

THE CHANGES IN INCOME TAX AS A TOOL FOR SOLVING THE FISCAL INBALANCE IN THE CONDITIONS OF THE SLOVAK REPUBLIC

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The state budget reflects the financial coverage of public expenditures and services and represents the balance of revenues and expenditures of given government. There are two approaches to the understanding of the revenues and expenditures. The first, classic approach, sees the expenditures from quantitative point of view, where the crucial importance is on total amount of expenditures and the incomes are secondary. The modern approach sees the expenditures from qualitative point of view, emphasizes the structure of expenditures and the incomes are of the first priority. The goal of economical policy of each state is to support the economic growth of the country, living standard of population and to improve the quality of business environment. Essential condition of achieving these goals is the income of public budget in the form of taxes, which serve to finance the public goods. On the other hand, the tax and duties burden represents the financial harm to the households and businesses in the country and influences their behavior and decision making process.

Key words: active incomes, nontaxable part of tax base, flat expenditures, tax free incomes.

INTRODUCTION

The Slovak republic has been getting into debt extremely fast during the last two years. The deficit of public finances reached 7,9 % of gross domestic product in 2009 and 2010 number is similar. The debt of public finances increased by more than a half, from 27,7 % GDP at the end of 2008 to expected 43,8 % GDP at the end of 2010. The debt per Slovak citizen increased from 3.439 EUR in 2007 to 5.326 EUR in 2010, which is an increase of more than 54 %. This growth of debt is partially caused by world economic crises. The improvement of public finances is the key priority of the government. In the Government Statement of Policy is stated that the main goal of the government of the Slovak republic is to decrease the deficit of public finances below 3 % of gross domestic product in 2013 so that Slovakia fulfills its obligations to the European Union, following the Stability and Growth Pact. The government of the Slovak republic will implement most of the actions required to decrease the deficit, starting in 2011. Based on the above mentioned, the Slovak government decided to improve the situation in public finances.

The main measure of public finances is their deficit or surplus. The government looked at two criteria when deciding on the amount of this parameter. Firstly, it was the interest to decrease the deficit, which would persuade the financial markets about the reliability of Slovakia. On the other hand, there was the intent so that the actions do not strongly harm domestic economy and do not slow down its growth. The level of budgeted deficit was therefore planned at 4,9% for 2011, but the deficit improvement will continue in the next two years so that Slovakia fulfills its obligation to the European Union and in 2013 reaches the deficit below 3% GDP.

The year over year decrease in deficit from expected 7,8% GDP in 2010 to 4,9% in 2011 was contributed by almost half percent by the economic growth. The deficit improvement actions will contribute to the decrease by another 2,5%.

The smaller amount of the improvement actions has been considered on the income side of the public finances. It represents actions in the area of VAT, consumer taxes, nontaxable incomes, as well as in the area of income tax and fringes. The tax and fringes burden will increase to 28,6% year over year by applying above mentioned actions. However, it will still stay below the 2008 level (28,9%) and during the years 2012 and 2013 it will go back below 2 % of GDP.

State has the opportunity of operative intervention in the tax system within the state's policy. As the tax measures we understand the implementation of new taxes, changes in tax rates, changes in the calculation of tax base, changes in the tax reliefs for certain areas, sectors, business units, etc.. The goal of the Slovak government is to prepare, so called consolidation package to improve the situation in the public finances and start up the economy. This package contains measures both on the side of expenditures as well as on the side of revenues. The part dealing with revenues is created mainly by changes in the area of taxes and fringes. In this article we describe the changes implemented by the amendment of the Act on Income Tax of natural entity for 2011.

1 CHANGES IN THE INCOME TAX FROM 2011

The government of the Slovak republic has enacted in the Act on Income Tax for natural entity following changes:

1) The main change is the adjustment of amount of nontaxable part of tax base per taxpayer. The nontaxable minimum was 4.015,70 EUR in 2010 and 3.559,30 EUR in 2011. The amount of annual nontaxable minimum is adjusted every year based on the amount of minimum living wage effective as of January 1st of tax period. It is

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the amount that represents 19,2 multiple of valid minimum living wage. If the annual taxpayer's tax base is higher than 100-multiple of valid minimum living wage, then a taxpayer's entitlement to apply nontaxable minimum is shorten.

The mechanism of nontaxable minimum calculation was adjusted for years 2009 and 2010, based on anticrisis measures. It was calculated not as 19,2

multiple, but as a 22,5 multiple of valid minimum living wage. In 2011 Slovakia came back to the system of nontaxable minimum that was used before temporary anticrisis measures, i.e. the amount of nontaxable minimum is again calculated as 19,2 multiple of minimum living wage, effective as of January 1st of given tax period. For 2011 it is 3.559,30 EUR, which represents decrease of 466,40 EUR compare to year 2010.

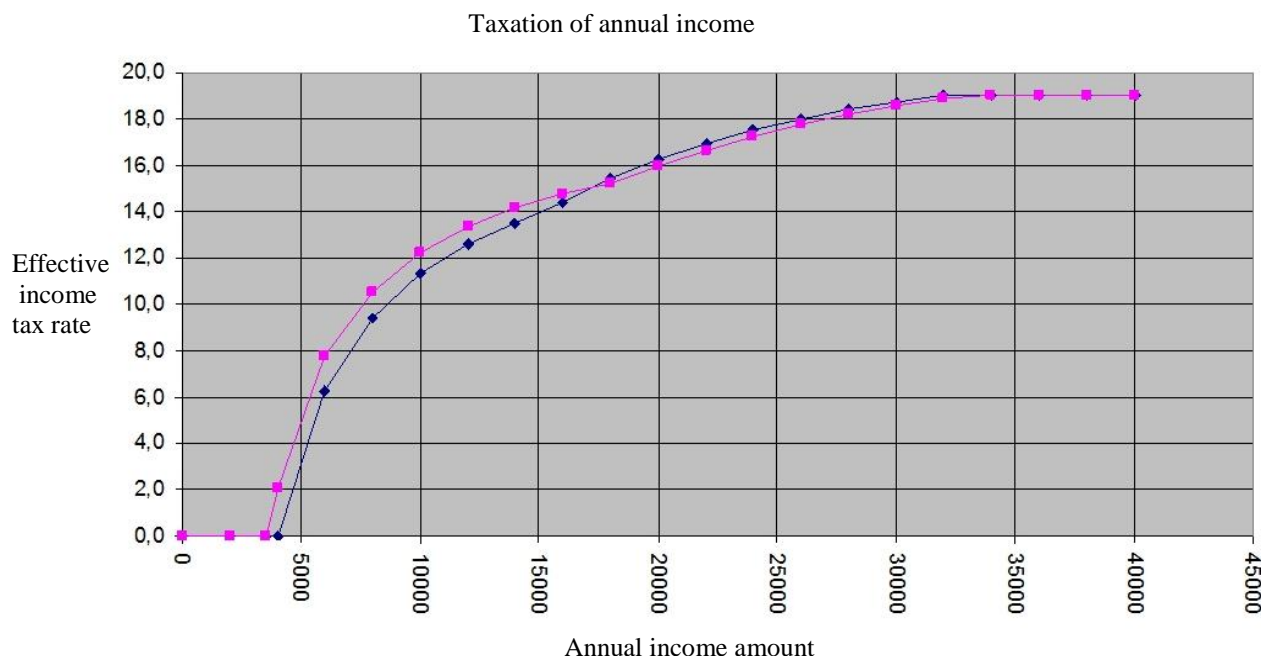


Figure 1 Taxation of annual income by applying nontaxable part for the tax period 2010 (curve with rhomb points) and for the tax period 2011 (curve with square points)

Source: Act on Income tax - www.investujeme.sk

Figure 1 does not consider fringes in calculation of income tax and it has only illustrative character. Its purpose is to compare increase of taxation as a result of decreased nontaxable part per taxpayer in the tax period 2011.

2) Besides the decrease of nontaxable part of tax base per taxpayer, also the nontaxable parts of tax base for specific savings, life savings and supplementary retirement savings were cancelled. Until the end of 2010 it was possible to apply the nontaxable part up to 398,33 EUR. As a result, the taxpayer will pay a higher income tax by 75,68 EUR starting in 2011, in opposite to the previous years when the nontaxable part could be applied.

3) The nontaxable part of tax base per taxpayer and per spouse will be applied only in case of, so called active incomes, which are incomes from employment, from entrepreneurship or from other self-employed gainful activity. If the taxpayer receives also other, so called passive incomes, the nontaxable part of tax base will not be applied anymore.

4) Business trip allowance paid to employees is subject to tax and fringes for insurance companies. The option to use business trip allowances for natural entities was cancelled.

5) The incomes of natural entity received from the rent, from occasional activities including occasional agricultural production, forest and water system activities

and from occasional rent of movable property, from transfer of options and securities and from transfer of participation in limited liability company, in limited partnership company or from transfer of member rights in cooperative society, are tax free only if they do not reach the amount of 500 EUR (the limit until December 31st 2010 was set as the 5-multiple of minimum living wage, i.e. 925,95 EUR).

6) Tax exemption of income from sale of apartment or residential house with maximum two apartments including associated properties, if the selling person had a permanent address there for at least two years right before selling, was cancelled. The condition of ownership of the real estate for at least five years, to receive a tax free income, stays unchanged.

7) The flat expenditures of natural entities with incomes from entrepreneurship and other self-employed gainful activity were integrated to unified level of 40 %. The vocational trade could apply flat expenditures of 60 % until the end of 2010.

8) Special changes are changes in the area of fringes for social and health insurance companies. The employee has to pay fringes also from the incomes, which were fringes-free until the end of 2010. These incomes are e.g. redundancy payment, payments received after termination of employment contract, anniversary bonuses,

incomes and extra pays for on-call duty, bonuses from social fund, employee's income from car usage for business and personal purposes, premiums for additional

retirement savings, which are paid by employer for employee and other nonmonetary benefits of employee.

Table 1 Split of active and passive incomes pursuant to the Act on Income Tax

Active incomes	Passive incomes
- from employment	- from the rent of real estate
- from self-employed gainful activity	- from capital assets
- from entrepreneurship	- from sale of movable property
- from agricultural production, from forest and water system activities	- from occasional incomes
- of associates and general partners in a limited partnership company	- from transfer of options and securities
- from the use or the offer of rights from industrial or intellectual property	- from transfer of participation in limited liability company, in limited partnership company and in cooperative society
- of certified experts and interpreters	- from inherited rights from industrial or intellectual property, from copyrights
- from the activities of dealers, which are not trade	- from winnings, prizes, derivative operations, from retirement payment and from other repeated benefits

Source: The Act on Income Tax No. 595/2003 Corpus Iuris

Mentioned changes, which were adopted in the Act on Income Tax in 2011, are applied on employee in text below. We were analyzing the impact of above mentioned measures on the amount of employee's net salary.

2 EXAMPLE OF EMPLOYEE'S INCOME TAX CALCULATION AFTER THE AMENDMENTS IN 2011, COMPARED TO YEAR 2010

are starting on January 1st 2011 subject to income tax as well as fringes to social and health insurance companies. The nontaxable part of tax base per taxpayer is applied and the employee paid life insurance through the year in the amount of 500 EUR (the taxpayer had the opportunity to deduct nontaxable part on specific savings, life savings and supplementary retirement savings up to 398,33 EUR in 2010).

The employee's total annual gross salary is 15.000 EUR. The employee also received other incomes, which

Table 2 Calculation of employee's net salary in the conditions of 2010 and 2011

Item	Year 2010	Year 2011
A Employee's gross salary	15 000,-	15 000,-
B Income which is subject to income tax as well as fringes, starting on January 1 st 2011 (e.g. redundancy payment, bonuses from social fund, etc.)	3 000,-	3 000,-
C Compulsory insurance paid by employee (13,4 %)	2 010,- (A x 13,4%)	2 412,- ((A+B) x 13,4%)
D Partial tax base	15 990,- (A+B-C)	15 588,- (A+B-C)
E Nontaxable minimum per taxpayer	4 025,70	3 559,30
F Nontaxable part of tax base for specific savings, life savings and supplementary retirement savings	398,33	0
G Tax base	11 565,97 (D-E-F)	12 328,70 (D-E)
H Income tax	2 197,53	2 342,45
I Employee's net salary	13 792,47 (A+B-C-H)	13 245,55 (A+B-C-H)

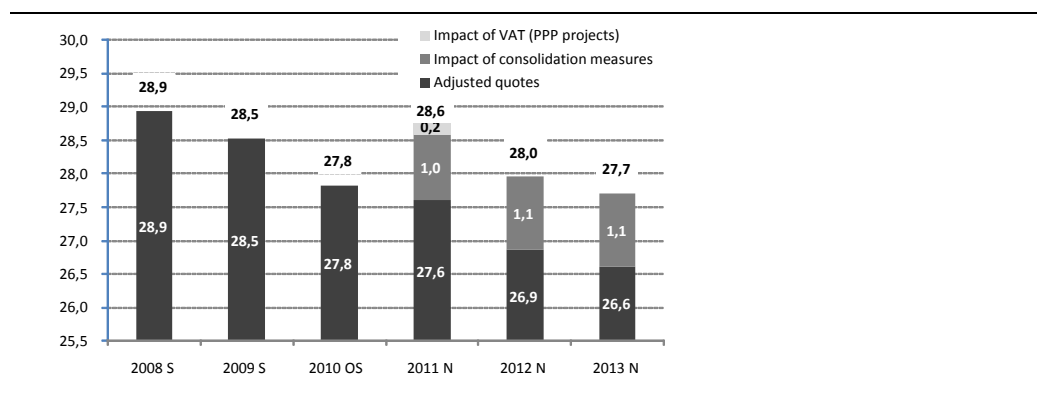
Source: www.podnikajte.sk and author's own calculations

Table 2 shows that due to the amendment of the Act on Income Tax, employee receives in 2011 lower annual net salary by 546,92 EUR compare to 2010, at the equal annual gross salary.

3 TAX AND FRINGES BURDEN

Recent taxes and fringes forecasts assume the stabilization of total tax burden throughout the period from 2010 to 2013. The tax burden should slightly decrease from 27,8 % GDP in 2010 to 27,7 % GDP in

2013. The share of taxes and fringes on GDP will not grow in the total amount by more than 1,0 % GDP, despite of implemented consolidation measures in the area of taxes and fringes. The reason of relatively unchanged share is the fact that if the consolidation measures were not implemented, the tax burden would decrease by 1,2 % compare to 2010, to the level of 26,6 % GDP. The total tax and fringes burden throughout the period 2008 – 2013 in Slovakia is shown in Figure 2. In 2008 and 2009 we show real numbers and the numbers from 2010 till 2013 are expected.



Source: Eurostat, MFSR

Figure 2 Total tax and fringes burden throughout the period 2008 – 2013 in Slovakia

From the fiscal politics point of view it is optimal that the total tax burden stays year over year unchanged if there are no legislative changes applied. Stable share of taxes and fringes on GDP increases the predictability of trend in public finances and allows quicker consolidation of public finances. The total tax burden in Slovakia has a long-term decreasing trend, which increases the severity of the fiscal consolidation as it requires implementation of stronger consolidation measures on the expenditure side.

CLOSURE

It is clear that nowadays the measures oriented on improvement of public finances have to be applied by governments of all European Union members as the situation is still very serious. The government of the Slovak republic is trying to decrease the deficit of public

finances the way, so that the impact of taken measures on the socially weakest groups of inhabitants is the lowest possible. However, the restriction will have its social impact. Now we can assume that in the future, the effect of applied measures might have a negative impact on population's employment and on living standard. The decrease of nontaxable part of tax base per taxpayer will decrease the real incomes of employees from middle class. The impact on upper class will not be significant, as starting with the tax base from certain amount, the nontaxable part has not been applied even till now. Besides the middle class, the lowest income class will be effected as well. The living standard of Slovak inhabitants will decrease and therefore it is likely that in the near future more inhabitants will live below poverty borderline.

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