Biuletyn Stowarzyszenia Absolwentów i Przyjaciół Wydziału Prawa Katolickiego
Uniwersytetu Lubelskiego t. XVII, 19 (2) 2022, s. 139-160

TAX COMPETITION *VERSUS* PERSONAL INCOME TAX HARMONIZATION AND TAX COMPETITIONS, LABOR MARKET AND ECONOMIC SECURITY CONTRIBUTIONS. SELECTED ISSUES

KONKURENCJA PODATKOWA A HARMONIZACJA PODATKU DOCHODOWEGO OD OSÓB FIZYCZNYCH W KONTEKŚCIE FUNKCJONOWANIA RYNKU PRACY I SYSTEMU UBEZPIECZEŃ. WYBRANE ZAGADNIENIA

Dr. Olena Ivashko

University of Economy and Innovation in Lublin
e-mail: olena.ivashko@gmail.com; https://orcid.org/0000-0003-2950-0474

Abstract

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. Mobile production factors (labor and capital) may easily be located in countries with low tax rates, which limits the possibility of increasing their taxation. 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.

ISSN 2719-3128; e-ISSN 2719-7336
https://doi.org/10.32084/bsawp.4770

Keywords: tax competitions, tax law, personal income taxation, tax harmonization process

Abstrakt

Konkurencja podatkowa to stosowanie takiej polityki podatkowej, która pozwoli na utrzymanie lub zwiększenie atrakcyjności danego systemu podatkowego zarówno w obszarze funcjonowania osób fizycznych, jak i prywanych obszaru dla lokalizacji inwestycji. Konkurencja podatkowa jest zjawiskiem bezpośrednio związanym z procesami globalizacji, a zwłaszcza ze wzrostem międzynarodowej mobilności pracowników i kapitału. Liberalizacja przepływu czynników pracy i kapitału oraz spadek kosztów transakcyjnych powodują, że zarówno osoby fizyczne, jak i kapitał poszukują atrakcyjnych jurysdykcji dla swoich lokat (inwestycji) nie tylko w kraju, ale i za granicą. Teoretycznie obniżenie stóp podatkowych nie musi skutkować zmniejszeniem dochodów budżetowych, gdyż dzięki przepływowi czynników pracy i kapitału wzrośnie baza podatkowa. Jeśli jednak (teoretycznie) wszystkie kraje UE zdecydują się na obniżenie stawek podatku od osób fizycznych, to względna atrakcyjność krajów dla podatników PIT (którzy mogą być traktowani jako inwestorzy) pozostanie niezmieniona, natomiast dochody budżetowe tych krajów spadną. Spadek dochodów podatkowych spowodowany obniżeniem stawek przy niezmienionej podstawie opodatkowania odpowiada sytuacji, w której państwo może przeznaczyć mniej pieniędzy na realizację swoich zadań związanych z dostarczaniem dóbr publicznych. Mobilne czynniki produkcji (praca i kapitał) mogą być łatwo lokowane w krajach o niskich stawkach podatkowych, co ogranicza możliwość zwiększenia ich opodatkowania. Istota konkurencji podatkowej często sprowadza się do przekonania, że małe obciążenia podatkowe są głównym czynnikiem decydującym o rozwoju danego terytorium i postrzeganiu go jako atrakcyjnego miejsca ostatecznego rozliczenia podatkowego.

Słowa kluczowe: konkurencja podatkowa, prawo podatkowe, opodatkowanie dochodów osób fizycznych, harmonicacja podatkowa

1. Research methodology

Research in the social sciences, is inspired by numerous and diverse needs. Therefore, we will reduce the existing needs in the article to two main types, to which certain types of research correspond. The first is combined with needs of a theoretical or cognitive nature, that is, it includes all those needs that are associated with the development of tax law. The second is combined with the various needs of practice. Focusing

attention on the aforementioned types of needs, we can point to the corresponding types of research. The main purpose of the work is to assess the impact of tax competition on the processes of tax law harmonization, but in the area of personal income tax. Induction was used as the main research method. It consists in drawing general conclusions or establishing regularities on the basis of analysis of empirically established phenomena and processes. It is a type of inference based on details about the general properties of a phenomenon or object. The use of this method requires the assumption that only facts can form the basis of scientific inference. These facts are real-life situations (social, legal, or organizational). Inductive methods include various types of analysis, expert opinion, statistical data and scientific documents used in social research. In addition, the paper uses two general research methods, i.e. analytical and synthetic methods, which are characterized by a particular approach to the study of reality. Analytical treats reality as a collection of individual, specific features and events. Following this research method involves breaking down the object of study into parts and studying each part separately or detecting the components of that object. A negative feature of the analytical method is the overexposure of details, sometimes resulting in losing sight of the whole object of study. This hinders full and objective cognition of reality, which is admittedly a collection of independent partial elements, but at the same time a set of parts closely related to each other into a limited whole. The research methods used in the study are: comparative analysis, functional analysis and the method of research in a dynamic approach.

2. Concept of tax competitions

The European Union has limited competence to act and legislate in the field of taxation. Ever since its creation, it has been committed to the convergence of European tax legislations regarding VAT or excise duties and has issued directives asking for cooperation between tax administrations. However, direct taxation remains the sole prerogative of individual member states, subject to the fundamental freedoms fixed in the Treaty on the Functioning of the European Union. In principle, tensions arising due to the spillover effects of individual member states' tax policies on other member states can only be addressed within the official EU framework

if they distort competition within the common market [Edwards and Keen 1996, 113-34].

In recent decades, the European Union has witnessed a decline in corporate income tax rates and top personal income tax rates as well as, more recently, an intensification of tax competition by means of preferential regimes targeting the most mobile parts of the corporate and personal income tax bases. In addition to harmful or aggressive tax competition as defined by the Code of Conduct group, non-action in the face of the general dynamic of tax competition raises potential risks for the European Union: 1) Public finances: Tax competition induces national governments to establish tax rates and regimes that do not correspond to the level of taxation otherwise applied in a harmonized scenario [European Commission 2020a]. This may lead to a lower provision of public services or jeopardize the sustainability of public finances by increasing the public deficit; 2) Social equity: The tax cuts are rarely uniform across all sectors, brackets and income types. Tax competition tempts governments to accept relative increases in the tax burden on the least mobile and least elastic categories of the tax base such as consumption or the wages and salaries of less mobile individuals [Zodrow 2003, 651-71]; 3) Political cohesion: The absence of tax harmonization following the creation of a common market tends to favour downward convergence in the field of taxation, which may be seen as a potential weakness in the political construction of the European Union. Perceiving other member states as competitors rather than as partners in a project of shared prosperity may reinforce Euroscepticism among citizens. One way for the European Union to mitigate the negative effects of globalization could be by establishing tax cooperation. In an individualistic scenario, member states would be obliged to lower their taxes, which would thus eventually lead to a lower quality of public services or more regressive tax systems. A cooperative scenario, on the other hand, would favour upward convergence in terms of tax revenue collection, public goods provision and social equity [European Commission 2020b].

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 [Desai, Foley, and Hines 2004, 1-10]. This model only presents a general concept of tax competition, in practice its mechanism is much more complicated and far from clear [Bujiink, Janssen, and Schols 1999, 9-15; Wołowiec 2014, 60-81]. Mobile production factors (labor and capital) may easily be located in countries with low tax rates, which limits the possibility of increasing their taxation [Verrue 2004, 1-9]. 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 [McGee 2004, 105-107].

3. Personal income harmonization

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 [Akcigit, Baslandze, and Stantcheva 2015, 2930-981].

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 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 [Wołowiec, Nedyalkova, and Cienkowski 2014, 89-99].

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 [Wołowiec and Cienkowski 2014, 21-38].

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. We should obviously remember that it is not only the level of PIT, but also lower labor costs (pension system), infrastructure, quality of workforce and administration, transparency of law, including tax and business law, that determine the investment attractiveness of a particular region or country and competitiveness of enterprises operating there. However, variety of conditions of running a business in particular countries and the existence of comparative benefits stimulate the development of international exchange, which, in turn, stimulates social and economic development of a particular region [Skrzypek-Ahmed and Wołowiec 2015, 77-105].

4. New trends in tax competition and tax harmonization process

Tax competition can be defined as noncooperative tax setting by independent governments, under which each government's policy choices influence the allocation of a mobile tax base among 'regions' represented by these governments [Farrell and Klemperer 2007, 1967-2072]. Governments may try to attract capital, workers or consumers from other countries by lowering general tax rates or by offering special regimes targeting a specific part of the tax base or taxpayers. The liberalisation of international capital flows and the advances in transportation and communication technology have generally increased the mobility of corporations and individuals. Nowhere is this more evident than in the case of large corporations and high-income earners. International tax competition over increasingly mobile factors provides a plausible explanation for declining corporate tax rates, the rise of dual income taxation or special regimes for capital income taxation in Europe (Eggert & Genser 2005), and declining top personal income tax rates. However, other factors such as changes in the political climate towards a less egalitarian view of distributive justice may also play a role [Hauter 2001, 17]. Early economic models of tax competition, where

countries compete over mobile business investment by cutting corporate tax rates, usually predict a race to the bottom in corporate taxes resulting in inefficiently low levels of public services [Zodrow 2003]. Proponents of tax competition argue that it constrains government officials who – pursuing their egoistic objectives – might increase the tax burden on their residents beyond the welfare-maximizing point [Edwards and Keen 1994]. EU tax revenue statistics suggest that tax competition in the EU has not coincided with a general decline of taxation as a percentage of GDP since 1951. Instead, there seems to be a tendency to shift the tax burden from the more mobile capital incomes to less mobile tax bases, such as consumption, with important distributional implications. In recent years, international initiatives have primarily focused on tax evasion and avoidance, with tax competition largely being sidelined. Preferential tax regimes granting tax benefits without requiring substantial real economic activity have moved into the limelight only recently, in large part because they are believed to intensify inefficiencies related to tax competitio. Some scholars argue that preferential regimes for highly mobile parts of the tax base may relax downward pressures on general tax rates. However, they undermine the horizontal equity of the tax system and may distort economic incentives when two taxpayers with the same amount of total income are subject to different effective tax rates. In the EU, both forms of tax competition – downward pressure on general tax rates and the spreading of preferential regimes – have the potential to undermine the vertical equity of tax systems due to the exceptional mobility that taxpayers enjoy in the common market. As cross-border tax optimization involves relatively high fixed costs, the tax benefits of this increased mobility are likely to be higher for high-net-worth individuals, high-income earners as well as large enterprises. For example, from the point of view of an individual, the financial benefits of a tax residence change must outweigh the costs, including either a complete change of the social environment or, more likely, the maintenance of two residences, frequent travelling, bureaucratic costs, and legal advice. Similarly, it is a privilege of MNEs to strategically locate economic activities across member states, in order to benefit from low taxation without giving up the benefits of public infrastructure in high-tax countries, which creates a competitive advantage over smaller or purely domestic enterprises.

In the field of personal income tax, coordinated EU action has been much more limited and mainly focused on avoiding double-taxation and on increasing transparency regarding received capital incomes [Osmundsen, Schjelderup, and Hagen 2000, 623-37]. The Code of Conduct only applies to business taxation and, even though the European Commission had already initiated debate on including certain regimes for highly qualified expatriate workers in accordance with the Code of Conduct in 2001, this initiative has not been pursued further. The asymmetric treatment of corporate and personal income tax may, however, come to an end as both the European Parliament and the EU Commission have recently acknowledged the need for action in the field of harmful personal income tax regime.

5. Harmonization of income taxation and 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 [Auerbach and Hines 2001, 3-15].

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 [Wołowiec and Cienkowski 2016, 111-24].

6. Barriers to harmonization of PIT and social security contributions

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) [Davidson 2007, 1-30].

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 [Cnossen 2001, 1-89]. 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 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. [Auberach and Kotikoff 1987, 49-55].

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. They do not have a possibility of using them in practice, which makes it difficult to maintain them, let alone improve them. Besides, lack of work makes it difficult for them to gain completely new qualification. For example, they do not learn new production techniques. The conclusions are as follows: the sharpness of progression is an internal issue of each member country and depends on the goals of state fiscal policy determined by economic and social factors.

7. Harmonization of employment – 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 [Torres, Mellbye, and Brys 2012, 1-56].

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.[1] Tax discrimination takes place when different people in comparable situation are treated differently by tax

---

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

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.[2] 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.[3] Within research work, we analyzed the tax rulings of the ECJ vital for the freedom of human flow.[4] The ECJ rulings have led to numerous amendments (standardization) or even repealing of internal tax regulations.

Conclusions

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 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 central budget but also

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

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

[4] 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).

budgets of self-government budgets or social insurance funds. Currently, most EU countries use progressive PIT rates, depending on the level of incomes, though 7 countries – Bulgaria, Czech Republic, Estonia, Lithuania, Latvia, Romania, Slovakia – have a flat tax. From the taxpayer's point of view, what really matters is the size of the minimum and maximum tax rates and the number of the so-called tax thresholds. However, on the basis of these data it is impossible to draw final conclusions concerning the size of personal income burden in particular member states, as of vital importance here is the method of determining tax base and all deductions from income or from tax amount. Below I will present changes in time concerning basic parameters characterizing taxation of personal incomes in the European Union countries.

As we already mentioned, 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 need to develop a common position on corporate taxation was manifested in the so-called Tax Package, whose element is the Code of Conduct for Business Taxation. The importance of this code, adopted in 1997, consists in obligation of member states to observe principles of fair competition and to resign from solutions causing harmful tax competition. In a 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 2) various social models which determine various financial needs of the state; 3) historical conditions, that is factors which shaped national tax systems; 4) inequality in competition between companies operating exclusively in the internal market and those which operate in many countries of the Community.

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: 1) trans-border balance of losses, 2) 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. Tax changes which are an attribute of power, will be forced by market mechanisms. This does not mean that we advise passivity of national and EU administration in this area.

Harmonization of taxation on money savings kept on bank accounts boiled down to ensuring that the principle of free flow of capital between countries should not be violated by home tax provisions. The essence of harmonization of taxes on savings does not consist in imposing one tax rate for all member states. On the contrary – each country enjoys freedom of determining the tax rate, its differentiation, for example according to the type of deposits, while savings incomes may be singled out of all personal incomes and included into them. The idea of harmonizing savings incomes is to ensure free deposits of savings in the EU member state by its non-residents, in the country in which the deposit conditions are the most beneficial as we take into account the offered interest rate. Savings

incomes of non-residents are transferred to the resident state and are subject to single taxation according to principles of taxation of a resident state. This principle has been observed by all member states since 1st July 2005.

During the development of the Treaty of Rome it was decided that, to assure 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: union creators assumed that income taxes will be neutral towards integration processes and there will occur a natural convergence of tax systems of nations belonging to the economic and currency union.

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.
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.
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 dependent 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.

REFERENCES

Akcigit, Ufuk, Salome Baslandze, and Stefanie Stantcheva. 2016. "Taxation and the International Mobility of Inventors." *American Economic Review.* 10:2930-981.

Auerbach, Alan, and James Hines. 2001. "Taxation and economic efficiency." *NBER Working Paper* 8181, 3-15. https://doi.org/10.3386/w8181

Auerbach, Alan, and Laurance Kotlikoff. 1987. "Evaluating fiscal policy with a dynamic simulation model." *American Economic Review* 2:49-55.

Buijink, Willem, Boudewijn Janssen, and Yvonne Schols. 1999. *Final report of a study on corporate effective tax rates in the European Union (commissioned by the Ministry of Finance in the Netherlands*. Maastricht: Universiteit Maastricht.

Cnossen, Sijbren. 2001. "Tax Policy in the European Union: A review of Issues and Options." *Studies in Economic Policy* 1:1-89.

Davidson, Sinclair. 2007. "Tax Competition. Much To Do About Very Little." *The Center For Independent Studies, CIS Policy Monograph* 78:1-20.

Desai, Mihir, Fritz Foley, and James Hines. 2004. "Economic Effects of Regional Tax Havens." *NBER Working Paper* 10806:1-10. https://doi.org/10.3386/w10806

Edwards, Justin, and Peter Keen. 1996. "Tax competition and Leviathan." *European Economic Review* 40:113-34.

European Commission. 2020a. *Taxation trends in the European Union. Data for the EU Member States, Iceland, and Norway. DG Taxation and Customs Union*. https://taxation-customs.ec.europa.eu/taxation-1/economic-analysis-taxation/taxation-trends-european-union_en [accessed: 22.11.2022].

European Commission. 2020b. "Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee. Tax policy in the European Union – priorities for the years ahead. COM(2001) 260 final." *Official Journal of the European Communities* C 284/6, 10.10.2001.

Farrell, Josepg, and Peter Klemperer. 2007. "Coordination and lock-in: competition withswitching costs and network effects." In *Handbook of Industrial Organization*, edited by Mark Armstrong, and Robert Porter. Elsevier 3:1967-2072.

Hauter, Alan. 2001. *Taxation in a Global Economy*. Cambridge: Cambridge University Press.

Huber, Brian. 1999. "Tax competition and tax coordination in an optimum income tax model." *Journal of Public Economics* 71:441-58.

James, Simon, and Christopher Nobes. 2012. *The Economics of Taxation*. Birmingham: Fiscal Publications.

Kesti, Juahni. 2020. *European Tax Handbook 2019.* Amsterdam: IBFD International Bureau of Fiscal Documentation.

Krajewska, Anna. 2012. *Podatki w Unii Europejskiej*. Warszawa: PWE.

McGee, Robert. 2004. *The Philosophy of Taxation and Public Finance*. Boston–Dordtech–London: Springer New York.

Osmundsen, Petter, Guttorm Schjelderup, and Peter Hagen. 2000. "Personal income taxation under mobility, exogenous and endogenous welfare weights, and asymmetric information." *Journal of Population Economics* 13:623-37.

Skrzypek-Ahmed, Sylwia, and Tomasz Wołowiec Tomasz. 2015. "The problems of personal income taxation harmonization process in European Union countries." *Zeszyty Naukowe Wyższej Szkoły Ekonomii i Innowacji w Lublinie* 10, no. 1:77-105.

Torres, Carolina, Kirsti Mellbye, and Bert Brys. 2012. “Trends in Personal Income Tax and Employee Social Security Contribution Schedules.” *OECD Working Papers* 12:1-56.

Verrue, Robert. 2004. *Tax Competition in the EU. A few remarks on the current state of play*. Brusseles: UE Commission.

Wołowiec, Tomasz, and Cienkowski, Mirosław. 2016. “The need to harmonize of personal income taxation: an attempt of evaluation.” *Zeszyty Naukowe Uczelni Warszawskiej im. Marii Skłodowskiej-Curie* 3(53):111-24.

Wołowiec, Tomasz, and Mirosław Cienkowski. 2014. “Personal income taxation as a very complex phenomenon: ways of reforming and a challenges for a future.” *Globalization, the State and the Individual* 3:21-38.

Wołowiec, Tomasz, Anna Nedyalkova, and Mirosław Cienkowski. 2014. “Assumptions of tax systems in the European Union countries.” *Globalization, the State and the Individual* 4:87-99.

Wołowiec, Tomasz. 2014. *Harmonization of personal income taxation across European Union member states*. Lublin: Innovatio Press.

Wołowiec, Tomasz. 2016. *Ways of personal income taxation harmonization process.* Lublin: Innovatio Press.

Zodrow, George. 2003. “Tax competition and tax coordination in the European Union.” *International Tax and Public Finance* 10:651-71.