

MARKET-BASED RESPONSES OF SUBJECTS TO TAXATION. LEGAL, MANAGEMENT AND ECONOMIC CONDITIONS

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Abstract: The content of financial policy is always the choice of certain objectives to be achieved through the management of finances (including taxes), as well as the methods and means of achieving these objectives. The financial policy of households and economic agents has a microeconomic scale, as it affects the individual economic objectives of individual consumers (households) and enterprises. The state's financial policy pursues defined objectives in three areas: stabilisation of the economy, allocation of production factors and redistribution of income. The implementation of the state financial policy in these three areas gives rise to the distinction between the three functions of state's financial policy: stabilisation, allocation and redistribution. The article analyses the legal and economic determinants of the impact of taxpayers' behaviour on the management of economic agents and household responses.

Keywords: tax law; financial law; tax liability; economics of taxation; decision making; tax management.

INTRODUCTION

Taxpayers' reactions are dictated by their subjective perception of the tax burden, which is expressed as the amount of taxes that reduce the taxpayer's income, being the difference between the income that would be available to the taxpayer if no tax had to be paid and the actual income available to the taxpayer after paying taxes. These taxpayer responses determine both economic and political incentives [Gomułowicz and Małecki 2004, 110-11]. Every form of taxation carries with it the effect of reducing the income that the individual expected to obtain from the original appropriation, production, or exchange. Since these activities require the use of scarce resources – such as time and the use of one's body – that could have been used for consumption or leisure, the opportunity cost of these activities increases. The marginal utility of appropriation, production and exchange becomes lower and the marginal utility of consumption or leisure becomes higher. Thus, by forcibly transferring valuable, not yet consumed goods from producers (production in a broader sense also includes primary appropriation and exchange) to people who have not participated in production, taxation reduces the current income of producers and their potential level of consumption. Moreover, the current incentives for future production of valuable goods also weaken, with a consequent reduction in future income and levels of future consumption [Rothbard 1970, 2].

1. PURPOSE OF ARTICLE, CRITERIA OF ANALYSIS AND RESEARCH METHODOLOGY

The social sciences use the typical methods found in the social sciences and humanities, i.e.: the study of documents (legal acts, expert reports, opinions, analyses), comparative methods (scientific articles, reports, analyses derived from linguistic, grammatical and historical interpretation) and case studies. The result of cognitive research is new claims or theories. The article is written according to the traditional methods used in legal research sciences, linguistic analysis (dogmatic-legal method and linguistic-logical method), and comparative (comparative) and economic method of legal analysis. The monograph takes the form of an in-depth legal analysis of the principles of property taxation in the Polish legal system and the legal systems of European Union countries. Particular attention has been given to the directions of reform of the property taxation system in Poland in the context of the legal regulations of the model based on the real estate cadastre (*ad valorem*). The methods used in the microeconomic analysis – the inductive influence of taxation on taxpayers' behaviour – were also used.

2. TAXATION AND THE SOCIAL AND ECONOMIC CONTENT OF GOVERNMENT FINANCIAL POLICY

From the point of view of taxation, fiscal policy is a fundamental tool for achieving the economic and social objectives imposed upon it. These objectives are reflected in the construction of the tax system, by both defining the types and amounts of taxes imposed on particular categories of taxpayers, but also by defining the detailed principles of tax construction – determining their personal scope, subject matter, tax base, methods of its calculation, tax rates and scales, and the system of tax allowances and exemptions (less frequently tax increases). “The implementation of the objectives of the state’s financial policy is based both on their qualitative definition, but also through the detailed definition of their subjective and objective scope, rules of assessment depending on the various subjective characteristics of payers, exemptions, reliefs, etc. It can be concluded that the process of collecting public revenues allows the creation and application of various tools for the implementation of state financial policy objectives” [Wołowiec and Cienkowski 2014, 25-26]. The tools of the state’s financial policy simultaneously perform all functions of financial policy, i.e. stabilisation, allocation and redistribution functions. “For example, if the personal income tax is based on progressive rates (increasing with an increase in the tax base), then as an instrument of state financial policy, it will automatically perform a stabilising function” [Wojciechowski, Skrzypek-Ahmed, Wołowiec, et al. 2023, 512].

3. TAXES AND THE STABILISATION AND STIMULUS FUNCTION OF FINANCIAL POLICY

Globalisation, in addition to its positive effects, has also exacerbated a number of negative phenomena, which we can include social and income inequalities, poverty, unemployment, increased social pathologies, disintegration of family and interpersonal ties, excessive consumerism, productivism, environmental degradation and terrorist threats [Wołowiec 2009, 5]. Recent years have seen dynamic changes in the fields of economics, public management and economic and social policy, with increasing consideration of a variety of social and environmental factors and attention to inclusive (sustainable) economic growth. Similarly, the concept of profit itself is no longer the primary paradigm for the role and importance of the company in the modern world. There is a growing awareness among consumers, as well as societies as a whole, of the role and importance of sustainability and equitable distribution of resources. Neo-liberal concepts of profit

maximisation at all costs and the “invisible” hand of the market have indeed devalued [Ivashko, Wojciechowski, Życzkowski, et al. 2023, 530].

What we have today is a discussion on changing the neoliberal model of capitalism, which is no panacea for contemporary economic and social challenges and problems. Capitalism is based on three principles: free market, free competition and property rights. Unfortunately, capitalism has many different faces and can take many different forms. The formula of capitalism in the Scandinavian countries differs from that in the Anglo-Saxon “version”. Since the 1970’s, neo-liberalism, based on market fundamentalism, i.e. the principle that the market decides everything and is infallible, has played a dominant role in shaping capitalism. Such an uncritical belief in the infallibility of the market means that, with absolute subservience to market mechanisms alone, the mechanisms of democracy are undermined. In this way, we become slaves to the market, and this contradicts the idea of freedom. Furthermore, ordoliberalism, which assumes that the idea of liberalism is linked to the principles of socio-economic order, is gaining popularity. Post-crisis experience shows that countries with capitalism in a formula closer to ordoliberalism are characterised by smaller income disparities and a fairer distribution of national income [Leoński 2015, 135-36]. Modern capitalism must be based on a more inclusive model, i.e. one that is oriented towards the widest possible inclusion of all resources, social and material, in order to improve the quality of life and avoid various forms of social exclusion. The constitutional model of the social and economic system in Poland is based on such a concept. An inclusive system is one that optimises the use of all resources and makes it possible to narrow the gap between the potential, i.e. achievable, level of GDP and its actual size. It is the financial crises and the covid-19 pandemic that have caused us to attach increasing importance to the so-called concept of sustainability and economic inclusiveness [Anisiewicz, Wołowiec, Marczuk, et al. 2023, 228]. It assumes that GDP growth is not an end in itself. More important is the distribution of the benefits of this growth and the levelling out of income and wealth inequalities [Leśna-Wierszołowicz 2016, 71].

The stabilisation function of the government’s finances includes measures aimed, *inter alia*, at achieving and maintaining a relatively high rate of economic growth, while limiting negative phenomena, i.e. high unemployment and inflation rates, mitigating fluctuations in the business cycle, stabilising the money market and making the most efficient use of tangible factors of production [Wołowiec and Cienkowski 2015, 14].

There are three main functions within fiscal policy. Stabilisation function of fiscal policy - involves influencing the level of aggregate demand in order to maintain macroeconomic equilibrium, i.e. price stability, full employment and currency market equilibrium. Redistributive function of fiscal policy - aims to reduce income inequality by transferring income from richer to

poorer segments of society through the tax system and social benefits. Allocative function - involves directing economic resources to sectors of greatest importance for economic development and social welfare. It is worth noting that these three functions are closely interrelated and influence each other. Therefore, an effective fiscal policy should take into account all these functions and strive to fulfil them simultaneously.

In practice, fiscal policy varies depending on the government's approach to shaping public finances. We distinguish between restrictive, loose, balanced, responsible and active policies, among others. Each of these approaches has advantages and disadvantages, and their application depends on the economic situation and economic policy objectives. Loose fiscal policy involves increasing public spending and/or reducing taxes to stimulate the economy and increase aggregate demand. This type of policy is used in situations of recession or economic downturn. Conversely, restrictive fiscal policy involves reducing public spending and/or increasing taxes to curb inflation and excessive economic growth. Responsible fiscal policy implies attention to the sustainability of public finances and long-term economic goals, such as sustainable development or the reduction of social inequalities. Active fiscal policy, on the other hand, involves the deliberate and flexible use of fiscal policy tools to achieve economic objectives and stabilise the economy. [Wołowiec 2019, 240].

Fiscal policy asymmetries arise from differences in the economic situation, the structure of the economy and the economic policy objectives of different countries. Fiscal policy can be shaped by various factors, such as the level of economic development, the structure of economic sectors, the level of public debt or social preferences. Consequently, fiscal policy differs between countries and its effectiveness depends on proper adaptation to the specific characteristics of the country and the economic situation. In some situations, fiscal policy tools may fail, leading to the inability of fiscal policy to achieve its intended objectives. An example of such a situation could be a lack of coordination between fiscal policy and monetary policy, which can lead to inefficient use of the available tools

4. EFFECTS OF TAXATION ON DEMAND, SUPPLY, SAVINGS AND INVESTMENT

In microeconomic terms, taxes influence the formation of demand, supply, equilibrium in the market for a given good and the decisions of producers, consumers and investors. The imposition or increase of a tax on a good will induce a decrease in the proceeds from its sale as a result of a decrease in demand for the good and a decrease in its net price. The increased gross price is covered in part by the seller and in part by the buyer. The

proportions of their share in covering the increased price depend on economic factors such as the price elasticity of demand and supply, the ability of the seller (producer) to influence the level and structure of its own costs. Under conditions of rigid demand elasticity, the entire burden of imposing (increasing) the tax will be borne by the buyer. If the elasticity of supply is rigid, then the imposition or increase of taxation under these conditions will not cause a change in the gross price of the good in question, but its net price will decrease by the amount of the imposed (increased) tax. The entire tax burden will then be borne by the seller. If the demand for the good in question were infinitely elastic, the consequence of imposing or increasing the tax would be to reduce this supply with an increase in the gross price, until the equilibrium price determined by the willingness of buyers to pay the higher price is reached. Thus, the less elastic demand and supply are, the smaller the impact of an income tax on a given economic activity, since the imposition of (an increase in) taxation does not induce major changes in the allocation of resources. The greater the elasticity, the greater the impact on resource allocation [Owsiak 2000, 172].

“A tax affects the price of the taxed good, and an increase in price affects the market. An increase in tax rates can result in a situation where the taxpayer’s gross taxable income remains unchanged, in which case his net after-tax income decreases, or the taxpayer manages to increase his gross income, so that his net after-tax income does not decrease. In the first case, an increase in taxation can translate into either a decrease in direct consumption or a decrease in savings. A reduction in consumption translates into a reduction in indirect tax revenue unless an increase in income tax rates is accompanied by an increase in indirect tax rates. This, however, can result in either a further decrease in consumption or a decrease in savings and capital supply” [Wołowiec 2017a, 182].

In a market economy, allocation decisions are more or less visibly linked to the monetary savings of actors. The propensity of actors to save depends both on the deposit interest rate and inflation and on the tax rate on income from capital (monetary savings). Also, the propensity of entities to invest depends on the income from invested capital. High taxation on income from capital can reduce its marginal productivity, causing investment to be allocated in preferentially taxed sectors but with lower productivity, leading at the same time to distorted investment decisions.

Undoubtedly, high income taxation reduces private investment by reducing the portion of income potentially allocated to investment, leaving taxpayers with only enough money for consumption. Some researchers take a different view, arguing that a progressive tax does not at all reduce the attractiveness of risky investments compared to risk-free investments for two main reasons. Firstly, taxation reduces the taxpayer’s overall level of income,

so that his or her attitude to risk may change. This effect occurs regardless of the form and manner of income taxation, and depends only on the size of the tax, i.e. the scale of the reduction in after-tax income. Whether the tax reduces or increases risk-taking depends on the shape of the utility function. Secondly, as Young argues, high effective income taxation with a smaller range of expected after-tax income, which induces actors to take risks [Cienkowski and Wołowicz 2014, 36]. Of course, Young's assumptions may seem somewhat controversial, as high effective income tax rates, by reducing a taxpayer's income, do not necessarily induce him to increase risk. Moreover, Young makes the simplifying assumption that all taxpayers do not differ in their degree of risk aversion, so that he concludes that a non-negative tax scale is risk-neutral if and only if it offsets either absolute or proportional sacrifice. If $U(x)$ presents the utility for income x in the absence of taxation, and $t = f(x)$ is the tax scale, then $V(x) = U(x - t)$ is the taxpayer's utility for income after tax. A tax scale is risk-neutral if the taxpayer makes the same choices with and without taxation [Young 1994, 112]. As the von Neumann-Morgenstern utility is defined up to a positive linear transformation, this is the same as saying that $V(x) = U(x - t) = AU(x) - B$ for $A > 0$. If $A = 1$, then $U(x) - U(x - t) = B$, this means that t compensates for the absolute sacrifice. In the situation where $A < 1$, and $b = B(1 - A)$, then $[U(x - t) + b] / [U(x) + b] = A$. By assumption, $t > 0$, and U is increasing, so $A < 1$. Thus, the tax offsets the sacrifice rate at a rate of $1 - A$. Note that the above argument has some weaknesses. Firstly, the utility function cannot be estimated individually for each taxpayer, so individual taxpayer decisions should not be "averaged". Besides, the degree of risk aversion varies, and this significantly affects the division of social roles and the social division of labour, as well as the consumption and investment decisions made by taxpayers.

5. SUBSTITUTION AND INCOME EFFECTS – AFTER-TAX REAL RATE OF RETURN ON SAVINGS VS. SAVINGS SUPPLY

In the light of cluster economic theory, the amount of household savings is influenced by the rate of return on savings, representing "unconsumed" income. Savings are the result of households choosing a particular consumption structure over time by comparing the subjective value of current consumption relative to future consumption (the discount rate) with the market interest rate, which determines the extent to which future consumption increases as a result of foregoing current consumption (the interest rate). The taxation of capital income (interest on bank deposits, bonds, investment fund units, dividends on company shares) reduces the effective rate of return, thereby reducing the remuneration of savings. Consequently, one would

expect a decrease in the level of savings (substitution effect), but there is also an income effect – a decrease in the effective rate of return on savings translates into a decrease in the level of household wealth. This can result in a reduction in current consumption as well as future consumption. A reduction in current consumption can result in an increase in the level of savings.

“The effect of a decrease in the net real rate, as a result of taxing savings income, is not clearly defined due to the presence of substitution and income effects. Economic research shows that in the long run the substitution effect is stronger than the income effect and a fall in the net rate of return interacts with a fall in the supply of savings” [Tanzi and Howell 1998, 4].

If, in the long run, a reduction in taxation of labour income and savings leads to an increase in the budget deficit, households (taxpayers) expect income taxes to increase in future periods. Taxpayers will save part of the additional disposable income gained as a result of the income tax cut, seeking to equalise the distribution of consumption expenditure over time. Assuming intergenerational altruism, we obtain the same effect regardless of whether income taxes increase while the household is still alive or whether the tax increase affects its descendants. We therefore have a substitution between public and private sector savings, with studies of EU economies and the US economy failing to confirm the full substitution of public savings for private savings.

Progressive taxation may lead to a decline in savings. The life-cycle hypothesis, assumes that households, seeking to equalise their spending over their lifetimes, increase their indebtedness in initial periods to increase current consumption, expecting higher income in the future to allow them to repay past debt. Households also expect their income to fall in the final life cycle, causing them to save part of their income to be consumed only after retirement. Thus, it can be seen that the lowest propensity to save is found among economically inactive households (pensioners), a slightly higher propensity among households in the early phase of the life cycle and the highest propensity among the most affluent households in the mature life cycle [Wołowiec and Kępa 2020, 497; Wołowiec 2020, 558].

Progressive income taxation places the heaviest burden on the incomes of households with the highest marginal propensity to save. At the same time, these households transfer part of their income to households in the early and canine phase of the life cycle (supporting children and parents with transfers). This creates a conflict between egalitarian tax policies and solutions to stimulate household savings. An important role in the analysis of this process is played by the guarantee of social and pension benefits by the state (financed by quasi income taxes – contributions charged to work), as the existence of such a guarantee system removes uncertainty related to the consequences of unfavourable events for the household and reduces to some

extent the propensity (need) to save. “In a situation where social transfers come from current public sector revenues, we may have to deal with a decline in aggregate savings and a weakening of the ability to finance investment. It therefore seems important to reduce the funding of pensions from current public revenues. Research by Feldstein and Samwick indicates that a change from a social security system to a funded system could increase US national income by 5% in the long term” [Wołowiec, Skica, and Gercheva 2014, 54].

Taking into account the differences in marginal propensity to save between households with different incomes, it can be seen that low-income households have limited access to capital (credit), which means that they have to finance the purchase of durable goods to a much greater extent from their own resources. Restrictions on access to credit, combined with a high level of income taxation, limit households’ consumption expenditure, while at the same time they may increase their savings for a given income distribution [Wołowiec 2017b, 41].

If households treat the retained profits of the businesses they own as their own savings, the level of income taxation of firms can significantly affect household savings. Households may save more when firms retain less profits and save less when firms retain more profits. In a situation where the marginal propensity to save of households with a significant share of corporate profits is higher than the population average, an increase in the tax burden on corporate profits (income) combined with a reduction in personal tax may reduce the size of aggregate private sector savings. In summary, it can be concluded that increasing taxation of savings income may lead to a decrease in aggregate savings stimulating investment objectives, mainly through a reduction in disposable income, lower returns on savings and income transfer between households with different propensities to save.

A factor that has a significant impact on the amount of investment is the cost of capital, which depends on the interest rate. Taxing investment or savings income increases the difference between the return on investment before income tax and the return on savings after tax. Thus, it is a kind of tax wedge between the supply of savings and the demand for capital, which generates a decrease in the net rate of return on savings and an increase in the gross rate of return on investment and, consequently, a decrease in capital expenditure. When analysing the impact of investment income taxation, it is important to focus on effective tax rates, as very often a reduction in nominal (statutory) rates need not positively stimulate investment growth if accompanying changes in tax law (e.g. elimination of allowances) lead to an increase in the real tax burden.

CONCLUSIONS

To sum up, it should be remembered that any increase in tax and para-tax burdens may translate into a decline in the economic growth rate. The obtained research results lead to the conclusion that a better solution for economic growth is to increase the fiscal burden with indirect taxes than to increase the labor burden. Research shows that the fiscal burdens that constitute the so-called labor costs. Interestingly, contrary to popular belief, research has not shown any correlation between the impact of income taxes on the economy and economic growth. The obtained research results do not allow, without detailed microeconomic analyzes (level of wealth of households, structure of expenses of these households, price elasticity of demand, etc.), to conclude that it is more beneficial from the point of view of socio-economic well-being to increase the revenues from indirect taxation in the structure of budget revenues. Reducing the burden of income taxes requires an increase in the burden of indirect taxes to maintain the neutrality of revenues. However, please remember that this may cause some negative consequences. An increase in effective tax rates on goods and services may lead to an unfavorable allocation of production towards goods with lower price elasticity of demand. Indirect taxes use consumers' utility preferences to meet the financial needs of the budget, but the structure of the economy is shifting towards goods with low demand elasticity (basic goods). This may be a factor weakening economic growth by reducing the market for higher-level goods that stimulate the competitiveness of the economy.

The increase in prices caused by the increase in indirect tax rates may lead to an increase in inflation processes. If there is an increase in the prices of consumer goods with low demand elasticity, the low elasticity will not cause a decline in demand (or a slight decline). Producers will increase prices, which will cause a multiplier reaction of changes in other prices. Households burdened by higher prices of basic goods limit the demand for higher-order goods, which lowers their price and production. Producers reduce production and the overall price level is determined by goods with low price elasticity of demand. High (rising) indirect tax rates, by increasing the price level and the inflation effect, reduce the real income of society, reduce demand, decrease production and, consequently, weaken the economic growth rate. Price increases resulting from rising indirect tax rates generate, in the long run, pressure to increase wages so as not to weaken global demand in the economy. This results in an increase in the costs of wages and the costs of other production factors (suppliers of these factors compensate for their costs by shifting the tax burden by increasing the requested price). Therefore, there is an indirect burden of indirect taxes on enterprises on the part of costs. The increase in prices, which is the result of an

increase in the burden of indirect taxes, leads to an increase in the quantity of money in accordance with Irving Fischer's exchange equation. This may cause an imbalance in the monetary system. Indirect taxes, by burdening consumption expenditure, weaken the income of poor households the most, which means a violation of the principle of equality and fairness of taxation. In a situation where the increase in indirect taxation applies to a greater extent to domestic goods than to imported goods, this worsens the situation of domestic producers. The increase in indirect taxation of basic goods causes an increase in social stratification by increasing economic inequalities in the distribution of national income, especially in conditions of a high share of household expenditure on basic goods.

Assessment of the impact of income taxes on taxpayers' behavior and, consequently, on economic growth requires taking into account the entire external environment, in which taxes are one of the important elements, but it is not an element that functions independently and determines economic growth. A feature of the environment is that it may have an inhibitory or stimulating effect on economic growth, as well as the fact that it is shaped independently of the will of taxpayers.

Pro-growth tax policy should include such actions as: reducing taxation of income from work by lowering marginal personal income tax rates and/or increasing the tax-free amount and eliminating all ineffective tax reliefs and exemptions; reducing nominal CIT rates (in a situation where taxation of business income would still be regulated in two acts, the minimum plan is to reduce the CIT rate to 18%), while simultaneously expanding the tax base and increasing the tax base. It should be emphasized that tax incentives for investing may consist not only in reducing the corporate income tax rate, but also in appropriately designed investment reliefs. In terms of the structure of income taxes, it is recommended to replace the existing personal income taxes (PIT) and corporate income taxes (CIT) with a personal income tax and a business tax, i.e. on business activity, regardless of the form of its conduct. It is also desirable to reduce social security contributions charged to employers, in particular aimed at those social groups that are most at risk of unemployment, i.e. young people, those with the lowest income and low qualifications. An increase in the role of indirect taxes (reduction of direct taxation at the expense of indirect taxes) in the structure of tax revenues should be achieved not by further increases in the basic VAT rate, but by expanding the tax base and introducing a uniform VAT rate or significantly limiting the use of reduced rates. It should be emphasized that due to the growing share of the burden of indirect taxes, it will be necessary to look for solutions that protect the poorest income groups. All the changes indicated above should also be supported by multi-directional activities to improve the functioning of tax administration in Poland. Such activities

include: streamlining tax regulations, better use of Internet technologies in tax administration, reducing administrative costs of tax collection, improving tax collection and undertaking a decisive and effective fight against the gray zone.

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