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The tax-free amount as an instrument for implementing the tax fairness principle

Abstract

This paper is devoted to analysis and evaluation of recent changes that have taken place in the structure of Polish personal income tax, with particular emphasis on the tax-free amount. The main effect of these changes is the increase of the tax-free minimum in comparison to the level of the subsistence minimum as well as the statutory obligation of the Minister of Finance to verify both of these. The author positively assesses the introduced changes, noting that they should be treated as the introduction to a discussion on a new model of the taxation of natural persons in Poland.

Keywords: personal income tax, tax free amount, tax fairness

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Among many of the currently propounded legal and tax doctrine principles, as well as the principles of personal taxation applied in practice, particular importance is attached to the principle of tax fairness. As the doctrine rightly points out, it is one of the most important but also difficult problems and has a historical, ethical and political dimension.²

Views on tax fairness have changed significantly, and while the concept of benefits and the equivalent of a tax burden for public services received from the state still prevailed at the beginning of the 20th century, it is now understood as the need to adjust the tax burden to a taxpayer's individual ability to pay. This ability is determined not only by the amount of the taxpayer's income, but also by the situation of the family, in particular by the number of children and other dependents, the age of the taxpayer, the state of the taxpayer's health, as well as certain other extraordinary circumstances, such as natural disasters which weaken the current ability to pay.

A tax system based on the principle of tax fairness has many important advantages, including, as the doctrine points out³ – the possibility of levelling out excessive income disparities, ensuring a balanced and moderate level of burdens, as well as the possibility of greater social acceptance for them. A perfectly fair tax burden is simply impossible to achieve and often irrational, not least because of the cost of collecting the tax, and even more so since there is always the possibility of implementing the idea of equity outside the tax system itself, i.e. in the form of social transfers.⁴ It is worth adding here that the opposite view can also be found in the doctrine, i.e. that it is the system of social benefits that is more costly and that, in addition, it does not guarantee that social benefits will reach the right people and their families.⁵

Most economists recognize that this tax can only complement and cannot replace the much more effective social transfers used for redistributive income distribution

² B. Kolankowska-Kowalska, L. Kołodziejczyk, *Podatek dochodowy od osób fizycznych w krajach UE*, "Studia i Prace Kolegium Zarządzania i Finansów SGH w Warszawie" 2003, 32.

³ See A. Bartosiewicz, R. Kubacki, *Podatki dochodowe, kierunek reformy*, [in:] "Przegląd Podatkowy" 2009, 8.

⁴ J. Ostaszewski, Z. Fedorowicz, T. Kierczyński, *Teoretyczne podstawy reformy podatków w Polsce*, Warszawa 2004, p. 87 et seq.

⁵ P. Russel, *Kierunki zmian w opodatkowaniu dochodów osobistych w państwach UE*, [in:] *Tendencje w opodatkowaniu dochodów osób fizycznych w państwach UE*, Warszawa 2008, p. 78.

purposes, which should provide resources for minimum subsistence for the poorest, as well as for the alleviation of income disparities resulting from the functioning of the market mechanism.⁶ Thanks to an active redistributive policy, many objectives can be achieved, especially in the area of reducing the income gap of households (through tax progression) and social benefits, as well as counteracting the unfavourable income situation of particular social and professional groups (easy adjustment of individual income), it can also affect the level and spending potential of local government units through subsidies and grants.⁷

In the legal doctrine there are views that income tax demonstrates greater effectiveness in equalizing income stratification.⁸

Achieving tax fairness in practice is difficult in two ways; there are no universal methods of putting it into practice, and secondly, the intentions of the legislature and the tax administration are not always understood in the way expected by the taxpayers themselves, some of whom consider that they have been unfairly treated in their tax burdens.⁹

The very idea of the fairness of taxation, which is clearly connected with an assessment of the law in terms of moral norms from the axiological and ethical-social point of view, should be transferred to normative ground so that it can be expressed in the system of law.¹⁰ It should be sought first and foremost in the basic laws, in the principles of shaping relations between the state and the citizen adopted therein. The point is that justice should be transferred from the axiological and ethical-social level to the normative level and should be reflected in the legal system.¹¹

In Poland, the principle of fiscal justice is derived directly from the provisions of the Constitution of the Republic of Poland. It is necessary to invoke here, in particular, the content of Article 1 and Article 2 of the Constitution, which express the main moral values and ethical principles uniting Polish society. In particular, the provision in Article 1 is of fundamental importance here, i.e. that the Republic of Poland is the common good of all citizens, the content of which derives directly from the obligation to impose public levies that take account of the welfare of all citizens and to place, if necessary, the general good above the individual good and

⁶ Z. Nowak, *Polityka budżetowa*, [in:] A. Fajferk (ed.), *Polityka ekonomiczna*, Kraków 1999, p. 99.

⁷ A. Wernik, *Finanse publiczne*, Warszawa 2014, pp. 152–153.

⁸ A. Gomulowicz, J. Małecki, *Podatki i Prawo Podatkowe*, Warszawa 2004, p. 50 et seq.

⁹ J. Głuchowski, *Powody ustanawiania ulg i zwolnień podatkowych*, [in:] J. Głuchowski, D. Handor, J. Patyk, J. Szymańska, *Forms of Tax Reduction in Poland*, Warszawa 2002, pp. 18–19.

¹⁰ A. Gomulowicz, J. Małecki, *Podatki i prawo podatkowe*, Warszawa 2004, p. 59 et seq.

¹¹ R. Mastalski (ed.), *Prawo podatkowe*, Warszawa 2016, pp. 61–63.

the individual good of particular group interests.¹² Also, the provisions of Article 2 stating that “The Republic of Poland shall be a democratic state ruled by law and implementing the principles of social justice” means the need to incorporate the requirements of the principle tax fairness into tax law. Reference should also be made here to the ruling of the Constitutional Court, which recognized the principle of social justice as a correction of the principle of the equality of rights for the benefit of citizens who find themselves in the most difficult economic situation.

Over the last few years, there has been a clear change in the approach of the Western European legal and financial doctrine as well as economic doctrine to the need to use income taxes to reduce the income gap in society, as well as to adapt a number of instruments of state intervention aimed at alleviating these income disparities. The change in this stance was undoubtedly caused by the crisis phenomena that occurred at the turn of the 20th and 21st centuries, and especially by the recent economic crisis of 2008–2009, which caused a complete reversal of the liberal trends which perceived income inequality as significantly beneficial, i.e. strengthening the clear motivation to increase economic activity and innovation, as well as a reversal of the thesis that income disparity in society is as an unavoidable cost of prosperity. Contemporary doctrine not only does not question the role of the redistributive function, but on the contrary seeks the optimal instruments for its implementation by both social policy and the tax system.¹³

The many years of experience of EU member states in levelling out differences in income between citizens indicate that social transfers in the form of increased expenditure on retirement pensions (*emerytura*) and disability pensions (*renta*), assistance for the poorest families, support for employment, and housing allowances are being used. In particular, most EU countries, especially during periods of crisis, have actively used the redistributive function of income tax by increasing rates for the highest income taxpayers or introducing additional rates for them, and have also exempted people from the burden and replaced flat-rate tax with progressive tax. At the same time, for taxpayers with the lowest income, the amount of their taxes was reduced or significant reductions in rates were introduced, or the amount of the minimum tax-free amount was increased for them.

In comparison to the significant activity of most EU countries in the scope of using the redistributive function of taxes, especially income tax, it is surprising

¹² M. Duda, *Kontrowersje dotyczące redystrybucyjnej funkcji podatków*, “Roczniki Naukowe Wyższej Szkoły Bankowej w Toruniu” 2009, 8, p. 225 et seq.

¹³ For more information on this topic, see K. Wójtowicz, *Rola polityki fiskalnej w ograniczaniu nierówności dochodowych w warunkach kryzysu ekonomicznego – doświadczenia wybranych państw UE*, [in:] *Nierówności społeczne a wzrost gospodarczy*, „Nierówności Społeczne a Wzrost Gospodarczy” 2016, 47(3), pp. 205–207.

that the actions by the Polish legislator to include appropriate solutions in the construction of Polish tax aimed at a broad use of its redistributive function have been rather passive.

The need to significantly strengthen the redistributive function of income tax in Poland is justified by the following two main reasons:

- ❑ significant income stratification of society, which occurs in particular in particular groups of households,
- ❑ the inadequacy of the current tax structure to act as an important instrument for compensating for glaring differences in the level of such income.

According to the results of the European Survey of Income and Living Conditions (EU-SILC) carried out in 2013,¹⁴ there is a significant income stratification of households in Poland. The risk of poverty or social exclusion index of households of disabled pensioners amounted to as much as 60.5%, and in territorial terms, households from the region of Eastern Poland were in the worst income situation, where the said index amounted to as much as 32.6%.

The level of income disparities, measured by the so-called GINI coefficient over the years, amounted to 30.7% in Poland in 2003 and was much higher than the EU average.

The average equivalent income at a household's disposal constituting the total income of all members of the household, after deducting the advance personal income tax payment, contributions to ZUS (Polish Social Insurance Institution) and NFZ (National Health Fund), as well as real estate tax in 2012 amounted to only PLN 25,007 in Poland, with as many as 1/3 of all households in Poland assessing their income situation as very difficult.

In 2014, the European Commission analysed Poland's economic policy and evaluated the National Reform Programme for 2011–2015 (*Krajowy Program Reform na lata 2011–2015*). As a result of these analyses, it was found that despite a reduction by as much as 1.5 million in the number of people in Poland living below the relative poverty line, in 2014 the percentage of people at risk of extreme poverty or social exclusion was still 1.3% higher than the EU average.

The above results were also confirmed by household surveys conducted by the Central Statistical Office (GUS), which stated that in 2014 2.8 million people lived in extreme poverty in Poland.¹⁵ As a result of the above data, on 12 August 2014 the Council of Ministers adopted the National Programme for Combating Poverty and

¹⁴ European Survey of Income and Living Conditions (EU-SILC) in 2013, Główny Urząd Statystyczny, Departament Badań Społecznych i Warunków Życia, Warszawa 2014, www.gus.gov.pl

¹⁵ See A. Bieńkuńska (ed.), *Ubóstwo ekonomiczne w Polsce w 2014 roku*, Warszawa 2015, p. 1.

Social Exclusion 2020 (*Krajowy Program Przeciwdziałania Ubóstwu i Wykluczeniu Społecznemu 2020*), the main objective of which is to further and significantly reduce unfavourable coefficients shaping the scale of poverty in our country.

It is also worth adding that the National Development Strategy 2020 stresses the particular importance of improving the standard of living of citizens.

Increased state spending on assistance for the poorest families, the significant income stratification of Polish society, especially the extent of the poverty of many groups of households, requires support in the form of appropriate use of the tax system, as well as increased state spending on assistance for the poorest families.

Personal income tax, as a general and personal levy on a taxpayer's global income, is even predisposed to acting as an instrument for mitigating the effects of excessive income disparity between individual groups of society, and in particular between individual groups of households. The main advantages of this tax are: the possibility to personalize the tax burden for particular groups of taxpayers and also its flexibility, which manifests itself in the ease of adjusting its burden to the changing economic situation of the taxpayer.¹⁶ Already in the early 1990s, income tax was presented in the doctrine as a tax ideal, because "it can meet all the demands of tax theory, which rightly calls it a fruit that only financially mature, economically and politically sound and healthy societies can break away from"¹⁷. This tax continues to be seen in the doctrine as an important attribute of the welfare state and an important means of distributing income from the rich to the poor.¹⁸

It is worth mentioning here that within the framework of personal income tax, which is an ideal tool of tax policy, there is no problem of harmonizing regulations within the European Union. Personal income tax has always been treated as the work of an autonomous legislator and its rich history shows that it has often also been used as an instrument of family, social and stimulus policy. In personal income tax policy, governments rely primarily on the principle of horizontal equity, not wanting to discriminate against taxpayers who are in identical situations and have similar criteria. On the other hand, the rules of horizontal fairness are not neutral, since they require clarification of the conditions for "identity" and "similarity", hence the judgement of these categories remains in the hands of the legislator. As an example, gender, age, race and religion are not accepted as grounds for differentiating the tax burden everywhere. Such criteria however are met by, for example, the number of a taxpayer's dependents, the state of the health of the

¹⁶ For more information on this topic see N. Pietrewicz, *Polityka fiskalna*, Warszawa 1993, p. 37.

¹⁷ S. Głabiński, *Nauka Skarbowości*, Lwów 1919, p. 392.

¹⁸ K. Polarczyk, *Funkcje podatku dochodowego od osób fizycznych w państwach UE*, [in:] *Tendencje w opodatkowaniu dochodów osób fizycznych w państwach UE*, Warszawa 2008, p. 11.

taxpayer and his/her marital status. In general, these factors are to persuade that an optimal tax policy should depend only on the criterion of a taxpayer's income, consumption and wealth.¹⁹ To prove the above, one can cite the fact that in many countries of the European Union it was decided, in the last decade of the 20th century, to introduce new top tiers of tax rates for the most affluent citizens and at the same time to limit the reductions of the lowest rates in income taxes, which for many years was an unwritten trend for Member States.²⁰ The drawbacks of the tax are: the complexity of its construction and the high costs of servicing the tax administration.

The main elements of the personal income tax structure used for the purposes of the fair redistribution of taxpayers' income are: the tax-free amount, the type of tax scale applied, including in particular the number and level of tax rates, as well as the scope and types of tax exemptions and reductions.

The tax-free amount, as a fixed component of personal income tax, is a structure designed to take account of the personal nature of such tax and, in particular, of the taxpayer's ability to pay. The doctrine rightly points out that²¹ the main reason why a tax-free amount was introduced in the system of personal income taxation was to recognize the principle that people living in poverty should not be required to make such sacrifices. An instrument that can serve as the poverty criterion should be the statutory minimum wage, retirement or disability pension. That amount must ensure that a minimum amount of financial resources is made available to the taxable person to cover his/her basic needs, below which there is a risk to his/her existence and physical and psychological development. Currently, this means that the value of the tax-free amount should refer to the minimum subsistence level or the social minimum, the level of which is determined in Poland by Instytut Pracy i Spraw Społecznych (Institute of Labour and Social Affairs). The minimum subsistence level covers expenditure on food, maintenance and operation of an apartment, purchase of medicines and hygiene products, as well as purchase of necessary clothing; and, in the case of a taxpayer's children in compulsory education, the cost of their educational needs.²² On the other hand, the social minimum includes not only the minimum subsistence level, but also expenses related to the costs of starting a family, bringing up children and maintaining social bonds at a minimum level.

¹⁹ B. Jacobs, *From Optimal Tax Theory to Applied Tax Policy*, "Public Finance Analysis" 2013, 69(3), p. 343.

²⁰ S. Godar, A. Truger, *Shifting Priorities in EU Tax Policies*, „IMK Study" 2017, 55(5), p. 10.

²¹ See G. Szczodrowski, *Polski system podatkowy*, Warszawa 2007, p. 143.

²² For more information on this topic, see J. Deniszczuk, B. Sajkiewicz, *Kategoria minimum egzystencji*, [in:] S. Golinowska (ed.), *Polska bieda II. Kryteria, ocena, przeciwdziałanie*, Warszawa 1997, p. 32.

It is worth noting that the tax-free amount has been, and remains, a permanent element in the construction of the Polish personal income tax since personal income tax was first introduced in 1920, right after Poland regained its independence;²³ it also appeared in the socialist system of income burdens on individuals, as well as in market economy conditions, i.e. in income tax since 1991.²⁴

This amount in the period 1992–2009 showed an upward trend and amounted, in the period 1992–1993, to old PLN 4,320,000 (prior to redenomination), while in 1995 – PLN 788.57 after redenomination, in 1998 – PLN 1465 and in 2000 PLN 2295.79. In subsequent years, i.e. 2003–2006, the amount remained at the level of PLN 2789.89 and from the beginning of 2009 until 2016, it was PLN 3091²⁵ – this was more than twice as low as the minimum subsistence level, which completely undermined the sense and importance of the institution of a minimum tax-free amount. Such a drastically low tax-free amount was the lowest among the countries of the European Union. This is illustrated in the table 1.

It is worth emphasizing that among EU Member States, only Hungary and Bulgaria do not apply a minimum tax-free amount. Out of all the EU countries, 12 have a minimum tax-free amount as a deduction from income, eight have a minimum tax-free amount as a deduction from the amount of tax already levied and seven have a minimum rate of zero.

For a more complete analysis and assessment of the minimum exempt from tax, it is interesting to examine the relationship between the amount of such minimum and the value of the lowest remuneration for work, which determines the real amount for the taxpayer of the amount exempt from tax. The table 2 shows such relationship.

²³ Ustawa z dnia 16 lipca 1920 r. o państwowym podatku dochodowym i podatku majątkowym, Dz.U. of 1920, No. 82, Item 550.

²⁴ For more information on the evolution of the amount of income tax free and the factors differentiating its amount, see M. Duda-Hyż, *Tax free amount in Polish in Income tax*, [in:] *Selected Issues of taxation and Tax Authorities*, ed. P. Smoleń, Lublin 2016, pp. 46–53; Ustawa o podatku dochodowym od osób fizycznych z dn. 26 lipca 1991 r., tekst jedn.: Dz.U. of 2018, Item 200.

²⁵ See B. Kucia-Guściora, *Kształtowanie się skali progresywnej w polskim podatku dochodowym od osób fizycznych na tle tendencji w państwach członkowskich UE*, "Przeгляд Ustawodawstwa Gospodarczego" 2012, 7, p. 16.

Table 1. Tax-free amounts in euro in selected EU countries in 2015

No.	State	Value of tax-free amount (in EUR)
1.	Cyprus	19,500
2.	Spain	17,707
3.	Finland	16,100
4.	UK	12,690
5.	Austria	11,000
6.	Belgium	8,680
7.	Germany	8,130
8.	Denmark	6,263
9.	France	5,963
10.	Italy	4,800
11.	Portugal	4,104
12.	Croatia	3,439
13.	Estonia	1,728
14.	Czech Republic	880
15.	Poland	746

Source: The justification for the project of the amendment to the Act of Personal Income Tax 29 th October 2015 and PWC report *Praca w UE podatki i składki*.

Table 2.

Year	Tax-free amount	Lowest remuneration amount	Relationship between the tax-free amount and the tax on the lowest remuneration
2009	3,091	1,276	2.4
2010	3,091	1,317	2.3
2011	3,091	1,386	2.23
2012	3,091	1,500	2.00
2013	3,091	1,600	1.80
2014	3,091	1,680	1.70
2015	3,091	1,750	1.60
2016	3,091	1,850	1.60
2017	6,600	2,000	3.3

Source: A. Pomorska (ed.), *Potrzeba i kierunki reformy podatków dochodowych w Polsce*, Lublin 2016, p. 58.

A comparison between the tax-free amount and the statutory minimum wage in EU countries shows that the ratio of the tax-free amount to the minimum wage in Poland is the lowest in comparison to the remainder of EU countries. Among EU countries, a particularly high tax-free ratio to the lowest wage is observed in Greece, Slovakia, Malta and Bulgaria, where the ratio is between 12 and 18 times the lowest wage. In France, Belgium, Estonia and Slovenia, on the other hand, this amount is equivalent to four to five times the minimum wage.

Even taking into account significant differences in the level of salaries in other EU Member States and in Poland, there is a clear disproportion between the ratio of the Polish tax-free amount and the lowest remuneration. The fact that the tax-free amount has been frozen since 2009 means that, with a fixed amount of tax-free amount, its multiple amount must gradually decrease as a result of a gradual, albeit slight, increase in the lowest wage in Poland.

While analysing and assessing the design and level of the tax-free amount applicable from 1992 to 2016, it is important to note a number of significant shortcomings, which have prevented it from acting as an instrument to protect the poorest taxpayers. First of all, the value of it failed to be adjusted to the minimum subsistence level, but was more than twice as low. The amount of this monthly minimum for a single employee household determined by the Institute of Labour and Social Affairs amounted to PLN 6,529.08 in 2014 and PLN 6,185.16 for a single pensioner household.²⁶ This gross disproportion led to a paradoxical situation where a person living in poverty, having full rights to social welfare benefits, was at the same time obliged to pay income tax.

The fact that the minimum subsistence level was ignored when designing the tax-free amount has been criticized on numerous occasions by the scientific community of lawyers and economists, who have pointed out that politicians have completely failed to understand the essence of income as a social phenomenon, which is the basic measure of a taxpayer's ability to pay.²⁷ What is more, some authors even stated that due to the fact that such tax-free amount cannot be acceptable because it is so drastically low, it cannot be assumed that Polish income tax applies the minimum tax formula at all.²⁸ The fact that the tax-free amount was not based on a minimum subsistence level throughout the period of 1992–2016 completely undermined the sense and importance of the tax minimum introduced

²⁶ See study of the Institute of Labour and Social Studies based on GUS data of 2015.

²⁷ A. Komar, *Finanse publiczne*, Warszawa 1994, p. 10.

²⁸ A. Gomulowicz, J. Małeki, *Podatki i prawo podatkowe*, Warszawa 2009, p. 664; see B. Kucia-Guściora, *Kształtowanie się skali progresywnej w polskim podatku dochodowym od osób fizycznych na tle tendencji w państwach członkowskich UE*, "Przegląd Ustawodawstwa Gospodarczego" 2012, 7, p. 17.

when designing the tax. Such a drastic difference in the tax-free amount resulted from the fact that it was not conditioned upon the number of household members and on the taxpayer's source of income, which was in turn taken into account by the Institute of Labour and Social Affairs when distinguishing between two types of households, i.e. a pensioner's and an employee's. Unfortunately, Polish tax law in the area of the taxation of personal income does not refer to the economic category of a household, limiting itself only to the possibility of joint taxation of spouses' income and the common income of a child raised by a single person together with the income of that person.²⁹

The scale of the discrepancy between the two amounts increased as the number of household members grew. As shown by the example given in the tax law literature³⁰ in the case of a three-person family, the monthly tax-free amount per person in the household was approximately PLN 86 per month, i.e. less than PLN 3 per day, which absolutely cannot be considered a sufficient income for physical and social survival. Meanwhile, the minimum subsistence level established according to the data of the Institute of Labour and Social Affairs amounted to PLN 440.60 per person for a three-person employee household.

As a result, the tax-free amount per person calculated above was as much as five times lower.³¹ That disproportion resulted from the failure to take account of the taxpayer's family situation when determining the value of tax-free amount. This was therefore another important shortcoming in the design of the tax minimum until 2017. It is worth emphasizing the judgment of the Federal Constitutional Court of Germany, which stated in 1993 that the part of a taxpayer's income ensuring a minimum standard of living for the taxpayer and his/her children should be exempt from taxation.³² This principle should be an example for designing income taxation in other EU countries, including Poland.

Another significant shortcoming of the current tax-free amount, prior to 2017, was the fact that all taxpayers were entitled to the same tax-free amount, regardless of their income, family or personal situation. This stood in conflict with a view often expressed in the theory of economics³³ that tax fairness should manifest itself in linking the tax burden with the taxpayer's individual ability to pay, which also

²⁹ C. Kosikowski, *Naprawa Finansów publicznych w Polsce*, Białystok 2011, p. 291.

³⁰ R. Zieliński, *Instrumenty personalizacji podatkowej w konstrukcji podatku dochodowego od osób fizycznych*, "Annales UMCS Sectio H" 2016, 1, p. 707.

³¹ Ibidem, p. 707.

³² See M.M. Hybka, *Opodatkowanie dochodów osób fizycznych w RFN*, Poznań 2005, p. 53.

³³ J. Ostaszewski Z. Fedorowicz, T. Kierczyński, op. cit., p. 91.

requires that the tax-free amount be individualized depending on the taxpayer's income, family and personal situation.

For quite a long time now, the literature has raised the problem of the appropriateness of taxation with respect to the lowest disability pensions, retirement pensions and benefits in general, especially when they are the sole source of income.³⁴

Another significant disadvantage of the design and value of the tax-free amount was the lack of its indexation, except for in the period 1992–2004, however, in this period the indexation mechanism itself was modified by changing the indexation rate. Initially, it was an increase in the average monthly salary in the national economy during three quarters of the year preceding the tax year. In 2001, the indexation mechanism was modified, assuming that the amount by which the tax was reduced would be increased each year to a level corresponding to the increase in consumer prices during three quarters of the preceding the tax year. By amending the Act of 2003, the provisions defining the mechanism for indexation of both the tax thresholds and the amount reducing the tax were repealed, without invoking any arguments of a social or economic nature. As a consequence of abandoning the automatic adjustment of the amount of the tax reduction, there was no increase in the said amount.³⁵ In the period from 2004 to 2016, the value of the tax-deductible amount was increased only once by the Act of 2006, by PLN 29.94. As a result, since 2009 it amounts to PLN 556.02 which corresponds to a tax-free amount of 3,091 PLN. It is worth noting that abandoning the mechanism indexing the tax-free amount became one of the main reasons for the Commissioner for Human Rights to file a request to the Tribunal in 2014 to declare the provision of the Income Tax Act unconstitutional, in so far as it determines the amount reducing the tax at the level of PLN 556.02. Following the examination of this request in October 2015, the Court ruled that Article 27 Section 1 of the Persona Income Tax Act, in so far as it does not provide for a mechanism to adjust the amount reducing the tax guaranteeing at least a minimum standard of living, violates the provisions of the Constitution of the Republic of Poland. At the same time, the Court stated that “the essence of the amount of the reduction is to correct the tax assessment basis in such a way as to leave a certain amount of income at the disposal of each taxpayer which should not be subject to taxation and, therefore, the determination of the amount of the reduction should not be detached from the normative basis for determining the minimum subsistence which is derived from human dignity”.

The fact that the tax-free amount was no longer indexed has progressively depreciated it in view of the increasing maintenance costs and fluctuations in the

³⁴ C. Kosikowski, *op. cit.*, p. 300.

³⁵ M. Duda-Hyż, *op. cit.*, p. 46 et seq.

inflation rate. On the one hand, this phenomenon resulted in a slight increase in the number of taxpayers whose annual income was in a higher range of the tax scale. On the other hand, however, it has preserved all the drawbacks of such a low tax-free amount. The doctrine points out that a way of remedying this situation, albeit in part, might be to include factors such as the level of prices of basic consumer goods and the inflation rate in structuring the minimum tax-free amount.³⁶

In Poland, it was not until 2014 that measures were taken to reform the drastically low tax-free amount, following an initiative by members of Parliament from *Twój Ruch* ("Your Movement")³⁷ who postulated that it be raised to the level of the minimum subsistence level. This attempt to amend the regulations proved ineffective as the Sejm rejected the draft upon first reading, citing an excessive decrease in tax revenues in the face of a significant budget deficit and the fact that the EU's excessive deficit procedure was introduced, which was later temporarily suspended, but at the cost of freezing the tax-free amount, tax thresholds and the total amount of tax exemptions in the Multiannual Financial Plan of the State for 2014–2017. This attempt, somehow condemned to failure from the start, disclosed to the general public how low the tax-free amount truly was.

It is worth noting that the delay in efforts to increase the tax-free amount was also caused by the specific, and criticized by the doctrine, so-called "indirect" manner of introducing the tax-free amount to the Polish tax system, by deducing from the tax calculated in the first threshold of the tax scale the same amount for all the taxpayers, i.e. PLN 556.02.³⁸ A much simpler procedure would be to introduce a minimum tax-free amount of PLN 3,091 into the text of the Act itself. This peculiar and skilfully camouflaged effort of the legislator resulted – it seems – in the fact that the majority of taxpayers when asked directly about the amount of the income tax-free amount would find it difficult to provide the correct answer. The same would be true for Members of Parliament.

The only another attempt by the Commissioner of Human Rights to increase the amount of the personal income tax-free amount in 2014 brought about positive results in the form of the judgment of the Constitutional Tribunal of 28 October 2015.³⁹ The Tribunal ruled that Article 27 of the Personal Income Tax Act is inconsistent with Articles 2 and 84 of the Constitution of the Republic of Poland in so

³⁶ T. Famulska, *Bezpośrednie opodatkowanie dochodów ludności*, "Przegląd Organizacji" 1992, 2, p. 314.

³⁷ Draft act initiated by members of Parliament on amending the Act on Personal Income Tax (Sejm paper No. 2414), considered at the session of the Polish Parliament (Sejm) RP No. 70, Warszawa 2014, pp. 285–295.

³⁸ B. Szolno-Koguc, *Reforma polskiego systemu podatkowego w latach 1990–1995. Założenia a realizacja*, Lublin 2000, p. 131.

³⁹ Judgment of the Constitutional Court of 28 October 2015, Court Reference No. K/21/14.

far as it does not provide for the adjustment of the minimum amount of tax-free income taking into account the minimum subsistence level.

While analysing the course of the trial itself as well as the substantiation of the judgement, one can reach the conclusion that the Constitutional Tribunal, out of two constitutional values, i.e. on the one hand ensuring a higher value of the tax-free amount and on the other hand protecting the budgetary balance, granted clear primacy to ensuring a higher amount of the tax-free amount. Moreover, the Tribunal recognized that the need to ensure income protection for the poorest stems not only from the principle of social justice (expressed in Article 2 of the Constitution) but also from the clearly emphasized, for the first time, principle of trust in the State and the rule of law established by it (Article 84), the content of which is the universal civic duty to pay taxes. The Tribunal has also linked this general obligation to pay taxes with the ability to pay the same, supporting the position expressed by the Commissioner for Human Rights, which means that the taxpayer's actual ability to pay must be taken into account. The Commissioner for Human Rights deduced this necessity from Article 20 of the Constitution, which indicates the nature of our state's system based on a social market economy. As a consequence, this requires that tax legislation take into account the social component, and not only the economic and financial one, in order not to lead the taxpayer into poverty. In this way the argument that the minimum subsistence figure must be taken into account when setting the amount of the tax-free amount is further reinforced.

It is worth noting that both the content of the judgment and its substantiation are clearly inspired by the rich case-law of the Federal Constitutional Court of Germany. Although this inspiration has not led our Constitutional Tribunal to consider minimum subsistence as a determiner of the tax-free amount, as is the case in Germany, in Poland it was recognized as a constitutional value.

One can hope, however, that in the near future it will be a constitutional obligation to include the minimum subsistence level in calculating the tax-free amount. This is likely to be an important step towards strengthening the protection of human dignity in tax law. Therefore, the view of the doctrine that "the ruling of the Constitutional Tribunal in 2015 constitutes a milestone" with respect to existing jurisprudence of the Tribunal itself concerning the rights of people living in poverty, shall be deemed convincing.⁴⁰

Despite the fact that the Constitutional Tribunal provided a *vacatio legis* of one year for the implementation of the judgement, its implementation was carried out

⁴⁰ For more information on this topic, see A. Płoszka, *Konstytucyjnie gwarantowane minimum egzystencji a kwota wolna od podatku. Uwagi na kanwie wyroków w sprawie K 21/14, "Kwartalnik o Prawach Człowieka" 2016, 1(17).*

too late and hastily. This is indicated mainly by the rapid legislative procedure on the amendment of the Personal Income Tax Act, which was conducted only within the last three days of November 2016. It can be assumed that the main reason for such rush was the fear that taxpayers would, on a large scale, resume their past tax proceedings which had concluded with decisions based on their incompatibility with the Constitution in light of the ruling of the Constitutional Tribunal. The discussion over the new mechanism of the tax-free amount, which was undertaken so late, had an adverse effect on its final legislative shape.

There is no doubt, however, that after several years of maintaining abnormally low levels of the tax-free minimum, which brought about negative social consequences, there has been a change in legislation, long-awaited by taxpayers, with the purpose of establishing the value of the tax-free amount at equal to the minimum subsistence level, although it was only a small step towards reducing areas of social poverty. It was a kind of political compromise between the fiscal interest of the State and the interest of the poorest taxpayers, who in this case received significant support from the Constitutional Tribunal. The second important factor which determined the final shape and amount of the tax-free minimum was also concern about negative fiscal considerations for the budget, which an increase in this amount could bring about, in the context of significant financial revenues guaranteed to the State and local budgets by personal income tax.

Particular attention and full acceptance should be given to the imposition, for the first time on the Minister of Development and Finance, of a statutory obligation to verify the value of the tax-free amount annually, taking into account the minimum subsistence level set by the Institute of Labour and Social Affairs.

A new personal income tax free scheme, already in force for the calculation of the tax for 2017,⁴¹ turned out to be extremely complicated due to the significant changes made to its previous principles. First of all, two of its principles were abandoned, i.e. the principle of the universality of the application of the tax-free amount for all taxpayers and the principle of an equal amount reducing the tax value, i.e. PLN 556.02 for all taxpayers. The third change was also the introduction of the tax-free amount of a degressive nature, meaning that its amount will gradually decrease with the increase in the taxpayer's income. The introduction of these new rules has made it extremely complicated for taxpayers to benefit from the tax minimum. Only the manner in which the minimum is introduced in the form of a tax reduction has not changed.

⁴¹ Act of 29 November 2016 on amending the Act on Personal Income Tax, Act on Corporate Income Tax and amending the Tax Ordinance Act and some other acts of law (Dz. U. of 2016, Item 1926).

The mere adoption of these new rules, and in particular the differentiation of the amount of the tax reduction in relation to the amount of a taxpayer's generated income, should not raise any major doubts of a substantive nature, especially in the light of the many years of experience of EU countries which have already applied them in their systems, and with good results. Not all of these countries have a tax-free minimum amount for each taxpayer when income is derived from specific sources; it is most often applied to the taxpayer's income derived from compensation for work, retirement pensions, disability pensions and self-employment. The main factor differentiating the amount of the tax-free amount is the value of the annual income obtained by a taxpayer and also, in selected countries, his/her family situation. In many EU countries, the tax-free minimum is designed as a two-part mechanism, i.e. a basic amount for the taxpayer and an additional amount awarded to the taxpayer with respect to the number of his/her number and other dependents who are members of such taxpayer's household. Such a mechanism is in force in Belgium, the Czech Republic, Estonia, Germany, Slovenia and Greece. The age of the taxpayer is also a factor differentiating the amount of tax-free amount, i.e. older people over 65 years of age are entitled to a much higher minimum tax-free amount.⁴²

The new tax rates, effective since 1 January 2017 in Poland and applicable to the taxation of income earned in the same year, divided the taxpayers into four mini tax groups depending on the value of the tax base in that year. Thus, in 2017, the amount of the tax reduction was as follows:

- PLN 1,188 – for a tax calculation base not exceeding PLN 6,600,
- PLN 1,188 less the amount calculated by applying the following formula:

$$\text{PLN } 631.98 \times (\text{tax base} - \text{PLN } 6,600) : \text{PLN } 4,400$$
 for the tax base higher than PLN 6,600 and not exceeding PLN 11,000,
- PLN 556.02 – for a tax calculation base exceeding PLN 11,000, not exceeding PLN 85,528,
- PLN 556.02 decreased by the amount calculated by the formula: $\text{PLN } 556.02 \times (\text{tax base} - \text{PLN } 85,528) : \text{PLN } 41,472$ with respect to the tax calculation base higher than PLN 85,528 and not exceeding PLN 127,000.

The amount of the tax reduction will not apply to the richest taxpayers whose tax calculation base exceeded PLN 127,000 in 2017.

The new system of the application of the personal income tax reduction in 2017 presented above clearly demonstrates the rather limited scope of the changes intro-

⁴² M. Korolewska, *Minimum podatkowe w podatku dochodowym od osób fizycznych w państwach UE*, "Infos BAS" 10 September 2015, 15(198), pp. 1–2.

duced, since only about three million of the poorest taxpayers will benefit from it. As many as 21 million taxpayers will not feel any positive change as the amount of the tax reduction will still not exceed PLN 556.02. Only about 650,000 taxpayers will pay more tax.⁴³ This means that the above reform, as assumed by the authorities, will not be too costly for the state budget.

Despite a generally positive evaluation of the very fact of the tax-free amount being more than doubled from its hitherto disgracefully low amount, there remains a clear mismatch between income tax brackets for individual groups of taxpayers and the minimum remuneration for work and the minimum retirement and disability pensions. The level of income brackets determining the possibility of benefiting from the increased tax-free amount or its appropriate reduction does not at all take into account the level of minimum salaries in the national economy in 2017, which amounted to PLN 2000 monthly,⁴⁴ neither the minimum level of retirement and disability pensions, which was as follows (table 3).⁴⁵

Table 3.

Period	1.03.2016 – 28.02.2017
Minimum wage in the national economy	PLN 2,000
Retirement pension and disability pension due to total incapacity to work and survivor pension (renta rodzinna)	PLN 882.56
Disability pension due to partial incapacity to work	PLN 676.75
Disability pension due to total incapacity to work due to an accident at work or occupational disease or occupational disease and survivor pensions related to an accident (renta rodzinna wypadkowa)	PLN 1059.07
Disability pension due to total incapacity to work due to an accident at work or occupational disease	PLN 812.10

Source: www.gofin.pl

The data in the table above indicate that only a small group of the poorest taxpayers earning income from the lowest salaries of minimum retirement and disability pensions will be able to take advantage of the new, more than doubled, amount of tax-free income when settling tax for 2017.

⁴³ See A. Cieślak-Wróblewska, *Kwota wolna od podatku nie dla najlepiej zarabiających*, "Rzeczpospolita" daily of 27 November 2016, www.rp.pl

⁴⁴ Ordinance of the Council of Ministers on the minimum wage for employment in 2017 (Dz.U. of 2016, Item 1456).

⁴⁵ Mon. Pol. of 2016 Item 168, Dz. U. of 2015 Item 1242 as amended.

It is both noteworthy and positive that the amount of the tax-free amount is continuing to increase to PLN 8,000, as announced by the President and the Government, and as was expected by the general public, by way of amending the Personal Income Tax Act.⁴⁶ It was introduced very quickly and will concern tax settlements for 2018. The implementation of this reform was recommended by the Minister of Development and Finance in accordance with the Multiannual Financial Plan of the State adopted by the Council of Ministers for 2017–2020 concerning an increase in of the tax-free amount to PLN 8,000. Pursuant to the Act (Article 27 Section 1a Items 1–3), the amount of tax reduction will be increased from the current level of PLN 1,188 to PLN 1,440 for the basis of calculation of tax for taxpayers with income up to PLN 8,000 in 2018. Another important change brought about by the Act is the increase in the income limit for the second group of taxpayers, whose tax base will exceed the amount of PLN 8,000 but will not be higher than PLN 13,000. Thus, when settling income tax in 2018, the following new, already increased, tax-reducing amounts will apply:

1. PLN 1,440 – for a tax calculation base not exceeding PLN 8,000,
2. PLN 1,440 decreased by the amount calculated according to the following formula: $\text{PLN } 883.98 \times (\text{tax calculation base} - \text{PLN } 8,000) : \text{PLN } 5000$, for a tax calculation base higher than PLN 8000 and not exceeding PLN 13,000,
3. PLN 556.02 – for a tax calculation base higher than PLN 13,000 and not exceeding PLN 85,528,
4. PLN 556.02 decreased by the amount calculated according to the following formula:
 $\text{PLN } 556.02 \times (\text{tax calculation base} - \text{PLN } 85,528) : \text{PLN } 41,472$.

It should be assumed that the benefits of increasing the tax-free amount as well as of increasing the income capacity for the second group of taxpayers will be felt in particular by persons obtaining minimum income from work and by the vast majority of pensioners and retired persons. These new increased amounts of tax reduction will be applied to tax for 2018, which means that their financial effect will be visible only in 2019.

Both increases in the tax-free amount will result in a loss of financial revenue both for the state budget, for which income tax is the third source of revenue in terms of financial efficiency, and for the budgets of local government units participating in the form of shares in such revenue. In 2015, shares in Personal Income

⁴⁶ See Act of 27 October 2017 on amending the Act on Personal Income Tax, Act on Corporate Income Tax and Act on Flat-Rate Income Tax and on Certain Income Generated by Natural Persons (Dz.U. of 2017, Item 2175).

Tax for local governments, in particular for municipalities, were the basic source of their finances. According to the estimations made in 2015 by the Civil Development Forum, the increase in the tax-free amount to the amount of PLN 8,000 will cause an annual loss of revenues in the public finance sector of about PLN 15 billion, of which the total annual loss of revenues from the Personal Income Tax in the entire local government sector will amount to about PLN 7.5 billion.⁴⁷

Concerns expressed in the literature about the negative impact of the two successive tax increases on the sustainability of the state budget should be considered unfounded, as the additional funds that will be left at the disposal of the poorest taxpayers will be used by them to purchase goods and services, resulting in increased revenue from consumption taxes. The expected increase in consumer demand will have a very positive impact on the economy, as it will affect its further development as well as the growth in GDP. A change in the structure of budgetary revenue, resulting in an increase in VAT revenue at the expense of a reduction in personal income tax, will also increase the efficiency of tax collection, as it will reduce the cost of collection, given that collection of VAT is significantly less costly and more efficient.⁴⁸

As regards the possibility of compensating for the personal income tax collection gap for the budgets of local government units, two solutions may be envisaged in particular, i.e. 1) an increase of their share in Personal Income Tax⁴⁹ or 2) tightening the current revenue system by increasing the effectiveness of local tax collection, in particular with respect to property taxes, and by gradually shifting to *ad valorem* tax system.

The fact that the reform of personal income tax has been initiated on the basis of two consecutive increases in the minimum tax-free amount for the poorest groups of taxpayers should be appraised highly, however, it is necessary to propose a further continuation of these reforms, by taking the following factors into account to further differentiate the applicable tax-free amount: family situation, in particular, taking into account the number of children and other dependents of the taxpayer, as well as his/her personal situation, determined by the age and state of health of a given taxpayer. We should take note of the rich and positive experience of EU

⁴⁷ M. Wiktorzak, *Wpływ zwiększenia kwoty wolnej od podatku PIT na dochody jednostek samorządu terytorialnego*, "Finanse Komunalne" 2016, 5, p. 20.

⁴⁸ See W. Wyrzykowski, *Kwota wolna od podatku dochodowego – istota i funkcja*, "Pieniądze i Więź" 2015, 3(68), p. 92.

⁴⁹ M. Wiktorzak, op. cit., p. 26.

Member States concerning the application of the minimum tax-free amount while implementing this postulate.⁵⁰

When public finances are improved, the most desirable action would be to further increase the statutory minimum amount of the tax free amount, which could be used by a larger group of taxpayers. However, it is necessary to simplify the method of calculating the amount of tax reduction by giving it the form of a lump sum instead of a mathematically over-complicated system of individual tax reductions, as is currently in place.

The direction taken to reform the tax-free amount should be regarded as generally appropriate, but should only be perceived as an introduction to a discussion concerning a new universal and fair personal income tax model, which is undoubtedly worthy of taking into account bearing in mind its fiscal importance and its redistributive nature.

In order to strengthen the effectiveness of the redistribution function of personal income tax in Poland, it is necessary, apart from further increases in the tax-free amount, to significantly change the current structure of the progressive scale, both in terms of the number and income capacity of its individual levels as well as the level of tax rates. Currently, only two unusually large income brackets are in force and two rates, 18% and 32% which correspond to them, as shown in the table 4, but it is difficult to consider them as sufficient to close such a large income gap among Polish taxpayers.

Table 4.

Tax calculation base in PLN		Tax amounts to
Over:	Up to:	
	85,528	18% minus tax reduction amount
85,528		PLN 15,395.04 + 32% of the surplus over PLN 85,528 minus tax reduction amount

Source: Article 27 par. 1 of Act of Personal Income Tax.

Considering the fact that the income of about 98% of all taxpayers falls within the first income threshold, including income which amounts to up to PLN 85,528 per year, this means that in practice we are dealing with a flat rate tax which is absolutely ineffective as an instrument to redistribute the income of taxpayers. As the doctrine rightly points out, "a flat-rate tax, as part of a liberal doctrine, leads

⁵⁰ M. Korolewska, op. cit.

to tax reductions for a narrow group of beneficiaries and to the passing on of the costs of this operation to lower-income groups while it has claimed, or rather “lied”, that it is about creating better conditions for capital formation and investment (the stated objective).⁵¹

It is therefore necessary to significantly widen the existing progressive scale by introducing at least two new income brackets and corresponding rates. First of all, taking into account the current level of the lowest remuneration for work and minimum retirement and disability pensions, an additional income bracket should be introduced, covering annual income of taxpayers in the amount of up to 45–50 thousand PLN with the corresponding rate of 10–11%. The second threshold would cover amounts over 45(50) thousand up to PLN 90 thousand with the rate of 18%. In turn, the proposed third threshold capacity would include the amount over PLN 90 thousand to PLN 180 thousand with the rate of 25%, and the fourth – income over PLN 180 thousand with the rate of 32%.⁵² The current 18% rate places a relatively high burden on income from labour as it is even higher than the average OECD rate of 15.5%.⁵³

It is worth noting that among EU Member States, only Denmark and Ireland have two income tax thresholds and corresponding rates in place – similarly to Poland – whereas in five other countries there are four rates and in as many as eight countries the number of rates is at least five or more.

It may be deduced on the basis of the rich experience of personal income tax systems that the most effective instrument to perform the redistributive function of personal income tax is a tax scale applicable with a wide and varied range of income brackets and rates. Further reforms of the Polish income tax concerning the tax-free amount should go in the same direction if it is to be a fair tax.

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⁵¹ G.W. Kołodko, *Wędrujący świat*, Warszawa 2008, p. 23.

⁵² The proposed amounts are based on a minimum level of pay for work in 2016 of PLN 1850, in 2017 of PLN 2000 and minimum amount of disability and retirement pensions.

⁵³ See A. Sieroń, *Polski system podatkowy: diagnoza problemów oraz propozycja reformy*, “Wrocław Economic Review” 2015, 21(1), p. 25.

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