Boosting taxes by sharing taxes?

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Coimbra, 16th June 2025

European Commission

Aumentar a receita fiscal através da partilha de impostos entre estado central e municípios?

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The tax dilemma

More tax revenues would enable central governments to

- Accelerate the reduction of state debt.
- And/or increase public investment in better public services and infrastructure.

However, increasing taxes is not a good option as it either increase the burden on businesses, reducing economic growth or the burden on citizens, fueling populism.

How to increase revenues, while keeping taxes constant?

Is there a state tax policy that could increase revenues from taxes without raising taxes?

This would only be possible **if taxes supported socially inclusive economic growth and increased voluntary tax compliance.**

The more economic growth and the more voluntary tax compliance there is, the more tax revenue there will be.

Some other states provide an inspiring example by sharing state income taxes on individuals and businesses with municipalities based on origin.

Hypothetical examples

1. Providing municipalities a 20% share in the **State Personal Income** Tax **collected by the state tax administration** within the jurisdictions of the municipalities.

   → The higher income of local population, the more revenues in municipal budgets.

2. Providing municipalities a 10% share in **State Corporate Income** Tax **collected by the state tax administration** within the municipalities’ jurisdictions.

   → The more productive local businesses, the higher revenues in municipal budgets.

Effect on local business climate

- Local councils and mayors get interested in increasing the local tax base, regardless of their political background.

- The share of income tax revenues works as an incentive for municipalities: the more local businesses flourish and the more people earn, the more tax revenues flow into municipal budgets.

- **Municipalities turn into ‘competing business hubs’, taking care for the needs of whatever type of businesses to get them growing.**

How can municipalities support business?

Business needs land and buildings

Use of land planning ('zoning') are **in the hands of Municipalities**.

Issuing land and buildings for industrial/commercial activities is usually unpopular. Nobody wants new noise, pollution, additional traffic in the neighborhood. This is triggering resistance against any new development, so called 'not in my backyard effects'.

Municipalities **have to work hard** to convince their electorate of the benefits of new businesses.

How can municipalities support business?

Municipalities implement regulations

- Implementation of regulations (business registries, construction (permits and control), labor, residential permits, production, environmental regulations) often in **the hands of Municipalities as delegated tasks.**

- **Fast and efficient** implementation of such regulations very decisive for productivity of local businesses.

Example

The number of days required for construction permits in various Italian cities (World Bank 2019)

Reggio Calabria:
325 days

Milan:
105 days

Compared to Milan, the Italian **state would lose 220 days in personal and corporate income tax** if the same business were to start up in Reggio Calabria.

Other levers of municipalities

- Quality of local physical infrastructure (roads, bridges)
- Public transport, basic services (water supply, sewage, waste management)
- Social services (like local childcare centers, school education and professional training and social housing)
- Local social cohesion and stability
- **Particular important for Portugal and Brazil: Harnessing the potential of local natural and historical amenities to attract highly skilled work force back home.**

The incentive effect

- Providing an excellent local business climate requires a high level of effort from municipalities and their enduring motivation. Investing in a good business climate should 'pay off' for municipalities.

- Replacing state transfers from the central budget to municipalities with a share of state direct taxes creates a direct link between local economies and local budgets.

- This incentivises municipalities to support all local economic activities (both individuals and businesses) using all the tools at their disposal, thereby unlocking untapped potential for local economic growth and increasing economic growth.

The tax compliance effect of tax sharing

Another effect of tax sharing with municipalities: Increasing (voluntary?) tax compliance.

The more taxes are paid to the municipality where the taxpayer is living,

- the more tangible for what to pay the taxes;
- the more informal control of the quality of local services and infrastructure provided by municipalities;
- and the better the quality of local services, the higher readiness to pay taxes.
- **Once a citizen has paid their taxes in full, they become an ally of the tax inspectors, exerting informal social pressure on their local peers to ensure they comply with tax regulations.**

Empirical evidence

- At the example of local governments in China:
  Chen, et al, 2024. ‘Revenue sharing, fiscal incentives, and economic growth: Evidence from China’, Kyklos, vol. 77(1), pages 149-183

- At the example of local governments in Italy:
  Ferraresi M. et al, 2025, ‘Does Local Fiscal Autonomy Increase Local Income? Evidence from Italy’, SSRN: *https://ssrn.com/abstract=5192019*

The case of Ukraine’s decentralisation reform

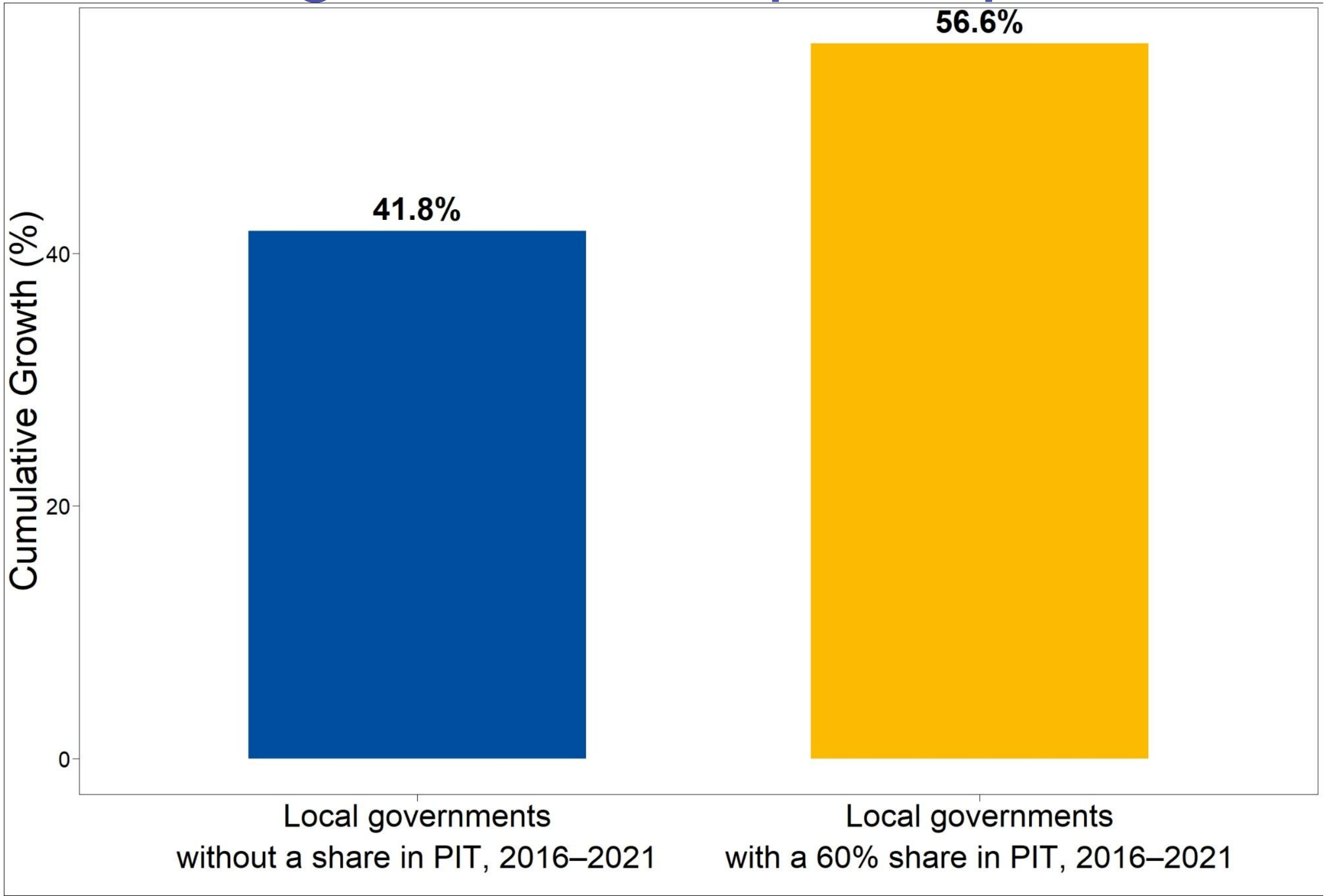
Settlements could amalgamate voluntarily into new local governments in the years 2015 – 2020.

Following constituent elections, **the new local governments received 60% of State Personal Income Tax collected** in their jurisdiction.

Remaining local governments had no share in State Personal Income Tax, received instead transfers from state administration.

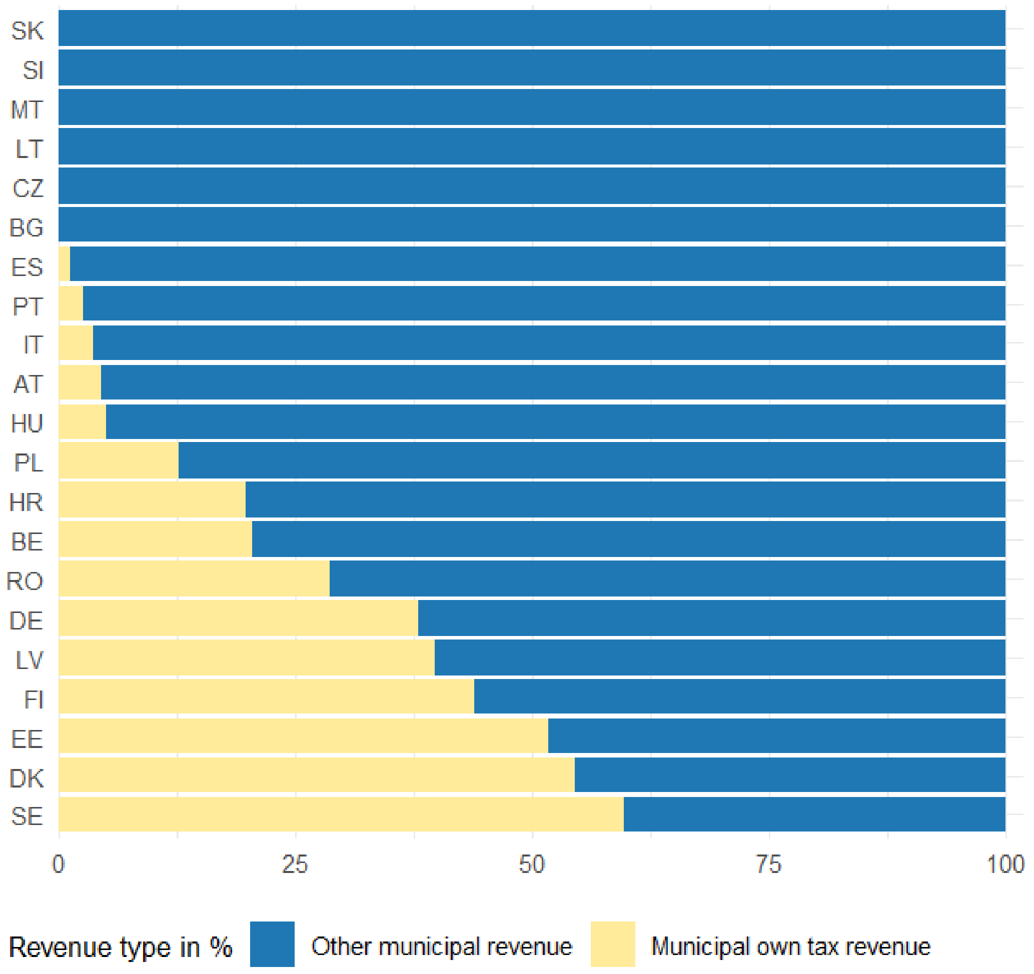
From 2016 to 2021 to fiscal structures coexisted in Ukraine: Local governments without a 60% share (more transfers instead) and local governments with 60% share in State Personal Income tax.

Cumulative growth in PIT per capita 2016 - 2021



Source: Own calculations, based on data from the Ukrainian Ministry of Finance

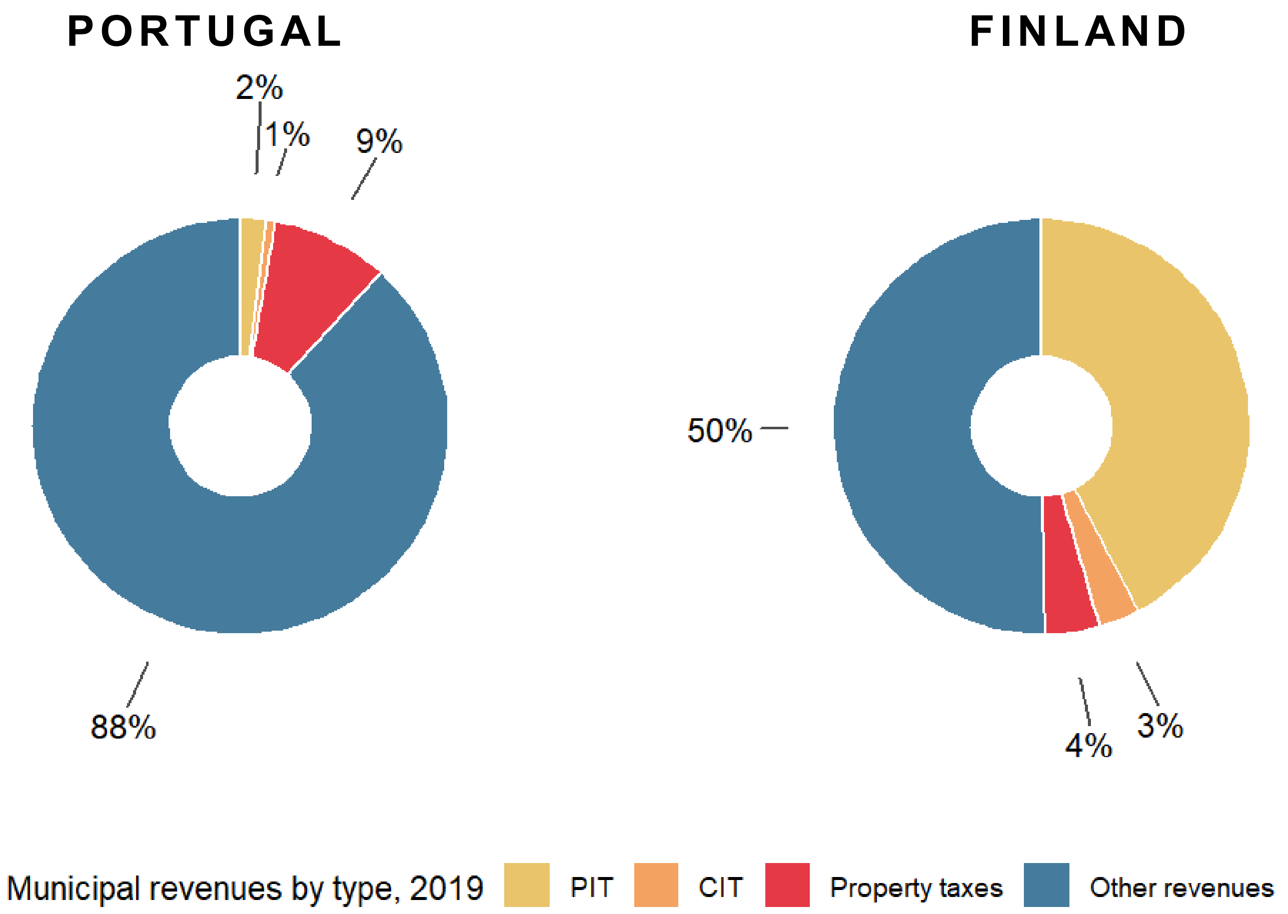
Shared income taxes across the EU



Share of municipal revenues from **direct income taxes (personal and corporate** in total revenues of municipalities, 2019

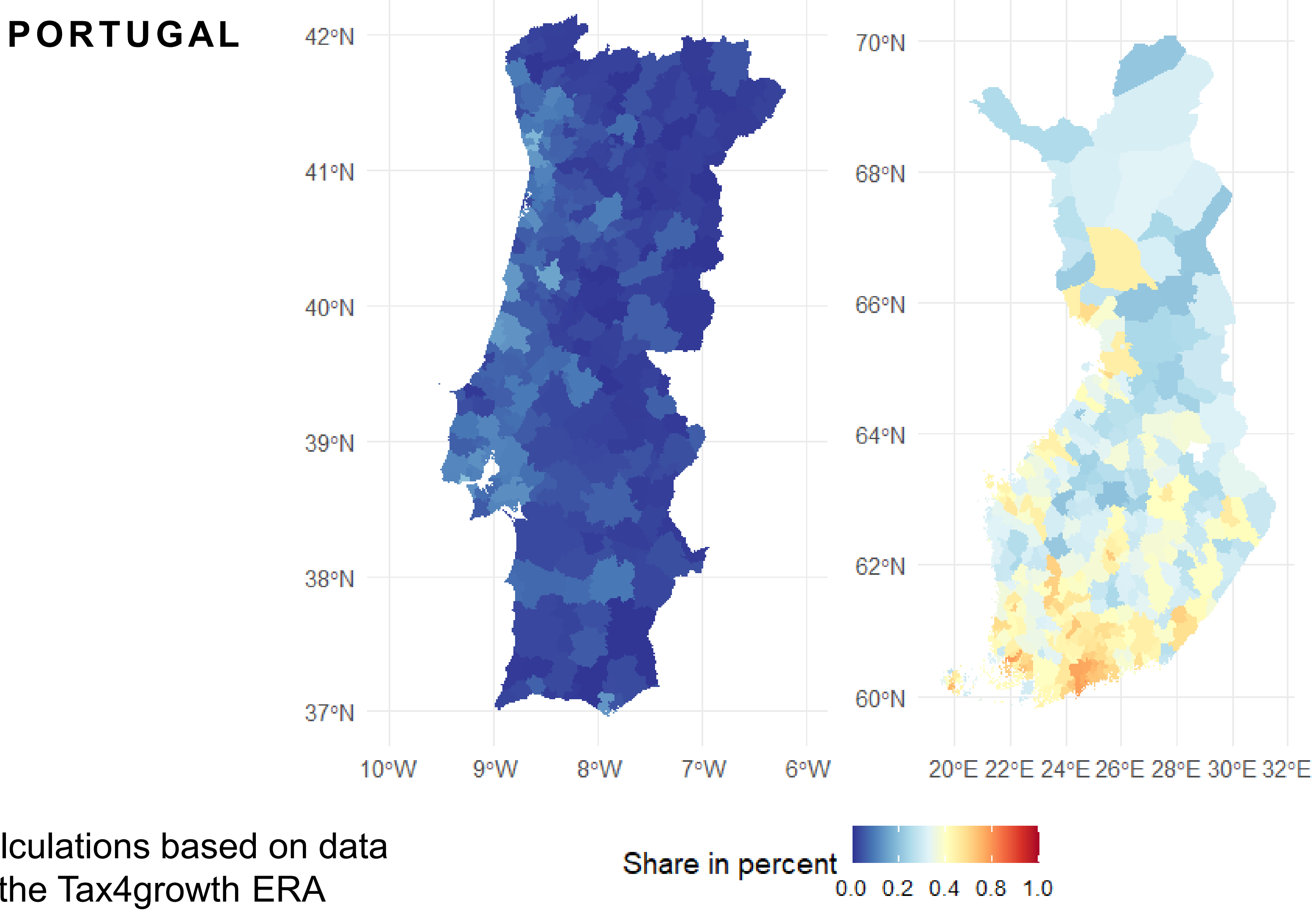
Source: Own calculations based on data collected within the Tax4growth ERA

Comparison local revenues Portugal – Finland



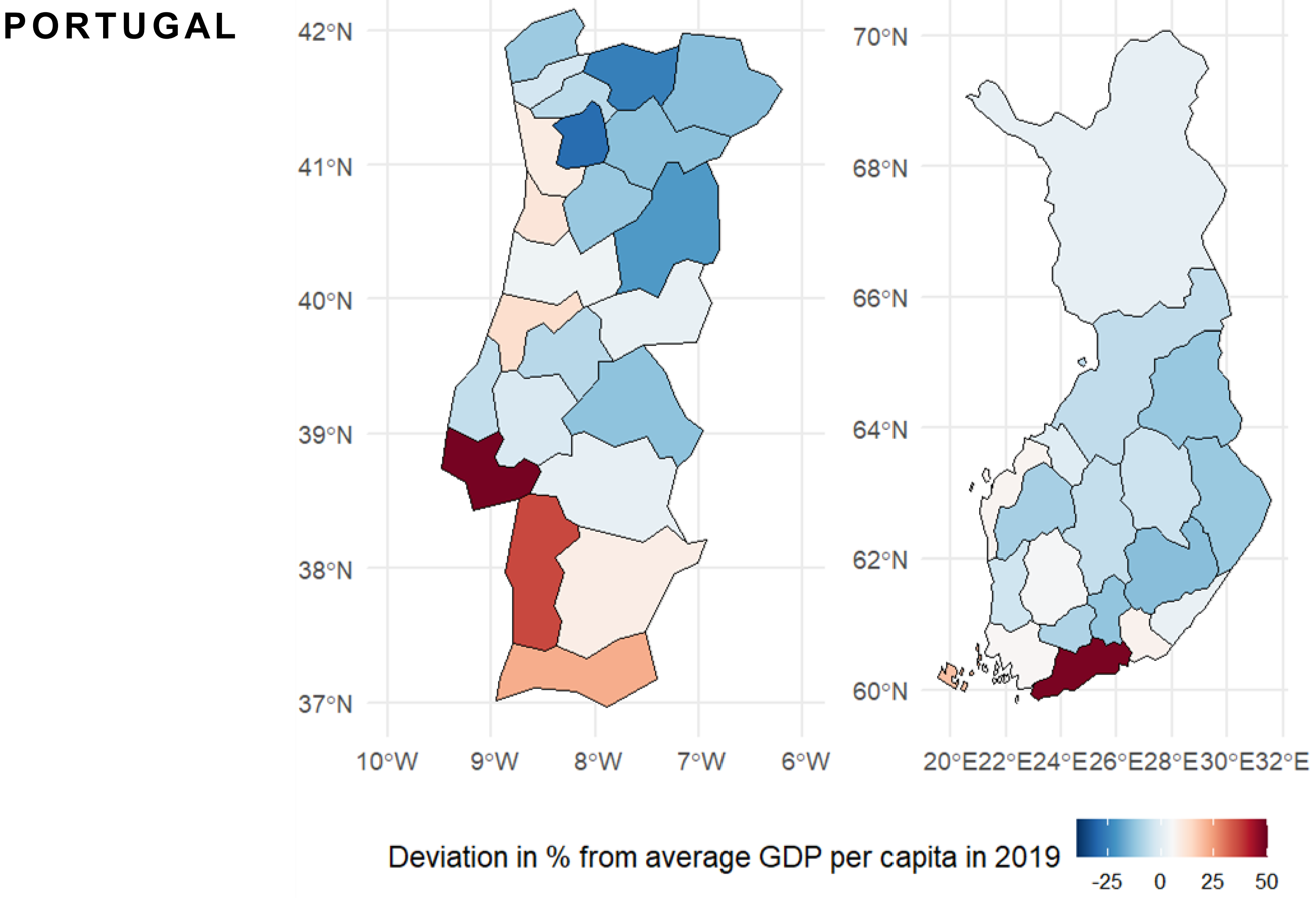
Source: Own calculations based on data collected within the Tax4growth ERA

Share of municipalities' revenues from direct taxes



Source: Own calculations based on data collected within the Tax4growth ERA

Heterogeneity of GDP/Capita



Source: Own calculations based on the ARDECCO Data base

For your considerations

Sharing state income taxes with municipalities might be a very promising approach for Portugal and Brazil to stimulate across the country

- Socially inclusive economic growth, which increases revenues to state budget while reducing the number of people in economic hardship.
- Voluntary tax compliance, further increasing revenues to central state budget.

Who is the main beneficiary of tax sharing?

- Citizens and businesses, as they get better local services and infrastructure.
- Municipalities, because they can fully develop their potential.
- Tax inspectors, as potentially more voluntary tax compliance.
- **But the main beneficiary most likely is the Central Government.**

Thank you for your attention