

NET EARNINGS AND TAX RATES - DEFINITIONS AND MODELS

“Net earnings and Tax rates” is a group of indicators and variables based on illustrative models developed by OECD. Information is provided on net earnings, tax rates, tax wedge on labour costs, unemployment trap and low wage trap. All indicators and variables are based on gross earnings, social security contributions, personal income tax, family allowances and other benefits.

Gross earnings cover remuneration in cash, paid during the reference year by the employer, before tax deductions and social security contributions payable by employees and retained by the employer. All regular and irregular bonuses are included. Severance payments and payments in kind are excluded.

Data refer to an average worker in different illustrative cases, defined on the bases of marital status (single vs. married), number of workers (in case of couples), number of dependent children and level of gross earnings, expressed as percentage of the average earnings of an average worker. According to the model developed by OECD, the average worker (AW) is a full-time employee who receives the average earnings in industries and services – sections C to K of NACE rev. 1.1 from 2000 to 2007, and since 2008 in sections B to N of NACE Rev.2.

A) Net Earnings

Information is provided for the variables: total labour costs, gross earnings, social security contributions, income taxes, family allowances, net earnings.

The following situations are considered:

- single person with no children and earnings level of 50%, 67%, 80%, 100%, 125% and 167% of the AW respectively;
- single person with two children and earnings level of 67% of the AW;
- married couple with two children and the following levels of earnings of the AW: husband 100%/wife 0%; husband 100%/wife 33%; husband 100%/wife 67%; husband 100%/wife 100%;
- married couple with no children and earnings levels as percentage of the AW: husband 100%/wife 33%; husband 100%/wife 100%.

Total labour costs cover annual gross earnings of persons for the corresponding family case plus the employer’s social security contributions.

Gross earnings are incomes from annual gross earnings for the corresponding family case.

Social security contributions represent the level of the employee’s statutory social security contributions under the Social Insurance Code and the Health Insurance Act.

The taxes include the taxes levied on the annual gross earnings under the Income Taxes on Natural Persons Act.

Family allowances include the family benefits for dependent children under the Family Allowances Act.

Net earnings are the annual net incomes for the corresponding family case, calculated from the gross earnings by deducting employees' social security contributions and personal income taxes, and adding family allowances (if applicable).

B) Average Tax Rate (ATR)

The tax rate is defined as the income tax on gross earnings plus the employee's social security contributions less family allowances, expressed as a percentage of gross wage earnings.

$$\text{ATR} = ((\text{T} + \text{SSC} - \text{FA}) / \text{GE}) * 100$$

or

$$\text{ATR} = (1 - (\text{NE} / \text{GE})) * 100$$

Taxes (T) - income taxes on gross annual earnings;

Social security contributions (SSC) - employees' social security contributions;

Family allowances (FA) - family benefits for dependent children;

Gross earnings (GE) - gross annual earnings;

Net earnings (NE) - net annual earnings for the corresponding family case.

The situations considered are identical with these for net earnings.

C) Tax Wedge on Labour Costs (TWLC)

The tax wedge on labour costs is defined as income tax on gross wage earnings plus employee's and employer's social security contributions, expressed as a percentage of the total labour costs.

The total labour costs are defined as the total from the gross earnings plus employer's social security contributions plus payroll taxes, paid by the employer (not applicable in Bulgaria).

The tax wedge on labour costs is calculated only for single person without children and level of earnings 67% of the AW.

$$\text{TWLC} = 100 * (\text{T} + \text{SSC} + \text{SSCe}) / (\text{GE} + \text{SSCe} + \text{Tp})$$

T - personal income tax;

SSC - employee's social security contributions;

SSCe - employer's social security contributions;

Gross earnings (GE) - gross earnings;

Tp - payroll taxes paid on behalf of employer (not applicable in Bulgaria).

D) Unemployment Trap (UT)

The unemployment trap measures the percentage of gross earnings which is taxed away by the combined effect of the levied taxes and social contributions and the withdrawal of unemployment, and other benefits, when an unemployed person returns to employment.

UT provides information what are the financial incentives for transition from unemployment to low-paid employment. This indicator is calculated for a single person without children with earnings level 67% of the AW when in employment.

$$\text{UT \%} = 100 * (1 - ((\text{NI in work}) - (\text{NI out of work}))/\text{GE})$$

Net income (NI) in work - net income of the person when in employment, calculated by deducting from annual gross earnings of the employee's social security contributions and income taxes, and adding social assistance, housing benefits (if applicable) and in-work benefits (if applicable).

Net income (NI) out of work - net income of the person while unemployed, calculated as total of unemployment benefit, social assistance, housing benefits (if applicable) and in-work benefits (if applicable).

Gross earnings (GE) - gross earnings.

E.g., if the UT is 82% it means that the employee retains only 18% more of the gross earnings that he/she receives from being employed. This little gain for the individual may take the view that “work does not pay” at such level of earnings.

E) Low Wage Trap (LWT)

The low wage trap measures the percentage of gross earnings which is taxed away by the combined effect of the levied taxes and social contributions and the withdrawal of social benefits, when employee's gross earnings increase from 33% to 67% of the AW.

LWT provides information on the financial consequences for an employed person when increasing his/her work efforts (either as an increased number of hours worked or due to changes in skills) and thus of his/her wages. The indicator is calculated for:

- single person with no children;
- one-earner married couple with two children.

$$\text{LWT \%} = 100 * (1 - (\text{NI}_{67\%} - \text{NI}_{33\%})/(\text{GE}_{67\%} - \text{GE}_{33\%}))$$

$(\text{NI}_{67\%} - \text{NI}_{33\%})$ - change of net income when gross earnings changes from 33% to 67% of AW.

$(\text{GE}_{67\%} - \text{GE}_{33\%})$ - change of gross income when gross earnings increase from 33% to 67% of AW.

Gross earnings (GE) - gross annual earnings for the corresponding family case.

Net income (NI) - net annual income for the corresponding family case, calculated by deduction from gross earnings of the employee's social security contributions and income taxes, and adding family allowances (if applicable) plus housing benefits (if applicable), plus social assistance, plus in-work benefits (if applicable).

E.g., if the LWT is 22% it means that from the increased gross earnings, as result from the increased work efforts, 22% are “taxed away” by the combined effect of reduced or withdrawn social benefits and higher tax and social security contributions. Put another way, the employee retains 78% more from the gross earnings increase which might be an incentive to continue to put in more work efforts.