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ECONOMIC AND SOCIAL ASPECTS OF PROGRESSIVE AND PROPORTIONAL TAXATION OF INCOMES

EKONOMICZNE I SPOŁECZNE ASPEKTY LINIOWEGO I PRGRESYWNEGO OPODATKOWANIA DOCHODÓW OSÓB FIZYCZNYCH

ЭКОНОМИЧЕСКИЕ И СОЦИАЛЬНЫЕ АСПЕКТЫ ЛИНЕЙНОГО И ПРОГРЕССИВНОГО НАЛОГООБЛОЖЕНИЯ ДОХОДОВ ФИЗИЧЕСКИХ ЛИЦ

Abstract

The case for a flat tax has been around for over two decades. In the early 1980s, Robert Hall and Alvin Rabushka of the Hoover Institution developed a tax system that is based on a single rate of taxation for all sources of income, as close as possible to the source. All income is classified as either business income or wages and taxed at one rate, except for a personal allowance exempting lower income individuals and families from taxation (this makes the Hall-Rabushka proposal to some extent progressive). There are no other exemptions, no deductions, no loopholes. The other essential aspect of the flat tax system developed by Hall-Rabushka is radical simplification of the tax system, by removing any deductions or reliefs, and by eliminating double taxation. This proposal represents a fundamental change in the way governments would collect tax revenue. Flat tax is believed to help reduce red tape and associated difficulties and confusion. With tax form down to size of postcard the flat tax system makes tax filling much simpler and more efficient; achieve simplicity, economic efficiency and fairness (same rate for all) – three principle of effective/sound taxation; reduce tax evasion and cheating, by lowering opportunity cost of avoiding taxes. Flat tax systems means elimination of relief, allowances and thus eliminates loopholes in the system and provide incentives to work, save and invest that trigger an economic boom.


Keywords: *taxation, personal income tax, flat tax, progressive taxation*

Streszczenie

Argumenty przemawiające za utworzeniem stałego podatku dochodowego zostały wydane ponad dwie dekady temu. We wczesnych latach 80-tych Robert Hall i Alvin Rabushka z Instytutu Hoovera opracowali system podatkowy, który był jak najbliższej źródła. Wszystkie

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dochody zostały uwzględnione w podatku dochodowym. Nie ma innych wyjątków, żadnych potrąceń i żadnych innych luk prawnych. Kolejnym istotnym aspektem stałego systemu podatkowego opracowanego przez Halla i Rabushkę jest uproszczenie systemu podatkowego poprzez zniesienie wszelkich odliczeń lub korzyści oraz wyeliminowanie podwójnego opodatkowania. Ta propozycja stanowi fundamentalną zmianę w sposobie, w jaki rządy będą pobierać wpływy z podatków. Uważa się, że stały podatek pomoże zmniejszyć biurokrację oraz trudności i zamieszanie z nią związane. Dzięki tej formie opodatkowania podatki są uproszczone i stają się bardziej wydajne; prostota, wydajność ekonomiczna i uczciwość (ponieważ ta sama stawka jest ustalana dla wszystkich) - to są trzy zasady efektywnego i niezawodnego opodatkowania; ograniczenie oszustw podatkowych i oszustw podatkowych poprzez ograniczenie alternatywnych kosztów związanych z unikaniem podatków. System stałego opodatkowania dochodów oznacza wyeliminowanie korzyści, a tym samym eliminuje luki w systemie i zachęca do pracy, oszczędności i inwestycji, które przyczyniają się do boomu gospodarczego.

Słowa kluczowe: opodatkowanie, podatek dochodowy od osób fizycznych, podatek dochodowy stały, podatki aktywne

Аннотация

Аргументы в пользу создания фиксированного подоходного налога были приведены уже более двух десятилетий назад. В начале 1980-х годов Роберт Холл и Элвин Рабушка из Института Гувера разработали систему налогообложения, максимально приближенную к источнику. Весь доход был включен в подоходный налог. Не существует никаких других исключений, никаких вычетов и никаких других лазеек. Другим существенным аспектом фиксированной налоговой системы, разработанной Холлом и Рабушкой, является упрощение налоговой системы, посредством отмены каких-либо вычетов или льгот и устранения двойного налогообложения. Это предложение представляет собой фундаментальное изменение в том, как правительства будут собирать налоговые поступления. Считается, что фиксированный налог поможет уменьшить волокиту и связанные с ней трудности и путаницу. С этой налоговой формой налоги упрощаются и становятся более эффективными; достигается простота, экономическая эффективность и справедливость (так как для всех установлена одинаковая ставка) – это три принципа эффективного и надежного налогообложения; снижение уровня уклонения от уплаты налогов и мошенничества за счет снижения альтернативных издержек по избежанию налогов. Фиксированная система подоходного налога означает устранение пособий и льгот, и, таким образом, устраняются лазейки в системе и возникают стимулы для работы, сбережений и инвестиций, которые способствуют экономическому буму.


Ключевые слова: налогообложение, подоходный налог с населения, фиксированный подоходный налог, прогрессивное налогообложение

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Statement of the problem in general outlook and its connection with important scientific and practical tasks.

Searching for criteria of “division” of tax burden, the legislator identifies the premises that would make the tax system rational from the perspective of fiscal and redistribution functions. In the equity norm, the lawmakers seek an objective criterion that would justify the necessity to impose taxes. Moreover, the equity norm was (and still is) to be a starting point for creating specific tax solutions, both in aspects of particular taxes and in the whole tax system. A fair construction was supposed to be a feature of a tax system. Tax equity is often treated as a maxim for the authority. Even so, only declaring that the equity postulate will be observed does not always translate into the compliance of tax practice to declared ideals of building the tax system (Głuchowski J., 1999). Fair taxation should also be considered in its normative aspect. A commonly held belief is that the law should respect (embody) the principle of equity. Tax law must be fair, as this is the idea of tax law (Tegler E., 1993). The problem of optimal distribution of income can be analyzed separately as well as in the context of other issues of economic policy, whose solution requires application of instruments affecting income distribution. Then the country chooses criteria of distribution of tax burden, shaping the final distribution of income and wealth (Acocella N., 2002). In such situations the indication of criteria determining tax burden of particular taxpayers which would ensure fair redistribution of income and effecting allocation of resources (the problem of *trade-off* between equity and effectiveness) requires an analysis of the issue of optimal tax system, that is a system which maximizes the function of social welfare (SWF), reflecting equity and effectiveness.

Postulate of tax equity – objective and subjective equity.

Firstly, equitable taxation (equity in taxation) is a problem which is still topical and controversial both in tax doctrine and legislation practice. Analyzing equity of taxation, tax doctrine assumes an ethical norm of conduct. Therefore all attempts at defining precisely this term must take into consideration equity as ethical norms (Gomułowicz A., 2001).

Secondly, the term ‘equity’ is positively valued, as referring to values which are axiologically considered good. The subject of such understood equity is always a particular set of social relations and appropriate norms regulating ways of its implementation. Various criteria of equitable distribution are preferred: 1) everybody gets the same, 2) everybody gets what they deserve, 3) everybody gets according to their contributions, 4) everybody gets what they need, 5) everybody gets according to their position, 6) everybody gets what the law grants them. The analysis of those distribution criteria allows us to discern that they are impossible to be met at the same time. There are three possible approaches to this situation: 1) either these concepts have nothing in common and they should not be defined in the same way, 2) or none of them can be called equity, 3) or one of them should be considered the only proper one (Peralman Ch., 1959). The choice of the prevailing model depends largely on the system of social and political forces or the existing practice.

Thirdly, in legislative practice the ethical norm of taxation generates two types of complications, based on lack of trust in the idea of equity, shown both by the legislator and the taxpayer. The legislator’s mistrust comes from the fear that equity can be

combined with taxation effectiveness (fiscal effectiveness) (Mastalski R., 1998; Harasimowicz J., 1997). The taxpayer's fear results from the awareness that the legislator often quotes the value of equity when implementing changes (or reforms) in the tax system that contradicted this principle. That is why an important element of all reforms is to obtain social acceptance for implementing it. Moreover, the taxpayer is aware that the equity argument may conceal the fiscal function of changes in taxation. Mistrust is also generated by the 'indefiniteness' of the equity formula itself. This causes that we can draw different rules of conduct from the ethical postulate and shape tax and legal solutions based on them. Doctrinal attempts at solving the problem of equitable taxation have never been successful, as it is very difficult to bring together the state interest (public good) and the taxpayers' interest (private good). A question arises then where we should set the border of taxation from the point of view of effectiveness and equity as well as scale and scope of tax redistribution.

Fourthly, the notion of equity should be considered in the context of solving the problem of contradictory interests of various social, professional and political groups. This awareness accompanies the activities of tax legislators, however, those contradictory interests make legal solutions incoherent (with the balance sheet law, for example), fragmentary (changes within particular taxes, without complex reform of the whole system), or sanction interest of various lobbying groups (Tax reliefs and exemptions).

Fifthly, we can observe mistrust between representatives of taxation theory and legislators (authority) imposing taxes, who understands the importance of theory in the context of creating ready-to-use rules of behavior.

Sixthly, both in theory and in practice, tax is a free, non-refundable, monetary, obligatory performance imposed unilaterally by the public and legal association, such as the state or a self-government unit, in order to finance public and social needs. Obligation distinguishes tax from voluntary performance. The relation between the taxpayer and an entity entitled to impose a tax is a relation of subordination. Tax obligation, therefore, can be enforced using the enforcement procedures.

Seventhly, taxpayers often and in various situations quote tax equity, identifying it mostly with reduction or elimination of tax burden. Tax equity in an objective form has some practical value, as it is taken into account by the authority who imposes taxes. Taking into consideration tax features as well as objective and subjective perception of tax burden, the taxpayer develops a defense reaction against decreasing their means. Simultaneously, expecting particular performances from public authority, the taxpayer may aim at reducing their own tax burden.

Eighthly, a view that is currently accepted states that equitable distribution of tax burden reflects tax capacity, so it adjusts tax burden to individual economic (and non-economic) situation of a taxpayer. The acceptance of this view is associated with differentiation between horizontal and vertical tax equity. Horizontal equity means that entities being in the same (or very similar) material situation should be burdened with tax in the same way, so taxpayers are "equally" subjected to tax burden. The use of this principle is not easy: it is not implemented by indirect taxes and material taxes, but it is fulfilled by personal taxes, due to personalized tax construction. Vertical equity means that entities in a better material and legal situation should be taxed more. This principle is fulfilled mainly by progressive taxes. There is always the

problem of balancing fiscal severity of consecutive progression steps (Famulska T., 1996). Tax progression assumes existence of several tax rates, which in practice does not have to mean a large degree of progression. Numerous reliefs in the system will limit its degree. We can measure the progression degree comparing average and extreme rates (Zee H.H., 2005). Assuming that $m(y)$ is extreme rate, t – size of tax as a function of income (y) before taxation, $a(y)$ is average rate, we have:

$$(1) \quad (y) = \Delta t(y) / \Delta y$$

$$(2) \quad a(y) = t(y) / t$$

Both volumes (1) and (2) will be from range $(0,1>$, and the system will be progressive when: $m(y) > a(y)$ and $\Delta a(y) / \Delta y > 0$ for all y . We should note that progression can be achieved using one tax rate and introducing reliefs to the system. The simplest solution is to introduce the tax-free amount – e , and a given tax rate $-\tau$. Dividing both sides of equation (3) by y we have equation (4), showing that in this case, the condition $m(y) > a(y)$ will always be met.

$$(3) \quad t = \tau(y - e)$$

$$(4) \quad a = \tau - \tau e / y$$

Talking of objective equity, we should state that:

- 1) it is accepted that fair taxes are general, so they cannot be negotiated or agreed individually;
- 2) equity requirement excludes elite reliefs in reduction of tax burden;
- 3) fair tax system is a system without legal gaps;
- 4) indirect taxes, included in prices of goods and services, are unfair taxes, causing tax regression with regard to affluent taxpayers (rather from an objective than subjective perspective);
- 5) the problem of tax equity should be considered with reference to the whole tax system.

The criteria of objective equity (horizontal and vertical) are problematic, as it is difficult to determine which groups should pay higher taxes and how much higher they should be. In spite of controversies, economists agree in two things. Firstly, the net effect of taxes should be progressive, so distribution of income after taxation should be less differentiated than before. Secondly, the obtained surplus should be distributed so as to increase incomes of more talented or poor people. The necessity of indicating the group which would receive this surplus causes another problem (Lea D.E.G., Webley P., Tarby R., 1987).


Analysis of latest research where the solution of the problem was initiated.

With reference to legal solutions in tax law, it is widely believed that taxes and the whole tax system should be neutral (Go-mułowicz A., Małeck J., 1995; Wójtowicz W., 1998; Wójtowicz W., Smoleń P., 1998). This means that taxes should be constructed so as not to make the existence and functioning of taxpayers difficult, but also so that they do not include any preferences for selected groups of taxpayers. Supporting tax neutrality does not determine negative attitude to using tax preferences as a means of achieving non-fiscal

aims by the state. It is assumed that tax equity is achieved through universality and equality of taxation Constitutional Tribunal (U. 7/87). The use of various tax preferences may be a consequence of reflecting tax equity understood subjectively. Such equity requires noticing different material, family or social situation of a taxpayer. It is widely believed that tax reliefs and exemptions are conducive to tax equity. The equity argument allows to obtain social acceptance for changes in the system of fiscal burden. Tax reliefs gain contradictory evaluations. Some people believe that

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they help correction of financial burden and fair adjustment of tax height to the financial situation of a person who is supposed to pay it. Other claim that reliefs are a sign of discrimination against those who do not use them. The difficulty lies in the fact that the taxpayer who was granted a relief does not treat it as a sign of preference, but as “fulfilling justice”. It would seem that, if we adopt this point of view as justified, that there are no tax privileges, only tax provisions treat some circumstances in taxation differently. An unprivileged person then will be someone who consumes and saves in a way that does not qualify them for any special privileges. Introducing tax reliefs, the country indirectly admits that fiscal burden is too high. In practice, introduction of particular tax reliefs may not support equity but sometimes deepen inequity. This is so in case of reliefs which can be taken advantage of by people with high or very high incomes. Tax reliefs may be treated as subvention payments for privileged taxpayers. This damages credibility of tax policy.

The main reasons why tax reliefs are passed are: high tax rates, technical complexity of taxation rules, legislative and executive division of state bodies and tradition and political system. Parliaments usually realize there are numerous ways thanks to which high tax rates cannot be applied, but executive organs do not have enough power to change this situation. Many reasons for tax reliefs and exemptions can be traced to the technique of tax law. They do not significantly affect the size of public income, but they do affect the incomes of individuals and social groups. Tradition greatly influences tax reliefs and exemptions. However, historical reasons are superseded by political ones. An MP is often forced to take into account interests of various pressure groups, as these groups may determine whether he/she will be re-

lected. Another important reason for passing tax privileges is public opinion’s ignorance of terminology. Citizens interested in the parliament’s work may mostly obtain information on tax rates structure, but they will not know what determine the parliament’s decisions concerning imposing significant tax burden on affluent citizens, etc. This issues are hidden in tax technique.

Psychological boundaries of taxation.

Subjective equity is the equity in the eyes of the taxed ones. “Taxes are equitable only when they are seen as such” (Lea D.E.G., Webley P., Tarby R., 1987). In all countries where surveys on tax system equity were conducted, most respondents saw taxes as unfair (Niesiołowska M., 2004). Another category of subjective evaluation of tax equity is the evaluation of the exchange between an individual and the state. According to Adam’s theory of balance, an individual is motivated by the feeling of equitable exchange. People compare their contributions and obtained results. If the balance is unfavorable to a given person, they will feel discomfort. The higher this discomfort, the greater the motivation to reduce such state. With reference to taxes it is the balance between benefits obtained by an individual and their contribution that makes the tax system perception as fair or not. If the perceived contribution exceeds benefits, taxpayers (citizens) see the tax system as unfair. They can limit their contribution or aim at maximizing their own benefits. Also the complexity of taxes influences the evaluation of their equity. Scientists are not unanimous in evaluating the direction of this influence. Some identify tax complexity with a strong feeling of injustice, as complicated legal regulations cause frustration and anger. Anger affects the evaluation of tax equity and changes the picture of the system into more negative one (Bradley B., 2004; Hite P., Roberts

M., 1992). Other researchers link high degree of tax complexity to the feeling of tax fairness (Eriksen K., Fallan L., 1996). This refers to situations in which complexity is perceived as curbing the abuses committed by people inclined to 'stretch' the law boundaries. Tax complexity is then seen as a sign of fair taxes. Research conducted in the USA revealed indirect influence of tax complexity on the evaluation of justice (Cuccia A., Karnes G., 2001). Complexity negatively affects the evaluation of tax system fairness, but only when there were no justifications and when it caused increased tax burden for a particular person. Thus we can conclude that taxpayers are inclined to tolerate tax complexity when they reduces their own burden. Moreover, by precise definition of goals and providing justification, we can affect the image of the system and make it more positive. The information passed to taxpayers contribute to the fact that they start to take into account social perception when evaluating taxes and thus they stop thinking only in categories of their own benefits and losses.

Lawmakers who want to ensure effective realization of their budget incomes cannot neglect the taxpayers' attitude to tax and the reasons behind such attitude. These reasons point at the phenomenon of tax psychology (Gaudamet P.M., Molinier J., 2000). Thus we can state that tax psychology examines the reasons and effects of the reactions shown by subjects of tax relations when making decisions concerning taxation. In its content, tax psychology refers to the saying: "old taxes are good taxes", taking into account the attitude to taxes determined by "vital sphere of a taxpayer's psyche". The main problem is an answer to the question on what could and should be the relations between the real (actual) height of tax burden and its real "return" by the taxpayer. This relation is an outcome of an individual assessment, whether we still work

for ourselves or for the state budget. This view is associated with the taxpayer's resistance threshold. The taxpayer first of all evaluates the income level which is at their disposal as a result of taxation. Their assessment is very often subjective and difference from the lawmakers' evaluation. The basic reference criteria for the evaluation of the situation which appeared after tax obligation was fulfilled is the wealth ratio, which is a derivative of consumption or production use of income. The taxpayer formulates a subjective evaluation which answers the question: what is my tax burden? Is it adequate to my tax capacity or is it too high?

Determining the burden level for tax system and its structure, lawmakers must follow the "golden means" rule developed by Aristotle. On one hand, budget needs determine the level of fiscal burden, on the other hand, political reasons recommend not only modesty but using such solutions which increase budget income and do not develop the feeling of increased tax burden in the taxpayer. The theory of public finance contains a research direction, little exposed, related to fiscal illusions referring to tax obligations (Buchanan J.M., 1997). Theories of fiscal illusions refer to psychological phenomenon of illusion and were developed by Italian economists A. Puviani and M. Fasiani (Puviani A., 1902; Fasiani M., 1961). The essence of fiscal illusions consists in hiding taxation, level of real tax burden, differentiation of tax burden, etc.

Fiscal illusions may be evoked by:

- 1) hiding the relationship between size of financial public means and benefits obtained by a taxpayer;
- 2) evoking the taxpayer's impression that taxes paid by him are beneficial, as thanks to them the taxpayer receives extraordinary benefits, then the imposed tax is seen as less burdensome;

3) substituting taxes with fees and contributions – it is an effective method of creating fiscal illusions (the taxpayer has false illusion that these are not examples of obligatory taxes);

4) using social moods concerning the issue whose solution requires imposing additional taxes, it is a convenient situation in which taxes could be introduced, as a result the taxpayer feels solidarity with the society;

5) frightening the society with negative effects of not imposing the tax;

6) introducing many tax titles (extending the tax base), which helps an illusion that taxpayer's burden is lower than in case of taxes on only one subject (income, property, sales, activity, etc.);

7) blurring the situation so that it is not clear who the tax really burdens.

Blurring the relationship between public expenditure and taxes paid by individuals may be performed through:

a) basing public income on public sector income, which was typical for real socialism countries; the tax is hidden, citizens believe that they do not pay taxes at all or pay the minimum;

b) using indirect taxes, hidden in prices of purchased goods and services;

c) contracting loans (public debt); this creates an illusion that the taxpayer still preserves their income, obtains interest on it (government bonds interest rate), forgetting that in the future public authorities will have to compensate expenditure on repayment and servicing of public debt by increasing tax burden;

d) financing expenses by inflationary creation of money and burdening the taxpayers with it through increased prices of goods and services;

e) making false promises that the imposed taxes are temporary due to the necessity of

expenses on extraordinary social or national goals, etc – in fact, imposed taxes quickly become permanent.

Determination of taxation boundaries has vital theoretical and practical implications.

A tax politician wisely avoids exaggeration in tax burden if they follow a directive of preserving the tax source with reference to the whole tax system. Violation of the tax source brings visible decline in tax incomes. Not recognizing tax boundaries, that is lack of knowledge of the “moment” when they are crossed shows lack of knowledge on effectiveness (productivity) of tax systems.

Individuals make their choices not on the basis of properly estimated tax costs, but often relying on their own awareness of these costs and their predictions as to their size. Unawareness of an individual as to their own tax obligations does not measure properly this “unawareness”. The better informed the taxpayer, the greater their “tax awareness” should be. Thus “unawareness” becomes in some imprecise meaning the measure of “tax unawareness”. The knowledge of the degree of reaction taxpayers show to tax changes allows the lawmakers to effectively implement their projects of changes in tax system. We can indicate the following areas of taxpayers' reactions:

1. The taxpayer perceives tax obligations through nominal rates. Assuming that the nominal rate is 20%, while the actual rate is 10% (thanks to the system of tax reliefs and exemptions), the lawmakers, by reducing reliefs, will move the nominal rate to the actual rate at the level of, say, 15%, thus obtaining two effects – taxpayers will think they pay less and the lawmaker will generate higher budget incomes.

2. A wide tax base means that the more subjects and objects are taxes, the lower

rates could be used in particular taxes. Taxpayers are under the illusion that particular taxes are “low”.

3. Introducing payments and contributions of tax nature allows to conceal the actual level of fiscal burden. Taxpayers perceive their burden through taxation rates, not noticing other hidden and obligatory public and legal dues.

Selected theories of equity. Universality is one of principles of equitable taxation. According to this principle, tax burdens should be universal, that is each citizen should be covered by a tax, if conditions for tax relationship are met. The second principle is the principle of equality. It is a mistake to use the term ‘principle of equality’ in the primary meaning of this word. It is characteristic that A. Smith does not use the term “equity” but “equality”, and does it in a social, not ethical context. From the principle of equality we cannot derive the postulate of proportional taxation (although one of possible implementations of the principle of equality is to tax taxpayers proportionally to their income). Adam Smith states that „the subjects of each state should contribute to maintaining their government as closely to their capabilities as possible, that is proportionally to their income which they obtain under the protection of the state” (Smith A., 1954; Kristol I., 1978; Gwiazdowski R., 2001). This is an economic argumentation, not an ethical one (It is worth noticing that, as some authors claim, Smith found the idea of progressive taxation close to him. This is what A. Gomulowicz and J. Malecki claim, as they found such opinions: “it is not an unreasonable thing for the rich to participate in public expenses not only proportionally to their income, but slightly above this proportion”. The issue of tax equality was seen differently by J.B. Say, whose argumentation was of ethical nature. J.B. Say uses the

concept of equitable distribution of tax burdens (Say J.B., 1960). He believes that an equitable tax is a progressive tax and he tries to explain it in the following way: tax is a sacrifice we make for the society and public order. This sacrifice cannot lead to some families resignation from some indispensable things. As he writes: “who will dare say that a father should deprive his children of bread and warm clothes in order to pay tax? [...] What use is such social order to him that takes the goods which are his property, indispensable to his existence, in order to exchange it for the benefit of something that is uncertain and distant and what he would abhor? [...] If we were to establish tax for each family so that it was lighter as it burdens the most necessary incomes, it should be decreased not proportionally but also progressively” (Say J.B., 1960). The development of the concept of economic and social equity was greatly affected by “the Edinburgh principle – leave them as you find them” formulated by D. Ricardo in 1823. Ricardo points at negative effects of taxation in economic and social sphere. He postulates to evaluate the ‘evil’ of taxation through the scope of tax interference in tax and wealth distribution shaped as a result of the market mechanism. Ricardo notices that from the perspective of the principle of rationality the whole tax system should be analyzed, not only particular taxes. The Edinburgh rule shows some premises of rational tax policy. The maxim derived from this rule states that taxation should leave everyone in relatively the same income situation as they were before. According to Edinburgh rule, taxes should not cut into sources of tax income. Tax should not be detrimental to production, it should not fight or hinder the process of savings accumulation by households. The Edinburgh rule is thus a germ of the idea of tax neutrality.

Analyzing the implication of the “Edinburgh rule” for contemporary understanding of the equity principle, we can state that now the principle of equity is considered in theory in a deeper and more complex way. Our interpretation of the principle of equity assumes that “equality” of taxation, due to various conditions of taxpayers, may lead to disproportionate burdens. Thus we cannot clearly state whether a tax system that is equal to all taxpayers is equitable, without analyzing all burdens imposed on a taxpayer (consumption taxes, social insurance contributions, property taxes, etc) and the possibility of shifting them. A wider analysis of the shifting phenomenon allows us to claim that income taxes can also be shifted, though the process is much more difficult from an economic and technical point of view. Thus we can indicate advantages and disadvantages of household and company taxation with direct and indirect taxes, from the perspective of theoretical principles of taxation. Although the tax doctrine has not found a clear and satisfactory – from the perspective of relations between economic effectiveness and equity (Grądalski F., 2004; Grądalski F., 2006) understood objectively and subjectively – an answer to the question concerning taxation equity. Equity has always been referred to a particular era, as there has been time conventions of tax equity typical for a particular period of history (Zdzitowiecki J., 1937). Tax doctrine has not been free from the problem of valuation. Tax equity should also be perceived in this context. Changes concerning the concept and the role of the state in economy, prevailing views on social and economic issues have affected evolution of tax equity concept. Direct taxes – due to their advantages – more widely implement the principle of tax equity (especially personal income tax) Why? (Wołowiec T., 2007).


- 1) as taxation forms imposed directly on taxpayer’s income or revenue, they are more difficult to shift than income taxes;
 - 2) it is easier to shape finance policy through direct taxes, taking into account the way and strength of taxes influence on particular taxpayers;
 - 3) relative resistance to economic crises, manifested in stability in budget tax revenues (Wrona B., Wołowiec T., 2005);
 - 4) flexibility to legal regulations, through influence of changes in statutory rate(s) on fiscal efficiency of tax;
 - 5) income taxes directly burden the source of income or revenue, which allows us to establish, in advance, appropriate tax rates – this allows us to establish tax in an equitable way, taking into account social and economic aspects of taxation, including the principle of tax capacity (efficiency);
 - 6) adjusting the height of tax burden to individual tax capacities of a taxpayer (tax personalization) – by using various increases, decreases, reliefs and exemptions, including a zero rate or tax-free amounts, as well as differentiated costs of obtaining revenue (O’Donoghue C., Sutherland H., 1998; Głuchowski J., 1985; Krajewska A., 2004; Komar A., 1996; Messere K.C., 1993; Wołowiec T., 2005; Wołowiec T., 2004);
 - 7) presentation of the issue of the economy of tax subject taxation – technique of determining income by defining a catalogue of costs and losses that are deductible and non-deductible in order to obtain income allows the lawmakers to influence the rational economic activity of the taxed subject;
 - 8) relative savings in collection costs.
- The concept of Say was criticized by J.S. Mill, for whom equity was equality in sacrifice made. The sacrifice should be equal,

not the tax. It is based on an idea that an affluent taxpayer should pay higher taxes than a poor person, as the former does not feel the financial loss as much as the latter. He refers to similar principles, such as the theory of paying capacity and decreasing borderline usefulness. The share of each individual in covering government expenses „*should be so that the person felt neither more nor less distress than any other individual experiences from their participation*” (Mill J.S., 1966). The loss of direct benefits equals the value of loss in an income caused by payment of tax, therefore taxpayers with the same income should pay the same taxes. The premise of tax burden equity for Mill is the principle of equal treatment of taxpayers. This principle means (1) the same financial sacrifice or (2) the same loss of wealth. The loss of wealth is equal to the loss of income caused by payment of tax. So the wealth level is always a function of income. Thus – due to the above – taxpayers with the same income level should pay the same, that is equal taxes. It is obvious then that the differentiated level of income translates into different amount of tax paid. Mill also emphasized the necessity of exempting the poorest taxpayers from tax. We cannot talk of equal sacrifice when we demand 10% for public goals from an affluent person and from a poor man. The required sacrifice made by the latter would not only be higher than the one imposed on the former, but would be totally non-comparable, as it would deprive him of the means ensuring the basic existence level. Tax should be paid on income being a surplus over determined minimum, which is necessary to get hold of „*what is needed to survive and to preserve health and to protect against common body harms, but not enough to indulge oneself*” (Mill J.S., 1964). The requirements of equity force Mill to formulate a demand for shaping tax burdens so as equal

financial sacrifice caused equal loss of benefits among people taxed. It is worth noticing that in the classic economy, represented by A. Smith and J.S. Mill, the prevailing concept was that of proportional taxation as well; as equal and equitable burden. After Mill, the doctrine of equal sacrifice developed in several directions. A.J. Cohen and C. Stuart proposed that everyone should suffer the same relative percentage loss of usefulness Stuart C., Cohen A.J., 1958). This criterion is known as “*equal proportional sacrifice*”. If the usefulness function is logarithmic, it gives a tax scale in form of $t(x) = x - c(x/c)^{1-r}$ for $x \geq c$, we call it the Cohen-Stuart tax scale. The level of income C (minimum borderline of poverty) is a zero tax rate, while above c the tax rate grows, gradually approaching 100% for high incomes (Young H.P., 1994). Mill’s views were developed and expanded by F.Y. Edgeworth. Using the concept of border usefulness of taxpayer’s income, the scientist concludes that taxes should be imposed so as to obtain as equal as possible income after taxation. The thesis is founded on the premise that the border usefulness of each person’s income is identical, so tax should be imposed mostly on the rich, as their lost benefits as a result of taxation (redistribution) of income will be lower than in case of the poor (Edgeworth F.Y., 1959). The concept of equal sacrifice contains the so-called alternative rules, as it can be interpreted as: equal marginal (border) sacrifice, equal absolute sacrifice or equal proportional sacrifice. Assuming different functions of usefulness, the marginal (border) sacrifice would be a synonym to regressive income taxation. So taxpayers with lower incomes and relatively low loss of benefits from wealth, would be burdened with tax to a greater degree than taxpayers with higher income and greater intensity of benefits. With equal absolute sacrifice, all taxpayers experience

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loss of benefits in the same absolute amount, regardless of how unequal their incomes are. In a situation of equal proportional sacrifice, taxpayers experience the same sacrifice in relation to joint benefits from income. The course of the benefits curve does not exclude the application of progression.

Adolf Wagner made a significant contribution to the theory of taxation. He focused on redistributive function of taxation. The task of tax policy is to correct extreme social injustices, that is correction of domestic product. He believed that thanks to redistribution, the incomes of the poorest, who have the greatest inclination to consume, will strengthen global demand. This is important for economic growth. The nature of legal functions of tax boils down to the fact that apart from income (fiscal) function, taxes also perform some non-fiscal functions – intervention ones (economic, social, political). Universality of taxation and tax progression are, according to Wagner, the basic indicators of taxation equity (Wagner A., 1889). Universality must take into consideration covering all tax sources and subjects with tax obligation, preserving the possibility of applying tax-free amounts and different treatment of deductible and non-deductible incomes. A significant aspect of equity is Wagner's thesis that distribution of goods made by the market is unfair, as it does not provide everyone with equal chances of growing wealthy. Therefore the second component of equity is a postulate of introducing progression to tax system. In his opinion, progression allows to differentiate tax burden in relation with economic payment capacity. Wagner supports mild progression, thanks to which we can obtain even taxation by adjusting tax burden to actual income and wealth conditions of a taxpayer. Progression is an instrument, which more

equitably distributes tax burden with relation to proportional rates approved so far.

Conclusions:

1. The dispute concerning taxation equity is a dispute on tangible interests of the state and the taxpayer. So, in common perception, an equitable tax is a tax paid by others.
2. Controversies, doctrinal disputes and legislative practice indicate that it is not possible to express the idea of equity in a perfect and certain way. Numerous impressions of taxation equity allow us to state that equity concept formulas will change in time.
3. Taxation equity is best expressed in principles of equality and universality of taxation. They are controversial, as they require searching for a significant feature that should be the basis of equal treatment in distribution of tax burden.
4. We cannot talk of equitable taxation without demanding that the principle of equality and universality of taxation should be observed.
5. The principle of tax capacity as the "measure" of taxation equity is not questioned by the doctrine – even though there some differences of opinions. The problem is its acceptance by tax system. This is determined by the willingness of the parliament in a democratic state. A politician would find it easier to directly question the fact that tax burden should be distributed depending on tax capacity. Therefore politician often conceal their real activities by verbal acceptance of the principle of payment capacity and quoting it when making tax regulations, but without implementing it in the content of the law.
6. When creating a rational (or reforming) tax system, lawmakers must take notice of the rules that make the principle of fiscal effectiveness coincide with the principle of tax equity. The principle of tax equivalence (equal tax sacrifice)

cannot constitute the theoretical or practical basis for shaping the tax system. It must be replaced with the principle of payment capacity, which, due to its universality and values, combines equity with effectiveness of taxation and thus can be a premise for shaping the legal construction of direct taxes.

7. In the analytical approach to the principle of tax equity we encounter the problem of accepting or rejecting the inequalities (Buchanan J.M., 1997). A tax system may correct proportions of primary distribution of national product if this distribution is considered inequitable. The tool used to achieve this are progressive taxes, especially income ones, but two major questions appear:

I. Who decides whether imposed tax burdens and income distribution are equitable or not?

II. To what extent can we tolerate income differences before and after taxation?

8. Tax technique is related to the law-making process. We cannot respect the principle of payment capacity if two basic elements: the base of tax calculation and progressive tax scale do not respond to the requirements posed by this rule. Lawmakers, when formulating the tax content, may take payment capacity principle into account to the extent at which the nature of taxation is not impaired significantly (fiscal effectiveness, providing appropriate budget revenues). Respecting the principle of payment capacity with reference to taxation base and progressive scale should be perceived through the prism of tax sources efficiency. We should bear in mind that the tax income function is only performed when tax burden does not cause reactions destroying tax sources and leading to tax avoidance.

9. Determining taxation borders has significant theoretical and practical implications. Tax policy wisely avoids exaggeration in tax burden if it follows the principle of preserving tax sources with reference to the whole system. Impairing income sources leads to definite decline of tax incomes. Not recognizing tax limits, that is ignorance of the "moment" they are exceeded, is paramount to lack of knowledge on effectiveness of tax systems.

10. Personal income tax is considered to be the fairest instrument of taxing population (Gomułowicz A., Małecki J., 2004), due to the possibility of individualizing taxation base by reflecting all economic and social circumstances in it. They are mainly manifested in the system of reliefs, exemptions, tax-free amounts and tax rates, but also in the construction of revenue, costs of obtaining it or definition of the tax subject (a single person, a married couple, or the whole family) (Kulicki J., 2006).

The role of the state in economy and interpretation of the principle of equity and effectiveness. The biggest controversies and doubts are aroused by interpretation of principles of equity and effectiveness of a tax system, which largely depends on the way of seeing the state's role in economy. In understanding the principle of equity we can point at the following issues:

- we should not demand sacrifice from people living in poverty,
- direct taxation is considered more equitable, mostly due to more difficult shifting, directness, individualization of tax burden, personalization and measurable tax burden,
- universality, great fiscal significance and covering basic consumption goods with indirect taxes requires such determination of tax technique elements that allows to obtain progressiveness of the

whole tax system, implementing the principle of adjusting tax burden to the taxpayer's payment capacities,

- progressiveness of the whole tax system is not treated as progressiveness of particular taxes. If direct taxes are disgressive, corporate income tax (CIT) is proportional, then personal income tax must be progressive (Gwiazdowski R., 2001; Gwiazdowski R., 2007; Kula G., 2005; Nojszewska E., 2004; Wołowiec T., 2006).

Contemporary arguments concern the problem of the height and type of rates and possible preferences in personal income tax. Discussions evolve around the understanding of vertical equity, which means strong progression, numerous tax reliefs and exemptions and horizontal equity, assuming low (flat) tax rate, wide tax base and equality of subjects against the law.

The shape of the policy of redistributing wealth and income is related to the theory of equity worshipped by the government. There is an infinite number of effective allocations in Pareto meaning, the choice of any option always requires adopting some criteria of equity. We can assume that there will always be differences between incomes of particular individuals, resulting from various features of these individuals, such as:


- a) various rights they enjoy;
- b) differences in effort, productivity or participation in results;
- c) different allocation of resources;
- d) differences in beliefs concerning features of goods;
- e) differences in taste or in ability to use various goods;
- f) different needs;
- g) different talents and possibility of acting.

The choice between effectiveness and equity. The relationship between effectiveness and equity is vital in the context of tax

issues. Taxes cause income and substitution effects both on the producer's and on the consumer's sides. Therefore taxes lead, on one hand, to economically locative ineffectiveness, as producers encounter different market prices than consumers. On the other hand, thanks to taxation revenues, the state has a possibility of more equitable (in social perception) distribution of income. We can pose a fully justified question – to what extent lawmakers, when constructing the tax system, may be indifferent to the requirements of effectiveness and expectations of social equity? Taxes are not neutral, neither to locative effectiveness nor to redistributive equity. The higher the level of fiscal burden and scope of taxation base (tax base), the more distorted allocation effectiveness of market mechanism, but this allows the government to make more even redistribution of income (and vice versa). Thus we can state that there is a specific *trade-off* between allocation effectiveness and redistribution equity (Browning E.K., Johnson W.R., 1985; Stiliz J.E. 1988). As a result of this trade-off, the government faces a dilemma: choosing between two options. In the first option, the government decides to what extent allocation properties of market mechanism could be distorted to implement, through various forms of taxation, more even distribution than the one offered by market mechanism. In the second option, the government decides to what extent it can resist demands for more egalitarian distribution to protect the allocation effectiveness of market mechanism. The conflict between the goals of effectiveness and equity stems from difficulties in clear establishment of objective criteria for both these phenomena. The criteria of allocation effectiveness are based on economic analyses and boil down to comparing outlay against results, while equity criteria depend on political choices and are based on the accepted system of values (*a priori*). In

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economic categories, a classic definition of allocation effectiveness and Pareto balance in perfect competition conditions (Laidler D., Estrin D., 1991; Czarny E., Nojszewska E., 2000). Optimal allocation of resources in Pareto meaning may be achieved with different variants of initial provision of producers with production factors and consumers with final goods and services. Thus the conclusion that there are many optimal states of effectiveness. Each optimal variant of allocation of assumed resources makes it impossible to improve the position of one entity without worsening the position of another subject, however it does not say anything on whether the situation of these entities is acceptable at all within a particular system of social values and preferences. Therefore effectiveness in Pareto meaning does not show how to make a hierarchy of states *optimum optimorum* from the perspective of social acceptance for particular distribution relations. For the hi-

erarchy to be possible it is necessary to introduce an additional, external criterion that would allow us to evaluate the states of economic effectiveness through the prism of equity. Such criteria in theory of economics can be found in the concept of social function of welfare, which gives proper weight to the postulate of equity and reveals social preferences concerning the scale of inequalities of distribution that are acceptable. The shape of the social function of welfare is determined by its underlying system of values, which is established in the process of political public choice and as such cannot be included in the economic analysis. Equity can be interpreted differently, various attitudes and value systems may accompany it, which is confirmed by the number of hypotheses concerning the shape of the welfare function. Thus, contrary to the criterion of economic usefulness, the equity criterion is relative.

Aims of paper. Methods.

The aim of the paper is to present economic and social aspects of progressive and proportional taxation of incomes related to the justice of taxation rules. In order to accomplish such research goals we need to differentiate the following research schemes, that is the ways of coordinating activities: comparative research and review research. Such 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 to implement 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 construction, which makes it difficult to harmonize this form of taxation. Apart from the above research problems, several forms of problems have been singled out, corresponding to the assumed research hypothesis and research questions. The paper presents the research problems in the following forms: descriptive, explicatory, relative and optimizing. The main research method was induction. It consists in developing general conclusions or determining some regularities on the basis of empirically stated phenomena or processes. It is the kind of reasoning on the basis of details on general properties of a phenomenon or an object. The application of this method requires an

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assumption that only facts may constitute the basis for scientific reasoning. These facts are situations (economic, social, legal, organizational) that really took place. Induction methods cover various legal acts, analyses, experts' opinions, statistical data

and scientific documents used in social research. Moreover, the paper uses two general research methods, namely analytic and synthetic methods, characterized by detailed presentation of the reality research.

Exposition of main material of research with complete substantiation of obtained scientific results. Discussion.

The case for a flat tax has been around for over two decades. In the early 1980s, Robert Hall and Alvin Rabushka of the Hoover Institution developed a tax system that is based on a single rate of taxation for all sources of income, as close as possible to the source. All income is classified as either business income or wages and taxed at one rate, except for a personal allowance exempting lower income individuals and families from taxation (this makes the Hall-Rabushka proposal to some extent progressive). There are no other exemptions, no deductions, no loopholes. The other essential aspect of the flat tax system developed by Hall-Rabushka is radical simplification of the tax system, by removing any deductions or reliefs, and by eliminating double taxation. This proposal represents a fundamental change in the way governments would collect tax revenue (Hall R.E. & Rabushka E., 2005). The Hall-Rabushka proposal has served as the blueprint for several proposals to reform tax system in other countries (i.e. Russia, Slovakia). Flat tax is believed to:

- 1) Help reduce red tape and associated difficulties and confusion. With tax form down to size of postcard the flat tax system makes tax filling much simpler and more efficient.
- 2) Achieve simplicity, economic efficiency and fairness (same rate for all) – three principle of effective/sound taxation.
- 3) Reduce tax evasion and cheating, by lowering opportunity cost of avoiding


taxes. Flat tax system means elimination of relief, allowances and thus eliminates loopholes in the system.

- 4) Provide incentives to work, save and invest that trigger an economic boom.

Introduction of flat tax rate tends to redistribute income that encourages saving because higher-income families tend to be bigger savers than lower-income families, even on a lifetime basis. The saving incentives come from the increase in the after-tax return from postponing consumption. Second, one flat rate at personal- and corporate-level removes the double taxation of corporate equity and hence tend to reduce the cost of corporate capital. Moreover, dividends and interest are not taxed at individual or household level, which encourage real investment in economy. Finally, broadening the tax base may imply lower overall marginal tax rates and reduce the overall cost of capital. A switch to flat tax may cause the supply of labor to increase, depending on the significance of reductions in marginal tax rates and a lower price of future consumption in relation to present consumption. Marginal tax rates on labor directly reduce the after-tax wage and hence reduce the relative cost of leisure. Thus, people have an incentive to work less. Further, what matters the most for the labor supply is the marginal tax rate on total compensation, not just the marginal tax rate on wages received. Total compensation includes fringe benefits, such as health insurance and pension benefits, as well as payroll taxes paid by the employer. Fringe

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benefits are often excluded from tax under current law, and thus the effective marginal tax on compensation might be much less than the statutory tax rate on wages. High marginal tax rates induce individuals and firms to change the form of compensation from taxable cash to tax free fringe benefits, including nicer working conditions and other perks. The effects of tax reform on human-capital accumulation depend largely on whether human capital is more of a substitute for or a complement to new physical capital.

The effects of switching to flat tax are somewhat uncertain and depend critically on the details of the reform. Thus existing empirical results need to be interpreted carefully. Many estimates apply to a pure, well-designed flat tax while any compromises in the design, such as including some deductions or exemptions are said to reduce the gains or turn them into losses. However, in principle, some broad conclusions stand out that high and increasing marginal tax: impede the formation of capital and hinder economic growth and constrain aggregate labor supply. Adoption of flat tax plan similar to one proposed by Hall-Rabushka for US economy leads to an increase in labor hours, income and investment (or savings). As labor and investment are driving forces for growth, a flat tax rate raises the US economy's long run growth (by 0.2 to 0.8%. The strength of the growth effect crucially depends on elasticity of household labor supply, capital's share of output and elasticity of the capital stock with the respect to new investment. The gains are attributable to both the lowering of the marginal tax rate and full write-off of investment expenditures.

As a result of a more dynamic economy and less tax evasion, the government actually collects higher revenue. As evidence by Laffer's analysis if taxes are higher than optimal tax rate than implementation of the

moderately low flat tax rate would increase tax revenue. Flat tax leads to eliminates double taxation on saving and investment (if applied in ideal form as proposed by Hall & Rabuska). Since all forms of income are taxed only once people are free to choose whichever form of investment maximizes their profits. At the same time, a flat tax regime is understood to: eliminate practically all forms of tax exemptions and allowances, be non-progressive (at least as far as the 'marginal' rates are concerned), favour the wealthy at the expense of the poor and favour share and dividend-holders since profits are taxed only once, at source

Qualities of linear taxation. As qualities of progressive taxation were mentioned in the previous chapter it would only be wise to mention qualities of linear taxation in this chapter. Getting right to the point I will start off with Milton Friedman's (Friedman M., 2006) perspective on this subject who happens to be a Nobel Prize winner in the field of economics. According to him the view on the fact that taxation has to be adapted to payment capacity, namely the rich are to be charged with a greater tax burden than the poor along with the acknowledgement of each entities financial situation is a misbelieve. The abovementioned economist claims that on the theoretical side the tax rates are differentiated, however in the tax law there are a number of gaps, an amount of special privileges that makes the high tax rates seem to be a decoration. A low and linear tax rate, for instance 19% as in Poland at the time being, imposed on income that exceeds the tax relief would bring more national revenue. From the taxpayers perspective, their financial situation would also improve due to the fact that this linear tax would save costs in terms of tax avoidance being less useful. The economy on the other hand

would also benefit from this type of taxation thanks to the greater feasibility of budget resource allocation. The only people that would be in a losing situation are lawyers, accountants, IRS officers, members of the legislature, who would be unnecessary for filling in declaration forms, or detecting and eliminating gaps in the tax law. Elaborating on Milton Friedman's insight on this issue it can be said that linear tax in comparison to progressive tax would be more efficient and effective due to reduced costs of collection among all other reasons that support the implementation of this tax. A single tax rate would simplify the present and complicated tax system through the decrement of costs that taxpayers bear in order to abide by the tax law. What is also very crucial is the fact that this method of imposing tax would enable easier payment, which would diminish costs that involve controlling the probability of potential mistakes or evasion by taxpayers. In other words this kind of tax would be more simple, understandable, and more friendly to the people who pay it. Moreover tax declaration forms could be more visible and clear for the taxpayers who fill it out saving much time, in addition with the lack of a tax relief the use of these tax forms could even be unnecessary. The intention of linear tax is to impose a tax rate on the whole income, with the exception of the flat tax, where a tax relief is present. Nevertheless the elimination of tax credits, relief's and tax exemptions would result in real income being subject to taxation, which in the end would reduce the discrepancy between the nominal and real tax rate to a situation where they would be equal. What is more, income is taxed only once, at the time it is earned. In the present linear tax system in corporate income tax income is subject to taxation on four levels. First tax is imposed on a taxpayer of legal character and his income, secondly tax is

charged when the taxpayer receives the other source of income as dividends or interest, next the taxpayer may be subject to taxation when he sells his shares, and in case of unfortunate death, inheritance tax is imposed on the wealth being inherited.

The implementation of the linear tax system would have impact on income only once, when it is earned. The taxation of income right at the source would inflict the enterprise in paying personal income tax for employees, which means that individual taxpayers would receive income without the necessity of paying tax. In addition such form of this tax would exclude the possibility of imposing taxes, that can be called penalty taxes, for instance taxes on dividends, tax on return on capital, and interest. What is more taxes on retirement funds and pensions, as well as other welfare payments could be eradicated due to the fact that after all they do not bring any revenue, just redundant costs. Linear tax could positive influence on the economy, among many reasons such as encouraging labor, entrepreneurial activity, increasing national production through the accumulation of capital, and what is also very important the increment of general well-being. In the case of the labor market, a raise in wages through lower taxes could be an essential motivation increasing productivity, which in the outcome increases global production. Also the accumulation of capital leads to overall investment growth, which has great impact on economic indicators.

Imperfections of linear taxation. In Poland most of the political parties support the concept of an integrated linear tax system, as well as the people related to the political environment and liberal economic organizations such as Business Centre Club, Polish Employers Confederation or Polish Business Council. However the idea

of imposing a proportional tax rate on personal income encountered a strong opposition of this form of taxation. People who oppose linear taxation underline the fact that it does not have to be all that simple as was introduced, contrarily to what has been mentioned earlier opponents claim that this tax can even be complicated. To be exact the base of taxation also has to be calculated, many costs, tax credits and exemptions may be implemented. The authors of the linear taxation program R.E. Hall and A. Rabushka (Tomkiewicz J., 2006) present their perspective of the complicated linear tax. Linear tax rates do not have to be low at all as to what some perceive it as. For instance it could be as high as 30%, or we can observe a quite low progressive tax system in Hong Kong, namely 1% - 17%. Additionally according to adversaries of proportional taxation the assumption that linear taxation means lower tax rates is equally incorrect as the assumption stating that progressive taxation supports the poor at the expense of the rich. It turns out that in the opinion of taxpayers, regardless of their wealth, the preferable taxation system is progressive after all, however with the tax rates starting from below the level of the linear rate, which would have to be developed on the basis of the highest progressive rate. Every taxpayer would prefer to pay progressive tax 1% - 17% rather than linear tax at 17% taking the Hong Kong example under consideration. This is for an obvious reason, a large portion of the income would be charged with lower tax rates according to the income groups. The wealthiest are going to be privileged with a lower tax rate, the poorest are going to have the benefit of employing tax credits, whereas the middle class has a legit reason to apprehend the greater tax burden, which happens to be the most productive part of the society. In the table below the presented highlighted income levels are the

ones that will notice the increase in the tax burden the most. Implementing linear taxation on personal income while eliminating all tax exemptions and allowances would result in not considering the source of income during calculations of the income under taxation. According to opponents of the proportional tax the source of income plays an essential role and should be taken into consideration when declaring income tax. They also believe that the possibility of earning income is connected to its source and the size of the firm. Linear tax, which treats all subjects under taxation equally is inconsistent with the taxation principle of equity. The introduced plan to equalize both income taxes may aggravate competitiveness of small and medium sized companies in comparison with the well developed ones.

Lowering the tax rates would support all business activity, however the elimination of tax payment preferences would lead to equal conditions for all taxpayers. Therefore according to the adversaries of such a reform there is exists an apprehension that stimulation function will not be accomplished through taxes, despite of lowering the tax burden. What is more the scale of progressiveness does not depend only on the marginal level of tax rates, but also on the amount of the tax credit, tax exemption or allowance. That is why personal income tax with one homogeneous tax rate including one tax credit, in other words a flat tax could exhibit more progression than the real present progressive tax system with several progression levels, a tax credit and many tax allowances. We may observe a false image of a flat tax, which may lead to vast costs in system functioning. The connection of linear taxation with the stimulus for economic growth gives a reason for supposition in the opinion of its opponents. It can be easily presented that the implementation of the linear tax in the place of

the inherent progressive tax system and its punishing character due to higher tax burden on the most productive part of the society may lead to a paradoxical decline in this productivity. This is a highly rational reason for the possible lack of motivation workers may experience due to this increased tax burden.

Also statistically, adversaries of linear tax claim that the rest of the taxpayers earning the same or a slightly increased amount of income for the same effort of work may lead to a similar result. In addition this boost in efficiency generally considers a simultaneous increase of indirect tax burden on households, and as it is commonly known, such taxes have a regressive nature, which means that the poorest households would suffer the most. The argument stating the fact that the reason for the existence of the grey market are high tax rates is absolutely inaccurate. Moreover the belief that the decrement in income tax will entail the exposure of the grey market does not find and support in the experience background of other countries, unless the highest tax rate was particularly high and as linear tax opponents repeat, in Poland this is not the case.

In the opinion of W. Wójtowicz and P. Smoleń (Wójtowicz W., Smoleń P., 1999) the linear tax proposition enclosed in the White Paper on Taxes does not foresee any appliance of pro-family resolutions that would directly effect the taxpayers family situation. The authors belief In the fact that the White Paper project complies with family interest, because of the increased amount of tax credit that can be deducted from tax that is charged as well as the decrement of the average nominal tax rate by almost 4%, also the fall in the effective tax rate by 1,7% has no real interrelation with the notion of family support. Specialists who are obviously against the linear tax are confident that the reform would reduce the

national income, which in the end leads to limited funds that can be devoted to public investments and supporting social advancement of different citizen groups. Moreover according to them lowering the tax burden without a thorough analysis of the influence it may have on national income, could lead to disturbed balance of the budget. What is also important is the fact that the implementation of the linear tax along with lowering the highest tax rates will eventually cause unbalance between effectiveness and equity. The rise in national income would be divided unevenly, which could worsen the general social dissatisfaction, frustration, and the lack of support for reforms.

Among the opponents of the proportional tax system we can also observe the lack of acceptance towards the resignation of fairly efficient, firm and commonly applied tools, for instance tax credits and tax allowances, where on the other hand among the wealthiest taxpayers we can observe the complete opposite, which is pressured in order to lower the tax rates for this narrow group of taxpayers. Linear taxation is not only criticized by advocates of the progressive tax, but also criticism is also coming from supporters of capitation tax. Their argumentation is that if the tax system was to be looked into from the perspective of fairness, then taking the social need of solidarity under consideration it should symmetric. This means that tax credits should protect the poorest, then tax should be imposed proportionally to earned income, however until a certain amount is reached. Moreover the calculation of a citizens fundamental needs can be just as easily specified as the benefits that are to be provided by the government for that citizen. The capitation tax would could only provide this level of fairness. Nevertheless as the adversaries of such a tax system claim, this form of taxation is clearly a utopia and does not hold

any promise of finding application in practice. In addition the only example of this tax existing is in Europe, exactly in Great Britain when Margaret Thatcher had term of office. In the year 1990 a poll tax was implemented, equal for every adult citizen, which caused a greater burden for the poorest, later on leading to socio-economic crisis, in effect impelling the "Iron Lady" to resign from the prime ministers chair.


Juxtaposition of linear and flat tax. Linear tax, which simply is a proportional tax, imposes a constant proportion of tax in relation to income, to be more specific the tax rate is a fixed rate in relation to the base of taxation regardless of the amount subject to calculation of tax. For instance taking our situation in Poland under consideration at the tax rate of 19%, furthermore hypothetically imposing this rate on a 10 000 PLN income, the tax charged would be 1 900 PLN, also if a different taxpayer were to earn ten times more, namely 100 000 PLN, his tax rate would also be 19%, thus a 19 000 PLN tax due. In other words from every PLN earned a 0,19 PLN of tax is levied. The application of such a tax means that it does not allow and change of proportion in relation to the base of taxation, in other words a tax base twice times greater than another before taxation will stay twice times bigger after taxation. The tax amount charged subsequently changes in relation to the change of the tax base subject to taxation. A five times greater income will result in a five time bigger amount of tax and the other way around. Linearity and progression considering income can be very often confusing to some taxpayers, namely one constant tax rate ensures a linear tax system, progression on the other hand consist of a few rates depending on ones income, however linearity is also connected to one other condition, namely the lack of a tax credits or tax sheltered amounts. The implication of tax credits determines the

fact that there exists a sort of progression in the proportional tax due to the share that the poor and the rich would divide in the national budget. In addition when the base of taxation rises the effective tax rate consequently draws near the proportional tax rate in this case the nominal rate, thus in this case we call this a flat tax.

The flat tax system also has a single proportional tax rate, however it is accompanied by a tax progression tendency caused by the deduction of the tax relief amount from the taxpayers income. On the other hand in linear tax system it is not allowed to employ tax relief's, which results in the lack of progression. A situation can be very often observed where a single proportional tax rate accompanied by a tax relief is called a linear tax, when in fact it is a flat tax. A *true* flat rate tax is a system of taxation where one tax rate is applied to all income with no deductions or exemptions. When deductions are allowed a 'flat tax' is a progressive tax with the special characteristic that above the maximum deduction, the rate on all further income is constant. Thus it is said to be marginally flat above that point. The conceptual difference between a true flat tax and a marginally flat tax, can be unified by recognizing that the latter simply excludes certain kinds of funds from being defined as income. Then they are both flat on "taxable" income. There are many proposed marginal flat taxes systems. Modified flat taxes have been proposed which would allow deductions for a very few items, while still eliminating the vast majority of existing deductions. Charitable deductions and home mortgage interest are the most discussed exceptions, as these are popular with voters and often used. Another common theme is a single, large, fixed deduction; the concept here is that this blanket deduction rolls up a myriad of ubiquitous, fixed, living costs and has the simplifying side-effect that

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many (low income) people will not even have to file tax returns.

Economic issues. The impact a tax system has on the economy is an important if not the most significant element of its existence to the extent where the tax system would be completely useless if it were to harm the economy. Advocates of this form of taxation underline the gravity of long term changes or influence on the economy that proportional taxation will entail after its implementation. Adversaries of linear taxation most often estimate national income in a moderate manner, in other words they tend to assess the future national income through the implication of the new laws to the existing economic situation, however disregarding the fact that the new laws may bring completely different outcome. In the economy feed-back can be observed automatically. Alterations that take place in the economy interact with each other, while creating even newer modifications, which effects the national income as well as the taxpayers situation.


On the other hand advocates of the linear tax system claim that additional economic growth generated by tax reform would ensure greater national income from taxes at a percentage that would allow funds to cover up losses involving these changes. Not including this advantage in the profit/loss statement would definitely put this proposal in an inconvenient situation. That is why the outcome has to be judged from a broader perspective, moreover the analysis cannot treat the effects individually, yet in general as well as the reasons and consequences of decisions. The same point of view share American researchers, who employed the computable general equilibrium model intended to analyze the consequence of imposing a 17% linear tax in the American economy (Gwiazdowski R., 2001; Gwiazdowski T., 2007). According to this analysis, the introduction of a

17% linear tax rate would influence the economy in such a way that every production sector would grow faster than in any other tax system. In addition savings would benefit the most thanks to the implementation of the linear tax system, 7,4% savings growth to be exact, which is also another positive result in comparison to any other tax system thanks to the exclusion of profits on investments from the base of taxation and imposing tax on capital outlay and other production expenditures according to one linear tax rate. High growth, namely 3,5% could also be found in the chemical industry, plastics industry, manufacturing industries, as well as the comestible industry.

Furthermore an increment in income after taxation would consequently enhance consumption. Researchers discovered the fact that every consumption sector would grow by average 2% – 4%, however the mentioned exception would be the financial services sector, who's detriment would be an effect of a vast amount of capital transferred to the mentioned production sectors. What is more due to this analysis researchers have also discovered that the home construction industry would grow by 1,5%, which is an improved outcome in comparison to an economy without the linear tax. This finding is very likely to be present, regardless of the lack of tax credits, which enables taxpayers to deduct interest from a mortgage. In the opinion of the aforementioned researchers the national income growth is induced by the growth of the majority of economic sectors followed by the enhanced engagement of work and capital. The increased economic activity being a result of eliminating tax rate discrepancies and tax incentives would be significant to the extent where the national income would increase by a noteworthy 1,8%. Nevertheless these findings have to be treated with certain distance due to the fact that they are

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a result of a simulation. The previously set forth study and its affirmative outcome also finds support from many economists. The most often affirmation brought up is that proportional taxation as opposed to tax progression encourages saving. Moreover some economists claim that the rise in tax rates diminishes the value of the taxpayers income throughout their working life span, which leads to the decrement of savings. Also the layout of consumption and savings is attributable to the redistribution function of progressive taxation also leads to lower savings throughout the taxpayers lifetime. It turns out that in the long run aggregate savings are influenced by taxation on income received throughout our life. Therefore socio-politics biased by the redistribution of income may be inconsistent with the policies, which aims are to increase private savings of the public (Nojszewska E., 2002). In addition the proneness to save is the highest for people in the mature phase of life, in other words people of the biggest income. Furthermore the savings rate is somewhat lower for families at the beginning and the lowest for the ones at the end of the life phase, who have the lowest income at the same time. Therefore from a certain perspective progressive income taxes burden the taxpayers with the highest tendency of saving. Provided that public expenditure finances the welfare of taxpayers who are in the beginning and in the end of their life phase, the additional burden of entities with the highest tendency of saving strengthens the declination of aggregate savings. Therefore dropping the top tax rates increases the level of national savings, which are a fundamental source of advanced investments. Thus getting rid of the inconvenient progressive taxation of all income groups would boost the generation of capital, increase productivity and economic development. The present tax system imposes taxes at high rates and double

taxation on investments and savings. As a result the this tax system triggers expenditure at a greater degree instead of encouraging to save. On the other hand linear taxation treats consumption and savings on the same level, which makes it a neutral tax in relation to individual economic decisions. Inflows from individual savings and investments would not be subject to taxation, hence eliminating double taxation, which is present in the challenging tax system due to the fact that persons of legal character and entities are subject to taxation on the same income. The level of tax rates in the long run play a crucial role. The experience of many countries from several years in the past proves the argument, namely money that is saved by the public is invested in a more vast degree than through public expenses, however not including some exceptions.

Linear tax would eliminate such harmful occurrences because it contains the only homogeneous incentive for various kinds of investments. Consequently it would improve the efficiency of capital invested. Moreover linear tax would contribute to the declination of interest rates. The present high level interest rates are maintained at such high level partially due to tax deduction on behalf of interest paid and tax on interest gained. Dealing with linear tax, it would be easier for taxpayers taking loans in bearing the rate of interest, also creditors would not have to be concerned about taxes. On the credit market where taking out loans equals giving out loans, lower interest rates would start to settle. Without the deduction of interest paid from taxes, taxpayers taking out loans will demand lower costs of such credits, moreover without taxation on interest creditors would be prone to lowering the costs. What is more as a result of such action the real estate market would experience a stimulation. Economists agree on the fact that upon the

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introduction of linear tax system almost every groups of taxpayers would react in increasing hours worked. A small portion of taxpayers would not show any additional effort due to low variation of tax rates or due to the fact that the additional pay resulting from lower taxes would encourage them to work less as their pay is satisfactory for them. However for the majority of taxpayers the declination of tax rates should be an incentive for a growth in the labor supplied especially for women, moreover the quality of work and effort would increase as well. One low tax rate thus should function as an encouragement for greater labor activity. Linear taxes could also positively influence personal capital. On the other hand progressive taxation decreases the return rate on income from personal capital due to lower labor supply caused by lower net pay. This means that the return rate on capital decreases because due to the reduction of the

rate of investment. Progressive taxation shrinks future income from investments more than limits the costs, and that is why this system does not persuade generating extra capital unlike in the case of proportional tax. The application of one low homogeneous income tax rate would result in the exposure of business running illegally or at least in partial illegal manner. In the opinion of linear taxation supporters even the slightest minimization of the underground market would reimburse the loss taken due to implementation procedures of the linear tax. What is more reducing the upper marginal tax rates would result in the reduction of execution costs of highly qualified workmanship, namely highly paid, hence enabling further modernization and development of enterprises. In addition the transferring of income abroad would diminish also effecting national income to grow.

Conclusions.

Milton Friedman in the 1960's was the first person to propagate the notion of substituting progressive tax with linear taxation at rate of 23,5% (Friedman M., 1962). However this concept was not taken seriously until the year 1985 when the topic was put forward by American economists Robert Hall and Alvin Rabushka. Both of the economists suggested a 19% homogeneous tax rate imposed on wages, social welfare benefits and income from own business exclusive of tax allowances and tax exemptions, however with a small exception for the taxpayers with the smallest income, namely a small tax credit would be applied which the purpose would be to slightly diminish the tax burden. The base of taxation for taxpayers running their own business activity would be the difference between revenue from goods or service sold and the

costs of raw materials, stock goods, machines and paid wages. What is interesting in this case is the fact that depreciation of goods has been put aside, while the possibility of deducting the whole amount of capital invested from revenue is being respected. According to this concept taxes would be charged only on income that would be allocated for consumption, not investment purposes. In addition in the opinion of the above mentioned economists this tax reform would be developmental.

Hall and Rabushka justified the introduction of a tax credit (automatically making this a flat tax) by explaining that dismissing the poorest from the obligation of paying the full amount of taxes eliminates the necessity of implementing progressive taxation with high tax rates for families with the

highest incomes. On the other hand the application of a homogeneous tax rate on income above a certain level automatically creates progressiveness without the necessity of employing noticeable differentiation in rate levels. Advocates of the implementation of the tax credit in linear taxation agreeing on this opinion add that the employment of a tax credit assigned to the poorest families make tax collection more feasible and efficient, not involving the internal revenue authorities in any action towards collection due to the incommensurability of the value of collected taxes to the cost of levying them. However such resolution is an advantage only when comparing to the individual progressive income tax, not the classic linear tax, which does not allow any tax exemptions.

On the foundation of their study Congressman Richard Armey and Senator Richard Schelby had introduced to the Congress a bill called "Freedom and Fairness Restoration Act", known better as proposal H.R. 1040. Unfortunately this linear taxation plan had not succeeded in the vote. Although the tax reform initiated by Ronald Reagan in the years 1980 and 1986, consisted in replacing the previous tax rates 15%, 28%, 31%, 36% and 39% with two rates, namely 15% and 28%. This action seemed to be a step towards fulfilling Hall and Rabushka's concept. In order to balance the loss in the difference of tax rates in personal and corporate income tax as well as the increment of the amount subject to tax credit in the case of personal income tax, the reform put forward a fundamental reduction in tax allowances. This was also necessary from the perspective of simplifying the system, in addition this notion was predicted to eliminate the distorting effect the tax allowances had on the direction of business activity. In the new proposed reform the leveling of legal issues in personal and corporate income tax have been also

forecasted in terms of taxes on capital gains. The set forth modification in the tax system in the White Paper assumed the induction of two effects.

- The first effect was the dynamic effect. As a result of eliminating tax progression in personal income tax, substantially reducing the corporate income tax rates, the standardization and simplification of tax regulations, such incentives towards increasing income would be encouraged through legal work and entrepreneurialism, hence increasing the national income. The originators of this project also assumed that citizens would find education more profitable due to fact that their future income will be imposed under more placid taxes. All in all this will have positive impact on the economy improving welfare of taxpayers.
- The second foreseen effect was the redistribution effect, which consisted in the alteration of relative tax burdens on taxpayers with different incomes. The first dynamic effect would obviously have greater meaning in the improvement of the life standard of taxpayers in comparison to the redistribution effect, because of the constant and systematic functioning of the dynamic effect towards growth, whereas the second effect consists in the shifting of its share. Therefore we can claim that in the founders opinion of this tax reform the main goals were:
 - To stimulate the economy through the encouragement of investing, create new job positions, the increment of self efficiency and individual qualifications, also the increase in profitability of gaining additional legal income etc.
 - To enhance citizens trust in the law, eliminating sources of manipulation and tax abuse, as well as the simplification of the tax system.

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- Ensuring the Polish economy a competitive tax system, which would prevent migration of citizens, companies and capital to countries where it is more advantageous.
- Considering the changes resulting from alterations in different economic sectors, among all the needs that are an outcome of the territorial government extension of authority and the reform of health care.
- The adaptation of the Polish tax system to European Union requirements. It has to be also mentioned that other than a very convincing keyword, namely linear taxation, the White Paper on Taxes did not bring any concrete proposals and only met with defiance from the political elite and the society itself. Despite of the introduced solutions in the White Paper, very similar to the ones proposed R.E. Hall and A. Rabushka, they did not initiate, however this notion originated important discussion about the need and the direction of Polish tax system reform, and the possibility of implementing proportional taxation in the case of personal income tax.

Many European Union members including Poland, as well as non members have put a tax reform into practice, some countries are planning on implementing changes, the rest have already done so. However not one of them have decided to implement linear income tax rates or standardize the PIT rates with CIT rates, which is becoming more common due to countries situated on the Baltic and their success in the above. Since many years this tax is in practice in counties such as Bulgaria, Czech Republic, Estonia, Latvia, Lithuania, Romania, Russia, Slovakia and Ukraine. However it will be necessary to bring closer only a few of the countries from the graph below. Although Czech tax system has linear rates, the replacement of the progressive tax system was put into practice too soon for it to be credible enough in this analysis.

Estonia was the first former soviet Baltic country to reform their taxation system through the implementation of a proportional income tax. The tax reform introduced PIT with rates ranging from 16% to 33%. Those rates were replaced in 1994 by a flat 26% income tax. What is interesting is the fact that Estonia's corporate income tax was also progressive with rates 15%, 23% and 30%. However since 1992 until the end of 1993 the CIT was altered to a linear tax at 35%. The CIT was cut in 1994 from 35% to 26%. So, the initial idea of reform was to apply the same flat tax rate for personal and corporate income tax in simplifying in this way the system and signaling to taxpayers neutrality of authorities to corporate versus non-corporate form of economic activities. Starting from January 1, 2000 the new Income Tax Law introduced several new regulations regarding personal and corporate income tax. The most disputable topic was exemption of undistributed profits from corporate income tax. The taxation reform in this country was carried through during a domestic economic recession, when in 1993 the fall in GDP amounted to 8%. Nonetheless in time positive effects could be observed due to the applied changes, which could be supported by the average GDP growth of 8% since the year 2000 (59). The Estonian tax system is settled through one legal act simply by the act on income tax, therefore there does not exist a clear discrepancy between personal and corporate income. This act considers mostly personal income, whereas corporate income is not subject to taxation, unless it is allocated for dividends, donation, endowments or other purposes related to functioning of the business. That is why this system encourages further investment of the capital gained. In the case of personal income tax the subjects under taxation are payroll, business activity, capital or pension. Other than the tax

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credit there also are a number of income sources that are exempted from taxation, such as welfare, scholarships, indemnities, lottery wins or international scientific and cultural rewards and distinctions. Moreover there is a separate category of revenue which can be subject to lump-sum tax. The following sources of income are contained in this category, namely non-resident payroll, income from being and artist, income from sports 15%, dividends 25-26%, pension 0%, 10%, 26%.

The second country to reform their taxation system by implementing a proportional taxation technique was Latvia. Exactly on the 1st of April 1995 the Corporate Income Tax law was adopted, which covered personal income tax as well. Until the end of the year 2001 legal persons income was charged with 25% linear tax rate, which later on was reduced to 22%, followed by a reduction to 19% in 2003, and since 2004 the rate is 15%. The stimulating policy to support investment has been realized through tax concessions. The 40% reduction of corporate income tax is applied for projects supported by the Latvian Government and only after the implementation of the respective project. Starting from January 1, 2001, Latvian companies producing high tech and hardware or software products for computers are granted a 30% tax reduction of the corporate income tax. This tax reduction is guaranteed only to producers whose output 75% consists of those products and who have ISO 9000, ISO 9001, ISO 9002 certificates. Personal income tax was charged with a linear tax rate at the level of 25% with a tax credit and an allowance on children, now this tax rate is reduced to 23%. As a result of the carried through tax system reform only in the first year 1995 a negative GDP growth was observed, however in time positive tendencies of GDP growth started to appear, especially after the year 2000. Apart from that

Latvia has a lump-sum tax and it consists of five different tax rates 2%, 5%, 10%, 15% and 25%.

In Lithuania the flat 33% personal income tax has been applied since 1994. The corporate income tax history on the other hand start in Lithuania with 35% tax rate established in 1990 and reduced to 29% in 1991. Since 1993, a 10% rate has been applied to profits invested into the company. Companies and dividends are charged with a flat corporate income tax rate in the amount of 20%. Companies in Lithuania have the advantage of a smaller tax burden in comparison to natural persons. Moreover non-residents of legal character in Lithuania are charged with a 10% lump-sum tax rate. An interesting fact is that there are certain alternatives that allow elements of progression, namely subjects that employ no more than 10 employees and their annual income does not exceed approximately €120 000, are charged with a lower 13% tax rate. Depending on the source of income, different tax rates apply, namely 15% to 33%. A 15% tax is charged on payroll, capital interest, business activity involving sports or art, pensions, income from renting or selling real-estate or the payout of life insurance installments. The rest is subject to the higher tax rate, furthermore a tax credit is allowed in the amount of approximately €1000 annually. Natural persons running business activity may apply corporate tax, however in this case a 15% tax rate will be charged on gross income, without any deductions (60).

Russia also implemented the flat tax system, however after the economic recession did they decide for such a radical change. Before this reform Russian taxpayers as the majority of the world abided by progressive tax rates at 12%, 20% and 30%. In 2001 the progressive tax system was replaced by a 13% flat tax rate. In addition 30% and 35% flat tax rates were imposed

depending on the source of income. Legal persons were charged with 35% tax until 2002, which was then reduced to 24%, although financial institutions were still charged with 27% tax. Moreover along with the implementation of the linear tax, Russia was running a tax campaign advertising the fact that the tax law is for everyone to obey.


There saying was "if you don't come to us, we will come to you". Many claim that this campaign caused many millionaires to reveal their wealth as well as themselves. Generally speaking Russia's tax system underwent simplification, to be exact the social insurance contribution was standardized, most companies began to rightfully pay VAT, also most tax rates were either eliminated or substantially reduced in other tax categories and the same was done with stamp duties. Furthermore the tax administration had been strengthened, as well as the penalty system, which evidently enhanced the effectiveness of tax collection. Due to such alteration in Russia's tax system, their economy experienced a boost after about two years of these changes. National revenue from personal income tax was rising by 50% annually, followed by a maintained level of national expenses, economic growth was inevitable. Despite of the fact that Russia's personal income tax burden is not substantial, there still are many tax allowances as such, tax credits, tax exemptions allowing for deductions in the category of having someone under your support, tax allowance in result of building or purchasing a home, medical expenses, charity donations or education of child or yourself. Corporate income tax also respects tax allowances, however it is in their nature to enhance investment and it applies to small enterprises. Companies that employ up to 100 employees and with a turnover not exceeding 15 million Russian Rubles are exempted from VAT, sales tax and

real estate tax, social insurance contributions and they have the possibility to choose the method of charging tax, namely 15% income tax or 6% on turnover (61).

Other than the countries that have been analyzed previously, most recent tax system reforms that have been enforced using the linear taxation method were in Slovakia and Ukraine in 2004. In Slovakia the tax reform was thoroughly altered, namely they did not only consider income tax, but also VAT, excise duties, transportation tax and real-estate tax. However other than income tax is irrelevant to my analysis. Before 2004 the progressive personal income tax rates were 10%, 20%, 28%, 35% and 38%, corporate income tax was 25%, all of these rates were replaced by a linear tax rate 19%, both in personal and corporate income tax. What is more as VAT was also reduced to 19% linear tax rate. The Slovakian tax reform also consisted of eliminating many tax credits and exemptions in order to optimally simplify their tax system. Ukraine on the other hand replaced their progressive personal income tax system with a 13% linear tax rate in 2004, which was changed to 15% in 2007 and applies till this day. The previous progressive rates were 10%, 15%, 20%, 30% and 40%. In consequence of the tax reform new tax exemptions have also been implemented, namely in 2004 taxpayers had the privilege of deducting a social exemption in the amount of 30% of the minimum wage, which has been increasing annually until 2007 when the exemption reached the 100% level of minimum wage. For taxpayers that are single parents an exemption of 150% of minimum wage has been provided. In addition to the changes in 2004 corporate income tax has also been reduced from 30% to 25%. We can clearly observe that these two countries have implemented two dissimilar tax systems, however based on the same notion (62).

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Wolowicz T., (2018) Economic and Social Aspects of Progressive and Proportional Taxation of Incomes

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Now that seven countries have been examined from the perspective of tax reform using linear taxation, it is more feasible to reason and develop an opinion, on which taxation method is optimal. The tax reforms have been quite successful for the reason that all countries managed to avoid very critical budget deficits. From the above mentioned data and facts it can be clearly stated that the dominant goal for these countries, analyzed from the perspective of tax reform and its effect on economic stability or instability, was encouragement towards investment and creating new job positions. The concern about budget income declination declared by various researchers seems to be unjustified. Better administration of existing taxes and harmonization with the EU requirements are next important tasks in improving the tax systems. Moreover in the Baltic States, the share of tax revenues in GDP has had different trends. Estonian total budget revenue increased from approximately 37%, since the introduction of the new tax system, to around 39% in the early 2000's, tax revenue increased respectively from 34% to 37%. Furthermore in Latvia the share of total income increased from approximately 37% to 39%, but the share of tax income decreased from about 34% to 33%. In Lithuania, the share of total income in GDP declined from 40% to 32% and tax revenues fell from 36% to 30%. As we can also observe in the graphs provided above, those countries could experience a fall in GDP in the first couple of years due to the lower tax burden these new tax systems had set forth,

however this was partially compensated by the outcome that the authorities had primarily forecasted, namely increased ability to invest, greater savings, hence leading to more job positions. Latvian, Lithuanian, Russian, Ukrainian tax systems although, they are not as developed as the Estonian system they are still far from being a perfect simple linear tax system, namely without any tax credits, exemptions, allowances and deductions, with complete proportional taxation. If a tax does not possess such privileges, then it becomes less competitive. As a result these countries implemented a tax system that in reality does not differ from the good old progressive taxation. What is more we can claim that the only factors leading towards a linear tax system due to the reform is the simplification of the progressive system with less tax credits and exemptions and no income thresholds.

That is why the new tax systems in the Baltic countries can be declared as flat taxes not linear. Supporters of linear taxation propagate the strong stimulating impact it has on the economy along with the elimination of tax credits and exemptions, including the ones that enhance investment and savings. The outcome of my analysis shows that Baltic countries, as well as Slovakia owe their increased economic growth rate to the constantly developing system of pro-investment tax allowances. Therefore it is difficult to present a case of perfect linear taxation and its impact on the economy due to the lack of one.

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