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BARRIERS IN THE PROCESS OF HARMONISATION OF PERSONAL INCOME TAXATION IN EU (selected issues)

In the process of furthering EU integration little attention was given to the role of income taxes. Multiple income tax systems exist across the Union and their differentiation negatively impacts the European labour market, investments and savings, inhibiting economic growth. Individual nations have little motivation to harmonise as they can engage in tax rate competition and income taxes are interwoven with social security systems that make any attempts at reform extremely complex and politically unpopular.

Key words: EU integration, tax harmonisation, personal income taxation, tax system differentiation

Introduction

The idea of a single economic and currency area is based on enabling the free flow of goods, capital and people (labour) while subject to a single currency regime. The idea deals effectively with currency risk, trade barriers, assures easy access to the labour market and provides opportunities for investing in all member states. Full economic integration requires consideration of taxes as an important factor in the furthering of integration processes, since EU member states are tax nations, e.g. countries where budgetary incomes come primarily from taxation. EU member state tax systems are strongly diversified, due to individual developmental paths shaped by national history of various lengths, civilisational development, culture, value systems, social and economic policy that also define the state's current financial needs. The harmonisation of direct (income) taxes was not considered as they were seen as not significantly affecting the single internal market. Problems tied to direct taxation became visible as integration proceeded, the EU grew, its citizens began to migrate, multinational enterprises increased in size and scope and their financial flows (capital and profit transfers between headquarters and subsidiaries in different EU countries) became seriously affected.

Because the Euro zone is relatively young and many integrative processes haven't reached their end, we can look for analogies elsewhere: of nations that have a single currency but maintain differentiated tax systems in different parts of the country. Canada and United States are good examples of federal states that have a single currency and where attempts at harmonisation of taxation were unsuccessful [1; 2]. Both countries are experiencing tax rate competition between different states (provinces) and research done on this topic [3] is seen as extremely important for the furthering of harmonisation policies in the European Union as seen in the works of G.R. Zodrow [4]. It is worth mentioning that most works present controversies regarding the possibilities and need for tax system unification as well as positive and negative consequences of tax rate competition and its impact on the behaviour of individuals and firms. Nonetheless, income tax harmonisation is seen to be rather inevitable and should be understood as a natural effect of progressing unification that follows the removal of trade barriers, restrictions to the flow of capital and labour and the acceptance of a single currency. In the theory of a single economic area, virtually no work was done on income taxation, its characteristics and differentiation, variation of tax rates, rules governing tax setting and preferences.

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Two major issues should be pointed out about European integration:

1. Union creators assumed that income taxes will be neutral towards integration processes.
2. There will occur a natural convergence of tax systems of nations belonging to the economic and currency union.

A question should be posed: is harmonisation occurring in accordance with a predefined programme (that can be defined as tax system coordination) or is it forced upon nations by the market (understood as «quiet» harmonisation of a paralegal nature) [5]. Although tax rates are set by governmental institutions (national, regional, local), decisions about them are strongly influenced by competitive market forces present in the Union while aggressive tax competition may lead to negative consequences, especially reduced budgetary revenues and those will cause a reduction in the state's ability to complete its tasks (e.g. in the areas of social and economic policies) [6].

1. Differentiation of personal income taxation across the Union

EU member states have to consider the taxpayer's ability to pay (occurring jointly, separately or as selected elements) when creating different components of Personal Income Tax (PIT) policies, which may include:

– Setting a tax-free level of income that is offered to an unemployed spouse or offered for each child being supported by the parents.

– Joint taxation of married couples.

– Specific and unique taxation of family income (France operates family quotient taxation that considers the number of children in the family).

– Constructions that permit the deduction of certain costs incurred while bringing up children or even when supporting the family.

– Size and breadth of tax brackets.

– Systems defining the permissible and deductible expenses.

– Systems of preferences depending on the family's situation.

When analysing tax credits and allowable deductions present in EU member states (as subject-specific credits, deductions from tax and tax base), four main categories can be identified:

1. Compensation-type preferences: equivalency and compensation payouts for used tools, clothing, travel costs, refunding travel-to-work expenditures, etc.
2. Social-type preferences: deductions for social support for foster families, support for foster families, war veterans, victims of crime, handicapped, elderly, etc.
3. Stimulation-type (economic) preferences: aimed at stimulating the taxpayer to engage in specific activities or modifying his behaviours. We can include deductions for housing (development and renovation), preferential treatment of savings, purchasing of stocks and bonds, educating children, professional development, health expenditures and retirement fund investments.
4. Differentiated incomes, for example gambling wins, research grants, rewards for scientific activity, scholarships, contributions towards professional associations, etc.

The personal income tax (PIT) schedule is a complex of different instruments, such as rate structure and various tax advantages. Final tax liability is determined by different factors: pre-tax income (X), tax exempt categories of income (E), tax deductions (D(X)) and tax allowances (A) than can be applied on pre-tax income, the rate schedule (r(Y)) and tax credits (K). Pre-tax income X includes all income components before tax, and thus determines to a great extent tax liabilities. Taxable income Y must be distinguished from pre-tax income. Some income components are part of pre-tax income, but don't have to be declared to the tax authorities, and thus are not included in the concept of taxable income. A further distinction between pre-tax and taxable income arises from the existence of tax allowances and deductions. Tax allowances A are defined as a fixes amount subtracted from pre-tax income. Tax deductions D(X) also reduced taxable income. Contrary to tax allowances, they are not allowances, they are not a fixed amount but their level is a function of pre-tax income. So taxable income Y = X – E – D(X) – A. The rate schedule r(.) is then applied to taxable income thus leading us to gross tax liability Tg = r(Y). Finally, we find net (or final) tax liability Tpit by reduction gross tax liability Tg with total tax credits K, which may itself be a function of X: Tpit = Tg – K(X).

The different tax components of personal income tax system in chosen EU countries present tab. 1.

Tax rates vary between nations, mode of progression, number of tax brackets– Table 2 presents tax levels in EU member states.

Definition of income concepts for UE countries. For each country we have defined the following income concepts [7]:

1. gross or pre-tax income (X), which inc1udes all gross cash benefit payments, grass income from work (salaries, wages, self-employment income), property income, other cash market income and occupational pension income
2. total taxes (T = Tpit + Tsic + Tsth)
3. (net) personal income tax liability (Tpit)
4. other direct taxes (Toth)
5. social insurance contributions (T_{sic})
6. net or disposable income (N = X – – T)
7. exemptions (E)
8. allowances (A)
9. deductions (D)

Table 2

The tax levels in EU member states

Nation	Highest and lowest levels of taxation (in %)	Nr of tax brackets	Taxing incomes of married couples
	2002 / 2009	2002 / 2009	2009
Austria	21-50 / 0(23)-50	4/4	Independent
Belgium	25-55 / 25-50	6/5	Independent
Cyprus	0-30 / 0-30	4/4	Independent
Czech Republic	15-32 / 15	4/1	Independent
Denmark	5,5-59 / 5,5-59	3/1	Independent
Estonia	26(10) / 24(10)	1(2)	Optional
Finland	0-37 / 0-33,5 + 16-20	6/6	Independent
France	9,5-54 / 6,83-48.09	6/6	Joint
Great Britain	10-40 / 10-40	3/3	Independent
Greece	5-42.5 / 0-40	4/4	Independent
Germany	(0) 25-51 / (0) 15-42	4/4	Joint
Holland	32-52 / 34,40-52	3/4	Independent
Hungary	20-38 / 18-38	2/2	Independent
Ireland	22-44 / 20-42	2/2	Optional
Italy	18-45 / 23-39	5/3	Independent
Latvia	33 or 15	1/1	Independent
Lithuania	25 / 25	1/1	Independent
Luxemburg	(0)14-42 / 0-38	16/17	Joint
Malta	0-35 / 0-35	6/6	Joint
Poland	19-40 / 19-40 (18-32)	3/3 (2)	Optional
Portugal	14-40 / 12-40	6/6	Joint
Slovak Rep.	10-38 / 19	4/1	Optional
Slovenia	16-50 / 16-50	5/5	Independent
Spain	15-45 / 15-45	6/5	Optional
Sweden	0-25 / 27-34	3/3	Independent

Source: compiled by Author.

Table1

The different tax components of personal income tax system in chosen EU countries

	Exemptions	Imputed taxable income	Deductions	Allowances	Credits
Austria	FP: Child benefits; Pregnancy benefit; Maternity allowance; Care benefits; ED: Study allowances; MI: Social assistance; OA: Private pension benefit payments; OS: Unemployment benefits; HO: Housing benefits; CI: Investment Income; PP: Private transfers received,	–	SIC; ER: Cost of earnings and limited; expenditures; Part of 'other earnings'	DI: disability; ER: Self-assessment income; agricultural workers	FP: General; Child tax; Lone parent; single earners; OA: pensioner; ER: Commuters'; income tax reduction; wage earners; progression adjustment Preferential tax of other earnings
Belgium	FP: Child benefit, Birth/adoption allocation; ED: Study allowances; MI: Minimum income; MI & OA: Minimum income for old persons; DI: Allocation for handicapped people; PP: 20% of maintenance payments received.	Imputed rent; 40% of property income	FP: Marital quotient (pos/neg); PP: Maintenance paid (80%); SIC; ER: Professional expenses; RE: Mortgage interest; dwelling allowances;	–	FP: Basic (for single/spouses); Family credits (for children, handicapped, lone parents); OA & OS: Replacement income tax credit; Zero tax for low replacement incomes.
Denmark	FP: Child benefit; Family allowances; Day care subsidies; ED: Study allowances; HO: Housing benefits; DI: Part of disability pensions;	Lump sum income	PP: alimony received for children; SIC; RE: mortgage interest;		DI: Disability; PP: Child maintenance; CI: Deficit capital compensation (including mortgage interest)
Finland	FP: Child benefits; Child day care payments; Home care benefits; MI: Social assistance; DI: Military injury compensation HO: Housing benefits; CI: Part of investment Income; PP: Maintenance payments received; ER: Part of self-employment income	–	OA: pension deduction; SIC; ER: work-related expenses; travel expenses; Income losses; for sailors; RE: mortgage interest	–	DI: Disability; PP: Child maintenance; CI: Deficit capital compensation (including mortgage interest)

Table 1

	Exemptions	Imputed taxable income	Deductions	Allowances	Credits
France	FP: Family benefits; Lone parent benefit; MI: Minimum income; Minimum pension; Social aid; DA: Social benefit for dependent elderly; DI: Allocation for handicapped people; Invalidity pension; War pension; CI: Investment income; Property income; PP: Maintenance payments received.	–	FP: Personal deduction; DA: Pensions deductions; SIC: Partly; ER: Professional expenses.	–	ER: Low incomes; various types (imputed)
Germany	FP: Child benefits; ED: Study allowances; MI: Social assistance; DA: Nursing home insurance premier received; OS: Unemployment allowances HO: Housing benefits	–	DA: Civil servant pensions; Old age; Non-earnings part of non-civil servant pensions CI: Investment income; PP: Maintenance payments ER: Expenditures; Professional expenses;	FP: Children; Lone parents	–
Ireland	FP: Child benefits; Maternity contributory benefits; Orphan's contributory benefits; Carer's non-contributory benefits; Family Income Supplement; ED: Study allowances; MI: social minimum; DI: Invalidity and disability contributory benefits; OS: most of unemployment benefits; HO: Housing benefits; PP: Maintenance payments received;	–	OA: Pension contributions	FP: Lone parent; Single/married; widowed; DA: Age; ER: Employee	FP: Children; Household expenditure; DA: private pension contributions PP: permanent health insurance relief RE: Mortgage interest relief
Italy	FP: Family allowances; MI: Social pension; DI: War pension; Disability benefits; OS: Social security benefits from local authorities; CI: 15% of property income; PP: Maintenance payments received;	Imputed cadastral values	SIC: Employee; ER: Expenditures deductions; RE: Owner occupied house deduction	–	FP: Dependent spouse; Children; Lone parents; Other dependants; PP: Insurance; ER: Work-related expenses; RE: Mortgage interest

Table 1

	Exemptions	Imputed taxable income	Deductions	Allowances	Credits
Portugal	FP: Child benefits; Family benefits; ED: Study allowances; MI: Social assistance; Income supplement to ensure minimum income; OS: Unemployment benefits; HO: Housing benefits; CI: investment income; property income; PP: Maintenance payments;	Lump sum income	OA: for pension income; SIC ER: for self-employment income; RE: Housing debt;	–	FP: For tax unit composition
Sweden	FP: Child benefits; ED: University/Study grants; Educational benefits; MI: Social assistance; OA: Non-taxable pension; OS: Sick benefit self-employed; Residual tax free benefits; HO: Housing benefits; CI: Investment income; part of self-employment income PP: Maintenance payments;	–	OA: Pension contributions; PP: Periodic maintenance payments; SIC ER: basic/special deduction; Work-related traveling; New started company	–	CI: Reduction on capital
UK	FP: Child benefit; Family Credit; Attendance allowance; ED: Study allowances; Training allowance MI: Income Support; DI: Disability & incapacity allowances; HO: Housing benefits; CI: Part of investment income; PP: Maintenance payments received;	–	OA: Private pension contributions	FP: Personal; OA: Age-related persona	FP: Married person s; Lone parents OA: Age-related married person; RE: Mortgage interest tax relief (refundable).

FP = Family Policy related; ED = Education; MI= Minimum Income; OA = Old Age; DI = Disability & Invalidity; OS = Other Social benefits; HO = Housing; CI = Capital Income; PP = Private Provisions & Transfers; SIC = Social Insurance Contributions; ER = Earnings Related; RE = Real Estate; Neg, = Negative

Source: compiled by Author on a base of EUROMOD Working Paper No. EM5/04

10. taxable income (Y), which corresponds to X – E – A – D

11. gross tax liability (Tg)

12. credits (K)

For the various income concepts we list in this appendix the income components that are included. Below we present definition of income concepts for chosen UE countries.

Austria:

Gross Income (X)

Total taxes (T) T = Tpit + Tsic + Toth

Tsic = self-employed contributions to disability insurance + employee health insurance contributions + self-employed health insurance contributions + employee contributions to pensions insurance + self-employed contributions to pensions insurance + employee contributions to unemployment insurance + employee contributions to housing subsidy + employee compulsory union contributions

Toth = withholding tax on capital income + church tax + other personal taxes and contributions + wealth or national property tax + sub-national (local or regional) taxes

Net income (N) N = X – T

Exemptions (E)

– maternity payment; maternity allowance supplement; pregnancy benefit; child benefits; child birth benefit; addition to child benefit Jor disabled children; provincial family bonus; small children benefit; child care benefit; caring benefit

– study allowances

– social assistance

– 38.5% of private pension benefit payments

– unemployment benefits; unemployment payments

– housing benefits (housing benefits)

– investment income (taxed as part of 'other taxes', i.e. withholding tax on capital income)

– maintenance payments; private transfers received

Allowances (A)

– for disability

– for self-assessment income

– for agricultural workers

Deductions (D)

– for single earners

– cost of earnings; part of 'other earnings'; limited expenditures

– SIC (self-employed contributions to disability insurance; self-employed health insurance contributions; self-employed contributions to pensions insurance; employee SIC)

– Church tax

– Charitable donations

– Exceptional costs

Taxable income (Y)

Y = X – E – A – D (correction of Y, D, A for negative values of Y)

Gross tax liability (Tg) = application of rate schedule before tax credits

Credits (K)

– general; child tax credit; lone parents; Single earners

– pensioners

– Commuters; income tax reduction; wage; progression adjustment

– Preferential tax of other earnings is a negative tax credit (as it increases taxes)

Net personal income tax liability (Tpit) = national income tax (is sometimes negative. Some tax credits are refundable in Austria)

France:

Gross Income (X)

Total taxes (T) T = Tpit + Tsic + Toth

Tsic = ail employee social insurance contributions

Toth = sub-national (Local or regional) taxes + other personal taxes and contributions + wealth or national pro party tax + capital income tax

Net income (N) N = X – T

Exemptions (E)

– family benefits (allocation familial; family benefit for young children; family benefit for many children; social benefit for special education; social benefit for parental education; support for chi Id care; lone parent benefit; social benefit for lone parents) minimum income; minimum pension; social aid

– social benefit for dependent elderly

– allowance for handicapped persons (means tested); invalidity pension; war pension –

– investment income

– maintenance payments received

– property income

– other (irregular lump sum benefits; other regular primary income; other private transfers received)

Allowances (A)

none

Deductions (D)

– personal deduction

– for pensions

– for professional expenses

– part of SIC: general employee social insurance contributions; css contribution on unemployment and on pensions; special contribution on unemployment income for pensions; contribution on pension income for sickness;

– part of csg-contributions on employment income, on unemployment income, on pensions and on other income

Taxable income (Y)

Y= X – E – A – D (correction Y, D and A, if Y < O)

Gross tax liability (Tg)

Includes both application of the rate schedule as the advantage of the Family Quotient.

Credits (K)

– Tax rebate (decode);

– Tax credit imputed:

– Net personal income tax liability (T_{pit}) = national income tax

Greece:

Gross Income (X)

Total taxes (T) T = $Tpit_t$ + Tsic + Toth

T_{sic} = civil servants social contribution + ika employee contributions + farmer's sic + ika pensioner contributions + self-employed contributions

Toth = other personal taxes and contributions + wealth or national property tax + sub-national (local or regional) taxes

Net income (N) N = X – T

Exemptions (E)

– Housing benefits

– Study allowances

– other private transfers received

remark: lump sum income is imputed taxable income

Allowances (A)

none

Deductions (D)

– Social Insurance contributions (Tsic)

– Mortgage interest payments

– Medical expenses deduction

– Private education expenditure deduction

– Rent deduction

Taxable income (Y)

Gross tax liability (Tg) = taxes after application of the rate schedule

Credits (K)

– Household expenditure Private pension contributions Children

Net personal income tax liability (T_{pit}) = national income tax

Ireland:

Gross Income (X)

Total taxes (T) T = $Tpit_t$ + Tsic + Toth

Tsic = general employee social insurance contributions

Toth = other personal taxes and contributions + wealth or national property tax + sub-national (local or regional) taxes

Net income (N) N = X – T

Exemptions (E)

– Housing benefits Study allowances

– Maintenance payments received Career's non-contributory benefits

– Child benefits

– Short Term Disabled Contributory Benefits

– Family Income Supplement

– Long Term Invalidity Contributory Benefits

– Unemployed (Non-)contributory Benefits

– Matemity Contributory Benefits

– Orphan's Contributory Benefits

– Social Minimum non–contributory benefits

– Unemployment supplement

other (irregular lump sum benefits; other regular cash payments, deserted wives' non-contributory benefits)

Allowances (A)

– Age

– Lone parent

– Single/married

– Widowed

– Employee

Deductions (D)

– Pension contributions

– imputed Self-Employment Deduction

Taxable income (Y)

Y=X-E-A-D

Gross tax liability (Tg)

Credits (K)

– mortgage interest relief

– permanent health insurance relief

Net personal income tax liability (Tpit) = national income tax

Sweden:

Gross income (X)

Total taxes (T) T = Tpit + Tsic + Toth

Net income (N) N = X – T

Exemptions (E)

– Investment income Maintenance payments received

– Child benefits

– Housing benefits (housing benefits;

– Housing benefit supplement for pensioners)

– Social assistance

– other (irregular lump sum benefits; other regular cash payments: other regular primary income; other private transfers received)

– Reside. Tax free educational benefits

– Residual tax free benefits

– University grants; Study grants for high school

– Sick benefit self-employed (is maybe part of self-employment income)

– Non-taxable pension

– Part of self-employment income.

Allowances (A)

None

Deductions (D)

– general pension fee (Tsic)

– Pension contributions

– Deduction from income tax base

– Deduction for new started company Deduction for periodic maintenance payments

– Deduction for travel between home and work'

Taxable income (Y) Y=X-E-A-D

Gross tax liability (Tg) = national income tax

Credits (K) = tax reduction on capital + limitation rule

Net personal income tax liability (T_{pil}) = net national income tax

When considering the differences presented above, we should expect rational individuals to pursue tax-benefit-seeking mobility of labour. In reality the extensiveness of this mobility would be dependent not only on «tax wedge» levels (share that PIT and national insurance consume from gross income) but also on level of wages, gross income levels, the nature of the labour market, quality of public services and infrastructure. Such rent-seeking tax migration would lead to increasing the supply of qualified labour in the market of the accepting country (with a competitive tax system and good labour market) while worsening the labour market situation in the country from which a worker has departed. As a result, countries keen to gain valuable workers could consider setting competitive tax rates to lure in new employees who would migrate and stay, contributing to national economic growth and pay their taxes in the accepting state. In this context harmonisation would be seen as a process of equalisation of life and employment conditions that would reduce the need for «tax wedge» oriented analyses by workers.

2. Theoretical foundations of income tax harmonisation

Inadequacies of tax theories combined with a polarisation of opinion maker positions concerning personal income taxes impact even the microeconomic approach, where it should be easy to establish a causal link between the tax burden, tax scale and the taxpayer's economic situation and resulting decisions. This is a result of multiple interacting factors affecting the taxpayer; therefore isolation of the tax factor is difficult, if we bypass highly abstract analyses. The situation becomes even more complicated when the subject of analysis becomes the impact of a given tax on a specific group of taxpayers or of a specific tax on the entire economy (e.g. automatic stabiliser theory) [8; 9].

The complexity of tax analysis from the perspective of income tax impacting a taxpayer and the wider economy increases, when we take the analysis beyond the borders of a single country. Tax relations become increasingly complex, and the impact of particular income taxation becomes extremely difficult to evaluate, quantify. This statement can be taken as the explanation for existing tax controversies: tax harmonisation between nations versus the freedom to engage in unlimited tax competition.

Both tax rate harmonisation and tax rate competitiveness require additional consideration of:

Impact of PIT rate harmonisation upon the state budget and possible imbalance of public finances (harmonisation worsening national budgets, e.g. through downward integration of tax rates).

Impact of labour mobility upon the nation's economy.

Impact of changes in the tax system, which affect the ratios of: indirect-direct taxes, CIT-PIT, when they are intended to draw in foreign investments.

Economic aims of tax harmonisation may be unachievable due to legal reasons, since a tax is not only an economic category but also a legal one, and its legal side is affected by:

– Relationship between national and Community law, and when considering the supremacy of EU law over national rules, many issues emerge.

– Problems of applying (and in what measures) unlimited tax duty in one country compared to applying unlimited tax duty in one country with a limited duty in the second country and, finally, how to apply unlimited tax duties in both countries.

– How to formulate and agree upon treaties on avoiding double taxation (not only achieving consensus between nations but also following local political patterns, taxation trends).

– Problems in whether to collect the tax in country of residence or non-residence and in what proportions.

3. Legal foundations of harmonisation

The problem of taxing personal incomes and their impact on the free movement of labour and capital was only partially visible to the Union. Below is a list of documents in which the topic of taxing personal income appeared in various contexts and partial manner:

– Neumark Report, 1962;

– EU Commission Memorandum, 1967;

– EU Commission Memorandum, 1969;

– White Book on the Creation of the Common Market, 1985;

– Ruding Report, 1992;

– White Book on integrating associated nations of Central and Eastern Europe with the EU internal market that was approved at the EU Council meeting in Cannes, 1995;

– Code of Conduct for Business Taxation;

– Council Directives in various years covering avoidance of double taxation, taxing savings, dividends, shares and entities operating in various member states.

3.1. Rules regarding the avoidance of double taxation of income and wealth

Tax problems for individuals who change their place of work and residence are not new, especially when we consider the notion of avoiding double taxation of income. Currently, the majority of nations have signed bilateral agreements on avoiding double taxation, based on early work by the OECD that had developed a «model agreement» intended to ease negotiations, with the newest model proposed in 1996. Only the Nordic Treaty [10] between Denmark, Finland, Sweden, Iceland and Norway is not bilateral in nature and should be seen as a precursor of things to come in providing precise multinational solutions. The OECD Convention is still the prime example and has affected the development of similar policies in the Union. It predicts three possibilities for taxing income gained in different nations:

1. Taxing the entire income or wealth created in a different country.

2. Nations share the income from taxation in varying proportions depending on the subject of taxation (dividends, interest on savings, etc).

3. Nations, on whose territory the income or wealth was created cannot tax them (sale of shares, license fees, scholarships).

3.2. Rules regarding capital income tax

The current investor-friendly culture assures that increasing numbers of EU citizens invest their money in multiple companies and expect to gain a profit that is later taxed. The broad rules for taxing dividends and profits from business operations of multinational businesses are defined by EU directives. Yet, individual countries, have certain freedom in this respect, for example by differing in the way such taxes are collected. Two methods exist: taxing the profits of the company and foregoing taxing shareholders and partners or allowing the company not to pay a tax on the paid-out profit and the tax obligation rests on shareholders and partners. Countries differ in the preferred method.

3.3 Rules regarding taxing profits from savings

Harmonising the taxation of savings residing in bank accounts has focused on preventing any restrictions to the flow of capital between member states that could be imposed by national tax laws. The key to such harmonisation is therefore not to enforce a single tax rate for all states: every state is free to set its own taxes (level, differentiation) and profits from savings can be separated from other personal income and taxed with a separate rate or included in total incomes.

3.4. Taxing individual incomes for those not conducting business activity

The main characteristic of direct taxation is the small extent to which it has been normatively harmonised. Since direct taxes are seen to have less of a negative impact on the operations of the Common Market, therefore work on their harmonisation has begun late and has not progressed as far as the work done on indirect taxes. Nations have been left to define their own internal policies but are required to assure fair treatment to local and international entities. The analysis of individual income taxation in EU states, the direction of its evolution and the future of tax policy allows for the formulation of two arguments: the extensive difficulties of harmonising the construction of personal income tax and a progression of «quiet harmonisation» (paralegal). The arguments presented below confirm the proposed arguments.

EU member state tax systems created since the Second World War, were strongly influenced by the ideas of John Maynard Keynes who moved away from the notion of tax neutrality and placing specific Para fiscal functions on the tax system. Taxation of personal income is one of the most fundamental techniques for redistributing income, allowing for the realisation of principles of equality and justice and taxing of «pure income» (all three rules are expected of every tax system in the union), and stimulating desirable behaviours in the spheres of production and consumption. As such direct taxes have a much different impact upon the division of income and wealth than indirect taxes. Income taxes possess an «inbuilt stabilising flexibility», e.g. in times of recession they inhibit the fall of global demand and in times of growth, slow down its expansion. Progressive income taxation of individuals leads to a much faster fall in governmental revenues due to a fall in the citizens' income. As such, despite declaring intended tax system neutrality, EU member states allow Para fiscal functions to affect the construction of the PIT framework, which in turn makes harmonisation extremely difficult.

The current belief is that differentiation in setting the rules governing direct taxation poses a small challenge to the functioning of the Common Market. It is based on:

1. Income taxes in their pure form do not stimulate the propensity to save and invest. Income taxes impact both the saved part of income as well as the spent. To stimulate saving and/or spending it is necessary to introduce allowable deductions and tax credits that would be obtainable upon increasing existing savings or investments or undertaking them.
2. Income taxes do not affect the choice of socially beneficial structure of production and selection of factors of production nor the application of technologies that will protect the environment. Achieving these aims requires the application of allowable deductions and tax credits.
3. Income taxes do not affect the choice of socially beneficial structure of consumption. It does not seem possible to introduce appropriate allowable deductions and tax credits that would allow for guiding the expenditure of households.

Harmonisation of income taxes is much more difficult than harmonisation of indirect taxes from the practical, technical and legal perspective and is a result of:

1. When creating the Treaty of Rome it was decided that direct taxes would not have a notable impact on the operations of the internal market, and that approach led to a lack of appropriate regulations, especially in the area of personal income taxes.

2. Income taxes, as forms of direct taxation are an important tool for fiscal policy that affects social and economic activities and it is difficult for politicians to abandon this tool for managing national policies.

3. Directives requiring the formulation of direct tax harmonisation must be agreed upon with a majority vote in the national Assemblies (Parliaments), which leads to a lack of consensus on desired aims, costs and benefits, procedures.

4. Progress in direct tax harmonisation creates an aura of challenges to the tax independence if nations and leads to entrenchment of state and elite positions.

5. EU member states have different rules for remunerating employees, setting incomes from retirement funds and affecting the structure of income-generating costs and expenditures that reduce the tax base.

Despite the lack of Directives to regulate the rules of taxing personal income, the rules are emerging spontaneously and tax burdens are slowly equalising. This process is the result of competition between EU member state tax systems-nations extensively are utilising the construction of the personal income tax to utilise the stimulating functions of the tax system, which in turn impacts the possibilities open to spontaneous PIT harmonisation. Due to the effects of «quiet» paralegal harmonisation, several common PIT characteristics can be found in the EU:

1. Placing subjectivity on the principle of residence. Rules on limited (<183 days), and unlimited (>183 days) tax duty.

2. The dominant concept is of a global tax. Joint taxation of all incomes obtained by the taxpayer from different sources (only the rules regarding capital interests are exempt from being combined with other incomes).

3. The tax is progressive and specific solutions concern different tax rates, types of scales, rules regarding progression and the size of the minimal and maximum rates.

4. Tax burdens are designed to follow inflation through a system of automatic or semi-automatic indexation or through the change of tax brackets.

5. Different regulations are applied to a family income, sale of real estate, assets and investment incomes.

6. In every construction there exists a sum free from taxation and, in varying degrees, considers the minimal level of (biological) existence and costs of obtaining an income.

7. Tax burdens are considerate of, in varying degrees, state of the family and capabilities to pay through a system of rebates and deductions.

8. Multiple rebates and deductions exist that are of a simulative and social character (investment, building and renovation, health, donations).

The analysis of Union laws indicates that personal income tax harmonisation is extremely difficult due to historical, political, social and technical factors. Decisions by the European Court of Justice (ECJ) concern mostly tax deductions by individuals who are not Union residents and the deductions of contributions made to retirement funds operating outside the EU.

Alongside minimal lawmaking at the European level, minimal progress of harmonisation is a result of:

Political factors:

– PIT payers are the largest group in any nation.

– PIT harmonisation is not an important factor in the evolution of the Common Market.

– PIT taxes mainly incomes from work and retirement and the level of taxation does not increase intra-EU migration.

– In EU member states, social support systems are funded from different sources: taxpayer contributions, direct funding from the state and as they form part of the total «tax wedge», their harmonisation will be even more difficult.

– EU member states possess different systems of labour remuneration and shaping of citizen income levels, different methodologies of designing tax progression.

5. Perspectives for and possible directions of PIT harmonisation in the EU

Harmonisation in general is a difficult challenge, and any debate about harmonising PIT systems brings out major counterarguments:

1. Further loss of sovereignty in national financial policies, which will inhibit the state's ability to affect economic processes and (especially) social ones. Harmonisation of the rules for calculating the basis for taxation and the acceptance of unified rates would mean the transfer of tax-setting prerogatives to a trans-national institution: the EU.

2. Different social models and retirement systems, when combined with varied degrees of PIT integration with retirement contributions, determine various financial needs of the state, therefore harmonisation would have to reach far beyond «mere» PIT systems.

3. Historical, cultural, social factors that have shaped national tax systems enforce claims that path-dependent process will be difficult to reverse.

4. Competitive inequality between taxpayers who operate in one market and those that function in multiple EU member states.

Not withstanding abovementioned criticisms, the following predictions can me made regarding income tax (primarily PIT) harmonisation across the European Union:

1. Harmonisation of direct taxes is unavoidable, but it will be a long-term process and will affect CIT before PIT [11] (reducing complexity of trans-border business operations will be a priority compared to easing the life of individual taxpayers).

2. The current process of direct tax harmonisation is in an early stage of progress due to existing extensive national variations. Forces promoting reform are more economic and include the unified market, common currency, need to increase competitiveness.

3. At the very least, it is crucial to assure the enforcement and optimisation of regulations covering the avoidance of double taxation, both personal (PIT) and business (CIT). The need for speedy resolutions stems from the growth and expansion of trans-border economic activity and the removal of barriers to the movement of labour which complicates proper income taxation (calculation and collection) [12].

4. PIT harmonisation should focus on achieving intergovernmental agreement on calculating the tax base, to avoid distortions in the real tax rate (tax brackets). The concept of taxable income is a result of local costs of generating the income, rebates and deductions and the current methods of setting them differ in each country.

5. When discussing PIT harmonisation it is important to remember about the integration of this tax with social security contributions, as both contribute to the burden placed on labour. They are complementary and form the «tax wedge» (the difference between the gross labour costs to the employer and the net income for the employee) and are important for businesses when considering the costs-versus-reward of creating new employment opportunities (positions).

6. A controversial issue is the competitive lowering of PIT rates, and nations intent on lowering («dumping») their effective tax rates ought to consider the impact of those actions on the wider Union, especially from the perspective of affecting competitive equilibriums.

7. It is important to approach with caution the concepts regarding the removal of the capital gains tax since this would promote speculative activity (due to resulting high profits), while discriminating against labour incomes and profits from (more laborious, productive and long-term) economic activity.

8. It is difficult to expect that the EU will evolve into a federal state, but only such a structure would give the Union the right to set and collect taxes. The, tax policies would be formulated and implemented in a top-down manner that would allow for the implementation of a uniform (harmonised) tax system.

9. A question emerges regarding the future possibilities for the income tax becoming a «European tax» and whether such

an idea is realistic. The debate about setting a European tax started with the underlining of the weaknesses of available financial resources and defining the new model of EU budget revenues. When considering the PIT, the Commission proposed three possible ways of establishing the PIT as a European tax: poll tax, percentage of national PIT revenues or separate EUPIT (two tax declarations: national and EU).

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У процесі подальшої інтеграції до ЄС недостатньо уваги приділяється ролі податків на доходи. Численні системи оподаткування доходів та їх диференціація негативно позначаються на європейському ринку праці, інвестиціях та заощадженнях, стримують економічне зростання. Окремі країни мають слабку мотивацію для узгодження своїх можливостей з конкуренції у галузі ставок оподаткування та оподаткування доходів у поєднанні із системами соціального захисту, що робить будь-які спроби реформування вкрай складними та політично непопулярними.

Ключові слова: європейська інтеграція, податкова гармонізація, оподаткування особистих доходів, диференціація системи оподаткування.

В процессе дальнейшей интеграции в ЕС недостаточное внимание уделяется роли налогов на доходы. Многочисленность систем налогообложения доходов и их дифференциация негативно сказывается на европейском рынке труда, инвестициях и сбережениях, сдерживает экономический рост. Отдельные страны имеют незначительную мотивацию для согласования своих возможностей по конкуренции в области налоговых ставок и налогообложения доходов в сочетании с системами социальной безопасности, что делает любые попытки реформирования крайне сложными и политически непопулярными.

Ключевые слова: европейская интеграция, налоговая гармонизация, налогообложение персональных доходов, дифференциация налоговой системы.

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