

Ability-to-pay Principle and the Structure of Personal Income Tax in Poland (Selected Issues)

*Robert Zieliński*¹

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Abstract

The ability-to-pay principle is one of the two principles that legitimise the collection of taxes. It pertains to the correct distribution of the tax burden that gives rise to a great deal of controversy and disputes in the theory and practice of financial law. The objective of this article is to demonstrate whether the Polish legal structure of personal income tax enables the distribution of tax burdens among citizens in accordance with this principle.

Keywords

ability-to-pay; personal income tax; tax progression; tax-free amount

1 Introduction

The doctrine of financial law is constantly accompanied by the question of the desired (appropriate) distribution of tax burdens. The answer is not simple, as it requires setting limits to taxation and thus indicating what is meant by tax justice and how to achieve it. The literature on financial law points out that tax justice can be achieved through two tax theories: equivalence and ability-to-pay (Gomułowicz, 1995: 59). However, currently the fair tax burden cannot be justified by its development proportionally to benefits acquired by the entity obliged to pay taxes on public law entity authorised to obtain tax revenues (Nita, 2013: 19–20). The reason for this is, *inter alia*, the absence of an objective measure of the benefits provided to the taxpayer by the state or a local self-

¹ PhD, Division of Financial and Tax Law, Collage of Law, Kozminski University, Poland. The author specialises in tax law. He is a member of the Information and Organization Centre for the Research on the Public Finances and Tax Law in the Countries of Central and Eastern Europe. Contact email: rzielinski@kozminski.edu.pl.

government authority (Gomułowicz, 2001: 66). This is due to the fact that in the concept of the equivalence of benefits, tax is similar to the price that a taxpayer is required to pay in return for the provision of public and social goods (Nizioł, 2007: 120). For this reason, in democratic states under the rule of law that frequently declare and guarantee the protection of citizens' financial and economic interests in their constitutions, the ability-to-pay theory is universally applied. It assumes that the amount of tax burdens should correspond to the taxpayer's individually determined ability to bear the tax burden.

The objective of this article is to show whether the current legal structure of personal income tax in Poland guarantees the distribution of tax burdens among citizens in accordance with the taxpayer's ability-to-pay principle. However, due to its limited scale, the considerations are limited to the analysis and assessment of two elements of the structure of this tax, *id est* the tax-free amount and the tax progression.

2 The Essence of the Taxpayer's Ability to Pay

The ability-to-pay principle as a rule justifying tax collection appeared in the 19th century doctrine of financial law with the emergence of a new direction in tax thought, exposing the non-fiscal objectives of taxation. In literature, its main representative is considered to be Adolf Wagner, a representative of the so-called German Historical School. He claimed that taxes ceased to be used only and exclusively to accumulate public revenues, but they also fulfil broadly understood socio-political and social functions, including an effective instrument for correcting inequalities in the distribution of the national income. Conversely, such objective of the tax policy is achievable, if the citizens are involved in financing costs of the state's operation differently and adjusted to their individual subjective payment ability (Zieliński, 2016: 702).

The ability-to-pay concept is vague, ambiguous and stirs disputes (Gomułowicz, 1990: 27). In legal and financial literature, it is synonymous with the strength and ability of a taxpayer to make a financial sacrifice (Gomułowicz, 2013: 50). In view of the foregoing, it can be concluded that it constitutes the taxpayer's ability to bear a tax burden which does not fundamentally alter his or her economic position (Gomułowicz, 1990: 27). Therefore, the respect of the ability-to-pay principle requires adjustment of tax burdens to the individual possibilities of providing services, based on taking into account all of its elements, both personal and, above all, economic and financial (Nizioł, 2007: 119). These include, in particular, the amount of income earned by the taxpayer in the tax year, as well as significant circumstances differentiating his or her personal situation, such as: civil and family status, the number of dependants, health and age, ability to work, and extraordinary events (e.g. natural disasters with damage to property or personal nature that weaken that ability) (Pomorska, 2016: 49; Gajl, 1995: 25–26; Kalinowski, 1996: 55).

The literature indicates that the application of the ability-to-pay principle has certain advantages (Gomułowicz, 1998: 88; Nizioł, 2007: 120). Firstly, since it requires tax to be considered a general obligation and not to be combined with any payment on

the part of the state, the distance between the taxpayer and the spending of funds from the state budget is maintained, which in turn ensures impartiality towards the citizen. Secondly, it contains a characteristic measurement scale of the tax burden as – if properly implemented – it may put an end to the fiscalism associated with the collection of (economically) unjustified tax burdens. Thirdly, the tax ability principle requires that the legal and economic protection of sources of taxation be respected, both in terms of the benefits to the taxpayer and to the state. Finally, by applying the principle in question, it is possible to gain public acceptance of tax law, which is undoubtedly important for the authority of the state and for the law itself. Negating this principle may therefore erode attitudes towards taxation, which in turn may jeopardise the smooth functioning of the fiscal function of the tax.

Considering the foregoing, in the modern fiscal doctrine, the ability-to-pay principle is considered the cornerstone of fair taxation. Equating the ability to pay with a fair distribution of the tax burden has, in turn, led to vertical and horizontal tax justice. The first one is observed when individuals whose financial position is better are levied with greater taxes than those whose abilities to assume tax liabilities are lesser (Famulska, 1996: 3). This justice is therefore expressed in a differentiated ability to pay, with less attention to the taxpayer and more to the amount and type of income he or she receives (Szołno-Koguc, 2016: 169). On the other hand, the horizontal tax justice presupposes equal treatment of entities in identical economic conditions, which, in turn, is connected with respect for the postulates of universality and uniformity of taxation.

The literature indicates that the ability-to-pay concept that individualises the tax burden mainly applies to direct taxes (Gomułowicz, 1995: 62), most notably taxes on general income that reflects the taxable capacity of a taxpayer more than partial income (Pomorska, 2009: 129). It follows from the above that the rules for burdening natural persons' income cannot be dissociated from their ability to pay. Therefore, in the legal structure of this tax, the legislator applies elements enabling the aforesaid postulate to be carried out. These primarily include the amount of income exempt from taxation, tax allowances and exemptions, the type of tax scale applied, as well as preferential taxation of income of the taxpayer's family members.

3 Legal Structure of Personal Income Tax in Poland

The rules for burdening the income of natural persons in Poland are regulated by the Personal Income Tax Act of 26 July 1991 (hereinafter: Act). This tax is paid by natural persons generating income from the sources of income listed in the Act.²

² The sources of revenues whose incomes are levied with this tax may be divided into four fundamental groups. The first group comprises revenues from the taxpayer's own work and they are as follows: remuneration paid under employment relationships, contract of mandate, contract for specific work and the like, revenues generated by self-employed professionals, revenues from the non-agricultural business activity and form special divisions of agricultural production. The second group includes

The tax base in this tax is income obtained from one source of revenues or a total amount of incomes generated from several sources of revenues subject to accumulation. Unless otherwise specified in specific provisions, income from the source of revenues is defined as the surplus of revenues from this source over deductible costs of income generation during the fiscal year. The tax base determined in this way is further reduced by the income tax deductions set out in the Act³ and then it is subject to taxation with the tax progression shown in the table below.

Table 1. Scale of personal income tax in 2018

Tax assessment basis (in PLN)		Tax amounts to
over	to	
	85,528	18% less tax reduction amount
85,528		PLN 15,395.04 + 32% surplus above PLN 85,528 less tax reduction amount

Source: Art. 27(1) of the Act.

Further, the calculated tax is reduced by the tax deductions set out in the Act⁴ and is paid into the bank account of a competent tax office within the period of lodging the tax return, i.e. by no later than the 30th day of April of the subsequent tax year, amounting to the difference between the tax due on income set forth in the tax return and the total advance personal income tax payments made during the tax year.

4 Selected Instruments Taking into Account the Taxpayer's Ability to Pay Included in the Legal Structure of the Polish Personal Income Tax

An analysis of the legal structure of personal income tax in Poland allows stating that it generally provides for all the elements taking into account the taxpayer's ability to pay. These are a tax-free amount, tax credits and allowances, tax progression, and preferential rules for burdening income of the taxpayer's family members that enable

subsidy revenues such as: disability pensions, retirement pensions, some scholarships, benefits and the like. The third group consists of revenues from capitals and property rights and their sale (e.g. shares in joint-stock companies, shares, bonds, interest on bank savings, sale and replacement of real estate property). The last group includes revenues from other sources such as revenues that are not based on disclosed sources or deriving from undisclosed sources (Wójtowicz, 2014: 243).

³ These are as follows: social security contributions, disability allowance, Internet allowance, donations to the purposes specified in the Act in kind or in cash up to a total amount of 6% of the taxpayer's annual income, donations to charity and care activities of the Catholic Church (or other churches authorised under agreements), expenditures on research and development, and payments made by the taxpayer into an individual pension security account during the tax year.

⁴ They are as follows: social security contributions amounting to maximum 7.75% of their assessment, expenses for children upbringing and the so-called abolition allowance.

joint taxation of income of spouses and of single-parent families. However, as indicated in the introduction, further consideration will only focus on the analysis and assessment of two of them, *id est* a tax-free amount and tax progression.

4.1 Tax-free amount

The reference books rightly postulate that the taxpayer’s income that constitutes the basis for taxpayer’s material existence and is the only source of income should not be subject to taxation at all (Kosikowski, 2011: 300). There is no doubt that the taxpayer as a natural person needs to have a certain amount of income to live. Otherwise, not only can this person be a taxpayer of income tax, but he or she also becomes a beneficiary of various forms of social assistance, which are necessary for this person’s biological existence (Wójtowicz, 2017: 20). For this reason, the legal structure of personal income tax should include an amount of non-taxable income, and its amount should reflect the minimum amount of financial resources necessary for the taxpayer to satisfy his or her basic needs, *id est* it should take into account the so-called minimum subsistence.

The tax-free amount is a permanent component of the construction of personal income tax in Poland. It appeared both in the legal regulation of the interwar period and in the period of centrally planned economy (Duda-Hyz, 2016: 46–53). It should be noted that its amount is not specified directly in statutory regulations, but it results indirectly from the fact that the income tax calculated according to the tax progression is reduced by the amount of tax reduction indicated in the Act. Pursuant to Art. 27(1a) of the Act, this amount is as shown in the table below.

Table 2. Amount of income tax reduction in 2018

Tax assessment basis		Tax reduction amount
over	to	
	PLN 8,000	PLN 1,440
PLN 8,000	PLN 13,000	$PLN 1,440 - [PLN 883.98 \times (\text{tax assessment basis} - PLN 8,000) / PLN 5,000]$
PLN 13,000	PLN 85,528	PLN 556.02
PLN 85,528	PLN 127,000	$PLN 556.02 - [PLN 556.02 \times (\text{tax assessment basis} - PLN 85,528) / PLN 41,472]$
PLN 127,000		Lack of tax reduction amount

Source: The author’s calculations under Art. 27(1a) of the Act.

According to these data, personal income tax is not collected in Poland from taxpayers who earned income lower than PLN 8,000 in the tax year. At the same time, it is the maximum tax-free amount. For taxpayers whose annual income ranges from PLN 8,000 to PLN 13,000, the tax-free amount decreases from PLN 8,000 to PLN 3,091. A similar situation is faced by taxpayers whose annual income ranges from PLN 85,528 to PLN 127,000.

Their tax-free amount is reduced from PLN 3,091 to PLN 0.00, respectively. On the other hand, those taxpayers whose annual income ranges from PLN 13,000 to PLN 85,528 are entitled to a fixed tax-free amount of PLN 3,091, and natural persons whose annual income exceeds PLN 127,000 are not entitled to the tax-free amount.

In assessing the aforesaid solutions, it should first be noted that they are complex and difficult to apply. Therefore, they negate one of the fundamental principles that forms the basis for the general personal income tax system, namely the simplicity of taxation. Secondly, the tax-free amount is now degressive, *id est* it decreases with an increase in the tax base and is not available to all taxpayers. This solution should be considered consistent with the concept of the taxpayer's ability to pay, but with the proviso that the method of differentiating this amount (*id est* the value of the tax base on which this amount depends) adopted by the legislator is arguable. As a result, over 80% of the taxpayers are entitled to the tax-free amount of PLN 3,091 per annum. Thirdly, it should be noted that only the maximum tax-free amount (amounting to PLN 8,000 per annum) corresponds to the level announced by the Institute of Labour and Social Affairs, the so-called minimum subsistence level.⁵ In 2018, it amounts to PLN 9,111.81 per annum, which means that this amount constitutes about 114% of its value. It should be noted, however, that this is the biological minimum set for a one-person household. If the tax-free amount is compared with the minimum subsistence values set for other types of households, the situation changes dramatically. For a three-person household the biological minimum value amounts to PLN 18,267 per annum, whereas in a five-person household this amount equals to PLN 30,133.20. This means that the maximum tax-free amount represents just 43.8% of the value of the minimum subsistence level adopted for a three-person household and 26.5% of the value of this minimum level determined for a five-person household. These ratios are drastically reduced, if the aforesaid minima are compared to the tax-free amount that is currently due to most taxpayers, *id est* PLN 3,091 per annum. Therefore, it follows from the above that this amount constitutes only about 34% of the minimum subsistence level set for a one-person household, about 17% of this level set for a three-person household, and about 10.3% of this level set for a five-person household.

It is also noteworthy that the implementation of the ability-to-pay principle requires the tax-free amount to be individualised, *id est* this amount is made dependent on the personal situation of a particular taxpayer and his or her family. Unfortunately, in the legal structure of personal income tax in Poland, it is difficult to find the implementation of this postulate, apart from the degressive nature of the tax-free amount and the fact that it is granted only to selected taxpayers. Definitely, there are no absence of such solutions which

⁵ The minimum subsistence level, also called the biological minimum, defines the limit below which there is a biological threat to human life and psychophysical development, and it includes expenditure on survival, primarily related to the purchase of food (at a level that does not give rise to the biological degradation caused by quantitative and qualitative diet deficiency), the cost of maintenance and use of the apartment, and to a certain extent expenditure on the purchase of clothing, medicines, personal care products, as well as books and school supplies related to the performance of compulsory schooling.

can be found in tax jurisdictions of other states, and which in practice respect this demand. For example, in Germany the tax-free amount is twice as high for married couples who settle together (EUR 17,304 per annum) as for other taxpayers (EUR 8,652 per annum). In Spain, on the other hand, the tax-free amount equals to EUR 5,500 per annum, while for taxpayers aged over 65 this amount is EUR 1,150 higher and for persons aged over 75 it amounts to EUR 1,400 higher per annum. In Ireland, the tax-free amount to which taxpayers are entitled depends on their marital status. For married/registered couples and widowers in the mourning year, this amount is EUR 3,300 per annum, for unmarried persons this amount equals to EUR 1,650 per tax year, and for widowers and singles living in civil partnerships it amounts to EUR 2,190 per tax year.

4.2 Tax progression

In order to spread the tax burden according to the taxpayer's ability-to-pay concept, the construction of tax progression is widely used in addition to the tax-free amount. Its essence consists in a relatively heavier burden on higher incomes and a lighter one on lower income, which is intended to reduce the income inequality among citizens. Since its implementation, personal income tax in Poland has been a progressive tax. In the years 1992–2008, a three-tier tax scale was in force with rates ranging from 19% to 45%.⁶ However, starting from 2009, the scope of this progression was significantly narrowed since there was implemented a two-tier tax scale with rates of 18% and 32% which is in force until now and in which the amount of PLN 85,528 was adopted as a criterion for differentiating their amount. Therefore, the introduced change contradicts the rule of shaping tax obligations in accordance with the taxpayer's ability-to-pay concept. It should be considered that the criterion for differentiating the amount of progressive tax rates was PLN 85,528. As it is indicated in the literature, it was taken over automatically from the previous three-tier scale in which it was used as the marginal threshold of the second income bracket (Pomorska, 2016: 62–63). It has, therefore, not been adapted to economic, social and demographic conditions and has been preceded by a macro- and micro-economic analysis in order to maximise the beneficial impact of this tax on the economic and social spheres (Wolański, 1999: 3). As a result, the scope of progression in personal income tax in Poland is too narrow. This is due to the fact that the same tax rate of 18% is imposed on both low income from minimum and average wages or pensions, and much higher income of over PLN 7,000 per month (Pomorska, 2016: 61–62). Moreover, the progression in personal income tax is only apparent as, in practice, it takes the form of proportional tax. This is proved by statistical data of the Ministry of Finance, according to which in the years 2009–2016, the tax rate was

⁶ In 2005, another fourth tax rate of 50% was implemented to burden income exceeding PLN 600,000 in the tax year. However, due to the lack of an appropriate period of *vacatio legis*, the Constitutional Tribunal considered its introduction inconsistent with the Constitution of the Republic of Poland.

lower, *id est* 18%, from 98.41% to 96.96% of the total taxpayers of this tax, and only from 1.59% to 3.04% of taxpayers who paid the tax at a higher tax rate.

In the light of the foregoing and the postulates resulting from the ability-to-pay principle, there is no doubt that the construction of tax progression in Poland needs to be urgently reviewed. It should aim to increase the number of tax thresholds, e.g. to four, to introduce corresponding tax rates (ranging from 10% to 32%) and to substantially rebuild the income capacity of its various ranges (Pomorska, 2016: 65). As it is emphasised in the literature, only a mild progression can combine the effective implementation of tax revenues with the taxpayer's ability to pay (Gomułowicz, 2013: 55).

5 Conclusion

To sum up, the aforesaid considerations on the tax-free amount and the tax progression as the construction elements of this tax that take into account the taxpayer's ability to pay, it should be noted that they implement this postulate to a rather limited extent. This is mainly due to the fact that the tax-free amount is not individualised. As indicated, over 80% of the taxpayers are entitled to the same amount and additionally it does not correspond to the value of the so-called minimum subsistence. Moreover, when determining the amount of the tax, the legislator did not consider such circumstances as the taxpayer's age, marital status or joint taxation of spouses (spouses who jointly tax their income are entitled to the same tax-free amount as those who account for this tax individually) that significantly diversify this ability. Similarly, the tax progression included in the construction of this tax is too narrow and, consequently, it does not protect the least prosperous taxpayers from excessive and inadequate taxation in relation to their ability to pay, hence it does not distribute the social tax burden in a fair way.

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