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Tax Expenditures in Poland

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It is my pleasure to present the first comprehensive report on tax expenditures in Poland.

As we began working on the report, we were convinced that there was a need for an in-depth analysis of tax expenditures, at this particular point in time. This conviction resulted, on one hand, from activities aimed at improving effectiveness of public spending, the most emphatic form of which is the performance based budget, being implemented in Poland for a few years now. Tax expenditures may often act as a substitute for direct budget spending. Choosing the most effective form of public intervention requires knowledge in both areas. Public intervention via tax system by its very nature is not subject to annual budget debate. As a result, cost and benefit analysis of different public intervention instruments is not complete without information on tax expenditures.

Secondly, necessary efforts towards consolidation of public finance, undertaken by the government, include rationalization of spending, temporary increase of tax rates, as well as introducing new regulations, including e.g. expenditures rule. In such a process, tax expenditures may pose a temptation to bypass the previously adopted prudential and restructuring solutions, as an alternative for increasing real expenditures. This may constitute an additional risk for stability of public finance and the objective of balancing the budget. Therefore, I believe that this report is a response to current real needs of public policy, and not just a publication intended to expand our knowledge. It should be added, however, that an indirect objective of the report is to increase transparency of public finance. Without full knowledge about scale, beneficiaries and forms of tax expenditures the view of public finance is skewed.

The idea of this report was born in the beginning of 2010 and was warmly received by Minister Jacek Rostowski. From the start it also found understanding in Warsaw Office of the World Bank. In march, in cooperation with the World Bank, we have organized in Ministry of Finance a seminar dedicated to methodology issues and experience of other countries in scope of publication of tax expenditure reports. The amassed knowledge allowed us to prepare the methodology very quickly and initiate the process of data and information collection from public administration units, then further processing thereof and finally preparation of the report itself.

The first full Polish report covering tax expenditures in all the main taxes may be placed right next to similar reports published in many countries. Methodology adopted for this report is the same as in majority of reports of this type, namely value of tax expenditures is presented as forgone revenue. However, far going caution should be exercised with respect to direct international comparisons of estimated forgone revenue, resulting from tax expenditures. It results mostly from different definitions of what is a tax expenditure and what is an inherent feature of the tax system, a so-called benchmark tax system. OECD research shows, that the amount of revenue forgone resulting from application of tax relief measures, exemptions and reduced rates vary from 0,74% GDP in case of Germany and 12,79% GDP in case of UK. Number of tax expenditures ranges from 86 to 381, depending on the country. In case of Poland, estimated loss of revenue resulting from tax expenditures amounted to 4,9% GDP and resulted from application of 352 instruments.

I believe that it's not the total values that are most important, but analysis of individual solutions, their justification, budget impact, as well as efficiency and effectiveness in achieving the assumed social or economic objectives. For better clarity of the report, tax expenditures have been grouped by their objectives.

I would like to thank all those, who contributed to creation of this report. First of all I would like to thank the coordinator of the entire effort, Mr. Artur Świsłak from Tax Policy Department. Under difficult conditions, he was able to conclude the works on this pioneering report. It required expertise as well as ability to cooper-

ate with many people from different institutions. Mr. Marcin Piątkowski from World Bank Office in Warsaw has ensured friendly cooperation of that institution, which was important, in particular at the initial stage of our work. Many people from outside of the Ministry of Finance have provided us with necessary information and estimates. I would like to thank very warmly all the employees of Ministry of Finance involved in creation of this report.

I hope that the tax expenditures report shall become a durable, cyclical element of public finance debate, contribute to a better evaluation of impacts of various tax solutions on budget revenues and facilitate implementation of effective forms of public intervention.

Executive summary

Polish tax system, as majority of tax systems worldwide, envisages a number of tax preferences, the objective of which is to stimulate the behavior of taxpayers, supporting specific types of activity and selected sectors of the economy, or change of progressive features of the tax system.

Tax preferences, from the legal perspective, may take different formats – most often those are tax reliefs, exemptions, reduced rates, but also tax waivers or joint taxation of taxpayers' income. One feature they have in common is reducing the tax liability and hence decreasing potential budget revenues – to either central budget or budgets of local government units. This means such preferences have a value, which is expressed in lost revenues of the budget and are perceived as tax expenditures.

Tax expenditures are a *de facto* substitute of budget expenditures and in certain conditions may be an alternative to direct transfers from the state budget or municipal budget. As a form of expenditures effected through "back door" measures, tax expenditures are difficult to reconcile with basic principles of budgeting. In fact, they are financed through tax system, but, as opposed to budget expenditures, they are not subject to in-depth scrutiny and control. One reason for that is the fact, that budget expenditures are presented in a single document, around which the budget debate is centered, while tax expenditures are dispersed in different tax laws, often hidden, difficult to notice, and their value is not known. Such a situation distorts the transparency of financial management of the state and creates the risk of improper allocation and distribution of public funds.

Knowledge about value of tax expenditures is therefore of key importance for appropriate shaping of fiscal policy of the state. On one hand, it enables proper allocation and redistribution of public funds in course of the budget debate, on the other it provides a starting point for evaluation of effectiveness of individual tax expenditures and the tax system as a whole.

Preparing tax expenditure reports has a long tradition in OECD countries. First reports were prepared in the 1960s in Germany and United States. Now it is practiced in most OECD countries. In Poland, preparing such a document is not mandatory by the law; the practice has not been formed as yet, either. This document is the first attempt of estimating the value of tax expenditures in Poland.

A necessary condition for estimating the value of tax expenditures is identifying them. Not all tax solutions which are tax relief measures (tax exemptions, tax credits, etc) are a true tax expenditure. Some of them serve to rationalize the tax system, reduce collection costs, or result from international or community obligations and as such are deemed as a benchmark tax (tax standard), so in a way the primary (natural) scope of taxation. Only those solutions which depart from the adopted benchmark tax have the features of tax expenditures.

Determination of the abovementioned benchmark tax is, by nature, characterized by a certain degree of subjectivity. In the debate, experts shall argue as to whether the given solution indeed constitutes an inherent feature of the given tax or is it a privilege for a specific group of taxpayers, activity, sector of the economy etc.

Benchmark tax adopted for this study has been defined based on the most important principles of taxation (universality, completeness and equity of taxation) based on conceptual approach – separate for each group of taxes (income, consumption and property). One should also not exclude the possibility that a modification of thus described benchmark tax may be necessary.

Value of tax expenditures was estimated based on revenue forgone method, without taking into consideration changes in taxpayers' behavior, resulting from cancellation of the given tax expenditure – based on data from tax returns and data received from various institutions. The research included state taxes (PIT, CIT, VAT and excise) and local taxes (real estate tax, agricultural tax and forestry tax).

In the area of taxes covered by the study, a total of 473 tax expenditures were identified, including 402 in the area of state taxes and 71 in local taxes. The greatest number of various tax expenditures is found in income taxes (138 in PIT and 54 in CIT). Among the local taxes included in the analysis, the greatest number of expenditures is found in real estate tax.

Based on available data, value of 352 tax expenditures has been determined (74% of all expenditures identified). In 2009, their value amounted to 65,9 billion PLN, which constituted 4,9% GDP. The value of tax expenditures in the area of VAT (vast majority of which are reduced rates) was estimated in total at 34,2 billion PLN. Value of estimated tax expenditures in PIT is approximately 16 billion PLN, in CIT it's 7,6 billion PLN, and in excise tax 1,7 billion PLN. Total estimated value of tax expenditures in local taxes was 6,3 billion PLN, which constitutes 0,5% GDP.

Tax expenditures with highest estimated value are reduced VAT rates (7%) for construction and assembly works in housing sector, child tax credit and joint taxation of spouses in PIT.

The most supported areas (among 9 areas identified) are family, economy and agriculture, which receive respectively 29,1 billion PLN, 8,8 billion PLN and 7,2 billion PLN.

It is not the objective of this report to present justification for, or negating the purpose of, further application of identified tax expenditures. However, with respect to six selected tax expenditures, preliminary effectiveness analysis is presented in the report – understood as the extent to which the given tax expenditure fulfills the socio-economic objective intended by the legislators. Analyses conducted hereunder in some cases indicate reduced effectiveness of tax relief measures. This results either from the fact that the tax expenditure is used – directly or indirectly – by groups of taxpayers other than originally assumed by the legislators, or the level of support varies greatly depending on level of income. Some tax expenditures, introduced a few years ago, have lost their impact on taxpayers' behavior and at this point their main outcome is reduction of budget revenues.

In case of child tax credit (5,6 billion PLN), there are serious doubts as to whether it fulfills the objective usually set for such tax expenditures. However, it is support for families with children. This relief measure may be utilized in its full amount by taxpayers with higher income, for whom the financial incentive is probably less important with respect to decision on having children. With respect to taxpayers with lower income levels, who often do not utilize the full amount of the tax credit, stimulation value of the tax expenditure is limited. As a result, the tax relief measure leads to reduced progressivity of the income tax.

Internet tax allowance (0,4 billion PLN) is an example of a tax relief measure, which originally had met its objective, i.e. mitigating the effect of increased service price, resulting from cancellation of reduced VAT rates for Internet access service provision. In following years average prices for Internet services have dropped and their quality has improved. At this point it would be difficult to state, that this tax expenditure still constitutes an incentive for the taxpayers to purchase such services. Data of Central Statistical Office suggests, that decisions about connecting to Internet are influenced by non-tax factors.

Joint taxation of spouses' incomes (2,7 billion PLN) – the oldest of analyzed tax expenditures – invariably enjoys a high level of interest. It has a significant impact on reduction of fiscal burden of family income and in this sense, constitutes an element of pro-family policy of the State. However, this tax expenditure is not aimed at implementation of any specific objective. Hence, measuring its effectiveness seems to be difficult.

Tax Deferral for entrepreneurs – objective of which was to improve financial liquidity of enterprises – is not popular among taxpayers (its value is close to zero). As such, it does not fulfill its intended objective. The reason for such lack of interest should be found in the construction of this solution, i.e. too many conditions for eligibility for this tax relief measure.

Reduced rate for hotel services (0,7 billion PLN), resulting in lower prices of hotel services, seems to have a potential to increase attractiveness of Poland for tourists and contribute to development of Polish hotel market. However, when taking into consideration the fact, that hotel services are usually purchased by the wealthier part of the public, this relief measure does not improve progressivity of the tax system. Moreover, assuming that large part of hotels' clientele are business clients and foreign guests (whose presence in Poland rarely results only from competitive pricing of hotel services), one should be cautious in evaluating effectiveness of this tax expenditure.

Excise tax reliefs for biofuels (1,2 billion PLN) do not support domestic production of biofuels on the previously expected level. Large portion of bio-components used for fuel production were not produced in Poland. Achieving the environmental objective, namely broad use of biofuels, seems to be possible without applying the tax relief, based exclusively on obligating fuel manufacturers to purchase them.

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Annex A: Objectives and mechanism of tax expenditures.....www.mf.gov.pl

Annex B: Value of tax expenditures.....www.mf.gov.pl



I. INTRODUCTION

The overriding objective of tax policy is to shape the scope of taxation in such a way as ensures high effectiveness and transparency of the tax system. Effectiveness of the tax system, in simplified terms, comes down to securing fiscal needs of the state while maintaining the highest possible economic growth and providing appropriate living standard to the society. This compromise between fiscal, economic and social objectives is achieved mostly by differentiating the object of taxation (consumption, revenues or property) and construction of taxes themselves, including rates, deductions and exemptions. Applying such solutions allows for greater flexibility of scope of taxation and stimulate taxpayers' behaviors in line with expectations of the state. On one hand, such solutions constitute a preference for a specific group of the taxpayers, on the other, they deprive the state of a part of potential tax revenues. In other words, the state gives up on a portion of tax revenues in order to implement a specific objective.

Over the past two decades, a number of tax expenditures were introduced in Poland. They reflected the then-current objectives of state policy. Some of them took roots in the tax system for good (e.g. joint taxation of spouses, or so-called rehabilitation tax relief), some of them remained in operation for a specific period of time (e.g. investment tax relief in 1995-1999, interest tax relief in 2002-2006), and some are relatively new (e.g. child tax credit). Such tax relief measures do not always result from tax-related acts of law (e.g. exemption for entities operating in special economic zones), they often function as acquired rights (e.g. interest tax relief) and in legal sense they take different forms – usual ones are exemptions, tax credits and allowances, but also reduced rates (e.g. in VAT and excise). As a result, creating a current list of them is not an easy task. Difficulty is exacerbated by the fact, that not all the exclusions, exemptions as well as tax credits and allowances may be viewed directly as tax expenditures. Many of them constitute a certain standard, serve rationalization of tax collection or result from international (community) obligations.

The objective of this study is to present results of the review of tax expenditures existing in Polish tax system. Works related to this issue included:

- determining the nature of benchmark tax and tax expenditure,
- identification of tax expenditures,
- classification of such expenditures by supported areas,
- indicating objectives for implementation of individual tax expenditures,
- presenting mechanisms of their operation,
- estimating the value of tax expenditures (their cost to the budget, measured as revenue forgone).

It is the first comprehensive review of tax expenditures in Poland¹. It covers tax expenditures existing in 2009 in taxes which are most important from the perspective of the state budget revenues, i.e. tax on goods and services (hereinafter: „VAT”), excise tax, personal income tax (hereinafter: „PIT”), tax on income of legal persons (corporate income tax, hereinafter: „CIT”) as well as in taxes important for municipal budgets, i.e.: real estate tax, agricultural tax and forestry tax.

It is not the objective of this report to present justification for, or negate the purpose of, further application of identified tax expenditures. In this study, results of in-depth analysis were presented only with respect to a few selected expenditures – joint taxation of spouses, children tax credit, Internet tax allowance, tax deferral for entrepreneurs, reduced VAT on hotel services and excise relief for biofuels. The report does not include final evaluation as to relevance of further application of such tax expenditure or need for its modification. The intention of the authors was to look at the current tax system and an attempt to analyze existing tax expenditures in scope of intended objectives, their current relevance, level

¹ Every year, the Ministry of Finance prepares information on settlement of the income tax. It covers personal income tax (general principles and flat rate on registered income) and corporate income tax. Presented values pertain only to tax expenditures covered by tax reporting (amounts of exemptions, tax allowances and credits declared in tax returns). Cf. www.mf.gov.pl, tab: Podatki / Statystyka

of implementation, and finally, the taxpayers' interest.

Further chapters of this study present:

- international context of work on identification of tax expenditures and estimating their value (chapter 2),
- nature of tax expenditure(chapter 3),
- benchmark tax in Poland (chapter 4),
- methodology for estimating value of tax expenditures (chapter 5),
- analysis of value of tax expenditures in Poland (chapter 6),
- effectiveness of selected tax expenditures (chapter 7),
- summary (chapter 8).

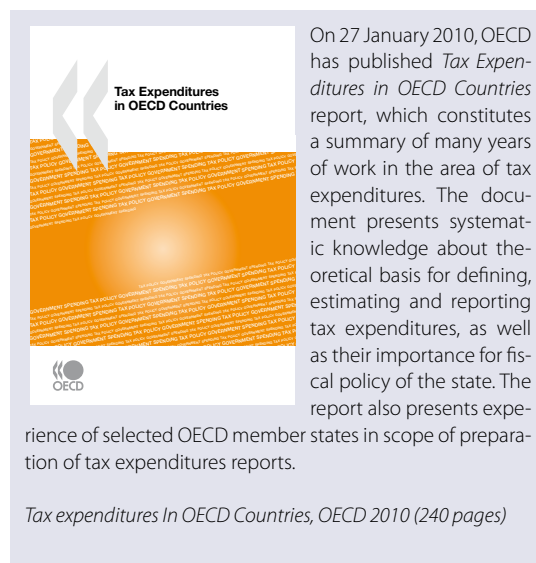
A detailed list of all identified tax expenditures including their objectives, mechanism of operation and value, has been presented in Annex A and B attached to this publication (available on Ministry of Finance website²).

II. METHODS FOR ESTIMATING THE VALUE OF TAX EXPENDITURES, APPLIED IN OTHER COUNTRIES

Knowledge of value of tax expenditures is of key importance for appropriate shaping of fiscal policy of any country. State governments are seeking answer to the question: „How much do the tax expenditures cost us (the budget)?”. Data on value of tax expenditures makes appropriate allocation of public funds significantly easier. Expanded knowledge about tax expenditures and the areas they support allows additional proper use of such expenditures and thus, further rationalization of public funds management.

The basic instrument of fiscal policy, used to achieve the above objective, is preparation of periodical reports on tax expenditures. Actions in this scope were initiated (almost at the same time) by Germany and United States in 1960s. In 1970s, tax expenditures reports were already systematically prepared in Austria, Canada, Spain and UK. At present, it is common practice in most OECD countries. It was the OECD³ that first undertook the analysis of the issue of reporting tax expenditures and contributed to dissemination of knowledge on application, estimation of value, as well as evaluation of tax expenditures.

Despite OECD's recommendation, that reports on tax expenditures, which are a *de facto* substitute for budget expenditures, were included in the budget debate, practice of preparing reports, as well as methodology thereof, adopted by different countries, clearly vary. For example, authorities of Austria, Belgium, France, Germany, Portugal, Spain and UK are obligated by law to prepare such reports, while authorities of other countries have not taken such an obligation upon themselves. In most cases, the re-



² www.mf.gov.pl

³ Works on nature and reporting of tax expenditures are also conducted by International Monetary Fund, World Bank and a number of other organizations, e.g. Urban Institute (cf. *Tax Expenditures and Tax Reform: Issues and Analysis*, 2005), or Inter-American Development Bank (cf. *Tax Expenditure Budgets. Concepts and Challenges for Implementation*, April 2010)

port is prepared annually, but e.g. in Germany it is prepared every two years, and in Italy only from time to time. In Australia, Belgium, Finland, France, Portugal and Spain, tax expenditures report is directly related to work on state budget. In USA the report is not included in preparation of the state budget, but it does have the status of budget-related document.⁴ It is worth emphasizing, that in USA individual states, as well as large cities (e.g. New York) prepare their own tax expenditures reports.

Besides OECD publications, other literature pertaining to the nature of tax expenditures confirms the conclusions from analysis of individual country reports – namely, there is no uniform and generally accepted definition of a tax expenditure. It results mostly from far-going differences between tax systems of different countries, as well as their approach to the function of tax expenditures. There is, however, a general agreement as to the role attributed to benchmark tax (*benchmark tax system*), namely a certain ideal structure of taxation, which constitutes a reference point for identification of tax expenditures. According to OECD, tax expenditure is a solution which constitutes a departure from the benchmark tax⁵.

In this respect, determination of benchmark tax becomes particularly important. There is no uniform approach among the countries as to principles which should describe a benchmark tax. Some countries describe the benchmark in a very general way, e.g. using only such general features of tax as neutrality of taxation (Japan), while other countries (Belgium) define the benchmark tax in a very precise manner.

Despite the individual approach to defining the benchmark tax, adopted by different countries, in practice there are three prevailing concepts:

- conceptual approach, in which the benchmark tax equals the primary tax structure, without taking into consideration certain tax-related legal definitions, providing a more precise interpretation of certain notions (e.g. object of taxation) and facilitate tax collection (in Polish conditions, forbearance on collection of taxes on income from sales of movable property after 6 months from the date of purchase thereof would be deemed a tax expenditure);
- legal approach, under which the basis for definition of the benchmark tax are the provisions of tax law (in Polish conditions, exemption for value of free-of-charge benefits granted to immediate relatives would be deemed a tax expenditure);
- analogous subsidy approach, where the benchmark tax encompasses all those tax solutions, which cannot be replaced by a direct transfer. This means, that any solution, which could be replaced by a direct transfer, would be deemed a tax expenditure (in Polish conditions it would be e.g. Internet tax allowance, but reduced tax rate on unprocessed food – it would seem - could not be seen as tax expenditure).

It is obvious, that individual countries apply specific models with certain modifications, as it is important that the benchmark tax would reflect the specificity of the tax system. Due to differing nature of income, consumption and property taxes, it is necessary to define benchmark tax separately for at least each category, if not for each tax.

⁴ Polacova, H.B., Valenduc, M.A.C. and Swift, L.Z., 2004. *Tax Expenditures – Shedding Light on Government Spending through the Tax System, Lessons from Developed and Transition Economies*. Washington, DC: The World Bank

⁵ Tax expenditures in OECD Countries, OECD 2010

III. NATURE OF TAX EXPENDITURE

As mentioned above, in the simplest approach, any departure from the benchmark tax adopted for the given country is deemed a tax expenditure. Such a departure results directly in reduction of tax burden for the beneficiary of the expenditure. “Saved” tax is intended to induce the beneficiary of the expenditure to behave in a manner expected by the state. Specific solutions of the tax system are used in this way to give preference to certain groups of taxpayers (e.g. parents, farmers, entrepreneurs), sectors of the economy (construction, farming) or activity (e.g. investment, innovations, savings). From technical point of view, tax expenditures may take different forms. Most frequent ones include: exemptions, tax credits, reduced rates, waivers.

It is worth noting, that each of the tax expenditures has its own impact in scope of lost revenues of the budget. State (or municipal) budget is receiving a smaller amount of funds than would have been the case if the given tax relief measure didn't exist. In this sense, they constitute tax expenditures. As a “back door” form of expenditures, tax expenditures (not unlike off-budget expenditures - *vide* earmarked funds, loans, guarantees, public-private partnership) are difficult to reconcile with basic budgeting principles. Tax expenditures – understood as specific expenditures of the state – are first of all contradictory to the principle of unity of the budget⁶. In fact, they are financed from taxes (as most budget expenditures), but they are not subject to in-depth scrutiny and control as tight as in case of budget expenditures. Budget expenditures are presented in a single document, around which the budget debate is centered, while tax expenditures are dispersed in different tax laws, often hidden and difficult to notice. Such a situation distorts the transparency of financial management of the state and creates the risk of improper allocation and distribution of public funds.

Tax expenditures are an alternative to direct budget transfers. Difference between them comes down to the fact, that spending budget funds is composed of two steps: receiving the money and spending it. In case of tax expenditures revenue is immediately consumed by the expenditure. However, as opposed to direct transfers, value of tax expenditures (value of revenues lost by the budget) is not always known.

In order to differentiate between the two forms of public spending, certain features were identified, such as allow separating and performing a comparative evaluation of tax expenditures and direct budget expenditures. Those include *inter alia* ease of access for potential beneficiaries, administrative costs of the expenditures, possible abuse in terms of usage of funds, flexibility of spending, transparency and accountability for spending, expenditures control, effectiveness of expenditures and correctness of their redistribution⁷. In considering the above, one cannot make a definite judgment of either of the forms of expenditures having an advantage over the other. Therefore, assessment, as to which form of spending public funds should be applied to achieve a specific objective has to result from an in-depth analysis of each specific case.

Countries worldwide are using tax expenditures as a tool of financial policy of the state. By implementing specific tax solutions, they want to achieve specific results. Most frequent objectives for introduction of tax expenditures include increasing progressiveness and efficiency of the tax system, stimulating consumption of specific goods or supporting development of a specific region or sector of the economy⁸.

The mechanisms of operation of tax expenditures, however, in some cases result in problems related to this form of public spending. These stem from the very structure of tax expenditures' operation. Most important disadvantages of tax expenditures usually include: lack of effectiveness, regressive character,

6 Best practice guidelines – off budget and tax expenditures, Public Governance Committee, OECD 2004 [GOV/PGC/SBO(2004)6], pp. 3-4

7 Tax Expenditure Budgets. Concepts and Challenges for Implementation, Luiz Villela, Andrea Lemgruber, Michael Jorrittthe, Inter-American Development Bank, 2010, p. 12 [based on: Tokman, J. Rodriguez and C. Marshall S., *Las excepciones tributarias como herramienta de política pública*, In *Estudios Públicos* N. 102.

8 As above, pp 6-9

generating unexpected profits for certain groups, control difficulties, increased spending on administration, erosion of the tax base and need to increase tax rates, or reduced transparency of the tax system⁹. Equally important risk seems to be the risk of violating the principles of competition, and thus operation of the free market.

In Poland there is no universally accepted definition of tax expenditures as per approach presented above. In the Tax Law¹⁰ tax relief is defined as exemptions, deductions, decreases or reductions envisaged by the provisions of the tax law, application of which results in reduced taxable base or amount of tax¹¹. This definition, even though it reflects the nature of tax expenditures, is not sufficient for this study. On one hand, not every tax exemption or deduction recognized as such in legal sense will constitute a departure from defined benchmark tax (in effect, it shall become a part of the benchmark tax – e.g. deducting social insurance contributions or object exemptions from income tax, resulting from international obligations). On the other hand, also other solutions included in the tax system, such as are not directly compliant with definition of a tax relief measure, may be perceived as a departure from the adopted benchmark tax, and hence as tax expenditure (e.g. joint taxation of spouses, excluding income from agricultural activity from income tax taxation).

Solutions not deemed a tax expenditure will include also such options as reduction of personal income tax by the amount donated to a public benefit organization (so-called transfer of 1% of tax)¹² or reimbursement, to natural persons, of certain expenditures related to housing construction¹³. Transfer of 1% of tax does deprive the budget of part of tax revenues¹⁴, but in fact it does not reduce tax liability of the taxpayer. It gives the taxpayer the option to determine the use of part of tax due ("sharing" it with a selected public benefit organization), but it does not translate into actual savings. So in this sense, this expenditure does not have a measurable value for the taxpayer. Also reimbursement of certain expenditures related to housing construction results in cost for the budget¹⁵, but it does not reduce the tax liability. Similar to transfer of 1% of tax, the reimbursement is administered by tax authorities and is, in essence, a form of direct transfer. Benefit to the taxpayer is effected at the taxpayer's application, by way of decision of a tax authority.

Taking the above into consideration, for the purpose of this report the definition of tax expenditures as proposed by OECD should be adopted. According to this definition, tax expenditure means a transfer of public resources that is achieved by reducing tax liability with respect to a benchmark tax.

It would seem, that the additional condition for recognizing a specific solution as tax expenditure should be its abstract and general nature, i.e. eligibility for unspecified number of taxpayers. This condition will be met by expenditures (exemptions, tax credit, etc.) resulting from tax-related acts of law or waiver of tax collection by way of an ordinance of Minister of Finance, pursuant to art. 22 of the Tax Law. It will not, however, be met by a relief on settlement of tax liability, granted to an individual taxpayer in his individual case by a tax authority, pursuant to 67a of same Law.

Due to juxtaposition of tax expenditure and benchmark tax, the key element of tax expenditure identification process shall be a precise definition of the benchmark tax.

9 *Tax expenditures: a theoretical review*, Jekoslav Bratić, Institute of Public Finance, 2006, s. 123-125

10 Art. 3 par. 6 of the Act of 29 August 1997 Tax Law (consolidated text.- Dz. U. of 2005 Nr 8, item 60 as later amended; hereinafter: „Tax Law”)

11 Except for reduction of tax due by the amount of tax calculated within the VAT tax, in the understanding of regulations on tax on goods and services, as well as other deductions, constituting structural elements of that tax.

12 Art. 45c of the Act of 26 July 1991 on personal income tax (consolidated text – Dz. U. of 2010 Nr 51, item 307 as later amended; hereinafter: „PIT Act”)

13 The Act of 29 August 2005 on reimbursement, to natural persons, of certain expenditures related to housing construction (Dz.U. Nr 177, item 1468 as later amended)

14 In 2009, public benefit organizations have received 381,5 million PLN from 1% of tax due for 2008

15 Reimbursement of certain expenditures for purchase of construction materials in 2009 has amounted to 1.001,2 million PLN

IV. BENCHMARK TAX IN POLAND

Definition of the benchmark tax shall be a starting point for the debate as to whether a given solution constitutes a tax expenditure, or an inherent feature of the tax system. As already indicated above, there is no single, generally accepted model in the OECD countries. Each country determines the benchmark tax on its own, for purpose of its own study.

So far, Ministry of Finance has not conducted any work on defining the benchmark tax. Its precise definition is not an easy task to accomplish. In the benchmark tax debate, experts shall argue as to whether a given solution indeed is an inherent feature of the given tax, or is it a privilege for a specific group of taxpayers, activity, sector of economy, etc. A typical example of this dilemma is the possibility of subtracting cost of obtaining revenue from taxable income. As a principle, it is a general rule adopted in the income taxation system, nonetheless in some cases, the deduction may be seen as a tax privilege (e.g. 50% cost of obtaining income in case of revenues from copyright and related rights). Another solution which may be subject to debate is recognizing the possibility to deduct, in consecutive years, losses from a specific source of income, or “subject based tax relief” in case of VAT, as tax privilege.

Determination of the benchmark tax is, by nature, characterized by a certain degree of subjectivity. It does not, however, in any degree, disqualify the need to define it – as indicated before, it is a necessary tool (a point of reference) for identifying tax expenditures.

It should be also emphasized, that recognizing any solution as a tax expenditure does not make it a good or bad solution *per se*. Decision as to whether the solution is good or bad should be made based on in-depth effectiveness analysis (including absence of premises for replacing such a tax expenditure by a direct transfer).

Defining the benchmark tax requires indicating the most important tax principles, as well as those solutions embedded in the tax system, which are a tax relief measure in legal sense, but in practice they are a part of benchmark tax (are not deemed a tax expenditure).

Principles, which should be recognized as common for the entire tax system are the principle of universality¹⁶, completeness and equity of taxation, which in practice require every entity covered by subject scope of the given tax to pay a tax on any object (event) covered by object scope of the given tax, while all the entities characterized by a specific significant feature in equal measure should be treated equally, so without either discrimination or preference¹⁷.

What should be recognized as part of the benchmark tax are such exclusions envisaged in the tax-related acts of law as constitute a more detailed definition of subject and object scope of taxation (e.g. excluding, from object scope of personal income tax, revenues obtained as a inheritance or donation, as those are subject to taxation by a separate tax). However, some exclusions, e.g. exclusion of income from agricultural activity, shall not be an element of the benchmark tax, as those revenues are not taxed by another income tax.

Another item, which should be recognized as benchmark tax, are the rates of specific taxes (tax scale in PIT, flat rate tax, or base rate of VAT), principles of tax amortization, possibility of subtracting mandatory levies (e.g. social insurance and health insurance contributions) as well as any solutions (e.g. exemptions) resulting from international obligations, as well as principles set forth in the community law, which are obligatory for all member states.

It is not possible to define a single benchmark tax for all taxes. Insofar the above principles may be applicable to every tax, characteristic features of individual taxes imply the need for additional assumptions, e.g. with respect to harmonized taxes, structure of which results from community law and leaves the member states with very little influence on outsourcing final shape. This means, that with respect to income, consumption, and property taxes separate (more precise) definitions of benchmark tax must be provided.

¹⁶ Cf. art. 84 of the Constitution of Republic of Poland: “Everyone is obligated to carry public levies and charges, including taxes, as set forth in the law”

¹⁷ Cf. ruling of the Constitutional Court of 11 April 1994 (K 10/39)

1. Income taxes

Benchmark tax for income taxes is defined as a system of income taxation, following the principles of:

- universality of taxation – income of all entities is subject to taxation, regardless of area, scope and form of their activity,
- completeness of taxation – every revenue/income is subject to taxation, regardless of source of income, payer category or intended use of income,
- taxation of actual income – taxation of such income, as may be used for consumption or increasing wealth,
- individual taxation – taxation of only the person/entity which obtains revenue, without the possibility of sharing this revenue with other entities,
- annual tax cycle,
- taxation by a specific rate (PIT and CIT) or progressive tax scale (PIT).

Any tax solutions which meet specified conditions should be recognized as benchmark tax and treated as point of reference for identification of tax expenditures. It will be the case with, for example, cost of obtaining revenue, however with certain exceptions in scope of flat rates for cost of obtaining revenue. Benchmark tax includes also all the solutions preventing double taxation, i.e. exemption for dividends, or application of methods resulting from agreements on double taxation. Seeing as the basis for taxation is the actual income, benchmark tax includes all the exemptions applied to reimbursement of previously incurred expenditures, deposits, shares, co-payments etc. (e.g. exemption of amounts reimbursed by the investment funds companies as a result of expiration of permit for establishment of an investment fund). By the same principle, benchmark tax includes e.g. exemption of nominal value of shares (stocks) in a company, received in return for a contribution in kind in form of an enterprise or an organized part thereof.

Despite non-compliance with the principles of benchmark income tax system described above, for the purposes of this report benchmark tax shall also include:

- subject exemptions envisaged for the Treasury of State, budgetary entities, territorial self-government units¹⁸, earmarked funds and certain state legal persons – due to transfer originator being the same as tax privilege beneficiary,
- subject exemption envisaged for the National Bank of Poland, due to its obligation to transfer a portion of profits to the state budget,
- depreciation of fixed assets as well as intangible and legal assets – due to the need to adjust taxation levels to the actual time of use (and wear&tear) of such assets,
- simplified forms of taxation (e.g. tax card), where the amount of tax is calculated based on predetermined indicators and not actual income – due to the fact, that application of such forms of taxation results mostly from their simplicity and low cost of servicing, which does not equal reduced tax liability,
- material allowances and monetary equivalents, received by employees from employers pursuant to labor law – due to the fact, that the employer is obligated by the law to provide such benefits, and moreover, the aforesaid benefits mostly serve to provide the employee with basic conditions for performing labor (e.g. company clothes, equivalent for using employee's own tools at work).

18 Hereinafter: „TSG”

2. Consumption taxes

In scope of VAT and excise tax, benchmark tax shall follow the principles obligatory for all EU member states, set forth in EU law. All optional tax solutions adopted in scope of those taxes (solutions which the state may, but does not have to, apply) should be deemed as departure from benchmark tax.

Same is true for tax rates. Benchmark tax should include the base rate. Reduced rates – both in case of excise tax and VAT – should be treated as tax expenditure, e.g. reduced VAT on vegetables (as in this scope the directive permits application of rate other than baseline).

However, benchmark tax should also include such solutions, as limit the scope of taxation for administrative or control reasons, e.g. excise tax exemption for homemade beer, wine and fermented drinks manufactured by natural persons for their own use and not intended for sale, or subject exemption in the VAT Act¹⁹.

Due to community regulations, possibility of deducting the entire amount of VAT when purchasing a car with internal divider should also be recognized as an element of benchmark tax, as well as when purchasing fuel for such vehicles²⁰, even though such a solution is a certain tax expenditure²¹ to the benefit of the entrepreneurs.

In case of excise tax, benchmark tax should also include exemptions for goods subject to excise in cases, in which they will be taxed anyway, albeit at a later stage in turnover (deferred taxation), e.g. energy products from confiscation, intended for processing in tax warehouse, for which the tax liability arises as a result of placing such products in the tax warehouse.

3. Property taxes

Benchmark tax in case of real estate tax, agricultural tax and forestry tax should be based on principle of universality of taxation. At the same time, benchmark tax should include existing exclusions from such taxes, such as provide a more precise definition of subject and object scope of taxation. Additionally, in case of real estate tax, the benchmark tax should include the tax rates as adopted by the municipal council, and not the maximum rate set forth in the law.

The above means, that all exemptions and relief measures, resulting both from tax related laws and resolutions of municipal councils, as well as reduced prices of rye and timber, adopted for determination of rates in agricultural tax and forestry tax, should be deemed tax expenditures. Other items to be recognized as tax expenditures include separate rates for buildings or parts thereof, used for business activity in scope of trading in qualified seeding material, and in scope of health services provision, for which the maximum rates of real estate tax are lower than maximum rates for buildings or parts thereof related to business activity of a different kind.

¹⁹ The Act of 11 March 2004 on tax on goods and services (Dz.U. Nr 54, item 535 as later amended; hereinafter: „VAT Act“)

²⁰ In 2009 this possibility was utilized by taxpayers pursuant to ECJ ruling in Magoora case (sentence of 22 December 2008 in case C-414/07) In this ruling, ECJ confirmed, that the standstill principle allows to maintain only such limitations as were in place before the given country joined the EU.

²¹ Amount of lost revenues resulting from VAT deduction in case of purchase of vehicles with internal divider as well as fuel for such vehicles, based on Magoora ruling, in 2009 amounted to 1,3 billion PLN.

V. METHODS OF ESTIMATING TAX EXPENDITURES IN POLAND

A necessary condition of proper allocation of public funds is knowing their amounts. As opposed to direct transfers (budget and off-budget expenditures) value of tax privileges is not known *ex ante*. Possibilities of determining their exact value *ex post* (after the end of fiscal year) are also limited, as tax expenditures usually do not carry detailed reporting requirements.

Therefore, determining value of tax expenditures requires estimations, performed by application of specific methodology. The most frequently used method of estimation of tax expenditures value is the revenues forgone method, which comes down to estimation of amounts, which were not paid into the budget as a result of existence of a given tax expenditure, while disregarding other related factors, such as possibility to select a different taxation strategy in absence of given tax expenditure. This method was adopted for the purpose of this report, as is the case in most countries estimating the value of tax expenditures.

Other applicable methods include revenue gain method and outlay equivalence method. Revenue gain method is based on estimation of amounts, which would be paid into the budget if the given tax expenditures were eliminated from the tax system, however taking into account a change in taxpayers' behavior, resulting from elimination of the given expenditure (e.g. a taxpayer, who would no longer be able to benefit from income tax exemption for entrepreneurs operating in a special economic zone, could "save" part of his income if he decided to use the tax relief for new technologies, which he is currently not using, even though he meets all the required eligibility conditions). Outlay equivalence method consists of estimation of value of monetary expenditures, which would be necessary to finance the given objective outside of the tax system (e.g. expenditures on increasing social assistance benefits or subsidies for purchase of new technologies).

Tax expenditures, presented in further part of the report, were estimated based on actual data, obtained from tax returns filed by taxpayers, or based on data of Ministry of Finance (e.g. official budget reporting of territorial self-government units, data obtained from surveys in municipalities, information from customs databases), other ministries and institutions (e.g., Central Statistical Office²², Polish Academy of Sciences²³).

The number of tax expenditures, for which the value was estimated based on actual data is small, as a result of limited amount of data provided in the tax returns. This results from Ministry of Finance's efforts towards simplification of tax settlements and thus reducing the cost of meeting tax obligations. For example, in case of income taxes, in which various object exemptions abound, only very few of those are included in the tax return, and even those are often not individualized – given field in the tax return may contain a combined amount of exemptions from different titles. This causes difficulties in separating them and attributing correct amounts to each exemption.

Due to the above, using microsimulation model for estimating value of identified TE was not possible. Aiming to estimate the largest possible number of expenditures, the authors of this report have used data obtained from different institutions. However, it was not possible in all cases, hence in some items lack of data is indicated.

With respect to reduced VAT rates, estimates were based on statistical data pertaining to final consumption by households, indirect use and gross expenditures for fixed assets in the sector of government institutions, self-government, non-commercial and other institutions – developed based on national accounts for 2007 and structures from tables on use of goods and services in 2006. For 2009 conditions, input data was developed by application of macroeconomic indicators.

²² Hereinafter: „GUS”

²³ Hereinafter: „PAN”

With respect to income taxes (PIT and CIT), in which territorial self-government units have a share, estimated value of expenditures means loss of global revenues, i.e. revenues which did not flow into either state budget, or budgets of individual local government units (impact on public finance sector).

It was the aim of the authors to present the value of tax expenditures as of 2009. However in some cases – due to lack of current data – value from previous years was shown. Due to exceptional complexity of the task and multiplicity of actual statuses, to which individual tax expenditures pertain, in many cases assumptions were made as well, such as allowed creation of a most representative model for the estimates. Assumptions adopted, source and year, to which the data used for estimation pertains, are all indicated in the tables, presenting value of tax expenditures (Annex B of this Report)²⁴.

Value of tax expenditures has been presented in PLN millions. Value of „0” means, that the value of the given expenditure is lower than one million PLN.

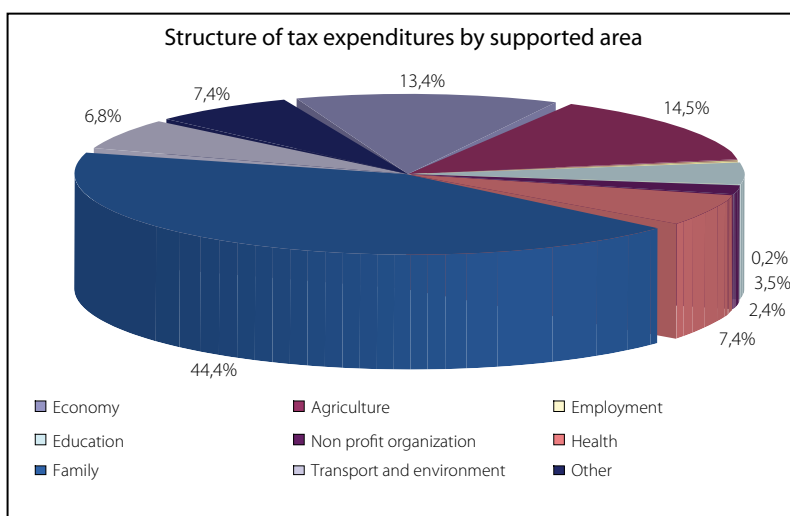
Authors of the report have made all efforts to ensure accuracy of presented values. However, possibility cannot be excluded of a certain margin of error. Therefore, results of the estimation should be interpreted with caution, if for no other reason, then because data used for analysis is very sensitive to changing economic parameters – in practice, behavior of tax expenditures beneficiaries remains under influence of a number of economic factors and regulatory actions of the state, which modify the reality in which the beneficiaries operate.

VI. Analysis of value of tax expenditures in Poland

A total of 473 various tax expenditures were identified in Polish tax system. Reduced VAT rates for various goods and services make 195 expenditures. In income taxes 192 expenditures were identified, and most of them pertain to personal income tax (138). In scope of state taxes, least number of expenditures was found in scope of excise tax (15). In the area of local taxes, a total of over 70 expenditures was identified.

A global amount of tax expenditures, for which the value was estimated, amounted to 65,9 billion PLN, which constitutes 4,9% GDP²⁵. Value of tax expenditures in state taxes has amounted to 59,5 billion PLN, which constitutes 4,4% GDP and at the same time 24,1% of tax revenues in 2009 (246,9 billion PLN²⁶). Value of tax expenditures, identified in the area of local taxes, amounts to approx. 6,3 billion PLN, or 0,5% GDP.

For the purposes of this report, nine support areas were identified, i.e. 1) economy, 2) agriculture, 3) employment, 4) education, science, culture, sport, 5) public benefit organizations²⁷, churches, social and civic organizations, 6) health, 7) family and social assistance, 8) transport and



The graph includes local taxes

²⁴ www.mf.gov.pl

²⁵ According to GUS, GDP value in 2009 was 1 343 657 million PLN

²⁶ This value includes share of self-governments' share in income taxes, but does not include tax on games, tonnage tax and repealed taxes.

²⁷ Hereinafter: „PBO”

environmental protection and 9) other – this category includes such expenditures, as cannot be attributed to other categories. The main area supported by the state via tax expenditures is family and social assistance. Such state expenditures have amounted to 29,2 billion PLN (2,2% GDP) in this case and constitute almost half of all the tax expenditures (44,4%). Further areas, which enjoy state support via tax system to a large extent are economy (13,4%) and agriculture (14,5%). In total, they have received assistance amounting to 16,0 billion PLN in form of taxes, which are revenues of the state budget. Additionally, agriculture was supported by 2,3 billion PLN worth of tax expenditures in the area of local taxes.

Value of tax expenditures by supported areas and type of tax

amounts in PLN millions

Area of support	PIT	CIT ²⁸	VAT	Excise tax	Total
Economy	494 0,04% PKB	5 879 0,44% PKB	2 442 0,18% PKB	15 0,00% PKB	8 830
Agriculture	2 012 0,15% PKB	96 0,01% PKB	5 111 0,38% PKB	-	7 219
Employment	122 0,01% PKB	-	-	-	122
Education, science, culture, sport	2 0,00% PKB	150 0,01% PKB	1 891 0,14% PKB	-	2 043
PBO, churches, social and civic organizations	164 0,01% PKB	1 384 0,10% PKB	-	-	1 548
Health	432 0,03% PKB	-	4 101 0,31% PKB	110 0,01% PKB	4 643
Family and social area	10 333 0,77% PKB	0 0,00% PKB	18 800 1,40% PKB	-	29 133
Transport and environmental protection	-	-	1 821 0,14% PKB	1 357 0,10% PKB	3 178
Other ²⁹	2 456 0,18% PKB	111 0,01% PKB	26 0,00% PKB	208 0,02% PKB	2 801
Total	16 015 1,19% PKB	7 620 0,57% PKB	34 192 2,54% PKB	1 690 0,13% PKB	59 517

A large portion of pro-family tax expenditures is found in personal income tax – i.e. 10,3 billion PLN (0,8% GDP). Beneficiaries of half of this amount are families utilizing the child tax credit. The next significant item in this area is the possibility of joint taxation of spouses (2,7 billion PLN) and exemption from tax of family and nursing benefits, childbirth benefits etc. (1,5 billion PLN).

In corporate income tax, most tax expenditures are found in the area of economy – 5,9 billion PLN (0,4% GDP). The objective of those expenditures is to support business activity, and indirectly, improved financial liquidity of enterprises. The dominating item in this category is the possibility of deducting losses from previous years (1,2 billion PLN) and exemption from tax of income from business activity conducted in special economic zones (1,2 billion PLN).

Total value of tax expenditures in VAT is estimated at 34,2 billion PLN (2,5% GDP). Those include mostly reduced rates - 3% and 7%. Reduced VAT rate on construction and assembly works in housing development etc. has reduced state budget revenues by 8,9 billion PLN, which constitutes approx. 0,7% GDP. The next group of high value tax expenditures are medicinal products³⁰, value of which is estimated at

²⁸ For reporting reasons, it is difficult to separate out the amounts of individual tax expenditures – data presented herein is limited only to those expenditures, for which it was possible to estimate the value or to separate it out from global data.

²⁹ The value does not include the impact of forbearance of tax collection announced under ordinances of Minister of Finance, issued pursuant to art. 22 Tax Law.

³⁰ Medicinal products entered listed in the Registry of Medicinal Products permitted for commerce in the republic of Poland, referred to in the Pharmaceutical Law.

3,6 billion PLN (0,3% GDP). Bread and baked goods, as well as dairy products enjoying reduced VAT rate constitute tax expenditures of total value of 3,2 billion PLN (0,2% GDP).

In the area of excise tax, tax expenditures reduce state budget revenues by 1,7 billion PLN (0,1% GDP). Main areas supported under this tax are environmental protection and agriculture. Promotion of renewable energy sources, activation of agricultural areas are two objectives which enjoy preferential (reduced) rates of excise tax on fuels including biocomponents.

Tax expenditures of highest value, in state taxes

Tax expenditure	Value of tax expenditures (PLN millions)	Share in total value of tax expenditures within given tax	Percentage for revenues from given tax ³¹	Percentage of GDP
PIT				
1. Child tax credit	5 633	35,17%	8,98%	0,42%
2. Joint taxation of spouses	2 693	16,82%	4,29%	0,20%
3. Agricultural subsidies	1 947	12,16%	3,10%	0,14%
4. Exemption of family benefits, family and nursing benefits, etc.	1 478	9,23%	2,36%	0,11%
5. Cost of obtaining income (50%) from copyright and related rights	628	3,92%	1,00%	0,05%
CIT³²				
1. Loss for previous years	1 232	16,17%	4,00%	0,09%
2. Special economic zones	1 172	15,38%	3,81%	0,09%
3. Exemption of revenues of non profit organizations	849	11,14%	2,76%	0,06%
4. Subsidies from state budget	499	6,55%	1,62%	0,04%
5. Exemption for companies with participation of foreign capital	168	2,20%	0,55%	0,01%
VAT				
1. Construction and assembly works in housing construction	8 886	25,98%	8,93%	0,66%
2. Medicinal products	3 559	10,41%	3,58%	0,26%
3. Bread, baked goods and pastries, fresh	1 643	4,81%	1,65%	0,12%
4. Dairy products, with exceptions	1 545	4,52%	1,55%	0,11%
5. Gastronomy services (with exceptions) and canteens	1 383	4,04%	1,39%	0,10%
EXCISE TAX				
1. Reduced rate for fuels with biocomponents	1 048	62,01%	1,94%	0,08%
2. Preferential rates for biocomponents constituting fuels in themselves	183	10,83%	0,34%	0,01%
3. Exemption of power generated from renewable energy sources and used in cogeneration	126	7,43%	0,23%	0,01%
4. Exemption from excise tax of excise products not suitable for consumption, further processing or use, in case of their destruction	110	6,51%	0,20%	0,01%
5. Exemption from excise tax of ethyl alcohol used for medical purposes in hospitals, pharmacies and clinics	61	3,61%	0,11%	0,00%

31 In case of income taxes (PIT and CIT), data was presented in line with complete tax revenues, i.e. revenues of state budget and share of territorial self-government units in those taxes.

32 For reporting reasons, it is difficult to separate out the amounts of individual tax expenditures – data presented herein is limited only to those tax expenditures, for which it was possible to estimate the value or to separate it out from global data.

In case of local taxes, the most significant amounts were noted in case of real estate tax. Those include exemptions for farm buildings, or parts thereof, located on agricultural property, serving solely the purpose of agricultural activity (1,6 billion PLN), exemptions for waste land, exemptions for railway buildings and land used thereby. Besides tax expenditures resulting from acts of law, in scope of local taxes the municipalities have the authority to conduct autonomous tax policy – municipal councils may introduce object exemptions by way of a resolution.

Tax expenditures in local taxes

Tax expenditure	Value of the expenditure (PLN millions)	Share of total value of expenditures in local taxes	Percentage of GDP
1. Exemptions for farm buildings, or parts thereof, located on agricultural property, serving solely the purpose of agricultural activity	1 591	25,10%	0,12%
2. Exemptions for railway buildings and land used thereby	985	15,54%	0,07%
3. Exemptions for waste land	975	15,38%	0,07%
4. Exemptions from real estate tax, introduced by resolutions of municipal councils	596	9,41%	0,04%
5. Exemptions for land with trees or shrubs.	492	7,76%	0,04%

Value of tax expenditures in local taxes

Area of support	Local taxes (PLN millions)
Economy	_33
Agriculture	2 335 (0,17% PKB)
Employment	_34
Education, science, culture, sport	236 (0,02% PKB)
PBO, churches, social and civic organizations	BD
Health	250 (0,02% PKB)
Family and social area	112 (0,01% PKB)
Transport and environmental protection	1 310 (0,10% PKB)
Other	2 094 (0,16% PKB)
Total	6 337 (0,47% PKB)

The dominating area of support in scope of local taxes is the agriculture, which is responsible for 36,8% of the total value of expenditures in those taxes.

In the tax system there is a numerous group of tax expenditures of marginal importance (81) – value of such expenditures falls below one million PLN. Such expenditures constitute 17,1% of all identified tax expenditures and 23,1% of tax expenditures with known or estimated value.

Low value expenditures include tax deferral for entrepreneurs and a number of object exemptions from the personal income tax (e.g. monetary benefits to blind civilian victims of acts of war), as well as a number of items with reduced VAT rate (e.g. sublimated or precipitated sulfur, rennet and rennet concentrates).

33 Exemptions in this area are compensated to municipalities from state budget, in the amount of 14 million PLN and as compensation such amounts constitute tax revenues of municipalities.

34 Exemptions in this area are compensated to municipalities from PFRON, in total amount of 165 million PLN and as compensation such amounts constitute tax revenues of municipalities.

VII. EFFECTIVENESS OF SELECTED TAX EXPENDITURES IN POLAND

1. Child tax credit

Nature and objectives

Eligibility for child tax credit³⁵ arises with each minor child, in connection with execution of parental authority, and in connection with the function of legal guardian or foster parent, and in case of children of age, in connection with fulfillment, by taxpayers, of their alimony obligations.

Taxpayers eligible for child tax credit are only PIT taxpayers, taxed in accordance with tax scale. Taxpayers

using other forms of taxation, i.e. lump sum on registered income, tax card, flat rate tax, tonnage tax, are not eligible for this tax credit. The tax credit does not include any criteria related to income, wealth or number of children. Persons who have revenues exempt from income tax (e.g. farmers) or persons without income (e.g. unemployed without right to benefits) are not eligible for this tax credit.

The tax credit involves deducting, from tax due, the amount of 92,67 PLN per month per child. The deduction is made jointly for both parents, legal guardians, or married foster parents.

The tax credit was introduced on January 1, 2007. Taxpayers have deducted the child tax credit for the first time in 2008, when filing tax returns for income achieved in 2007.

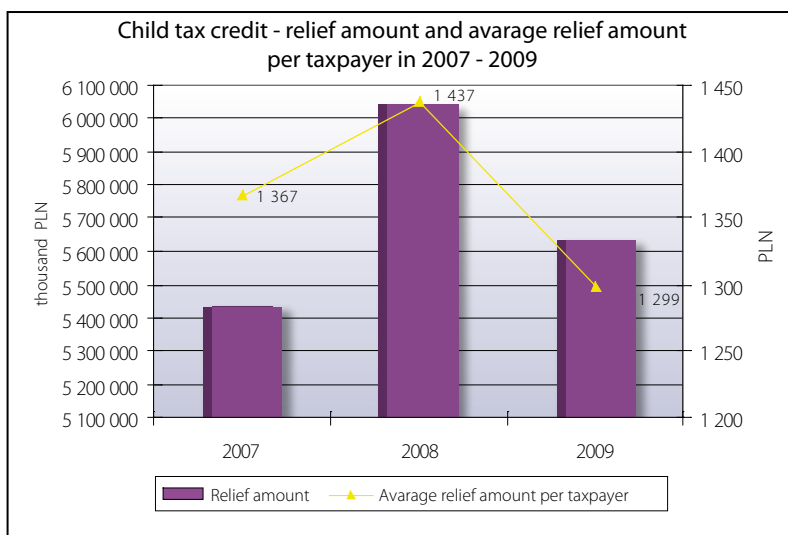
The objective of the tax credit, in light of unfavorable demographic indicators in the country, was to support families with children, regardless of their wealth or income status. The tax credit does not depend on eligibility for state assistance in form of family benefits or social assistance benefits.

Cost

The draft bill prepared by the government has envisaged a deduction in the amount of 120 PLN multiplied by the number of children under care (reduction of revenues in budget year 2008 was estimated on the level of 700-800 million PLN). Finally, as a result of parliamentary processing, the amount of deduction was specified as twice the amount of tax reduction per child (for 2007 – 1 145,08 PLN) and it was estimated, that reduction of budget revenues would reach 7,1 billion PLN (assuming that the tax credit would be applicable to 6,2 million children).

In 2007 and 2008, the deduction limit per child was respectively: 1 145,08 PLN (2 x 572,54 PLN) and 1 173,70 PLN (2 x 586,85 PLN). The above amounts were calculated as twice the amount of tax reduction specified for the first tax bracket in 2007 and 2008. Starting from tax returns for 2009 – the tax credit is settled monthly and constitutes 1/6 of tax reduction amount, i.e. 92,67 PLN per month per child.

In settlement for year 2007, child tax credit was applied by 3 973 668 taxpayers, to the total amount of 5 432 million PLN. In 2008, tax credit was applied by 4 205 909 taxpayers, to the total amount of 6 044 million PLN. In 2009, the tax credit was applied by 4 337 164 taxpayers, to the total amount of 5 633 mil-

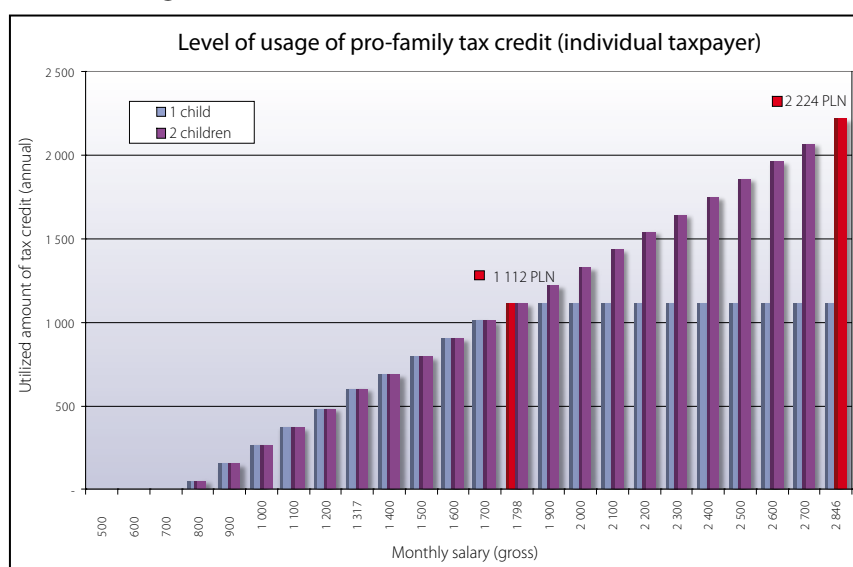


lion PLN. Those are the amounts, by which budget revenues were reduced. The percentage of taxpayers using the child tax credit shows a steadily growing trend – in 2007, a total 16,43% of all taxpayers used the benefit, in 2008 – 17,21%, and in 2009 – 17,77%. Level of utilization of this tax relief measure is highest among the taxpayers who file their tax returns individually, using PIT-37 form (over 80%).

In 2007 and 2008 average deduction amount per taxpayer was respectively 1 367 PLN and 1 437 PLN, and average deduction amount per child respectively 903 PLN and 951 PLN. According to tax return data for 2009, average deduction amount per taxpayer was 1 299 PLN, and average deduction amount per child – 898 PLN. Differences in the deduction amounts result, among other reasons, from the fact that limit per child changes from year to year.

Practical aspects of benefitting from the tax credit

Full amount of tax credit per child (1 112,04 PLN in 2009) may be realized by a taxpayer, whose gross salary (from labor) exceeds a monthly average of 1 798 PLN (21 576 PLN per year). If the taxpayer's salary is lower, such taxpayer may utilize only part of the tax credit. A taxpayer with two



the full amount of tax credit if he receives a monthly salary of 2 846 PLN gross (34 152 PLN per year).

Taxpayer with minimum salary (1 317 PLN gross monthly) raising two or more children shall realistically realize only part of the tax credit (54% of the annual limit) per child (600 PLN per year). The remaining portion of the tax credit for first child and limits for remaining children shall remain unrealized due to insufficient amount of income tax. Scope of utilization of the child tax credit shall be reduced respectively, if the taxpayer first utilizes such relief measures as reduce taxable base, and, as a result, the tax (e.g. Internet tax allowance or rehabilitation tax allowance) or files his/her tax returns as a single parent. Such a person, in order to fully utilize the tax credit amount for one child, would have to achieve a monthly salary of 2 322 PLN gross, for two children – 3 370 PLN. In case of average gross salary below 1 275 PLN per month, the taxpayer does not have the possibility to utilize the child tax credit. For example, in case of a taxpayer earning minimum salary with five children, the tax credit limit is 5 560 PLN, but in real terms the taxpayer will be able to deduct only 601 PLN.

Income below 30 000 PLN characterizes 73,6% of taxpayers filing individual tax returns and single parents, 64,4% are married couples. Over half of the children (55,3%) are brought up in such families. Child tax credit in such cases is utilized only in part or not at all. The real beneficiaries of this tax relief are families with higher income levels.

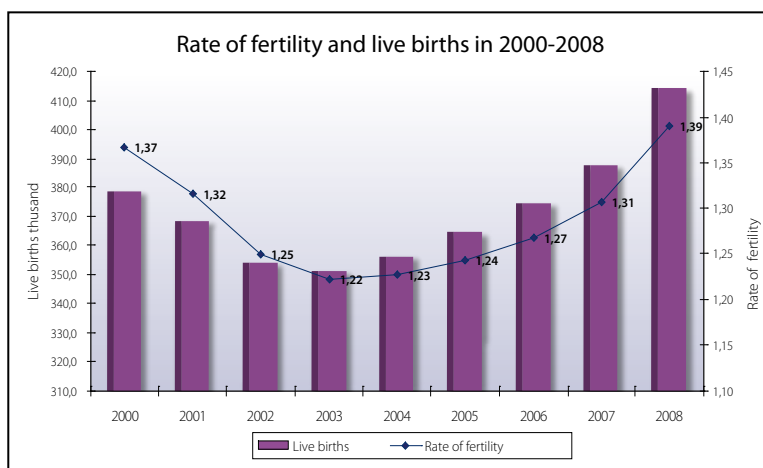
Child tax credit by income groups in 2009

Income group	Total taxpayers (thousand)	Number of taxpayers applying the child tax credit (thousand)	Percentage of taxpayers applying the child tax credit	Number of children (thousand)
Individual tax returns and single parents				
up to 15 thousand PLN	4 207	338	8,0%	432
15 - 30 thousand PLN	2 403	470	19,6%	617
30 - 45 thousand PLN	1 252	335	26,8%	472
45 - 60 thousand PLN	580	169	29,1%	241
60 - 75 thousand PLN	233	75	32,4%	109
75 - 90 thousand PLN	122	35	28,7%	50
above 90 thousand PLN	183	61	33,3%	86
	8 981	1 483	16,5%	2 007
Joint tax returns of spouses				
up to 15 thousand PLN	2 853	597	20,9%	866
15 - 30 thousand PLN	3 524	1 039	29,5%	1 557
30 - 45 thousand PLN	1 858	629	33,8%	946
45 - 60 thousand PLN	846	297	35,1%	450
60 - 75 thousand PLN	367	130	35,4%	196
75 - 90 thousand PLN	196	72	36,7%	107
above 90 thousand PLN	256	90	35,2%	145
	9 900	2 854	28,8%	4 267
Total	18 881	4 337	23,0%	6 274

Demographic background³⁶

In 2008, population of Poland was 38,1 million, of which 7,3 million children and youth, aged 0-17, which constituted slightly over 19% of total population. Share of children and youth in total population is steadily decreasing since mid-1980s. Rapid reduction of children and youth population results from changes in demographic and migration processes, but mostly from deep demographic low in 1990s and the beginning of the century. Number of births in 1984-2003 has been decreasing systematically (from 723 thousand to 351 thousand), which resulted in steady decrease of numbers of children and youth.

Despite the growing number of births, total fertility rate still does not ensure simple generation replacement. Birth depression, observed since 1989, continues. In 2008



fertility rate was 1,39, which means an increase (by 0,17 pt) compared to lowest, in 50 years, fertility rate noted in 2003. It should be emphasized, that currently women born during the last demographic high (years 1979-1983, as well as 1984-1988) are currently in top, or high, fertility age, hence the increase in the number of births. It is forecasted, that within the next 25 years the population of the country is going to decrease and society aging process shall progress.

Summary

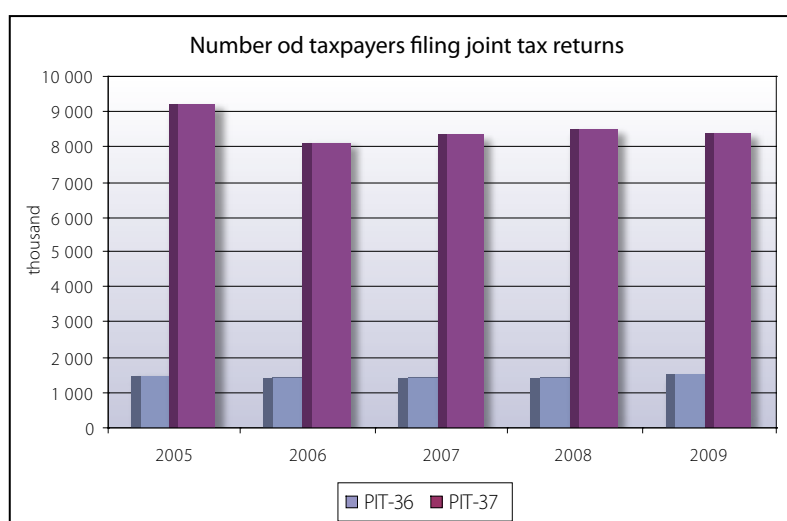
The fundamental feature of the child tax credit is the correlation between income and number of children. A taxpayer with many children but average to low wages is practically excluded from full utilization of the tax credit. Paradoxically, at this point it's a tax relief for high income taxpayers, in case of whom the very existence, or level of child tax credit will not matter much for the decision on expanding the family. Child tax credit is seemingly attractive for families with low and average income, but in practice the support remains potential because, as indicated above, many such families utilize this relief only to a small extent, due to low income levels.

Reversing the unfavorable demographic trends requires comprehensive actions. It is difficult to expect, that a tax relief related to children would have a significant impact on number of births.

2. Joint taxation of spouses

Nature and objectives

Spouses, who maintain statutory joint property throughout the fiscal year, and who remain married throughout the fiscal year, may, upon request expressed in joint annual tax return³⁷, file the tax jointly on the sum of their income. In such case, tax return is filed in names of both spouses, in the amount of twice the amount of tax due on half of total income of the spouses, however, this total does not include revenues taxed on a lump sum basis.



Joint taxation of spouses does not apply, if even one of the spouses is subject to provisions pertaining to 19% tax rate on revenues from business activity and special sections of agricultural production, Act on lump sum income tax or Act on tonnage tax. Joint taxation may be applied in case of revenues obtained from lease or subleasing, taxed by lump sum income tax, on condition, that provided that at the same time the following are not applied: 19% tax rate on revenues from business activity and special sections of agricultural production, revenues covered by Act on lump sum income tax or Act on tonnage tax.

Preferential taxation of spouses has been in place since the beginning of income taxation in its current shape (universal taxation), so since 1 January 1992. Introduction of this solution was justified by implementation of pro-family policy objectives as well as mitigation of results of tax progressivity in case of disproportionate incomes of spouses.

³⁷ Request for joint taxation of spouses, who maintained statutory joint property throughout the fiscal year, may also be filed by a widowed taxpayer.

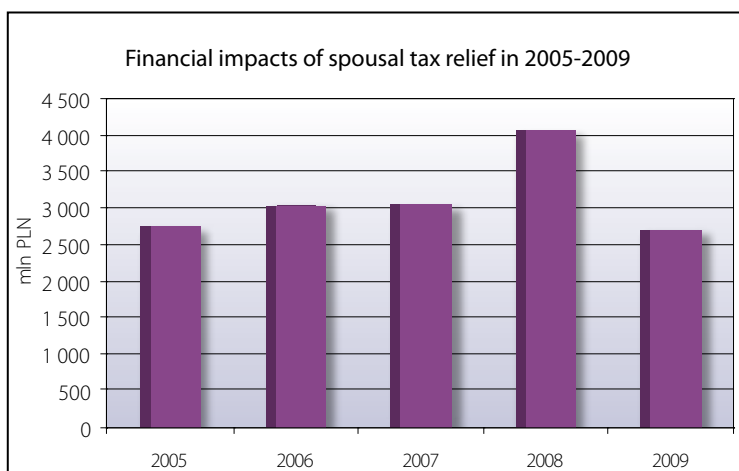
Cost

Possibility of joint taxation of spouses has an impact on reduction of tax amount in case of major differences in levels of income achieved by spouses, or in cases in which one of the spouses has no income at all (this pertains to approx. 5% of taxpayers).

Joint taxation was applied in settlement for 2005 – by 10 641 814 taxpayers (44,45%

of total number of taxpayers subject to tax scale), for 2006 – by 9 525 326 (39,58%), for 2007 – by 9 736 632 (39,81%), for 2008 – by 9 901 352 (40,01%), and for 2009 – by 9 899 750 taxpayers (40,01% of total number of taxpayers subject to tax scale).

Joint taxation of spouses results in reduction of tax revenues. In 2005 it amounted to 2 740 million PLN, in 2006 – 3 008 million PLN, in 2007 – 3 058 million PLN, in 2008 - 4 054 million PLN, and in 2009 - 2 693 million PLN.



Summary

Reduced tax progressivity was very beneficial for taxpayers especially before 2009, i.e. when tax scale was composed of three income brackets. Average benefit to taxpayer amounted to: in 2005 - 257 PLN, in 2006 - 316 PLN, in 2007 - 314 PLN, in 2008 - 409 PLN, in 2009 - 272 PLN.

Joint taxation of spouses is most financially beneficial for taxpayers in situation in which one of the spouses does not earn any income or earns income much lower than the other spouse. For example, if in 2010 a taxpayer achieves annual income from labor on the level of 180 thousand PLN, and his/her spouse has no income at all, by applying joint taxation the taxpayer shall save almost 11,5 thousand PLN worth of tax. Constant high interest in this form of taxation is also related to reduced number of formalities involved in filing a tax return (a single form) even if it's financially neutral for the spouses. Joint taxation of spouses simplifies tax procedures (joint liability of spouses) and reduces costs of tax administration.

3. Internet tax allowance

Nature and objectives

This relief measure is intended for PIT payers, earning income subject to taxation by tax scale or lump sum on registered revenues. The relief allows to subtract, from taxable income, the amount of expenditures incurred as a result of using an Internet connection in the taxpayer's apartment (building) of residence, in the amount not exceeding 760 PLN³⁸. This limit has not changed since the introduction of the allowance, i.e. since 1 January 2005. The taxpayers were able to make the deductions for the first time in 2006, when filing the tax returns for 2005.

The objective of introducing this tax allowance was to mitigate the impact of taxing Internet services provision with VAT (increased price of services).³⁹

³⁸ Art. 26 par. 1 item 6a of PIT Act.

³⁹ Taxing Internet access services by base VAT rate (22%) resulted from the requirement to harmonize the provisions of national law (under which Internet access services were so far exempt from VAT) to requirements of community law, as European Commission has already initiated procedures against Poland for violation of community law in this scope.

Cost

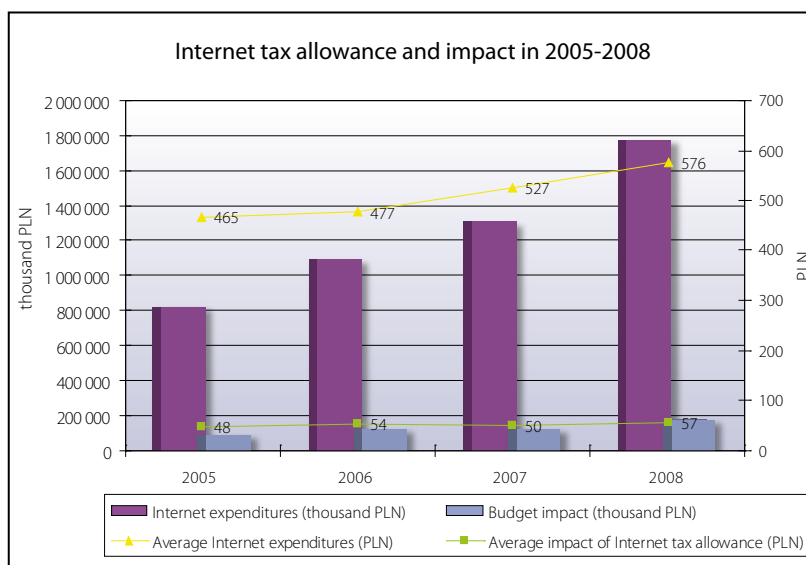
The allowance was introduced as a result of MP initiative. At the stage of legislative processing it was estimated, that the Internet allowance would result in public sector revenues being reduced by 199 million PLN, which corresponded with expected increase in revenues from VAT (approx. 200 million PLN).

In 2005-2008 value of the deductions has been

gradually growing. In 2008, as compared to 2005, it has grown by as much as 118%. In the analyzed period, average annual Internet expenditures per person were: in 2005 - 465 PLN, in 2006 - 477 PLN, in 2007 - 527 PLN and 576 PLN in 2008. Taxpayer savings resulting from Internet tax allowance amounted to respectively 48 PLN in 2005, 54 PLN in 2006, 50 PLN in 2007 and 57 PLN in 2008.

In 2009, approximately 15% of taxpayers have benefitted from Internet tax allowance (in 2005 - 6%). When compared to penetration indicators for broadband access services⁴⁰ this data indicate, that most taxpayers who had access to broadband connections have applied the allowance. As taxpayers' income brackets increase, so does the value of Internet expenditures deducted. Taxpayers with income up to 10 thousand PLN have deducted in average 540 PLN per year, while taxpayers with income over 50 thousand PLN - 612 PLN.

Geographical analysis of application of Internet tax allowance in 2008 shows, that the value of deducted expenditures was highest in Mazowieckie voivodship (16%) and Silesian voivodship (15%). At the same time, those voivodships had the highest number of taxpayers benefitting from this tax privilege. Structure of deducted Internet expenditures indicates, that the share of remaining 14 voivodships in global expenditures has not exceeded 10% (Wielkopolskie 9%, Dolnośląskie and Małopolskie 8%, Łódzkie 7%).



Availability of Internet

GUS data⁴¹ shows, that the number of Internet users is growing steadily. In 2004, 26% households had Internet access. Since 2004, this number has grown by 2,7 million households connected to the Internet. In 2008, total number of connected households got close to 6 million (48% of the population). The largest percentage of households with Internet access are households with children (61% in 2008) and households located in large cities (56% in 2008). In rural areas, in 2008 every third household had access to Internet, however those households have the greatest growth dynamics (in 2004 it was only 15% of households).

⁴⁰ Detaliczny rynek dostępu do Internet szerokopasmowego, Urząd Komunikacji Elektronicznej (hereinafter: „UKE”), April 2009
⁴¹ Społeczeństwo informacyjne w Polsce, Wyniki badań statystycznych z lat 2004-2008, GUS 2010.

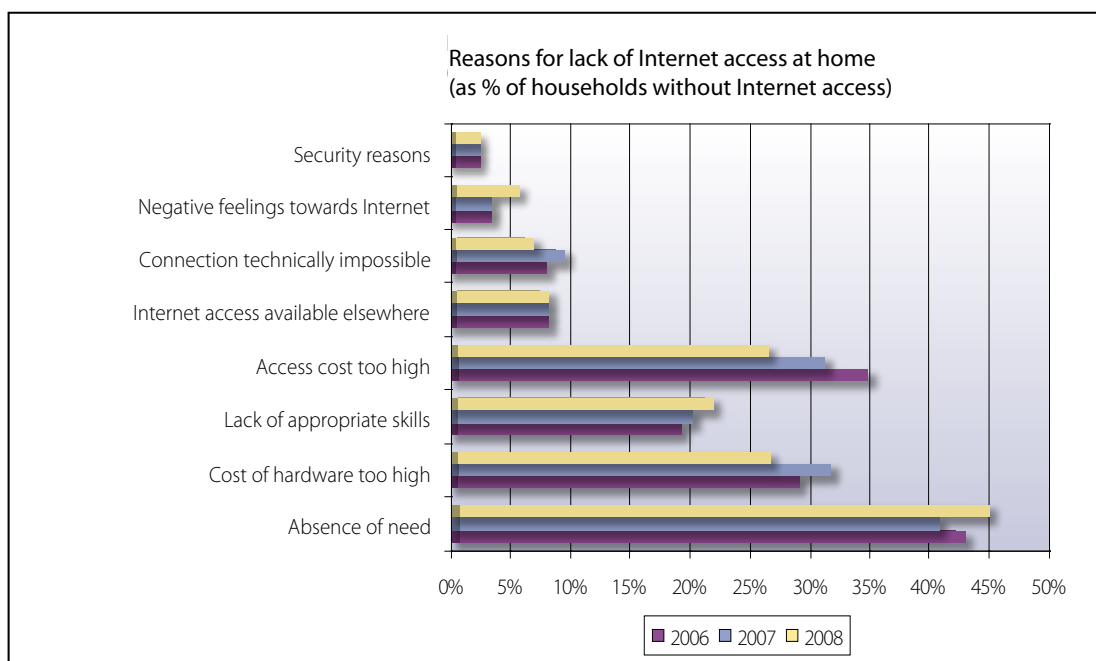
Percentage of households with Internet access at home

	2004	2005	2006	2007	2008
Total	26	30	36	41	48
Type of household					
Households with children	34	38	47	53	61
Households without children	19	27	31	35	41
Residence					
Large cities ⁴²	34	40	46	50	56
Smaller towns	28	31	36	44	50
Rural areas	15	19	25	29	36

Source: *Spółeczeństwo informacyjne w Polsce, Wyniki badań statystycznych z lat 2004-2008, GUS 2010*

Internet is popular among employees (72% of self-employed and 58% paid employees – in 2008). It is even more popular among the pupils and students (92% of respective population in 2008), however those by principle are not PIT taxpayers and thus cannot become beneficiaries of the Internet tax relief.

GUS research shows, that the main reason for lack of Internet access was absence of perceived need, declared, in 2008, by 45% of household without access to Internet. High cost of access and equipment was an important barrier for over one fourth of households without access to Internet at home in 2008.



Source: *Spółeczeństwo informacyjne w Polsce, Wyniki badań statystycznych z lat 2004-2008, GUS 2010*

Continuous increase of market saturation with broadband services is clearly visible in Poland. Only between June 2008 and January 2009 number of broadband connections has grown by over 656 thousand, and Internet access via fixed networks has reached 11,7%.

Analysis conducted by UKE⁴³ shows, that Poland is one of the countries where Internet access is relatively inexpensive (with due regard to purchase power parity).

⁴² Large cities are defined as cities with population exceeding 100 000.

⁴³ Analiza cen usług stacjonarnego dostępu do Internet w Polsce na tle krajów Unii Europejskiej, UKE, czerwiec 2010

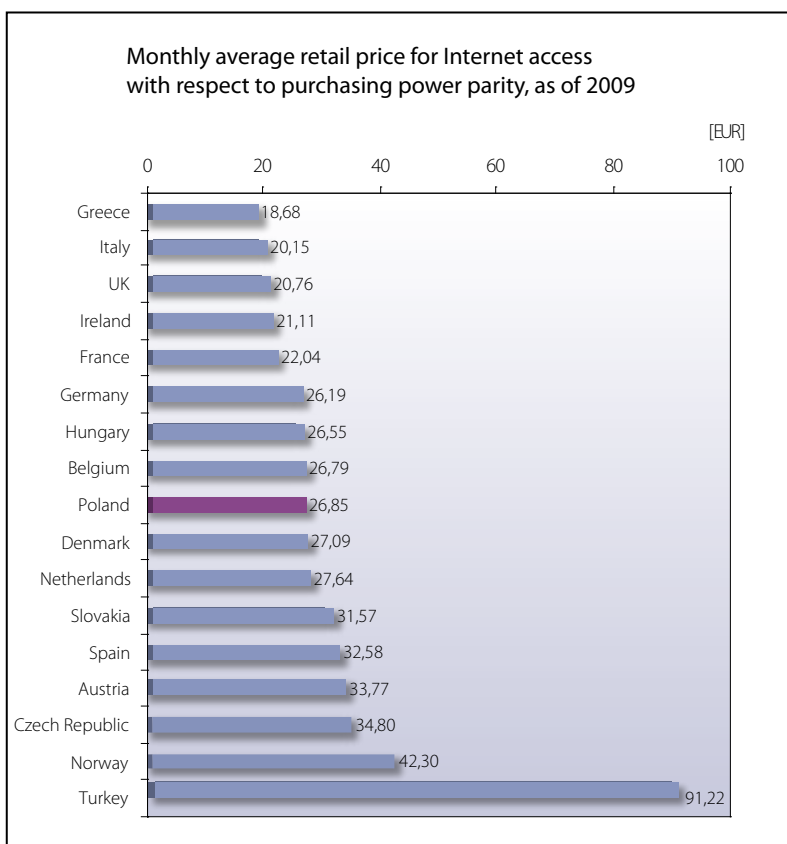
Summary

For a large part of the society, Internet access has become an everyday thing. It should be noted, that at the current stage of Internet access saturation, obtaining access depends on three factors, really: the need for Internet access, technical possibility and retail price of service.

Internet tax allowance has an impact only on the final price of the service. Prices of Internet access services are reduced from year to year, while simultaneously the quality of access improves. At the same time, price of Internet access service is no longer a factor in purchase

decision. Internet tax allowance is available only to a portion of the society – large groups of the public (e.g. farmers, entrepreneurs using the tax card, pupils, students, social assistance beneficiaries) cannot use this relief measure. Other social groups, especially those with lower income, only use this tax relief in minimum extent. Additionally, it should be noted, that the number of Internet-connected households in the rural areas increases faster than in the cities. Seeing as farmers cannot benefit from this tax allowance, it means, that absence of tax allowance is not a factor discouraging from obtaining Internet access.

The tax allowance has fulfilled its objective, namely offsetting the increase in service prices resulting from repeal of reduced VAT rate on Internet access services, when the prices were relatively high. Currently, the main result of the tax allowance is a reduction of tax liability.



Source: OECD

4. Tax deferral for entrepreneurs

Nature and objectives

Tax deferral is applied to entrepreneurs, who for the first time begin a non-agricultural business activity, from income tax (withholding tax) in the first year of business activity⁴⁴. Payment of tax due is spread over the next five years without imposing penalty interest for delayed payment. This object exemption has been in place since 26 October 2002.

Tax deferral may be applied by taxpayers, who, in the period envisaged in the Act, meet a set of specific requirements, namely:

- 1) during the initial period of their activity they will maintain employment on a specific level, while minimum number of employees cannot be less than 5,
- 2) in the period preceding the year in which exemption is to be applied, they achieve average monthly revenue from business activity on the level of at least equivalent of 1 000 EUR in PLN,
- 3) in the non-agricultural business activity they conduct, they do not utilize fixed assets, intangible and legal assets, or other assets specified in the Act – such as carry significant value – made available to them free of charge by persons from I and II tax group, in the understanding of regulations pertaining to inheritance and donations tax, such as were previously used in their business activity and constituting their property,
- 4) they submitted, to the appropriate director of tax authority, a statement on utilization of tax deferral,
- 5) in the year in which tax deferral is to be applied they are taxed by tax scale.

The objective of introducing the tax deferral was to stimulate entrepreneurship and limiting unemployment. It should be emphasized, that maintaining a specific level of employment is a condition for applying the tax deferral. Tax unpaid at the beginning of business activity constituted an investment loan of sorts. It was assumed, that after the development stage of the enterprise is completed, the deferred tax would be repaid in equal installments over the following five years.

Cost

As tax deferral was introduced it was forecasted, that budget revenues would not be reduced, only deferred. At the same time no estimation was made of the number of entities which could be interested in such deferral.

Number of taxpayers utilizing the tax deferral in 2004-2010

Year	Number of taxpayers, who submitted the statement on application of tax deferral			Number of taxpayers indicating repayment of tax deferral in their tax returns		
	PIT	Lump sum on registered revenues	CIT	PIT	Lump sum on registered revenues	CIT
2004	1	0	1	0	0	0
2005	0	0	1	1	0	0
2006	0	0	1	1	0	1
2007	0	0	0	1	0	2
2008	0	0	0	1	0	2
2009	0	0	0	1	0	2
2010	0	0	0	b/d	b/d	b/d
Total	1	0	3	-	-	-

⁴⁴ Art. 44 par. 7a of PIT Act. Same principles, by virtue of art. 21 par. 6 of the Act on lump sum income tax on certain revenues obtained by natural persons apply to taxpayers who pay lump sum tax on registered revenues, and by virtue of art. 25 par. 11 of the Act of 15 February 1992, CIT Act, to CIT taxpayers.

In practice, tax deferral is not popular. Only one PIT taxpayer and three CIT taxpayers decided to use it. None of the taxpayers of the lump sum on registered income. Loss of budgetary revenues related to deferred inflow of tax revenues is minimal.

Summary

Tax deferral does not fulfill its objectives related to stimulation of entrepreneurship and reduction of unemployment. Even during recent economic slowdown (2008-2009), where lack of financial liquidity was one of significant problems, entrepreneurs did not choose this solution.

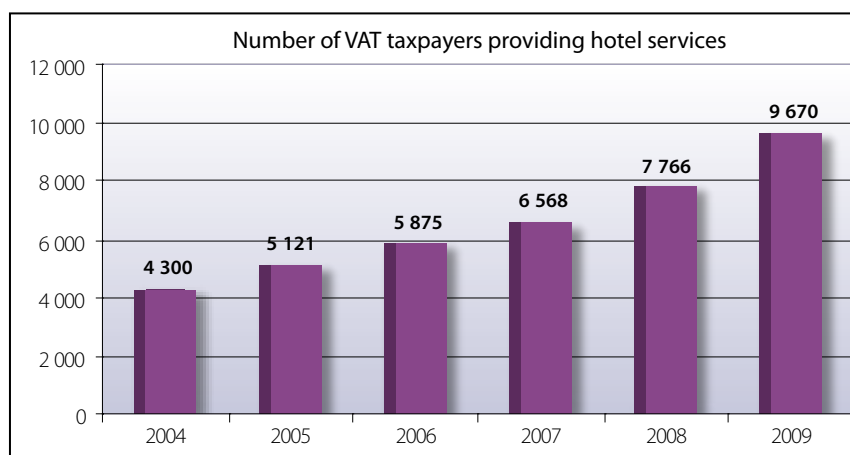
One may suppose, that the main reason for lack of interest from small entrepreneurs was the requirement to meet rather strict conditions. Under current financial circumstances, both domestic and abroad, it is difficult for entrepreneurs to determine level of their income and employment on a five year time horizon, and benefits from receiving the deferral in the given year seem to be out of proportion with respect to obligations, resulting from the established requirements. An additional factor discouraging the taxpayers from using the tax deferral were potential sanctions for violation of even one of the eligibility conditions.

Tax deferral may be used only by a taxpayer, who has obtained taxable income. Large part of entrepreneurs at the initial stage of their activity do not generate any income, as a result of previous investment expenditures related to starting the business activity and limited markets. Additionally – in light of economic slowdown and reduced revenues, large portion of the companies have not generated revenues, which would also explain lack of interest in the tax deferral. Moreover, other, much more competitive support instruments for entrepreneurs became available on the market (including EU funds, reduced social security rates for business startups, etc.). In light of such solutions, a formalized tax deferral is not a very attractive instrument.

5. Reduced VAT rate on hotel services

Nature and objectives

Reduced VAT rate on hotel services, on the level of 7%, has been introduced on 5 July 1993, when Act of 8 January 1993 on tax on goods and services and excise tax⁴⁵ entered into force.



Cost

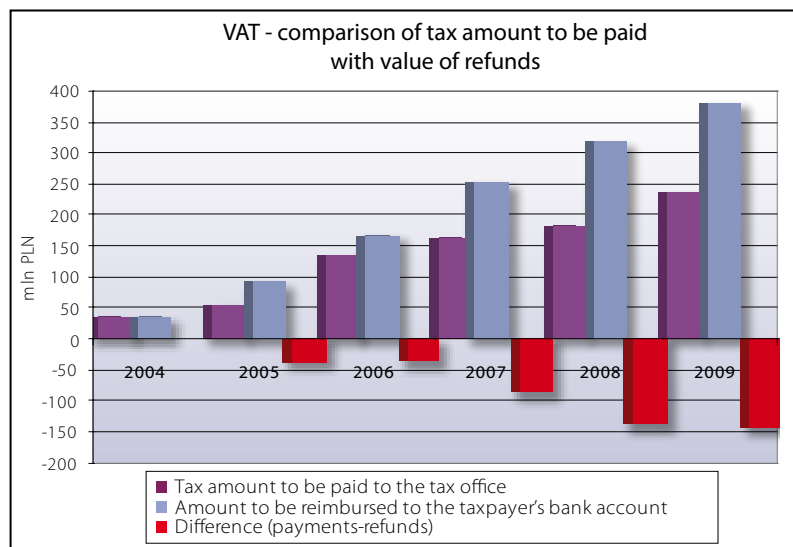
Value of this tax expenditure, in 2009 conditions, is estimated at approximately 732 million PLN (of which 118 million PLN pertains to services provided by tourist accommodations facilities and other short term stay facilities, except for services of school and university dormitories)⁴⁶.

In 2004 - 2009 number of VAT taxpayers providing hotel services has been growing systematically, in average by 18% per year. This trend has reached its highest dynamics in recent years.

⁴⁵ Dz.U.93.11.50

⁴⁶ This estimate was calculated based on statistical data on final consumption in households, indirect consumption, and gross expenditures on fixed assets in the sector of government institutions, self-government, non-commercial and other institutions – developed based on national accounts for 2007 and structures from tables of use of goods and services for 2006. Additionally it was assumed, that share of informal economy and sale by entities excluded based on subject exemption amounts to 20%.

In 2009, number of taxpayers settling their taxes in form of tax card and providing hotel services in form of renting guest rooms and tourist bungalows (if total number of rooms doesn't exceed 12) was 11 664. Assuming, that the share of VAT taxpayers in this number would be around 30%, number of all entities providing hotel services could be estimated on the level of about 17 thousand.



Source: EUROSTAT

It should be noted, that in average 60% of turnover of such VAT taxpayers is attributable to sales of services bearing 7% rate, mostly hotel and gastronomy services⁴⁷. Value of sales achieved by such VAT taxpayers in the discussed period is characterized by very high dynamics, approximately 40% a year. Comparing data for 2004 and 2009, sales taxed by 7% rate has grown fivefold, reaching, in 2009, the value of 5 395 thousand PLN.

In 2004-2009 both value of VAT paid to tax offices by taxpayers providing hotel services and amount of VAT reimbursed to them were growing. In 2006-2008 value of realized reimbursements grew due to numerous investment efforts on the market.

Hotel market

Hotel resources, and most of all, the number of beds, have been growing over the past years. Employment in the area of hotel and gastronomy services (section "hotels and restaurants") in 2005-2007 was growing every year and in 2007 reached the level of 239,9 thousand persons (average growth by approximately 10 thousand people a year)⁴⁸. Value added generated in the area of hotel and gastronomy services constituted 1,1% GDP in 2008 (this share has not changed over the recent years). Prices of hotel and gastronomy services have been growing slightly faster than the general price index of consumer goods and services (in 2005-2007 in average by 1 p.p).

A similar trend can be observed in case of number of overnight stays in 2004-2008. (2009 drop by 2% results from global economic crisis and fits within a broader European trend on the hotel market – in most EU countries analyzed value has decreased). In 2009, number of overnight stays in hotels (and similar facilities) amounted to 17 036 thousand. Along with development and growing hotel base, in 2005-2007 an increase in hotel rooms occupancy could be observed (in average 1,8 p.p a year). According to GUS data, in 2007 it reached 44,1%. Despite that, Poland has the lowest hotel saturation index in the entire EU.

⁴⁷ According to GUS data, in 2007 in hotel facilities (mostly hotels, motels and B&Bs) there were 3589 gastronomy facilities (including 1845 restaurants, 1318 bars, 256 canteens, 170 gastronomy sales points).

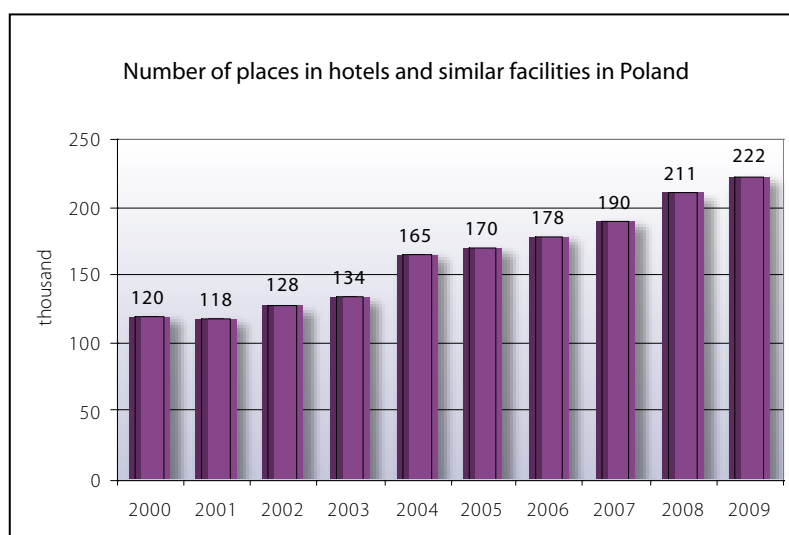
⁴⁸ Macroeconomic data was taken from Journal of Statistics of Central Statistical Office for 2008.

Summary

Reduced VAT rate for hotel services, resulting in reduced prices of hotel services, has increased attractiveness of Poland for tourism and contributed to development of hotel market. In 2004-2009 this market was growing very dynamically (as measured by number of overnight stays, number of service providers in the market, number of facilities and places therein, hotel rooms occupancy rate). This phenomenon should be doubtlessly viewed as positive, as it leads to increased profitability of the hotel sector, which translates into increased revenues from income taxes. However, when taking into consideration the fact, that hotel services are usually purchased by the wealthier part of the public, this relief measure reduces progressivity of the tax system. Moreover, assuming that large part of hotels' clientele are business clients and foreign guests (whose presence in Poland rarely results only from competitive pricing of hotel services), one should be cautious in evaluating effectiveness of this expenditure.



Source: EUROSTAT



6. Excise tax relief for biofuels

Nature and objectives

Exemption of biofuels and fuels with biocomponents from excise tax was introduced for the first time on 1 January 2004⁴⁹ and continued⁵⁰ until 15 October 2009, when the statutory system of reduced excise tax rates for engine fuels (gasoline and Diesel fuels) with biocomponents and for biocomponents constituting fuels in themselves entered into force.

According to Act on excise tax⁵¹, for products resulting from mixing gasoline with biocomponents, including over 2% of biocomponents, such as meet quality requirements specified in separate provisions of the law, excise tax rate in the amount of 1 565,00 PLN/1000 l is reduced by 1,565 PLN per each liter of biocomponents added to such gasoline, while for products resulting from mixing Diesel fuels with biocomponents, including over 2% of biocomponents, excise tax rate of 1 048,00 PLN is reduced by 1,048 PLN per each liter of biocomponent added to such fuels – however the amount of excise tax due cannot be lower than 10 PLN/1000 l.⁵² At the same time, excise tax rate for biocomponents constituting fuels is 10 PLN/1000 l.

Besides reduced rates of excise tax envisaged in the Act, there is also an exemption from excise for biocomponents for liquid fuels or liquid biofuels⁵³ meeting quality requirements set forth in separate legislation. This exemption applies in case of completion of procedure of suspension of collection of excise tax with respect to biocomponents for liquid fuels or liquid biofuels. In practice, such biocomponents do not utilize the exemption from excise tax, because by principle, such biocomponents as well as liquid fuels and liquid biofuels are produced in tax warehouses, where procedure of suspension of collection of excise tax applies.

The main objective of those tax relief measures is to support the development of biocomponents and biofuels market, and thus improvement of energy security of the state, which should be understood as reduced dependency on external supply of any and all fuels. This objective should be achieved by, among other things: increasing agricultural production for energy sector, increased employment, development of initiatives aimed at increasing production and use of biocomponents and biofuels in Poland, ensuring price competitiveness of fuel with biocomponents offered on the market as compared to price of mineral fuel, public assistance to biocomponents manufacturers to compensate for higher cost of production of biocomponents as compared to traditional fuels.⁵⁴

The system of tax reliefs for biocomponents and fuels with biocomponents in scope of excise tax is to support the implementation of National Indicative Target⁵⁵, i.e. minimum share of biocomponents and other renewable fuels in total volume of liquid fuels and liquid biofuels used throughout the year in transport, measured by caloric value. According to National Indicative Target, minimum share of biocomponents that should be observed on the domestic fuel market in 2008 and 2009 was on the level of respectively 3,45% and 4,60% (according to energy value of fuels used in transport). It should also be indicated, that National Indicative Target values adopted for 2008 and 2009 were achieved. National Indicative Target assumed for 2010 is to be 5,75%, for 2011 – 6,20%, for 2012 – 6,65%, and for 2013 – 7,10%.

49 § 10 of the Ordinance of the Minister of Finance of 23 December 2003 on excise tax (Dz.U.03.221.2196).

50 § 12 of the Ordinance of the Minister of Finance of 26 April 2004 on exemptions from excise tax (Dz.U.06.72.500 j.t.).

51 The Act of 6 December 2008 on excise tax (Dz.U.09.3.11; hereinafter: „Act on excise tax”).

52 Reduced excise tax rates for fuels including biocomponents, set forth in z art. 89 par. 1 item 3, 7 of the Act on excise tax, constitute the maximum tax relief as they are applied, in accordance with art. 16 of the Directive of the Council 2003/96/EC of 27 October 2003 on restructuring community framework legislation on taxing energy products and electrical energy.

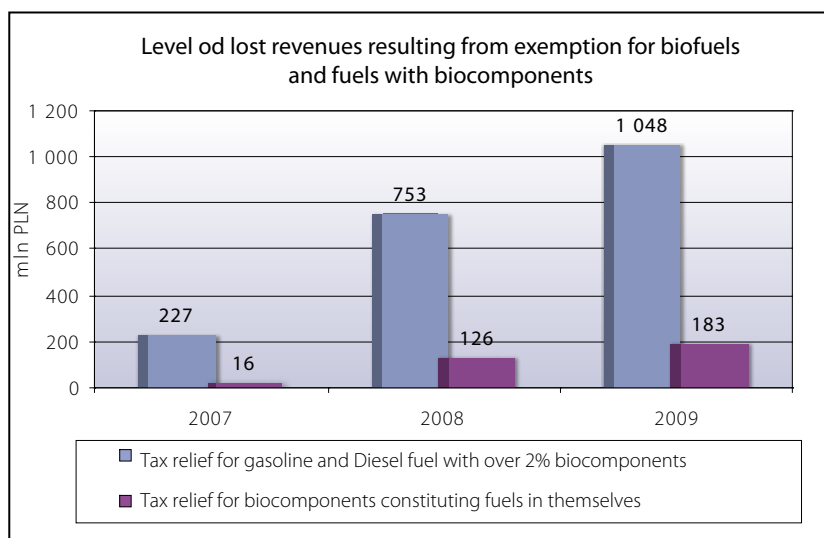
53 § 11 of the Ordinance of the Minister of Finance of 24 February 2009 on exemptions from excise tax (Dz.U.09.32.228; hereinafter: „Ordinance on exemptions from excise tax”).

54 According to assumptions of the Multiyear Program for Promotion of Biofuels and Other Renewable Fuels for 2008-2014, adopted by Council of Ministers by way of Resolution Nr 134/2007 of 24 July 2007 (M.P. Nr 53, item 607) it is to achieve specific economic, environmental and social objectives.

55 Referred to in Act of 25 August 2006 on biocomponents and liquid biofuels (Dz.U.06.169.1199 as later amended) and Ordinance of the Council of Ministers of 15 June 2007 on National Indicative Targets for 2008-2013 (Dz. U. Nr 110, item 757).

Cost

During introduction of the tax relief measure, reduction in revenues from excise tax was estimated as 376,4 million PLN. In extending the exemption for 2006 it was assumed, that if planned revenues from excise tax on fuels for 2007 shall exceed 18 billion PLN, and target for biofuels production (2,3%)



is achieved, global reduction of budget revenues resulting from exemptions on excise tax with respect to fuels with biocomponents should be estimated at approximately 400 million PLN.

In 2007, utilization of tax relief for fuels with biocomponents was lower than estimated, while further years it has already grown significantly. In 2009 the amount of revenues lost as a result of the tax relief measure was 39% higher as compared to previous year, and over 4 times higher than in 2007. At the same time, in 2009 the number of entities benefitting from this tax relief has returned to 2007 level, after temporary decrease in 2008. As far as tax relief for biocomponents constituting fuels in themselves, in 2009 we saw the increase of the amount of lost revenues resulting from the tax relief by 45% as compared to previous year, while in comparison with 2007 the growth was over tenfold. This results from the fact, that 2007 was the first year of application of this tax relief measure. At the same time, in 2007-2009 the number of entities utilizing the tax relief for biocomponents constituting fuels in themselves was gradually growing.

Summary

Support of market for biocomponents and fuels containing biocomponents in form of excise tax relief as described above, constitutes state aid. European Commission, in issuing the consent for implementation of such state aid has indicated, that the system of reductions of excise tax in Poland is combined with obligatory delivery of biofuels (which is related to implementation of National Indicative Target). The obligation to provide a specific amount of biofuels eliminates the need for granting state aid (like reduction of excise tax and corporate income tax or exemptions from fuel levies), because the environmental objective of promoting biofuels may be achieved thanks to obligation of the state only. Hence, in longer time perspective, state aid will not be necessary.

Further support for market on biocomponents and biofuels from public funds is not justified, as it does not translate into implementation of basic economic and social objectives included in the *Multi-year Program* (...).⁵⁶ Already implemented mechanisms of development of market for biofuels, facilitating implementation of National Indicative Target, do not support domestic production of biocomponents on the expected level (available data shows, that large portion of biocomponents available on the market were not manufactured domestically).

⁵⁶ Comprehensive information about implementation of multi-year program of promotion of biofuels or other renewable fuels for 2008-2014, adopted by Council of Ministers on 26 January 2010.

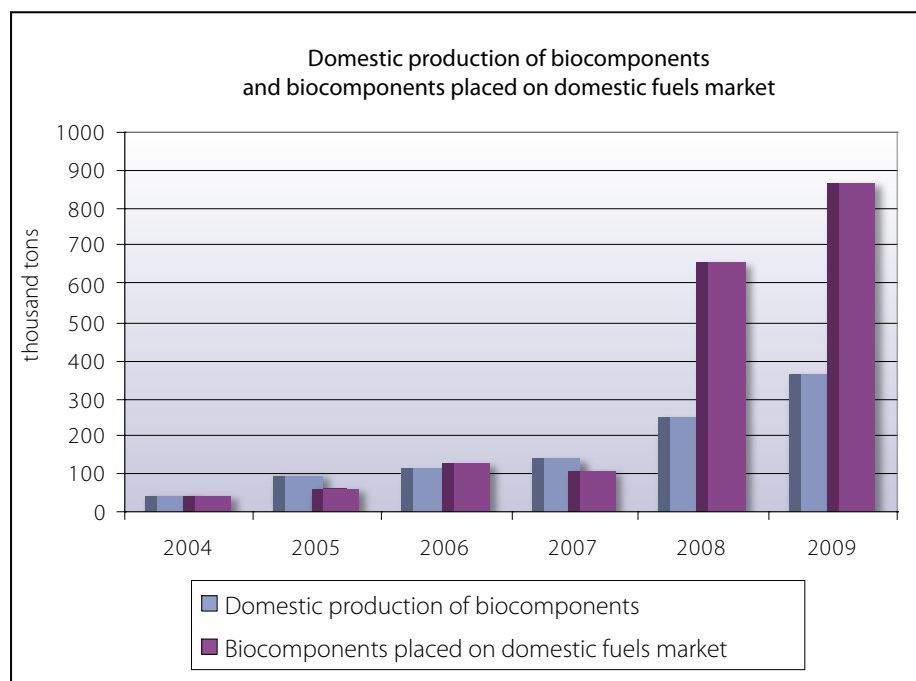
Share of domestic production in market for biocomponents commercially traded in 2009			
Name	Traded (thousands of tons)	Produced domestically (thousands of tons)	% share of domestic production in total consumption
Bioethanol	232,17	130,72	56%
Esters	632,47	364,72	58%

Source: Calculated based on aggregate quarterly reports on market for biocomponents and liquid fuels of President of Energy regulatory Office.

This results in e.g. decreasing number of registered manufacturers of biocomponents, significant regression, instead of expected increase, of domestic production of bioethanol (which is related to decrease of employment in distilleries and reduced amount of domestic raw materials used for production), unused declared raw material and production capacity.

Production capacity of biocomponents manufacturers, registered with Agricultural Market Agency in 1 st half of 2009			
Name	Number of registered manufacturers (31.12.2009)	Declared capacity	Capacity utilized in 1 st half of 2009
Bioethanol manufacturers	14	573 tys. ton	8,4%
Esters manufacturers	19	620 tys. ton	27,7%

Source: Data of Agricultural Market Agency, from registry of manufacturers



Source: Comprehensive information on implementation of multi-year program of promotion of biofuels or other renewable fuels for 2008-2014, adopted by Council of Ministers on 26 January 2010

Applied state aid has also no significant impact on wholesale prices of fuels with biocomponents. Prices of liquid fuels with biocomponents up to 5% placed on the market are no different than prices of those same fuels without biocomponents. State aid was used to finance some of the technological needs of fuel sector, related to quality of liquid fuels (such as ensuring appropriate lubricity of diesel fuel or octane number of gasoline).

The factor determining the share of biocomponents in domestic fuel market is obligation to apply them, under the pain of high penalties, by entities implementing the National Indicative Target, placing fuels on the market.⁵⁷ Such obligation is fulfilled regardless of tax relief measures applied, constituting public aid in scope of biofuels market support. With respect to the above it should be stated, that the regulations imposing the obligation to apply a minimum share of biocomponents in total volume of liquid fuels and liquid biofuels are effective and in practice sufficient for implementation of National Indicative Target.

VIII. SUMMARY

Polish tax system offers numerous tax expenditures. The largest stream of public funds is directed to support family, social objectives, agriculture and economy. Much less support is given to employment, philanthropy, culture, science, education and sport. Jointly they generate a significant loss of tax revenues, thus leaving less funds for dedicated direct expenditures. Tax expenditures of value determined this year have reduced the revenues of the public finance sector (state budget and budgets of territorial self-government units) by almost 66 billion PLN.

In some cases, analyses conducted hereunder indicate reduced effectiveness of tax relief measures. This results either from the fact that the tax expenditure is used – directly or indirectly – by groups of taxpayers other than originally assumed by the legislators, or the level of support varies greatly depending on level of income. Some tax expenditures, introduced a few years ago, have lost their impact on taxpayers' behavior and at this point their main outcome is reduction of budget revenues.

In this respect, the identified tax expenditures require further research resulting in answers to the question as to the extent, in which their further operation in their current shape is still justified.

Gathered information and undertaken analysis also stated that some goals of tax expenditures are not clearly defined or are difficult to measure. This leads to situation in which an assessment of their effectiveness in such cases is seriously hampered. As a result, making a decision as to what kind of public intervention is required may not be an easy task. However, this report significantly increased the knowledge of tax expenditures, which indirectly helps in the process of consolidation of public finances.

⁵⁷ Obligation to ensure, in the given year, at least minimum share of biocomponents and other renewable fuels in total volume of liquid fuels and liquid biofuels stems from the Act on biocomponents and liquid biofuels, in connection with art. 3 par. 1 of the Directive of European Parliament and Council 2003/30/EC of 8 May 2003 on support for use of biofuels or other renewable fuels in transport.





Tax Expenditures

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