

## Borderline cases for salary, social contribution and tax

(Workshop on Labour Cost Survey, Rome, Italy 5-6 May 2015)

Sometimes it is not crystal clear what the differences are between salaries, social contributions and taxes. This paper describes some borderline cases regarding this issue.

It became evident when the National Accounts (NA) in Sweden made a stricter interpretation of the classification of statutory social contributions vs. taxes for 2012 when ESA 2010 was introduced. LCS did not change the definition but need to consider what to do for the next LCS 2016. If comparison will be made with NA it will be better to have the same definitions. If comparison will be made with previous LCS, no changes should be made. Below follows some background to the borderline case.

### 1. Social contributions and taxes in Sweden

Besides salaries, the employers need to pay social contributions and taxes when they employ staff. Social contributions were introduced in Sweden in 1960 and were a small percentage of the employee's gross salary. It has increased and been over 30 percent since the end of the 1970s. The employer's contribution peaked in the early 1990s, when it was near 40 percent. Social contributions are calculated as a percentage fee on the gross salary for employees. The social contributions consist of various parts specified for the social security system, and are paid as a total amount to the tax office.

#### Statutory social contributions on the gross salary in %, 2000-2012

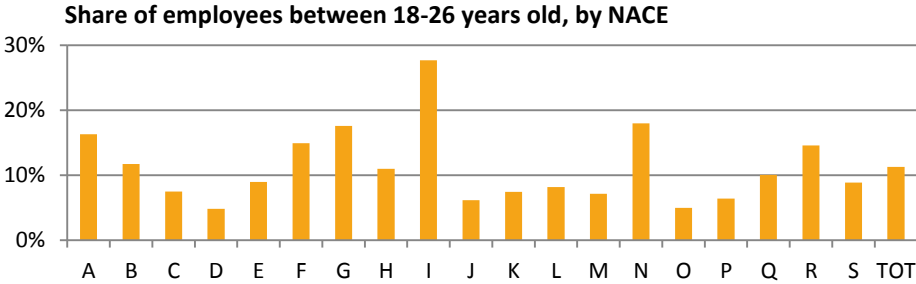
| Year                                    | 2000  | 2004  | 2008  | 2012  |
|---|-------|-------|-------|-------|
| <b>Statutory social contributions %</b> | 32.92 | 32.70 | 32.42 | 31.42 |

Information about the statutory social contribution rate can be found on the Swedish tax authority's website. The rate has decreased from 32.92 % to 31.42 % between 2000 and 2012. The rate is even lower in 2012 for young employees who have not yet turned 26, approximately half cost, only 15.49 % compared to 31.42 %. This is a political decision and can be useful information when analysing data. Below are the different parts listed, that constitute the statutory social contributions employers have to pay on the gross salary to the tax office in 2012.

| <b>Employers' social security contributions required by law</b> | <b>2012 &gt; 26 years</b> | <b>2012 &lt; 26 years</b> |
|---|---------------------------|---------------------------|
| Pension contribution  | 10.21 %                   | 10.21 %                   |
| Survivor's pension  | 1.17 %                    |                           |
| Sickness insurance  | 5.02 %                    |                           |
| Parental insurance  | 2.60 %                    |                           |
| Occupational injury   | 0.30 %                    |                           |
| Labour market contribution                                      | 2.91 %                    |                           |
| General wage fee  | 9.21 %                    |                           |
| <b>Total</b>  | <b>31.42 %</b>            | <b>15.49 %</b>            |



From the yearly salary survey information regarding the share of young employees can be estimated. In the graph below the share of young employees (18-26 years) by NACE are shown. The highest share can be found for NACE I (*Accommodation and food service activities*), almost 30 %.

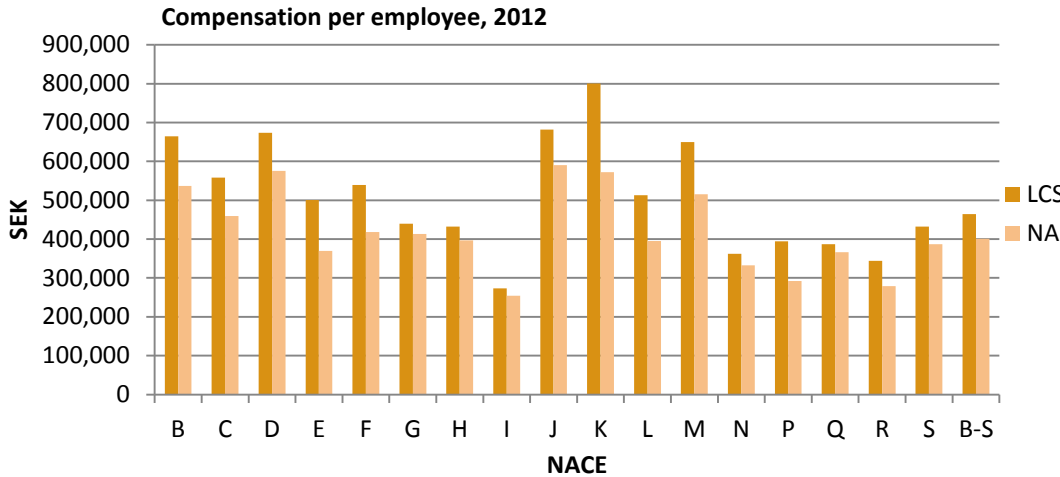


Most enterprises also pay collectively agreed social contributions. It is mainly costs for pensions. The employers need to pay a special tax on that pension cost, 24.26 %, which usually correspond to around 1 % of the gross salary. This is the only part that is considered as tax (D4) in LCS.

National accounts changed the definition of taxes and social contributions for 2012 and consider parts of the statutory social contributions as taxes instead.

*- Labour Cost Survey vs. National Accounts*

The graph below shows the *Compensation per employee*<sup>1</sup> during 2012 in LCS and National Accounts (NA). LCS excludes enterprises with less than 10 employees, which is one explanation why the LCS-bars are higher than NA-bars. Larger enterprises are considered to have slightly higher compensation per employee. Also, NA has changed the definition of social contributions vs. taxes when ESA 2010 was introduced in 2014 back to 2012. In connection with the transition to ESA 2010, a stricter interpretation of what should be included in social contributions was introduced. Only fees earmarked for its purpose, such as pension contributions are recognized as social contributions. A large part of the statutory social contributions are now considered as taxes instead and the compensation of employees is therefore lower. LCS2012 did not change the definition of statutory social contributions vs tax. Should that be done for LCS2016?



<sup>1</sup> Code D1, divided by the value of code A1, in appendix 1 to Regulation No 1726/1999. D1(compensation of employees), A1(number of employees)

Below are the statutory social contributions that the employer pays to the tax office and the difference between what is classified as social contributions vs tax in LCS and NA 2012. Pension costs, 10.21 %, are now the only part that is considered as social contributions and the rest is considered as tax in NA.

The reason why NA changed the definition is that the items are not 100 % earmarked for the special items, some are over financed and some underfinanced. The guideline is that the social contributions need to be earmarked for special purposes otherwise it is considered as a tax.

| Statutory social contributions and taxes | 2012           | Social contributions vs tax in LCS | Social contributions vs tax in NA |
|--|----------------|------------------------------------|-----------------------------------|
| Pension contribution                     | 10.21 %        | D1                                 | D1                                |
| Survivor's pension                       | 1.17 %         | D1                                 | D4                                |
| Sickness insurance                       | 5.02 %         | D1                                 | D4                                |
| Parental insurance                       | 2.60 %         | D1                                 | D4                                |
| Occupational injury                      | 0.30 %         | D1                                 | D4                                |
| Labour market contribution               | 2.91 %         | D1                                 | D4                                |
| General wage fee                         | 9.21 %         | D1                                 | D4                                |
| <b>Total</b>                             | <b>31.42 %</b> |                                    |                                   |
| Special wage tax <sup>2</sup>            | ca 1-3 %       | D4                                 | D4                                |

Note: D1(compensation of employees), D4(tax)

The enterprises are asked to report LCS on a web based questionnaire. The Swedish LCS questionnaire looks like this regarding the social contributions.

| E. Social insurance contributions                              |                                  | SEK thousands | If no cost, please mark! |
|--|----------------------------------|---------------|--------------------------|
| E.1 Employer contributions according to the law                |                                  |               |                          |
| E.2 Employer contributions according to contractual agreements | a. Collective agreement benefits |               | <input type="checkbox"/> |
|  | b. Individual contract benefits  |               | <input type="checkbox"/> |
|  | c. Other social insurance        |               | <input type="checkbox"/> |
| E.3 Special wage tax, etc.                                     |                                  |               | <input type="checkbox"/> |

E1. *Employers contributions according to the law*, is 31.42 % for employees between 26-65 years. For young and old people the contributions are lower. The *Special wage tax* (E3) is a tax (24.26 %) on pension cost that is paid when an enterprise have a collective agreement or individual agreement regarding pension. According to the new interpretation of the definition in NA, part of E1 should be considered as tax instead of social contribution. If LCS changes the definition, companies will have difficulties to separate the different parts of the social contributions. The companies that follow recommended standard for accounting usually have two account numbers for statutory social contributions, one for the young employees and one for the rest. If LCS need to change the definition it will most likely be very difficult, maybe impossible, to collect this separate. One option is to try to create a model to separate parts of statutory social contribution (E1) to be classified as tax (D4) together with E3.

It is a borderline between what should be considered as social contributions vs taxes. Some say that, since it is "earmarked" funds for various work-related expenses it is not a tax, like funds in event of sickness, pensions, different kinds of insurance and so on. In practice, some say that not all money is used for this and therefore it can be considered as tax instead of social contributions.

<sup>2</sup> Special wage tax is 24,26 % of pension costs

Are there similar borderline cases and discussions in other countries? What is the best solution for LCS2016? Below is a table that show the distribution for salaries, social contributions and tax in the countries from LCS2012.

**Distribution of Salaries, Social contributions and taxes from LCS2012**

| GEO/LCSTRUCT           | D11 - Wages and salaries | D12 - Employers' social contributions | D4 - Taxes |
|------------------------|--------------------------|---------------------------------------|------------|
| France                 | 65,37                    | 30,89                                 | 2,30       |
| Belgium                | 72,20                    | 30,38                                 | 0,06       |
| Sweden                 | 68,22                    | 28,80                                 | 1,58       |
| Lithuania              | 72,02                    | 27,78                                 | 0,13       |
| Italy                  | 72,02                    | 27,62                                 | 0,00       |
| Czech Republic         | 73,22                    | 26,03                                 | 0,01       |
| Estonia                | 73,39                    | 25,82                                 | :          |
| Slovakia               | 74,19                    | 25,35                                 | 0,01       |
| Spain                  | 74,07                    | 25,26                                 | :          |
| Austria                | 73,73                    | 23,89                                 | 2,21       |
| EU (28 countries)      | 75,75                    | 22,67                                 | 0,54       |
| Hungary                | 75,26                    | 22,29                                 | :          |
| Greece                 | 77,97                    | 21,98                                 | 0,05       |
| Romania                | 77,29                    | 21,84                                 | :          |
| Germany                | 77,76                    | 21,73                                 | 0,05       |
| Netherlands            | 76,15                    | 21,46                                 | 0,06       |
| Finland                | 77,84                    | 21,31                                 | :          |
| Latvia                 | 79,18                    | 20,62                                 | 0,04       |
| Iceland                | 79,30                    | 19,96                                 | 0,74       |
| Portugal               | 80,38                    | 19,17                                 | :          |
| Montenegro             | 79,82                    | 19,13                                 | 1,35       |
| Switzerland            | 79,04                    | 17,56                                 | :          |
| Poland                 | 81,67                    | 16,46                                 | :          |
| Cyprus                 | 83,35                    | 16,08                                 | 0,23       |
| Serbia                 | 84,50                    | 15,97                                 | :          |
| Bulgaria               | 84,32                    | 15,80                                 | 0,05       |
| Turkey                 | 83,81                    | 15,67                                 | 0,01       |
| Slovenia               | 84,27                    | 15,42                                 | 0,14       |
| Croatia                | 85,08                    | 14,65                                 | :          |
| United Kingdom         | 83,64                    | 14,06                                 | :          |
| Ireland                | 86,37                    | 13,06                                 | :          |
| Luxembourg             | 86,27                    | 12,91                                 | :          |
| Denmark                | 86,92                    | 10,76                                 | 1,44       |
| Norway                 | 81,88                    | 8,15                                  | 10,76      |
| Bosnia and Herzegovina | 91,63                    | 7,95                                  | :          |
| Malta                  | 93,07                    | 7,91                                  | :          |
| Macedonia              | 94,50                    | 1,05                                  | 1,82       |

Source: Eurostat's database

## **2. Pension cost for former employees not working anymore**

Another borderline case is how should to treat pension costs for employees that now are retired and no longer employed?

Some enterprises in Sweden pays pensions to persons who were employed by the company, but now are retired. This pension cost is included in the social contributions and in these cases the social contribution cost per employee can be high. It is a cost for the company, but not for having the present employees. Should this cost be included? Where should it be included?

## **3. Sick pay and payment for parental leave - Salary or social contributions?**

A third borderline case is how sick payments are considered. Sick pay and payment during parental leave are treated as salary by the enterprise in Sweden but treated as social contributions in LCS. It can be confusing and sometimes difficult to collect.

### **Payment in event of sickness**

Companies in Sweden record sick payment as salary and it is part of the gross salary in the accounting. By law the companies need to pay 80 % out of agreed salary to the employees, sick day 2-14. (Salary is not paid for first day of sickness.) After 14 days of sick leave the Health insurance found pays the employee and the employer don't have any costs for that person. (Sometimes a company pays more if collective agreement states that.) This 'salary' is treated as social contributions in LCS. Sometimes the companies only have information about gross salary and the amount of salary that have been reduced, not the sick pay. This can be tricky to calculate. To not confuse the respondents the sick pay is asked for as a salary, but are transferred to social contribution when reporting LCS to Eurostat.

### **Payment from parental leave**

Parents get 80 % from the Health insurance found when they are on parental leave. The companies have no cost for them, but it is common that the company pays additional 10 % out of agreed salary to persons that are on parental leave because of collective agreements. Sweden have collected this cost together with payment for sickness and transferred to the socials contribution item in LCS.