

Finland's System of a Tax Reduction for Household Services

This box presents a general review of Finland's system of a tax reduction for expenditure on household services. The system was introduced on a temporary basis in 1997–2000 and was made permanent as from 2001.

Purpose of the Regulations

Persistently high unemployment in Europe has led to a situation where more unconventional methods have been used to alleviate imbalances on the labour market.⁴² This practice is based on the conclusion that much of unemployment is structural. One reason is that the composition of the labour supply differs from that of the demand for labour; another is that traditional labour-market policy is associated with a number of limitations.

Since the early 1990's, several European countries (among them France, Denmark, Finland, Belgium and Germany) have adopted various methods (like tax reductions) to promote the creation of new markets in labour-intensive areas of the private services sector. The primary purposes of the Finnish system with its tax reduction for household services are the following:

- To reduce the tax difference between taxed and untaxed work in order to increase household demand for household services.
- To reduce the extent of work for undeclared pay in the private services sector.
- To encourage individual initiatives to provide health and other personal care.
- To increase employment and to encourage small businesses in the private services sector.

The Finnish Tax Rules

Through the Finnish system of a tax reduction for household services, demand is increased for relatively unskilled labour. The work may consist

of traditional household chores such as cleaning, laundering and cooking, but households may also hire outside help for health care and care of the elderly or handicapped, or for planning, building and repair work of various kinds.⁴³

The tax reduction is first applied against central government taxes. If the reduction is larger than the amount of central government income tax, the local government tax is then reduced as well.⁴⁴ The maximum tax reduction is 1 150 euros, roughly equivalent to SEK 10 100, per person per year. The amount is the same whether the household purchases the service from a firm or employs an individual.

If the service is purchased from a firm, the tax reduction is 60 percent of the labour cost including VAT and employer contributions. If the household instead hires an individual, there is a tax reduction of 10 percent of the wage paid and 100 percent of the employer contribution. The maximum tax reduction is allowed for compensation paid, or wage costs, of approximately 2 083 euros (about SEK 18 300) and 3 907 euros (SEK 34 000), respectively.⁴⁵ With this tax reduction, the degree of subsidization is 55.2 ($=1\,150/2\,083$) percent if the service is purchased from a firm. When the VAT exemption is also considered, the degree of subsidization is 42.2 ($=(1\,150+860)/(3\,907+860)$) percent if the household employs an individual.⁴⁶

Prior to 2003, the Finnish system was considered neutral in regard to the choice between engaging a firm and hiring someone. At this point, the tax reduction was 40 percent of the labour cost (including VAT and employer contributions) for a service purchased from a firm. If the household hired a person instead, only a tax reduction of 100 percent of the employer contributions was allowed.

⁴³ In Sweden there is currently a similar system for construction and repair work. The tax reduction, or so-called ROT deduction, is 30 percent of a basis consisting of expenditure on building work.

⁴⁴ If the amount of tax is not enough for a deduction, the cost may not be carried forward to reduce taxes in future years.

⁴⁵ The maximum tax reduction is calculated in the following example: if the service is purchased from a firm, $[(2\,083 \cdot 0,60) - 100 = 1\,150]$; if the household employs an individual, $[(3\,907 \cdot 0,10) + (3\,907 \cdot 0,22) - 100 = 1\,150]$. The employer contributions vary from case to case but are assumed in this example to be 22 percent. The amount of 100 euros means that there is no tax reduction for minor amounts.

⁴⁶ The VAT rate in Finland is 22 percent, for an amount of $3\,907 \cdot 0,22 = 860$ euros.

⁴² SOU (Official Government Reports) 1997:17, "Skatter, tjänster och sysselsättning", (Taxes, Services and Employment). Report of the Committee on Taxation of Services.

Evaluation of the Reform

The general effects of the Finnish system on the economy are currently being studied. The prevailing view, as presented in the mass media, for example, is that the system increases employment, but this effect may well be limited. Among the reasons are the following:

- Developing new markets takes time.
- The incentives to invest in creating a new market may be limited by the history of the Finnish system, which previously had the profile of an experiment with an uncertain future.
- The willingness of consumers of household services to pay may be limited.

Lower taxes in this sphere, at least in the long run, must be balanced by higher taxes in other areas or lower general government expenditure, which may have the countereffect of curtailing employment.

The findings of the Finnish study will be published after year-end and may have a considerable impact on the subsequent discussion both in Finland and in Sweden.