Working Party No. 2 on Tax Policy Analysis and Tax Statistics

CLASSIFICATION OF GENERAL SOCIAL SECURITY CONTRIBUTIONS IMPOSED IN THE NETHERLANDS

(Note by the Netherlands)

This document is submitted to the Steering Group on Revenue Statistics to Working Party No.2 FOR DISCUSSION under item V of the agenda of their meeting to be held on 14 November 2000.

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CLASSIFICATION OF GENERAL SOCIAL SECURITY CONTRIBUTIONS IMPOSED IN THE NETHERLANDS

I. Introduction

1. The Netherlands has always reported revenues from general social security contributions in Revenue Statistics under heading 2000 of the OECD Classification of Taxes. The WP2 Secretariat has questioned this practice, given that after the tax reform of 1990 the tax base of these contributions is the same as the tax base of the personal income tax, with all personal allowances applied. The WP2 Secretariat has suggested that revenues from such contributions should instead be reported under heading 1000, in view of what is said in paragraph 30 of the OECD Interpretative Guide. This paragraph states that “included in the heading Taxes on income, profits and capital gains (1000) are social security contributions based on net income after deductions and exemptions for personal circumstances.” Only “when such contributions are based on eligible earnings without deduction or exemptions for personal circumstances, they are normally included in heading 2000.”

2. In the case of the Netherlands, the classification of general social security contributions is no small matter. In year 2000 revenues from these contributions amount to Gld 78.6 bn or 8.9 per cent of GDP.

3. During the 6th Meeting of the Steering Group on Revenue Statistics, the Delegate for the Netherlands indicated that his country did not share the Secretariat’s interpretation of the Interpretative Guide. It was then agreed that the Secretariat, in close co-operation with the Delegate for the Netherlands, would draft a note reviewing both the arguments in favour and against classifying the contributions concerned under headings 1100 and 2400, respectively (see paragraph 29 of the Minutes of the 6th Meeting of the Steering group, DAFFE/CFA/WP2/M(99)4). The goal of this exercise is to reach a balanced conclusion regarding the classification of general social security contributions levied in the Netherlands, taking into account relevant particulars of the programmes concerned.

4. The present note follows up on what was agreed at the 6th Meeting of the Steering Group. It is organised as follows. Section II introduces the social protection system of the Netherlands. This essential background information may assist Delegates in their appreciation of the type of programmes under review. Section III details the three general social security programmes concerned. Section IV reviews the arguments to classify the contributions to finance these programmes as taxes on income (under heading 1000) or alternatively as social security contributions (under heading 2000). Section V concludes.

II. System of social protection

5. This section introduces the system of social protection in the Netherlands. The description refers to social programmes as in force per January 1, 2000. As is the case in most other OECD Member countries, both cash and non-cash benefits are organised through a multitude of public programmes, often supplemented by various private plans.
Public programmes

6. **General social security programmes.** These Beveridge-type programmes provide for basic old age pension (AOW), survivor’s pension (ANW) and cover costs of long-term health care (AWBZ). Currently, outlays for these three programmes are almost exclusively financed out of revenues from earmarked social security contributions levied by the Internal Revenue Service. As a consequence of the Tax reform 2001, by 2002 about 16 per cent of the outlays for general social security programmes will be financed out of general government revenues (see Table 4 below). The general social insurances are discussed in greater detail in Section III.

7. **Employee social insurances.** These Bismarck-type programmes provide workers with benefits in the case of unemployment (WW), disability (WAO) and sickness (ZW). Benefits are related to previous earnings, with a maximum. The ZFW programme has a broader target group than just employees, covering medical costs of both lower-paid employees, almost all benefit recipients and self-employed earning relatively small profits. About 64 per cent of the population is insured under the obligatory ZFW-programme (CPB 1999a, 211). The employee social insurances are almost exclusively financed by earmarked contributions paid by employers, their employees and benefit recipients. Contributions are flat rate, with a cap, and are collected by specialised agencies responsible for carrying out the employee social insurances (so-called ‘uitvoeringsinstellingen’, of which there are currently five).

8. The **disability insurance for the self-employed** (WAZ) is financed by earmarked contributions due by the insured group and collected by the Internal Revenue Service.

9. **Social assistance programmes** include the national social safety net (ABW), child benefit (AKW), various programmes offering additional (public) employment, and disability benefits for handicapped without a previous employment record (WAJONG). All social assistance programmes are financed out of general government revenues.

10. General government also hands out various **cash benefits**, such as student loans and grants, and subsidies to make quality housing available to low-income renters. Among other items, **non-cash transfers** to families include free education for children under 16 and provisions for the handicapped (transportation, adaptations in the home).

11. Table 1 summarises public outlays for all programmes identified in paragraphs 6-9.

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1 Public sickness insurance offers protection to workers (flexworkers, pregnant workers) not covered by the obligation of employers to continue paying wages to sick employees (paragraph 13).

2 The remaining 36 percent of the population have to take out private health insurance.

3 The self-employed are covered by the ZFW programme as from 2000 and also pay contributions for this employee social insurance scheme.
Table 1  Social insurance and social assistance, 1999 (billions of guilders)

<table>
<thead>
<tr>
<th>Outlays</th>
<th>Financing</th>
</tr>
</thead>
<tbody>
<tr>
<td>General social security (exclusive of AWBZ)</td>
<td>General social security contributions</td>
</tr>
<tr>
<td></td>
<td>72.4</td>
</tr>
<tr>
<td>Employee social insurances</td>
<td>Employee social insurance contributions</td>
</tr>
<tr>
<td></td>
<td>60.4</td>
</tr>
<tr>
<td>Disability insurance for the self-employed</td>
<td>Contributions for disability insurance of self-</td>
</tr>
<tr>
<td></td>
<td>employed</td>
</tr>
<tr>
<td></td>
<td>1.2</td>
</tr>
<tr>
<td>Social assistance programmes</td>
<td>General revenue</td>
</tr>
<tr>
<td></td>
<td>32.7</td>
</tr>
<tr>
<td>Health care a)</td>
<td>Private payments b)</td>
</tr>
<tr>
<td></td>
<td>15.0</td>
</tr>
<tr>
<td>Surplus</td>
<td>Cross-payments c)</td>
</tr>
<tr>
<td></td>
<td>2.8</td>
</tr>
<tr>
<td></td>
<td>184.5</td>
</tr>
<tr>
<td></td>
<td>184.5</td>
</tr>
<tr>
<td>as per cent of GDP</td>
<td>22.8</td>
</tr>
</tbody>
</table>

a) Includes AWBZ and privately insured health care.
b) Includes privately insured health care.
c) Received from other social protection agencies.

Source: Ministry of Social Affairs and Employment (1999, 172 and 176)
             Ministry of Health (1999, 157)

Private plans

12. Apart from this broad range of publicly financed cash and non-cash transfers to families, government regulation (for example, dealing with legal minimum wage and labour conditions) and various private plans offer workers additional social protection.

13. In the case of sickness, employers are obliged to pay at least 70 per cent of the contracted wage for up to a year. In practice, almost all collective wage contracts stipulate that sick workers are entitled to the full contracted wage. In 1998, on an annual basis, the costs to employers amounted to Gld 12.4 bn or 1.6 per cent of GDP (CBS 1999, 185). To cover this risk most smaller firms have taken out private insurance; often these are ‘stop-loss’ policies where the insurance company has agreed to reimburse any wage payments made to sick employees once such payments by the employer exceed a given threshold amount.

14. Almost 90 per cent of all employees are covered by occupational pension plans offering old age pension, starting at age 65, which tops up the basic public AOW pension. Virtually all occupational pension plans are of the defined benefits-type, mostly of the final-pay variant. Employers pay about two-thirds of the contributions to occupational pension plans, employees contribute the remaining one-third.

15. Most employees have the option of early or flexible retirement. In practice, many workers retire at age 61-63 and they may in that case receive (net) benefits as high as 75-90 per cent of their previous (net) wages. These plans used to be financed on a pay-as-you-go basis and are rapidly being replaced by funded flexible retirement schemes.

16. Self-employed and directors of closely-held companies will often contract private social insurance, notably to cover the risk of income loss due to sickness/disability.
17. Table 2 summarises the costs of private plans identified in paragraphs 14, 15 (funded early retirement plans only)\(^4\) and 16. Wages paid to sick workers are not included, the main reason being that Table 2 is based on National Accounts data. In the National Accounts amounts paid by employers to their sick employees are registered as part of total wages and not as transfer payments.

**Table 2**: Pension fund saving and private social insurance, 1998 (billion guilders) a)

<table>
<thead>
<tr>
<th>Funding</th>
<th>104.3</th>
<th>Outlays and growth of reserves</th>
<th>104.3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contributions to pension schemes</td>
<td>22.6</td>
<td>Pension benefits</td>
<td>34.4</td>
</tr>
<tr>
<td>Income earned by funds</td>
<td>48.3</td>
<td>Life insurance payments</td>
<td>11.3</td>
</tr>
<tr>
<td>Contributions to life insurance companies</td>
<td>19.4</td>
<td>Private social insurance benefits b)</td>
<td>2.2</td>
</tr>
<tr>
<td>Income earned by life insurance companies</td>
<td>11.8</td>
<td>Accumulated funds</td>
<td>57.4</td>
</tr>
<tr>
<td>Private social insurance contributions b)</td>
<td>2.2</td>
<td>Total</td>
<td>104.3</td>
</tr>
<tr>
<td>Total as per cent of GDP</td>
<td>13.4</td>
<td>Total</td>
<td>104.3</td>
</tr>
</tbody>
</table>

a) The left-hand and the right-hand panel of this table do not show administrative costs and profits of private insurance companies which total Gld 11.7 billion.

b) Excluding private health insurance.

Sources: CBS (1999, 164)

III. General social security programmes

18. The three general social security programmes have in common that, in principle, they cover the whole population. These programmes are also similar in that they are currently financed by earmarked social security contributions collected by the Internal Revenue Service in combination with the personal income tax (see Table 3). The tax base of general social security contributions and the personal income tax is identical. Also, all personal allowances of the personal income tax apply when computing contributions for the general social security programmes.

19. Under the AOW programme, all individuals aged 65 and over are entitled to basic old age pension. With one important exception, pensions are not related to contributions made in the past.\(^5\) Pension benefits are not tested for other income or net wealth of recipients. The amount of the pension, which is paid out monthly, is linked to the level of the (net) minimum wage and differs only by household type. Single senior citizens receive about 70 per cent of net minimum wage; seniors sharing a household – married or unmarried – are each entitled to a pension equal to about 50 per cent of net minimum wage. The rate of the earmarked social security contribution to finance the programme is 17.9 per cent and it applies to taxable income in the first and second brackets of the personal income tax. The contribution is capped, since income in the third and fourth brackets is subject only to personal income tax. In 2000,

\(^4\) In the system of the National Accounts, the costs of pay-as-you-go financed early retirement plans are a component of aggregate wage costs and cannot be identified as a separate item.

\(^5\) The exception is that Dutch citizens living abroad lose 1/50\(^{th}\) of their entitlement for each year abroad when they miss paying (on a voluntary basis) the maximum contribution due.
revenue from the AOW contribution amounts to Gld 44.6 bn (Ministry of Social Affairs and Employment 2000, 215).

20. Under the ANW programme, individuals aged under 65 with children aged under 18 are entitled to survivor’s pension. Survivor’s pension is not related to contributions made in the past. The benefit for survivors is equal to (about) 70 per cent of net minimum wage. A means test applies: benefits are reduced by 1/3 of income from (self-)employment. The rate of the earmarked social security contribution is 1.25 per cent. The tax base of the contribution is taxable income in the first and second brackets of the personal income tax. In 2000, revenue from the ANW contribution amounts to Gld 3.7 bn (Ministry of Social Affairs and Employment 2000, 215).

21. The AWBZ programme covers mainly costs of long-term health care. Entitlements are not related in any way to contributions made in the past. Care providers are directly reimbursed out of the AWBZ Fund. In a number of cases, patients are in addition required to make direct payments to providers. The rate of the earmarked social security contribution is 10.25 per cent. The tax base of the contribution is taxable income in the first and second brackets of the personal income tax. In 2000, revenue from the AWBZ contribution amounts to Gld 30.3 bn (Ministry of Health 2000, 196).

22. Table 3 summarises the combined rates of personal income tax and contributions for the three general social insurances that apply to taxable income.

<table>
<thead>
<tr>
<th>Bracket</th>
<th>Number length GLD</th>
<th>Personal Income tax</th>
<th>Contributions</th>
<th>Combined rate a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>15,255</td>
<td>4.5</td>
<td>17.9</td>
<td>1.25</td>
</tr>
<tr>
<td>2</td>
<td>33,739</td>
<td>8.55</td>
<td>17.9</td>
<td>1.25</td>
</tr>
<tr>
<td>3</td>
<td>58,762</td>
<td>50</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>4</td>
<td>00</td>
<td>60</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
</tbody>
</table>

a) Rates differ because senior citizens do not pay AOW contributions.

23. From the description above, it follows that the three programmes reviewed here are no insurance arrangements in the usual sense of the word, because in practice there is no actuarially fair link between individual entitlements, risk (for example, health status) and contributions paid. The “insurance” element – in so far as there is any – is further weakened because over the years the general social insurances have been financed partly out of general government revenues, instead of fully out of contributions proper (see Table 4).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>General government revenues</td>
<td>22</td>
<td>2</td>
<td>28</td>
<td>0</td>
<td>0</td>
<td>16</td>
</tr>
</tbody>
</table>

a) Estimate.

Source: Stevens Committee (1991, 184) and Ministry of Finance (2000, 217 and 220)

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6 Under a grandfathering clause, all individuals born before January 1, 1950 are entitled to survivor’s pension, also in cases where they do not take care of child(ren) under 18.

7 In applying the means test, income from (self-)employment up to 50 per cent of the minimum wage is exempted.
24. Although contributions to finance general social security are levied as a percentage of taxable income, and contribution rates are co-ordinated closely with rates of the personal income tax, said contributions differ from the personal income tax in a number of ways. First, revenues from these contributions are earmarked to finance the three major transfer programmes. Second, the over-all distributive impact of the contributions is regressive (because of the cap) and differs markedly from the progressive distribution of personal income taxes, reflecting the idea that in the case of an insurance there should be limits to the degree of solidarity the government can impose on taxpayers. As noted, this argument need not be decisive, given that the programmes discussed here can hardly be said to be of the insurance type. Third, different from the personal income tax, contributions to finance the general social insurances are outside the territory covered by international tax treaties. This can be illustrated for the cases of employees who live in the Netherlands and work in Belgium or Germany, countries on the southern and eastern border of the Low lands.8

25. Article 15, paragraph 3 of the double taxation Treaty concluded between the Netherlands and Belgium stipulates that cross-border workers are taxed in the country where they are domiciled, provided they work and live in designated border areas.9 In cases where this condition is met the Dutch worker employed in Belgium pays personal income tax in the Netherlands (on his labour income earned in Belgium). The Treaty is currently being revised. Under the new Treaty rules, that will probably enter into force in 2003, workers will pay personal income tax in the country where they are employed (in this example, in Belgium). Social protection programmes are governed by completely different rules. Individuals who live in the Netherlands and work in Belgium (for more than three months) are no longer covered by general social security in their country of residence. More generally, once individuals resident in the Netherlands are protected by more or less similar programmes in third countries, they are no longer covered by Dutch general social security programmes and no longer pay contributions in the Netherlands. This national legislation is in line with principles and regulation governing social protection in EU Member States. To avoid situations where citizens are doubly insured and pay twice for social protection, in principle, workers are protected by the social security system of the country where they are employed and must pay their contributions in the country of employment. Currently, some 6,000 Dutch workers are employed in Belgium.

26. The Protocol of 1979 that was added to the double taxation Treaty concluded between the Netherlands and Germany rules that workers pay tax on their wage earnings in the country where they are employed. Under the Protocol, Dutch workers employed in Germany – this group numbers about 15,000 – may for income tax purposes claim all allowances that German workers are entitled to under domestic law, provided that 90 per cent or more of the income of Dutch cross-border workers is taxed in Germany. These workers are covered by German social protection programmes, thus are outside the domain of Dutch general social security and are exempt from paying contributions in the Netherlands.

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8 The following is based on Kavelaars (1996, 176-183, 213 and 224-227).

9 Except Dutch nationals who migrated to Belgium after 1970 and kept their job in the Netherlands. Their labour income remains taxable in the Netherlands.
IV. Classification of general social security contributions

27. This section reviews arguments why general social security contributions, in spite of the explicit wording of paragraph 30 of the Interpretative guide, might still be classified in heading 2000 instead of in heading 1000. Before dealing with the various arguments pro and con it should be noted that the classification of these contributions offers no clear-cut case: the contributions concerned are situated in a ‘grey area’ between headings 1000 and 2000. The discussion below first addresses the arguments advanced by the Delegate for the Netherlands at the 6th Meeting of the Steering Group (refer paragraph 28 of the Minutes). Then there follow some additional arguments in support of continuing reporting revenues from general social security contributions in heading 2000.

28. One argument to include general social security contributions in heading 2000 may be that the tax base of these contributions is limited to taxable income in the first and second brackets (Table 3). As a consequence, the tax base of contributions includes only 75-80 per cent of the aggregate personal income tax base. On the other hand, for classification issues the Interpretative guide refers to the definition of the tax base as such, not to the part of the (potential) tax base that is actually subject to a particular tax.

29. The second argument to include general social security contributions in heading 2000 runs that the elderly pay a lower rate of contributions, since they are exempted from paying the AOW contribution for the basic old age pension. Therefore, contributions should not be reported under heading 1000. The exempted status of senior citizens reflects the idea that the AOW programme encompasses important insurance element. Once the insured risk (old age) has materialised, programme participants are no longer expected to contribute premiums, similar to the case where fire insurance premiums are no longer due once the insured building has burnt down. The alternative view is that it is the tax base that matters when classifying taxes (contributions), not the rate structure.

30. The third argument to include general social security contributions in heading 2000 is that the proceeds flow into separate funds that may, in principle, show no surplus or deficit. In this respect, the contributions differ from other taxes. The alternative view is that the destination of unrequited payments – to the general government budget, or to social funds – is not a relevant criterion when classifying taxes.

31. The fourth argument to include general social security contributions in heading 2000 refers to the fact that workers in border areas pay income tax (wage tax) and social security contributions under different regimes, depending on tax Treaties and EU social security regulations, respectively. The cases of cross-border workers employed in Belgium and Germany have been considered in paragraphs 25 and 26 above. In the view of some, this argument is not to the point, given that it is the tax base that should determine how a particular compulsory payment to general government is classified. Since the contributions finance social security programmes, it is not without logic that they are governed by EU social security rules which may imply an allocation of taxing powers between jurisdictions different from that laid down in tax Treaties covering the personal income tax. However, this need not bear on the classification of the proceeds of these contributions.

32. Few will dispute that the Interpretative guide should decide in matters of classification and the text of paragraph 30 of the Guide seems to state unequivocally that the contributions discussed in this note should be reported under heading 1000. However, the Delegate for the Netherlands has drawn attention to paragraph 39 of the Guide, which states “Exceptionally, however, social security contributions calculated on an income tax base may be included under 2000”. The Delegate has stressed that the Netherlands – in line with this opening offered by the Guide – strongly prefers to continue reporting contributions to finance general social security under heading 2000. However, given the spirit and general thrust of the illustrative
example included in the next sentence of paragraph 39, one may doubt whether the exception was written into the Guide to cover the case of the Dutch contributions to finance social security.

33. The Delegate for the Netherlands also stresses that his country reports revenues from general social security contributions under the equivalent of heading 2000 to the International Monetary Fund and the European Union. Both international organisations have adopted the interpretation of relevant international guidelines by the Dutch Central Bureau of Statistics how these contributions should be reported. A major inconsistency of international tax statistics would arise, were the OECD to report these contributions under a different heading. However, it should also be noted that the OECD is the only international organisation to include in its comparative tax statistics social security contributions imposed by general government. Other international organisations (IMF, Eurostat) follow National Accounts conventions and include government plus private sector contributions to finance social security under different headings. As a direct consequence, for a number of countries the Revenue Statistics report tax amounts that differ from aggregate tax revenues reported in other international statistical surveys.

V. For discussion

34. In a letter to the Secretariat, the Delegate for the Netherlands has underscored the view of his country that contributions to finance the three general social security programmes should continue being reported under heading 2000 of the OECD classification of taxes. This note outlines the programmes concerned and reviews arguments pro and con classifying these taxes under headings 1000 and 2000, respectively. Delegates are invited to discuss the issues raised in the note.

35. Issues related to social security contributions have been raised at previous meetings of the Steering Group. At the fourth meeting (§13 of the Minutes), the issue of whether a part of social security contributions could be regarded as fully requited was raised. At the sixth meeting (§48-57 of the Minutes) a number of issues were raised, including the borderline between compulsory and non-compulsory contributions. These issues have not yet been fully resolved by the Steering Group.

36. In view of the fact that there are several unresolved issues related to social security contributions, it may be appropriate to consider all of them together. One way to proceed on this would be for the Secretariat to prepare a Special Feature on social security contributions for the 2001 edition of Revenue Statistics, which could be discussed at the June 2001 meeting of the Steering Group or of Working Party No. 2. This would require some input from Delegates, in the form of descriptions of the aspects of their social security systems that may require particular consideration.

37. If Delegates accept this suggestion, the outstanding issues may be decided in June 2001, before the publication of the next edition of Revenue Statistics. If some of the issues remain unresolved, the Secretariat recommend that current reporting practices be continued for the time being, but that some method be used to draw attention to the issues involved. The Delegate for the Netherlands has suggested that one possibility would be for revenues reported under 2000 to be split between those that are raised on a base similar to income tax and those that are raised on a base of earnings, payroll or number of employees. A footnote would be used to explain the difference between the schemes.
REFERENCES


