

SINGULAR LEVEL VS. PROGRESSIVE TAXING SYSTEM

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Abstract: *An important part of State's income comes from collections that the State makes through taxes. The way the fiscal system is designed, which principles are promoted differ from country to country and from one historical stage to another. There is a dispute though: does the fiscal system have to be designed to meet fiscal equity requirements, so it can be as just as possible, or does it have to meet requirements to make economical activity as efficient as possible? The dispute is kept going by the fact that a just tax is not always efficient and vice versa.*

Key words: *fiscal system, efficiency, equity, economic growth.*

In order to meet the general needs of the society, the state needs income. An important part of this income comes from collections that the State makes through taxes and other contributions, that is through taxes *lato sensu*. These represent the main means of resource collection for the state, which are necessary to cover public expenses. So, taxes represent an evil because they affect the level of tax-payers' income, but a necessary evil because the income collected will be spent for the benefit of the society. The number and the type of taxes that make up the fiscal system of a state depend on the economic, social, political situations, taking into account the fact that each country has the right to freely establish its own fiscal system, on the grounds of its independence. We are talking about the fiscal independence as a part of the national independence. The fiscal system works on older principles, like the equity principle (on establishing taxes the tax-payers' income is taken into account), the

exactness principle (taxes must be clearly mentioned), the economical principle and the efficiency principle (the collected income must be higher than the expenses made to administer taxes), or newer ones, like the non-discrimination principle (the tax must not be discriminatory, but it must include identical rules for all tax-payers), the neutrality principle (the state must not interfere with the economy through the fiscal system, must not "model" the economic actions). The way the fiscal system is designed, which principles are promoted differ from country to country and from one historical stage to another.

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The concept of the fiscal system equity focuses on social protection, while the concept of economical efficiency focuses on economic growth. But is it possible for

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the economic growth to co-exist with the social protection? The dispute is kept going by the fact that a just tax is not always efficient and vice versa. Equity means justness concerning the collection of taxes *lato sensu*, and can be obtained through differentiated taxing of income and establishing a non-tax minimum. In this case, the fiscal duty is established depending on the financial power of each tax payer. So the principle of equity is incompatible with the principle of non-discrimination which supposes equality in fiscal treatment, like in the case of the application of the singular level. One must distinguish between *equality in front of taxes* and *equality through taxes*. The equality in front of taxes exists when the same rules apply to all tax payers (i.e. the principle of non-discrimination), for example in the case of the application of the singular level of taxing, and the equality through taxing exists when the fiscal duty differs depending on where the income comes from (i.e. the principle of equity).

Depending on the target assumed, one can opt for one of the following types of taxing: (1) *taxing in a fixed amount* – method which does not take into account the tax payer's income; (2) *taxing in percent levels* – type which insures an equal distribution of the fiscal pressure. In its turn, taxing in percent levels may use *progressive taxing*, *regressive taxing* or *proportional taxing*. In the case of the progressive taxing, the tax level rises with the income obtained; in the case of the regressive taxing, the tax level lowers as the income rises, and in the case of the proportional taxing, the tax level remains the same no matter what the size of the income obtained is (singular level). The progressive taxing is used mainly to tax the income of natural persons, the regressive taxing is used in the case of indirect taxes, placed on consumptions (this type of tax has the purpose of stimulating it), and the proportional taxing is placed on the profit,

the income, but also on the consumption, like the added value tax.

The question of which one of these presents a higher efficiency has been a reason of meditation for the theoreticians and practitioners in the fiscal area. *The ideal tax is that which requires minimum administration costs and has minimum effects on the motivation to work, invest, save.* Of the taxes analysed, the fixed tax is rarely used. E.g. in our country we apply the tax on the agencies, which is the lei equivalent of 4000 euros per year. Of the percent level taxes, we have already mentioned where we find the regressive taxing and which are its effects. There are discussions about the other two systems: the progressive and the proportional (singular level), when they involve direct taxes, as they affect the personal income and the property. In the following, we shall present the arguments that support as well as those that deny the efficiency of these systems, so we can have an image as complete as possible of the advantages and disadvantages that they present.

The progressive taxing system consists in applying a larger taxing level to income that surpasses a certain value cap.

Arguments for. The progressive taxing is supported by arguments that have to do with fiscal equality, so the larger income is more severely taxed than the smaller, thus protecting the persons with low incomes.

Arguments against. *Firstly*, administering taxes in the progressive system is difficult and costly, thus lowering the overall efficiency of the system. Nevertheless, it must be kept in mind that processing data in a software makes work considerably easy, so this argument can easily be questioned. *Secondly*, this taxing system leads to tax evasion through methods like not declaring incomes, finding ways to reinvest profits, the "loss" of profit through accountancy methods, orienting towards less taxed activities etc, the phrase "High taxes kill taxes" being well-known. *Thirdly*, a hard

or almost impossible to combat argument is that the progressive taxing taxes work, initiative, saving and efficiency, protecting under its wing the disinterest for these values, for the sake of social equality in general and fiscal equality especially. The virtue of this system is placed in the fact that larger sums are collected at the budget than if the singular level were applied, sums out of which the state can better fulfil its tasks, covering to a larger extent the general needs of the society (education, health, public order, justice, defence, diplomacy, etc), including the need for social care.

The singular level system consists in the application of the same taxing level to all incomes, no matter what its amount.

Arguments for. Firstly, the singular level is characterized by simplicity, transparency, easy administration, contributing to the reduction of bureaucracy and of corruption. Secondly, this system supposes the application of the same level for all taxes (income, profit, etc), so it represents a stimulus to fill the labour market and for investments. Thirdly, the singular level discourages speculative transactions and the underground economy, leading to the reduction of tax evasion, which means that the actual income to the budget coming from taxes can be higher than in the case of the progressive system. The fiscal relaxation obtained through the singular level determines the rise of the assessable total, by reducing tax evasion, so the total amounts collected by the state can be, as we have mentioned, larger than in the case of the progressive system. There is another extremely important advantage; the business environment is consolidated (of course, this depends on other internal and external factors) and the discontent for the state which punishes the entrepreneur and efficient and supports the less efficient and less active disappears. The fiscal motivation is extremely important for the economic growth. Fourthly, we know that

public finances fulfil 2 functions: the distribution function and the control function. The distribution function is fulfilled in its turn in two phases: the collection of budget income and their distribution on categories of expenses. In the case of the singular level, the redistribution of revenues in the society (the distribution function) takes place through the expense policies and not through the income collection policies. By choosing the solution of the singular level, the state will have to carefully fundament its expenses and act as a responsible manager. Taking into account that the reporting, calculation and recording system is simplified, the control function is more easy to fulfil and soothe efficiency of the specialized bodies for the financial-fiscal control will grow, correspondingly growing the efficiency of the administration of taxes lato sensu.

Arguments against. Firstly, by eliminating the progressive taxing system, the singular level proposes the obtaining of fiscal neutrality, meaning the lack of intervention by the state into the economy through taxes lato sensu and stimulating investments, production and exports. Thus, the principle of fiscal equality – respected in the case of the progressive tax – is replaced with the principle of fiscal neutrality. This change can stimulate the industry, agriculture, trade, services and can determine an economic rise in the long term. But, in the short term, the reduction of budget income is an obvious reality. It explains why the adoption of the singular level is followed by fiscal measures meant to cover the void created, like the rise of the number of taxes lato sensu and/or the rise of the amount of indirect taxes, which affects the consumption (for example, the added value tax supported by the final beneficiary – the consumer). Paradoxically, the principle of neutrality seems abandoned (which can be interpreted as proof of inconsequence), and efficiency is given to rather a principle of

equality (but not fiscal), according to which, who works a lot, can consume a lot. *Secondly*, the growth of the amount of indirect taxes (VAT, nuisance taxes, etc) leads to the rise of prices, a worrying fact for governments that target the avoidance of inflation growth. Indirect taxes, that is, those taxes placed on the consumption (VAT) or on the production and consumption (nuisance taxes) have the advantage that they require low administration costs, but have the disadvantage that they impoverish tax payers with low incomes and give birth to prices rises. *Thirdly*, the singular level advantages only a small parts of tax payers; more exactly it advantages only those with high incomes. This can lead to the sharpening of income differences and to the existence of two social classes: rich and poor. In order to rectify this shortcoming, there should be regulated deductions and exemptions, but these measures would contravene too to the principle of fiscal neutrality, which the supporters of the singular level try to respect. *Fourthly*, the provision of budget resources constitutes a problem (because most of the times the needs are greater than the incomes), even for the developed countries, and that is why the adoption of the singular level is taken into consideration with precaution.

Each state has the right, as we were saying at the beginning of the analysis, of establishing its own fiscal system, based on the fiscal sovereignty it holds, of course, while respecting the international treaties signed by the country. The founding of the European Communities, of the Common Market and then of the European Union has lead to the appearance of a huge financial space, in which, of course, the problem of fiscality, was raised, so Chapter 10 of the Community *acquis* is dedicated to fiscality and chapter 25 to customs union. The creation of the Common Market has determined the elimination of customs taxes between th

member states, the forbidding of equivalent targets and of internal discriminatory taxing. The European Community treaty forbids all protectionist or discriminatory fiscal policy measures. It constraints the member states to correlate their legislation with the community rules, by imposing the harmonisation if the fiscal legislation at community level. Certain community provisions trace specific restrictions on the free practice of the national fiscal policy, restrictions that target the insurance of the freedom of competition in the community area. The fiscal harmonization concerns mainly the indirect taxes and, within them, the added value tax and the nuisance taxes, art. 93 of the Treaty comprising the basis of this harmonization process. *Directive no. 6 of 19 October 1992* supposes the application by the member states of an added value tax that cannot be lower than 15%, allowing a reduced tax for certain goods and services, a tax that cannot be lower than 5%. The commission has developed, beginning with the year 2000, a strategy to perfect the functioning of the added value tax system, with targets like the simplification, modernization and even application of the existing rules, as well as the administrative cooperation (*Commission Communicate of 17 July 2000, Strategy concerning the improving of the VAT system on the internal market*). The nuisance tax regime is also subjected to harmonization, which regards: defining nuisance tax products establishing measurement units, exemptions, minimum limit for taxing, rules regarding the circulation of nuisance tax products (*Directive 92/12/CEE of the Council of 25 February 1992, regarding the general detaining, circulation and control of products subjected to nuisance taxes*). The level of nuisance taxes are established by states, while respecting the minimum level established by the Union, but the Community authorities have traced the approaching of the nuisance tax levels. The treaty does not include precise

dispositions regarding the harmonization of direct taxes of member states. Still, based on article 94 of the Treaty, the Council, at the proposal of the Commission and after consulting the Parliament and the economic and social committee, adopts directives in the purpose of approaching the law and administrative provisions of member states, which have a direct incidence on establishing and functioning of the common market. From this perspective, the Commission has formulated recommendations destined to guide the states in applying the Treaty, in interpreting the case law of the European Court of Justice and in coordinating the fiscal provisions of the member states. It also fulfils the role of Treaty guardian, which allows it, on the grounds of article 226, to notify the Court every time it finds incompatibilities of fiscal measures of member states with the community law. The free exercise of the fiscal policy in the field of direct taxes, by the member states of the European Union is limited by the obligation to respect community law and the principles of the common market that establish the four big circulation freedoms: of person, products, services and of capital.

Choosing the taxing system (progressive or percent) is in the internal competence of member states. Today, of the 27 Union member states, 22 apply the progressive taxing and only 5 apply the proportional taxing (singular level). They are Lithuania, Latvia, Estonia, Slovakia and Romania, countries from Eastern Europe, which have recently acquired the status of Union member. Developed countries like Germany, France, Great Britain apply the progressive system. From this perspective, the application of the singular level appears in disagreement with the Union practice, and rather in agreement with the countries from the old Eastern block. It has to be mentioned that in Eastern Europe, and in non-community states, like the Russian Federation, Serbia, Ukraine, Georgia, the proportional system is applied

(the singular level). A possible explanation is found by analyzing the advantages of the singular level: growing investments, new work places and unemployment reduction, reduction of tax evasion, bureaucracy and corruption. In other words, these countries wish to surpass their status as ex-communist states, with a centralized economy, developing countries, and to take firm steps toward economic growth, while simulating investments, work productivity, economic efficiency.

In Romania, after the December 1989 Revolution, there was an attempt at carrying out a reformation of the fiscal system, so it can correspond to the changes determined by the economic reformation as a whole. The fiscal reformation had the following targets: creating a coherent, efficient and stable fiscal system; eliminating discriminations and exemptions from the payment of direct or indirect taxes; evening out the customs tax for imports of Romania in accordance with the international treaties signed; perfecting the administration of tax collection and reducing its costs; reducing and preventing tax evasion. Respecting the commitments assumed through the Association Treaty to the European Communities, signed in 1993, and through the Maastricht Treaty has become a constant preoccupation for the Romanian authorities, which are under the surveillance of community institution and of international financial institutions (IMF and the World Bank Group). In the annual country Reports concerning Romania, the European Commission mentioned the status of the harmonization of the Romanian fiscal legislation with the community legislation.

The *Fiscal Code adopted in 2003* (under social-democrat government) established the legal frame for the taxes that constitute revenue to the state budget and the local budgets, mentions the tax payers which must pay these taxes, the method of calculation and payment, establishes the principles of fiscality (neutrality of fiscal

measures; certainty of taxing; fiscal equality, efficiency of taxing), while *imposing the progressive taxing system*. In the 2003 country report, there are outlined the progresses regarding the alignment of the Romanian legislation to the community acquis and specifies that the effort to modernise the fiscal administration must be continued. The 2004 country report mentions the adoption of the Fiscal Code and of the Fiscal Procedures Code, and in the 2005 report, Romania is criticized for the mediocre level of fiscal debt collection and for the efficiency of the financial-fiscal control activity, while maintaining the recommendation to modernise the fiscal administration. The changes appeared following the elections have had an impact on the philosophy of the fiscal policy. Thus, the *Fiscal Code is modified* (under liberal-democrat government) and starting with the year 2005 the progressive taxing system is replaced with the singular 16% level both for the income and for the profit tax. “The taxing level shall be competitive compared to the states with which Romania is competing, in the purpose of attracting direct foreign investments” – is shown in the Governing Program for 2005-

2008. In the same programme it is mentioned: “The foundation of the Government policy is the fiscal relaxation as a means of relaxing the business environment, of stimulating the private initiative and encouraging the legalizing of the hidden economy”. The review of the results of these measures could constitute the theme of another article. The author’s intention was to explain the advantages but also the shortcomings of the two types of taxing, so we can have a pertinent and competent point of view in the dispute regarding the adequateness of one or the other.

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