Tax Liabilities on the Workforce: A Comparison between Turkey and OECD Countries

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Abstract

One of the frequently criticized issues in the Turkish tax system is the existence of a tax burden on employment. As it is known, according to the tax laws, the wages -which are one of the components of the income and when it said employment, it confronts us- has a significant place especially in the working process of the working world. The sum of all taxes and similar financial obligations on employment is called tax wedge. Income tax and social security cuts locate within the tax wedge. Besides, the burdens of tax on the employment-generating economic units and the spending and treatment tax that the employees have to bear while wasting their wages have an indirect effect on the employment. Tax responsibilities on the labor force constitute the subject of the study. In this context, a comparison was made between Turkey and the OECD countries at the point of the tax wedge, and the problems caused by tax wedge were determined. In conclusion, in the light of the findings that presented has been trying to put forward solutions.

Keywords : Labor, Tax Wedge, Turkey, OECD.

JEL Classification Codes : H21, H24.

Introduction

Wages, which are one of the elements of income according to tax laws, have a significant place, especially in the working process of the world of work. The results of policies developed and implemented on wages can be highly effective in determining and regulating the level of employment. In many countries, legal regulations on this issue occur in the form of reductions in wages or subsidies to wages. Policies developed for employee wages are becoming increasingly important today. The most important reasons for this are the general crises in the economies and the unemployment problem which has an increasing tendency in most countries. In addition to the macroeconomic stability and recovery in public finances, income-increasing measures, which are frequently used in times of crisis, have been replaced by tax cuts and demands for reducing the tax burden on employment have been discussed more intensively. The reason for this is that despite the positive developments in the growth, the desired improvement in the field of employment cannot be achieved and there is a heavy tax burden on individuals.

In the context of production factors, the question of how the tax burden on wages, which is the return of labor power, capital, and profit on capitals return, should be distributed fairly to society remains a matter of debate in the economic and financial field as it was in the past. Taking into account that the wage and tax structure on wage naturally affects the relative prices of goods, the position of capital and other production factors, the state's income structure and the distribution of national income, it is not easy to solve the problem. In simple terms, since a tax on production factors changes relative prices, this situation determines the employee decisions of enterprises affected by the tax systems (Connolly & Munro, 1999). In other words, the taxation of wages affects the employee costs incurred by employers and the net disposable income achieved by employees, and this mainly determines the supply and demand decisions of labor markets.

Tax Wedge

Labor has three dimensions that can be expressed as a factor of production, a human resource, and a primary source of income (Fleisher & Kniesner, 1980). The business relationship between the employee and the employer is based on a legal basis. This relationship can become functional by establishing either according to a contract of employment (service) or according to the rules of status law. With the establishment of such a relationship, a debt relationship reveals between the parties. This legal relationship between the parties of the business relationship brings along with the employee's dependence on the employer. In this context, it is called the labor market where labor supply and demand are faced, and wages, which are the price of labor, and other working conditions are determined. The concept of the labor market has been widely discussed, since the view that it degrades labor is dominant. (Ehrenberg & Smith, 2014). As it is known, goods and services are bought and sold in the markets, and the workforce cannot be bought or sold due to its structure. Therefore, the issue of taxation of labor from past to present has been widely discussed.

There are three basic methods in theory and practice in obtaining tax in proportion to financial power. The first is the principle of increasing ratio taxation, the second is the minimum living allowance, and the third is the principle of separation. However, tax cuts, exemptions, and exceptions applied for social purposes are also used to ensure justice in taxation. Since an individual whose income is barely sufficient to maintain its physiological existence cannot have tax payment power, the exclusion of the individual from the tax liability (Nadaroğlu, 1996: 310-315) is a requirement of the state's existence.

Taxation of labor or wage income is one of the important techniques for accessing the ability to pay in terms of tax justice. Based on the assumption that income generated by labor needs protection compared to capital income; the principle of separation is called to be taxed on labor income at a lower rate compared to income on wealth and capital (Akdoğan, 2011:252). In the economic doctrine, it has been suggested that labor income is weaker than capital income due to the quality difference between labor income and capital income and it is accepted that tax rates should be differentiated according to the source and quality of income (Şener, 2010: 251; Akdoğan, 2011: 252).

In Turkey, social security contributions, unemployment insurance fund, the employee share, income tax, and stamp tax are the primary financial obligations on wages. A financial obligation is taken from both the employee and the employer on the minimum wage, and the cost of the minimum wage to the employer is 3.006,12 TL according to 2019 data. The total cost to employer was 1.332,45 TL for 2014 and 2.088,56 TL according to 2017 minimum wage data. In the current tariff of income, however, wage income and other income are in different tax brackets at the same tariff. This is a reflection of the separation principle.

On the other hand, the most important application to reduce the tax burden on the minimum wage is the As Minimum Living Allowance, which is implemented instead of "Tax Wage Reduction" and is available to those who have been earning labor income since 2008. However, another financial obligation is social security contributions. Unemployment insurance fund cuts, which are used as automatic stabilizers of public expenditures and used to reduce social risks during periods of unemployment, are another financial obligation. Unemployment insurance applications in Turkey, have started to be implemented towards the end of the 1990s and against unemployment addition to the severance pat with the 1999 reform was launched as a new social and economic assurance mechanism.

The stoppage at source method is mainly used in the taxation of wages, and in some cases, the taxation of those who earn wage income by giving a declaration is adopted (Aydın, 2013: 82). In this method, the employer shall deduct the income tax raised from his salary from his source before paying his employee's salary to the employee or officer and pays it to the tax office on behalf of the employee as a taxpayer (Ünsal, 2006: 105). Therefore, the deduction made by the taxpayer means the last taxation.

The difference between the total cost of the employee to the employer and the net wage received by the employee is known as "tax wedge" in the literature. While the tax wedge adversely affects economic targets related to employment and the informal economy, it can also prevent the distribution of income groups and the equality target in the distribution (Aytaç, 2015: 136). Tax wedge, showing the ratio of total tax and insurance premium deductions to labor cost, shows the financial burden on employment in Turkey is too heavy (Yereli & Karadeniz, 2004; Tunç, 2007: 54). Above all, the high tax wedge leads to the growth of the informal economy and adversely affects competition and thus, domestic investments.

Tax Wedge in OECD Countries: Comparation with Turkey

When deductions in the wage of employees in OECD countries examined also seen similar practices to those in Turkey. The similarity of the applications is important in making comparisons.

In recent years, a number of practices have been introduced, especially in order to ease the tax burden of the wage sector. Similar to the minimum living allowance in Turkey, an application which called as "green check" was put into effect to financial facilities for employees in Denmark (Aydın, 2013: 82). Total liabilities of the employees in OECD countries, just as in Turkey, is the sum of personal income tax and social security cuts.

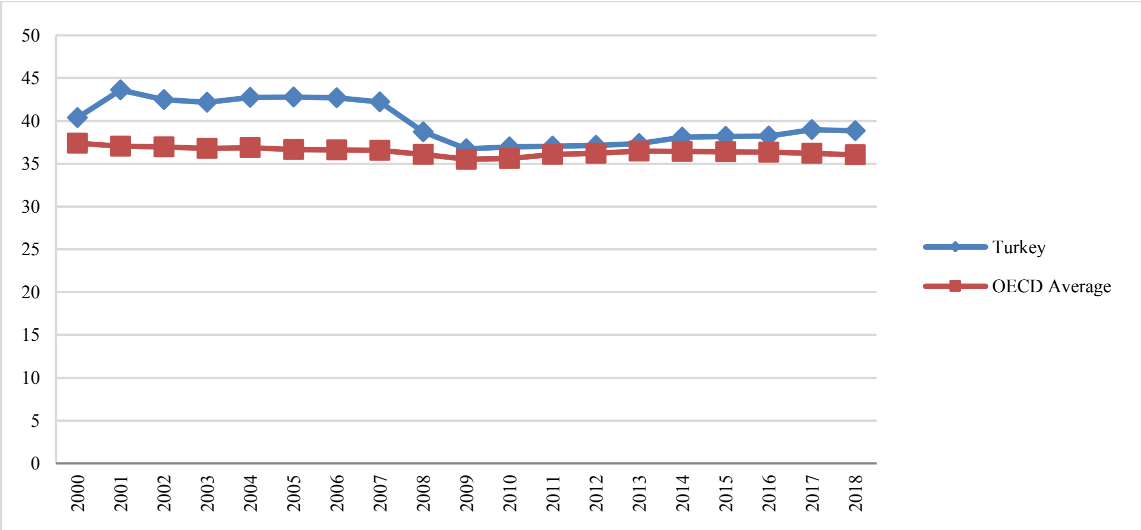
Table: 1 - Income Tax Plus Employee and Employer Social Security Contributions (%) (2018)

			Social Security Contributions	
Countries	**Total Tax Wedge**	**Income Tax**	**Employee**	**Employer**
Switzerland	22.2	10.5	5.9	5.9
Germany	49.5	16.0	17.3	16.2
Belgium	52.7	20.3	11.0	21.3
Luxembourg	38.2	15.1	10.8	12.3
Austria	47.6	11.6	14.0	22.1
Netherlands	37.7	15.6	11.6	10.4
Iceland	33.2	26.6	0.3	6.3
France	47.6	12.3	8.8	26.5
Sweden	43.1	13.8	5.3	23.9
Ireland	32.7	19.3	3.6	9.8
Norway	35.8	17.1	7.3	11.5
Australia	28.9	23.3	0.0	5.6
United Kingdom	30.9	12.6	8.5	9.8
Korea	23.0	5.8	7.7	9.5
Denmark	35.7	35.8	0.0	0.0.
Finland	42.3	16.6	8.1	17.6
Japan	32.6	6.8	12.5	13.3
Italy	47.9	16.7	7.2	24.0
United States	29.6	14.9	7.1	7.6
Spain	39.4	11.5	4.9	23.0
Canada	30.7	14.1	6.6	10.0
Greece	40.9	8.1	12.8	20.0
Israel	22.4	9.5	7.6	5.3
New Zealand	18.4	18.4	0.0	0.0
Czech Republic	43.7	10.2	8.2	25.4
Slovenia	43.3	10.3	19.0	13.9
Estonia	36.5	10.0	1.2	25.3
Portugal	40.7	12.6	8.9	19.2
Poland	35.8	6.3	15.3	17.4
Hungary	45.0	12.4	15.3	17.4
Turkey	**38.9**	**11.2**	**12.8**	**14.9**
Slovak Republic	41.7	8.0	10.3	23.5
Lithuania	40.6	10.0	6.9	23.8
Latvia	42.3	14.0	8.9	19.4
Chile	7.0	0.0	7.0	0.0
Mexico	19.7	7.9	1.2	10.5
OECD Average	**36.1**	**13.5**	**8.2**	**14.4**

Source: OECD Tax Wages 2018.

As can be seen, the financial obligations on wages vary between countries proportionally. The remarkable point in the table is the high employer share in social security cuts. The financial obligations under the responsibility of the employees are quite low in these countries. In this context, it is seen that there is an application in terms of labor protections in the mentioned countries.

Graph: 1 - Tax Wedge in Turkey (%) (2000-2018)



Source: OECD Tax Statistics, 2019.

When the Graphic is examined, it is seen that Turkey's tax wedge ratio has always watched over the OECD average. OECD average has remained stable at around 36% since 2001. In Turkey in 2000 was 40.3%, this rate increased to around 42% in 2005. Although it reached 38.9% in 2018, it is still above the OECD average. In the light of the information provided, in 2018, when compared to other countries, income tax and employer social insurance premiums are in OECD averages in Turkey, but employees' social security premiums are higher compared to other countries.

Conclusion

The height of the tax wedge causes the employer to shift production to the informal area. This leads to both unregistered works of employees and thus exclusion from social security, as well as the loss of taxation by the state. In recent years, the tax wedge tends to fall. It is possible to evaluate this trend as a positive development. The tax wedge rate, which had the highest value, with 43.6% in 2001, has seen the lowest rate of 37% in 2007-2008. In 2018, it was around 38.9%.

On the other hand, easing the tax wedge had a positive impact on workforce participation rates. However, it is rightly criticized for the high financial obligations on employment, which is seen as one of the main reasons for informal employment. As is known, the Turkish social security system is a system that works with a high rate of premiums. In our country, an amount close to the net wage received by the employee is paid to the related public institutions as insurance premium, income tax, and stamp tax. For this reason, employees turn to informality in order to avoid a heavy financial burden.

Lowering the tax wedge will alleviate the tax burden and become an important element in preventing informality. As a result, with the establishment of a fair tax system and the spread of the tax to the base, the tax wedge on the employees and the employer will be alleviated.

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