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TAX POLICY IN NEW EU MEMBERS: POLAND

LUCIA VERGANO AND FRANCESCA ZANTOMIO

Department of Public and Environmental Economics – University of Pavia, Italy

This paper is part of a wider research on Tax systems and Tax Policy in EU New Members, carried on at this Department, under the direction of L. Bernardi, M. Chandler and L. Gandullia, and the supervision of V. Tanzi.

JEL CLASSIFICATION: H20 – H24 – H25

KEYWORDS: Taxation, Tax Reforms, EU New members, Poland

TAX POLICY IN NEW EU MEMBERS: POLAND

by

Lucia Vergano and Francesca Zantomio[1]

Abstract

This paper is a part of a wider research program on taxation in EU New members, directed by L Bernardi, M. Chandler and L. Gandullia under the supervision of V. Tanzi. Poland is the biggest country among the incoming EU New members, and is considered as one of the most successful transition economies. The broad features of Polish tax system, as reformed in the early 1990's, are not very different from the corresponding EU models, even though with some distinctive peculiarities (mainly a set of generous allowances in personal and corporate income tax, reduced rates and exemptions for VAT). The main sources of revenue, whose level is well above some OECD countries but below the EU average, arise from employed labor, followed by consumption. Despite the efforts undertaken to start developing those tax system reforms needed to get closer to the EU, further interventions are still needed in order to meet EU requirements and contribute to the improvement in Poland's economic situation.

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Key words: Taxation, Tax Reforms, EU new members, Poland

E-mail Addresses: lucia.vergano@yahoo.com; francescazantomio@virgilio.it

Department of Public and Environmental Economics
University of Pavia - Italy
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[1] A preliminary version of this paper has been carefully revised by R. Morawczynski of Krakow University of Economics, to whom we express our warmest thanks. L. Vergano is responsible for paragraph 2, and for paragraph 3 as to the corporate income tax, the excise duties, the social security contributions and the other minor taxes. F. Zantomio is responsible for paragraph 4 and 5 and for paragraph 3 as to the personal income tax, the VAT, the agricultural property tax, the forestry property tax and the real estate property tax.

1. Introduction and executive summary

Poland, with its 312,685 Kmq and 38 millions six hundred thousands inhabitants, is the biggest economy among the EU New members. At the end of Second World War, Poland experienced a communist regime until its collapse in 1989-90, when it became a democratic country. In 1997, the National Assembly approved its actual parliamentary Constitution[2]. As other EU New members, Poland entered into NATO in 1999 and also will enter *de facto* into the EU in 2004, as it was established by the Nice Treaty (2001) and finally agreed during the Copenhagen Summit (2002) and signed in Athens (2003). Local currency is the zloty (the exchange rate in July 2003 was 1ZL = 0.2254 €).

During the 1990s, the Polish economy showed a GDP average growth rate (4.5 per cent) definitely above the EU average level (2.8 per cent); nevertheless recently the unemployment rate is growing (18 per cent in 2002). At the beginning of the 21st century, Poland experienced an economic slowdown: GDP growth fell to 1-1.4 per cent in years 2001-02. Recently, symptoms of recovery were observed: GDP growth for 2003 is expected to be 3.6 per cent and according to forecasts it will be even higher in 2004 (4.5-5.1 per cent). At the end of the 1990s, the general government deficit was between three and four per cent, but in the last few years has grown and is likely to widen in 2003.

Due to the main features of its tax system, during the 1990s Poland, unlike other transition economies, has not experienced any kind of fiscal crisis. Altogether, the Polish tax system is not very diversified and the level of aggregate taxation is more stable than that of most other transition economies.

In 1998, the level of total Polish fiscal revenue was about 38 per cent of GDP, an high value with respect to some OECD countries, but below the EU's average. As to direct taxes and social contributions, the revenue does not reach the EU average level: as a consequence, the Polish total fiscal pressure is close to the average of selected New members, but is about five per cent below the EU-15 average. Following the common trend of New members, indirect taxes play a larger role than in the EU as a share of total taxation and the opposite happens in the case of direct taxes (Mitra and Stern 2003).

The Polish budget system, traditionally very centralized, has been progressively decentralized starting from the reform of Local governments in 1991-93 and then of the public administration in 1998: even though the principal aim of this reform was to transfer

[2] In 1997 tax issues were regulated in the new constitution. In the same year, The Act on Rules for Taxation came into force: it regulates tax liabilities, tax information, tax proceedings, tax audits, fiscal confidentiality.

policy functions to the level of government where these policies could be implemented, the Local governments still maintain a little autonomous power in making tax policy decisions and strongly depend on Central government subsidies. Therefore, the process of delegating tax policies to regions has still to be completed, what will be even more needed due to the demands of EU aid funds systems.

At present, the broad features of Polish main taxes, as reformed in the early 1990's, are not very different from the corresponding EU models, even though they show some distinctive peculiarities. The basis of assessment of the income tax, collected by the Government and partially distributed to the local communities, includes all revenues from labor, capital, business, property, but there is a wide and generous set of allowed deductions and exemptions. The corporate income is taxed on the basis of the *classical system* but, to reduce the impact of double-taxation, dividends are taxed at only 15[3] per cent. The general VAT tax rate of 22 per cent and the two reduced rates for certain categories of goods and services, three and seven per cent, result from the reform proposed since 1999 by national authorities, in order to harmonize VAT with EU requirements in view of accession. Excise duties are charged on consumer products, referred to as "excisable products", with tax rates widely ranging from 25 to 1900 per cent. The major remaining State sources of revenue are the social security contributions, paid by the employers, the employees and the self-employed individuals and earmarked for large extra-budgetary social security funds. The picture is completed by the Agricultural Property Tax, the Forestry Property Tax, the Real Estate Property Tax and some other minor taxes.

As to the distribution of the fiscal burden, the main source of revenue arises from employed labor, followed by consumption. Implicit tax rates confirm for Poland that employed labor is the factor most heavily taxed, but we can notice that in the recent years there has been a process of gradual substitution in taxation, from labor to consumption, which has been also a saving inducing incentive. Looking at the structure of revenue according to economic function, peculiar features of Poland are the significant difference of taxes and contributions on employed labor from the EU average, being seven percentage points lower, and the higher share in total taxation of taxes on consumption.

Although Poland is actually seen as one of the most successful transition economies because of its efforts to start developing those structural reforms needed to get closer to the EU (Tanzi and Tsibouris 2000) like the stabilization of the economy, the reorganization of the

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[3] Since 2004 it will be 19 per cent.

public finances, the implementation of an effective monetary policy, liberalizations and privatizations, unemployment has risen and investment has fallen, as a result of the recent economic slowdown.

The general government deficit is likely to widen in 2003 (the official estimate is of 6.4 per cent): further structural expenditure reforms and a redefinition of budget priorities are necessary in order to make the public debt reaching the constitutional and Maastricht limit of 60 per cent. Entry into the EU could decrease artificially the deficit, due to the much more permissive methodology of public accounts' calculation used by the EU. The needed reforms of public finance expenditures are being prepared at the end of 2003. The main goal is to narrow the budget deficit.

The tax reform proposals launched in 1999 by the authorities have been only partially enacted in 2000. In particular, the proposed changes regarding the PIT, providing for a progressive reduction of the tax rates so as to create a tax regime inducing more job creation, have not been completely adopted: the current high tax rates and social security contributions involve a particularly high tax wedge that leads to high unemployment and to an oversized underground economy. Moreover, further measures need to be taken in order to reduce the amount of disability and sickness pensions and early-retirement pensions. A new tax reform is expected for year 2004: its main outcome will be the reduction of the CIT from 27 to 19 per cent, which could improve Polish enterprises' competitiveness and encourage FDIs inflow. Also entrepreneurs paying the PIT will be charged with only one rate equal to the CIT rate (19 per cent). In 2004, for the first time, incomes from the stock exchange will be taxed by 20 per cent tax.

Another recommended reform concerns the autonomy of tax policy for Local governments, which should be given the opportunity to manage their own tax base. This reform is needed due to the opportunity of profiting from the EU structural funds. To meet these requirements, a new Act for Local governments finance is being prepared for 2004.

A final relevant need is to unify different tax rates on capital incomes and, in order to get closer to EU requirements, to introduce charges on those product that are damaging for the environment, as coal, fertilizers, leaded gasoline.

Fifteen years of budget consolidation and tax reforms: an essential calendar

1988 Plans of tax reform

1989 Beginning of the transition, massive reforms

The same CIT obligation for state owned and private companies

1990 State budget regains its balance after 1988-1989 crisis

1991 Public finance split into the State and Local government parts

New budget crisis

1992 Introduction of PIT

1993 Turnover tax substituted by VAT and excise taxes

1997 New constitution (60 per cent public debt to GDP limit)

Act on Rules for Taxation

1998 Act on Public Finance

1999 New reform of Local governments system

2001 Beginning of new budget crisis, the budget is unbalanced until today

2002 Negotiations between Poland and EU are over. Final tax adjustments must be introduced until 2008

2004 Massive reforms of Local government finance, CIT (19per cent), PIT, VAT and excise duty, in order to adjust the system to the EU regulations.

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2. The structure of the system at the end of the 1990s and its development after the collapse of U.S.S.R.

2.1 A broad view at the current structure of taxes and social contributions

At the end of the 1990s, one of the main features of the Polish tax system was its capacity to generate a sizeable revenue on a continuous basis, so as to finance government spending and lower the budget deficit. Because of this reason, unlike other transition economies, Poland has not experienced any kind of fiscal crisis (OECD 2002).

In 1998, the level of total fiscal revenue was about 38 per cent of the GDP, which stands high, with respect to some OECD countries, but not with the EU average level (OECD 2001). This ratio of revenue to GDP is a legacy from the years of central planning, when the high public spending was in particular due to the generous public pension schemes[4].

[4] A new pension fund system was introduced in 1999: labor taxes have been substituted with contributions to individual pension accounts, which are a form of compulsory savings.

Table 1 Structure and development of fiscal revenue in Estonia, selected new members and EU average as % of GDP, 1992-1998

	1992			*1994*			*1996*			*1998*		
	Poland	*New Members*	*EU*	*Poland*	*New Members*	*EU*	*Poland*	*New Members*	*EU*	*Poland*	*New Members*	*EU*
Direct Taxes, of which	12.2	10.1	13.5	12.5	10.0	12.9	11.7	9.6	13.4	11.2	9.2	13.7
Personal income	7.6	6.4	9.6	9.2	7.0	9.3	8.7	7.1	9.3	8.3	6.7	9.3
Corporation income	4.6	3.6	2.3	3.2	2.9	2.4	2.9	2.5	2.7	2.9	2.5	3
Indirect taxes, of which	14.6	15.6	13.4	16.1	16.5	13.7	15.6	16.9	13.7	14.4	15.5	13.9
VAT	0.0	5.1	6.7	6.7	7.4	6.8	7.3	7.4	6.9	7.9	7.9	7.0
Excise duties	0.0	3.4	3.4	4.0	4.2	3.5	4.0	4.1	3.4	3.9	4.1	3.5
Others	14.6	9.3	3.3	5.4	5.0	3.4	4.2	4.9	3.4	2.7	3.6	3.5
TOTAL TAX REVENUE	26.8	25.7	26.9	28.6	26.4	26.6	27.3	26.5	27.1	25.6	24.7	27.6
Social contributions	11.3	16.1	14.5	12.0	15.7	14.9	12.4	14.3	15.3	12.2	14.2	15.0
Employers	4.1	10	8.1	4.3	9.0	7.9	4.4	8.0	8.3	4.4	7.9	8.2
Employees	4.2	5.3	4.8	4.4	5.1	5.2	4.6	4.8	5.1	4.5	4.8	5.0
Self employed	3.1	1.8	1.6	3.3	1.6	1.8	3.3	1.5	1.9	3.3	1.6	1.9
TOTAL FISCAL REVENUE	38.1	41.8	41.4	40.6	42.2	41.5	39.7	40.8	42.4	37.8	38.9	42.6
Administrative level												
Central government	24.1	25.9	22.8	25.6	25.8	22.4	23.8	25.4	22.4	22.3	23.9	22.9
Local government	2.8	3.0	3.0	3.0	3.5	3.2	3.5	3.4	4.0	3.4	3.7	4.0
Social Security	11.3	12.9	14.5	12.0	12.9	14.9	12.4	11.5	15.2	12.2	11.4	14.9

Sources: EU Commission (2000) for Poland and selected New members (unweighted average); Eurostat (2000) for EU-15 (1997 unweighted average).
Notes: Czech data start in 1993 and Social security is only health.

The general government revenue can be split into the chief three broad categories of direct taxes, indirect taxes and social security contributions, each of them respectively contributing to approximately 30, 40 and again 30 per cent of total revenue (Bartoszuk and Lenain 2000), but with a tendency of decreasing importance of direct taxes revenues (Central Statistical Office of Poland 2003).

Expressed as a ratio of GDP, direct taxes revenue (11 per cent of GDP) is instead below the EU average (14 per cent of the GDP): this is due to the low personal income tax revenue. Indirect taxes revenue amounts to 14[5] per cent of GDP (very close to the EU average): the VAT and excise duties revenues are substantially in line with that of the EU countries (Eurostat 2002). Also as to the social contributions, the revenue does not reach the EU average level (12[6] per cent instead of 15 per cent of GDP), but is quite high if compared to the average of the OECD countries: this feature is partially an other legacy from the communist system and is also shared by Hungary, Czech Republic and several other European Eastern countries.

The tax system is less diversified than in other countries: small taxes, such as property, inheritance or environmental fees, produce almost no revenue. Thus Poland has a somewhat narrow range of tax instruments.

2.2 The development of the system from the early to the late 1990s

The taxation reforms in Poland were connected with political, economic and cultural changes at the beginning of the transition period. The only common tax was a tax imposed on salaries (20 per cent), which was invisible for the workers, because it was paid directly by the employers. At the same time, as an acute budget deficit emerged in 1991-92 showed, the new tax system was necessary in order to keep the budget deficit under control. The old system wasn't able to cope with new demands and the tax authorities were highly inefficient in terms of tax collection. It is common to refer to the scope and speed of the reforms taking part in years 1991-93 as to "tax revolution" (Owsiak 2002).

The Polish tax system has been distinguished apart from that of most other transition economies because of its stable - instead of decreasing - revenue to GDP ratio: at the end of

[5] Source: Central Statistical Office of Poland, 2003.

[6] The system is highly subsidized from the central budget: another five per cent comes from the budget (Central Statistical Office of Poland 003).

1990s, the total fiscal revenue was almost the same as that of the beginning of the transition period in 1991.

Nevertheless, in the early years of the 1990s, the level of aggregate taxation experienced some fluctuations: from 37 per cent of GDP in 1991, it grew to 42 per cent in 1993, but then it went back again slightly below 40 per cent since 1995, reaching a minimum of 38.5 per cent in 2002. In the coming years, this ratio is expected to grow, in most part due to the inflow of EU structural funds aid. Moreover, there were some great structural shifts within the categories of indirect taxes (introduction of VAT and excise duties in 1993, abolishment of previous turn-over tax in 1994) and direct taxes (personal income tax revenue started in 1992 and corporate income tax lowered from 1992 onwards).

This structural changes resulted in the following developments:

1. the gradual reduction of the load, in terms of implicit tax rates, of taxes and social contributions levied on employed labor from nearly 16 per cent in 1991 to about 14 per cent in 1996;
2. the rise of the tax revenue from self-employed labor from about three per cent of GDP in 1991 to five per cent since 1993;
3. the fall of the revenue from Capital & Business (excluded self-employed labor) from nearly nine per cent of GDP in 1991 to about 4.5 per cent in 1995 and since: this was mostly due to a reduction in the legal rates of corporate tax;
4. an increasing amount of taxes on transfers, because state pensions became taxed like any other personal income;
5. the appreciable contribution of the taxation of energy from 1994 onwards.

2.3 The apportionment of revenues among Government layers

In 1991 the public finance system was split into two parts: Central and Local governments. Local governments took over most of the revenues from minor taxes and also participate to CIT and to PIT (after its introduction) revenues.

Poland has inherited from the past a very centralized budget system: still in 2001, the most part of revenue went to the State (19.1 per cent of GDP) and the social security administrations (16 per cent), but one third of the social security revenue goes through the

central budget as appropriated allocations, subsidies and additional founds[7]. Among non-central tax revenue, more than half is derived from individual income tax, of which the Central government transfers a share of 0.276 per cent to the municipality of residence of the tax payer; five per cent of the CIT is paid by the companies registered in the area where the enterprise is run (Denek et al. 2001). The remainder comes mostly from the real estate tax levied by non Central government and few minor taxes (EU Commission 2000a).

This kind of splitting has not much changed during the 1990s, but in 1998 the authorities introduced an important reform of the Polish public administration, beginning a process of gradual decentralization, in order to attribute to Local governments (*Gminas*, *Poviats* and *Voivodships*)[8] a growing role in expenditure decisions. Following the principle of subsidiarity, the reform has actually brought policy functions closer to the people, transferring them to the level of government where these policies can be implemented.

Nevertheless, Local governments maintain a little autonomous power in making tax policy decisions and a strong dependence on Central government subsidies (grants and transfers). These subsidies (special purposes subsidies, education subsidy, general purpose subsidy, compensation grants) are based on the size of the population living in each region: while helping Local governments to cover the expenditure they are responsible for, they do not succeed in closing the income gap between regions (EU Commission 2000b). Local governments have no power to change the level of main taxes (PIT, CIT, VAT, social taxes) and have limited possibilities to change the rate of few less important taxes.

Moreover, this contrasts with the principle of attributing more powers to localities to implement their policy decisions and their development strategy. The process of decentralizing tax policies to regions is still far from being completed. The new reform prepared for 2004 is aiming at increasing incomes of Local governments mainly through higher participation in PIT and CIT revenues: *Gminas* will get 41.4 per cent of their revenues from PIT, *Poviats* 10.6 per cent from PIT and *Voivodships* 18.4 per cent from CIT.

In 1991, Local governments took over 8.9 per cent of public finance revenues from taxes. In 1995, it was 11 per cent, and in 2000 13.2 per cent (Misiag W. *et all.* 2001). Their participation in revenues is rising and the tendency will continue after Polish accession into the EU.

[7] Calculated on the basis of data from the Central Statistical Office.

[8] *Powiats* are basic levels of the state administration, *Gmina* is a basic level of local government, whereas *Voivoidship* is a mixture of both at the middle level.

2.4 A comparative view with other main new members and the average of EU

It has been already showed that in 1998 the Polish total fiscal pressure (about 37.8 per cent of GDP) was close to the average of selected new members (38.9 per cent), but was about five per cent below the EU 15 average (42.6 per cent). This spread is firstly explained by the social contributions: the lower revenue from the social contributions levied on the employers (about half of that of the EU 15) is just partially compensated by the higher social contributions revenue levied on self employed people (EU Commission 2000a). The same could be said also with respect to the New members, but the average spread is less large.

Also the level of total taxes helps explain the difference between the Polish and the EU 15 tax system revenue: even if the system is more advanced with respect to the average of New members, it maintains a gap between direct and indirect taxes revenue still bigger than in EU 15 countries. This is due to the lower revenue from the personal income tax, only partially compensated by the higher revenue from VAT and excise duties. The common trend of New members is actually that indirect taxes as a share of total taxation play a larger role than in the EU and the opposite happens in the case of direct taxes.

2.5 Public finance deficit evolution in the transformation

One of the most important problem for Poland in the coming years is the growing budget deficit. In the period of so called “shock therapy” (1989-91), Poland underwent dramatic budgetary problems, which were even worsened in 1992 after the “Russian crisis” (export decline to the Eastern markets). The new budgetary law introduced at the beginning of 1991 allowed to lower the deficit, which in the best year reached two per cent, not being balanced even in the “golden years” when GDP growth was seven per cent. The most important weakness of the public finance system was the reform of pension system negligence. Neglected public finance reforms resulted in budgetary problems since the end of the 1990s; some costly reforms (pension system, health care system, educational system and new administrative division) worsened the situation. Structural reforms in the “old economy” (heavy industry, coal mining, iron companies) were postponed, due to their social and political costs (Misiag *et all*. 2002). The slowdown in the economy resulted in a lower increase in fiscal revenues, whereas most of the expenditures were “fixed”. At the same time, revenues from privatization started to fall. New reforms are even more needed due to the fact that Poland is facing in the coming years external demands.

In 1990, the public debt was estimated at 95 per cent, mostly as a consequence of the foreign debt inherited from the socialist period. The budget wasn't never balanced, but due to the faster GDP growth and the reduction of foreign debt (Paris and London Clubs) the government debt was reduced to 40 per cent in 2000.

3. Some quantitative and institutional features of main taxes[9]

3.1 Personal income tax (*podatek dochodowy od osób fizycznych*)

The personal income tax was introduced in the Polish tax system with the Tax Law of 26th July 1991 and came into force in 1992. The main beneficiary of the revenue is the Central government, even though the 27.6 per cent of the yield is then distributed to communities where taxpayers have their place of residence.

Personal income tax has to be paid by Polish citizens, who are taxable on their income from national sources and, in absence of bilateral taxation treaties, also from foreign sources, trough specific rules. It has also to be paid by foreigners staying in Poland for a period longer than half a year.

The unit of taxation is optional in that it can be chosen by the individual taxpayer: generally each individual is taxed separately but it is also possible to apply for a joint taxation system based on the average income of a married couple (half of their joint income), taxed with the same rates[10]. Dependent children income has then to be added to parents' income.

The basis of assessment includes all revenues from labor, capital, business, property and established incomes as scholarships, pensions and benefits.

In particular, the law lists, as income to be taxed, the following categories:

a) income from dependent services such as employment or pensions;
b) income from independent services like professional, intellectual, artistic or sports activities;
c) income from business;
d) income from specialized branches of agriculture;

[9] This paragraph owes much to EU Commission (2000) and IBDF (2002a).
[10] There are some typologies of income which cannot be subject to joint taxation between married couples: incomes from given loans, dividends on shares and other shares in net profits of corporations, incomes which are

e) rental income;
f) income from monetary investment and property rights;
g) income from the sale of real estate and of property rights;
h) other incomes like social security benefits, grant scholarships or others, not belonging to the other categories, unless they are exempt.

Losses can be carried forward at one third each, against the income of the next three years, even though prior losses cannot increase current ones. One peculiar feature of the Polish tax system is the wide and generous set of allowed deductions, even though recently reduced. First of all, for each category of income, expenses sustained to produce this income are deductible: in some cases, they are deductible as a fixed percentage of earned income (20 per cent for independent activities, 50 per cent for license fees for inventions or copyright royalties) while the same rules regarding corporate income have to be applied to business income.

Then, from the aggregate net income, it is possible to further deduce:

a) social security contributions (unless they have already been deducted as expenses in some category of income);
b) donations to advocate science, education, culture, religion, sports, ecology and charity, up to 10 or 15 per cent of income[11];
c) costs for training and continuing education, in connection with taxpayer's income[12];
d) cost of earning income, deducted automatically as a fixed percentage of 25 per cent, unless the real cost of earning income can be proved to be higher (so that the entire real cost will be deductible);
e) expenditures on annuities, donations to corporate bodies[13] which pursue socially worthy causes (with the upper limit of 15 or 10 per cent of income) and expenditures on rehabilitation;
f) interest on loans for housing purposes[14].

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paid to help police, organs of State protection and treasury control, incomes from undisclosed sources of revenues and from winnings in games and competitions.

[11] In 2004 changes are expected: the percentage limit will be liquidated and instead of it there will be the limit of 350 zloty.

[12] In 2004 it will be probably liquidated.

[13] In 2004 the number of such bodies will be reduced: entities will be expected to be officially recognized for their social role.

The Polish law provides also for a large number of exemptions, the most important of which are:

a) income from non-specialized agricultural activities;
b) income from forestry;
c) gains from selling agricultural or forestry land for agricultural or forestry use;
d) social welfare benefits and benefits paid by social funds in case of accident, long illness or death;
e) income from selling of a flat or building, when proceeds are used within two years for the purchase of another flat or building;
f) most fringe benefits.

Income from interests on bank accounts, if unconnected to business activities, and income from sale of compensation certificates and from interest and discount of government securities and local government bodies, have been taxed by 20 per cent since 2002.

Taxable income, net of income deductions, is then subject to a progressive schedule with three different brackets and three marginal tax rates: in 2002, 19 per cent from zero to 37,024 Zl (corresponding to about 9,600 €[15]) with a tax credit of 530.08 Zl (about 135 €), 30 per cent from 37,024 (about 9,600 €) to 74,048 Zl (about 19,200 €) and 40 per cent above 74,048 Zl (about 19,200 €)[16]. It's important to observe that, because of the narrow income distribution, the bulk of taxpayers falls into the first bracket: in 1999 94.9 per cent of PIT taxpayers were in the first bracket, 3.9 per cent in the second and 1.2 in the third; in 1992 it was respectively 96.1 per cent; 3.2 per cent and 0.7 per cent (Misiag W. *et all.* 2001). The present tax rates are lower than the previous ones (in fact in 1996, the three marginal rates were 21, 33 and 45 per cent) and, moreover, the purpose of the future aforementioned reform of PIT will be to reduce further the three rates, going towards a flat rate income tax.[17] It must be stressed, that at the moment farmers are excluded from PIT obligation, and pay Agricultural Property Tax, which is not connected with their real incomes. It creates next complications for health care system, revenues of rural *Gminas* (local governments) and social insurance system.

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[14] Not valid since 2002.

[15] The exchange rate used (2002) is 3.85742 Zl for one Euro; in 2003 it is 4.5 for one Euro, due to rapid depreciation. At the end of October it is even 4.7.

[16] Expressed in Polish currency, brackets are the same for 2003. Due to the depreciation of Zloty, in Euro it would be (1 Euro apx 4.5 zloty) 8,200 Euro, 16,500 Euro; tax credit 115 Euro.

[17] Due to the huge deficit, PIT reduction in few coming years is not to be expected, especially flat rate system is not probable. Nevertheless this issue is still discussed in the political dispute.

Finally, the law provides for particular regimes, based on the payment of lump-sum taxes, for particular categories of taxpayers, with the aim of simplifying their fiscal duties: they are the "tax card" and the "lump sum income tax" on registered revenues from small businesses.

With the tax card the taxpayer has to pay a lump sum tax that substitutes his personal income tax, so that he hasn't to prove with documents all his revenues and costs, to keep the register, to declare income received and to pay the monthly advance tax payments. This scheme is designed for people having small scale production, providing particular kinds of services and running production activities, retail trade in groceries, door to door sale of commodities, catering, transportation services, entertainment activities, home meal sale, veterinary services, free professional health services. The amount to be paid is a fixed amount, decided by the Tax Authority for each particular period[18]; then the tax rate can be increased or reduced according to the individual situation. Particular preferences are designed for people running their business in areas with high structural unemployment.

The lump sum income tax, based on turnover, is designed for people running own small businesses (small scale entrepreneurs with turnover below 250,000 € in the year before the current one) who don't meet the conditions to use the tax card. The taxpayer has to keep a simplified register of revenues and purchases and to hand in information about the amount of revenues in the first half of the year and after a year. People running some activities are excluded from this form of taxation: they are people running a pharmacy, legal services, exchange office, pawnshop or services in accountancy. The particular tax rate depends on the activity the taxpayer runs: three per cent on revenues from trade and catering, 5.5 per cent on revenues from manufacturing, construction and cargo transport and 8.5 per cent on revenues from services. Since 2002 there are two additional rates: 17 per cent for some services and 20 per cent for people running more sophisticated businesses (teachers, nurses, veterinary surgeons). In comparison to PIT, there are very limited possibilities for deductions – mainly sum paid as social contributions.

There is also special lump sum tax for clericals. The sum paid by them depends on the number of people living in the perish and the position of a clerical. In 2003 the minimum was 100 Zloty (approximately 23 €) and maximum 1100 Zloty (approximately 240 €).

[18] The tax authority decides every time, but in general the decision is based on the official tables. The amount is based on three aspects: number of employees, number of people living in the place, where the enterprise is run and on the kind of activity.

3.2 Corporate income tax *(Podatek dochodowy od osób prawnych)*

The uniform income tax for legal entities - the corporate income tax (CIT) - was introduced in 1989, instead of two existing separate profit taxes for legal entities in the public and private sectors of the economy (Bartoszuk and Lenain 2000). This tax was firstly reformed in the early 1990's (Tax Law 15 February 1992), in order to achieve the standards in force in the European Union countries. From 1989 to 1996, the CIT rate was 40 per cent, but in the following years it decreased: 38 per cent in 1997, 36 per cent in 1998, 34 per cent in 1999, 30 per cent in 2000, 28 per cent in 2001 and 27 per cent in 2003. A new reform of corporate income taxation was passed into law[19] and become effective in 2000: the main purposes were to lower the tax rate and to broaden the tax base at the same time. A new reform is being prepared for year 2004. The rate will be reduced from 27 to 19 per cent, but the number of deductions will be reduced as well.

All legal entities (joint-stock companies, limited liability companies, state enterprises and cooperatives) incorporated in Poland are subject to corporate income tax on their total incomes, including income from abroad *(unlimited tax obligation)*. All legal entities incorporated abroad (with head office or managing board situated abroad) are instead subject to tax only on income gained on Polish territory *(limited tax obligation)*. Partnerships are not treated as companies[20] and some institutions without legal personality - schools, educational associations, health service bodies - are not treated as corporations. The exemption from tax is provided for a list of institutions: State Treasury, National Bank of Poland, budgetary economic units, purposeful funds, international holdings, communities and units of communities. The number of bodies exempted from CIT will be limited since 2005.

The CIT is based on the *classical system*, i.e. corporate income is fully taxed and distributed profits (dividends) are taxed once again by way of withholding: to reduce the impact of double-taxation, however, under the personal income tax dividends are taxed at only the 15 per cent, but the tax rate will be increased in 2004 to 19 per cent. The tax may be credited against the receiving company's tax debt. Dividends may be distributed only from after-tax profits.

The tax basis is the world-wide income of the resident corporate entities, including the capital gains from the sale of business assets, after the deduction of the expenses sustained to obtain such income.

[19] In accordance with the 1997 Constitution of the Republic of Poland, taxes and other public contributions cannot be levied unless the appropriate statutory law has been passed.
[20] Partners are subject to individual taxation on their share of income.

The incomes exempt from the corporate income tax are the following:

a) income from non-specialized agricultural activities and from forestry;
b) gains from the sale of agricultural and forestry land that remains used as such;
c) indemnities received;
d) income from foreign sources as far as provided in an international agreement;
e) income allocated and transferred to legal entities for charitable purposes and for the furthering of science, education, health, culture, sports, infrastructure development and environmental protection.

Exemptions are also granted in 17 Special Economic Zones (SEZs): economic entities operating in SEZs are eligible for tax allowances, preferential treatment and other benefits (Easson 1998). Income of entities whose investments exceed a certain threshold, characteristic of each zone, or investors, which create a certain number of jobs, are totally exempted from CIT, through a period equal to half of the period for which the zone has been established. After that time, the exemption of taxation is granted just up to 50 per cent of the income. Preferential treatment and other benefits are granted to entities not eligible for tax exemption. As a consequence of the tax reform enacted in 2000 no new tax exemptions will be granted in SEZs starting in January 2000. This issue was a subject of hard negotiations between Poland and the EU for a long time: eventually, after Poland's entry into the EU, no preferences for companies starting their activity in the zones will be allowed.

After the last reform of the capital income tax, the number of depreciation rates has been reduced to 10 and investment incentives (previously offered in the form of investment allowances to encourage investments in certain sectors of activity) have been eliminated in order to broaden the income tax base.

The 2003 corporate income tax rate is 27 per cent, but according to the reform being prepared now, from 2004 will decrease to 19 per cent[21]. According to new proposition, the same flat rate will be offered for enterprises taxed now under personal income regime, but the number and scope of deductions available for such firms will be sharply limited.

[21] In the previous years, the CIT rates has been the following: 34 per cent in 1999; 30 per cent in 2000; 28 per cent in 2001 and 2002.

Table 2. Tax items in Poland by starting years

Tax items	*Starting years*	*Revenues in 2000*	*Apportionment of the revenues*	
			State	*Local governments*
		mn zl	%	
Legacy and donation tax	1983	162,7	0	100
Agricultural property tax	1984	720,8	0	100
Personal income tax	1991	32099,9	69,9	30,1
Real estate property tax	1991	6644,1	0	100
Forest property tax	1991	96,4	0	100
Transport Vehicles Tax	1991	386,8	0	100
Corporation income tax	1992	17852,8	94,5	5,5
Value added tax	1992	51749,8	100	0
Excise duty tax	1993	27312,0	100	0
Tax card income tax	1993	315,0	0	100

Source: Misiag W. 2002, p. 24

3.3 Value Added Tax (*Podatek od Towarow I Uslug)*

The Value Added Tax was introduced in the Polish tax system in 1993 after five years' preparations[22]. In 1993 the turnover tax, with more than 100 rates, was removed. Previously the rates of turnover taxes varied, depending on the kind of the purchased good (Owsiak, 2002). The only beneficiary of the revenues is the Central government. The tax is payable by natural persons, legal persons and organizational units (and, with agreement of the Treasury office, also branches of them) that sell or import taxable goods and services in Poland and that have an annual turnover which exceeds 10,000 € (if they don't reach this sum, they are not obligated to register for VAT). But once they decide to be a VAT payer, the decision couldn't be changed for a period of three years.

The basis of assessment is the compensation received for goods supplied and services rendered, less the VAT; for imported goods, the tax base includes excise duties and custom fees too. The tax is levied at each stage of the production and distribution process; accordingly to a tax-to-tax scheme, the input tax on purchases is deductible from the output tax.

Besides, are also subject to VAT:

a) the donation of commodities and providing of services for needs of advertisement;

[22] Actually the preparation started in 1988; one of the most important obstacle was fear of inflation.

b) the donation of commodities and providing of services for personal needs of taxpayer, partners, shareholders, member of supervisory board and managing board, members of association, employed and former workers;
c) the exchange of commodities and services;
d) the donation of commodities;
e) the providing of services without payment;
f) the providing of commodities or provision of services in return for debts;
g) the provision of services or providing of commodities instead of payment.

On the contrary, the exemptions from VAT includes

a) unprocessed agricultural products, unprocessed foodstuffs;
b) financial, insurance, educational, health, art, cultural and social services, communal services;
c) apartment rental;
d) the sale of the whole or part of a company;
e) activity in random-games;
f) illegal activity.

People paying income tax in tax card form were exempt from VAT until the end of the 1990s, but this is not a rule anymore. Moreover, VAT doesn't apply to some sales in duty free zones and also agricultural production is not subject to VAT. Currently, the general tax rate is 22 per cent, while there are two reduced rates, three per cent (milk and dairy products, raw meat, poultry, fish and some of their products and folk and artistic handicraft products) and seven per cent (most processed foodstuffs, most construction raw materials, some construction works, long distance passenger transport, medicines and pharmaceuticals, articles for children) for certain categories of goods and services. To exports, books, magazines, basic agricultural inputs, applies a zero per cent rate.

Since 1999, national authorities proposed tax reforms also aiming at harmonizing VAT with EU requirements of the Sixth Council Directive, in view of accession, and some changes, accepted by the Parliament, became effective since 2000. Looking at Poland, the standard rate of 22 per cent and the reduced rate of seven per cent are well above EU requirements; moreover, the tax reform enacted in 2000 decrees that also municipal services have to be taxed with a seven per cent rate, and that construction materials and services have to be taxed with an increasing tax rate, set to 22 per cent since 2003, while for other goods or services (articles for children, new residential constructions, legal services, newspapers) there

will be transition periods towards EU requirements for social and political reasons. In 1993 there were three rates: standard 22 per cent, reduced seven per cent and zero per cent. In 2000 three per cent rate was introduced for agricultural goods. For a period of time (1999) there were new "transitional rates" of two per cent, four per cent and 12 per cent; more and more goods were shifted from zero per cent to higher rates. In the future only export will be charged with zero per cent. The new Act on VAT is being prepared for 2004 in order to adjust the law to the EU requirements: the most important changes will relate to demands of intra-Community trade regulations. In particular, they will relate to territorial scope, categories of taxpayers, definition of the concept of tax duties. According to the draft law, the VAT rates' structure will not change much.

3.4 Excise duties *(Podatek akcyzowy*)

The excise tax was introduced in 1993, with the Value Added Tax and excise duty Act. The taxpayers are manufacturers and importers; the duty is to be paid before introducing a commodity into the market (Bartoszuk and Lenain 2000). The excise tax applies to the sale and exchange of excisable goods, as well as to importations or donations; it is not levied on exports. Excise duties do not apply to some sales in duty-free zones.

If there is turnover of goods by manufacturers, the tax basis is the value of commodity increased by duty. For other goods, the tax basis is the quantity or the sales price diminished by the VAT due.

Excise duty is charged on consumer products, referred to as "excisable products", including: alcoholic beverages, tobacco, fuel, passenger cars, luxury electronic equipment, gambling, salt, plastic packaging, furs, cosmetics, luxury boats, sailboats. The most revenues for central budget comes from fuel, alcohol beverages and tobacco excise taxes.

In 2002, the tax rates ranged from 25 per cent to 1,900 per cent. At the moment, there are goods in which the share of excise duty reaches 90 per cent (Ziolkowska 2002)[23]. According to the Polish Ministry of Finance, until 2003 the adjustment of the excise duty tax to the EU requirements are almost completed. However, the most important adjustments are still to be

[23] In general, the scope of goods charged with excise duty tax is much wider in comparison to that one of other accession or EU member countries. Thus, the number of goods charged with excise tax will be decreased soon in order to adjust to EU regulation and to prepare for competition with neighboring countries (especially for alcohol beverages). On the other hand, excise tax on cigarettes will be increased in a stepwise manner until 2008 (Ziolkowska 2002).

made for tobacco products, for which the excise duty tax will be substantially increased until 2008.

3.5 Social security contributions *(Skladki na ubezpieczenia spoleczne)*

The contributions to the Social Insurance Office *(Zaklad Ubezpieczen Spolecznych - ZUS)* are paid by the employer (18.4 per cent of gross wage), the employee (18.7 per cent of gross wage) and the self-employed individuals, who must pay both the employer and the employee contributions (Bartoszuk and Lenain 2000). These contributions finance the first and the second pillars[24] of the old-age pension system, the disability pension regime and other social benefits. While most direct and indirect taxes are collected by the State to finance the general budget, the social security contributions are earmarked for large extra-budgetary social security funds (Social Insurance Fund, Health Fund, Pension Funds). They are split into different accounts: old-age pension (19.52 per cent), disability pension (13 per cent), health and maternity insurance (2.45 per cent) and work injury insurance (per cent rates of wage differentiated, depending on the branch). The exemptions are limited to a few professions and activities.

The basis of the contributions is individual income as defined for income tax purposes, except for farmers, judges and prosecutors. For self-employed persons there is a maximum base of assessment for pension and disability insurance which amounts to 30 average salaries as projected for the respective year: with respect to health, maternity and injury insurance there is no such maximum.

Obligatory premiums are also due to the Labor Fund (2.45 per cent of the payroll expenditures) to finance unemployment benefits and active labor market.

A contribution equivalent to 7.5 per cent of taxable income was introduced in 1999, as part of the health insurance reform, to provide financial resources to the newly created health funds. Employers and other providers of income must withhold insurance premiums and pay them directly to *ZUS* on a monthly basis: *ZUS* then channels these premiums to the National Health Fund[25]. Most income sources (salaries, self-employed income, farmers' income,

[24] The pension insurance is a "three pillar system". Pillar I: obligatory public system financed through the Social Security Fund (ZUS); Pillar II: obligatory private pillar based on private pension funds; Pillar III: all voluntary private pension plans, life insurance, etc.. Persons born before 1949 are obliged to stay at Pillar I only. Persons born after 1969 should participate in Pillar I and II, while Pillar III is voluntary for them. Persons born between 1949 and 1969 had the opportunity to choose one of the two systems presented above: since it is already made, there is no possibility for them to change it (Denek *et all*., 2001).

[25] Since sickness Funds were liquidated, there is only one centralized institution: the National Health Fund.

pensions and other social benefits) are subject to the health insurance premium, while income from financial sources (interest, dividends and capital gains) is not. The health insurance premium is entirely deductible from personal income tax liability.

Finally, employers must also pay contributions, treated as business costs, to the Wage Guarantee Fund, in order to satisfy the claims of the employees in the case of bankruptcy proceedings against an insolvent employer, a business closing down or when an employer factually ceases the business and doesn't have the financial resources to pay off the wages due to his employees.

There is a special system of social insurance for farmers, called *KRUS* (Agriculture Social Insurance Fund). Farmers pay much lower amount and the fund is highly subsidized by the State (more than three billion € per year). The system is abused by people running other businesses, who keep small farms in the agricultural areas and avoid paying much higher standard social taxes from other economic activities.

3.6 Agricultural Property Tax (*Podatek ronly)*

This tax obligation was imposed with the Act of 15th November 1984 as a property tax: currently, Local governments derive benefit from the relative revenues. Taxpayers are the owners of agricultural property (who are in possession of a farmland) apart from the fact of carrying out farming and gaining income from it.

The basis of assessment is the area of the farm in conversion hectares, that is a conventional unit whose conversion rate is based on three objective criterions (land location, kind of land, soil quality).

The law provides for a number of exemptions from this tax: for example, land used for activities different from agriculture, land of historical interest, wasteland, land with drainage systems, land along the border line, land under lakes, running water, dams and water containers, arable land where the production has been ceased for three years (up to 20 per cent of total farm land). Some specific tax exemptions are allowed; finally the tax rate is constant and depends on the purchase price of rye: the tax corresponding to a single conversion hectare is equivalent to the gains from 2.5 quintals of rye.

3.7 Forest Property Tax (*Podatek lesny)*

This tax was introduced in 1991, with the Taw Law of 28th September: again, the beneficiary is the Local government. This tax is very similar to Agriculture Property Tax: the taxpayer is the owner of the property, and the basis of assessment is the number of conversion hectares of the owned forest even though in this case the conversion rate depends on the tree main species in the strand and on the classification of the strand for each species, as they result from the plan of arranging the forest on 1st January, every year.

The tax on a single conversion hectare is equivalent to the proceeds from the sale 0.2 m^3 of coniferous sawmill timber (the price used is that for the timber acquired by forest superintendence).

3.8 Real Estate Property Tax (*Podatek od nieruchomosci)*

This subject is regulated by the Law of 12th January 1999; again, beneficiaries of the revenues are the Local governments. The tax is due by natural persons, legal persons and other units that own property or building structures not connected with land, that own or manage real estate or building structures that are National Treasury's or Communes' property, that are perpetual lessee of property.

The basis of assessment is the area covered, in square meters, of buildings or part of them, structures for economic activity (left out agriculture and forestry) and land not subject to agriculture or forestry tax and used for activities different from agriculture or forestry.

The law provides for numerous kinds of exemptions: for example, property used for public purposes, property in Special Economic Zones, property of foreign states or International organizations, real estate exempted on the basis of separate legislation; the local Council has then the power to introduce further exemptions. Minimum and maximum rates are defined by decree of the Ministry of Finance every year and, within this boundaries, Local government councils determine the yearly rate.

3.9 Other minor taxes

To the Central government are also due the customs duties and the gambling tax: differently from the VAT revenues coming from gambling, the tax rate and the basis of assessment vary according to the kind of game.

Among taxes paid to the Local government, natural persons gaining a donation or a legacy situated on Polish territory at no cost (inheritance or donation) are subject to inheritance and gift taxes: the basis of assessment is the net market value of all property received by the beneficiary (Bartoszuk, L. and Lenain, P. 2000). Natural and legal persons that are owner of a motor vehicle must also pay a tax on means of transportation dependent on the kind of motor vehicle[26]. Finally, the fiscal charge payable on transactions is collected by the central government, but it constitutes a source of income for the Local government.

4. The fiscal burden

4.1 The distribution of tax charge: taxation by economic function and implicit tax rates[27]

Generally speaking, the classification of revenues according to economic functions clearly shows how any factor contributes to the total amount of revenue: each value is given by the ratio of the total tax revenue attributed to that factor to a measure of total tax revenue or to GDP. By looking at Poland, we can see that the main source of revenues arises from employed labor, that contributed as to 14 per cent of GDP in 1998 (of which 4.7 was paid by employers and the 9.3 was paid by the employees). This is not at all uncommon, while an unusual high value characterizes consumption, that contributed as to 13 per cent of GPD. Revenues from self employed labor amounted to a comparatively high 5.1 per cent of GDP, while revenues from capital and business, whose main component come from profits (2.9 per cent) and real estate (1.1 per cent), amounted just to 4.2 per cent of GPD.

By looking at the same categories, but related to total revenue, and not to GDP as above, we can see that taxes and contributions on employed labor were the 37.1 per cent of total revenue, while taxes on consumption gave the 34 per cent of total revenue; taxes and contributions on self-employed and non employed labor covered the 13.4 per cent of total

[26] Among the more interesting taxes there is a tax charged on the owners of dogs, equal to 37zl (8 €) per year (Denek et al, 2001).

[27] This paragraph is mainly due to EU Commission (2000).

Table 3 Structure and development of taxation by function and by implicit rates in Poland, new members and EU 15, 1992-98

	1992			*1994*			*1996*			*1998*		
	Poland	*New members*	*EU*	*Poland*	*New members*	*EU*	*Poland*	*New members*	*EU*	*Poland*	*New members*	*EU*
Economic function %of GDP												
Consumption	11.5	13.6	10.9	14.4	14.5	11.2	14.1	14.7	11.3	13.0	13.5	11.4
Labor Employed	14.7	19.7	20.6	14.7	19.4	20.7	14.3	19.0	21.4	14.0	17.9	21.2
Labor self-employed	4.7	2.9	2..4	5.2	2.8	2.4	5.2	2.6	2.4	5.1	2.6	2.3
Capital & Business	5.9	4.3	7.2	4.6	5.0	6.8	4.4	4.3	7.1	4.2	4.5	7.5
Implicit tax rates												
Consumption	13,8	16.3	16.2	17.9	17.4	16.5	17.6	17.8	16.7	16.3	16.6	16.8
Labor employed	31.2	37.1	39.0	35.2	38.3	40.2	33.0	37.4	42.0	32.2	38.0	41.9
Capital & Business	-	-	32.2	-	-	30.3	-	-	30.5	-	-	31.1

Sources: EU Commission (2000) for Poland and New members (unweighted average); Eurostat (2000) for EU 15 (1997 unweighted average).

Estonia's 1992 implicit rates and all Czech rates refer to 1993. Implicit rates for Capital & Business are not available for all New members except Estonia.

revenue and, in the end, taxes on capital and business covered the 11.4 per cent of total revenue. Finally, if we consider that in Poland state pensions are taxed as personal income, we may notice that taxes on social transfers amounted to 1.6 per cent of GDP at the end of the 1990s.

By going now to the dynamic of revenue according to economic function, from the beginning to the end of the 1990s, we can observe that taxation of consumption went up from 9.7 of GDP in 1991 to about 14 per cent in 1993 and has been almost constant since then. Alongside an opposite trend, the load of taxes and social contributions attributed to employed labor has been slightly reduced from 15.6 per cent of GDP in 1991 to 14 per cent of GDP in 1998. Tax revenue from self employed labor shows an increase from 3.2 per cent of GDP in 1991 to 5.3 per cent in 1993 and has remained constant since then; finally, revenue from capital and business (with the exclusion of self employed labor) shows a gradual but noticeable decrease from 8.6 per cent of GDP in 1991 to 4.2 per cent in 1998, due to the reduction in legal tax rates of corporate income tax.

The implicit tax rate on an economic factor is the ratio of the total tax revenue attributed to that factor to the total income or cost of that factor, expressed as percentage. Thus, for instance, the implicit tax rate for employed labor is given by the ratio of paid taxes and social contributions on employed labor to the compensations of employees; and so on for capital and final consumption[28]. These tax rates shows the relative weight of fiscal burden which hints every factor, irrespective of the amount of the tax base considered.

The implicit tax rates for Poland confirms that employed labor is the most heavily taxed, at an implicit tax rate that was 32.2 per cent in 1998, even though the dynamic of this rate shows a progressive decline from the early (37.3 per cent in 1991) to the late 1990s. The implicit tax rate for consumption was 16.3 per cent in 1998 and its dynamic in the 1990s shows a progressive increase from a value of 11.9 per cent in 1991 to one of approximately 18 in 1995, followed by a very weak decrease during the subsequent years. Thus it is possible to plainly observe a process of gradual substitution in taxation mix, from labor to consumption, that may also be an inducing saving incentive.

[28] Because of the unavailability of data, it is impossible, at present, to calculate implicit tax rates for capital and business.

4.2 Other indicators of fiscal burden

4.2.1 Labor tax wedge

Poland presents a particularly high labor tax wedge that contributes, together with a rigid labor market, to a low employment rate and an oversized underground economy. The joint impact of social security contributions and personal income taxes creates a large gap between labor costs and workers disposable income. The gross average tax rate reached 42 per cent of the labor cost for the average productive worker in 1999, while the marginal tax rate was 45 per cent (Lenain and Bartoszuk 2000).

This is surely due to the generous pension schemes that characterize Polish public spending[29]: on the one hand this is very important for the social cohesion of the country but on the other hand, considering that Poland spends more on pensions than on education, research and development and public investments, it has become necessary to change this tradition. A new pension fund system was established in 1999: however, the reduction of the large labor tax wedge remains an important objective for Poland.

4.2.2 Gini coefficient

Historically egalitarian countries, as the New members were, have traditionally stood out for the lowest values of the Gini coefficient, approximately 0.2, while the same coefficient reaches a higher value in less egalitarian countries, where powerful elites dominate the economy; in the USA the value of the Gini coefficient has been approximately 0.4 in the 1990s (and it is still rising), while in most European countries it gets around 0.3.

Generally, it is expected for a transition economy to experience a sizable increase in the Gini coefficient, during the transition period: this is due to the pre-tax distribution of income, that becomes more unequal because of the shift to market economy. Transition, and the shift to a market economy, is believed to cause a change in the distribution of income because of the privatization of public assets (that is responsible for changes in ownership, wages and occupational choices); the development of new markets in privately-provided substitutes to public services (as telephones, schools, health-care); and changes in the returns associated with different skills that is responsible, with a more flexible labor market, for an increase in

[29] Polish population age distribution, quite similar to that of the others New members, is characterized by a small share of people in retirement age: the dependence ratio, quite reassuring, is about 0.18 (calculated accordingly to Eurostat data for 2000 about population structure): it means there are about 5.4 men in working age to provide for any old man.

earnings inequality. Actually, transition economies reported some of the largest increases (around ten percentage points) in Gini coefficients between the early 1980s and the early 1990s.

Then, if conventional wisdom suggests that the pattern of sharply rising inequality has been nearly universal for transition economies, Poland's experience is in a striking contrast with this pattern: Poland's transition started with the "big bang reform" of August 1989-January 1990 and, since then, Poland is one of the few transition economies that has experienced substantial growth with real GPD, which stayed 28 per cent higher in 1999 than in 1989, when the transition began.

However, household level data (Polish Household Survey, Ministry of Finance) show that since then income inequality fell slightly below pre-transition level (that was approximately 0.25) during 1990-92, when Gini coefficient registered a value of approximately 0.23. Since this time, inequality started increasing only gradually, rising just slightly above pre-transition levels by 1997, when it reached about 0.275.

Poland experienced, as other transition economies, a relevant increase in labor earnings inequality: the returns to education increased and, in particular for workers with college and high school degrees, wage premiums nearly doubled from 1989 to 1996. It has also been noticed (Sibley and Walsh 2002) that earnings inequality is higher in regions that are more advanced in restructuring (higher labor productivity/job reallocation rates): there's a positive relationship, at the regional level, between earnings inequality and the stage of transition, while at the national level rapid growth does not seem to be associated with earnings inequality.

4.3 A comparative view with other new members and EU 15 countries

When compared to the EU average, the structure of revenue according to economic function of Poland, shows some remarkable differences, as we can see from Table 2. First of all, taxes on consumption have an higher share in total taxation than in the EU, and also with respect to New members' average. Secondly, taxes and contributions on employed labor differ significantly from the EU average, being seven percentage points lower. This is a peculiar feature of Poland, and not a general characteristic of New members. Their value for taxes and contributions on employed labor stays at an intermediate level between Poland and the EU average. As to taxes and contributions on self-employed labor, we can distinctly observe that the value for Poland is approximately three percentage points higher than the EU

average and, again, this is a peculiar feature of Poland's tax system: contrary, the value for the new members on average is quite similar to that of EU countries. Finally, taxation on capital and business in Poland is close to the average of the other New members: their value is three percentage points lower than the EU one.

Implicit tax rate on consumption is quite similar in Poland, in the New members and in the EU, even if in Poland it is a bit lower and it was much lower at the beginning of the 1990s (13.8 per cent in Poland, 16.3 per cent in the New members and 16.2 in the EU in 1992). A more relevant difference is observable for employed labor: Polish implicit tax rate is approximately ten percentage points lower than the EU one.

5. Tax reforms and further steps to get closer to the EU

5.1 Macroeconomic and budget outlook

Poland is actually one of the most successful transition economies: during the 1990s, it did relevant efforts to stabilize the economy, to improve the public finances, to run an effective monetary policy, to liberalize and privatize, and to start developing those structural reforms needed to get closer to the European Union (EU Commission 2000b).

During the all decade, as inflation gradually fallen, the output has grown at strong rates of six-seven per cent yearly, mostly as a consequence of the dynamism of the private sector, except than at the end of 1990s, when in 1998 the economy decelerated sharply in the wake of the Russian crisis. The objectives to be reached during the next decade are envisaged in stable growth, inflation under control, adequate finance for the large current account deficit and, finally, strong efforts to consolidate public finances and implement structural reforms for improving public spending quality and reducing the excessive tax burden. In 2000 the general government deficit reached 3.5 per cent of GDP (Eurostat 2002), primarily owing to deficits in social security funds, state enterprises arrears on their social contributions and increased borrowing of local governments.

The first two years of the current decade have been not easy, because of cyclical weakness of the Polish economy and, as a result of the economic slowdown, unemployment has risen and investment has fallen. At present, Poland has entered 2003 with the beginning of a recovery supported by the growth of private consumption and exports (partly because of the effective depreciation of zloty). Growth is expected to be about 3.6 per cent in 2003, while,

for the following years, due to the present large output gap, a strong recovery is forecast (five-5.5 per cent fort the middle of the decade). Price stability has been reached: inflation is expected to be below two per cent at the end of 2003 (Ministry of Finance of Poland).

High unemployment along with the rising budget deficit are the two most important problems of Polish economy while entering the EU. The general government deficit has widened in 2003 (the official estimate is of 6.4 per cent) chiefly due to the deficits of agricultural agencies and social security funds, and public debt raised to about 52 per cent of GDP. Thus the strong need for further structural expenditure reforms is pressing to scale down budget deficit to the Maastricht limit of three per cent, to avoid the chance that the public debt reaches the (also constitutional) level of 60 per cent, and, finally to rearrange budget priorities (partly in view of co-financing EU-financed projects)[30] and to face a need to pay higher rates of foreign debt.

At the end of 2003 the government announced a new strategy of government debt stabilization: the main part of it is a rationalization of social expenditures and a reduction of state administration expenditures. According to many observers it will be extremely hard to reach these goals, also because of elections coming in 2005: there is a danger that inability to fulfill the Maastricht criteria would postpone Polish accession to the EMU. As for now the most probable date is 2009-10.

In the same time Poland will have to cover the EU contributions and payments. Due to the relative centralization of the public finance, the government has to transfer important resources to the regions in order to make available their participation in the EU structural founds. Polish accession to the EU is going to bring changes in the structure of public finance: according to forecast for years 2004-06, the EU will be net payer to Poland. Poland will gain resources from many EU founds and from the special budgetary compensation negotiated on the Copenhagen Summit at the end of 2002; substantial support will be directed to the agriculture and industry, also without state budget intermediation. According to the forecast

[30] It is to be noticed that there is a huge difference in the calculation of the public finance deficit while using Polish and ESA'95 methodologies. According to ESA'95 methodology the Agricultural Market Agency and research development units don't belong to the government sector. The second important difference is the second pillar of pension system (*OFE)*, which according to ESA'95 belongs to the public system. At the moment according to the Polish methodology *OFE* represents private sector and government has to transfer almost 12 billion zloty (three billion €). Furthermore ESA system is based on the accrual basis, whereas Polish methodology uses cash basis, which results in different attitude to several operations. For example, ESA system doesn't include projected payments (Pre-accession economic programme (2003), Ministry of Finance, Warsaw). As the result according to the ESA'95 Polish public debt is much lower. According to Polish methodology the public debt was amounted to 47.2 per cent in 2002; 51.5 per cent in 2003 and is forecast to 54.8 per cent in 2004 and will almost reach the constitutional limit of 60 per cent in 2005. Using ESA methodology it will be respectively 41.6 per cent in 2002, 44.8 per cent in 2003 and 51.4 per cent in 2005.

of the Ministry of Finance, in 2004 Poland will get appropriation of payments of 2.5 billion €, paying at the same time 1.3 billion € as a contribution: the net effect would be surplus of 1.2 billion €. In years 2005-06 the surplus is forecast to be 2.1 and 3.6 billion €, but most of the resources will omit the central budget and will go directly to the regions, agriculture and industry. The public sector revenues/GDP ratio is expected to grow in years 2004-06; this fact is mostly attributable to the growing value of aid funds coming from the EU. After gradual decline from 41.9 per cent in 1995 to 38.5 per cent in 2002, total fiscal pressure is expected to grow to 41 per cent in 2006 (Pre-accession Economic Programme, 2003).

5.2 Last years' and planned tax reforms

Tax reforms have been remarkable during last years in Poland, because the authorities are trying to better continue in replacing the old communist tax system, rested on transfers from state owned enterprises, with a new system suitable for a market economy: thus, in 1999 the authorities formulated tax reform proposals, partially enacted in 2000, designed to lower direct taxation and tax rates, to reduce tax allowances, to broaden the tax bases and to simplify the tax code.

While the proposed changes to CIT and VAT were adopted, those regarding PIT were vetoed by the President; with regard to CIT, the aim was to lower the tax rate (from 34 per cent in 1999 to 22 per cent in 2004) and at the same time to broaden the tax base, removing tax deductions for companies with high investment; with regard to VAT, the aim was the harmonization with EU requirements (EU Sixth Council Directive) in view of future accession, introducing VAT rates for products so far untaxed (services, starting in 2002, and agricultural products, starting in July 2002)[31]. In 2003 the CIT rate was 27 per cent; in the end of this year new reform is being prepared. According to the act being prepared CIT will be decreased to 19 per cent from 2004 but almost all deductions and allowances will be removed. The same flat rate will be available for entrepreneurs paying taxes under the PIT regime. The main purpose of this reform is to improve competitiveness of Polish enterprises and to encourage FDI flow to Poland; in the nearest future it is planned to raise the tax rate on dividends from 15 per cent to 19 per cent.

New Polish VAT law is being prepared in order to harmonize completely Polish regulation with the EU standards. Among new regulations the most important are those adjusting Polish law to the intra-Community trade. These regulations are directly involved

with abolishment of customs borders and they relate to the territorial scope, categories of taxpayers, definitions of the concept of tax duty and tax eligibility in transactions between EU-member states, specifying the persons obliged to pay VAT in intra-Community transactions. According to the plans the standard rate will stay unchanged (22 per cent) and the reduced as well (seven per cent). Until 2008 new rate of three per cent for unprocessed agricultural products should be maintained. The same rate should be applicable for delivery of goods and services for agricultural production (except from machinery). Until 2007 the rate of seven per cent will be applicable on provision on construction, renovation and repair services. In the same time certain books and magazines will be provisionally charged with 0 per cent. It is probable that after entering the EU the standard rate will be lowered and the reduced one increased.

The planned reform for PIT, was not enacted, and a progressive reduction of the tax rates from the current three brackets (19, 30, 40 per cent) to only two brackets of 18 and 28 per cent in 2002 is abandoned. This plan wasn't enacted until 2003, and according to new act being prepared at the end of 2003, 19-30-40 per cent brackets will be unchanged in coming years. Most of the deductions and allowances will be systematically removed from the system, so that the tax base will be enlarged. But at the same time plans for the PIT rates' decrease are present in the political debate. Furthermore, some significant changes has been introduced (IBDF 2002b): under the amendments to the Individual Income Tax Law, applying from January 2001. The withholding tax rate on dividends paid to residents and non resident taxpayers was reduced from 20 to 15 per cent and will be increased again in 2004 to 19 per cent, whereas individual income tax rates has remained unchanged, and the same will be also for 2002, 2003 and further. From January 2002, the level of tax exemption has been increased from Zl 493.32 (about 128 €) to Zl 530.08 (about 135 €); besides, since March 2002, a 20 per cent withholding tax applies to interests derived from bank accounts, securities issued by the state, bonds issued by local authorities and income from participation to investment funds; a lot of tax deductions and tax credits for expenditures borne for purchasing land to construct, for constructing dwelling house or expanding for housing purposes have been reversed.

The amendments provides also for a deduction for interests on loans secured by a mortgage and taken up after January 2002 up to Zl 189,000 (about 48,000 €) and for a two per cent rate transfer tax, levied on capital transfers abroad, applying until December 2003 .

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[31] For a more detailed description of the reform, see par. 3.

As regards VAT, from July 2001 a Decree of the Ministry of Finance provides for a repayment, in observance of particular conditions, in favor of foreign enterprises, for VAT incurred in the purchase of good and services in Poland; from July 2001, amendments to The VAT and Excise Duty Law provides for a seven per cent VAT rate applying to Internet access services (with an exemption in favor of schools and educational facilities).

During 2001, new rules regarding income taxation of leasing for corporate and individual taxpayers, the new Law on Stamp Duty and Law on Tax on Civil Law Transactions (replacing the Law of 1989) came into force too. As it comes to excise tax, the main change will be reduction of number of goods, charged with this tax. Most of them will be removed or decreased. But the most important rise is expected in case of tobacco products. In 2004 it will be increase by 9.1 per cent, in 2005 by 10.4 per cent and 18.9 per cent in 2006 as a consequence of adjustments demanded from the EU (Pre-accession Economic Programme, 2003). The full harmonization is expected for the year 2008.

In 2004 Poland will join European custom union: 75 per cent of revenues collected on the borders with not-EU members will be redirected to the EU budget. As a result of Community Customs Tariff adoption the effective custom duty rate is going to decrease (Pre-accession economic program (2003), Ministry of Finance, Warsaw). New law for local government financing is planed for 2004. Among new regulations the most important is further decentralization of tasks and public funds, which should also result in wider participation of local governments in the public funds. There is also need to link the local governments standings with the macroeconomic situation. The system will be more flexible in order to enable local governments participation in EU funds. It is also planned that the most of local government tasks should be financed from their own resources and transfers from state budget should play additional role, what isn't a case at the moment.

In the last years number of actions were adopted in order to improve effectiveness of tax collection system. Modern IT system is being implemented since 2001. This system will improve co-operations among tax offices. In 2003 provisions of Tax Code entered into force. The new regulations aim at narrowing the scope of the "hidden economy" and enforcing tax collection.

5.3 The need for further steps

Polish tax reform certainly represents a fundamental step towards the modernization of the tax system, which is thus becoming more equitable and incentive-inducing. Nevertheless,

other relevant reforms are still needed. First of all, a reform of personal income tax, in order to lower tax rates and thus to create a tax regime more favorable to job creation. The combined effect of current high tax rates and social security contributions involves a particularly high tax wedge that contribute to lead to high unemployment and an oversized underground economy. An important step has been taken through the introduction, in 1999, of a comprehensive reform of the pension system, which is expected to make pension contributions more similar to saving rather than a further tax, so as to stimulate labor supply and the shifting of workers out from the underground economy (Lenain and Bartoszuk 2000); however, further actions need to be taken in order to reduce the amount of disability and sickness pensions and early-retirement pensions still applying to those born before January 1949.

Another recommended intervention regards the autonomy of tax policy for local governments, which still rely on large financial transfers from the central government. Local governments should be given the opportunity to manage their own tax bases. As to this point, a chance would be that of a property tax based on the value (and not on the size, as currently arranged) of properties. However, careful supervision of local governments and monitoring of possible borrowing is strongly recommended in order to avoid financial crisis and the worsening of budget imbalance at the central level.

Further, in order to get closer to EU requirements, Poland should introduce charges on those products that are damaging for the environment, as coal, fertilizers, leaded gasoline. Moreover, there is the necessity to reform property market taxation, by bringing residential construction into the tax net (applying the standard rate is required by the Sixth Directive, while, as permitted under Annex H, a reduced rate could be applied to social housing).

Another relevant need is to unify different tax rates on capital incomes, in order to reduce possible distortion in savings allocation and investments financing: at present, Poland has different effective tax rates on corporate income (according to the source of financing, the legal form of the investor, the residence status of the lender) that should be aligned.

Finally, a fundamental step is that of improving and simplifying tax administration, partly in view of the EU accession, making the system more transparent and taxpayers' friendly, for example by removing the need to fill a tax return for most individual taxpayers, whose taxes are withheld (Lenain and Bartoszuk 2000). Similar measures could help keeping voluntary tax discipline in the future.

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