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Dilemmas and Confines with Personal Income Taxation Harmonization Process

Introduction

I would like to enunciate main aim of the paper. This aim is to determine whether harmonization of personal income taxation in the European Union countries is possible and desirable. The assessment of the possibility and desirability of harmonizing this form of taxation has been limited (range of research) to personal income of individuals who do not conduct any form of business activity and it reflects the short and long-term run.

The object of our research is personal income tax imposed on people who do not conduct economic activities, taking into account its construction in tax systems of EU countries, challenges for the process harmonization. The subject of research covers regularities, specificity and special features of the personal income tax construction, taking into account the processes of globalization, micro and macro-economic challenges facing tax policy and pro-competitive and pro-social model of personal income taxation. The paper objective formulated in such a way requires conducting a comparative analysis of personal income taxation systems in the European Union countries, taking into account the specificity, common features and differences in income tax constructions in the surveyed countries as well as the areas, possibilities and potential directions for harmonizing this form of taxation.

Within the conducted analysis we attempted at verifying the following research hypothesis: *there are economic, political and social reasons for harmonization of income taxation of individuals who do not conduct any business activity in the European Union countries.*

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It has been assumed that the verification of the adopted research hypothesis which is not more than a speculation or a guess made provisionally determines the necessity of obtaining answers to the following research questions:

1. Does large differentiation of personal income taxation systems in the European Union countries constitute a threat to the common market?
2. Does harmonization of personal income taxation of individuals who do not conduct any business activity make sense?
3. What benefits will we obtain thanks to harmonization of the analyzed taxation form and what costs do we bear as a result of its lack?
4. What and how did various economic and social conditions determine the heterogeneity of personal income taxation in the European Union countries?
5. What sources of similarities can be found in personal income taxation in tax systems of the European Union countries, taking into account the so-called 'quiet harmonization' and the role of the European Court of Justice?

Selection of Research Problems

The choice of the subject and such formulation of research questions have been determined by the following circumstances:

Firstly: Personal income taxation has become one of the most important tools for population income redistribution, allowing to implement the principles of universality, equity (equality) and taxation of the so-called net income (these three principles are to be observed in any contemporary personal income tax in the EU countries), as well as to stimulate desirable behaviors in the consumption sphere. Therefore income taxes affect distribution of income and wealth quite differently than indirect taxes.

Secondly: Income taxes have an 'in-built stability flexibility'. This means that in recession times they slow down the global demand decrease while in expansion periods they slow down its increase. For example progressive taxation of population incomes accounts for the fact that in recession times, when population income falls down, income revenue falls down much faster (due to progression). Therefore in all EU countries, in spite of the declared neutrality, non-fiscal functions significantly influence the PIT construction, which makes it difficult to harmonize this form of taxation.

Thirdly: It is assumed that the differences appearing in the area of direct taxation principles constitute a much lower danger for the functioning of the common market, as:[1]

- In their pure form, income taxes do not stimulate the tendency to invest and save. Income tax puts the burden on both the saved and the spent part of income. In order to stimulate saving and/or investing, it is necessary to supplement the tax construction with tax reliefs and exemptions granted for making (increasing) savings and/or starting investments.
- Income taxes, in their pure form, do not influence the choice of the socially beneficial structure of production and selection of production means, or on the use of technologies saving natural environment. In order to attain those goals it is necessary to use a system of tax reliefs and exemptions.
- Income taxes do not influence on the choice of the socially beneficial structure of consumption. The choice of the socially appropriate consumption structure can only be related to the taxpayers of personal income tax. It seems impossible to introduce into the construction of this tax such tax reliefs and exemptions that would enable us to steer the expenditure of households. Income taxes are of little use for exerting such influence.

Fourthly: Harmonization of income taxes is much more difficult than indirect taxes, both from the political, technical and legislative point of view. Therefore work on their harmonization started later, lasted longer and did not go as far as in case of indirect taxes. The regulations concerning direct taxes in the European Union are left at the discretion of member states. Particular member states thus have significant influence on shaping home solutions in this area. However, they are obliged to treat equally national and foreign entities as far as taxes are concerned. Quite slight scope of harmonization has several reasons presented below:

- When writing the Treaty of Rome, it was generally believed that direct taxes do not significantly influence the internal market, which led to lack of detailed regulations concerning harmonization of direct taxes.
- Income taxes, as direct forms of taxation, are a vital and valuable tool of fiscal policy applied by particular countries, affecting social

[1] Compare: K.C. Messere, *Tax Policy in OECD countries. Choices and Conflicts*, IBFD Publications BV, Amsterdam 1998; K. Messere, *Tax Policy in Europe: A Comparative Survey*, „European Taxation", no. 12/2001.

and economic life, and politicians find it hard to resign from this form of exerting tax influence.
- The progress in harmonization of income taxes is perceived as threatening tax sovereignty and accounts for more rigid attitudes demonstrated by member states.
- EU countries have various forms of rewarding employees, determining incomes from, for example, disability and retirement pensions and shaping the costs of obtaining revenue and expenditures lowering the tax base.

Fifthly: In spite of the lack of directives standardizing principles of personal income taxation, such principles are developing on their own, while tax burdens tend to level off (the so-called quiet harmonization). The burden becomes a competitiveness factor for particular countries and thanks to this EU countries experience evasion of tax burdens. Observing changes to tax laws in EU countries we can notice that the principles of personal income taxation are becoming similar to each other, while burdens level off on their own, as tax systems of member states compete. This means that the construction of personal income tax is used intensely to stimulate taxation functions, which greatly limits the possibilities of harmonizing the personal income tax construction.

Taking into account the European integration process and the freedom offered by treaties, the European Union countries experience the process of quiet harmonization. As a result, we can differentiate several common features of the personal income tax (PIT) in the EU countries:
- Basing the subjectivity on the so-called principle of residence (the principle of limited and unlimited tax obligation).
- The concept of global tax dominates – there is joint taxation of all incomes of a taxpayer, from various sources (only the principles governing taxation of incomes – capital revenues are not subject to accumulation with other sources of income.
- Tax is progressive, detailed solutions concern a different number of tax rates, types of tax scales, principles of shaping progression and the height of the minimum and the maximum rates.
- All constructions use the allowance against tax which reflects, to various degree, the existence minimum and costs of obtaining revenue.
- Tax burdens reflect, to a varying degree, the state of the family, their paying capacity through the system of tax reliefs and exemptions.

- There are also various tax reliefs and exemptions of stimulating nature (investment, housing, health reliefs, donations).

Sixthly: In spite of the lack of harmonization directives, it is possible to indicate the following similarities in the personal income tax constructions in the Community countries:

- Tax is related to joint (global) incomes of a taxpayer.
- Scales are progressive, with various numbers of thresholds and different levels of minimum and maximum tax rate.
- Most countries use the allowance against tax.
- Tax burdens are usually adjusted to the inflation rate through the system of automatic or semi-automatic indexation or through changes to tax thresholds.
- Personal income tax reflects the principle of a taxpayer's paying capacity through differentiated system of tax reliefs and exemptions.
- Different rules are applied to taxation of family incomes, revenues from property and movables sales and capital gains.
- There is a differentiated system of costs of obtaining revenue determined by the way of obtaining this revenue.
- It does not differentiate tax burden due to sources of income from which it is obtained or its destination.
- Income tax contains tax preferences related to the way of spending the income.

Economic Integration and Globalization

Full economic integration requires consideration of taxes as an important factor in the furthering of integration processes, since EU member states are tax nations, e.g. countries where budgetary incomes come primarily from taxation. EU member state tax systems are strongly diversified, due to individual developmental paths shaped by national history of various lengths, civilization development, culture, value systems, social and economic policy, that also define the state's current financial needs. Even in a single state, taxes cannot remain neutral towards economic and social processes. Therefore, the challenge faced by EU creators was not the outright neutralization of the impact that taxes had on the integration process, rather they worked towards limiting the negative consequences of overly diversified national tax systems. Gradual, long-term harmonisation emerged as a continent-wide process. During the development of the Treaty of Rome it was decided that, to assure a common market, it was enough to harmonise indirect taxes and remove trade barriers as they were the prime inhibitors to the flow of goods and services. The harmonisation of direct (income) taxes was not considered as they were seen as not significantly affecting the single internal market. Problems tied to direct taxation became visible as integration proceeded, the EU grew, its citizens began to migrate, multinational enterprises increased in size and scope and their financial flows (capital and profit transfers between headquarters and subsidiaries in different EU countries) became seriously affected. Two major issues should be pointed out about European integration: union creators assumed that income taxes will be neutral towards integration processes and there will occur a natural convergence of tax systems of nations belonging to the economic and currency union.[2] Personal income taxes are strongly differentiated in EU member states in terms of setting the size of tax brackets and taxable income level, where the differentiation focuses on different perceptions of what should constitute the basis of taxation, different tax scales, tax credits and allowable deductions. This process erodes the tax base. Most nations have a tax-free income that represents the expenditure for minimal biological survival. Tax credits and allowable deductions are not only differentiated country by country but also are subject to fluctuations due to a changing social and economic national environment, the preferences of ruling political parties, phase of the business cycle.[3] EU member states have to consider the taxpayer's ability to pay (occurring jointly, separately or as selected elements) when creating different components of Personal Income Tax (PIT) policies, which may include:

- Setting a tax-free level of income that is offered to an unemployed spouse (e.g. in Slovakia), offered for each child being supported by the parents (e.g. Belgium, Czech Republic, Estonia, Holland, Germany, France, Greece, Slovenia, Lithuania).
- Joint taxation of married couples (e.g. in Ireland, where we can find separate tax scales for single taxpayers and married couples).
- Specific and unique taxation of family income (France operates family quotient taxation that considers the number of children in the family).
- Constructions that permit the deduction of certain costs incurred while bringing up children (e.g. France) or even when supporting the family (e.g. Germany).

[2] T. Wołowiec, *Wybrane zagadnienia harmonizacji opodatkowania osób fizycznych*, Finansowy Kwartalnik Internetowy „e-Finanse", vol. 7, no. 2/2011, www.e-finanse.com, pp. 34–52.

[3] T. Wołowiec, *Specifics of taxation approaches of EU member states to the Personal Income Tax*, „Academy Review", Dniertopietrovsk University of Economy and Law, vol. 34, no. 1/2011, pp. 116–129.

- Size and breadth of tax brackets.
- Systems defining the permissible and deductible expenses.
- Systems of preferences depending on the family's situation.

When analysing tax credits and allowable deductions present in EU member states (as subject-specific credits, deductions from tax and tax base), four main categories can be identified[4]:

1. Compensation-type preferences: equivalency and compensation payouts for used tools, clothing, travel costs, refunding travel-to-work expenditures, etc.
2. Social-type preferences: deductions for social support for foster families, support for foster families, war veterans, victims of crime, handicapped, elderly, etc.
3. Stimulation-type (economic) preferences: aimed at stimulating the taxpayer to engage in specific activities or modifying his behaviours. We can include deductions for housing (development and renovation), preferential treatment of savings, purchasing of stocks and bonds, educating children, professional development, health expenditures and retirement fund investments.
4. Differentiated incomes, for example gambling wins, research grants, rewards for scientific activity, scholarships, contributions towards professional associations, etc.

So we should expect rational individuals to pursue tax-benefit-seeking mobility of labour. In reality the extensiveness of this mobility would be dependent not only on 'tax wedge' levels (share that PIT and national insurance consume from gross income) but also on level of wages, gross income levels, the nature of the labour market, quality of public services and infrastructure. Such rent-seeking tax migration would lead to increasing the supply of qualified labour in the market of the accepting country (with a competitive tax system and good labour market) while worsening the labour market situation in the country from which a worker has departed. As a result, countries keen to gain valuable workers could consider setting competitive tax rates to lure in new employees who would migrate and stay, contributing to national economic growth and pay their taxes in the accepting state. In this context harmonisation would be seen

[4] T. Wołowiec, A. Suseł, *Harmonization of personal income taxation and the process of EU integration*, in: *Business and Management 2010, Volume II*, ed. R. Ginevicius, L. Vytatus, A. Rutkauskas, R. Pocs, Gediminas Technical University, Riga Technical University and Tallinn University of Technology, Vilnus 2010, pp. 760–766.

as a process of equalisation of life and employment conditions that would reduce the need for 'tax wedge' oriented analyses by workers.

Labour Taxes

In most Member States, social contributions account for a much greater share of labour taxes than the personal income tax. On average, about two thirds of the overall ITR on labour consists of non-wage labour costs paid by both employees and employers. In Denmark, Ireland and the United Kingdom personal income taxes form a relatively large part of the total charges paid on labour income, while in countries like Poland and Greece less than 20% of the ITR on labour consists of personal income tax. Between 2000 and 2013 the components of the ITR on labour changed markedly in several Member States. For the EU-27 personal income taxation of labour as well as employees' SSC and payroll taxes fell, while employers' SSC showed a very slight increase (all as a percentage of total labour costs). For the euro area, all components fell, with the main drop once again being in personal income taxation, and social contributions falling more sharply than in the EU-27 overall. Looking at changes in single Member States, most of the countries reduced their ITR; the change was to a large extent driven by reductions in PIT or employers' SSC. In many countries one notices a shift in the different components of the tax burden.[5]

The discussion in the preceding sentences is based on the ITR[6] on labour, which gives a picture of the average tax burden on labour across all income classes. However, even at an unchanged overall tax level, the burden of taxation may be shifted between high and low-income taxpayers resulting not only in redistribution but notably also in a different impact on employment. In particular, over the last decade policymakers have often resorted to cuts in labour taxes that are targeted to the bottom end of the wage scale in order to boost employability of low-skilled workers. To evaluate progress in this direction, this section looks at the evolution of the tax wedge – i.e. the difference between labour costs to the employer and the corresponding net take-home pay of the employee. We can find out a long and steady downward trend indicating a clear impact from targeted cuts in taxes.[7]

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[5] J. Kesti, *European Tax Handbook (years) 2009–2014*. IBFD, Amsterdam (years) 2010, 2011, 2012, 2013, 2014 and 2015.

[6] The ITR on labour is calculated as the ratio of taxes and social security contributions on employed labour income to total compensation of employees and payroll taxes.

[7] *OECD Revenue Statistics 1965–2013*; *Inventory of Taxes In the Member States of the European Union*, Luxembourg 2000; *Structures of taxation systems In the European Union 1995–2003*, Luxembourg 2004.

While the tax wedge is lower in 19 Member States in 2012 compared to 2000, the reductions appear to be particularly large in the Netherlands, Sweden, Bulgaria, Finland, Cyprus and Slovakia. Among the countries that have increased the tax wedge in this period, France shows the biggest increase with 3.4 percentage points Overall during the 1996–2009 period, the EU average tax burden on labour was on a downward trend, but both indicators have started to rise again since then. Up to 2000 the ITR on labour increased, whereas the tax wedge started to decrease markedly already from 1998. The gap between the two indicators opened up indicating that targeted tax cuts were playing a growing role. In the second period, from 2001–2008, the two series run roughly parallel, both showing a downward trend. However, since 2009 both indicators have picked up after several years of decline.[8]

Income taxes are characterised by a clear link between the taxpayer's situation (income, wealth) and the tax burden placed upon him. As such, income taxes can have a negative impact, be de-motivating, as the tax will inhibit income-generating and investment activity and that will negatively impact the speed of economic. This means that not only the sheer size of the tax burden is important, but also we have to consider the entire structure of the tax system, each tax and the definition of tax scales/ brackets.

Inadequacies of tax theories combined with a polarisation of opinion maker positions concerning personal income taxes impact even the microeconomic approach, where it should be easy to establish a causal link between the tax burden, tax scale and the taxpayer's economic situation and resulting decisions. This is a result of multiple interacting factors affecting the taxpayer, therefore isolation of the tax factor is difficult, if we bypass highly abstract analyses. The situation becomes even more complicated when the subject of analysis becomes the impact of a given tax on a specific group of taxpayers or of a specific tax on the entire economy (e.g. automatic stabilizer theory). We have to add the fact that income taxes are only part of a wider burden, since they are combined with national security contributions (social insurance) and often it is those social security contributions that are modified to increase governmental revenues, while maintaining an illusion of tax rate stability.[9]

A theoretical analysis of the effects of tax differentiation can occur on several axes, including:

[8] C. Torres, K. Mellbye, B. Brys, *Trends in Personal Income Tax and Employee Social Security Contribution Schedules*, "OECD Working Papers", no. 12/2012.

[9] Ibidem.

1. Impact of PIT on costs of labour. High taxes increase labour costs since after-tax income (disposable) is low and thus causes pay-increase demands from the workers and this in turn complicates the company's competitive standing and affects its profitability (when compared to companies operating in other, more beneficial tax environments).
2. Taxes as a burden. They force a defensive response from the taxpayer in the form of seeking opportunities to transfer the burden onto other entities. Centuries long observation of taxpayer reactions to tax burdens show that, even if desirable, burden shifting is much easier in the case of indirect taxes than direct ones (in this case the most common technique involves limiting economic activity).
3. Tax burden transferability is different for employees and employers. Increased labour costs will affect production costs and this affects final product/service prices. Opportunities open to the employer will depend on the type of the good/service under taxation and the state of the market (competition), which is defined through elasticity of demand.
4. Measuring the transferability of the tax burden. The process is difficult even in the case of a closed economy because the effects of increasing taxes can be hidden in prices, non-wage production costs, producer profitability. These difficulties are multiplied in an open economy where the mechanism of transferring the tax burden affects the society and economy of a different nation. In a theoretical sense, 'tax dumping'[10] leads to a redistribution of income between different societies as it assures that part of the income is transferred to nations with lower taxes through transfer pricing or through the transfer of company operations to locations with favourable tax regimes. The impact on nations not operating "tax dumping" policies is a need to increase tax rates to maintain governmental revenues (for those taxpayers that remain) or reduce governmental expenditures (politically difficult) or increase national debt (finding lenders willing to fund continued expenditures).[11]

[10] The term 'tax dumping' was popularised by Chancellor Gerhard Schroeder in 2004, when he challenged new EU member states and their tax reforms that were aimed, as Schroeder claimed, at affecting fair competition policies in the Union by offering good operating conditions for companies form the 'old' Europe.

[11] On 26th May 2004, Ministers of Finance from Germany and France, worried that their countries would suffer the most from tax-benefit-seeking company migration, proposed the first unification of corporate (CIT) tax rates: minimal rates, formalising the methods of calculating incomes, profits, defining expenses.

In the era of internationalization of economic relations and integration, the tax burden transfer mechanism becomes international, in terms of taxation on incomes, labour, economic activity, interest, capital returns, etc. Personal decisions regarding where to undertake paid employment (with the assumption that there are no restrictions on the movement of labour) will be affected by offered wages and required taxes. Income migration therefore becomes natural as people gravitate towards locations where incomes and taxes are the most beneficial.

Both tax rate harmonisation and tax rate competitiveness require additional consideration of:[12]

1. Impact of PIT rate harmonisation upon the state budget and possible imbalance of public finances (harmonisation worsening national budgets, e.g. through downward integration of tax rates).
2. Impact of labour mobility upon the nation's economy (income migration further enhanced by PIT rates).
3. Impact of changes in the tax system, which affect the ratios of: indirect-direct taxes, CIT-PIT, when they are intended to draw in foreign investments.

Economic aims of tax harmonisation may be unachievable due to legal reasons, since a tax is not only an economic category but also a legal one, and its legal side is affected by:

1. Relationship between national and Community law, and when considering the supremacy of EU law over national rules, many issues emerge (e.g. conflicting regulations, different interpretations).
2. Problems of applying (and in what measures) unlimited tax duty[13] in one country compared to applying unlimited tax duty in one country with a limited duty in the second country and, finally, how to apply unlimited tax duties in both countries.
3. How to formulate and agree upon treaties on avoiding double taxation (not only achieving consensus between nations but also following local political patterns, taxation trends).
4. Problems in whether to collect the tax in country of residence or non-residence and in what proportions.

[12] T. Wołowiec, M. Duszynski, *Selected issues in harmonisation and taxation of PIT in EU member states*, „Держава Та Регіон", nr 7/2009, pp. 5–10.

[13] Unlimited tax duty applies to those residing in a country for more than 183 days of a tax year, while limited tax duty is applied to those who spend less than 183 days.

Harmonization of Income Taxes

Harmonization of income taxes is much more difficult than harmonization of indirect taxes from the practical, technical and legal perspective and is a result of:[14]

1. When creating the Treaty of Rome it was decided that direct taxes would not have a notable impact on the operations of the internal market, and that approach led to a lack of appropriate regulations, especially in the area of personal income taxes.
2. Income taxes, as forms of direct taxation are an important tool for fiscal policy that affects social and economic activities and it is difficult for politicians to abandon this tool for managing national policies.
3. Directives requiring the formulation of direct tax harmonisation must be agreed upon with a majority vote in the national Assemblies (Parliaments), which leads to a lack of consensus on desired aims, costs and benefits, procedures.
4. Progress in direct tax harmonisation creates an aura of challenges to the tax independence if nations and leads to entrenchment of state and elite positions.
5. EU member states have different rules for remunerating employees, setting incomes from retirement funds and affecting the structure of income-generating costs and expenditures that reduce the tax base.

Despite the lack of Directives to regulate the rules of taxing personal income, the rules are emerging spontaneously and tax burdens are slowly equalising. This process is the result of competition between EU member state tax systems – nations extensively are utilising the construction of the personal income tax to utilise the stimulating functions of the tax system, which in turn impacts the possibilities open to spontaneous PIT harmonisation. Due to the effects of 'quiet' paralegal harmonisation, several common PIT characteristics can be found in the EU

[14] See: J. Głuchowski, *Harmonizacja podatków pośrednich i bezpośrednich*, „Glosa", no. 8/1999; B. Brzeziński, J. Głuchowski, C. Kosikowski, *Harmonizacja polskiego prawa podatkowego z prawem Wspólnot Europejskich – perspektywy, zagrożenia, warunki*, in: *Polska w Unii Europejskiej. Perspektywy, warunki, szanse i zagrożenia*, ed. C. Mik, TNOiK, Warszawa 1997; C. Kosikowski, *Ocena harmonizacji polskiego prawa podatkowego z prawem Unii Europejskiej*, in: *Harmonizacja prawa podatkowego Unii Europejskiej i Polski*, PWE, Warszawa 1998; B. Brzeziński, M. Kalinowski, *Europejskie prawo podatkowe w świetle orzecznictwa Europejskiego Trybunału Sprawiedliwośc*i, ODDK, Gdańsk 2001.

1. Placing subjectivity on the principle of residence. Rules on limited (<183 days), and unlimited (>183 days) tax duty.
2. The dominant concept is of a global tax. Joint taxation of all incomes obtained by the taxpayer from different sources (only the rules regarding capital interests are exempt from being combined with other incomes).
3. The tax is progressive and specific solutions concern different tax rates, types of scales, rules regarding progression and the size of the minimal and maximum rates.
4. Tax burdens are designed to follow inflation through a system of automatic or semi-automatic indexation or through the change of tax brackets.
5. Different regulations are applied to a family income, sale of real estate, assets and investment incomes.
6. In every construction there exists a sum free from taxation and, in varying degrees, considers the minimal level of (biological) existence and costs of obtaining an income.
7. Tax burdens are considerate of, in varying degrees, state of the family and capabilities to pay through a system of rebates and deductions.
8. Multiple rebates and deductions exist that are of a simulative and social character (investment, building and renovation, health, donations).[15]

The analysis of Union laws indicates that personal income tax harmonisation is extremely difficult due to historical, political, social and technical factors. Decisions by the European Court of Justice (ECJ) concern mostly tax deductions by individuals who are not Union residents and the deductions of contributions made to retirement funds operating outside the EU. The ECJ decisions cannot affect the rules for harmonising personal income taxes because they concern the taxing of income from savings and the exchange of tax information, while the progressing 'quiet' harmonisation is rather a result of inter-nation competitiveness and not of any formal ECJ rulings.[16] Alongside minimal lawmaking at the European level, minimal progress of harmonization is a result of:[17]

[15] B. Brzeziński, J. Głuchowski, C. Kosikowski, *Harmonizacja prawa podatkowego Unii Europejskiej i Polski*, PWE, Warszawa 1998, p. 23.

[16] W. Maruchin, G. Lutz, F. Hirsch, *Harmonizacja w zakresie podatków bezpośrednich*, „Prawo Unii Europejskiej", no. 6/2001; J. de Goede, *Integracja europejska a prawo podatkow*, „Kwartalnik Prawa Podatkowego", no. 1/2003, p. 130.

[17] T. Wołowiec, *Podmiotowy i przedmiotowy zakres opodatkowania dochodów osób fizycznych w krajach UE*, „Przegląd Prawa Europejskiego Międzynarodowego", nr 1/2008, pp. 35–49.

1. Political factors: PIT payers are the largest group in any nation. Politicians are unwilling to abandon PIT techniques in pursuing regulatory and stimulatory tax functions, that are of a political nature, e.g. any activity in this are will have an impact on the political balance of the nation. PIT setting is an important and valuable tool in maintaining relations with voters.
2. PIT harmonization is not an important factor in the evolution of the Common Market. It is neutral to internal trade and does not affect intra-EU competition and as such will not become a European priority for some time.
3. PIT taxes mainly incomes from work and retirement and the level of taxation does not increase intra-EU migration (although in the long-run this may change).
4. In EU member states, social support systems are funded from different sources: taxpayer contributions, direct funding from the state budget (social security contributions are then contained within standard taxes, e.g. Denmark) and as they form part of the total "tax wedge", their harmonisation will be even more difficult (while exerting sizeable influence on the PIT system).
5. EU member states possess different systems of labour remuneration and shaping of citizen income levels, different methodologies of designing tax progression. Therefore even creating a holistic and long-term understanding of existing complexities will be difficult.

Major Counterarguments Against Harmonising

Harmonisation in general is a difficult challenge, and any debate about harmonising PIT systems brings out major counterarguments:

Further loss of sovereignty in national financial policies, which will inhibit the state's ability to affect economic processes and (especially) social ones. Harmonisation of the rules for calculating the basis for taxation and the acceptance of unified rates would mean the transfer of tax-setting prerogatives to a trans-national institution: the EU. In such a situation, each nation must conduct its own analysis of costs and benefits (of transferring those competencies versus their retention).

Different social models and retirement systems, when combined with varied degrees of PIT integration with retirement contributions, determine various financial needs of the state, therefore harmonisation would have to reach far beyond 'mere' PIT systems.

Historical, cultural, social factors that have shaped national tax systems enforce claims that path-dependent process will be difficult to reverse.

Competitive inequality between taxpayers who operate in one market and those that function in multiple EU member states. Depending on their primary country of residence it can be an advantage to pay taxes elsewhere (when the other nation's tax regime is friendlier, e.g. for Poles employed and taxed in the UK) or a disadvantage (when British taxpayers operating in Poland or Poles earning in the UK are subject to Polish taxation).

Not withstanding abovementioned criticisms, the following predictions can me made regarding income tax (primarily PIT) harmonisation across the European Union:[18]

1. Harmonisation of direct taxes is unavoidable, but it will be a long-term process and will affect CIT before PIT (reducing complexity of trans-border business operations will be a priority compared to easing the life of individual taxpayers). It is likely that the global economic crisis will negatively impact the speed of any harmonisation as governments focus on surviving the difficult period and, since research suggests that speedy harmonization negatively affects economic growth, governments will remain wary of such processes, keen to defend any possible economic growth (and thus their own positions).
2. The current process of direct tax harmonization is in an early stage of progress due to existing extensive national variations. Forces promoting reform are more economic and include the unified market, common currency, need to increase competitiveness. Opposing forces are more ideological and focus on the dangers of sacrificing fiscal competencies, especially that these powers will be handed over to a supranational body. The need for unanimous voting when backed by the complexity of current tax policies are the main causes for a slow harmonisation process (rationality of pure tax-related arguments comes in conflict with local political rationality).
3. At the very least, it is crucial to assure the enforcement and optimization of regulations covering the avoidance of double taxation, both personal (PIT) and business (CIT). The need for speedy resolutions stems from the growth and expansion of trans-border economic activity and the removal of barriers to the movement of labour which complicate proper income taxation (calculation and

[18] Compare: A. Krajewska, *Podatki. Unia Europejska, Polska, Kraje Nadbałtyckie*, PWE, Warszawa 2004, pp. 74–75; Z. Ofiarski, *Ewolucja funkcji pozafiskalnej podatków w Polsce po roku 1990*, in: *Kierunki reformy polskiego systemu podatkowego*, UMCS, Lublin 2003, pp. 105–106.

collection). It is necessary to employ a holistic approach to this issue and that calls for a review of signed bilateral agreements by their signatories, introducing required corrections and signing of new agreements with EU members.

4. PIT harmonization should focus on achieving intergovernmental agreement on calculating the tax base, to avoid distortions in the real tax rate (tax brackets). The concept of taxable income is a result of local costs of generating the income, rebates and deductions and the current methods of setting them differ in each country. The same comment relates to the methodology used for defining tax progression and the concepts of minimal and maximum rates and the social aspects of the PIT.
5. When discussing PIT harmonization it is important to remember about the integration of this tax with social security contributions, as both contribute to the burden placed on labour. They are complementary and form the 'tax wedge' (the difference between the gross labour costs to the employer and the net income for the employee) and are important for businesses when considering the costs-versus-reward of creating new employment opportunities (positions). When PIT is coordinated with social security contributions, attempts at coordination or harmonisation become extremely difficult as two different deduction systems and multiple ministries in each state become involved.
6. A controversial issue is the competitive lowering of PIT rates, and nations intent on lowering ('dumping') their effective tax rates ought to consider the impact of those actions on the wider Union, especially from the perspective of affecting competitive equilibriums.
7. It is important to approach with caution the concepts regarding the removal of the capital gains tax since this would promote speculative activity (due to resulting high profits), while discriminating against labour incomes and profits from (more laborious, productive and long-term) economic activity. Much more beneficial would be the removal of taxes on savings, as it would stimulate an increase in the rate of savings and make more capital available to fund economic growth.
8. It is difficult to expect that the EU will evolve into a federal state, but only such a structure would give the Union the right to set and collect taxes. The, tax policies would be formulated and implemented in a top-down manner that would allow for the implementation of a uniform (harmonised) tax system. It is unlikely that member

states will agree to such a solution, especially due to the political importance and financial role of income taxes. Therefore, we can expect that income taxes will remain decentralised, e.g. under the control of individual nations.

A question emerges regarding the future possibilities for the income tax becoming a 'European tax' and whether such an idea is realistic. The debate about setting a European tax started with the underlining of the weaknesses of available financial resources and defining the new model of EU budget revenues. The EU Commission proposed the personal income tax as a tax that fulfils eight criteria (in three groups): budgetary (sufficiency and stability), effective (recognition, low operating costs, effective allocation of resources), just (vertical and horizontal, income that assumes that the level of this tax is in balance with economic development).

Conclusions

The theoretical theorems, scientific conclusions, practical proposals and recommendations made by the author in this paper all aim at the conclusion that although harmonization of personal income taxation is possible from a legal point of view in the long run, from the economic and social perspective it is unjustified to harmonize this form of taxation. Thus, proving the thesis that we can find out the main reference points for transformation of an individual's taxation system in European Union Countries and there is no goal and sense in harmonizing and standardizing PIT constructions, and theoretical, methodological and practical novelty of the dissertation consists in:

1. In their pure form, income taxes do not stimulate inclination for investment and savings. Income tax is a burden on the saved and spent part of income. In order to stimulate saving and/or investing, it is necessary to introduce some reliefs and exemptions to the tax construction, granted for creating (developing) investment.
2. The obtained results of the research do not allow us without first conducting detailed microeconomic analyses (household prosperity level, structure of household expenses, price flexibility of demand, etc.) to propose a thesis that it is more beneficial for the social and economic prosperity to increase revenues from indirect taxation in the structure of budget tax revenues. Lowering the burden placed by income taxes requires offsetting the lost revenues with increased indirect taxes in order to maintain neutrality of revenues.
3. In their pure form, income taxes do not influence the choice of socially beneficial structure of production and choice of produc-

tion factors or on using technologies saving natural environment. Achieving these goals also requires application of the system of tax reliefs and exemptions.[19]

4. Income taxes do not affect the socially beneficial structure of consumption. We can talk of appropriate structure of consumption only in case of personal income taxpayers. It does not seem possible to introduce reliefs and exemptions into the structure of this tax that would allow us to steer household expenses. Income taxes are of little use for such influence (these statements are vital both for understanding the specificity of income taxes and from the point of view of the analysis of the purpose and nature of preferences used in income taxes).
5. Tax systems in the European Union countries are a product of long evolution and feature a lot of similarities. Similarities of Community states tax systems are the effect of the same factors affecting a particular tax policy and features of legal solutions in taxes. Such factors include: degree of economic development, social and economic systems and doctrines of economic policy, similar social, demographic and economic problems, Integration of the European economy, globalization of the world economy and principles of cooperation with international organizations. These factors are a result of similar economic and social structures, determined by similar cultural, historical, sociological and political factors. In practice, the shape of the tax system reflects the necessity to take into consideration interests of various social groups and a consequence of frequent changes in legal solutions, being an effect of political plays. As a result, the functioning tax systems are determined both by model and actual (mostly political) factors.
6. The tax doctrine formulates guidelines on what rational and effective tax policy the state should run. These postulates are determined in various ways, depending on adopted criteria concerning goals to be achieved thanks to tax policy. First we should ask about the functions of tax policy and then about norms and ways of their implementation. The primary goals of tax policy are presented as: efficiency in implementing the income function, efficiency in implementation of non-fiscal functions, equitable distribution of tax burden and lows costs of tax collection.
7. Personal income taxes, due to their significance in national fiscal policy should not be harmonized, due to their role in fiscal policy,

[19] J. Ostaszewski, Z. Fedorowicz, T. Kierczyński, *Teoretyczne podstawy reformy podatków w Polsce*, Difin, Warszawa 2004, pp. 76–78.

as automatic stabilizers of business cycle. Using income taxes, we can affect taxpayers' behavior in various ways, through tax reliefs and exemptions as well as shape and structure of tax scale. It is necessary to realize national tax policy, whose specificity and economic, historical and social idiosyncrasies require freedom in constructing PIT.

8. Differentiated reward systems, various constructions of tax-free amounts, and, most of all, different level of salaries in the EU countries makes it impossible to conduct a rational and sensible harmonization of this form of taxation. Also the way of financing social insurance systems differs in the EU countries, which is reflected in labor costs structure.
9. Personal income taxes also constitute the revenues of communes, districts and regions in EU countries. In practice this means that PIT is a differentiated construction as far as its role and importance in self-government own revenues are concerned. In some countries self-governments have their own income taxes, in others they have shares in PIT revenues transferred by central government. Local tax authorities have different entitlements, the local PIT has different levels of burden and legal construction. An attempt at harmonization would infringe the local authorities autonomy and would also require complex standardization of local governments' sources of revenue in all EU countries, which is impossible from the legal point of view and highly ineffective from the economic point of view (the author's own research).
10. Personal income taxes do not affect the freedom of people and capital movement, therefore their harmonization is not justified from a legal point of view.

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Key words: Income, Personal Income Taxation, Harmonization, Competitiveness

Abstract

During the development of the Treaty of Rome it was decided that, to assure a common market, it was enough to harmonise indirect taxes and remove trade barriers as they were the prime inhibitors to the flow of goods and services. The harmonisation of direct (income) taxes was not considered as they were seen as not significantly affecting the single internal market. Problems tied to direct taxation became visible as integration proceeded, the EU grew, its citizens began to migrate, multinational enterprises increased in size and scope and their financial flows (capital and profit transfers between headquarters and subsidiaries in different EU countries) became seriously affected.