NEGATIVE TAX EXPENDITURES IN THE TAX SYSTEM

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Abstract

Governments which realized active fiscal policy often use many solutions of reducing tax final burden, such as exemptions, rate reliefs or tax deferrals. These elements in literature are known as tax expenditures and leads to support pointed tax payers or activities. The analysis of tax systems leaded to identify another construction defined as negative tax expenditures. However these instruments makes higher tax incomes in state budget – arises when arrangements impose an additional charge than a benefit as it is in case of tax expenditures.

Key words

tax expenditures, negative tax expenditures, tax incentives, tax panelties

According to the economic literature, the state can fulfil a number of functions in relation to society and business. What should be the exact number of those functions and to what extent the state should interfere in the economy have always been among the fundamental issues of economics. These two questions frequently become the focus of heated debates among economists, who can be roughly divided into those who fear the unreliability of the market and those who are more afraid of the unreliability of governments[1]. The functions of the state can be accomplished through, for example, economic policy, i.e. a body of decisions which are taken by public sector institutions, and which concern the following three fields[2]:

- institutional choices regarding the very existence of state and market,

- social choices as regards the role of the state and public sector,

- ongoing choices as to the objectives of public institutions.

Thus defined, economic decision-making comprises: fiscal policy and monetary policy, frequently referred to as policy mix.

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[1] J. Żyżyński, Budżet i polityka podatkowa, WN PWN, Warszawa 2009, s. 10.

[2] Ibidem, s. 23.

The present article is concerned with the scope of income-related instruments of fiscal policy, which has not yet been discussed conclusively in the literature. For M. Pietrewicz, fiscal policy is ‘a state policy carried out by means of the accumulation of public assets’[3]. He realises, however, that this approach is debatable, and that much of the modern literature takes a different stand. The Anglo-Saxon economists understand fiscal policy very broadly as a policy implemented by the public finance sector. J.D. Gwartney and R.L. Stroup J.D. see it as a combination of tax and expenditure policies, and believe that its objective is to ensure the achievement of macroeconomic goals[4]. A similar view is expressed by S. James and Ch. Nobes, who define fiscal policy as one which involves two fields of governance: income and expenditures[5]. This approach is somewhat narrower as it identifies fiscal policy with tax policy[6].

It is through tax policy that the state, using tax instruments, obtains income with which to fund public purposes. The accumulation and management of taxpayers’ money should be supported by efficient procedures concerning collection and distribution of financial resources.

In every economy, taxes perform specific functions. The most important one is the income (or fiscal) function. The efficiency of a tax system is usually measured by this criterion, which was succinctly articulated by king Louis XIV’s finance minister, Jean-Baptiste Colbert: ‘The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing.’

The transparency of fiscal policy is one of the prerequisites of an efficient tax system. According to the International Monetary Fund: ‘first, fiscal transparency requires providing comprehensive and reliable information about past, present, and future activities of government, and the availability of this information informs and improves the quality of economic policy decisions. Fiscal transparency also helps to highlight potential risks to the fiscal outlook that should result in an earlier and smoother fiscal policy response to changing economic conditions, thereby reducing the incidence and severity of crises. Second, fiscal transparency benefits citizens by giving them the information they need to hold their government accountable for its policy choices. Third, more transparent

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[3] M. Pietrewicz, Polityka fiskalna, Poltex, Warszawa 1996, s. 7.

[4] J.D. Gwartney, R.L. Stroup, Macroeconomics. Private and public choice, Harcourt Brace Jovanovich, Publishers, 1987, s. 176.

[5] S. James, Ch. Nobes, The Economics of Taxation, Prentice Hall Europe, 1987, s. 114.

[6] M. Pietrewicz, Polityka fiskalna, Poltex, Warszawa 1996, s. 7.

governments also benefit from improved access to international capital markets'[7].

On the basis of the above, it can be concluded that transparency of tax policy implies full access to information concerning all categories of taxpayers, as well as the scope of taxation and the amount of money thereby collected. In other words, every tax regulation must be explicit as to its objective and subjective scope, and to the available exemptions and reliefs.

An extension of the tax system is often performed by involving various fiscal institutions in the creation of new instruments designed to either reduce or increase the eventual tax burden. The more intermediaries in the system, the more complicated and obscure – and, consequently, inefficient – it becomes. In order to comprehensively analyse the tax system, that is to identify all the effects of its functioning, the notion of tax expenditure can be used. The term refers to fiscal privileges granted to specific groups of taxpayers, leading to a reduction of government revenue. S. James and Ch. Nobes state that such privileges are not a result of direct subsidies from the state budget, but of indirect (fiscal) support in the form of tax reliefs or exemptions[8].

S.S. Surrey, a pioneer of research into tax expenditures, defines them as the amount of tax foregone to the State in tax reliefs and other kinds of tax stimuli[9]. The authors of Tax Expenditures use the eponymous phrase alternatively with the term spending programmes, thereby emphasising the expense aspect of the notion[10].

In general terms, the concept can be best defined as a certain mode of active fiscal policy (or tax policy). From this point of view, tax expenditures can be said to effect a deviation from the generally accepted rules (regulations) – so called normative tax construction, in order to support selected types of activity or groups of taxpayers[11]. This kind of support means a reduction of tax burdens, rather than direct payments from the budget.

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[7] International Monetary Fund, Manual on Fiscal Transparency, 2007, s. 8.

[8] S. James, Ch. Nobes, The Economics of Taxation, Prentice Hall Europe, 1987, s. 114.

[9] J. Saxton, Vice Chairman, Tax Expenditures: A Review and Analysis, Joint Economic Committee, United States Congress, August 1999.

[10] S. Surrey, P.R. McDaniel, Tax Expenditures, Cambridge, Mass.: Harvard University Press, 1985, s. 1.

[11] L.E. Burman, Is the Tax Expenditure Concept Still Relevant?, National Tax Journal, September 2003, s. 2.

The authors of the report Tax Expenditures in OECD Countries use the following definition of the discussed concept: 'provisions of tax law, regulation or practices that reduce or postpone revenue for a comparatively narrow population of taxpayers relative to a benchmark tax'[12]. As they also remark, for a government, a tax expenditure is a loss of revenue, whereas for a taxpayer, it is a reduction in tax obligation.

Tax expenditures can take a number of forms, including[13]:

- allowances: amounts deducted from the benchmark to arrive at the tax base;

- exemptions: amounts excluded from the tax base;

- rate relief: a reduced rate of tax applied to a class of taxpayer or taxable transactions;

- tax deferral: a delay in paying tax;

- credits: amounts deducted from tax liability.

It is clear that the above measures benefit taxpayers. However, tax systems also contain solutions which involve hidden tax increases, bringing additional income to the state budget. The literature describes them as negative tax expenditures or tax penalties. They arise when tax regulations impose extra liabilities[14].

Such solutions result in additional benefits (tax revenue), which should be identified and accounted for in regular tax revenue reporting budgets[15]. As in the case of tax expenditures, in order to be included in budget, these measures must be identified and the amount of special tax revenue that they generate must be evaluated[16].

Therefore, complete transparency of fiscal policy seems to demand an analysis of the tax system, as well as an assessment of negative tax expenditures.

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[12] Tax Expenditures in OECD Countries, OECD 2010, s. 12.

[13] Ibidem, s. 12.

[14] D. Shaviro, Rethinking Tax Expenditures and Fiscal Language, NYU Law School, Public Law Research Paper No 72, New York University School of Law 2009, s. 39.

[15] E. Hutton, A Basic Framework for Evaluating Value Added Tax Expenditures, Inter-American Development Bank, Institutional Capacity and Financial Sector, No IDB-DP-138, June 2010, IDB 2010, s. 3.

[16] Ibidem, s. 3.

Practice shows that negative tax expenditures usually take the form of[17]:

- double corporate taxation – which arises when income generated by enterprises (in Poland, corporate income tax payers) is taxed once, and later, after net profit distribution, it is taxed again at the shareholder level; various loss disallowance rules[18];

- consumer interest – disallowance of deductions for consumer interest is inconsistent with the inter-temporal approach to income tax;

- lack of inflation indexing – in the case of quota-based taxes, lack of indexing can generate additional tax income. This is particularly significant as regards progressive taxation scales (so-called cold progression)[19];

- treatment of human capital – under a Haig-Simons approach[20], education expenses, i.e. human capital expenditure, should be amortised and allowed during the period when they are bringing income, instead of being treated as a standard consumption expenditure and, as such, disallowed;

- other possible tax penalty items – e.g. regarding bribes, fines or excessive remuneration as non-deductible for tax purposes.

The above examples have been selected following an analysis of specific regulations in the United States; some of them, however, can be considered standard negative expenditures.

All the aforementioned types of negative tax expenditure can be observed in the Polish tax system: double corporate taxation, disallowance of deductions for consumer interest and losses, lack of inflation indexing of personal income tax rates (in the years 2001-2006, the legislator failed to index the tax brackets for inflation; as the accumulated rate of inflation in those years reached 30.1%, it can be concluded that some taxpayers had to bear heavier tax burdens), and the tax code's disallowance of cost recovery for human capital spendings are ample evidence of negative tax expenditures.

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[17] D. Shaviro, Rethinking Tax Expenditures and Fiscal Language, NYU Law School, Public Law Research Paper No 72, New York University School of Law 2009, s. 57-59.

[18] As D. Shaviro mentioned, this is the only negative tax expenditures which is evaluated.

[19] See B. Heer, B. Süssmuth, Cold Progression and its Effects on Income Distribution, CESifo Working Paper No. 951, Category 6: Monetary Policy and Intenational Finance, May 2003, s. 2.

[20] See S. Surrey, P.R. McDaniel, Tax Expenditures, Cambridge, Mass.: Harvard University Press, 1985.

What also contributes to this phenomenon is the way in which the present tax code regulates the question of deductible expenses. The standard definition of 'income' states that it is a surplus of revenue over the deductible costs. It is then justified to suppose that a taxpayer is entitled to subtract tax-deductible expenses from the overall revenue. The legislator, however, effectively limited the tax deductions available to Polish taxpayers.

As far as the model of taxation is concerned, the legislator used three approaches to defining deductible costs, namely:

- accepted the standard definition of the term,

- adopted flat-rate cost solution (as a fixed amount or as a percentage),

- equated revenue with income, making it impossible to deduct expenses.

Each of the above approaches relates to a different source of revenue from which a taxpayer can derive income.

The first one primarily concerns entrepreneurs, who are obliged to follow their own interpretation of the tax code (that is they have to themselves identify deductible expenses as costs incurred in order to obtain revenue or to maintain/secure the source of revenue)[21] in order to be able to qualify expenditures as tax-deductible and thus reduce the income subject to taxation. Moreover, they have to comply with the current version of the deductible expenditures catalogue[22], considered by many authors to be an efficient instrument for 'tacit' tax increases.

A close reading of the Corporate Income Tax Act reveals that the list of non-deductible expenses has considerably expanded. When the Act was first passed, Article 16 comprised merely 19 types of expenses which entrepreneurs could not subtract from revenue. In its present form, it lists more than 60 general categories of expenses, which are further subdivided into more detailed ones. I. Ożóg commented: 'at the beginning of the 1990s, the list included only 17 items. Nowadays, it exceeds 60, not to mention numerous subparagraphs which altogether add up to nearly 100 items'[23]. Article 16 has been undergoing dynamic changes. As has been mentioned, the number of paragraphs grew from 19 in 1992 to 65 in 2004 (1993 – 52, 1994-95 – 53, 1996 – 57, 1997-98 – 59, 1999 – 62, 2000 – 64). What is more, the

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[21] Article 15 of the Act of 15 February 1992 on corporate income tax or article 22 of the Act of 26 July 1991 on personal income tax.

[22] Article 16 of the Act of 15 February 1992 on corporate income tax or article 23 of the Act of 26 July 1991 on personal income tax.

[23] P. Skwirowski, Polski CIT jednym z najniższych na świecie, „Gazeta Wyborcza", 05.07.2006.

number of subparagraphs grew even faster. This is reflected in the sheer number of words used in particular paragraphs. In 1992, the Article consisted of 503 words, but by 2008 it had 5256 words. This clearly indicates that, despite actual decreases in tax rates, the legislator seeks alternative methods of increasing taxes. This results in, e.g. constant lengthening of the list of non-deductible expenses. As it turns out, in spite of relatively low tax rates, the ratio of paid taxes to gross revenue in Polish enterprises is among the highest in the world. In Poland, this ratio in 2006 was 43.6%, whereas in Slovakia – 38.8%, Great Britain – 33.5%, USA – 20.1%, and South Korea 17.3%. Only in Belgian, German and Swedish enterprises this indicator was higher: 55.4%, 51.8% and 47.9% respectively[24].

The second approach to tax deductions applies to non-business revenues. These are obtained from the most popular source of earnings, i.e. remuneration for work, also termed as contractual employment. As many authors point out, the widest category of taxpayers receives very unfair treatment under the income tax code. They are only allowed to deduct fixed costs, quite independent of the actual expenses incurred to obtain revenue.

The last of the aforementioned approaches applies to capital income – here taxpayers are not allowed to deduct any costs.

It must be strongly emphasised that identification and evaluation of both tax expenditures and negative tax expenditures are indispensable conditions for transparency in fiscal policy. The identification and evaluation of these elements of a tax system should guarantee that the overall scope of state tax powers is publicly known.

Although the idea of tax expenditures budgets has been gradually gaining approval, the proposal to identify and evaluate negative tax expenditures has not been met with similar approval.

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