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THE IMPACT OF THE FLAT TAX ON BUDGET REVENUES

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ABSTRACT. *The flat tax, in the modern world, is a phenomenon that started in the US, but in just a few decades it spread around the world, especially in developing countries. It is characterized by a single rate of taxation, regardless of the amount of income. He has no tax-free income. There are also different rates - steps, of taxation. The flat tax is easier and cheaper to administer, both for taxpayers and for the countries that have introduced it. At the household level, the flat, lower rate incentivizes taxpayers to voluntarily declare all the tax they owe, leaving a larger portion of income at their disposal. This, in turn, is expected to lead to increased savings and economic growth. At the budget level, however, the flat tax appears, at first sight, to be a less favorable solution. The fact is that for states this type of taxation means more stable and predictable sources of revenue. It is these effects that lead to the clarification of which approach is better for countries - depriving countries of the budgetary advantage originally thought to bring the flat tax, or treating all tax subjects equally, regardless of the scale of the tax burden. Their labor and the risk they take will be explored in this article. The research should also answer the question of whether countries collect more taxes as a result of the implementation of the flat tax or whether their tax revenues decrease after the introduction of the same.*

KEYWORDS: *Flat tax, fees, taxation, inequality, budget, sources of revenue, budget practices, fiscal base.*

JEL CLASSIFICATION: *H24, H31, H61*

INTRODUCTION

The main revenues of the state and municipalities are formed through a combination of corporate taxes, excise duties, indirect taxes, taxes on wealth and income. Among them, income tax stands out as the only possible basic structurally progressive levy (Wiehe et al, 2018) – assuming that such an approach is correct and in the interest of the country and society. The taxes levied on the owners of movable and immovable property, taking into account the fact that in Bulgaria they are in favor not of the state, but of the local administration, concern only the entities that own such property. Here we are talking about property taxes, which in general are always in principle proportional to the price of the movable or immovable property owned. Globally, there are no established techniques of property taxation that are based on a size disproportionate to the cost of property.

Indirect taxes and excise duties also hit hardest those taxpayers who spend the most. Value added tax (VAT), which is the largest representative of indirect taxes, is borne by end consumers based on their purchases. This means that those who buy more and at higher prices pay a higher absolute indirect tax. In this way, after paying the income tax, with the remaining available funds, goods and services are purchased, the price of which includes indirect taxes and excise duties. The above comes to show that the individual, using the remainder of his disposable income after paying income taxes, still pays excise and indirect taxes proportional to his consumption. Here is the place to point out that excises and indirect taxes are always proportional to consumption and purchases. The question of whether they should be tied to any levels of consumption/taxation has never been raised in relation to them. This is because they are by definition bound by the volume of consumption, which depends on the economic capabilities of individual subjects.

Regardless of the above, there is still the argument that the income tax remains one which, if the principle of flat taxation is abandoned, could lead to a situation where those who work more and take more burdens and risks should pay a higher percentage of tax burden compared to other tax subjects. This thesis in no way takes into account the consumption-equivalent bearing of the burden to the state of duties for excise duties and VAT. In continuation of the above, the application of the flat tax on income, in the end, it turns out that if it is rejected, it will lead to a situation where all other taxes collected by the state and municipalities are based on proportional to consumption or on property basis.

The subject of the current one is the study of which would be a fair tax system - the flat (proportional) one or one in which different tax rates are introduced, depending on the amount of income.

There is one main advantage of the flat tax used in defense of this system of taxation, which is the simplification of the whole process, since it involves only one and not several rates. There is another thesis according to which, from the point of view of law, the complexity of tax legislation is determined by the way the tax base is formed and its specifics, including the multitude of exceptions, and not by the applied rates. At the same time, the calculation of the amount of tax due, under a flat rate structure, is usually carried out by a simple arithmetic rule, automatically by software or an accountant without additional costs of preparing the tax base expressed in time or money. This facilitates both taxpayers - declaring the tax, and revenue administrations - in the control of the submitted declarations.

1. ADVANTAGES AND DISADVANTAGES OF THE FLAT TAX FROM THE POINT OF VIEW OF TAXPAYERS AND THE STATE

Fair distribution of tax and insurance burdens among people – to the extent that such a burden can exist at all – it is an approach that states are less and less interested. We can reach this conclusion on the basis of research worldwide, which shows that the retirement age for those who work is increasing, combined with an increase in social spending in favor of those who have never worked and do not intend to work social security contributions. In this situation, it is not permissible to have a legitimate expectation from the state, related to the conscientious fulfillment of the tax and insurance obligations of its citizens, given that some of them are doomed to pay for years - it is not clear until when - insurance and taxes , and others are freed from such a burden, their social disengagement being incentivized with funds collected from entities paying insurance and taxes.

Any appropriate tax system must maximize the social welfare function under the government budget constraint, while recognizing that social welfare is greater when resources are more evenly distributed. Yet redistribution of taxes and transfers can negatively affect the willingness to work and/or save, further creating a trade-off between equity and efficiency. In this respect, very high earners may have high and rising income tax rates, while the incomes of low-income families must be subsidized (mainly because low-income earners' decisions are whether or not to participate in the labor market). Therefore, there is an understanding that the optimal profile of transfers and taxes is highly non-linear and very difficult to even approximate by imposing a flat tax (Diamond, Saez, 2011).

The discussion of taxation most often focuses on the two effects that occur: the income effect and the substitution effect. High taxes lead to a reduction in the individual's disposable income, which in turn can compensate for this "loss" through more hours worked (the income effect). On the other hand, a high marginal tax rate may lead an individual to prefer leisure to work if the extra hours do not bring a significant after-tax surplus from income (a substitution effect that can be seen as an indicator of economic inefficiency) (Meade, 1978).

Flat taxation has its advantages and disadvantages both from the point of view of taxpayers and from the point of view of the budget. The literature on the subject points to some specific benefits: the flat rate is simple, easy to understand and inexpensive to implement in terms of administrative costs (Hall, Rabushka, 1995); it equally affects taxpayers, which can be perceived as a measure respecting the freedom of the individual (Shapiro, 1996). The use of a fixed tax rate is related to the reduction of cases of tax evasion - and hence to the increase of revenues in the budget (Paulus, Peichl, 2019); applying a flat rate to all workers is considered an incentive to work and earn more, with a positive effect on productivity (Bikas et al., 2014).

As the main disadvantage of flat-rate tax systems, Paulus and Peichl (Paulus, Peichl, 2019) point out that a flat tax leads to a relatively higher tax burden on low-income individuals, which leads to a negative effect on social justice and an increase in inequality in income. The authors use EUROMOD to simulate different flat tax scenarios for Hungary and Slovenia; their results show that the introduction of a flat tax scheme would lead to a significant increase in the tax burden on people who before the introduction of the flat tax were taxed at the lowest rate of the progressive, leading to an increase in inequality and poverty in both countries (Paulus et al, 2009). This is the place, however, to point out that the "inequality and poverty" referred to are of primary origin the lower incomes of this stratum of people, for which the others - who were taxed at the high tax rates - are not at all to blame.

Of course, choosing a tax system – flat or progressive – is an important decision from many points of view. According to Slemrod (Slemrod, 1994), when deciding the question, one must take into account fundamental economic problems and specific to the country in question - especially the degree of income inequality and the behavior of taxpayers. Sabirianova and colleagues (Sabirianowa et al, 2009) studied the tax systems of 189 countries from 1981 to 2005 and concluded that in developed countries there is a direct and strong relationship between tax rates and budget revenues collected from taxes, while this relationship is much weaker in countries with a low level of economic development and weaker state institutions.

Rogers and Philippe (Rogers, Philippe, 2019) show that countries with a flat tax regime impose higher taxes on workers on average than those with progressive taxation. This trend continued in 2019, where the total real tax rate in flat-tax countries averaged 45.58% of gross wages, compared to 44.52% of gross wages in progressive tax systems. In general, the flat rate tax policy imposes a flat income tax, the lowest in the EU being in Romania and Bulgaria at 10%. Conversely, in these countries social contributions are higher than in progressive systems.

As for progressive systems, Popescu and colleagues (Popescu et al., 2019) note that they have a slight negative effect on the total estimated tax revenue in the budget as a relative share of GDP – in the case of developing countries such as Bulgaria and Romania , where the rate is 10% of income. These total calculated revenues as a relative share of GDP under the flat tax revenues fall from 1.51% of GDP to 1.43%, but for Romania and Bulgaria, compared to developed countries, but with a progressive tax they would be 1.36%. This confirms the hypothesis stated above that one of the strong positive effects of the flat tax is the reduction of tax evasion cases, which leads to an increase in revenues to the state budget.

The same research shows that people taxed at the middle and high rates of progressive systems are relieved by the flat 10% tax (since under a progressive system their deductions would be around 14-15%) and so are incentivized to pay voluntarily and on time due. Here is another argument in favor of the claim that under a flat tax system, higher revenues are largely due to incentivizing more people not to evade taxes.

To a large extent, tracking the effects of a flat tax on income in the budget, in different countries and comparing them, is made difficult by the fact that each national legislation has its own "reading" of what exactly a "fixed" rate means (Prodanov and Naydenov, 2020). In reality, in very few countries the rate is such for all types of income (including profit, capital income, corporate income, etc.).

In its pure form, a flat tax would impose a single rate on the entire population, regardless of their income levels (and their ability to hide income, e.g. through transfers to foreign countries), thereby effectively abdicating the role of the state of redistributive tax revenues. This can save administrative costs, as each redistribution is expensive. To reduce resistance to payment as well as social inequality, in all flat tax countries except Georgia and Bulgaria, there is basic assistance for people on low incomes, often supplemented by a family allowance. It is an expression of the social function of the state, which uses the income from taxes and excise duties. The above approach is less visible to people taxed at the above rates - if the progressive tax was applied, which definitely leaves an impression on them of their equal treatment by the state with those who, for one reason or another, cannot realize more large incomes.

The use of the flat tax can be an attractive option to simplify the levy scheme and reduce tax benefits. In this case, one should take into account the fact that in progressive taxation systems, there are many tax reliefs that affect the final amount of the tax base. This means that with an example income of 100 units, the tax base is less than 100. It is reduced by different amounts and types of tax reliefs. This means that many documents must be collected during the tax year, which should be processed and the tax base calculated as a result of the deductions. As a result, situations may arise where people taxed at the average rates under progressive tax systems would have similar tax burdens if they were subjected to flat taxation (e.g. at 100 units of income, from deducting reliefs of 50 units – eg for 3 school children and a home loan repayment taxed at 20%, the tax liability would be 10 units; the same would be the case if 100 units of income were taxed at 10 % rate and the lack of reliefs). As stated, simplifying tax assessment reduces administrative costs and improves collection. On the other hand, the flat tax rates required to achieve budget neutrality tend to favor high-income individuals at the expense of low- and middle-income households (Lelkes and Benedek, 2007; Paulus and Peichl, 2008). As Polus and Peich note, this may explain why flat taxes have not taken hold politically in Western European countries. Here is the place to point out that the "benefit" in question does not mean different - in percentage terms, taxation. It is only a matter of applying the same rate to all income. The issue can also be seen as a return to equality in taxation, inasmuch as taxes in kind in Medieval Europe were, for the most part, determined on the basis of flat taxes. In Bulgaria in particular, the so-called "tithe" was also applied - a tax in kind of 10 percent of the amount of plant and animal production acquired during the year.

2. BUDGET REVENUES AND THE FLAT TAX

Despite the international popularity of the flat tax in the New World countries, no large-scale research has yet been done in Western Europe on its impact on macroeconomic efficiency and tax compliance.

As an example of a positive impact on tax collection when introducing a flat tax, Ivanova and colleagues (Ivanova et al., 2005) give Russia, where in 2001 such a reform led to an increase in budget revenues by 25%. This, in turn, leads to rapid economic growth of the country and even greater tax revenues. In this regard, however, Gorodnichenko (Gorodnichenko et al., 2007) advocates the thesis that the positive effect is mainly related to increased attention to compliance with tax legislation and not to improved law enforcement.

By using EUROMOD to simulate different flat tax scenarios, it is found that under a more radical scenario – for example, a 20% flat tax rate without any tax relief (apart from exempting pensions) – social inequality deepens, and a large part of the government expenditure is borne by the groups of people with the lowest incomes. So it turns out that only the richest ⅕ of people and the state budget benefit from this scenario, where revenues can increase. However, if the scenario were slightly softened – a 20% flat rate, but with basic assistance for the poorest and family benefits, the negative impact on the population would be less. In this case, there will be negatives for the budget, where the effect will also be negative. For this reason, if a flat tax is applied, it should be at a rate of 10% or very close to it.

Our understanding of the matter, however, is related to the thesis that the intertwining of the state's tax policy with its social policy should not be deepened. In this case, we are talking about two different spheres of government (Zahariev et al., 2021). They can interact, but deepening the ties between them can lead to a number of distortions in the labor market. For GDP to exist, there must be people to work and companies to produce goods and services. The state should create favorable conditions for entities that produce GDP. Of course, the state is supported by the taxes it collects. Insofar as the levies are an expression of the sovereign powers of the state and are not tied to specific actions of the state towards each specific taxpayer of taxes and excises, they cannot by definition be perceived as positive by their payers. Taxpayers are forced by the state to pay the levies determined by it. That being so, the state should at least seek to have the taxpayers have an equal obligation to it. Equality is achieved precisely through the application of the flat tax. Of course, one could argue that absolute equality would exist when the state collects the same amount of taxes from all its taxpayers, regardless of their income. Such an approach, however, would deprive the states of revenues in the budget, which is why it does not find practical application.

As for the state's social policies aimed at its poorest citizens, they should be carried out outside the taxation system. Mixing the tax and social systems leads to a sharp drop in the motivation to work. In a historical aspect, this is clearly visible from the labor market in the countries of the so-called socialist bloc, which operated in the period 1945-1990. In particular, the situation in Bulgaria during this period was subordinated to the understanding that everyone should work " as much as he can" and receive, "as much as his needs are". The results of this social experiment are clear, and in no case are they beneficial to the state.

A similar situation would arise if the state began to solve its social tasks by doing so directly through the tax system. Even so, the state's social funds come from the budget, which is replenished by taxes. Once this is the case, the social policy of the state - related to helping the poorest of its citizens, should be aimed at creating conditions for increasing their income - through education (acquiring work habits and skills), through accommodation of the children of young families in kindergartens, the provision of employment in spheres financed by the state, etc. As a last resort, the state could also distribute direct social benefits (preferably in kind), although such an approach is extremely unfavorable for it. This is because in addition to the fact that a person does not contribute to the GDP and does not pay taxes, but the state incurs expenses for him, which in the frequent case are for the rest of his life.

Perhaps this is precisely why, even in the first Bulgarian written laws - those of Khan Krum, there is a provision that forbids giving alms to beggars, but decrees that, if possible, they can be provided with work to earn their own living. This ancient wisdom in recent years has been abandoned in many European countries (as opposed to the countries of the New World), which has recently started to lead to social tensions - the increasingly frequent protest actions in various countries of Europe, accompanying the attempts of countries for another way to increase the retirement age for workers.

Of course, the state also has a social responsibility towards the sick, the disabled and the infirm, which should also not be confused with its functions towards the poorest citizens and attempts should be made to address them directly through the tax system.

To return to the essence of the topic, we will point out that researchers from the Institute of Market Economy (IME) (IME, 2016) annually prepare an alternative to the officially adopted state budget. Precisely one such from 2003 is their proof that in Bulgaria the flat tax with the relatively low rate of 10% compared to a number of European countries can lead to economic growth and to an improvement in the state budget. Of course, this also happens in the context of the ever-increasing prevalence of the flat tax in other countries of the region. The argument is also the fact that the flat rate works in relation to various economic problems such as massive tax evasion (such as the above example with Russia).

Innovators like Estonia and the other Baltic countries introduced a flat tax, and soon after, Romania, Slovakia, Georgia, Macedonia, Serbia, Albania and others followed suit. To a large extent, the fact that Bulgaria needs foreign investments, and is surrounded at the same time by a number of countries in which the tax reform is already a fact (and the rates are between 9 and 16%) become the main reasons for adopting this model. but also for determining the amount of the 10 percent rate itself. In view of our competition with the other countries of the Balkan Peninsula, Bulgaria could not currently have any other taxation system other than the flat tax and the rate of 10%.

The flat tax was introduced in Bulgaria on 01.01.2007 and the rate is 10% both for the taxation of the income of natural persons and for the taxation of the income of companies.

A flat tax rate of 10% was arrived at after a gradual reduction of tax rates on profits after 1997. This leads to some curious results. In practice, this does not have a negative impact on budget revenues. Moreover, in some years more tax revenue was reported despite the reduced rate (e.g. 2001 and 2003). The above became a trend after 2004 as corporate tax revenues regularly exceeded budget plans. In 2005, revenues continued to increase despite a significantly reduced (to 15%) tax rate. These are the main arguments in favor of the flat tax rate of 10%.

In the very beginning, when the idea of a 10% flat tax was formulated, the concept behind it was that the tax should be low enough to reduce the burden on taxpayers and encourage payment, but also to provide sufficient funds for the government budget. According to the IME (IME, 2016), a rate of 10% seems like a very good solution, as other research shows that avoiding declaring a profit (eg through false invoices) costs about 8 to 10%. In other words, a rate of 10% eliminates incentives for tax avoidance while at the same time greatly increasing the tax base. Thus, with a low rate, the state could receive the same or higher revenue, while encouraging investment and development, by seizing a smaller amount of income through taxes.

CONCLUSION

The effects of the introduction of a flat tax on the state budget depend both on the degree of economic development and social inequality in the country, as well as on the state of institutions and law enforcement, on tax legislation and even on the upbringing of individuals and legal entities.

The main positive effects of the flat tax are the shrinking of the gray sector and the significant reduction of incentives for tax evasion. This automatically leads to an increase in budget revenues.

Through the application of the flat tax, conditions are created for equality in relation to taxpayers - insofar as each of them owes the state an equal part of their income. With the increased revenue from the implementation of the flat tax, the state can perform its social functions better.

Over the past twenty years, a number of European countries have introduced flat taxation. It is specific to each of them. Despite the nuances in the amount of the rate and in filling in the very concept of "flat" tax, the general thing is that none of them returned to progressive taxation.

In relation to Bulgaria, an increase in budget revenues has been observed, after the introduction of taxation with flat taxes at a rate of 10%. In view of the competition of our neighboring countries - in which flat taxation is applied (Turkey, Macedonia, Serbia and Romania), to attract foreign investments and the risks of a sharp and long-term decline in budget revenues, Bulgaria in the foreseeable future could not to afford a change in its system of taxation under the Personal Income Tax and Corporate Income Tax, both in terms of type and amount of the rate.

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