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**Article**

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TOMASZ WOŁOWIEC\*

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## Potential and Possible Ways of Harmonizing the Personal Income Taxation Process

### Abstract

*Personal income tax (hereinafter referred to as PIT) has a short history, as it appeared in tax systems of EU countries as late as at the end of the 18<sup>th</sup> century. As a specific universal structure it performs two economic functions: providing financial means for covering some public expenses (fiscal function), leveling inequalities – through its structure – in population incomes (a redistribution function). It also implements social functions of taxation through various tax reliefs and exemptions or the structure of the tax scale. Contemporary personal income tax in European countries has been shaped by many years of evolution. This process is continuing, taking into account the process of European integration and the processes of standardizing and harmonizing tax systems in European Union countries. Most EU states only sporadically implement major reforms of personal income taxation. The scope of such changes is usually limited and determined by current fiscal needs or the need to stimulate a particular behavior of taxpayers. 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 its social, cultural, economic and political system aspects.*

**Keywords:** *personal income taxation, EU integration, harmonization process, tax system, public finance*

**JEL:** *F15, H24, K34*

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## 1. Introduction

The main aim of the paper is to determine whether harmonizing personal income taxation in European Union countries is possible and desirable. The subject of the research is personal income tax imposed on people who do not conduct economic activities, taking into account its structure in tax systems of EU countries and challenges for the harmonization process. The subject of the research covers regularities, specificity and special features of the personal income tax structure, 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. Within the conducted analysis we attempted to verify the following research hypothesis: there are economic, political and social reasons for the harmonization of income taxation of individuals who do not conduct any business activity in the European Union countries. It has been assumed that the verification of the adopted research hypothesis which is not more than speculation or a guess, provisionally determines the necessity to obtain 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 harmonizing personal income taxation of individuals who do not conduct any business activity make sense?
3. What benefits will we obtain thanks to harmonizing the analyzed taxation form and what costs do we bear as a result of its absence?
4. What and how did various economic and social conditions determine the heterogeneity of personal income taxation in European Union countries?
5. What sources of similarities can be found in personal income taxation in tax systems of European Union countries, taking into account the so-called “quiet harmonization” and the role of the European Court of Justice?

Taking into account the specificity of personal income tax, the issues of tax competition and significant differences in PIT structures in EU countries, it was decided to assess whether it possible and desirable to harmonize this form of taxation with reference to individuals who do not act as economic operators. We should remember that the principles of personal income taxation in EU countries do not constitute such an important area of harmonization as indirect taxes. It is assumed that the differences found in direct taxations are less dangerous for the functioning of the common market. Moreover, harmonizing of these taxes is much more difficult than indirect taxes, from the political, technical and legislative points of view. The main element differentiating direct taxation is its slight degree of normative harmonization. It is commonly believed that direct taxes exert a less destructive influence on the functioning of the common market; therefore, work on their harmonization started later, lasted longer and did not go as far as in the case of indirect taxes.

Competition between tax systems forces certain solutions in national tax systems, aimed at bringing closer the structures of certain taxes in order to ensure the optimal functioning of the common market. Thus “quiet harmonization” is a consequence of progressing competition among national tax systems in particular forms of taxation. The effect of quiet harmonization is bringing closer structural solutions in personal income tax in European Union states. This has led to us finding out that the main reference points for the transformation of an individual’s taxation system in European Union Countries has been limited to the personal income of individuals who do not conduct any form of business activity and it reflects the short and long-term run. Referring to PIT it was emphasized that the tax should remain at the discretion of the member states. The only harmonization activities should concern removing barriers to the four economic freedoms and provide uniformity of taxation (Davidson 2007; Torres, Mellbye, Brys 2012).

## 2. Literature review

The concept of income was of vital importance in the development of income tax. We can differentiate two basic concepts of income (Holmes 2001). The first one is the concept of the theory of revenue sources focused on the regular inflow of economic value from particular sources, historically linked to the English income tax system. According to this theory, taxable income is a regular surplus coming from regular sources. A much broader concept of income is offered by the theory of net asset growth which combines taxable income with the growth of economic ability to spend the income, whether it is regular or a one-off. The essence of this theory is the economic ability of a given individual obtained in a specified period of time and calculated by summing all net revenues (incomes) and benefits, even one-off ones (such as donations, lottery wins, etc.), obtained in one tax year (Krajewska 2012, McGee 2004). The presented theories significantly influenced the development of particular types of income tax (Auerbach, Hines 2001).

We can differentiate three basic types of tax: Roman (mixed), German (global) and British (scheduler). The Roman type was a historical transition from revenue tax to income tax. Its specific feature lies in the fact that particular parts of income are first placed in tax schedules and are taxable according to the progressive or proportional rate, and then the general income is established and taxed according to the progressive rate. This type of income tax can be found mostly in the tax systems of France, Italy, Belgium or Portugal (Gwiazdowski 2007; Zee 2005). The German type of income tax originated in East Prussia and then spread to the Netherlands, Switzerland, Austria and Scandinavian countries. In this system the tax is collected from global (general) income, regardless of the source of obtained

revenues, using the progressive tax rate. In the British (scheduler) type of income tax, income is not determined globally, but partial incomes are summed, specifically defined in the so-called schedules. The sum of partial incomes gives the total (consolidated) income. Partial incomes are taxed according to proportional or progressive rates. The tax collected from scheduler incomes is treated as an ordinary tax, in contrast to the tax collected from general income using the progressive rate, which is then treated as an additional tax. Schedules determine particular incomes very precisely, and then, within them further (detailed) division of incomes into particular groups takes place (Cnossen 2001; Kesti 2012–2016).

The evolutionary development of income tax has led to the development of several specific features dominating contemporary tax systems. The first one involves basing the income tax structure on the theory of net asset growth, which offers its broad understanding, and, in connection with this, adapting global income as the basis for taxation (freeing taxation from sources of obtaining revenue). A contemporary version of the theory of net asset growth is the theory of market income (originating in the German tax doctrine), according to which the income of a particular entity is the asset growth generated and performed by this entity (James, Nobes 2012). This means that income is generated only in the economic turnover, as an effect of human work, investment of capital, thus excluding inheritance, donations and other extraordinary incomes. In taxation practice, some elements of the theory of sources are also used, by excluding incomes obtained from determined sources from general income and taxing them according to a separate tax rate (usually the proportional one) (Holmes, 2001).

Since global (unitary) income tax is a structure commonly used in contemporary tax systems, taxation of a taxpayer's income is based on the principle of tax assessment and self-calculation of tax or calculation conducted by the payer. Some factors affecting the taxation method have been selected and introduced into tax systems because of the tax purpose, depending on whether fiscal burden rests on the taxpayer alone and depending on the costs of administering (managing) taxes (Inventory of Taxes 2011–2016). Therefore the taxpayer cannot – as a result of payment collection – have at their disposal the amount of tax, while the difference resulting from it – in the case of some alternative investment – would allow them to obtain some additional profit (benefits), calculated at the current value of money. In the second case, when the tax is collected using the above method, it is called tax at source. Even though the tax is paid by the payer to tax organs, the recipient of this income in this case is the taxpayer (Wołowiec 2011; KMPG's 2012–2016).

In order to make an assessment of tax, tax organs must have reliable data (information), which is necessary when determining the amount of tax. The nature of tax assessment by tax organs imposes on the taxpayer a duty of submitting (communicating) relevant information in their tax return (declaration). If the taxpayer, despite this obligation, does not meet it, in this case the tax organs are

entitled to assess the tax by assessing the taxpayer's income. Many tax systems abandoned the assessment method in favor of the taxpayer's self-calculation of tax (Hite, Roberts, 1992; Structure of European Union Taxation Systems 2010–2016). This mostly concerns corporate income taxation, which is a situation in which tax obligation is created by law. Despite the self-calculation technique, no tax system has abandoned the obligation to submit a declaration in order to make it easier for tax organs to control the correctness of a self-calculation performed by the taxpayer. This method of tax assessment is used only with reference to taxes constituting a burden on the taxpayer's global income (Holmes 2001; James, Nobes 2012).

Tax collected at source may be treated as a specific down-payment towards income tax. In this method, the taxpayer is obliged to declare in his annual return form, the size of obtained income and is entitled to lower (reduce) the amount of due tax calculated in this tax return by the amount of tax that was collected at source. The tax collected at source is called 'tax paid at source included'. Alternatively the tax collected at source may be the final tax collected at source. In this case income recipient (taxpayer) is exempted from an obligation to submit tax declaration and from obligation concerning the amount of collected tax. Taxes collected at source usually have a fixed rate, which is applied to the revenue (not income), which means that we do not take into account any costs of obtaining revenue or the personal situation of a taxpayer (income capacity). Therefore we can state that taxes collected at source are examples of scheduler taxes (Wyściśłok 2000; Wołowicz, Suseł 2010). With reference to the income related to work remuneration, most countries combine both methods of collection, that is assessment and collection of tax at source, which is known as the 'pay as you earn (PAYE) system' (Kesti 2011–2016; Tax reforms in EU Member States 2013). In this system, employers (payers) are obliged to collect tax at source from the remunerations of their employees.

The structure of contemporary personal income tax should be based on three principles: universality, equality (equity) and taxation of pure income (Taxation Trends in The European Union 2012–2016; Cnossen 2001). The advantages of income taxes include (McGee 2004):

1. Relative resistance to economic crises, shown in the stability of budget tax revenues.
2. Flexibility to legal regulations through the influence of statutory rate(s) change on the fiscal effectiveness of the tax.
3. Relative savings in collection costs.
4. Adjusting the size of the tax burden to the individual tax capacities of the taxpayer (tax personalization).
5. The disadvantages of this form of taxation include:
6. Slow collection, i.e. a significant time span between the appearance of a taxation object and the payment of the tax.
7. The absolute transparency of the collection.

8. The unequal burden on various social classes.

9. The complexity of taxation.

Income taxes, due to their direct nature, are an equalizing instrument and introduce the principle of taxation equity into the tax system. Taking into account the fact that indirect taxes have institutional injustice, tax callousness and excessively burden the poorest taxpayers, we can compensate for this injustice using direct taxation. Income taxes also help the taxpayer realize, thanks to their directness and ostentation of collection, the level of the tax burden. Basing the structure of budget tax revenues on revenues from direct or indirect taxes is based on defined criteria concerning both fiscal and stimulation functions. Such criteria may include:

- in the sphere of implementing the fiscal function of taxation:
- the fiscal effectiveness of taxes, reflecting the current financial needs of the public sector,
- the costs of tax collection, expressed in percentage of revenues,
- resistance to tax avoidance and tax fraud,
- effectiveness in speed of collection,
- the ability to automatically adjust to the cyclical development of the economy (self-regulation).
- In the area of implementing the stimulation function:
- tax influence on the inclination to save and invest,
- tax influence on the choice of production techniques,
- tax influence on the shape of a socially desirable consumption structure.

Income tax is highly valued in the financial law doctrine. It is seen as a type of taxation which meets all theoretical requirements of science, constitutes an efficient source of public income and does not harm the economy. There are two variations of income tax: scheduler tax (on partial incomes) and global tax (on general income). Scheduler tax consists of the separate taxation of incomes from various sources, using different tax rates. The income which is taxed separately is then summed up and taxed again as general (global) income. This means that the same income is double-taxed. The use of the second concept, namely global income tax, means that all incomes obtained from various sources by the taxpayer are taxed. The joint taxation of all the incomes obtained by the taxpayer allowing his/her subjective payment possibilities resulting from his/her material and family situation to be taken into account. Such a concept of income tax is widely used and is connected with the application of progressive tax scale. Progression, however, evokes natural tendencies to take into consideration various exemptions and reliefs, which lower the tax base and consequently lead to the application of a lower tax rate resulting from the progressive scale (Henman 2007; Kesti 2010–2016). The “pro-family nature” of the whole tax system, especially its personal income tax element, quite often appear both in politicians declarations, social activists statements and in the hopes of taxpayers, especially those with large families. In practice, legal solutions, especially those concerning the taxation of personal incomes, should not

ignore pro-family social expectations. At the same time we should stress the widespread view that taxes should be neutral, which prevails in the doctrine. The belief that taxes should be neutral stems from their fiscal function. We should not – according to some experts – use taxes to achieve various social goals, some of which may go against the fiscal requirements of the state. Such goals should be accomplished using other, non-tax instruments (for example by introducing family benefits rather than pro-family tax preferences). With such different positions of the financial law doctrine – on the one hand, and many politicians and a considerable part of the society – on the other, is it possible to introduce pro-family solutions into the tax system that do they make sense. One wonders what such “pro-family” solutions would involve (Litwińczuk 2009; Lipniewicz 2011).

### **3. Personal income tax and community tax legislation**

The imperative for harmonizing direct taxes, including personal and corporate income taxes and taxes on property gains, was not clearly stated in the Treaty establishing the European Economic Community. The legal basis for initiatives in the harmonization processes was Article 100 of the Treaty, stipulating the harmonization of those regulations that directly affect the creation and operation of the internal common market. The process of harmonizing direct taxes covered different income tax regulations which limited the freedom of income flow in the form of dividends, interests, license fees and capital between Community members (this will be discussed in a separate analysis of the principles of capital income taxation). We should remember that the principles of income taxation in EU countries does not constitute such an important area of harmonization as indirect taxes. It is assumed that the differences found in direct taxations are less dangerous for the functioning of the common market. Moreover, harmonizing these taxes is much more difficult than indirect taxes, from the political, technical and legislative point of view. Only some elements of corporate income tax are being harmonized, as they relate to international aspects of company operations that could cause potential discrimination in the treatment of domestic and foreign companies and which refer to avoiding double taxation. It is probable that further elements of corporate income tax will be harmonized next – tax rates and the taxation base (Militz, Dominik-Ogińska, Pomorska, Wróbel, Murdecki 2011).

The main element differentiating direct taxation is its slight degree of normative harmonization. It is commonly believed that direct taxes exert a less destructive influence on the functioning of the common market; therefore work on their harmonization started later, lasted longer and did not go as far as in the case of indirect taxes. Direct tax regulations in the European Union are left at the discretion

of member states (except for the need to observe the areas presented in the table). Particular member states enjoy significant freedom in shaping their domestic solutions in this area. However, they are obliged to treat domestic and foreign operators equally as far as taxation is concerned. There are several reasons for the relatively low scope of harmonization (Taxation Trends in The European Union 2012–2016; Structures of the taxation systems in the European Union 2012–2016).

Firstly, when signing the Treaty of Rome, it was believed that direct taxes do not significantly influence the internal market, as a result of which there are no specific regulations on harmonizing direct taxes. Thus, community law in direct taxes can only be based on the general regulations of Article 94 of the Treaty establishing the European Community. The Article authorizes the Council to pass directives in order to bring closer statutory, enforcement and administrative provisions of member states that directly affect the establishment or operation of the common market.

Secondly, income taxes, as direct forms of taxation are an important and valuable tool of fiscal policy used by particular states, influencing social and economic life and it is hard for politicians to get rid of this way of exerting influence. Non-fiscal functions of taxation can easily be realized with income taxes. The process of tax law harmonization will not eliminate the stimulation function which involves using different tax structures, as visible differences in the development of particular states and regions as well as specific traditions of national tax systems will require the (temporarily) application of various types of instruments and tools of tax policy.

Thirdly, directives concerning the harmonization of direct taxes must be passed with majority of votes, which accounts for the lack of unanimity in this area (de Goede 2003, p. 130).

Fourthly, progress in income tax harmonization evokes the fears of losing tax sovereignty and leads to hardening positions by member states towards processes aimed at harmonizing income taxes.

Fifthly, EU countries have various rules of rewarding employees, establishing incomes from pensions and shaping costs of obtaining revenue and expenses which lower the taxation base.

The first document emphasizing the need for direct tax harmonization was the Neumark Committee Report from 1962. Following the concepts presented therein, the Community Committee presented a program of harmonizing direct taxes in 1967. It included all main ideas which, in the following years, were gradually implemented by the Community legislation or are still an element of the harmonization program (Brzeziński, Głuchowski, Kosikowski, 1998, p. 23). The most important issues raised by this document were Directives 90/434/EEC, 90/435/EEC and 2003/48/EC: integration of corporate and individual income taxation and abolishing income tax collected at source for dividends and interests and the standardization of personal income taxation rules.

The only directive concerning personal income taxation is the one from 3<sup>rd</sup> June 2003 (2003/48/EC) on the taxation of savings income in the form of interest payments. As far as the taxation of personal income from remuneration is concerned, all attempts at harmonization have been limited to various proposals on joint principles of determining taxation base, size of tax rates and methods of shaping tax progression (Druesne 1996). Taking into account PIT specificity and detailed general issues of income tax harmonization, I believe that for personal income taxation we can only expect to bring closer some systemic solutions as a result of leveling the development level in member states and improvements in tax techniques and the popularization of its most effective solutions. On 23<sup>rd</sup> June 2011 the European Commission issued a statement on tax policy aims for the coming years (COM (2011) 260 final).

Apart from the above directive, EU countries have been given freedom in shaping other principles of personal income taxation. In this sense, the principles of personal income taxation are not an area where Polish standards can be adjusted. European Union countries independently decide on the structure of costs of obtaining revenues, the scope for tax reliefs and exemptions, the way in which things progress, etc. (Hamakers, Holmes, Głuchowski, Kardach, Nykiel 2006). In spite of the lack of directives normalizing principles of individual income taxation, such principles are self-created and the burden levels equalize. We can say that due to the principle of competitiveness included in the tax law, member states make adjusting attempts in their adopted tax structures. This is to increase the attractiveness of their tax systems. Competition between tax systems forces certain solutions in national tax systems, aimed at bringing closer the structures of certain taxes in order to ensure the optimal functioning of the common market. Thus “quiet harmonization” is a consequence of progressing competition among national tax systems in particular taxation forms. The effect of quiet harmonization is bringing closer the structural solutions in personal income tax in European Union states (Cullen, Gordon 2002). 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. The similarities in the personal income tax in EU states concern the following areas (Krajewska 2010; Hall, Rabushka 2000; Gajl 1995):

- The tax is related to the total (global) income of the taxpayer,
- Scales are progressive with various numbers of ranges and minimum and maximum tax rate values;
- Most countries use tax-free amounts;
- Tax burdens are usually adjusted to the inflation rate through a system of automatic or semi-automatic indexation or changes to tax thresholds;
- Personal income tax reflects the principle of the taxpayer’s payment capacity through its varied system of tax reliefs and exemptions;

- Different rules are used for the 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 the tax burden based on the sources of revenues from which it is obtained or how it is allocated;
- Income tax contains tax preferences related to the way the income is spent.

#### 4. Research methods

The aim of the paper is to determine whether harmonizing 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 to the personal income of individuals who do not conduct any form of business activity and it reflects the short and long-term run. The paper objective formulated in such a way requires that a comparative analysis of personal income taxation systems in the European Union countries be conducted, taking into account the specificity, common features and differences in income tax structures in the surveyed countries as well as the areas, possibilities and potential directions for harmonizing this form of taxation. In order to accomplish such research goals we need to differentiate the following research schemes, i.e. the ways of coordinating the activities:

1. Comparative research, aimed at revealing the differences and similarities between personal income tax structures in the European Union countries, taking into account the rulings of the European Court of Justice and potential areas of coordinating and harmonizing the elements of PIT structure.
2. Review research, involving the analysis of the elements of PIT techniques, taking into consideration the ways and challenges of the personal income taxation harmonization process and tax competition and the phenomenon of quiet harmonization.
3. A case study devoted to the evaluation of the ECJ rulings as far as the implementation of tax regulations in national tax systems is concerned (standardizing and harmonizing the elements of the PIT structure).

Such a formulation of the aim of this thesis is determined by the following circumstances:

Firstly: Personal income taxation has become one of the most important tools for population income redistribution, allowing for the implementation of the principles of universality, equity (equality) and taxation of the so-called net income.

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. Therefore in all EU countries, in spite of the declared neutrality, non-fiscal functions significantly influence the PIT structure, 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.

Fourthly: Harmonizing income taxes is much more difficult than indirect taxes, from the political, technical and legislative points of view. Therefore work on their harmonization started later, lasted longer and did not go as far as in the case of indirect taxes. The regulations concerning direct taxes in the European Union are left at the discretion of member states.

Fifthly: In spite of the lack of directives standardizing the 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.

Within the conducted analysis we attempted to verify the following research hypothesis: there are law, political and social reasons for the harmonization of income taxation of individuals who do not conduct any business activity in the European Union countries. The analysis and evaluation of the possibilities of harmonizing personal income taxation in the European Union countries will be conducted taking into account four basic criteria. These are:

1. An evaluation of the economic and social importance (weight) of personal income tax, taking into account its influence on consumption, the mobility of the workforce, labor supply and starting a business activity.
2. An evaluation of the influence of direct taxation on economic growth, the labor market and the economic (macro-economic) policy of the government.
3. The scope of originality and individuality of personal income taxation solutions in the European Union countries.
4. An evaluation of the influence of 'quiet harmonization' as the result of competition among national tax systems and decisions of the European Court of Justice on unifying structural solutions for personal income taxation.

## **5. Results: ways of harmonizing personal income taxation principles**

The tax systems of the 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 an additional global tax, progressively taxing the sum of taxpayer's incomes. Combining them, which involves both global and scheduler tax allows us to com-

bine both taxation techniques and preserve the differentiation, personalization and progression of the tax. Tax systems in the European Union member states are evolving from the way income is taxed in Latin-American countries (the scheduler system) to the method used in Anglo-Saxon countries (the global income method). Total income is determined by indicating taxable sources of revenues. The taxation of personal incomes in the European union countries is based on five fundamental tax principles (Grądański 2006; Gwiazdowski 2007):

- subject universality – it means that tax should cover all people receiving an income in the taxed area. This means eliminating 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 the taxation of the joint income of an individual (global tax), not incomes from some sources of revenue (scheduler tax). Consistent application of this rule does not allow separate taxation of some incomes or using separate tax scales of rates. It allows the deduction of incurred losses from one source of revenue from other incomes;
- the 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 so-called tax equity, which postulates exempting people with the lowest incomes from taxation, leaving a tax-free subsistence minimum, using social and family preferences, and differentiating the tax burden in line with payment capacity by applying tax progression;
- the taxation of “pure income” in the 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 costs of obtaining revenue);
- the taxation of “pure income” in the subject perspective – connected with leaving some tax-free amount (the subsistence minimum) for taxpayers in order to satisfy their basic individual and family needs. Non-compliance with this rule would necessitate returning the taxes collected by public authorities in the form of various social allowances.

In personal income tax structures implemented in European Union countries, the principle of payment capacity is taken into account in various elements of tax structure (appearing separately, jointly, or as selected elements), such as:

1. Determining the tax-free amount for a spouse who does not work (Slovakia) or for each child maintained by parents (for example in Belgium, the Czech Republic, Estonia, the Netherlands, Germany, France, Slovenia and Lithuania).
2. Joint taxation of spouses (for example in Ireland, where separate tax scales are determined for single people and for married couples).
3. Specific and unique taxation of family income in the French tax system (the system of *family quotient taxation*, reflecting the number of children in a family).

4. Structures granting the right to make tax deductions of some expenditures for children maintenance (for example in France) or even family (Germany).
5. The size and span of tax rates.
6. The method of determining costs of obtaining revenue.
7. The system of preferences which take into account the family situation.

The shape of economic policy implemented by European Union countries, reflecting economic, sociological, cultural and historical factors allows us to indicate a number of arguments for tax progression (Browning, Johnson 1985; Taxation Trends in The European Union 2012–2016):

- Firstly – the implementation of the principle of tax equity. Taxpayers with the lowest incomes and poorly accumulating savings, pay income tax at the cost of consumption. The tax paid exceeds savings (surplus of income) which they can generate. Affluent taxpayers pay tax not at the cost of consumption, but savings (surplus), so tax is cheaper (lower) for them. In order to balance the subjective burden weights, less affluent taxpayers should be taxed according to a lower scale of summary taxation than affluent ones.
- Secondly – taxpayers with lower and average income should be taxed with a lower total income tax, as they generate the highest part of the global demand. We can say that tax progression should be a regression towards taxpayers with low and medium incomes to preserve their higher demand, vital for stimulating the economic cycle.
- Thirdly – taxpayers with medium incomes make up the majority management staff, while the level of their remuneration affects labor costs. If taxation of their salaries is higher in flat tax than in progressive tax, the final tax burden will mainly be shifted to employers, who will increase gross salaries as a result of higher taxation. Increasing the progression scale of income tax will translate into lower gross salaries and a reduction of labor costs.
- Fourthly – the affluent should pay higher taxes, as they should be interested in a strong state.
- Fifthly – in a situation of higher marginal progression rates, tax reliefs may work more effectively (provided they are precisely defined), aiming at mobilizing economic behavior that is effective for the economy.
- There is no empirical verification of the effectiveness of a flat tax, apart from theoretical considerations. Solutions introduced in the tax systems of Estonia, Lithuania, Latvia and Slovakia are not pure flat taxes. They can be classified as progressive taxes with one rate, as the system preserved tax-free amounts, tax reliefs and exemptions, including pro-family ones (Hall & Rabushka 2000; Gwiazdowski 2007).

Apart from the EU harmonization law (directives), EU countries have been given the freedom to shape other principles of personal income taxation. In this sense, principles of personal income taxation are not an area where Polish standards can be adjusted. In spite of the lack of directives normalizing the

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 attempts at adjustment in the adopted tax structures. This is intended to increase the attractiveness of their tax systems. Competition between tax systems forces certain solutions in national tax systems, aimed at bringing together the structures of certain taxes in order to ensure the 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 the structural solutions in personal income tax in European Union states.

Referring to PIT it was emphasized that tax should remain at the discretion of member states. The only harmonization activities should concern removing barriers to the four economic freedoms and providing uniformity of taxation.

Similarities in personal income tax in the EU states concern the following areas:

- The tax is related to the total (global) income of the taxpayer;
- Scales are progressive with various numbers of ranges and minimum and maximum tax rate values;
- Most countries use tax-free amounts;
- Tax burdens are usually adjusted to the inflation rate through a system of automatic or semi-automatic indexation or changes to tax thresholds;
- Personal income tax reflects the principle of the taxpayer’s payment capacity through its varied system of tax reliefs and exemptions;
- Different rules are used for the 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 based on the sources of revenues from which it is obtained and how it is allocated;
- Income tax contains tax preferences related to the way the income is spent.

Analysis of community tax legislation (rulings and cases of the ECJ) allows us to formulate a thesis that harmonizing personal income taxation principles is impossible for historical, political, social and technical reasons. The Court rulings cannot influence the harmonization of personal income taxation principles, as these concern only the taxation of savings income and the 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 court proceedings only before their home courts. According to Article 234 of the Treaty, lower instance courts may lodge the case with the ECJ, while higher instance courts must do so. Moreover, the Commission itself may question the conformity of member state legislation or agreements on avoidance of double

taxation to the provisions of the Treaty related to the four freedoms. Generally, difficulties in harmonizing personal income tax cover the following issues:

- Political factors – income tax payers are a very large group of voters. Politicians are unwilling to give up using the PIT tax technique in implementing the regulatory and stimulating function of taxation, as it is a valuable instrument in their relationship with voters.
- Harmonizing 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. They are both contributions made by taxpayers and direct financing from the state budget (premiums are then included in general taxes – as in Denmark).
- EU countries have various systems of rewarding work and shaping the population income level. There are various systems of costs of obtaining revenue, methodologies of shaping progression, etc.
- Personal income tax plays both a 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.

The proof for the thesis: (1) on the legal impossibility of personal income tax harmonization and (2) the progressing “quiet harmonization” (non-legal) is based on the analysis of the following elements of personal income tax techniques in European Union states:

1. the taxation subject;
2. methods of avoiding double taxation;
3. the subject scope of taxation;
4. social issues in personal income tax;
5. the system of preferences used in personal income tax;
6. the level of tax burden, including the relationships between levels of income tax rates;
7. tax progression versus proportional taxation – a comparative analysis;
8. the taxation of capital gains and comparison of personal income taxation rules in Poland and other EU countries and the identification of similarities in personal income tax structures in EU state tax systems.

Personal income structures differ widely in European Union countries. It is even difficult to compare such key elements in the personal income tax structure as the number and level of tax rates and related level and span of tax thresholds. In particular countries the issue of the general exclusion from taxation of in-

comes at specific level is approached differently, some have a zero tax rate, others different amounts of tax credit. An additional difficulty in comparisons is presented by the application of tax rates of various amounts depending on the source of income. The problems with comparing the personal income tax structure are also related to various systems of transfers to different public finance sectors – incomes from this tax may finance not only the central budget but also self-government budgets or social insurance funds (Koester, Kormendi 1989; Pecorino 1993; Levine, Renelt 1992).

As we already mentioned, the need to harmonize personal income taxation was established much earlier, and recently this was 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, in particular, this concerns tax policy towards companies (no PIT principles). In the case of PIT, the most important arguments against harmonization are listed below:

- 1) further loss of sovereignty in local (national) financial policy, which constrains the possibilities of influencing economic and especially social processes by the government. Harmonizing the principles of calculating the tax base and adopting uniform rates (rate) means passing tax prerogatives to a transnational institution – in this case the European Union. In this situation each country must conduct its own cost/benefit analysis (Koester, Kormendi 1989),
- 2) various social models which determine the various financial needs of the state,
- 3) historical conditions, i.e. factors which shaped the national tax systems,
- 4) inequality in the competition between companies operating exclusively in the internal market and those which operate in many countries of the Community (Heitger 2001).

## 6. Conclusion and recommendations

Full economic integration requires that taxes be considered an important factor in the furthering of integration processes, since EU member states are tax nations, i.e. countries where budgetary incomes come primarily from taxation. EU member state tax systems are strongly diversified, due to the individual developmental paths shaped by national histories of various lengths, cultural development, customs, value systems, and social and economic policy, which 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 the architects of the EU 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 harmonization emerged as a continent-wide process. During the development of the Treaty of Rome it was decided that, to ensure a common market, it was enough to harmonize indirect taxes and remove trade barriers as they were the prime inhibitors to the flow of goods and services. The harmonization 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: the originators of the union assumed that income taxes would be neutral towards integration processes and a natural convergence of the tax systems of the nations belonging to the economic and currency union would occur (Wołowiec 2011).

Personal income taxes are highly differentiated in EU member states in terms of setting the size of tax brackets and the 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, and the phase of the business cycle. EU member states have to consider the taxpayer's ability to pay when creating different components of Personal Income Tax (PIT) policies.

Both labor and capital would benefit from tax harmonization as it would simplify operations and create a more balanced environment that would reduce the need for mobility oriented purely on seeking tax benefits. Both tax rate harmonization and tax rate competitiveness require additional consideration of:

1. The impact of PIT rate harmonization on the state budget and the possible imbalance of public finances (harmonization worsening national budgets, e.g. through the downward integration of tax rates).
2. The impact of labor mobility on the nation's economy (income migration further enhanced by PIT rates).

The economic aims of tax harmonization may be unachievable for legal reasons, since a tax is not only an economic category but also a legal one, and its legal side is affected by:

- The relationship between national and EU law, and when considering the supremacy of EU law over national rules, many issues emerge (e.g. conflicting regulations, different interpretations).
- The problems of applying (and in what measures) unlimited tax duty in one country compared to applying unlimited tax duty in another country with

limited duty, and, finally, how unlimited tax duties should be applied in both countries.

- How to formulate and agree upon treaties on avoiding double taxation (not only achieving consensus between nations but also following local political patterns and taxation trends).
- The problems of whether to collect the tax in country of residence or non-residence and in what proportions.

Harmonizing income taxes is much more difficult than harmonizing indirect taxes from the practical, technical and legal perspectives. There are many reasons for that:

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 harmonization 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 and procedures.
4. Progress in direct tax harmonization creates challenges for the tax independence of nations and leads to the 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, rules emerge spontaneously and tax burdens are slowly equalizing. This process is the result of competition between EU member state tax systems—nations are extensively utilizing the structure of the personal income tax to use the stimulating functions of the tax system, which in turn impacts the possibilities open to spontaneous PIT harmonization. Due to the effects of “quiet” paralegal harmonisation, several common PIT characteristics can be found in the EU:

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. There is 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 minimum 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 family income, the sale of real estate, assets and investment incomes.
6. In every structure there exists a sum which is free from taxation and, in varying degrees, it considers the minimum level of (biological) existence and costs of obtaining an income.
7. Tax burdens are considerate of, in varying degrees, the state of the family and its 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).

The analysis of the European Union laws indicates that personal income tax harmonization is extremely difficult due to historical, political, social and technical factors. Decisions by the European Court of Justice (ECJ) mostly concern 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 harmonizing personal income taxes because they concern the taxing of income from savings and the exchange of tax information, while the progressing “quiet” harmonization is more a result of inter-nation competitiveness and not of any formal ECJ rulings.

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

1. The further loss of sovereignty in national financial policies, which will inhibit the state’s ability to affect economic processes and (especially) social ones. Harmonizing the rules for calculating the basis for taxation and accepting unified rates would mean the transfer of tax-setting prerogatives to a trans-national institution: the EU.
2. Different social models and retirement systems, when combined with varying degrees of PIT integration with retirement contributions, determine the various financial needs of the state, therefore harmonisation would have to reach far beyond “mere” PIT systems.
3. The historical, cultural, and social factors that have shaped national tax systems reinforce claims that a path-dependent process will be difficult to reverse.
4. In the field of *taxation* and cross-border workers, no rules exist at the EU level regarding the definition of cross-border workers, the division of taxing rights between Member States or the tax rules to be applied.

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## Streszczenie

### MOŻLIWOŚCI I KIERUNKI HARMONIZACJI PODATKU DOCHODOWEGO OD OSÓB FIZYCZNYCH

*Podatek dochodowy od osób fizycznych jest stosunkowo młodą konstrukcją w europejskich systemach podatkowych. Jest on formą daniny publicznej realizującej najczęściej pozafiskalne funkcje opodatkowania. Jako bezpośrednia forma podatku od dochodów wzbudza silne emocje polityczne pozostając najbardziej „rozpoznawalną” przez obywateli formą obciążeń publiczno – prawnych. W systemach podatkowych krajów Unii Europejskiej (UE) podatek dochodowy od osób fizycznych jest zarówno ważnym źródłem dochodów budżetowych, jak i instrumentem realizacji funkcji socjalnych, społecznych, stymulacyjnych oraz redystrybucyjnych. Mimo, iż opodatkowanie dochodów osobistych leży w kompetencji każdego z państw członkowskich, w wielu sytuacjach potrzebna jest koordynacja na poziomie unijnym regulacji podatkowych, mająca na celu zapewnienie swobód określonych w Traktacie ustanawiającym Wspólnotę Europejską oraz wyeliminowanie barier podatkowych w ponadgranicznej działalności obywateli państw – członków UE. W szczególności niedopuszczalne jest stosowanie – bezpośredniej, czy pośredniej – dyskryminacji ze względu na narodowość ani też żadnych nieuzasadnionych ograniczeń czterech swobód Rynku Wewnętrznego. Brak wymogów harmonizacyjnych (z wyjątkiem opodatkowania dochodów z oszczędności) oznacza, iż konstrukcja PIT w krajach członkowskich jest silnie*

zróżnicowana z uwagi na odmienne uwarunkowania społeczne, polityczne i ekonomiczne. Z drugiej strony pojawia się pytanie, czy harmonizacja tej formy opodatkowania jest w ogóle możliwa, a przy tym celowa? Niewątpliwie zróżnicowany poziom wynagrodzeń, różnice w kształtowaniu podstawy opodatkowania i wysokości podatku, i często odmienne zadania nakładane na podatek dochodowy utrudniają jego ujednolicenie i harmonizację. Wydaje się, więc, że wszelkie próby związane z harmonizacją ww. obciążeń fiskalnych należy rozpocząć od zdefiniowania i ujednolicenia w ramach Unii Europejskiej pojęcia dochodu podatkowego (podstawy opodatkowania).

**Słowa kluczowe:** podatek dochodowy od osób fizycznych, harmonizacja, integracja, systemy podatkowe, finanse publiczne