

INAUGURAL LECTURE FOR OPENING THE ACADEMIC YEAR 1999/2000

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**PROPOSALS OF CHANGES IN THE POLISH TAX SYSTEM
IN RELATION TO DIRECT AND INDIRECT TAXES**

The necessity of reforming the Polish tax system has been suggested by both business community and scientists and politicians as well as experts from the International Monetary Fund (IMF) and the European Commission (EU). In that respect, there exists far-reaching agreement. Proposals of changes in the Polish tax system in relation to direct and indirect taxes. The arguments start at the point of determining the direction of such reform and particular solutions, especially in the areas of income and capital taxation.

In the case of income tax for individuals, the IMF experts suggest abolishing housing relief, and education and health relief. They also suggest abolishing a joint tax return declaration for couples and single parents.

However, it turns out that housing relief is favoured by both wealthy and poorer people who have been saving in building societies for several years. As shown by the German experience, building societies (Bausparkassen) play an important role in social and economic life where they contribute largely to economic growth. It is untrue that housing relief causes a decrease in state revenue. Thanks to such relief many previously unemployed people find work in housing construction thus removing the need for paying them unemployment or other benefits, and at the same time providing income from which they have to pay income tax to the state budget.

As far as the proposal of abolishing joint tax return declaration for couples and single parents, such family oriented forms of taxation exist at present in the majority of EU countries (Inventar der Steuern 1998). It has a longstanding and stable position in the taxation systems of European countries. The abolition of such a system is not planned in the nearest future within the European Union. I think that Poland, in moving towards the harmonization of our taxation laws with those of the European Union standards, should not give

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up such a form of preferential family taxation because the financial results of abolishing such a system would be too high.

It is worth pointing out that a significant social function in the income taxation systems of individuals in OECD countries is fulfilled by tax-free allowance which for example in Germany amounts to nearly 12,000 DM and in France 42,500 FF. In Poland however, its share in income tax of individuals is rather symbolic.

The IMF experts also propose the abolition of investment relief in income tax. Investment relief have been widely used in European Union countries when there was a necessity for rapid technical and technological transformation. At present they have been restricted but, for example in the eastern lands of Germany there is still special tax legislation relating to investment relief, despite the fact that these areas receive every year 300 to 4,000 million DM from German or EU budgets, for the development of not only infrastructure. The Polish economy remains in an incomparably worse position than the eastern lands of Germany, and using tax motivation for investors, particularly in the sphere of introducing new technology and innovations, is in my opinion fully justified. Sufficiently strong market stimuli, which would result in a radical acceleration of such processes, do not exist.

The opponents of applying tax relief on investments use the argument that such relief results in a lowering of the state budget revenue. However, correctly formulated relief can become – when applied to sufficiently large motivating amounts – a significant factor in economic growth, and at the same time, an element “cranking up prosperity” without causing a fall in the revenue. This results from the fact that an individual or a company in undertaking an investment project usually has to purchase machines, equipment or technology on which VAT is payable. What is more, such investment is located on a piece of land on which there is also payable some property tax. Frequently there are some other payments to make on top of these, like excise duty, road tax or stamp duty. As a result, often even before making any deductions from taxes payable on investments, central and local authority budgets receive from an investor a tidy sum due from the mentioned payments. It is also worth remembering that a completed project brings more income, which has to be shared with the taxman. Hence tax relief on investments is referred to as a tax credit, which in most cases is repaid to the state promptly and at a profit.

The proposals of the IMF experts also aim at simplifying and changing the rules of amortization, which in turn would influence the levels of payable income tax. They suggest in particular moving away from further reappraisals of fixed assets, limiting the range of amortization rates and further amortization of parts of assets written off due to moral (economic) wear and tear.

The suggestion of abandoning the practice of further reappraisals of fixed assets in Poland, in conditions a single-figure – and still falling – inflation is fully justified. It is also necessary to reduce the range of rates applied to amortization allowances. At present there are 63 such rates, and cutting their number would greatly contribute to reducing costs connected with calculating amortization allowance for so many differently rated components of companies' assets.

The IMF experts also propose an introduction of taxes on interest accrued in bank accounts, at the same time still making exempt from income tax financial profits obtained mostly from trading in stocks and shares. In most EU countries there operates a system of taxing interest on deposit accounts of private individuals, this can also take a form of a lump sum arrangement (interest on income from such source), or income from interest accrued is taxable within the total income (Jacobs and Spengel 1996, p. 91 ff.).

So far the EU has not reached an agreement relating to a uniform system of taxing interest on bank deposits. I think Poland should not rush with accepting the solution based on taxing income from bank deposits. It is worth remembering that the habit of saving money is not widespread in Poland, and introducing such taxes would make it even less attractive. Also among the account holders there already exists a feeling that their deposits are already taxed, since part of the deposits is transferred to the National Bank of Poland in a form of not-earning-interest obligatory reserves. Their level is much higher than in the EU countries. It also has to be remembered that taxing the income from bank deposits with making income from capital profits tax-free, can only strengthen the tendency to abandon bank deposits in favour of other forms of investing money.

A report presented by IMF experts in December 1998 draws attention to the fact that the present threshold of lump sum taxation on registered income at a level of 400,000 PLN is too high. The report also formulates suggestions as to compulsory nature of lump sum system, for the period of at least four years.

The threshold of lump sum system, which has been further increased in 1999, is really too high, but the proposal of introducing a compulsory lump sum system for a period of a few years is not practical. In the Polish taxation system, a taxpayer can abandon a lump sum taxation and change in a new year to income tax collected on general principles. The opposite situation is also possible as long as the conditions determined for the lump sum taxation are observed. One should point out however that the subject scope of lump sum payment on registered income is seriously limited in Poland, therefore the introduction of a compulsory lump sum arrangement for a period of a few years would force the taxpayer to conduct activities only within the types of activity

subject to this form of taxation. It would therefore contradict the principle of free choice of economic sphere for entrepreneurs.

The IMF report also proposes abolishing in accordance with the decision of EU members which projects abolishing special economic zones cannot result in abolishing special economic zones within Poland. Such a solution remains in accordance with the decision of EU members which projects abolishing special economic zones by the year 2002. Abolishing special economic zones cannot result in abolishing exemptions and tax relief obtained earlier by the investors. The concessions granted earlier have to be respected until the point of expiry.

The non-changeability of tax laws in short periods is standard for EU countries. The reform of the Polish system of taxation should not mean permanent changes in tax laws as happens at present. The solutions once accepted should remain in force for at least a few years. The level of tax burden is an important parameter of economic calculus and their frequent changes introduce uncertainty as to the effectiveness of the decision taken.

But in the years 1993–1998 the income tax law for individuals was changed 31 times; income tax laws for legal entities were changed 39 times, and during four years (1994–1998) the law regarding tax on goods and services and excise tax was changed 16 times.

Tax reforms also have to ensure equal treatment of all economic subjects by tax authorities. Unfortunately apart from tax relief and allowances, of a systematic nature, tax laws also allow applying preferential treatment on merit. According to article 14 §1.2 of the tax law, The minister of finance attempts to ensure the uniform application of taxation laws. On the other hand, on the basis of article 22 §1 of the same Act, and also on the basis of the earlier decree on tax obligations, the Minister of Finance can order the suspension of fixing tax obligations and collections of taxes in cases justified by public interest of the important interest of tax payers. In practice, in the years 1995–1998, the Minister recommended in over 80 cases that the tax office does not collect taxes from specific taxpayers. Those rulings were followed by the respective organs, and as a result 600 millions PLN in taxes was not collected. And so the relief and s of merit were applied in those cases contradicting the principle of equality of companies before the law. It is worth pointing out the extremely imprecise wording of the decree on suspension of tax collecting in cases justified by public interest. The concept of public interest is very extensive and not very precise and creates a typical loophole for merit based decisions.

The reform of the Polish tax system has to move towards a simplification and uniformization of several legal acts. In income tax of individuals alone, there exist at present as many as 125 exemptions included in various decrees and regulations. The number of legal acts determining the taxations system is too

large. In all kinds of taxation the regulations constitute only a small part of the existing legal acts. For example, in the case of income tax of individuals, apart from the relevant decree, there are also in force recommendations from several other Acts, like trade unions or related to handicapped people. Apart from these, the functioning of this tax is regulated by 13 rulings of the Ministry of Finance, and 19 rulings of the Government and the Ministry of Finance.

Revenue from income tax can be a significant source of enriching local financial budgets. Nevertheless there should be created such a system in which local authorities would be interested in increasing this revenue through creating conditions for establishing new companies and new jobs. However in this situation when the share of local authorities in the income tax revenue is small (1% of the revenue will be directed to local budgets), it is hard to imagine that it could motivate such activities. If the own revenue of the counties (powiat) the expenditure of which is decided by the local authority, will constitute only 4% of the general revenue, and the remaining 96% of income received via subsidies and funding from the central budget will be decided by the Ministry, it would be hard to speak of self-government at the level of the counties (powiat). Such reform could be described only as a paper reform because in real terms it means going back by at least 20 years to the centralized system of financing the public sector.

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