and would occupy less offices.

6.4 Increased efficiency of the collection system

According to the Estonian and Dutch experience, the introduction of the merger of the administrative functions of social security contribution and tax collection increased the efficiency of the administration system with regard to the collection and has offered a greater convenience for the contributors as the administrative burdens are being thereby reduced. The administrative burdens have been further reduced with the introduction of electronic declarations; a very good example for the use of e-declarations is Estonia. Moreover, the use of unified payment forms in all the countries examined simplified the payment process and facilitated the administrative tasks performed by the employers and the insured persons.

6.5 Smooth introduction of the mandatory social security schemes

Two of the countries of our research, Estonia and Hungary, have recently implemented reforms to their social security systems. With regard to these reforms, it has been reported that the mandatory funded pension scheme which was implemented together with the unemployment insurance scheme could be smoother introduced due to the merged collection system in these countries.

6.6 Lower governmental administrative costs

Administrative costs are the operating costs of the institutions responsible for the collection of social security contributions and taxes, such as the gross wages, material costs and other current costs. Before the merger of the collecting functions, there were distinct departments in the social security administration dealing with the collection of social security contributions. After the introduction of the merger, these departments ceased to exist and, therefore, the administrative costs were reduced, especially with regard to facilities and personnel.

The collection of social security contributions by the tax authority may entail some operative costs which are, though, divided usually to the tax and social security contribution component proportionally³³⁸.

6.7 Distinction of competencies

With the merged collection system the tax administration was granted more competencies while the regional health insurance and pension administrations could focus more on their main activities³³⁹ and perform their duties more effectively. In addition, the experience in the Netherlands has shown that the contradictory decisions within the public administration have decreased because of this distinction of the competencies between the tax authority and the social security administrations.

6.8 Effective compliance system

Last but not least, the issue of overdue contributions has been dealt with more effectively after the introduction of the merged collection system in Estonia and in Italy as the doubling of control activities with the use of the same resources could minimize the contribution losses. However, this was not the case in all the countries studied in the present research; in Hungary, for example, it was reported that the social security institutions had no direct information about the calculation basis of the social security contributions as well as the actual amounts paid and, therefore, it was difficult to control the compliance of the contributors with their payment obligations.

³³⁸ Anusic, Z., International experience in consolidated social contributions and tax collection, reporting and administration, Report on Professional Development Matching Grant, World Bank, 2005.

³³⁹ See further the situation in Estonia.

7. Obstacles and problems faced when merging social security contribution and tax collection

It is quite common that when changes are implemented in the administrative system of a country, some temporary problems may arise. The most usual ones are the implications caused by the use of the new procedures, the new IT systems and electronic forms instead of paper forms. In Estonia some IT systems had to be adjusted and new tax return forms were designed for a smoother transition to the merged collection. On the other hand, in the United Kingdom, the IT systems were adjusted some time after the merger as there were other priorities in different areas of the merger.

Some other issues may concern the organization and structure of the human resources and facilities while communication problems may come up in relation to the exchange of data between the administrative authorities if these are not well coordinated. For instance, in Estonia there was a structural change in the tax authority; this happened with the centralization of the local revenue departments. That way the necessary human resources for the merged collection of social security contributions and taxes became available; however, still enormous work had to be undertaken so that the largest taxpayers would give up the reporting in paper format in favor of the electronic data exchange.

At this point there are a couple of issues that need particular attention. Although in some countries there has been a harmonization of the earnings concept, there are also other kinds of differences in the calculation basis for social security contributions and taxes which could become an obstacle to the smooth merged collection of both the levies; for example there can be *differences in the income sources covered*, such as the fringe benefits, investment and self-employed income. Moreover the *unit of assessment* can be differentiated in taxation and social security because social security contributions are levied on individual income whereas taxes are levied on family income. Finally, the *period of assessment* can be diversified, for example, annually for income taxes and monthly for social security contributions. All these may cause some problems to the accounting of the social security contributions and taxes as well as to the subsequent payment of the levies because the possibility of errors can be quite high.

There can also be practical problems when a multi-pillar social security scheme is involved. For example in Estonia due to the higher contributions owed for the participation to the second pillar social security schemes, the employers have to know specifically which employees have joined the second pillar schemes in order to calculate the correct amount of “social tax” payable to the tax administration. There have been cases of mistakes in the tax declarations that had to be settled before the funds would have been transferred to the competent social security administration.

In Hungary the collection of the contributions for the basic pension and health care systems has been integrated, but separate collection for the newly introduced funded tier has been decided. This has caused additional difficulties in modernizing the collection administration, such as deficiencies in compliance, record keeping and coordination.

In the Netherlands the most difficult issue with regard to the merger has been reported as the transfer of the employer's share of social security contributions to the employee's share with a compensating increase on wages. This change required some transitional measures in order to be implemented; these measures have further caused some implications in the merging procedure of the social security contribution and tax collection.

During the transformation of a collection system to a merged administration it has been reported in some countries (such as Hungary and the Netherlands) that the tax administration showed limited attention towards the social security contribution collection compared to the collection of other levies. Tax authorities are purely collecting authorities with main interest the collection of the revenues owed. As the tax authorities in most countries are not involved in the payment of social security benefits, they are alienated from the linkage between the collected social security contributions and the social security scheme and benefits paid by that scheme. Thus, the tax administration is probable to show limited attention to receiving the social security contributions which are necessary for the financing of the social security schemes in a country, and to be more interested in the levies that finance the national general budget. This can be dealt with by providing incentives³⁴⁰ to the collecting authority in order to collect efficiently all the levies owed.

Additionally, the system can prove to be vulnerable due to the massive processes, the large flows of information and the transfer of data; this was the case in the Netherlands when the implementation of the merged collection system took place'. It can be difficult to organize successfully the data flows in the newly introduced merged collection system and -as reported in some other countries- there can be many implications in the record-keeping of the funds received and the exchange of data between the collecting authority and the social security administrations. In order to cope with the large data flows in Estonia and Italy, there were agreements on the methods of information and funds exchanged as well as on the retrospective treatment of erroneous data.

Last but not least, the transfer of personnel to new positions requires training and education of the public servants involved in this procedure which can be time-consuming and requiring quite an effort and very good organization of the agencies. This problem has been dealt with successfully in some of the countries examined, such as the Netherlands, Italy and Estonia. It was reported that specialized training courses have been organized for the transferred personnel in order to meet the requirements of their new duties. There was also the case in the United Kingdom that merged support teams for both social security contribution and tax programs provided help workshops for businesses. The training of the employers regarding the merging of the collection administration is, therefore, equally important with training of the administrative personnel.

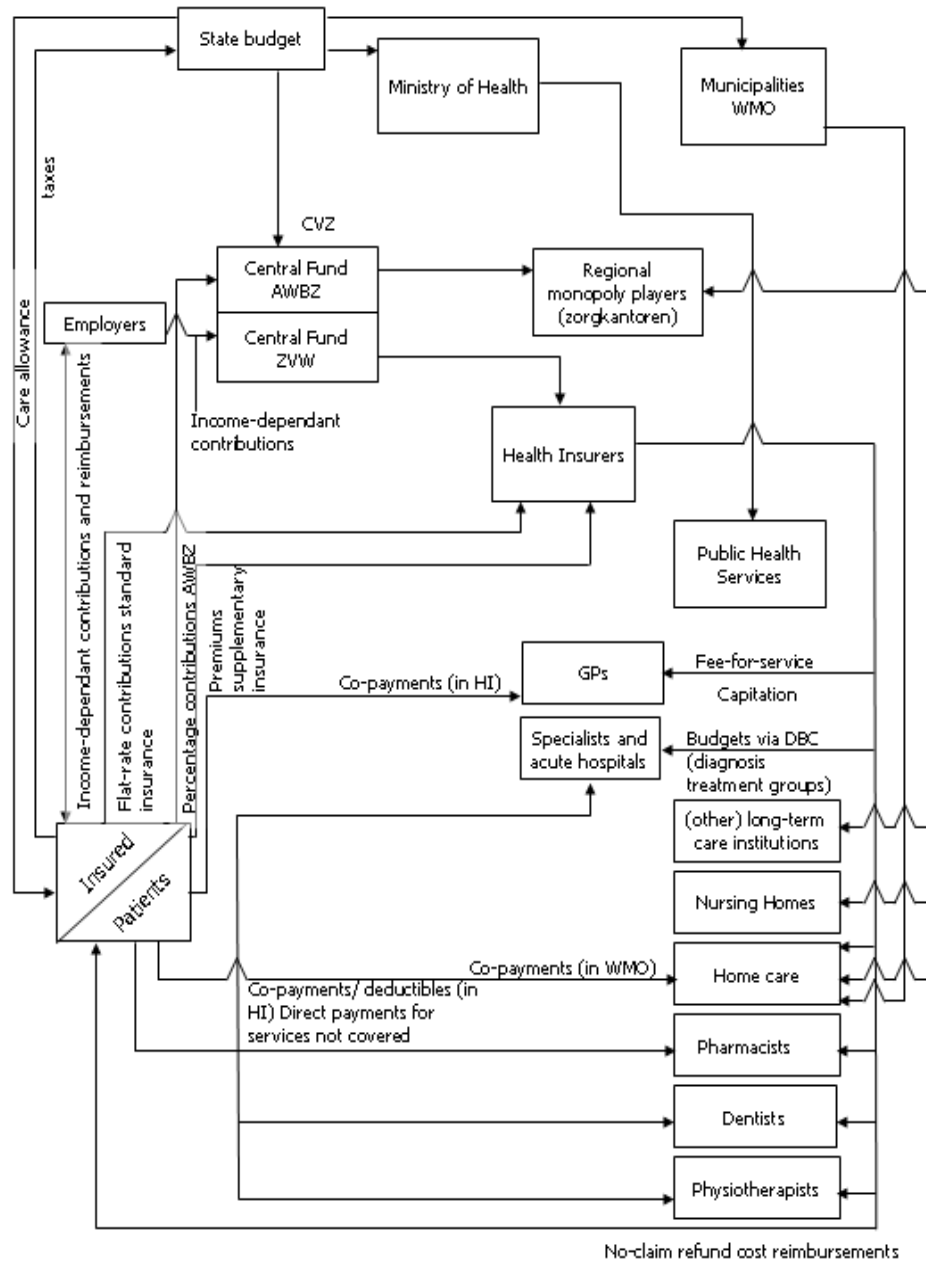
In conclusion, when implementing the merger, one comes across all these issues showing that sometimes not all the legal and procedural consequences of the merged collection process have been considered thoroughly.

³⁴⁰ These can be motivation incentives either in cash or in kind when performing the social security contribution collection. This is proportional with what is happening in the taxation field.

8. Annexes

Annex I Financing of health care in the Netherlands

Netherlands: Financing of health care, 2007



Source: <http://www.ecosante.org/ocde.htm>

Notes: ZVW = Health Insurance Act; AWBZ = Exceptional Medical Expenses Act; WMO = Social Support Act; CVZ = Health Care Insurance Board; HI = Health Insurance.

Source: Department of Health and Care, Statistics Netherlands, 2007.

Source: <http://www.ecosante.org/OCDEFRA/717.html>
http://www.oecd.org/document/33/0,3343,en_2649_34631_34973665_1_1_1_1,00.html

Annex II
Useful websites - Country specific

Estonia

Estonian Central Register of Securities ECDS (English)

<https://www.e-register.ee/en>

Estonian Health Insurance Fund (English)

<http://www.haigekassa.ee/eng/>

Estonian Financial Supervisory Authority (English)

<http://www.fi.ee/?lang=en>

Estonian Legal texts (English)

<http://www.legaltext.ee/indexen.htm>

Estonian Ministry of Social Affairs (English)

<http://www.sm.ee/eng.html>

Estonian Social Insurance Board (English)

<http://www.ensib.ee/?lang=en>

Estonia, Social Security Programs throughout the world, Social Security Online

<http://www.ssa.gov/policy/docs/progdesc/ssptw/2008-2009/europe/estonia.pdf>

Estonian Taxpayers Association (English)

http://www.maksumaksjad.ee/modules/eng_info/index.php?id=1

Estonian Tax and Customs Board (English)

<http://www.emta.ee/index.php?lang=en>

Estonian Unemployment Insurance Fund (English)

<http://www.tootukassa.ee/?lang=en>

Official Gateway to Estonia (English)

<http://estonia.eu/about-estonia/society/pension-system-in-estonia.html>

Pension Center

<http://www.pensionikeskus.ee/?lang=en>

Hungary

Hungarian Central Administration of National Pension Insurance (English)

<http://www.onyf.hu/en/>

Hungarian Ministry for National Economy (English)

<http://www.ngm.gov.hu/en>

Hungarian Ministry of Health (English)

<http://www.eum.hu/english>

Hungarian Ministry of Finance (English)

<http://www2.pm.gov.hu/web/home.nsf/frames/english>

Hungarian Ministry of Social Affairs and Labour (English)

<http://www.szmum.gov.hu/main.php?folderID=13318&langchanged=eng>

Hungarian National Health Insurance Fund

<http://www.oep.hu/>

Hungary, Social Security Programs throughout the world, Social Security Online

www.ssa.gov/policy/docs/progdesc/ssptw/2008-2009/europe/hungary.pdf

Hungarian Tax and Financial Control Administration (English)

<http://en.afeh.hu/>

State Audit Office of Hungary (English)

<http://www.asz.hu/ASZ/www.nsf/home.html>

The Visegrad Cooperation

<http://www.visegradgroup.eu/main.php?folderID=1082&articleID=4055&ctag=articlelist&iid=1>

Italy

Equitalia (Riscossione S.p.a.)

<http://www.riscossionespa.it/equitalia/opencms/>

Italian Data Management Agency SOGEI

<http://www.sogei.it/flex/cm/pages/ServeBLOB.php/L/IT/IDPagina/1>

Italian Ministry of Labour and Social Policy

<http://www.lavoro.gov.it/Lavoro>

Italian Ministry of Economy and Finance (English)

<http://www.tesoro.it/en/index.asp>

Italian National Employment Accident Insurance Institute (INAIL)

<http://www.inail.it/Portale/appmanager/portale/desktop>

Italian National Institute of Social Security (INPS)

<http://www.inps.it/newportal/default.aspx>

Italian National Insurance and Assistance Office for Workers in the Entertainment business (ENPALS)

<http://www.enpals.it/>

Italy, Social Security Programs throughout the world, Social Security Online
www.ssa.gov/policy/docs/progdsc/ssptw/2008-2009/europe/italy.pdf

The Netherlands

Burgerservicenummer

<http://www.burgerservicenummer.nl/> (in Dutch)

http://www.burgerservicenummer.nl/veelgestelde_vragen/english_faq (in English)

Dutch Employee Insurance Implementing Body

<http://www.uwv.nl/overuwv/over-UWV/wie-en-wat-is-UWV/profiel/index.aspx>

Dutch Inspectorate of Work and Income

<http://www.iwiweb.nl/>

Dutch Social Intelligence and Investigation Service (SOID) (English)

<http://www.siod.nl/content/view/22/42/>

Dutch Social Insurance Bank (English)

<http://www.svb.nl/int/en/index.jsp>

Dutch Tax and Customs Administration (English)

<http://www.belastingdienst.nl/english/>

Netherlands, Social Security Programs throughout the world, Social Security Online

<http://www.ssa.gov/policy/docs/progdsc/ssptw/2008-2009/europe/netherlands.pdf>

United Kingdom

Department for Work & Pensions

<http://www.dwp.gov.uk/>

Her Majesty's Revenues & Customs

<http://www.hmrc.gov.uk/ni/intro/basics.htm>

National Insurance Contributions Office HMRC

<http://www.hmrc.gov.uk/nic/aboutus.htm>

Annex III
List of abbreviations

AOW	Algemene Ouderdomswet (Dutch General Old Age Pensions Act)
AKW	Algemene Kinderbijslagwet (Dutch General Child Benefits Act)
ANW	Nabestaandenwet (Dutch General Surviving Relatives Act)
APEH	Adó- és Pénzügyi Ellenőrzési Hivatal(Hungarian Tax and Financial Control Administration)
AWBZ	Algemene Wet Bijzondere Ziektekosten (Dutch General Act for the Exceptional Medical Expenses)
Awf	Algemeen werkloosheidsfonds (Dutch General Unemployment Fund)
BIKK	Bijdragen in de Kosten van de Kortingen
BSN	Burgerservicenummer
CANHI	Central Administration of National Health Insurance (Hungary)
CANPI	Central Administration of the National Pension Insurance (Hungary)
CANSI	Central Administration of National Social Insurance (Hungary)
CTSV	College van Toezicht Sociale Verzekeringen (Dutch Social Security Supervisory Board)
CVZ	College voor Zorgverzekeringen (Dutch Health Care Insurance Board)
DWP	Department for Work & Pensions (UK)
ECDS	Estonian Central Depository for Securities
ECSHD	Europe and Central Asia – Human Development Sector Unit (World Bank)
EISS	European Institute of Social Security
EEK	Estonian kroon(s)

ENPALS	Ente Nazionale di Previdenza e di Assistenza per i Lavoratori dello Spettacolo (Italy)
ENSIB	Estonian National Social Insurance Board
ETM	Enterprise Tax Management System (Netherlands)
EU	European Union
EUR	Euro(s)
GAK	Gemeenschappelijk Administratiekantoor (Dutch Joint Administration Office)
GBA	Gemeentelijke Basisadministratie Persoonsgegevens (Dutch Personal Records Database of a municipality)
GUO	Gemeenschappelijk Uitvoeringsorgaan (Dutch Joint Implementation Office)
HMRC	Her Majesty's Revenue & Customs (UK)
HMSO	Her Majesty's Stationery Office (UK)
HM Treasury	Her Majesty's Treasury
HUF	Hungarian forint(s)
ID-number	Identification number
ILO	International Labour Organization
IMF	International Monetary Fund
INAIL	Istituto Nazionale per l' Assicurazione contro gli Infortuni sul Lavoro (Italy)
INPDAI	Istituto Nazionale di Previdenza dei Dirigenti di Aziende Industriali (Italy)
INPS	Istituto Nazionale Previdenza Sociale (Italy)
IPPR	Institute for Public Policy Research
ISSA	International Social Security Association
IT	Information Technology
JESP	Journal of European Social Policy
LISV	Landelijk Instituut Sociale Verzekeringen (Dutch National Social Insurance Institute)
MISSOC	EU's Mutual Information System on Social Protection

MHLW	Ministry of Health, Labour and Welfare (Japan)
NHS	National Health Service (UK)
NIC	National Insurance Contribution (UK)
NICO	National Insurance Contributions Office
NGO	Non-Governmental Organization
No.	Number
NPS	National Insurance and PAYE Service (UK)
OECD	Organization for Economic Co-operation and Development
PAYE	Pay-As-You-Earn
PIE	Project on Intergenerational Equity (Japan)
SIOD	Sociale Inlichtingen- en Opsporingsdienst (Dutch Social Intelligence and Investigation Service)
SOGEI	Società di Information and Communication Technology (Italy)
SOFI	Sociaalfiscaal nummer (Netherlands)
S.p.a.	Società per azioni (Public limited company)
Suppl.	Supplement
SVB	Sociale Verzekeringsbank (Dutch Social Insurance Bank)
UI	Unemployment Insurance
UK	United Kingdom
UWV	Uitvoeringsinstituut werknemersverzekeringen (Dutch Employee Insurance Implementing Body)
VAT	Value Added Tax
Vol.	Volume
WAO	Dutch Disability Insurance Act
WB	World Bank
Wfsv	Wet financiering sociale verzekeringen (Dutch Act on financing social insurance)
Wgf	Wachtgeldfonds (Dutch Redundancy Payment Fund)
WIA	Wet werk en inkomen naar arbeidsvermogen

	(Dutch Work and Income according to Labour Capacity Act)
WW	Werkloosheidswet (Dutch Unemployment Insurance Act)
ZW	Ziektewet (Dutch Sickness Benefits Act)
ZVW	Zorgverzekeringswet (Dutch Health Insurance Act)

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