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THE ELEMENTS OF PERSONAL INCOME TAXATION

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Abstract: *Personal income tax is one of the most important taxation forms. With him it is possible collect the big sum of gross revenues. In this article, we present the elements of tax structure in income taxation. An emphasis is on tax rate and flat taxation. This is new manner of taxation, with single tax rate from personal income tax and corporative income tax. In such a way, tax authority may reduce tax expense and realize principle efficiency.*

Key words: *personal income tax, tax unit, tax base, tax rate, flat taxation*

Introduction

The income tax is the most significant sources of tax revenue in developing and developed economies. In the taxation of income is important application the general principles of taxation. Income taxes discourage people from earning income, causing a substitution from income to activities not subject to the tax. The individual may also mean substituting out of work and into leisure. However, an offsetting effect can occur if people work harder to make up for income lost to the income tax.

The income taxation can be organized as synthetic or global, analytic or cedular and combined system. The analytic taxation is the system of income taxation where every income that a single person has realized is being taxed, with the proportional rate. The synthetic taxation regards income as a whole, which has one tax form, with the progressive tax rate. In the end, the combined system represents combination of previous two systems.

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However, the synthetic system has certain advantages in relation to remaining two systems.

Synthetic tax income synthetizes all incomes which the tax payer realizes and imposes a tax on neto income. In such a way, synthetic income taxation ensures appreciation the principles of efficiency and equivalence in taxation, because it imposes a tax on total economic power. Also, that system of taxation enables much larger government revenues and by that system the sum of net incomes is being taxed.

The taxation of income encompasses a number of other significant issues. Whether the tax discourages a saving and an investtition? Who is the tax unit- individual or family? Who must pay tax? 7

Certainly, a tax on consumption rather then income would encourage more saving, but there may be equity reasons for favoring an income tax over a consumption tax.

Elements of tax structure

We need to know who is subject to tax, called the tax unit; what is subject to tax, called the tax base and how the base is taxed, called the tax rate schedule. This is very complicate.

The tax unit may be the individual or the family. Most countries apply the individual taxation, rather then the family taxation.

Table 1: Tax unit in chosen countries

Country	*Tax unit*
Australia	individual
Austria	individual
Belgium	individual/family
Canada	individual
Czech Republic	individual/family
France	family
Germany	family/individual
Greece	individual
Hungary	individual
Italy	individual
New Zealand	individual
Poland	individual
Sweden	individual
United Kingdom	individual
United States	family/individual

Source: www.books.google.com

In our tax system, the tax unit is the individual. In the United State, the tax unit is the family. Deductions and tax rates schedules depend on the taxpayer's marital status and the number of dependents. Taxpayers who are married must file as married and taxpayers who are single must are file as single, or as head of household if they have dependents. Married taxpayer can file joint or separate tax returns; however, married taxpayers who file separately are not treated the same as single taxpayers. Married taxpayers filing a joint return pay taxes on their combined family income according to the tax schedule for married taxpayers. Married taxpayers who file separately keep their incomes separate, but they pay tax according to the married tax schedule.[1]

The combined tax is usually increased when two taxpayer with similar incomes get married. This is popularly know as the marriage tax or marriage penalty. The amount of tax paid depends on the marital status of the taxpayers. In cases where two people marry and only one of them earns income, amount of tax they pay may decrease instead.

In other case, dependents are usually the taxpayer's children, but they may be other relative such as grandchildren, parents, and grandparents, aunts, uncles etc. For each eligible dependent, the taxpayer can take a deduction called the personal exemption.

The tax base is the amount of income that is taxed, specifically taxable income. This is defined according to two principles. First, it is measure on a net basis, meaning that expenses incurred to acquire incomes are subtracted from the gross receipts of the taxpayer. In practice, however, not all cost the taxpayer incurs by working can be subtracted.

In the most countries, taxable income includes income earned as a consequence of employment, or earned income; income received as a consequence of owning property, or capital income; and some types of transfer income. In Serbia, taxable income includes all type of income as annual income, but it exist analytical taxation.

The first step in calculating taxable income is to find the sum of incomes received from all taxable sources. Incomes from taxable sources are wages and salaries, including self-employment income, the value of fringe benefits unless explicitly exempted, income from barter, unemployment compensation, interest on bank account and bonds, dividends received from the ownership of stocks in companies, realized capital gains from the sale of property, rental incomes and royalties etc.

[1] Harvey S. Rosen, Public Finance, McGraw-Hill International Edition, New York, 2005, p. 359.

The second step is to reduce this sum from adjustments, personal exemptions and deductions.

Taxable income = gross receipts from taxable sources - adjustments

Personal income tax base = taxable income-personal exemption - deductions

Personal exemptions is a fixed amount that taxpayers deduct from the sum of income. Another fixed amount taxpayers can subtract from the sum of income is called the standard deduction. The amount of the standard deduction depends on whether the taxpayer is single, a head of household, or married. [2]

The discussion of income taxation has been simplified because it assumed that there is no difficulty involved in determining what constitutes income for the purpose of taxation. On the surface, the definition of income seems relatively straightforward, but some ambiguities arise, especially concerning income in kind and the treatment of change in the value of a person's wealth. The company could pay the employees a large salary and allow the employee to buy his own car and insurance, but the payment in kind might be preferred by both parties for a number of reasons:

- the company may find it cheaper to buy automobiles and insurance in quantity and pass some of the savings on to the employee as a benefit of employment rather than pay the employee additional salary to purchase such items;
- the payment in kind may not be taxed as regular income to the employee, and avoidance of income taxes can provide a large benefit that can be shared between the employer and the employee to make both better off. The payment in kind is an attractive alternative to money income.[3]

Another problem in defining income for tax purposes is deciding how changes in a taxpayer's wealth resulting from unrealized capital gains should be figured into taxable income. Under Irving Fisher's definition, a capital gain would not count as income because it would not represent a sustainable flow.

From the income taxation it's necessary precise definition of income. The definition of income may be double:

[2] Neil Bruce, Public Finance, Addision Wesley Longman,Washington, 2001, p. 393.

[3] Randall Holcombe, Public sector economics, Pearson Education, New Jersey, 2006, p. 272.

- with economic-theoretical aspect and
- with fiscal-accounting aspect.

The economic-theoretical concept define the income as economy cathegory. In this sense, the income is consumption without the reduction of the possessions.

In the science of finances, the definition of income include two theories:

1. theory of source and
2. theory of net income.

The theory of source include the income with three features: permanence source, safety and regularity of income. But, with fiscal aspect, most income isn't include in this definition, so the theory of net income remove the imperfections of the theory of source. Some authors define an income as "distinction between inicial and final state of the possessions one person in the time."[4]

Professors Haig and Simons define income as the sum consumption and change of net possessions one person in one year. However, some authors consider that H-S definition should be limited in income realized.

Irrespective of the imperfections of H-S definition, it's adequate with equity and efficiency aspect.

The H-S criterion requires the inclusion of all sources of potential increases in consumption, regardless of whether the actual consumption takes place, and regardless of the form in which the consumption occures. This criterion also implies that any decreases in an individual's potential to consume should be subtracted in determining income. An exemple is expenses that are incurred to earn income.

The H-S definition encompasses: wages and salaries, business profits, rents royalties, dividends and interest. However, it also includes certain unconventional items:

- employer pension contributions and insuranse purchases,
- transfer payments, including social security retirement benefits, unemployment compenzation and welfare,
- capital gains,
- income in kind.

[4] Dejan Popović, Gordana Ilić-Popov, Ekonomija oporezivanja i poresko pravo, Pravni fakultet, Beograd, 1996, str.237

Pension contributions, even though not made directly to the recipient, represent an increase in the potential to consume.

Transfer payments, including social security retirement benefits, unemployment compenzation and welfare are incame. Any receipt, be it from the government or an employer is income.

Increases in the value of an asset are referred to as capital gains, decreases as capital losses. If a owner sells this shares at the end of the year, the capital gains is realized; otherwise it is unrealized. From the H-S point of view, it is absolutely irrelevant whether a capital gain is realized or unrealized. It represents potential to consume and is income.

Some people receive part or all of their incomes in kind- in the form of goods and services rather than cash. For example, an official car, floor-level seats, courtside seats, access to apartment, a satellite TV etc. Farmers provide field hands with food; corporations give employees subsidized lunches or access to company fitness centres. One important form of income in kind is annual rental value of owner-occupied homes. The imputed rent is equal to the rental payments that would have been received had the owned chosen to rent the house out, after subtracting maintenance expenses, taxes etc.

Table 2: Progressive tax rate and number of tax bands

COUNTRY	TAX RATE (%)	TAX BANDS
Austria	21-50	4
Belgium	25-50	-
Cyprus	20-30	4
Denmark	38-59	-
France	10-48	-
Germany	15-42	4
Greece	0-40	5
Hungary	18-36	2
Italy	23-43	5
Japan	5-40	6
Poland	19-40	3
Portugal	10,5-40	7
Slovenia	16-50	3
Sweden	0-56	-
Turkey	15-35	4
United Kingdom	0-40	3
United State	0-35	6

Source: Revenue statistics OECD 1965-2006

In theory, ***the tax rates*** may be proportional, progressive and regressive. But, the most countries use progressive tax rates. This is called tax rate schedule. The personal income tax rate varies according to the taxpayer's income. The tax rate varies because of the graduated tax rate schedule, which imposes different tax rates on income in different tax brackets. The tax brackets are defined by taxable income thresholds.

Flat taxation

An income tax that has a single tax bracket is popularly known as a flat tax. A flat tax has several advantages. The first is greater compliance. Under current systems in wealthy countries, the incentives for the rich to avoid high taxes (legally or otherwise) are enormous. Furthermore, the opportunities to do so, which arise from the very complexity of the codes themselves, are also large. In the flat tax system, the rich usually end up paying the same amount as they do under an orthodox code, since the appeal to high earners to be compliant with a flat rather than a graded tax, is obvious.

Another advantage of the flat tax is, that it is simpler to administer and results in government savings. The costs of administering a conventional system are outrageous. For example, it costs the United States between 10% and 20% of revenue collected to administer and enforce its own tax code.[5]

However, flat taxes are not synonymous with low taxes, though most countries have cut their tax rates as they have flattened them. In 1994, Ukraine's top rate reached level of 90%, before descending to its current single rate of 13%.

Table 3: Flat-tax economies

Country	Flat tax adopted	Personal Income Tax Rates
Hong Kong	1948.	16%
Estonia	1994.	26%
Lithuania	1994.	15/27%
Latvia	1997.	25%
Russia	2001.	13%
Serbia	2003.	10/12/20%
Slovakia	2003.	19%
Ukraine	2003.	13%
Georgia	2004.	12%
Romania	2005.	16%
Macedonia	2007.	12% (10%)
Czech Republic	2008.	15%

Source: www.worldwide-tax.com

[5] Randall Holcombe, Public sector economics, Pearson Education, New Jersey, 2006, p. 392.

The first country who introduced the flat tax is *Hong Kong*. But, in new history this is *Estonia*. This country used flat taxation from 1994. Estonia was a first of the current crop of flat taxes, initially at a rate of 26 percent. This rate has been lowered since, and is now scheduled to reach 20 percent in 2009.

Lithuania introduced its flat tax in 1994. at 33 percent, which was the highest of the marginal rates imposed prior to the reform. Revenue from the personal income tax rose with movement to the flat tax.

The flat tax in *Latvia* was introduced in 1997 at the rate of 25 percent. In the year prior to this, Latvia had an unusual degressive rate structure, with a starting marginal rate of 25 percent followed by a marginal rate of 10 percent on the highest incomes. Unusually adoption of the flat tax in Latvia thus resulted in increased tax liability at the very highest incomes.

Russia unified its marginal rates of personal income taxation at 13 percent in 2001. The threshold for taxable income increased only modestly in real terms. Revenue from the personal income tax rose by nearly one-quarter in real term: an experience that prompted much interest and emulation elsewhere. With flat's revolution in Russia, most countries of the East Europe start to use flat tax rate. [6]

In *Ukraine* a flat tax at 13 percent tax replaced a personal income tax with marginal rates ranging from 10 to 40 percent. The Ukrainian variant is not truly flat and, above the critical income level at which the allowance is withdrawn, becomes a proportional tax.

The *Slovak Republic* implemented a major and innovative tax reform in 2004, establishing a single common rate not only for the personal income tax and corporative income tax, but also for VAT.

A flat tax on personal income of 12 percent was introduced at the start of 2005, replacing a schedule with rates of 12, 15, 17 and 20 percent. A unique feature of the *Georgian* flat tax is that there is no basic allowance: in this case, the tax on labor income is not merely flat but, at all income levels, proportional.

In *Romania* effective January 2005, a flat rate of 16 percent replaced a personal income tax schedule with five marginal rate, rising from

[6] Anna Ivanova, Michael Keen, Alexander Klemm, The Russian Flat Tax Reform, IFM Working Paper, WP/05/16

18 to 40 percent. Revenue from the personal income tax fell following the reform by a total of around one percentage point of GDP.[7]

In considering the impact of income tax systems, it is important to understand the difference between average and marginal tax rates. A person's average tax rate is the amount of tax paid divided by the person's income. A person's marginal tax rate is the percentage of any additional income that will have to be paid in tax. This is an example of a progressive tax structure because the percentage of income paid in tax rises as income rises. Note that with progressive taxation, the marginal rate exceeds the average rate. The reason for using a progressive tax structure is its redistributive characteristics. A progressive tax structure applies the ability-to-pay principle by having people with larger incomes pay a higher percentage of their incomes in taxes. But it also has the effect of making marginal tax rates higher then average tax rates, which increases the excess burden of taxation when compared with a proportional tax structure that raises the same amount of revenue.[8]

The tax income in Serbia

In our country the income taxation has very specific form. This is combination of analytical and global taxation. Any income is taxable with proportional rate, and in the end of year, annual income is taxable with progressive tax rate. Exactly, annual tax treats only this income who is bigger from legitimate amount.

Tax unit of income tax is personal. Any person pay the tax from all type of income. Our law regulate eight types of income:

1. wages/salaries,
2. income of agriculture and forestry,
3. income of own-self work,
4. yield of capital,
5. income of real estate,
6. capital gains,
7. income of copyrights and industrial property rights,
8. the others incomes.[9]

[7] Michael Keen, Yitae Kim and Ricardo Varsano, The "Flat Tax(es)": Principles and Evidence, IFM Working Paper, WP/06/218

[8] Dejan Popović, Gordana Ilić-Popov, Ekonomija oporezivanja i poresko pravo, Pravni fakultet, Beograd, 1996, p. 284.

[9] Zakon o porezu na dohodak građana, Službeni glasnik RS, br. 24/01, 80/02,135/04,65/06

Every income has different rate. The table around present these types of incomes and theirs rates.

Table 4: The types of income and tax rates in Serbian income tax

Type of income	Tax rate
Wages/salaries	12%
Income of agriculture and forestry	14%
Income of own-self work	10%
Yield of capital	20%
Income of real estates	20%
Capital gains	20%
Income of copyrights and industrial property rights	20%
The others incomes	20%

Source: www.poreskauprava.com

In the end of year, taxpayer who has an income bigger from legitimate amount, must pay the annual tax. In such a way, income taxation in our tax system has a heterogeneous form. The annual tax has a progressive tax rate. From income which present amount less of six average income, the tax rate is 10%, but from income bigger of this amount, tax rate is 15%.

Conclusion

The large number of countries in the world has synthetical form taxation, whith different tax reductions and exemptions. The tax rate is progressive.

Our tax system has analytical form, with one synthetic element-the annual taxation. But, it's necessary to take up a radical reform in income taxation. The tax base should be total income. This income must include all sorts of income: wages/salaries, income of agriculture and forestry, income of own-self work, yield of capital, income of real estate, capital gains, income of copyrights and industrial property rights, others incomes.It's necessary introduce progressive tax rate. In such a way the principle equality and efficient in taxation will be satisfied.

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ELEMENTI POREZA NA DOHODAK FIZIČKIH LICA

Rezime: Porez na dohodak fizičkih lica je jedan od najznačajnijih poreskih oblika. Pomoću njega je moguće prikupiti veliki procenat ukupnih poreskih prihoda. U ovom radu, prikazaćemo elemente poreske strukture poreza na dohodak fizičkih lica. Naglasak je stavljen na delu o poreskim stopama i flat oporezivanju. Ovo je novi način oporezivanja, sa jednom poreskom stopom za oporezivanje dohotka i fizičkih i pravnih lica. Na taj način poreske vlasti mogu smanjiti troškove oporezivanja i omogućiti realizaciju principa efikasnosti u oporezivanju.

Ključne reči: porez na dohodak fizičkih lica, poreski obveznik, poreska osnovica, poreska stopa, flat oporezivanje