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Selected Problems of Personal Income Taxation in European Union Common Market (Economic and Political Issues)

Introduction

As for the legal solutions in tax law, the doctrine commonly accepts the view that taxes and the whole tax system should be neutral and should perform only the fiscal function of taxation. This means that taxes should be constructed so as not to hinder the existence and operations of taxpayers, but also so that they do not contain any preferences for selected groups of taxpayers. Favoring tax neutrality does not determine the negative attitude to achieving non-fiscal goals of the state through tax preferences. For example, using various forms of tax preferences may be a consequence of subjectively understood tax equity.[1]

Although personal income tax is commonly used to achieve various economic and social goals, its fiscal function is still considered the most important one. We should also observe that the doctrine quite commonly tries to promote the thesis of tax neutrality as a specific panacea for weakened economic growth of EU countries and deteriorating competitiveness of European economies. The belief in tax neutrality stems from the fiscal function of taxes. According to some representatives of the doctrine, we should not use taxes to achieve various social goals, often contradictory to fiscal requirements of the state. It is difficult to agree with the concept of tax neutrality, as it impossible in practice to separate tax law from the influences of broadly understood politics.[2]

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[1] For example: R.A. Musgrave, P. Musgrave, *Public Finance in Theory and Pracice*, McGrow-Hill Company, New York 1994; T. Wołowiec, P. Wolak, *Opodatkowanie dochodów osób fizycznych w krajach Unii Europejskiej (wybrane aspekty)*, Wyższa Szkoła Biznesu – NLU, Nowy Sącz 2009.

[2] See more: J. Simon, Ch. Nobes, *The Economics of Taxation*, Fiscal Publication, Birmingham 2012.

The Place of Personal Income Tax in the Tax Systems of EU Countries

In tax systems of EU countries, personal income tax plays a vital role both as a source of budget tax revenues and as an important instrument of implementing non-fiscal functions of taxation. Tax systems in EU countries contain a full range of taxation subjects and objects. Differences can be found only in the significance of particular taxes in the structure of national tax systems. We can distinguish countries with relatively balanced structure of budget tax revenues from direct and indirect taxation, countries where direct taxation dominates and those in which indirect taxation prevails.

Table 1. Structure of budget tax revenues with social security contributions EU-15 in 1965–2015 (in %)

Share of Personal Income Tax (PIT) in budget tax revenues of EU countries (in%)					
Years	1965	1987	1995	2005	2015
European Union (EU-15)	21.0	29.2	28.6	27.7	26.9
Share of Corporate Income Tax (CIT) in budget tax revenues of EU countries (in %)					
European Union (EU-15)	7.0	6.0	6.32	7.0	10.4
Total income taxes					
European Union (EU-15)	29.0	36.2	36.8	37.0	36.8
Share of VAT tax in budget tax revenues of EU countries (in %)					
European Union (EU-15)	38.2	32.0	34.0	35.6	36.9
Share of social security contributions in budget tax revenues of EU countries (in %)					
European Union (EU-15)	24.5	32.0	30.4	31.2	36.0%
Share of property taxes in budget revenues (in %)					
European Union (EU-15)	6.7	4.3	3.9	4.6	5.3

Source: own elaboration on the basis of OECD, Revenue Statistics 1965–2015.

Comparing the above data we can state that the main sources of budget tax revenues in EU-15 countries are revenues from direct and indirect taxes. Moreover, an important source of budget revenues are social security premiums, often analyzed together with PIT as a category of "tax imposed on work". Taking into account the structure of total direct and indirect taxes in GDP, only Belgium, Denmark, Finland, Sweden and UK have a higher share of income taxes in GDP. In other countries indirect taxes prevail, but the difference is not big (around 8–10%). Only Greece and Portugal show dominance of indirect taxes in GDP (over 60% more than direct taxes). In this respect, Greece and Portugal are very close to new members of the European Union (NMS), where revenues from indirect taxation prevail (50–60% more than direct taxes). Detailed analysis of the structure of budget revenues in new European Union member states was presented below.[3] Comparing only personal and corporate income taxes and value added tax we can see that budget revenues from income taxes exceed those from VAT by 6% in EU-15 countries. Analyzing statistical data we can notice that the biggest changes in the structure of budget tax revenues happened in 1965–1980. The share of social security premiums grew by 5.4%, while personal income tax – by 4.3%. Direct tax share decreased by 5.7%, property tax – by 2.5% and corporate income tax – by 1.2%.[4] In 1965–2015 characteristic tendencies for change could be defined as decreasing the value added tax share in budget tax revenue and increased share of social security premiums in budget tax revenues, caused by increased level of social performance and demographic changes resulting in an increased number of recipients.

More detailed analysis of the structure of budget tax revenues allows us to draw some conclusions:

1. EU contemporary tax systems reach for a wide tax base, covering full range of taxation subjects and objects. The fundamental difference consists in a different strategy for shaping tax system structures.
2. There is no universal tax system. The shape of the tax system is determined by various factors, both economic and non-economic ones.

[3] T. Wołowiec, *Harmonization of personal income taxation across European Union member states*, Wyższa Szkoła Ekonomii i Innowacji w Lublinie, Lublin 2014.

[4] See: *Revenue Statistics of OECD Member Countries 1965–2009*, OECD, Paris 2010; *Structure of European Union Taxation Systems 2014*, European Commission Taxation and Customs Union – EUROSTAT, Luxembourg 2015; *Tax Guide to Europe*, OECD, Paris 2010; *Tax reforms in EU Member States 2013*, "European Economy", no. 5/2013, p. 118; *Tax revenue in EU Member States: Trends, level and structure 1995–2003*, Statistic in Focus "Economy and Finance", no. 3/2005, p. 8; *Taxation Trends in The European Union*, Publications Office of the European Union Commission, Luxembourg 2014.

3. Tax reforms implemented in recent years are directed mainly at reducing income tax burden (together with social security contributions). This is reflected in decreasing share of both income taxes both in budget tax revenue and in relation to GDP.
4. Decreasing revenues from income taxes are compensated by increased share of indirect taxes and social insurance contributions, both in budget tax revenues and in relation to GDP. Recently, we have observed an increasing fiscal significance of property type taxes.
5. Based on current change trends we can assume that indirect taxes share in the structure of EU countries budget tax revenues will increase. The progressing 'quiet harmonization', being an effect of competition among national tax systems, will lead to decreased tax burden in the area of income taxes and compensating those budget deficits with additional revenues from indirect taxation and other titles.
6. A visible element of tax policy in OECD countries is a relatively small share of corporate income tax in the structure of budget tax revenues.
7. An observable tendency in most countries is a visible increase in social security contributions share, both in the structure of budget tax revenues and in relation to GDP.[5]

NMS countries have a lower share of personal income tax in tax revenues than EU-15 countries. Another feature distinguishing new member states from EU-15 countries is higher share of indirect taxes and social insurance premiums in total tax revenue structure. The differences in the structure of tax revenues between NMS and EU-15 countries can be attributed to historical, sociological, political and administrative factors. We can point at the following determinants of NMS tax systems[6]:

1. Personal income tax was introduced in most new member states at the beginning of 1990s. It did not gain social acceptance right from the start, in times of radical social and economic changes.

[5] *Inventory of Taxes In the Member States of the European Union*, European Commission, Luxembourg 2014; H. Zee, *Personal income tax Reform: Concepts, Issues, and Comparative Country Development*, "IMF Working Paper", no. 05/87/2005, pp. 3–58.

[6] T. Wołowiec, *Specifics of taxation approaches of EU member states to the Personal Income Tax*, "Academy Review", vol. 34, no. 1/2010, pp. 116–129; T. Wołowiec, A. Suseł, *Harmonization of personal income taxation and the process of EU integration*, in: *International Conference Business and Management*, Gediminas Technical University, Riga Technical University and Tallinn University of Technology, Vilnus 2010, pp. 760–766.

Table 2. Comparison of budget tax revenue structure in NMS, EU-15 and EU-25 countries in 1995–2015

Taxes (arithmetic mean)	NMS	EU-15	Difference between 1995–2005 for NMS	Difference between 1995–2005 for EU15	NMS-EU15	UE-25	Difference between 1995–2015 for EU25
Tax revenues as GDP %	34.7	41.6	-1.3	0.5	-6.9	39.2	-0.6
Indirect taxes as GDP %	13.8	14.5	-0.5	0.4	-1.7	14.3	0.0
Indirect taxes as % of total tax revenues	38.7	34.0	1.5	1.1	4.7	36.4	1.2
VAT as GDP %	7.8	7.5	0.1	0.4	0.3	7.6	0.3
VAT as % of total tax revenues	21.5	17.2	3.9	0.5	4.3	17.4	0.6
Excise tax as GDP %	3.3	3.0	0.5	-0.3	0.3	3.2	-0.1
Excise as % of total tax revenues	9.7	6.3	1.2	-0.2	3.4	6.4	-0.1
Income taxes as GDP %	9.1	15.3	-0.4	0.4	-6.2	13.1	-0.4
Income taxes as % of total tax revenues	22.5	33.5	-6.6	2.0	-11.0	33.0	1.6
PIT as GDP %	5.7	10.8	0.3	-0.3	-5.1	9.1	-0.4
PIT as % of total tax revenues	14.4	24.5	-3.0	1.1	-10.1	23.7	0.9
CIT as GDP %	2.6	3.4	-0.3	0.7	-0.8	3.1	0.3
CIT as % of total tax revenues	6.6	5.9	-2.7	0.9	0.7	6.0	0.8
Social insurance premiums as GDP %	11.8	11.7	-0.4	-0.2	0.1	11.8	-0.3
Social insurance premiums as % of total tax revenues	36.7	32.8	5.1	-3.1	3.9	32.9	-2.8
Employer's premiums as GDP %	8.3	6.7	-1.1	0.2	1.6	7.2	-0.1
Employer's premiums as % of total tax revenues	24.8	18.3	-5.5	-0.5	6.5	18.5	-0.5
Employee's premiums as GDP %	3.6	3.9	0.5	-0.3	-0.3	3.8	-0.1
Employee's premiums as % of total tax revenues	12.9	10.7	3.6	-2.0	2.2	10.7	-1.8

Source: own elaboration.

2. Lower share of income taxes in budget tax revenue structure can be partly explained by quite a large share of 'grey zone' in economies of new members.
3. Building market economies from scratch, combined with lower level of social and economic development and young and poorly educated (at the beginning of transformation) administration translates into simpler and easier to administer tax techniques based on indirect taxation.
4. Higher share of social insurance premium in budget tax revenues of new Community members is an effect of deep economic transformation. At the beginning of 1990s, when reforming economies and relieving tensions in labor market – some employees were sent to early retirements – which resulted in increased expenses for social performance. As a result, a considerable part of expenses serviced by public insurance funds has been related to costs of rebuilding economies of these countries.

Relations Between Personal Taxation and Social Security Contribution (SSC)

Taxes on labour income – including personal income taxes and social security contributions – account for roughly one half of total tax revenue, on average, across OECD countries. High reliance on labour income taxation often results in high tax burdens on workers. Tax burdens can be measured with several alternative indicators, including marginal and average personal tax rates. Marginal personal tax rates, denoting the tax payable on an additional currency unit of earnings, influence incentives to increase work effort, to follow training or to look for a better-paid job. Average personal tax rates, indicating the share of gross earnings spent on taxes, may affect incentives to participate in the labour market. Average personal tax rates that increase with income imply that the amount of tax paid is related to a person's capacity to pay, and that the tax and benefit system is progressive. Average and marginal personal tax rates on wage income are determined by the interaction of provisions that define the tax base, statutory tax rates, and tax credits that are deducted after the application of tax rates to the tax base.[7] While statutory tax rates are only one of the components that determine average and marginal personal tax rates, they are of great importance for various reasons. First, given the

[7] C. Torres, K. Mellbye, B. Brys, *Trends in Personal Income Tax and Employee Social Security Contribution Schedules*, "OECD Working Papers", no. 12/2012, pp. 1–56.

fact that policymakers cannot directly adjust average and marginal tax rates, changes to statutory rates prove a powerful policy tool to change tax burdens indirectly and to modify incentives to work and build human capital. Second, while average and marginal tax rates involve complex calculations that must rely on a variety of assumptions, statutory rates are defined by legislation and do not require computation. As such, they can be easily known by the general public. Third, due to their unambiguous nature, statutory rates, and particularly top statutory PIT rates, are often cited as a relevant indicator of taxation in international comparisons. In conjunction with statutory rates, other elements of the tax system defined in the legislation determine average and marginal personal tax rates. Social security contributions sometimes reduce marginal personal income tax rates when PIT relief is provided for them, but also increase the combined PIT and employee SSC marginal tax rates, affecting the progressivity of the tax system as a whole.[8]

Subject and Object Scope of Taxation

Tax systems of EU states use either a form of global tax or a mixed form, in which, apart from a flat scheduler tax (on capital gains, for instance), there is additional global tax, progressively taxing the sum of taxpayer's incomes. The combination consisting in using both global and scheduler tax allows us to combine both taxation techniques and preserve both differentiation and personalization and progression of the tax. Tax systems in the European union states evolve towards adjusting the way of taxing income in Latin countries (scheduler system) to the way of taxing income in Anglo-Saxon countries (global income system). Total income is determined by indicating taxable sources of revenues. Taxation of personal incomes in the European union countries is based on five fundamental tax principles[9]:

- subject universality – it means that tax should cover all people obtaining income in the taxed area. This means exclusion of subject exemptions, except for cases justified by international law or customs (such as exemptions of diplomatic and consular staff respecting the principle of mutuality);
- object universality – it is expressed in taxation of joint income of an individual (global tax), not incomes from some sources of revenue

[8] Compare: *KPMG's Individual Income Tax and Social Security Rate Survey 2011*, KPMG, Swiss 2011, p. 84; *KPMG's Individual Income Tax and Social Security Rate Survey 2012*, KPMG, Swiss 2012, p. 92.

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

(scheduler tax). Consistent application of this rule does not allow separate taxation of some incomes or using separate tax scales of rates. It allows deduction of incurred losses from one source of revenue from other incomes;

- principle of equality (equity) – states that all taxpayers obtaining the same income are treated equally, regardless of their source of revenue. This principle is often expressed as the principle of the so-called tax equity, postulating exempting people with the lowest incomes from taxation, leaving tax-free subsistence minimum, using social and family preferences, differentiation of tax burden adequately to payment capacity by applying tax progression;
- taxation of "pure income" in object perspective – this means taxation of only the income that is at the taxpayer's disposal, after deducting expenses made in order to obtain revenue (decreased by the so-called costs of obtaining revenue);
- taxation of "pure income" in subject perspective – connected with leaving some tax-free amount (subsistence minimum) for taxpayers in order to satisfy their basic individual and family needs. Noncompliance with this rule would necessitate returning the taxes collected by public authorities in form of various social allowances.

Subjectivity of personal income tax is based on the so-called principle of residence, which takes into account the individual's residence address. It postulates that taxation should cover all incomes, regardless of the place where they were obtained, in the state in which the taxpayer has its registered seat or place of residence. Possible conflicts of tax jurisdictions should be solved by reference to the taxpayer's residence. From this perspective tax legislation in the EU countries is characterized by unlimited tax obligation, placed on individuals whose residence is in a particular EU country or who stay in the member state for longer than 183 days in a given tax year (with reference to corporations this means their registered seat or board). Unlimited tax obligation is when the taxation subject has to pay tax on all its incomes, regardless of their source. This obligation covers both home and foreign sources of income. Unlimited tax obligation does not concern people who are employed by various foreign companies and enterprises operating in a particular country.[10] It does not cover people enjoying diplomatic and consular privileges and immunities, staff of multinational and transnational organizations. The principle of source states that taxation should be imposed on each income obtained in the country.

[10] Vienna Convention on Diplomatic Relations from 18th April 1961 (Journal of Laws from 1995, No. 37, item 22 – attachment & Convention on Consular Relations from 24th April 1963 – Journal of Laws from 1982, No. 13, item 98 – attachment).

The Object of Taxation

The tax law doctrine formulates two basic concepts of income: concept of sources and concept of pure assets (total income). The first concept emphasizes regularity and stability of receiving income from particular revenue sources (work, capital, etc.). The concept of pure assets (total income) is based on wide treatment of taxation base. In this concept income comprises all revenues, monetary performances from third persons, gifts, inheritances, lottery wins, while interests on debts and materials losses are excluded. This concept – compared to the concept of sources – broadens the concept of income by all incomes from extraordinary sources. Its contemporary variation is the concept of market income. It was created in German doctrine and is a variation of pure assets concept. It states that income is generated exclusively as a result of own work and capital. Such definition of income excludes for example inheritances, donations, scholarships, allowances or income from selling one's own property. In all EU countries the term income used in acts normalizing personal income tax does not fully correspond to the concept of sources or pure assets. Contemporary tax acts do not define this object of taxation by means of some abstract notion of income, but comprise a full or example catalogue from particular sources of revenue, whose sum makes up global income being the object of taxation. In practice, tax legislations of European Union countries, when determining the concept of income, more often refer to the concept of pure assets (total income) both in subject and object perspectives.[11]

There are many similarities in the EU countries in the concept of income itself. Income is determined as the difference between revenue and costs of obtaining it. If the revenue was higher than those costs, we have income, otherwise – we incur a loss. In income taxes found in various systems there is no uniform category of income, but there is a principle of identifying particular incomes from various sources. Generally, individuals' income is defined as a flow of goods and services from various sources (the so-called income in kind) and monetary amounts (financial income). Income is obtained as a result of producing goods and providing services, non-refundable transfers (retirement and disability pensions), and offering paid work. It may also come from assets, capital and other types of activity. Such differentiation results partly from different treatment of some revenue sources (using special tax regulations for property and material rights sale or exchange or from speculative incomes). Obtaining income

[11] S. Cnossen, *Tax Policy in the European Union: A review of Issues and Options*, "OCFEB Studies in Economic Policy", no. 1/2001, pp. 1–89.

and its definition are closely connected to the person obtaining it. Therefore the construction of this tax in legislation of EU countries reflects such personal features of a taxpayer as: age, health and family status. Incomes of single persons are taxed differently than incomes of taxpayers with families. The object of taxation are various types of income obtained by the taxpayer from particular revenue sources, except for those which come from sources not covered with this tax or statutorily exempted from it. Categories of exempted income are listed in tax legislation. When the taxpayer obtains income from several sources (tax categories), the object of taxation is the sum of incomes which are subject to joint taxation. Determining income from each source (tax category) is done separately, due to different costs of obtaining revenue. Tax legislation of particular countries defines precisely what expenses can be deducted from obtained revenues. There is also a possibility of compensating losses with profits coming from various sources (within the conducted economic activity).[12]

The Imperative for Harmonization of Direct Taxes *versus* Tax Competitions

In spite of the lack of directives normalizing principles of individual income taxation, such principles are self-created and burden levels equalize. We can say that due to the principle of competitiveness included in the tax law, member states make adjusting attempts in adopted tax constructions. This is to increase attractiveness of their tax systems. Competition between tax systems forces certain solutions in national tax systems, aimed at bringing closer constructions of certain taxes in order to ensure optimal functioning of the common market. Thus "quiet harmonization (back door)" is a consequence of progressing competition among national tax systems in particular taxation forms. The effect of quiet harmonization is bringing closer construction solutions in personal income tax in European Union states. Referring to PIT it was emphasized that the tax should remain at discretion of member states. The only harmonization activities should concern removing barriers to four economic freedoms and providing uniformity of taxation. Similarities in the personal income tax in Community states concern the following areas:

- The tax is related to total (global) income of a taxpayer,
- Scales are progressive with various numbers of ranges and minimum and maximum tax rate values,

[12] *Structures of the taxation systems in the European Union 2014*, European Commission Taxation and Customs Union – EUROSTAT, Luxembourg 2015.

- Most countries use tax-free amounts,
- Tax burdens are usually adjusted to inflation rate through the system of automatic or semi-automatic indexation o changes to tax thresholds,
- Personal income tax reflects the principle of taxpayer's payment capacity through its varied system of tax reliefs and exemptions;
- Different rules are used for taxation of family incomes, revenues from selling property and movable assets and capital incomes,
- There is a varied system of costs of obtaining revenues, related to the way in which revenue is gained,
- It does not differentiate tax burden due to sources of revenues from which it is obtained and its allocation,
- Income tax contains tax preferences related to the way the income is spent.

Tax Competition

Tax competition is a phenomenon directly related to globalization processes, especially to the growth of international mobility of employees and capital. Liberalization of labor and capital factors flow and decline of transaction costs account for the fact that individuals as well as capital seek attractive jurisdictions for their deposits, not only at home but also abroad. Theoretically, lowering tax rates does not have to result in lower budget revenue, as due to the flow of labor and capital factors, tax base will grow. However, if (theoretically) all EU countries decide to lower personal tax rates, the relative attractiveness of countries for PIT taxpayers (who may be treated as investors) will remain unchanged, while their budget revenues will decline. The tax income decline caused by lowering rates at unchanged tax base accounts for a situation when the country can allocate less money to accomplish their tasks of providing public goods.[13] This model only presents a general concept of tax competition, in practice its mechanism is much more complicated and far from clear.[14] Mobile production factors (labor and capital) may easily be located in countries with low tax rates, which limits the possibility of increasing

[13] Compare: M. Desai, F. Foley, J. Hines, *Economic Effects of Regional Tax Havens*, "NBER Working Paper", no. 10806/2004.

[14] W. Buijnk, B. Janssen, Y. Schols, *Final report of a study on corporate effective tax rates in the European Union (commissioned by the Ministry of Finance in the Netherlands)*, MARC (Maastricht Accounting and Auditing Research and Education Center), Universiteit Maastricht 1999.

their taxation.[15] The essence of tax competition often boils down to the belief that small tax burdens are the main factor determining the development of a given territory and its perception as an attractive place for final tax settlement.[16]

The author's own research proves that tax competition in the area of PIT (and social insurance contributions) does not contribute to the increased mobility of workers. The obtained Pearson's correlation coefficient at the level of rxy = 0.19 (respectively rxy = 0.21) indicates that there is no relation between the level of PIT (level of social insurance contributions) and increased workers mobility. The factors determining the increased migration of employees are flexibility of labor market, levels of remuneration and social and welfare infrastructure.[17] Therefore it should be clearly indicated that the harmonization of the effective PIT rates and social insurance rates is not necessary or essential for the functioning of common market and four migration freedoms. Since the general level of social and economic competitiveness and attractiveness obviously includes a tax element, it is difficult to deprive particular countries of their right to shape their own tax system adequate to their possibilities and needs. It should be expected that the potential progress of the tax harmonization process will limit this competition in a larger or smaller degree. Tax competition is manifested in reduction of tax rates and introduction of tax preferences in order to stimulate activity of national economic entities and attract foreign investment (PIT is of no importance in this respect). This means that the public authorities use tax policy instruments to enhance the attractiveness of their own area. It should be emphasized that after the introduction of the common currency in some EU countries, income tax has become one of the last "economic variables", depending only on local and central law-making bodies, which may be a measurable stimulus for stimulating taxpayers behavior. The author's own research shows that PIT is not a decisive factor in capital mobility, nor is it an instrument determining the attractiveness of a given country both for the workforce and investment.

The best situation would be the one in which the marginal cost of providing the next unit of public goods and services equals the cost of PIT taxation. Such optimal level of taxation can be established in a closed

[15] R. Verrue, *Tax Competition in the EU. A few remarks on the current state of play* (conference materials), Bruksela 2004.

[16] R. McGee, *The Philosophy of Taxation and Public Finance*, Boston–Dordtech–London 2004, s. 105–107.

[17] Statutory research, Department of Economics of Enterprises and Local Development University of Economics and Innovation in Lublin, Lublin 2013–2015.

economy, that is when regardless of the size of tax, human and capital factors do not flow in or out. For an open economy, benefits of providing public goods and services remain unchanged, whereas the costs of PIT taxation grow. This is so as each income tax growth leads to the flow of capital to countries with lower rates. On the other hand, income tax decreases will have much weaker than in a closed economy effects, since (theoretically) they will attract foreign capital to the country. Taxation of this increased human and capital base may partly offset the losses incurred by lowering the PIT rate. We may infer from the above that in an open economy the stimuli for lowering the PIT taxation are stronger than in a closed economy. Such reasoning may be conducted for each country separately, therefore we can assume that they will all be inclined to lower their PIT rates. However, if they all do lower their rates, the benefits of such conduct will disappear: human and financial capital will not flow into the country with lowered taxes if taxes are lowered in other countries as well. The general capital resource will not change, in principle (if capital resource grows, it will only be due to the ability of lower taxes to generate new investment). On the other hand, all countries will experience lower incomes, thus they will be able to allocate fewer resources for allocating public goods and services. This process of lowering tax rates which leads to excessive reduction of budget revenues is often known as the race to the bottom. Assuming that in a situation preceding the opening of economies, all countries had optimal PIT rates, as a result of the race to the bottom the possibility of providing public goods and services by them must deteriorate. It would seem that the optimal solution in this situation would be an agreement between countries that they will not compete with tax rates. Unfortunately, this solution is impossible to implement. This can be attributed to the fact that citizens of various countries differ in their preferences for goods that in their opinion should be provided by the state. Moreover, a state renouncing its sovereignty in fiscal policy would politically be very controversial and it is hard to imagine any government that would decide to take such steps. Moreover, to achieve the desired effect, tax coordination would have to take place in all countries remaining in economic relationships. If it is done only by a group of states, other countries will be undisturbed in their race, which will bring about the flow of capital to them and the deterioration of the economic situation of the group of countries with harmonized rates.

It seems that we should be cautious when assessing the phenomenon of tax competition in PIT. This is mainly because the only obvious and measurable indicator related to this phenomenon on an international scale are differences in PIT rates (and social insurance rates, integrated with PIT) between particular countries. It must be added that although data on differences in nominal rates are easy to obtain, their interpretation, as well as the evaluation of differences in effective rates, calls for taking into account a lot of extra information (such as applied incentives, tax reliefs or the structure of national economy) and are methodologically complicated. What is more, it is hard to determine the power of influence of differences in effective PIT rates which are the main symptom of "tax competition" on phenomena considered to be its effects. For example, we cannot clearly determine what percentage of the whole decline in corporate income tax revenue is caused by the changes to the effective rate of such tax in another country. It is impossible to isolate some phenomena in fiscal sphere out of all economic conditions. Moreover, the power of influence of the tax competition phenomenon on a given country depends on the specific characteristics of that country as well as on the characteristics of the "tax competitor" (for example Poland versus Slovakia versus Czech Republic). Finally, even if PIT is radically lowered in one country, but the risk of conducting economic activity remains very high, the likelihood of attracting potential taxpayers from abroad is low.

Flexibility and freedom enjoyed by public authorities of every member state of the European Union these days in determining income tax rates guarantee the creation of favorable climate for economic activity and sound competition between countries, which may bring long-term benefits to all participants of this market game, provided they take advantage of opportunities available to them. A competitive game to attract investors is not a zero-sum game in which someone has to lose for another person to gain, especially in the long run. Sound tax competition between countries, apart from gradual decrease of tax rates, should force sanative activities in the public finance sphere and make countries with lower burden more attractive to investors.

Harmonization of PIT *versus* Labor Market Flexibility

PIT may reduce the number of jobs in an economy, affecting both labor supply and demand. Is this really true? On one hand, personal income tax and social insurance contributions decrease the benefits enjoyed by employees from their employment. People are interested to know how many goods they will be able to buy for their work, not how high their remuneration is before taxes (contributions) are paid. If taxes are increased, the threshold pay, that is the minimum level of remuneration before paying them, for which people are willing to work (the number of people willing to work may further decrease if some of the obtained tax revenues are allocated by the government to finance higher social benefits allowing to obtain income without going to work). In order to maintain their level of income after taxation, employees attempt at transferring part of the tax on their employers. The less flexible the labor market, the higher the degree of switching these costs, since the bargaining power of the employed grows at the cost of their employers. This means that what really matters is the flexibility and infrastructure of the labor market, not the level of PIT rates and social insurance contributions, which is in no way related to the degree of harmonization or coordination of personal income tax.

On the other hand, when calculating the profitability of employing an additional worker, the employer does not take into account the remuneration received by the employees, but total labor costs. Higher labor costs limit the willingness of employers to create and maintain jobs, since the labor of people becomes more expensive than the work of machines. The declining demand for work mostly affects people with low qualifications, able to perform only simple work. This type of work is easily replaced with machines. Research shows that entrepreneurs react more to the changes in labor costs and employees to changes in net pay. This means that the level of fiscal burden in PIT area and social insurance contributions which depend on national fiscal policy are more important than the process of harmonizing PIT and SSC.[18] The negative influence of taxation on employment may be strengthened by capital flows. With great freedom of these flows between countries, the companies; demand for employees is more sensitive to labor costs changes than in the opposite situation. Companies try to locate their production where it brings them the highest profits, while transfer of production from one country to another is becoming increasingly easy. Theoretically, taxation of incomes from work should be tantamount to uniform taxation of consumption. Two important factors determining the satisfaction people derive from life and which they influence are, on one hand – consumption, and on the other – free time. Consumption possibilities are determined by the size of incomes obtained mostly from work. On the other hand, work takes up our time. Both taxation of income from work and taxation of consumption in the same way disturb the price relation between free time and consumption. The higher the taxes on consumption and income from work, the more expensive (relatively) consumption becomes and the cheaper (relatively) free time becomes. As a result, both taxes weaken the people's stimuli to work. In practice, however, such equality is impossible due to at least two reasons.

[18] A. Auerbach, J. Hines, *Taxation and economic efficiency*, "NBER Working Paper", no. 8181/2001.

First of all, taxation of incomes from work is, by definition, imposed only on the workers, whereas consumption taxes present burden to everyone's expenses – also those who do not work. This difference would not have to be significant if those who do not work lived off their savings they accumulated during their employment. But in practice, the overwhelming majority of them live off the work of other people (including, sometimes, people who had to seek profitable employment abroad). Thus, although taxation of consumption does not affect the relations of consumption prices to, respectively, own and other people's work (including work abroad), the taxation of incomes from work limits consumption possibilities of only those who work (what is more – only those who work in the country).

Moreover, neither incomes from work nor consumption are taxed in a uniform way. On one hand, the state sometimes imposes exceptionally high taxes on people with high qualifications who naturally obtain high incomes. However, as incomes grow, people appreciate their free time more and pay less attention to further expansion of their consumption possibilities. The growing sensitivity to changes in the relationship between the price of consumption and free time, when their basic needs have been satisfied, account for the fact that the reduction of taxation imposed on employment incomes could significantly strengthen the stimuli to work in people with high qualifications. On the other hand, the consumption of goods which are characterized by high rigidity (such as food) has low taxation. Weak sensitivity of demand for these goods to changes in their prices means that increasing their taxation should not significantly limit their consumption.

Thus the research proves that harmonization of personal income tax has never been an important factor for creating a common market or for free flow of people and capital.[19] It is a neutral form of taxation in internal trade and does not disturb the conditions of competition on the common market. Personal income tax mostly refers to incomes from work and retirement benefits, whereas the level of fiscal burden does not translate into intensified migration within Europe nor does it affect flexibility of the European labor market. EU countries have social security systems financed from various sources. These sources are both contributions paid by taxpayers as well as direct financing from state budget. The construction of these models arises from social and historical circumstances and is an autonomous instrument of social and economic policy of particular EU

[19] A. Auerbach, L. Kotlikoff, *Evaluating fiscal policy with a dynamic simulation model*, "American Economic Review", vol. 77, no. 2, Papers and Proceedings of the Ninety-Ninth Annual Meeting of the American Economic Association, May 1987, pp. 49–55.

countries. Moreover, EU countries have varied systems of remuneration for work and shaping the level of population income. There are various systems of costs of obtaining revenue, methodology of progression, etc.

The third driving force behind development is the improvement of qualifications by employees. High qualifications, first of all, facilitate finding new, more efficient production techniques, and secondly, they often constitute a necessary condition for implementing and developing technologies invented abroad. The dependence of the country ability to adopt latest technologies on employees qualifications is particularly important for such economies as Polish economy, small globally and open to labor and capital flow, while still technologically lagging behind. The improvement of workers qualifications may be hampered by taxes. On one hand they reduce incomes that improved qualifications bring. On the other hand, they may increase costs related to them. Incomes attributed to improved qualifications are reduced especially by income tax, particularly when it is characterized by great progression. People who are better prepared to a job are able to produce more and better, as a result it is more beneficial for companies to attract them by offering them higher remuneration. Increasing the upper rates of income tax forces people with higher qualifications to give a higher share of their income to the state. Progressive income tax is a kind of tax on productivity. The higher qualifications we have and the higher income we obtain, the higher part of it – not only absolutely but also as percentage – is taken by the state. The same tax may simultaneously increase the costs of improving one's qualifications. Since the supply of good trainings is not rigid, the better quality they are, the more taxation increases their price, so better remuneration (after taxation) must be provided to trainers running them. Taxation, if it leads to lowering employment, it also lowers the degree in which society qualifications are used. The decline in employment as a result of taxation also causes the loss of some skills by people who are out of work.

Harmonization of Employment – Related Income Taxation *versus* the Rulings of the European Court of Justice (ECJ)

The issue of taxing incomes from employment abroad is a complex one, since we need to analyze not only Polish regulations, but also international ones (including relevant agreements on avoiding double taxation concluded between Poland and particular countries) and regulations in a country where work is performed. It is necessary, inter alia, to determine whether such incomes must be settled in Poland at all. If the answer is positive, then the question arises of how to avoid double taxation, if, for example, these incomes were also taxed in the country where a person performed their job. This is of vital important both in case of people who individually start working for foreign employers and for employees delegated by employers to work abroad. An essential issue is to determine in which country an employee is obliged to pay social and health insurance contributions. This is regulated by the so-called coordination provisions issued by relevant bodies of the European Union. They also include regulations governing some specific groups, for example employees delegated to work abroad or running their own business activity also on the territory of another country. Another issue concerns regulations governing benefits which can be obtained when working in various EU countries, for example the amount of future retirement pension. Additionally, it is essential to know where and how this retirement pension will be taxed. It may happen that a particular person (taxpayer) will have more than one place of residence (that is both in Poland and in a country where he or she works – on the basis of internal regulations of these countries). In this case, in order to determine which country is the final country of residence for tax purposes, certain criteria are applied, based on a relevant agreement on avoiding double taxation, concluded between Poland and that country. As a result of such analysis, a taxpayer should be able to determine in which country their final place of residence is. It is advisable that this should be confirmed with a tax residence certificate issued in that country. This does not mean, however, that the taxpayer will pay taxes only in one country. If this person is a tax resident of a given country, but performs work in another, he may be subject to taxation both in the country where he works (as the country of source) and in the country of tax residence. In order to avoid double taxation, an appropriate method adopted in a relevant agreement on avoiding double taxation must be applied.

It is worth remembering that it is possible to deduct from obtained income (or – respectively – tax) mandatory social and health insurance contributions paid in another country of the European Union, European Economic Area or Switzerland. In order to take advantage of this entitlement, one must meet certain requirements. The deduction does not concern contributions whose calculation base is income exempted from tax on the basis of agreement to avoid double taxation (that is when we apply the method of exclusion with progression to particular revenue). Moreover, contributions cannot be deducted from income (tax) in a country where the work is done. It is also necessary to have legal base arising from an agreement on avoiding double taxation or other international agreements ratified by Poland in order to provide the tax authority with some information from the tax authority of a state in which the taxpayer paid contributions. EU countries have widely varied PIT structures and retirement pension contributions systems, which makes it practically impossible to fully harmonize these public tributes. Nevertheless, it is possible to attempt at coordinating the principles of calculating and settling, without harmonizing the rates, tax credits, or tax deductions and reliefs.

The rulings of the ECJ exert significant influence on the PIT in EU countries as well as on the areas of potential harmonization. These rulings translate into automatic (forced by the rulings) coordination of tax legislature and provisions regulating social insurance. ECJ rulings greatly affect domestic tax law and, by the necessity of implementing rulings into domestic tax law, they contribute to standardization (harmonization) of tax provisions, especially in the area of human flow and PIT settlement as well as SSC in member states. As a result of ESC rulings, regulations are becoming similar and uniform, which is an element directly preceding potential future harmonization (of selected elements in PIT structure). According to ECJ rulings, it is forbidden to discriminate citizens of one member state in another member state.[20] Tax discrimination takes place when different people in comparable situation are treated differently by tax regulations. Different tax treatment of residents and non-residents does not have to mean discrimination. The situation of individuals who have limited tax obligations in a given member state is not comparable to the situation of individuals with unlimited tax obligation. A taxpayer's personal situation is usually taken into account when taxing income in a country of their residence. However, if a non-resident obtains in the source country "most of their income" or "the whole or nearly the whole income", whereas he or she does not obtain in the country of residence sufficient income to take advantage of tax reliefs used there (for example – joint taxation with a spouse), then the source country should threat such a person as its resident and grant them relevant tax reliefs.[21] The situation of both categories of taxpayers is comparable concerning tax rates, therefore it is not allowed to use a higher personal income tax rate for an individual with limited tax obligation.[22] Within research work, we analyzed the tax rulings of the ECJ vital for the freedom of human flow.[23] The ECJ rulings have led to numerous amendments (standardization) or

[20] Compare cases: Schumacker (C-279/93); Saint Gobain (C-307/97); Wielockx (C-80/94) and Asscher (C-107/94).

[21] See more: case Schumacker (C-107/93); Sermide (C-106/83).

[22] See more: Asscher (C-107/94).

[23] Rulings of ECJ: Biehl (C-175/88); Bachmann (C-204/90); Werner (C-112/91); Schumacker (C-279/93); Wielockx (C-80/94); Gilly (C-336/96); Gschwing (C-391/97); Gerritse (C-234/01); Wallentin (C-169/03); Ruffler (C-544/07) and Asscher (C-107/94).

even repealing of internal tax regulations. The analysis of the ECJ rulings allows us to formulate a number of conclusions related to harmonization, essential for the standardization of the PIT structure in the EU countries and indicating areas of further harmonization:

1. The community law bans all forms of tax discrimination not only related to nationality, but also bans hidden forms of discrimination which lead to the same result by using various differentiating criteria. The application of a permanent place of residence with reference to the return of PIT down-payments usually results in worse treatment of citizens of another member state.
2. Failure to grant tax relief to taxpayers who paid social insurance contributions for foreign insurers is compensated by exempting benefits paid out in the future from tax. If a state was to allow deduction of social insurance contributions, it should also be able to tax the sums paid out by citizens. Obliging the insurer to collect tax or adopting solutions in bilateral agreements are no less restrictive means. In the Bachmann case, the argument concerning the coherence of a tax system concerned the same taxpayer and the tax of the same kind, whereas there was a close relationship between deducting insurance contributions and taxation of future benefits.
3. In a situation when a non-resident obtains in the country of their employment most or all of their income, while not obtaining sufficient income in the country of residence to take advantage of tax reliefs (such as joint taxation with a spouse), then the country of employment should treat such a person as its resident and grant them relevant tax reliefs.
4. Non-resident who obtains the whole or nearly the whole income in a country where they perform their job is in the same situation as the resident of this state who performs the same job.
5. Member states are competent to determine the reasons for taxation in order to avoid double taxation via international agreements.
6. Granting tax reliefs in PIT in the source country (tax credit, joint taxation) depends on where a taxpayer obtains most of their taxable incomes.
7. Taxation of people who work or receive retirement or disability pension, but live or have dependant relatives in another member state has always been a source of problems. Generally speaking, bilateral agreements allowed to avoid double taxation, but did not solve such issues as application of different forms of tax reliefs available in the country of residence with reference to the income obtained in the country of employment.

8. There is a rule according to which a given member state, when collecting income tax and social insurance contributions, cannot treat EU citizens not residing in this country but, taking advantage of free movement, working in its territory, in a less beneficial way than its own citizens.
9. Generally, we can say that integration in the area of direct taxation of individuals has taken place more as a result of the European Court of Justice rulings than normal legislative procedure.

Conclusions

Analysis of community tax legislation (rulings and cases of the ECJ) allows us to formulate a thesis that harmonization of personal income taxation principles is impossible to historical, political, social and technical reasons. The Court rulings cannot influence harmonization of personal income taxation principles, as these concern only taxation of savings income and exchange of tax information, while the progressing and visible “quiet harmonization” is a result of competition among national tax systems, not ECJ rulings. Generally, individuals may appear as parties in the court proceedings only before their home courts. According to Article 234 of the Treaty, lower instance courts may, while higher instance courts have to lodge the case to the ECJ. Generally, difficulties in harmonizing personal income tax cover the following issues:

- Political factors – income tax payers are a very numerous group of voters. Politicians are unwilling to resign from using the PIT tax technique in implementing regulatory and stimulating function of taxation, as it is a valuable instrument in their relations with voters.
- Harmonization of personal income tax has never been a vital factor for creating the common market. It is a neutral form of taxation for internal trade and does not disturb competition conditions in the common market.
- Personal income tax is imposed mainly on income from work and retirement benefits, while the level of fiscal burden does not translate into increased migration in Europe.
- In EU countries, social security systems are financed from various sources. These are both contributions made by taxpayers and direct financing from state budget.
- EU countries have various systems of rewarding work and shaping the population income level. There are various systems of costs of obtaining revenue, methodology of shaping progression, etc.

- Personal income tax plays both fiscal and non-fiscal role in EU state tax systems, which makes it impossible to create a homogenous system of personal income taxation, especially if we take into account the necessity of unanimity of the Council in passing any directives in this respect.

Personal income constructions widely differ in the European Union countries. It is even difficult to compare such key elements in the personal income tax construction as the number and level of tax rates and related level and span of tax thresholds. In particular countries the issue of general exclusion of incomes at specific level from taxation is approached differently, some have zero tax rate, others different amounts of tax credit. An additional difficulty in comparisons is presented by the application of tax rates of various amount depending on the source of income. The need to harmonize of personal income taxation was discerned much earlier, and recently this has been manifested in the Lisbon Strategy, in which the common tax policy of the European Union was treated as a necessary requirement to be met in order to improve the competitive ability of the whole economic system but this concerns especially tax policy towards companies (no PIT principles). The most advanced discussion and logistic work concern the introduction of the common consolidated corporate tax base. Therefore the adoption of the common principle of determining tax base for CIT would bring the following benefits: trans-border balance of losses, elimination of tax difficulties when restructuring international companies. The chances for CIT harmonization are closely related to the scope of freedom given to national powers within other taxes. This especially concerns personal income tax (PIT), which may and should be the basic tax tool of the country in implementing particular social policy. If this is so, then such solution excludes – not only because of this – the concept of a flat rate PIT, as flat rate tax cannot be used as a tool for influencing social processes. This means that the requirement for standardization of principles of taxation and standardization of CIT rates is the existence of differentiated PIT as far as the rates (scale) and preferences used by particular countries are concerned. Only such an approach will allow progress in harmonization of corporate tax, leaving considerable tax autonomy to particular countries. It is a vital argument, as the resistance from governments hampers harmonization of direct taxes. It is partly justified also by the fact that EU states see some drawbacks of losing monetary policy autonomy and fiscal policy. The harmonization of principles of calculating CIT base and rates is also advisable as it would make the tax policy of a given country more transparent as far as principles of granting public aid to entrepreneurs are concerned.

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Abstract

The current taxation of personal incomes is a very complex phenomenon which should be analyzed not only from the legal point of view, but also taking into account into social, cultural, economic and political and system aspects. We cannot isolate the economic sphere from the tax sphere, as income taxes directly affect the way taxpayers function, their purchasing power, they determine labor costs for entrepreneurs and thus significantly influence the GDP growth rate. The issues of harmonizing taxation of incomes obtained by individuals who do not act as economic

operators is practically absent in scientific literature. The only issues that are analyzed are those related to taxation of incomes from savings, transfers, capital gains, mergers and divisions. This is so because it is required by the nature of conducting economic operations within the common market.