Agencia Tributaria

TAX REVENUE ANNUAL REPORT

2017

TAX REVENUE IN 2017

In 2017, Total Tax Revenue stood up 4.1% to €194 billion. The main two reasons for this performance were the tax bases evolution and, on the other hand, the results of Personal Income Tax and Corporation Tax 2016 annual returns. The boost of revenue driven by those factors was narrowed by the new Value Added Tax management system (known as Immediate Supply of Information, SII), which caused a displacement of collection to 2018 and an enlargement of the amount of refunds paid. **Without SII effect, revenue would have scaled by 6.4%**.

<u>Aggregate tax base, which includes the main taxes, grew by 5.6% in 2017, with an enhancing performance of both the bases linked to income as well as those linked to expenditure</u>. Income was boosted by jobs creation and corporations and personal businesses profit increase. On the other side, spending was higher too, especially in the first part of the year, pushed up by the prices hike that took place at the end of 2016 and the beginning of 2017. These data are consistent with the main features shown by the economic background in the year: slight lessening of economic activity, prices rise and employment generation.

<u>The second reason that explains 2017 Tax Revenue performance was the collection of Personal Income Tax (PIT) and Corporation Tax (CT) 2016 annual returns, particularly the first of them</u>. These results were not tied in with 2017 economy evolution but to the income generated in 2016, which was the period assessed in those returns. A part of the improvement has to do with the gradual way of carrying out the fiscal reform of the direct taxes, which began in 2015 and ended in 2017, once collected 2016 annual returns and after being in force the new CT base rules, passed at the end of 2016.

<u>Changes in VAT management had a noticeable impact on revenue evolution since the moment in which they were set out</u>. Along the year, receipts displacement and, at the same time, refunds increment, caused by SII, subtracted together €4.2 billion to total revenue. Nonetheless, some other new rules balanced partially that effect, so that the total loss was reduced finally to €3.4 billion.

The economic climate

Real GDP rose by 3.1% in 2017, two tenths under the rate scored in 2016. The track followed by economic figures along 2017 revealed a slight slowdown in the second half, if quarter-to-quarter rates are considered: 0.7%, below 0.8% in the first half. Breaking down GDP, domestic demand increased its overall weight. Employment generation (full-time equivalent figures) stemmed from the strengthening economy and achieved nearly the growth of 2016, though if it is measured using worked hours, the slowdown became sharper.

One of the most outstanding features in the year was the prices hike. After a long stable period, mainly at consumer level, prices bounced back in 2017, mostly in the first months of the year. At the end of 2017, GDP deflator went up by 1% and household final consumption expenditure by 1.8%. The key for the change in prices trend was in the energy prices, which fell in 2016 and bounced back strongly in 2017, though the prices of the rest of goods and services grew moderately too (core inflation of consumer goods and services was three tenths higher than in 2016).

In order to follow revenue performance the macro magnitude more relevant is the domestic demand at current prices. It increased by 4.6%, nearly two points above the rate scored in 2016, mainly as a result of prices evolution. Other magnitude related to tax revenue is the compensation of employees, which advanced a 3.3%, four tenths more than in 2016 (2.9%). The slight recovery of average compensation was higher than jobs creation slowdown. Short-term indicators, obtained from self-assessments, shown similar signals than those taken from summaries stats as the National Accounting. The main indicator is that of the non-financial Large Corporations sales, seasonal adjusted and deflated figures, which enlarged by 3.7%, two tenths higher than in 2016 (www.agenciatributaria.es). The trend was steady along the time, but taking a wider review on their evolution the total sales had touched a maximum in 2015 and followed a slowing down trend since then and until the end of 2016. In that moment, they bounced back gently and entered in a stable path in 2017. A similar course tracked the domestic sales, though some flatter, and so did exports. Related to the former, the growth was higher at the end of 2017 thanks to the performance of the sales for consumption. Concerning exports, the expansion was stable except in the middle of the year, moment in which they boosted, and returned to the previous rates in the last quarter of 2017.

The number of payroll workers in Large Corporations, used as indicator of wage employment, rose by 3.4%, rate under the one achieved in 2016 (3.6%). It reached the maximum at mid-year and lessened stepwise during the following months. Average gross salary in Large Corporations, a wage trend indicator, kept roughly the levels of 2016 but it was noteworthy the boost of the last months, well-established afterwards in the first months of 2018.

Tax Bases

In 2017, aggregate tax base, which includes the leading taxes, grew by 5.6%, nearly two points higher than in 2016. It enlarged for the fourth year in a row and it reaches a level alike to 2018 and close to 2017 maximum.

The enhancing performance was shown by both the bases linked to income as well as those linked to expenditure, though more powerful in this case pushed by prices hike. With some ups and downs, the trend was growing along the year, extending in time the upshot course revealed by the magnitude since mid-2015. This happened in spite of the lessening of prices along the year and its resulting effect in tax bases linked to expenditure.

Households' gross income increased by 4.1% (3.4% in 2016). It kept a stable growth, about 3.4%, from the beginning of 2015 to mid-2017, moment in which it began to follow an accelerated trend, long-established afterwards in the last quarters. This evolution did put income above the maximum levels of 2008. Earned income, the chief constituent, went up by 3.8%, compared to 3.4% in the previous year. The higher growth can be explained by wage bill evolution (4.6%), boosted by jobs creation and by average salary, in the last part of the year. On the other hand, pension bill rose by 2.8%, rate under the pace scored in 2016 because of the lack of growth of private pensions. Public pensions growth was alike to the one reached in 2016 (3%) and with a similar pattern (2% growth in average pensions due to the entering in the system of new retirees with higher pensions and 1% of higher number of pensioners).

Capital income (from savings, rentals and capital gains) enlarged by 4.9%, nearly three points above 2016, thanks mostly to capital gains (18.1%) with a particular strength of those proceeding from investment funds. Capital income from savings, mainly interests from bank deposits, kept on falling. Finally, personal businesses income ascended by 7.1%, more than in 2016 (5.5%).

Consolidated CT base estimate grew by 12.1%, rate more than a point higher than the one scored in 2016. In contrast to prior years, regulatory changes had little impact on the working out of the base in 2017. Anyway, it should be noted that the estimate is provisional as it includes only tax information available as of the closing date of this annual report (essentially, the bases of Large Corporations and Groups set in the instalments submitted to AEAT). Profit would have shown a positive performance too, likely with an enlargement of 11.2%, compared to 3.6% of 2016. Following the information included in instalments, Large Corporations and

Groups profit would have grown by 14.2%, but the profit would have been higher in the Fiscal Groups (18.2%) than in Large Corporations not belonging to Groups (8.5%).

Final spending subject to VAT scaled by 6.5% in 2017, 2.1 percentage points above 2016 rate. Prices hike can explain most of this difference: prices were stable in 2016, while they increased nearly 2% in 2017. Every component performed better than in the previous year. As the most weighty item, households consumption expenditure growth was the most significant of them all (6.5%), but at the same time this was the item most affected by prices hike. The other two items shown a stronger development: Public Administrations expenditure went from a 4.6% drop in 2016 to a 3.3% growth in 2017 and expenditure in new housing augmented by 16.4%, compared to 7.3% in 2016.

Consumption expenditure subject to Excise Taxes rose by 4.6%, opposite situation to the sharp fall of 2016 (4%). The value of these consumptions is largely conditioned by fuels and electricity prices. Fuels prices hike at the end of 2016 and the beginning of 2017 induced an upshot on the bases, but prices lessened in the second half of the year. On their side, consumptions measured in units, which are the base for some of these taxes, had an uneven performance. They grew in Fuel Excise Tax (with a pace alike to 2016') and Beer Excise Tax (3.9%), remained the same in Electricity Excise tax and shortened in Tobacco Excise Tax and Alcohol Excise Tax, in both cases due to the over- storing episode that took place before the rates rise of December 2016.

The effective tax rates

Effective rate on income and spending grew by 0.8% in 2017. The change in main taxes was not linked to legal alterations, which were marginal concerning rates, but to the own momentum of bases and prices, as it was the case of Excise Taxes. Average effective rate stayed around 15% in the last five years, higher than the maximum achieved before the economic downturn.

Effective rate on households' gross income rose by 1.9% (provisional estimate until the annual return result forecast is confirmed). Without the annual return, the effective rate would have only grown by 0.5%. The difference can be explained by the expected increase of the income not subject completely to withholdings (capital gains and businesses income, which are taxed with higher rates than average one) included in the 2017 annual return. For the rest of income (fully subject to withholdings), the growth was the result of the pensions effective rate increase, linked to the new retirees with higher pensions and to the income bands escalation effect ('bracket creep'), common for every recipient of labour income.

In 2017, a 3.2% increase in the effective rate of CT is expected. This growth is due only to a composition effect (the bases of the consolidated groups grow in a different way to that of the rest of the companies). Again, it has to be reminded that it is only a provisional estimate. Even so, the resulting estimate is inside the average rate since 2008 (20% if calculated on base and 10% if done on accounting profit).

The composition of spending is also the explanation for the slight fall (-0.2%) of VAT effective rate. The changes in the rates of some services (live shows, mixed hotel services), in force from mid-2017, are not relevant enough to impact in the whole tax. Along the last twelve years, VAT effective rate had changed from an average rate of around 11% to another above 15% after July 2010 and September 2012 increases.

Excise Taxes effective rate went down by 4.2%. The reason was the prices evolution, as explained before, that raised the value of consumptions subject to these taxes, in particular the products subject to Fuel Excise Tax. Nevertheless, this time there were certain changes in the legal rates, passed in December 2016, affecting Tobacco and Alcohol Excise Taxes. As a result, in the former, tax per pack of cigarettes grew by 2% and, in the latter, the tax per litre of pure alcohol increased by 4.3%.

Accrued Tax Revenue and Net Total Tax Revenue

As a result of bases and rates evolution, Accrued Revenue grew by 6.5% in 2017 (3.4% in 2016). The difference with the 4.1% Net Total Revenue pace was mainly driven by VAT management changes, particularly SII setting out. As it has been pointed out before, without

TOTAL TAX REVENUE
€ Million

	2013	2014	2015	2016	2017	growth rates (%) 13	14	15	16	17
Personal Income Tax	**69 952**	**72 662**	**72 346**	**72 416**	**77 038**	**-0,9**	**3,9**	**-0,4**	**0,1**	**6,4**
Corporations Income Tax	**19 945**	**18 713**	**20 649**	**21 678**	**23 143**	**-7,0**	**-6,2**	**10,3**	**5,0**	**6,8**
Non-Residents Income Tax	1 416	1 420	1 639	1 960	2 274	-17,1	0,2	15,5	19,6	16,0
Environmental taxes	1 570	1 625	1 864	1 574	1 807		3,5	14,7	-15,5	14,7
Other Revenue	167	195	256	197	193	-87,4	17,0	31,3	-22,9	-2,4
DIRECT TAXES TOTAL	***93 050***	***94 614***	***96 753***	***97 827***	***104 454***	***-2,1***	***1,7***	***2,3***	***1,1***	***6,8***
Value Added Tax	**51 931**	**56 174**	**60 305**	**62 845**	**63 647**	**2,9**	**8,2**	**7,4**	**4,2**	**1,3**
Excise Taxes	**19 073**	**19 104**	**19 147**	**19 866**	**20 308**	**4,7**	**0,2**	**0,2**	**3,8**	**2,2**
+ Alcohol, beer and other	1 008	1 073	1 091	1 108	1 176	-3,5	6,4	1,7	1,6	6,1
+ Fuels	9 933	9 724	9 783	10 556	10 881	15,6	-2,1	0,6	7,9	3,1
+ Tobacco	6 539	6 661	6 580	6 677	6 628	-7,4	1,9	-1,2	1,5	-0,7
+ Electricity	1 445	1 383	1 385	1 290	1 306	-4,1	-4,3	0,2	-6,8	1,2
+ Coal	148	265	309	229	312		79,2	16,8	-25,8	36,2
Custom Duties	1 311	1 526	1 757	1 856	1 928	-8,3	16,4	15,1	5,7	3,9
Insurance Primes Tax	1 325	1 317	1 355	1 376	1 449	-3,8	-0,6	2,9	1,6	5,3
Other revenue	86	113	164	178	186	-24,5	32,2	44,4	8,9	4,5
INDIRECT TAXES TOTAL	***73 725***	***78 233***	***82 726***	***86 122***	***87 518***	***3,0***	***6,1***	***5,7***	***4,1***	***1,6***
FEES AND OTHER REVENUE	***2 073***	***2 140***	***2 529***	***2 300***	***1 978***	***9,5***	***3,2***	***18,2***	***-9,0***	***-14,0***
TOTAL TAX REVENUE	***168 847***	***174 987***	***182 009***	***186 249***	***193 951***	***0,2***	***3,6***	***4,0***	***2,3***	***4,1***

SII effect, revenue would have climbed by 6.4%, pace alike to the one scored by accrued tax revenue.

Accrued PIT went up by 6% (4.6% without 2016 annual return). The most important component were payroll withholdings, which enlarged by 4.9%. Other items shown a more dynamic performance, as the withholding on investment funds gains, the payments on account and withholdings of personal businesses and, in the first place, 2016 annual return, though this last comment must be read with some caution, since at the time of closing this report there is only an estimated figure.

In 2017, PIT total revenue amounted to €77 billion and increased by 6.4% over 2016. The additional improvement observed in relation to the accrued tax was mainly due to the displacement of the annual return (2016 income was assessed in 2017), whose results were certainly boosting (the accrued annual return result showed a positive balance for the first time since 2006). In addition, although no changes were passed for the tax in 2017, cash collection was enhanced by new rules linked to the tax reform passed in previous years. Overall, the impact of regulatory changes that affected 2017 revenue amounted to €1.1 billion. After these impacts, the total estimate of reform cost is up to €7.7 billion.

Accrued CT estimate enlarged by 15.7% in 2017 (7.9% without the annual return). The main component of the tax are the instalments, which increased by 7.2%. Part of this augment was the result of the entering into force of RDL 3/2016, passed at the end of 2016; without it, the instalments rise would have been 5.7%. It is necessary to highlight also two more features of the growth. Firstly, the difference between the instalments increase in Small Corporations (22.7%), worked out according to the last annual return submitted, and in Large Corporations and Groups (5%), that do so on the current profit. Secondly, but linked to the first feature, the fall in the weight of the minimum payment (compulsory for the largest companies), due to tax base improvement.

CT total net revenue amounted to €23.1 billion, a rise of 6.8% over 2016. The instalments, the main component of the tax, grew at the same rate. In the rest of items, the increase in gross receipts of 2016 annual return (assessed in 2017) as well as in withholdings on investment funds gains were certainly outstanding. The decrease in the assessments worked out by AEAT, that scored unusually high levels in the two previous years, was also remarkable. The refunds paid to corporations enlarged too, although not with the same strength of the amounts requested in 2015 and 2016, fact that, as it is usual in this tax, helps to understand the differences between accrued taxes and collected revenue.

In 2017, accrued VAT grew by 6.2%, rate alike the increase in the final spending subject to VAT. In the year, the only legal changes were referred to rates lowering of some services, but its overall significance was just marginal. The two most impacting changes passed in 2017 (the new management through SII and the change of requirements needed to obtain deferments) do not affected the measure of accrued VAT, but distorted largely the cash receipts. Unlike accrued tax pace, VAT collection increased by only 1.3% to reach €63.6 billion. To find a comparable figure with 2016, the receipts displaced to 2018 as a result of SII setting out (€4.2 billion) should be added and 0.7 billion collected due to the change in the management of deferments should be subtracted. If this reckon is done, VAT revenue would have scaled by 6.8%, a rate consistent with the evolution of expenditure.

The accrued Excise Taxes rose by 0.2% in 2017 (2% in 2016). Puzzlingly, the low growth of revenue has to do with the rates rise of Tobacco and Alcohol taxes in December 2016. As it uses to happen in these cases, the rise was preceded by a massive output of the products from fiscal depots, which caused in the following months (the early months of 2017) a lower than normal consumption. The consequence was a decrease in accrued Tobacco Excise Tax (-4.8%) and in accrued Alcohol Excise Tax (-1.2%), despite the increase of rates in both items. Regarding accrued Fuel Excise Tax, the growth was similar to that of 2016 (2.6%), with a background of a mild lessening in the main consumption and an increase in natural gas consumption for the generation of electricity, linked to drought. This was also the fact that caused the boost of Coal Tax (30.5%). This upshot balanced the poor collection of 2016 and made the figure return to the level shown in 2015. Finally, accrued Electricity Tax went up by 1% without an increase of units consumption.

Excise Taxes total net revenue amounted to €20.3 billion and grew by 2.2%. The displacement to 2017 of revenue accrued in the last months of 2016 explains the better performance of cash receipts. This effect was seen especially in Tobacco and Alcohol Excise Taxes linked to the over-storing episode that took place prior to prices rise in December 2016 (the receipts associated to these greater outputs from fiscal depots were collected in 2017). Thus, Tobacco drop was only 0.7% while Alcohol increased by 7.2%. Although to a lesser extent, the temporary displacement also helped Electricity Excise Tax (1.2%) and Coal Tax (36.2%) yields. In addition, Fuel Tax refunds were reduced in 2017 and this fact provided an additional boost to cash receipts that finally grew by 3.1%.

In 2017, the rest of items collected €9.8 billion, 3.9% more than in 2016. Their weight on total collection was 5.1%. The highlights were the Non-Residents Income Tax (16%) and the Environmental Taxes (14.7%), both included in the first chapter of the Budget. Regarding the latter, it must be reminded that the opposite happened in 2016 (revenue decreased by more than 15%) and, in fact, the level reached in 2017 is still lower than in 2015. The explanation lies in the oscillations of prices in the electricity production market. On the negative side, it should be noted the fall of Chapter III (-14%), due to the decrease of the yield obtained from surcharges and interests, as well as the negative impact on Court Fees of the Constitutional Court Ruling of August of 2016 (declared some fees not to be according to law).

Tax Revenue and its comparison to Budget

In 2017, Total Tax collection were below the figure budgeted. The negative slippage was of €7 billion, that is 3.5% less than the level included in Budget. Most of the difference lies on SII entering into force, which displaced revenue from 2017 to 2018. Without this change in management, the drift would have been negative for an amount of €2.9 billion (1.4% of the amount forecasted in budget). Amending the impact of SII, the largest deviation is focused in Chapter III. PIT yield was 1.3% lower (1 billion). The main slippage occurred in payroll withholdings and was related to a wage increase far lower than that included, initially, in the macroeconomic scenery. The salary growth actually observed meant a lower wage bill than expected and, at the same time, a stability in the effective average rate, in contrast to what was derived from the growth of the average compensation of the budget forecasts. In addition, capital income fell more than expected and so did the withholdings. The good results of the annual return balanced about the half of these negative differences.

Also CT revenue was lower than that included in the Budget, amounting €1.3 billion less. The main cause of the slippage was a lower impact than expected from RDL 3/2016 rules, which brought about a lower revenue (0.9 billion) of instalments and 2016 annual return (submitted in 2017). In addition, the refunds requested were greater than expected, increasing the refunds paid also above the predictable figure by about 0.3 billion. Concerning VAT, without SII effect, the collection was higher than that foreseen in 0.3 billion. The explanation of this difference is found in a higher prices than those considered in the macro scenery (the consumption deflator was expected to grow by 1.5%, but finally it increased by 1.8%). Excise Taxes receipts were below the ones budgeted at 0.47 billion. The greatest deviations occurred in the Tobacco Excise Tax (-0.3) and in the Electricity Excise Tax (-0.13), in both cases due to a worse performance of consumptions than expected. Lastly, the lower growth of Fees, as well as the rest of Chapter III, meant a negative slippage of 0.5 billion under the initial forecast.