MASARYK UNIVERSITY
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**Michal Radvan, Jolanta Gliniecka,
Tomasz Sowiński, Petr Mrkývka (eds.)**

THE FINANCIAL LAW TOWARDS CHALLENGES OF THE XXI CENTURY

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PREFACE

The Gdansk University Centre for Self-Government and Financial Law (hereinafter – Centre) is an all-university, non-departmental unit of the University of Gdańsk which runs the activity aimed at the society integration as well as meeting the needs of non-academic communities. The centre has its seat at the Faculty of Law and Administration of the University of Gdańsk. It carries out its programme objectives related to self-government law, especially the local finance law as well as tasks realized in conjunction with the Chair of Financial Law of the Faculty of Law and Administration at the University of Gdańsk in the whole field of public finances and finance law.

The main objective of the Centre is especially the realization of its own projects or projects developed in cooperation with other academic and non-academic partners, public and private institutions, non-governmental organizations and others whose aims are coherent with the aims of the Centre. The Centre cooperates with other domestic and foreign scientific and didactic institutions, offering specialist courses and lectures on self-government law and local finance law. It participates in the organization of scientific and research meetings promoting scientific research activities, as well as consulting services.

One of the important forms of the Centre's activity is initiating and supporting various publishing undertakings which integrate the scientific society. It has already organized several international scientific conferences and seminars, moreover, issued a number of publications – mostly of international character. The Centre is also the publisher of an academic quarterly focused on financial law – Financial Law Review which is published in cooperation with De Gruyter Open in the electronic form and in English.

The Centre also carries out such research projects as "The Financial Law towards Challenges of the XXI Century" and "Self-Goventment21" which is a specialized form of the former research trend and focusing on the finances of local self-government. The Centre cooperates with numerous units of local self-government, non-governmental organizations, organizations grouping local self-governments and many other institutions.

The main partner and the initiator of the Centre is the Chair of Financial Law of the Faculty of Law and Administration at the University of Gdańsk. Every activity of the Centre is primarily realized in cooperation with the Chair of Financial Law and, in the first place, with its research workers. The Chair of Financial Law introduced the idea of the research project "Th The Financial Law towards Challenges of the XXI Century" and realized the first conference. The Centre took over the aforementioned idea and realized the subsequent editions of the research project, enriching it by creating a variation of it which is devoted to finances of local self-government – a project titled "Self-Government21". Over time other institutions started cooperation with the Centre, first the Faculty of Law and Administration at the Cardinal Stefan Wyszyński University in Warsaw and then the Chair of Financial Law and the Faculty of Law at Masaryk University, Brno, Czech Republik. Currently, the Chair of Financial Law of the Faculty of Law at the University of Paul Joseph Šafárik in Košice, Slovakia is also about to start cooperation with the Centre.

So far, together with the Chair of Financial Law of the Faculty of Law and Administration at the University of Gdańsk and in particular cases also with some or all of the mentioned partners as well as numerous NGOs, the Centre has already realized 5 research projects which resulted in 5 international conferences and international seminars witch supplemented or extended chosen issues of the conferences:

- I International Baltic Conference on Fincancial Law: „The Financial Law towards Challenges of the XXI Century", Gdańsk – Nynäshamn – Stockholm, 8–11 October 2010;
- II International Baltic Conference on Financial Law: „The Financial Law towards Challenges of the XXI Century", Gdańsk – Nynäshamn – Stockholm – Gdańsk, 19–22 April 2013;
- I International Baltic Conference on Finance and Finance Law of Self-Government Units: „Sources of Local Government Financing in the Light of Modern Regulations", Gdańsk, 15–16 September 2014;
- III International Baltic Conference on Financial Law: „The Financial Law towards Challenges of the XXI Century", Gdynia – Karlskrona-Gdynia, 24–27 April 2015;

- Международный научный семинар по налоговому праву: "Принципы противодействия уклонению от уплаты налогов в Польши и России" (International scientific seminar on tax law: "The Principles of Countering Tax Evasion in Poland and Russia"), Gdańsk, 27 April 2015;
- II International Baltic Conference on the Finance of the Local Self-Government: "Local Government Financing and its Tasks and European Charter of Local Self-Government. Practical Problems, Gdańsk, 25 April 2016;
- International Seminary of the Financial Law of Local Government: "Local Government Financing and its Tasks and European Charter of Local Self-Government", Gdańsk, 25 April 2016.

Altogether the Chair of Financial Law of the Faculty of Law and Administration at the University of Gdańsk and the Centre has published a dozen or so volumes of publications whose authors are several hundred researchers from several dozen research centres all over Poland, Chech Republik, Slovakia, Latvia, Croatia, Kazakhstan, and Russia:

- Dobaczewska, A., Juchniewicz, E., Sowiński, T. (eds.): System finansów publicznych. Prawo finansowe wobec wyzwań XXI wieku (The System of Public Finances. The Financial Law towards Challenges of the XXI Century), Warszawa: CeDeWu, 2010;
- Dobaczewska, A., Juchniewicz, E., Sowiński, T. (eds.): Daniny publiczne. Prawo finansowe wobec wyzwań XXI wieku (Public Levies. The Financial Law towards Challenges of the XXI Century), Warszawa: CeDeWu, 2010;
- Gliniecka, J., Wróblewska, M., Juchniewicz, E., Sowiński, T. (eds.): System prawnofinansowy. Prawo finansowe wobec wyzwań XXI wieku (Law and Finance. The Financial Law towards Challenges of the XXI Century), Warszawa: CeDeWu, 2013;
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- Gliniecka, J., Juchniewicz, E., Sowiński, T. (eds.): Finanse publiczne jednostek samorządu terytorialnego. Źródła finansowania samorządu terytorialnego we współczesnych regulacjach prawnych (Public Finance of Local Government. Sources of Local Government Financing in the Light of Modern Regulations), Warszawa: CeDeWu, 2014;
- Gliniecka, J., Drywa, A., Juchniewicz, E., Sowiński, T. (eds.): Prawo finansowe wobec wyzwań XXI wieku – The Financial Law towards Challenges of the XXI Century – Проблемы и задачи финансового права в XXI веке, Warszawa: CeDeWu, 2015;
- Gliniecka, J., Drywa, A., Juchniewicz, E., Sowiński, T. (eds.): Finansowanie samorządu terytorialnego i jego zadań a Europejska Karta Samorządu Lokalnego – Local Government Financing and European Charter of Local Self-Government, Warszawa: CeDeWu, 2016;
- Gliniecka, J., Drywa, A., Juchniewicz, E., Sowiński, T. (eds.): Finansowanie jednostek samorządu terytorialnego, Problemy praktyczne – Local Government Financing, Practical Problems, Warszawa: CeDeWu, 2016;
- Dzwonkowski, H., Gliniecka, J., (eds): Prawo finansowe (Financial law), Warszawa: C. H. Beck:, 2013;
- Financial Law Review no. 1–3 (2016), retrieved from https://www.degruyter.com/view/j/flr?rskey=bgWbuB & result=4;
- Gliniecka, J. (ed): Financial Law, Gdańsk-Warszawa: Wolters Kluwer, Wydawnictwo Uniwersytetu Gdańskiego, 2016.

IV International Baltic Conference on Financial Law "The Financial Law towards Challenges of the XXI Century" will take place on 21–24 April 2017 on the route from Gdynia – Poland, through Karlskrona – Sweden, to Copenhagen – Denmark. It will be organized by the Centre of Self-Government and Local Finance Law of the University of Gdańsk and the Chair of Financial Law of the Faculty of Law and Administration at the University of Gdańsk as well as the Faculty of Law at the Cardinal Stefan Wyszyński University in Warsaw, the Faculty of Law at Masaryk University, Brno, Czech Republik and the Chair of Financial Law and Tax Law at the University of Paul Joseph Šafárik in Košice, Slovakia.

The international cooperation is expected to result in, among others, a publication titled " The Financial Law towards Challenges of the XXI Century". Research papers that encompass the following areas were invited:

- Axiological and philosophical aspects of financial law;
- Constitutional aspects of financial law;
- Codification of financial law;
- Local government finance;
- Tax law;
- Monetary and banking law;
- Financial market law;
- Budget law and its principles;
- Economic aspects of financial law;
- EU Influence on financial law.

As there were many participants with many contributions dealing with many different issues from the broad area of financial law, organizers decided to devide the publication into five parts:

1. Axiological and Philosophical Aspects of Financial Law;
2. Public Financial Law – Selected Problems;
3. Tax Law;
4. International Financial Law;
5. Banking law.

It must be mentioned that financial law science in (Central and Eastern European) CEE countries is not unified. For example there is no concensus on existence of the general part of financial law, there is no unified approach to the financial market (capital market, monetary market, insurance) law. Tax law science has a longstanding tradition in the USA and Western Europe and is sufficiently advanced that the question is hardly even posed whether tax law can be considered an independent branch of law. In contrast, CEE legal science has only recently admitted the independent existence of financial law and the debates on independent tax law as a branch of law are just starting. In the next phase of development of financial law it will be necessary to react to these facts, which would with no doubt lead to a diversification of financial law.

All contributions were double (or sometimes triple) blind reviewed by experts in the area of financial law not only from the Central and Eastern European Countries.

Special thanks go to Masaryk University – Faculty of Law students Ivana Stehlíková, Sabina Pazderová and Tereza Čejková for the proofreding.

Tomasz Sowiński, Michal Radvan

PART 1
AXIOLOGICAL AND PHILOSOFICAL ASPECTS OF FINANCIAL LAW

AXIOLOGICAL ASPECTS OF THE STRUCTURE OF THE LEGAL INSTITUTION OF FINANCIAL SECRECY

Jolanta Gliniecka[1]

Abstract

One of the most important institutions of the financial law may be found financial secrecy, which allows for the implementation of an important principles of law. Principles of law express axiological bases, and because of that are considered to be the major values of law. Contemporarily, in the constructing of the legal institution of financial secrecy the "values" that should be protected are, among others, privacy, the duty to observe good faith and also the notion of "interest". It emerges with regard to the necessity for violating financial secrecy, which is universally justified by the concern to protect the public interest.

Keywords: Axiological; Financial Secrecy; Protection of Privacy; Financial Law; Duty of Good Faith; Public Interest.

JEL Classification: K39

1 Introduction

The financial secrecy can be specified as a prohibition of disclosure by financial institution of any information concerning this institution, as well as the financial services provided by it, its clients, and cooperating entities (e.g. experts, advisers, etc.) (Gliniecka, 2007). In general terms, this postulate is justified by two main arguments. The first one is privacy protection and the second one – the protection of the interest of the client and the financial institution. By its essence, the institution of financial secrecy is therefore based also, unlike almost any other, on mutual trust of the parties of that legal relation. The client's trust in the financial institution is expressed, first

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of all, in the belief that all information, both numerical, as well as descriptive, concerning all services, negotiations, plans, targets, and also information on persons who are parties to the agreements, persons who are not employees of the financial institution, but who perform tasks related to the services provided by that institution, e.g. on advisers, experts, shall not be disclosed. On the other hand – the financial institution has also the right to expect that information entrusted to the client shall be treated similarly. The scope of the subject matter of the financial secrecy is therefore broad. Its temporal scope is also broad, since secrecy encompasses – as has been mentioned – among others, information submitted during negotiations between the client and the financial institution and it lasts as long, as long the information are available on data carriers and regardless of the positive effect of such negotiations expressed, for example, in the conclusion of an agreement. Trust as the basis of protection of financial information is present also in another aspect, and that is the protection of information on the interests of the financial institution.

Financial secrecy is one of the most important institutions of the financial law. It allows for the implementation of an important principle of that law, which is safety, and the need for balancing the interests of the parties.

Principles of law are considered to be the superior values of law, because they express its axiological bases. They are the criterion of its interpretation. The necessity of a collision-free functioning of communities of diversified needs and beliefs requires the establishment and application of appropriate principles of such cooperation. Hence, the unquestionable need for seeking consensus on the common values, on which the structure of such principles is based. This need is also the need for public institutions which, not determining those values, firstly – operate within their scope, and secondly – decide upon them by carrying out their functions. At the same time, we cannot ignore the fact that "value" as an ambiguous term is also one of the most complex categories of axiology which is difficult to be defined in simple terms and the issues of axiology cannot be reduced only to the psychology of assessments. The issue requires a comprehensive relativization in order to refer it to the "value of law", which in this case is indispensable.

2 Protection of Privacy

Contemporarily, as is commonly assumed, the "value" deserving protection is, among others, privacy. This is evidenced both in the regulations of the international conventions, as well as the acts of national law, which ensure the implementation of this right to entities which are entitled to it.

The aim of this study is not to reconstruct the definition of privacy, however, it can be recalled, firstly, that the concept of this right was formulated at the end of the 19th century and comes from the American cultural circle (Warren et al., 1980); in Poland first works referring to the problem appeared more than forty years ago (Kopff, 1972). Secondly, that such elements of privacy as the right of an individual to determine the limits of availability of information about themselves (right to be alone) and the freedom to decide (upon themselves, their personal and family life), despite the different ways in which this notion is understood remain unchanged. However, the positive enumeration of elements that determine the scope of law application do not decide upon its content. Here, the method of determining its limits is significant, and also the specification of legally permissible interference into its content.

It is worth paying attention here to the relation between the right to privacy and privacy, because as long as the former is universal, the latter – cannot be enclosed within a precise framework, because there is no invariable "space" of privacy the same for all people. It can be and is not only differently understood by people coming from various societies, social groups and races (which can be to a large extent explained by cultural background) (Burszta, 1998: 85), but also within the framework of those societies, social groups and nations (Ossowska, 1985: 106; Safjan, 1997: 128; Hall, 1997: 189), considering that views on privacy are not invariable. Behavior that in one environment is considered acceptable in another can be considered a violation of privacy. Furthermore, what is considered a violation of privacy by some, others would regard as a testimony of a neighborly interest (Maslow, 1990: 226). As a consequence, there is no definition of the notion of privacy in the legislatures of individual countries. Attempts in that scope are made by the doctrine and the jurisprudence, which progress towards determining the area protected by right to privacy or provide examples of actions

violating privacy rather than construct the notion itself (Kański, 1991: 326).[2] As a result, the postulate of privacy protection can be implemented in different countries and environments with the use of different values (Kański, 1991: 322).[3]

The right to privacy protection is not absolute and is subject to limitations which, however, must be within the principles, especially such as the principle of necessity (indicating the connection of the limitation of right with the protection of the public interest) and proportionality (indicating the relative cohesion between the effects of the limitation of the right and the resultant burdens for the subject of law).[4] The aforementioned limitations are allowable when the protection of privacy, as excessive, is in contrast with any public interest used for the implementation of the common good and considered by the state (the lawmaker) as superior. We are, therefore, faced here with a conflict of values between one good, which is privacy, and another good, which is public interest. The protection of one value protected by law

2 Compare also the resolution of the Parliamentary Assembly of the European Council no. 428 of 1970, in which it was stated that "the right to privacy essentially consists of the right to lead one's own life with a minimum of interference. It concerns private, family and home life, physical and moral integrity, honor and reputation, avoidance of being placed in a false light, non-revelation of irrelevant and embarrassing facts, unauthorized publication of private photographs, protection against misuse of private communications, protection from disclosure of information given or received by the individual confidentially."

3 In the legal literature examples of the differences in the terms of privacy protection can be found.

4 Compare, for example, the recommendation No. 833 of the Parliamentary Assembly of the European Council of 1978, in which the attention is drawn to the need for limiting the excessive protection of bank secrecy in order to facilitate the proceedings in cases on the avoidance of payment of taxes or hiding income from criminal activity, however, with the due care for the protection of the individual's interests maintained. Compare also the Conclusions of the Presidency and the European Council adopted at the summit in Edinburgh in 1992, where it is stated that "Any burdens, whether financial or administrative, falling upon the Community, national governments, local authorities, economic operators and citizens, should be minimized and should be proportionate to the objective to be achieved" (The European Council in Edinburgh, 11–12 December 1992, the Conclusions of the Presidency, annex no. 1).
The principle of proportionality began to play a more important role as a basis for questioning national legal measures since the turn of the 70's and 80's of the 20th century, i.e. since the increase of the awareness of the community law. Whereas, the latter has become the reason for the increase of the number complaints to the European Court of Justice and references to the mentioned principles. More broadly Sobczyński, 2003. Compare also Walaszek-Pyziol, 1995; Chrzanowski, 1998; Garlicki, 2001: 5–24; Barciak, 2004; Safjan, 1997: 127 et seq.; Sajfan, 2006: 405 et seq.

can be repealed (limited) for the protection of other, which requires a certain "weighting" of the sacrificed good and the protected good. It also requires the fulfillment of other conditions of proportionality. The question emerging against that background, which cannot be omitted, is why one fundamental right is to be strengthened for the price of another right also subject to protection to have its protection decreased?

The premise used in order to find the answer to the formulated question, and at the same time, one of the premises of proportionality is the "necessity", the category of assessment, the reference to "privacy" of which, in order not to exacerbate the "sensitivity" of the latter, must be relativized. Determining what is "necessary" for the protection of one constitutional value (e.g. public interest) is implied also by the form of interference into the sacrificed good (the degree of ill for entities affected by it and the procedures protecting against excessive arbitrariness of the penetration of the privacy "space"). The limitation of a subjective right is a measure enabling the protection of another value and therefore it is required to use only such measures that ensure the achievement of the intended objective in real terms. The quantifier of "necessity" is the lack of other, less painful, measures which are characterized by comparable effectiveness. Which can be understood in such a way that the protection of some values, for which the protection of others is sacrificed, cannot be implemented otherwise than through the repealing (limitation) of the protection of the good of the former. Moreover, distinct boundaries (premises, conditions) must be indicated, which authorize the repealing (limitation) of the protection of those values.

It must be noted, at that point, that the problem is complex and remains under the influence of at least two circumstances. One of them is the case, in which the competition concerns equivalent values that are constitutionally treated equally. The second – the situation, in which in the system of law it is impossible to determine other, equally effective, but less painful measures. The attempt to resolve the problem may be the suggestion to apply the condition combining the "necessity" of actions with the values of the democratic legal system, however, there are no clear solutions of those issues from the constitutional point of view.

The state (the lawmaker) can interfere into the privacy "space" only when it is necessary and only in the necessary and, at the same time, minimal scope, and should also strictly determine the boundaries of that interference. The premise of "necessity" means in particular that the limitations of the right must remain in direct connection with the protected value. They cannot be substituted with other legal measures which would not lead to the limitations of rights and freedoms, and moreover, should be effective and take into consideration the proportions between the protected good and the one subject to limitation. It is preferable that those limitations were formulated so as to satisfy the statutory requirements, and the regulation indicated an adequate degree of precision at the same time.[5] Therefore, the lawmaker creating the law that limits that "space" is obliged to apply the less stringent measures to achieve their objective. At the same time, however, limitations of the protection of privacy in comparison with the right to privacy require such a substantive justification that the "axiological balance" was to their advantage. Thus, it can be said that the limitation of the right to privacy is unacceptable in a way that distorts the proportion between the degree of the infringement of that right held by an individual and the weight of the public interest, which is to be protected in that way, while it should be also added that the limitation in any case cannot violate the essence of the right itself.

5 The European Court of the Human Rights draw attention to that issue in the judgement in case Malone vs. the United Kingdom, 1984, A-82 (police eavesdropping and recording telephone calls from a specified telephone): "It would be contrary to the rule of law for the legal discretion granted to the executive to be expressed in terms of an unfettered power. Consequently, the law must indicate the scope of any such discretion conferred on the competent authorities and the manner of its exercise with sufficient clarity, having regard to the legitimate aim of the measure in question..."; similarly in the judgement Kruslin and Huving vs. France, 1990, A-176.

The premise of "necessity" and "proportionality" of the limitation of a particular right is in the Polish legal system the object of constitutional regulation (Art. 31/ 3). It was also repeatedly the object of assessment of the Constitutional Court.[6]

The right to privacy is encompassed by the international standards of human rights protection and follows from the Universal Declaration of Human Rights (Art. 12), the International Covenant on Civil and Political Rights (Art. 17) and the European Convention for the Protection of Human Rights and Fundamental Freedoms (Art. 8). It should be noted that those standards do not determine the boundaries of the right to privacy, leaving the issue of its concretization to be made by the national legislations.

The concept of the right to privacy in the Polish legal system has relatively recently started to play a more important role in the constitutional norms (Art. 47) and in the constitutional[7] and judicial (Supreme Court: III

6 Compare, for example, the judgement of 1 June 1999 on the rules of refusing the issuance of passport on the request of an authorized body, no. SK 29/98; of 9 November 1999 on the Tax Ordinance laws, in accordance with which some rights and obligations of taxpayers can be regulated in the resolutions of the Minister for Finance, no. K 28/98; of 10 May 2000 on the proceeding regulating the method of issuing safety certificates provided for by the classified information protection act, no. K 21/99; of 16 April 2002 on the constitutionality of the laws which make the preparation of a notarial deed or charging the things and property rights acquired through inheritance or prescription dependent on the obtaining a certificate from the Tax Office confirming the payment of a relevant tax; no. SK 23/01; of 17 November 2003 on the constitutionality of the act on the amendment of act on the shaping of remunerations in the state budget sphere and the amendment of some acts, no. K 32/02; of 14 June 2004 on the compliance of Art. 26 of the act of 3 April 1993 on the research and the certification from Art. 2 and Art. 22 of the Constitution, no. SK 21/03; of 20 June 2005 on the *Wojewódzkie Kolegia Skarbowe* [Voivodeship Tax Collegiums], no. K 4/04; of 21 December 2005 on the employment of nurses and midwives only on the basis of an employment contract, no. K 45/05.

7 Compare, for example, the judgement of the Constitutional Court of 21 October 1998, no. K 24/98 on the right to privacy for persons performing public functions; of 5 March 2003, no. K 7/01 on the autonomy of information of such persons; or the judgement of 6 December 2005, no. SK 7/05 on the receiving of remuneration by such persons for the functions, right and freedom of others (e.g. judgement of the Constitutional Court of 27 January 1999, no. K 1/98; of 12 November 2002, no. SK 40/01; of 20 October 2005, no. K 4/04; of 12 December 2005, no. K 32/04, which specify the degree of the interference of the public authorities in the individual's sphere of privacy), or the public order (compare, for example, the judgement of 24 June 1997, no. K 21/96 on the secrecy of data on the individual's financial position; of 11 April 2000, K 15/98 specifying the limits of the tax authorities right to access information on taxpayer bank accounts; of 20 November 2002, no. K 41/02 on the declarations of assets.

ARN 18/94) decisions. It should also be added that the right to privacy is subject to highest constitutional protection and as such cannot be subject to limitation due to martial law and the state of emergency (Art. 233/1).[8]

3 The Duty of Good Faith

In the constructing of the legal institution of financial secrecy, the value which is also used is the duty of good faith (Mudrecki, 2015). In general terms, this postulate is justified by two main arguments. The first one is the aforementioned privacy protection and the second one – the protection of the interest of the client and the financial institution. By its essence, the institution of financial secrecy is therefore based also, unlike almost any other, on mutual trust of the parties of that legal relation. The client's trust in the financial institution, for example a bank, is expressed, first of all, in the belief that all information, both numerical, as well as descriptive, concerning all bank services, bank negotiations, plans, targets, and also information on persons who are parties to the agreements, persons who are not employees of the bank but who perform tasks related to the services provided by the bank shall not be disclosed. On the other hand – the bank has also the right to expect that information entrusted to the client shall be treated similarly. The scope of the subject matter of the institution of bank secrecy is therefore broad. Its temporal scope, as has been mentioned, is also broad.

The principle of "good faith" (honest intentions, fair trade, good practice), is present in the doctrine also as the notion of *uberrima fides* (utmost good faith). Good faith seems to postulate the maintaining of trust between the parties of a legal and financial relationship, and this must be the utmost trust. This principle is not prescriptive; it functions within the system as an extra textual norm. The justification of that functioning should be sought in the rejection of the belief in the absoluteness of the system of the positive law and the need to supplement it in accordance with the socially acceptable values (Gajda, 1997: 43). It is impossible not to notice that the equity clauses through the sanctioning of the necessity to observe the values established in the culture of the society, play a positive role in the process of eliminating arbitrariness in the creation and application of law (Dajczak, 2001: 54; Safjan, 1990: 54 et seq.).

8 On the interpretation of Art. 233 compare the dilemmas of Barciak, 2004: 176ff.

The concept of good faith provides the opportunity for the assessment, on the basis of the entirety of circumstances and in particular the purpose, the measures and the effects, whether the parties of the legal relationship of the financial secrecy, in compliance with good faith, observe its conditions. In that sense this concept is objective and does not relate solely to the subjective state of mind of the party of that legal relationship, but encompasses, first of all, all the objective rules of conduct, even those existing outside the positive system of law. It is an objective assessment of the behavior of the parties as appropriate or inappropriate from the perspective of ethical standards adopted for relationships of that kind. Therefore, each party of a legal relationship, the conduct of which is impeccable from the point of view of, for example, the principles of social interaction or integrity, shall observe good faith. The implementation of that principle increases the sense of security of the participants of the business trading, which requires the protection of the interests of entities entrusting in confidence the information covered by the financial secrecy and equates the conditions of competition, which makes it particularly important. Because it meets the modern needs of the free market economy.

The formula of good faith has a long tradition. It is derived from the ethics of Romans which valued the duties of fidelity and trust, both in the relations between citizens, as well as foreigners (Schermaier, 2000: 79). *Bona fides* was subject to dynamic development in the medieval times. At that time, the notion of good faith and equity excelled in the commercial relations becoming essentially a *lex mercatoria* justification (Whittaker, Zimmerman, 2000: 16). The unquestionable achievements of the practical application of *bona fides* in the Roman times and medieval times was the contribution to the de-formalization, increased flexibility and strengthening of consensualism in the merchant relations. It undoubtedly contributed to the emergence of such concepts as equity *(aequitas),* benevolence *(benignitas*), loyalty and integrity in trade (*fair dealing*), becoming the permanent element of the heritage of legal systems (Schermaier, 2000: 48 et seq.).

In the contemporary contractual relations good faith has a well-established position. Theoretically it is possible to distinguish its three aspects: substantive – defining the ethical pattern of behavior of the parties

of an agreement, formal – as a general clause and institutional – combined with the judge's independence in the process of adjudication (Storme, 2003). The practice proves that the currently the principle of good faith is present basically in two dimensions: as a standard of contractual ethics and as a guideline of how to interpret the law, in the process adjudication, which means that as the general clause is refers to the judge's assessment and their axiological sense, determined by the objective and subjective conditions, which should be indicated in the content of the judgement.

The concept of good faith functions both in the acts of the international, as well as national law.

In the European law the principle of good faith was expressed relatively early, because in the preamble i Art. 3/ 1 of the directive regarding abusive clauses in consumer contracts (The Council Directive 93/13/EC). In the understanding of that directive, good faith requires that when assessing the contractual conditions both the different interests of the parties, as well as the strength of their bargaining positions be taken into account, and it requires that the seller or the service provider treated the other contractual party fairly and justly (equitably), with due regard to their legitimate interests. In such terms good faith is of procedural nature. A significant contractual imbalance to the detriment of the consumer indicated in the process of qualification of the conditions specified in the contract and recognized as unfair (e.g. recording provisions onerous for the consumer in small print) should be treated as violation of good faith (Clark, 1997: 513 et seq.). The axiological criterion of assessment of the clause as abusive is therefore clearly accented in the directive.

At this point it is worth mentioning that the scope of the directive remains under the influence of the abusive clauses. The list of those clauses specified in the annex does not constitute the list of abusive clauses, and indicates the contractual provisions that can be in the process of directive implementation regarded as abusive in the legislature of the implementing countries. This general assumption is not without exceptions, one of which applies to contracts on financial services. Here, the inadmissibility of abusive clauses is not absolutely required, which is described by the following situations. The pattern derived from the directive essentially does not allow for

clauses that allow for the amendment of the content of contract. Meanwhile, such solution is permitted in contracts for financial services concluded for an indefinite period of time with reference to the changes of the interest rates or the changes of the amount of charges for other financial services, provided that a modification clause exists, which envisages the notification of the other party of the fact and provides it with the right to terminate the contract. In turn, in case of transactions related to trading securities, financial instruments or other financial services, in which the price is dependent on the changes in stock quotations index or the rate of the financial market (and thus the indicators that remain beyond the influence of the entrepreneurs), as well as purchase (sales) contracts of foreign currency, traveler's checks or international money transfers in foreign currency, the prohibition of clauses related to unilateral contract termination, unilateral amendment of the content of contract, price changes within the contract duration, without the right of the other party to withdraw from the contract, does not apply. At this point, it is worth asking the question about the need for this type of solutions that essentially weaken the protection of consumers of financial services. It is a substantial question, especially considering the EU program of strengthening the consumer protection.

The control system of abusive clauses was introduced into the Polish legal system as a result of the amendment of the Civil Code in 2000 (The Act on the Protection of Certain Consumer and on the Liability for Damage Caused by a Dangerous Product). The context of the introduction of those laws (Art. 385/1 and Art. 383 of the Civil Code) justifies concurring with the opinion of the European Court of Justice of 27 June 2000 on the case of *Océano Grupo Editorial S.A.* vs. *Rocio Murciano Quinterio* and others. (C-240/98–244/98) that the interpretation of the rules of the national law must be compliant with the directive. The equivalent of Art. 3 of the directive in the Polish law is Art. 385/1/1, which allows for the conclusion that the violation of the consumer's interest is evidenced by the imbalance, to the detriment of the consumer, of the rights and obligations of the parties under the contract. The provision of Art. 385 typifying abusive contractual clauses, is an interpretation directive, the purpose of which is to facilitate for the court the investigation whether the provision *in causu* of the contractual

pattern is an abusive provision, i.e. such that shapes the rights and obligations of the consumer in a manner contrary to good practice, violating their interests. The court is, therefore, to assess whether the imbalance is significant that is "flagrant" in the understanding of the provisions of the Polish law (Supreme Court: I CK 297/05).

Returning to the issue of regulation of good faith in the European law, it should be mentioned that this concept has become a part of the Principles of European Contract Law (PECL) and the Principles of International Commercial Contracts published by the Institute for the Unification of Private Law (UNIDROIT), which are model law for the international contractual trade. In those regulations the principle of good faith is often compared with the principle of fair dealing.[9] It is also assumed that it should be interpreted in conjunction with the principles concerning the practices.[10]

The principle of good faith is formulated in PECL as a general duty, in accordance with which each party should observe the clause of good faith and fair dealing. It constitutes the rule of interpretation of the contract, during its conclusion, execution and enforcement, both in the sphere of rights, as well as obligations (Rajski, 2003: 262).

At the stage of contractual negotiations, this means the prohibition on the conducting and terminating negotiations contrary to the principle of good faith and mercantile integrity, under pain of liability for damages to the other party, including the prohibition on the commencement and conducting of negotiations without the real intention to conclude the agreement.[11]

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9 Art. 1:201 PECL: *"(1) Each party must act in accordance with good faith and fair dealing, (2) The parties may not exclude or limit this duty."* Compare also S. Whittaker, R. Zimmermann, op. cit., p. 13; M. Romanowski, *Ogólne reguły wykładni kontraktów w świetle zasad europejskiego prawa kontraktów a reguły wykładni umów w prawie polskim*, „Przegląd Prawa Handlowego" 2004, No. 8.

10 Art. 1:105 PECL: "*(1) The parties are bound by any usage to which they have agreed and by any practice they have established between themselves. (2) The parties are bound by a usage which would be considered generally applicable by persons in the same situation as the parties, except where the application of such usage would be unreasonable.*"

11 Art. 2:301 PECL: "*(1) A party is free to negotiate and is not liable for failure to reach an agreement. (2) However, a party who has negotiated or broken off negotiations contrary to good faith and fair dealing is liable for the losses caused to the other party. (3) It is contrary to good faith and fair dealing, in particular, for a party to enter into or continue negotiations with no real intention of reaching an agreement with the other party.*"

The ban on disclosing confidential information[12] and ban on taking advantage of the forced position of the other party are executed as part of the duty to observe good faith.[13] The duty to observe good faith is the duty to reduce the damage in one's own interests resulting from the non-performance of the contract by the other party.[14]

The principle of acting in accordance with good faith and fair dealing is one of the main criteria of the legal system resulting from the international commercial contracts, envisaged in the Principles issued by the UNIDROIT together with the commentary to each provision, explaining the *ratio legis* of the solution and presenting the eventualities of its application (UNIDROIT, 1994). The principles are a collection of the general rules developed by the international doctrine, legislature and practice in the field of international contracts (Rajski, 1987: 9 et seq.; Rajski, 1996: 237 et seq.).

The provisions contained in the Principles are of dispositive nature, which is confirmed by Art. 5. There are exceptions to this general rule, however, they must result from the wording of a particular provision indicating its imperative nature. Such a structure of the legal solution can be found in Art. 1/7 of the Principles which excludes the right of the parties of the contract to exclude or modify the principle of "good faith", while both the content, as well as the positioning of that provision within the systematics of the Principles convince that it relates to the behavior of the parties in all phases of the contract.

12 Art. 2:302 PECL: "*If confidential information is given by one party in the course of negotiations, the other party is under a duty not to disclose that information or use it for its own purposes whether or not a contract is subsequently concluded. The remedy for breach of this duty may include compensation for loss suffered and restitution of the benefit received by the other party.*"

13 Art. 4:109: "*(1) A party may avoid a contract if, at the time of the conclusion of the contract: (a) it was dependent on or had a relationship of trust with the other party, was in economic distress or had urgent needs, was improvident, ignorant, inexperienced or lacking in bargaining skill, and (b) the other party knew or ought to have known of this and, given the circumstances and purpose of the contract, took advantage of the first party's situation in a way which was grossly unfair or took an excessive benefit. (2) Upon the request of the party entitled to avoidance, a court may if it is appropriate adapt the contract in order to bring it into accordance with what might have been agreed had the requirements of good faith and fair dealing been followed. (3) A court may similarly adapt the contract upon the request of a party receiving notice of avoidance for excessive benefit or unfair advantage, provided that this party informs the party who gave the notice promptly after receiving it and before that party has acted in reliance on it.*"

14 Art. 9:505: "*(1) The non-performing party is not liable for loss suffered by the aggrieved party to the extent that the aggrieved party could have reduced the loss by taking reasonable steps. (2) The aggrieved party is entitled to recover any expenses reasonably incurred in attempting to reduce the loss.*"

In the principles of the European contractual law the presumption of good faith is assumed and therefore the burden of proof rests on the party evoking the lack of it. Unlike the Polish civil law, which recognizes the presumption of good faith only in relation to its subjective approach. In order for the protection of good faith to be applied, the legal provisions must provide for such a protection, however, they does not have to *expressis verbis* refer to it, which follows from Art. 7 of the Civil Code that makes the presumption of good faith statutory. In compliance with the Code "if the legal consequences of an act depend on good faith, its existence is presumed". Therefore, on the basis of the Polish law the notion of good faith exists in the form of a rebuttable legal presumption with the burden of proof incumbent on the person evoking bad faith.[15] It concerns good faith in subjective terms, which means that it refers to the mental state of an individual based on a mistaken belief with regard to a specified law (legal relation), justified in particular circumstances by the observance of due diligence (Pazdan, 1970). The protection of good faith in that sense allows – through the reference to the individual's mental state – for the change of the consequences of the legal consequences of events or actions following from the acts of law. The functional aspect of that structure is expressed in the pursue of protection of trust to the external form of the factual state, which cannot be overestimated in the efforts to maintain the safety of the legal transactions. Of decisive importance for the assessment of good faith is *scientia*, thus, a positive knowledge on the premises that can have a legal significance (Janiszewska, 2003; Gajda, 1995: 40.) Good faith is excluded by deliberate action and gross negligence (*culpa levis*).[16]

The concept of good faith in the objective sense existed in the Polish law on the basis of the provisions of the Code of obligations of 1932.

15 In the doctrine the presumption of fact is distinguished from the presumption of law. Also rebuttable presumptions (*praesumptiones iuris tantum*) are distinguished from irrebuttable presumptions (*praesumptiones iris ac de iure*). Compare also Bogucki, 2000; Nowacki, 1976.

16 In the study of the Roman law it is indicated that negligence can have to forms: *culpa lata and culpa levis*. The measure of diligence in the former was diligence that is expected from an average person. In the latter - the abstractly understood diligence of the reasonable family father (*diligens pater familias*), and the deviation from that model was defined as *culpa levis in abstracto*, or diligence expressed in own affairs the deviation from which was defined as *culpa levis in concreto*.

In particular is was expressed in Art. 189 of the Code of obligations concerning the method of executing the obligations, in accordance with which "the parties should perform obligations in accordance with their content, in a manner corresponding with the requirements of good faith and fair dealing" and in Art. 107 of the Code of Obligations in compliance with which "the declaration of will should be translated in such a manner, as the good faith and fair dealing require for the particular circumstances it was declared in". The content of those provisions has also found its place in the Polish Civil Code (Art. 354: "the debtor should fulfill the obligation in compliance with its content and in a manner corresponding to its social and economic purpose and the principles of the social coexistence, and should established customs exist in that scope – also in a manner compliant with those customs. The creditor should cooperate in the fulfilling of obligations in the same manner"), however, the functions of "good faith" began to fulfill here such clauses as the principles of social coexistence or the social and economic purpose of the law.

The concept of good faith plays an important role both in the European, as well as the Polish judicial and constitutional practice. In this respect it is worth mentioning the judgement of the European Court of Justice (*Cofidis SA* vs. *Jean-Louis Fredout,* C-473/00 of 21 November 2002, on the legal action of the lender towards the buyer of credit services), which orders that national courts take into consideration the plea of abusiveness of clause, even if it repeats the provisions of law. In other judgements the European courts indicate good faith as the leading interpretation rule of a contract not only at the stage of its negotiations (compare, for example, the judgement Cour d' appel de Lege, 7eme Chambre of 19 November 1996), but also the execution and enforcement (*Compagnie Générale des Eaux* vs.*OPHLM du Val-d'-Oise,* Cour de cassation, Chambre civile numéro 1, 23 January 1996).

4 The Protection of the Public Interest

The value used in the constructing of the legal institution of financial secrecy is also the notion of "interest" understood not only in the economic, but also social (public, general) categories. It emerges with regard to the necessity of violating financial secrecy, which is universally justified by the concern to protect the public interest.

The notion of public interest is an ambiguous concept, internally complex, and also more externally conditioned than others, which makes it difficult to attempt to specify its content. Those difficulties are exacerbated by a certain skepticism regarding the suitability of that notion in the existing legal system as a category empty in content and thus little advisable as the directive in the functioning of public entities (Bering, 1959:, 160 et seq.). The belief is also not without significance that "the requirements of the public interest undergo (…) a change in almost every legal institution", which makes it impossible to include this concept into the general system (Modliński, 1932: 13; Leys, 1962: 25). All this, however, does not exclude the attempts to determine the content and normative nature of the concept.[17] Some of them are worth a closer look.

The opinions on the topic of the nature and content of the notion of public interest have evolved. The first attempts in that regard were based on the contrasting of the private and the public interests (Wasiutyński, 1926: 120; Służewski, 1974: 132). The concept of public subjective rights as an emanation of the doctrine of the liberal Rechtsstaat has created a plane for another analysis of the position of an individual within the state and the nature of its interests on the sphere of parallelism and community with the public interest (Krüger, 1932: 34).

The concept of the relation of that interest to the liberties and freedom of an individual had also its place in the determining of the content of the notion of public interest (Rupp, 1968: 117). The complexity of that relation is related to its ambivalent nature; the individual freedom is a value which at the same time creates the notion of public interest and is restricted due to that interest.

The concept of the public interest as a "balance of interests" is a view that cannot be omitted in that review (Redford, 1954: 1104). It is based on the perception of society as a collection of groups of diverse interests and aspirations and the need for compromise between them. However, it is assumed at the same time that the public interest is the interest of the majority (Düring, 1949: 68 et seq.), many or the most, never of the individual.

17 In the opinion of Lang, the notion of public interest can be treated as a relation between some objective state and the assessment of that state from the point of view of the benefits understood as values (cultural, social or economic). Compare Lang, 1972: 100 et seq.

The notion of public interest sometimes also considered with reference to the state interest. Here, the opinion on the lack of identity between them is dominant, strongly accented in particular in the modern American doctrines referring to the politics and political actions (Friedmann, 1962: 86), where the public interest is treated as a model of the ethical assessment of the compliance of the state actions with the common good. Not identifying public interest with politics, it is at the same time regarded as its vital element.

The content of the "public interest" is sometimes also formulated through the prism of the relation with the system of values and then the notion of the public interest is defined with reference to that system. The consequence of the application of such a formula is, however, entrusting this notion with the stigma of relativity. This feature becomes deeper as a result of the relativization of the notion of "interest" to a certain axiological basis (Kamiński, 1983: 135).

Sometimes the notion of public interest is understood as the value obtained as a result of procedure appropriately applied by the state, established in accordance with the objectives and interest of the society. Theorists supporting the procedure as an element defining the essence of the public interest, appreciate its significance, in particular in the process of reconciliation of the conflicting interests of the parties (Leys*, 1962: 240*; Lasswell, 1962: 64). At the basis of that group of opinions lies the recognition of the conflicting nature of interests as the feature of the contemporary society.

Against the background of such opinions it is easy to conclude that the concept of "public interest" is an assessment category, dynamic, a balance of variables of a specified society in a particular time and space, which can be presented descriptively (Oppernheim, 1975: 270). It is connected to the ability of strategic predicting of possibly all the effects of actions which is difficult to achieve (Wyrzykowski, 1986: 47).

In the Polish legal system, the values on which the concept of "public interest" is based are derived from the Constitution. This concepts emerges also in the regular legislature.

The concept of public interest with reference to the institution of financial secrecy emerges, as has been mentioned earlier, with regard to the necessity of its violation. The institution of the financial secrecy requires that

both interests comprising the essence of that institution – the private and the public one – were well-balanced within the legal principles the financial secrecy is subject to. Both those aspects of the financial secrecy – the protection of the private interests and the protection of the public interest – are implemented by the Polish law.

5 Conclusion

Financial secrecy is one of the most important institutions of the financial law. It allows for the implementation of an important principle of that law that is safety and the need for balancing the interests of the parties. Principles of law are considered to be the superior values of law, because they express its axiological bases. They are the criterion of its interpretation. At the same time we cannot ignore the fact that "value" as an ambiguous term is also one of the most complex categories of axiology which is difficult to be defined in simple terms and the issues of axiology cannot be reduced only to the psychology of assessments. The issue requires a comprehensive relativization in order to refer it to the "value of law", which in this case is indispensable.

Contemporarily, in the constructing of the legal institution of financial secrecy the "values" that deserve protection are, among others, privacy, the duty to observe good faith and also the notion of "interest" understood not only in the economic, but also social (public, general) categories. It emerges with regard to the necessity for violating financial secrecy, which is universally justified by the concern to protect the public interest.

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POLISH CONSTITUTIONAL COURT DESCRIBES FRAMES OF THE PRINCIPLE OF TAX JUSTICE

Edward Juchniewicz, Magorzata Stwol[1]

Abstract

The term "principles of law" often is mentioned in scientific papers and judicial practice. Polish legal literature divides principles into two groups. The first group of principles has nothing to do with the provisions of legal regulations. The issue of justice has always been a disputable topic. Justice is also the main principle of the functioning of a state, markets and good human relations. It may seem that we know what justice is and what constitutes its content. For a long time, it has been attempted to work out a formula of justice, including also the development of universal and uniform definition of justice. Authors attempt to analyse the tax justice principle in the context of new judgment of Polish Constitutional Court related to income tax threshold and by using normative and dogmatic methodology to answer the question if modern taxation can be fair.

Keywords: Tax Law; Tax Justice Principle; Principles of Tax Law.

JEL Classification: H34

1 Introduction

The issue of justice has always been a disputable topic. It contains dilemmas of both philosophical, as well as practical nature. We are aware that injustice may concern every human being in various life situations. Justice is also

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the main principle of the functioning of a state, markets and good human relations. It may seem that we know what justice is and what constitutes its content. However, a detailed analysis of the problem shows that is a complicated task. For a long time, it has been attempted to work out a formula of justice, including also the development of universal and uniform definition of justice. In the face of different definitions, it should be assumed that justice constitutes an idea appropriate for the period of the existence of the community of people. It is a particularly changeable principle and dependent on concrete historical conditions, traditions, values accepted by people, first of all, analyzing the principle of justice. With the existence of many various concepts of justice, we may claim that ponderings upon justice will always be subjective. This shall be just, which shall be just considered just by a particular person.

From the point of view of law, the notion of "justice" is of strictly abstract nature, which does not have any limits of defining, uniform standards or assessments (Левченко, 2013: 38–41; Андриановская, 2007: 25–33). In accordance with one of the philosophical concepts of defining of notions – justice should be treated as a process, the content of which changes with time. Just is only this which is just at a particular point in time. The understanding of justice depends on the stage of historical and economic development of a society, social and legal status of a particular person, their world view and accepted values. People often try to define justice in the context of other abstract notions, which in the opinion of the authors, create the content of, for example, tax justice – e.g. solidarity, freedom, fundamental human rights, decent standard of living, etc. The manifestation of various views and contents of the principle of justice of taxation is the postulate of A. Smith concerning the uniformity of taxation, where the main value is the universality of taxation in relation to all taxpayers.

In the face of crisis phenomena in the economy, in the social, cultural realms and in particular tackling the world spread problem of unemployment, we ponder upon the sense of justice. The economic and legal models developed much earlier not always prove themselves in the current times. We are the witnesses of the social discontent present in the developing countries and the highly developed ones. We are observing high inequalities between

inhabitants of a particular country and in comparison with the citizens of other countries. The problem of justice is currently particularly valid.

The sense of injustice is basically intensified in times of crises, when we see no perspectives, this usually means that a loss of hope for the improvement of the situation is taking place. It is a fact that approximately half of the people working all around the world earn less than two dollars a day. This means that regardless of the location of their country in the world, they earn too little to lift themselves and their families from poverty. In the twenty richest countries in the world, the average income of their inhabitants is 37 times higher than average income in the twenty poorest countries. In the recent decades this difference has increased by more than a half. The majority of the contemporary societies are classic societies, in which the hierarchical justice is present. Each level of vertical power is governed by a custom shaped by the will of those in power and founding its fundamental basis in the applicable law.

The term "principles of law" often is mentioned in scientific papers and judicial practice. Polish legal literature divides principles into two groups. The first group of principles has nothing to do with the provisions of legal regulations. According to the polish literature, these principles are a kind of assumptions, which are not expressed directly in legal and they are essentially a manifestation of foundation of the state system or other basic principles related to human and their place at the society. So formulated "principles" in general cannot be found among the provisions of the regulations and this way they ARE called as "principles ideas". In turn, the second group of "principles of law" are legal rules, which are recognised as a kind of essential law standards. The law exactly regulates them or we can say that they are expression of fundamental legal norms (Dworkin, 1998: 60).

Each branch of law its own legal doctrine devoted to the principles of that branch and tax law is no exception. From legal doctrine, we see that principles of taxation are based on widely accepted values. For example, the idea of social justice and the principles of a democratic state could are analysed in the context as a taxation. In broad terms, even the development of tax regulation could be treated as a fundamental value (the manifestation of democratization of society and are the idea of state ruled by law).

We should be aware, that both, principles and substance of these principles ma change over time. Even they should be defined as process rather a permanent unchanging values. Various conditions and circumstances have an impact on the one hand on values, while on the other on the perception of different things in the context of tax law. Classic example for Poland would be the accession to the European Union, which results in the obligation to respect the principle of non-discrimination for tax purposes in EU.

2 Tax Justice Principle in the Light of Polish Law

The relationship between law and morality is the traditional area of scientific studies in every branch of law. Tax law is not an exception here. There are no doubts that taxation, as a social and legal phenomenon should take place with the reservation of some rules, which are of fundamental importance to tax law. In this sense, it would be almost ideal to base the regulations of both the national as well as international tax law on the values constituting the content of tax principles. The necessity to define the tax principles is a certain kind of an axiom of knowledge on taxes and tax law. According to the idealistic assumption, the observance of tax principles both by the taxpayers as well as the authorities (in the broad sense – the state) should ensure the implementation of tax functions on the one hand, in particular prevent the phenomenon of taxation avoidance and evasion and on the other hand ensure the implementation of tax justice, as the most important tax principle in the light of the taxpayers expectations (Gajl, 1995: 9–25; Demin, 2014: 192–200; Sugin, 2004: 1991–2014).

The justice is one of the fundamental ethical and legal term that appear in all the social sciences. This is a particularly difficult term to define, that also justifies the lack of a legal definition in Polish regulations. In the absence of legal definitions must be assumed that literature is distinguish various types of justice: classic, Catholic, social, natural, and economic etc. Absence of legal definitions of tax justice did not limit himself to work out more than one justice theory (Waldron, 2010: 1- 30).

A special feature of justice is its ambiguous nature, the scope of which distinguish the desire for happiness, life satisfaction, confidence of tomorrow's day, equality and equal opportunities, equal income etc. The point

of reference of any concept of justice should be considered in the broad sense of equality and freedom. Different conceptions of justice with regard to the conditions outlined respectively contain a different determination of equality and freedom. In a free market economy, we have in mind the equality of individuals and their freedom to shape economic relations. While the reasoning is erroneous identification only justice with equality and freedom for all extreme changes in these values will cause a significant variation in these values. Full freedom can lead to inequality of different entities (taxpayers), and regulation of equality in fact led to a restriction of liberty. If aware of any justification for inequality and lack of freedom, we still should strive to develop solutions to human welfare (Kaplow, Shavell, 2000: 34–70).

From legal point of view, the term "justice" is strictly abstract, which does not have any boundaries to define, or uniform standards and values. According to one of the philosophical concept, justice should be defined as a process, the contents of which change over time. Fair is just what is fair in a particular time. Understanding of justice depends on the stage of historical and economic development of society, social and legal status of a person, its beliefs and accepted values (Chauvin, 1999: 15–39). Justice often is trying to be defined by various authors in the context of other abstract terms, which in the authors' opinions create content for justice. For example for tax justice are used solidarity, freedom, fundamental human rights, decent living conditions etc (Gomułowicz, 2013). A manifestation of different views and content of the principle of tax justice principle, is the postulate of A. Smith that taxation should be equal and all taxpayers should pay taxes (Elkins, 2009: 73–105; Bradley, 2011: 1–33).

A. Gomułowicz defines justice as a feature of good law. At the same time author points that it should be the primary criterion of the law. This is so, because the law by their nature should be fair. Although the term of justice, including tax justice principle is extremely ambiguous, however, justice cannot be denied. Legal norms that do not have inside of them the asset of justice, remain only the law and never will not get the dignity of the law (Gomułowicz, 2008; Глуховский, 2007: 40–46; Гжескевич, 2007: 33–40). It should be added, that the legal doctrine of tax justice place

this principle as a core principle of construction of good tax systems. The classic approach of tax justice aims to protect the rights of taxpayers in the country (Vanistendael, 1996: 5–14).

3 The New Judgment of Polish Constitutional Court

Polish Constitutional Court[2] is always mentioned in the tax law literature as a creator of tax law principles. It should be mentioned here principles formulated by the Polish Constitutional Court: 1) principle of statute exclusivity in shaping tax obligations; 2) the principle of retroactivity of the tax law; 3) the principle of trust to the state (*sensu stricto* – tax authority and regulations of the state, 4) the principle of tax justice 5) prohibition of tax changes inflicted on the scale of taxes during fiscal year; 6) prohibition of tax law changes in the manner provided for the budget law; 7) the principle of legality (Constitutional Court U 9/97).

Some of them lately was included directly in the text of Polish constitution, where particular attention is devoted to the legal structure of the tax. (Art. 2 The Republic of Poland shall be a democratic state ruled by law and implementing the principles of social justice. Art. 84 Everyone shall comply with his responsibilities and public duties, including the payment of taxes, as specified by statute. Art. 217 The imposition of taxes, as well as other public imposts, the specification of those subject to the tax and the rates of taxation, as well as the principles for granting tax reliefs and remissions, along with categories of taxpayers exempt from taxation, shall be by means of statute.)

In the jurisprudence of the Constitutional Court emphasized, that implementation of the constitutional principle of justice does not mean having granting all categories of citizens (groups of entities) equal rights and the same duties (taxes). According to the Court the various entities (taxpayers) should be treated equally (cannot be discriminated) if they stay in the same factual situation. The Court pointed out that special attention should be precisely applied because of the imbalance between the parties (taxpayer and tax authority) with respect tax purposes (Constitutional Court, K 22/95; Constitutional Court, K 5/00).

2 Also name a Constitutional Tribunal, see more information on Constitutional Court in Poland at official website: http://trybunal.gov.pl/en/.

Mostly all Constitutional Court judgments related to tax justice principle are general and there were no any Court reflections, for example if any tax rate are too high. Something changed lately, that require our attention.

On October 20, 2015 The Constitutional Court recognized the request of the Ombudsman[3] for the income tax on individuals related to the income tax threshold (Saez, 2000: 3–36; Zheng, 2010: 2–10). In its judgment, the Constitutional Court ruled that: Art. 27/1 of the Act of 26 July 1991 on income tax from individuals in so far as it does not provide a mechanism to correct the amount of the income tax, guaranteeing at least a minimum standard of living, is inconsistent with Art. 2, and Art. 84 of the Constitution. The basic constitutional problem concerning was the lack of a mechanism to correct the amount decreasing the income tax and, consequently, lack realignment tax-free amount. The Constitutional Court pointed out that the legislature, shaping the tax system, in addition to the principle of fair taxation, which determines the shape of the tax, must take into account the principle of social justice. It is connected to human dignity. The legislator shaping tax scale should protect the standard of living of people, so as to prevent them falling into a state of poverty. Reducing the amount of tax is in fact possible to determine the income tax on individuals in such a way that the taxpayer is left determined the amount of income free disposal. This objective has a social dimension and is to leave the taxpayer a certain income required to meet its basic needs. The legislator, individualizing tax liability, must take into account the need for human subsistence minimum. This is supported by the subjectivity of man resulting from his dignity.

The Court, in assessing the constitutionality of the challenged by the Ombudsman regulations considered whether unchanged for many years free tax amount from individuals is located in the limits of the principle of fair taxation (tax justice principle), and whether such a condition is consistent with the principle of social justice. The Court found that free tax amount is an acceptable instrument for shaping obligation to bear by the public charges resulting from Art. 84 of the Polish Constitution. However, the free tax amount by itself does not prejudge the legitimacy of this institution that

3 Also named Commissioner for Human Rights, see more information on official website: https://www.rpo.gov.pl/en.

is shaped in accordance with constitutional requirements. It is important to answer the question, to what extent the shape of free tax amount is located in the tax justice principle and how it pursues social justice. In the opinion of the Constitutional Court, no correction mechanism, which reduces the amount of income tax from individuals, and long-term existence of tax-free amount at a constant level and its non-relation to socio-economic situation of the state, is a defect of the tax law and unacceptable in a democratic state ruled by law. Maintaining for many years a fixed amount decreasing the income tax and non-separation from the factors by which we can determine the taxpayer's ability to pay, violates Art. 84 of the Constitution and the consequent tax justice principle. This compound causes that although the tax rules are correct in terms of form, but they become unjust. The Constitutional Court also added, no correct amount of tax decreasing by the legislature, where it remains unchanged for several years, with the loss as the value of money, tax-free amount in fact become smaller and its role in the tax system is changed. Consequently, the following situation makes people with low ability to pay towards reliance on using forms of state social assistance.

The Court emphasized that the mechanism of correcting the amount of the income tax should be related to the principle of citizens' (taxpayers') trust to the state and its laws. The existence of decreasing the amount of tax is not a privilege given by the government to citizens, but it is an expression of support by the state of economic freedom. Leaving the taxpayer certain amount of income to free disposal (without the obligation to pay tax for it) is particularly important for people with low ability to pay tax.

One of the dimensions of the principle of legitimate expectation is also the predictability of the legislature (Givati, 2009: 3–8). The tax-free amount was established since 1992 and was integral part of the income tax system; in the beginning was systematically increasing. No correction mechanism reducing the amount of tax, let call this institution as an apparent one The Court pointed out that even the need to maintain a balanced budget and the planned implementation of the budget in particular, cannot justify the introduction to the legal system and the institutions of apparent solutions. According to the principle of democratic state ruled by law, it is prohibited the creation of such regulations. No realignment by the legislator amount decreasing the income

tax on individuals (and thus the tax-free amount) is that a given institution does not comply with the tax law established by the legislature.

The Court emphasizes, that it is not rational regulation of the tax law, which assumes a fixed amount decreasing income tax. So tax-free allowance is set at PLN 3,091, while the Social Welfare Act specifies, that a person living in poverty, when the annual income determined by this Act, does not exceed PLN 7,608 – for a single person household and PLN 6,168, in the case of a person in the family.

The Court pointed out, that the legislature, in determining the tax-free amount, must take into account the government's public finances. This does not mean, however, constitutional consent for the legislature in shaping the tax system and its components in an arbitrary and unfair way. Legislator's work in this area must take into account the principles and constitutional values, including proper weight distribution of public and individual ability to bear the tax burden.

4 Conclusion

The condition of the public finances allows for the justification of the contemporary tax policy. Sooner or later the majority of countries will be forced to introduce new taxes or increase the tax burdens in order to finance the expenses at the state or local government level. The issue of new taxes and the increase by tax burdens in the scope of the existing tax system is both the problem of philosophy, as well as economy, and the tax law. This type of changes in the tax system create new areas of questions in the scope of tax justice, efficiency of the tax system and the general welfare of the society.

The examples of the manifestations of inequity should be treated as one of the main premises of scientific research in the scope of taxes. With reference to the above, tax justice deserves another stage of analyses in tax law. The modern phenomenon which has a strictly law-tax nature is the worldwide tendency to introduce new taxes. In the doctrine of tax law, the issues of new taxes have their scientific reaction, in particular the tax policy and taxes are subject to assessment in the scope of limits of tax law, the object of taxation and object of taxes (in the classic terms of limits of taxation).

St. Thomas Aquinas, commenting on the fairness of taxation (tax justice principle), taught that the tax is fair if the government establishes and enforces it for the common good. In contrast, unfair taxes are those that are applied for the benefit of the particular interest and therefore against the common good (Gomułowicz, 2013). In the context of this thesis, probably all taxes and elements tax structure will comply with the tax justice principle. Quite simple answer, that tax as inherently unfair thing can be justified by good tax law (and poor one also).

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STABILITY AND STABILIZATION OF FINANCIAL LAW

Petr Mrkývka, Damian Czudek [1]

Abstract

Many publications on financial law focus primarily on issues of the current state of regulation of a particular segment of the public financial operations. Notably they contain the description and subsequent analysis of the impact of regulation into practical application. To a very limited extent, the authors devote the complex issues of financial law. These include the problem of stability of financial law. The frequency of changes in legal financial norms throughout their existence is significant and base alarming instability of financial law sector. The consequence of this instability is the inability to predict the form of legal regulation in the coming years. This unpredictability especially if tax obligations or subsidy mechanisms have a negative impact on all spheres of social life. This article is the excursion to the state of stability of the financial law in the Czech Republic and suggests some opportunities for improvement.

Keywords: Financial Law; Tax Law; Budget Law; Monetary Law; Codification; Constitution; Legal Process.

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1 Introduction

The traditional view of the financial law in Central and Eastern Europe is that it is a set of legal norms regulating social relations associated with the financial activities of the state and the public selfgovernment. Norms of financial law govern the behavior of a number of diverse entities that are involved in creating the material conditions of functioning local governments, state and supranational entities like European Union. At the same time these are norms that ensure the existence and functioning of the money establishment and financial market. From this perspective, it is clear that the financial law is closely linked with other parts of the legal system and in special way, secondarily affects the behavior of the subjects in social relations, which are primarily interest of other legal sectors. Acceptance of the range of financial law, whether it contain also tax law (Radvan, 2014), it is irrelevant for this moment and it is a matter of traditions and tendencies within the national legal sciences. The concept contained in this article is derived from public financing activities and represents the traditional concept of financial law as a public law that includes both components of public financial activities – fiscal and non-fiscal.

Financial policy is one of the most important parts of the economic policy of the state (government). Indications of the forms of financial policy are part of the electoral programs of political parties that are competing for the favor of their voters at all levels. Norms of financial law are less susceptible to variations in the light of political changes. It is not only about such a fundamental change, as happened in 1989, when the entire political and economic system was changed. It is enough to maneuver between center-left and center-right national leadership and it is similarly in municipal politics. After the election victory mainly norms of financial law are the tool of financial policy implementation and these norms are adapted to the needs of that policy. In limited way the norms of financial law creates limits of financial policy. Here is the importance of such norms, which are difficult to change, and those are the ones that are contained in the Constitution and those that are the result of implementing directives of the European Union or other international obligations. It is questionable how finance law should therefore be flexible and capable of adapting to political whims, but

also the economic situation, and conversely how stable the financial law is and at the same time ready to solve the various possible crisis issues, so how the financial law is predictable.

What is the financial law in the Czech Republic like? The key moments in the formation of the current financial law based on the principles of market economy, democracy and the rule of law were:

- 1990 – Start of economic transition, restoration of private enterprise, transitional tax reform, restoration of local government;
- 1993 – Breakup of the Czechoslovak federation, monetary reform, the introduction of the new tax system, a new customs law, adopting European standards;
- 2004 – Entry into the European Union, the completion of pre-accession harmonization of financial law.

Recodification of private law in the form of a new Civil Code was an earthquake for financial law. This reform necessitated adaptation of legal financial norms not only new terminology of private law, but also a new concept of private facts relevant to the creation, modification or termination of relationship regulated by financial law. The new terminology is essentially an old-new terminology. Often these are the terms and structure of private law which was in force until 1950, but sometimes they have new content.

Changeover of right-wing and left-wing coalition governments had effect on the formation of financial law. Especially strong personalities as Minister of Finance as Vaclav Klaus (1989–1992), Miroslav Kalousek (2007–2009, 2010–2013) and Andrej Babis (2014) significantly affected the form of financial law, inter alia, the introduction of new and unusual elements. The central bank governors and board members had a significant influence on the form of financial law in the non-fiscal part. Financial law was also affected by global, EU and Czech economic problems that had to be solved by interventions into norms of financial law.

Financial Law in the Czech Republic is characterized by:

- Frequent changes;
- Disrespect if the common legal financial terminology for the whole financial law sector;
- High casuistry;

- Experimenting in law, when legislators rely on the role of courts in resolving vaguely worded provisions;
- Abuse of institutes of financial law for achieving non-fiscal goals which deform fiscal mechanisms;
- Abuse of institutes in other law sectors to achieve the fiscal targets, etc.

As was already stated, the financial law is formed under the influence of powerful political figures. Any political change then induces changes in financial law in connection with the political intentions of the new government. It can be certainly expected that the elections will change the form of financial law under the government program, which is a compromise the coalition agreement, but always it can be expected that the changes will mainly correspond to the political preferences of the Minister of Finance. The Minister of Finance is *de facto potentior persona* to the other members of the government.

The financial law in the Czech Republic is also characterized by:

- Minimum constitutional basis;
- Lack of basic codes governing, at least in general terms, currency and public finances, including taxes;
- The atomization of partial codification (Babčák, 2015), when parts of acts are moved into other acts;
- Introduce new obligations during the term of the tax period,
- Transferring the responsibility for the collection of taxes on tax subjects without any bonus;
- Short *vacantia legis*;
- An engineering approach to creating financial law, without appropriate orientation in the law in a broader context;
- Inability to face lobbying interests.

The list could go on. Instability of financial law can be demonstrated by the number of amendments to several tax laws:

- Act on Income Tax (Act no. 586/1992 Sb.; regulates income tax on natural persons and legal entities) effective from 1 January 1993 and amended by more than 160 acts and decisions of Constitutional Court;

- Act on Immovable Property Tax (Act no. 338/1992 Sb.; regulates land tax and building tax) effective from 1 January 1993 and amended only 31 times;
- Act on Road Tax (Act no. 16/1993 Sb.; is a property tac applicable to vehicles owned by selected persons) effective from 1 January 1993 and amended 21 times;
- Act on Value Added Tax (Act no. 253/2004 Sb.) effective from 1 May 2004, amended 44 times in 12 years of its existence.

Of course there are differences in the novels. Some are merely technical and other novels change also the essential features of the tax. There are sub-amendment and also extensive novels. Always, however, when the Act is "opened" for changes, the form of the act at the end of the legislation process is uncertainty. For a brief overview it is also clear that the acts are being amended several times during one year.

The fundamental act governing the financial management of the State is the Act no. 218/2000 Sb., on Budgetary Rules, which was amended 58 times and several times during the financial year.

And thus it is possible to demonstrate the frequency of amendments in all segments of financial law. However, it is possible to find a common solution? The scientific methods as description, analysis, comparison, and synthesis are used to achieve the answer.

2 Codifications

One possible way to achieve a certain degree of stability of the part of the law is its codification.

Legislation is a set of legal norms regulating social relations in a given territory and at a given time, which compliance is enforced by public authorities. The possibility and ability to regulate behavior by power while opportunity and the ability to force these parties to a legally conforming behavior is a sign of the power of sovereignty, respectively corporation (mostly state or its autonomous part or some form of confederation).[2] Legal norms forming the legal system are primarily original rules laid down by such corpora-

2 Existence of own legal system is indeed a sign of state sovereignty, but it does not mean automatic recognition of its existence by the international community.

tion. In the case of succession and in the conditions for application of the principle of legal continuity there are also norms issued by predecessors of this corporation. Furthermore there are legal norms that do not originate from the legislative activity of the corporation, but they are accepted in different ways by the public authorities so that they are applied as their own norms and their compliance shall enjoy the same or similar protection. They differ in their origin and possibilities of their changes or repeals. Forms of legal acts which carry the legal norms, their genesis, as well as relations with other normative systems are dependent on many factors. The most important of these is the factor of legal culture. It means to which of the major legal systems the legal system of Czech Republic belongs to or which legal culture prevails (Knapp, 1995). Legislative traditions, historical experience, state system and form of government, but also the type of economy as well as foreign inspiration have also the influence on the formation of the legal system.

Legal systems of the European continent have undergone an interesting and varied evolution. In the vast majority it is linked to connection with continental European legal culture, application of the principle of separation of powers, the idea of a democratic legal state, experience with totalitarian dictatorships, human rights protection, but also a market economy and participation in a wide range of international and particularly European integration. Globalization and integration have a significant impact on shaping the legislation, which is evident especially in those countries which are member states of the European Union or aspire to membership (Pítrová, 2014). Basically participation in each community and obligations arising therefrom to some extent affect the form of the law. The norms of the legal system are either adapted in accordance with these commitments, or are inspired by the recommendations given by a particular community or prefer an international treaty by which the State is bound, in preference to its own regulation.

Specific area of political and legal geography is Central and Eastern Europe. Legal area, which is politically, legally and economically complex and painful shaped during the 20th and early 21st century on the ruins of multinational empires and has been, and unfortunately, always is and will be the center of attention and interest of powers. In terms of the formation of legal

systems after historical upheavals it was important to resolve relationship to the legal system of the previous state or to remove the previous regime. That means to resolve the conditions of acceptance of the previous legislation, or vice versa its rejection. Czechoslovakia chose the path of full legal continuity and took over all acts and regulations of countries and empires that become part of it by the article 2 of Act on Establishing the Independent Czechoslovak State from the 28 October 1918[3]. Gradually they should be replaced by new Czechoslovak regulation.

The main problem was the unification of legal system. The system was, in essence, different in so-called historical lands (Bohemia, Moravia and Silesia), which applied Austrian law, while the Slovak Republic and Ruthenia (since 1945 Transcarpathian part of Ukraine), on the contrary applied Hungarian law. In the existence of Czechoslovakia the differences in the legal systems had never been absolutely overcome. To illustrate the situation the Unification of Private Law occurred in 1950 by the adoption of the new Civil Code[4], which replaces the modified Austrian General Civil Code[5] (ABGB) and the Hungarian customary law[6] applicable in the Slovak Republic. Question of legal continuity or discontinuity had been dealt with during the course of the 20th century, several times. When the first Czechoslovak Republic (1918–1938) and 2nd Czech-Slovak Republic (1938–1939) built his legal system based on the principle of legal continuity and essentially also the Slovak State[7] and the Protectorate of Bohemia and Moravia[8] (1939–1945), then freed Czechoslovakia dealt with the legal continuity rather complicatedly.[9]

Continuity was maintained towards the First Republic[10] and regulations of period of Nazi occupation (1938–1944/45) was taken over only in con-

3 Act no. 11/1918 Sb.
4 Act no. 141/1950 Sb.
5 Imperial regulation no. 946/1811, as amended by acts of National Assembly of the Republic of Czechoslovakia.
6 Collection by Verböczy István.
7 Art. 3 of Act of Slovak Assembly no. 1/1939 Sb., on Independent Slovak State.
8 Art. 12 of decree of leader and Reich Chancellor no. 75/1939 Sb., on the Protectorate of Bohemia and Moravia.
9 Constitutional Decree of the President of the Republic no. 11/1944 of Czechoslovak Official Journal from 3 August 1944, on restoration of legal order.
10 See Art. 1 of constitutional decree.

dition that they were not in conflict with the democratic principles of the Czechoslovak Constitution[11] of 1920.[12] The last time when the issue of relationship to the legal system of the predecessor was being solved was in 1993, in accordance to the establishment of the independent Czech Republic after the dissolution of the Czechoslovak federation. In this case the new Czech Republic took over legal norm of Czech Republic – the subject Federation and federal laws, unless they were contrary to the regulations of the new Czech Republic.[13] Independent Czech Republic took over significant codes of Czechoslovakia: the Civil Code[14], the Commercial Code[15], Code of International Trade[16], Labour Code[17], Criminal Code[18], Civil Procedure Code[19], Criminal Procedure Code[20] and Administrative Procedure Code[21]. Both codes of lawsuits are still valid today and their planned, while also needed recodification is not realistic in the short term. It should be noted that the Czechoslovak legislation of the period of unitary state and also federal acts from the period of the Czechoslovak federation, if they were adopted into legal system of the successor states, then developed separately. There is not a cooperation of Czech and Slovak legislators in the amendment or the creation of new legislation, even in the case of implementation of EU law. Thus, the two legal systems of the Czech Republic and the Slovak Republic diverge. The Breaking up of more or less same concept of both jurisdictions was completed by the recodification of private law in the Czech Republic. The new Civil Code[22] (2012) which, in essence, returns to the Austrian basis, affected all areas of law, including financial law. It intervened in legal terminology. So besides of Slovak language purism when after 1992

11 As amended until 29 September 1938.
12 See Art. 2 of constitutional decree.
13 Art. 1 and Art. 2 of Constitutional Act no. 4/1993 Sb., on Measures Relating to the Dissolution of the Czech and Slovak Federative Republic.
14 Act no. 40/1964 Sb., as amended.
15 Act no. 512/1991 Sb., as amended.
16 Act no. 101/1963 Sb., as amended.
17 Act no. 65/1965 Sb., as amended.
18 Act no. 140/1961 Sb., as amended.. It should be noted that in the title of this provision the word "act", not "code" was used. It was because of the ideological reasons, though the prescription had all the features of the Code.
19 Act no. 99/1963 Sb., as amended.
20 Act no. 141/1961 Sb., as amended.
21 Act no. 71/1967 Sb., as amended.
22 Act no. 89/2012 Sb.

Slovaks removed terminology influenced by Czech language from their legislation, and also the new or old-new terminology of the new Civil Code has created significant terminological differences or even differences in the content of the used terms.

From a cursory review of codes taken from the period of the Czechoslovak state, it is clear that the codification of certain sectors in the territory of today's Czech Republic has relatively rich tradition already from the time of the Austrian monarchy. The current legislature continues in this tradition. The codification is implemented identically in most countries of Central and Eastern Europe, but also in the western part of continental Europe, in areas of law such as constitutional law, civil law, criminal law, employment law and in court proceedings.

The derogatory clauses of the first codes indicate that the date of its effectiveness the code repeals a considerable amount of legal norms, which together constitute the legal area. The introduction if the Code into life means the end of an era where the legal area had a nature of incorporated sector constituted by a plurality of primary and secondary normative acts, and then became codified industry.

Codified legal sector can be defined as the legal sector, whose core matter is contained in a single piece of legislation. This legislation has generally the nature of the primary normative act of a general nature (*lex generalis*). Other primary normative acts, whose norms are norms of the legal sector, are acts in the category of *lex specialis*. Secondary normative acts are acts of the executive power and have the role of implementing regulations which are restricted by the legal authorization. In private law we encounter situations where the Civil Code serves as a *lex generalis* to the codes of other private sector that they are essentially derivatives of civil law. These include employment law and commercial law. However, this situation does not happen all the time and everywhere. During the centrally planned economy Civil Code of 1964 and the Labour Code of 1965 were independent of each other, as well as there was not connection of *lex generalis et lex specialis* nor the connection of Civil Code and Economic Code, which regulated so called socialist economic system and relations between subjects which formed it.

Creating Code is extremely complex process and requires a high level of commitment of the team of experts not only in the area of the law, but also experts in legislation. The experts have to be persons who can perceive not only the legal sector as a whole complex, but also its interaction with other parts of the legal systems, international obligations and foreign experiences.

Codes, as a result of the hard work of their creators and legislators, have a greater degree of stability than other acts. In the case of the new Civil Code it is perhaps a fanatical aversion of its creators to accept possible changes. In essence, every "opening" of the Code in the legislative process can be destructive.

It can be stated that the codified legal sectors show a higher degree of stability than the so-called incorporated sectors of law.

3 Incorporated Sectors of Law

Incorporated sectors of law are legal sectors, which legal norms are contained in many legal regulations. In essence, these sectors have lack of act which can serve as general legal regulation (*lex generalis*) in relation to other acts – formal sources of such legal sector. Codified sectors are inherently tied so that systemic coherence of their norms is maximum; they have settled system configuration and their general part is recognized directly in the code. Definition of incorporation sector is mainly the result of the doctrine. If there is the will of the legislator and the willingness of its practical application, than it is accepted such as relatively independent sector. In the case of codified sector legislator already accepted the independence of the sector by the Code and we can conclude that its will lasts. Incorporated sectors are susceptible to various irredentist efforts, which are driven by political strategy more than by trying to achieve a comprehensive quality regulation and in the case of a doctrine often by personal ambitions of authorities.

The largest incorporated sector is administrative law. This heritage of non-codification was assumed by all the sectors that can be described as derivatives of administrative law. Administrative-legal essence of method of regulation is typical for derivatives of administrative law. It is associated with the participation of public administration in the implementation of their

norms. Derivatives of administrative law use forms and methods of public administration to achieve the purpose of regulation in various degrees. This implies scope for extensive secondary norm creation by the government and relevant ministries, but also for local law. The range of norms incorporated into this slice of law further increase. It is doubtful whether the regulation of the administrative law and administrative law derivatives can lead to the creation of some codes, whether all these sectors are codifyable.

The problem is in the diversity of the object of legal regulation and diversity of environments in which the social relations, which are precisely the object of regulation, are realized. Linkages between social relationships, that are the object of regulation of the sector, are often very vague. Then the relationships between the norms regulating these relations are very loose. In administrative law and its derivatives it is impossible to think of such codifications, which would include a substantial portion of matter in the sector. The possibility of partial codification can be admitted. Partial codification is comprehensive regulation of the essential part of a relatively independent subsystem of the legal sector. This has already succeeded in certain moments. In the case of administrative law it is for example construction law, in which the Construction Act fulfills the function of the code. Although the legislator did not mark it as a code, probably because the legislator does not accept it as an independently sector, and because of the lack of tradition. In the case of derivatives of administrative law, the situation is similar.

Traditionally conceived finance law, as the legal sector regulating relations related to public financial activities (financial activities of state and local self-government) is also incorporated derivative of administrative law with all the pathological ills inherited from the administrative law. Like administrative law the financial law does not have legislatively defined general section. Doctrinally and didactically we can expect from the general part the determination of the fundamental principles of the sector, basic institutes and institutions valid for the whole sector and the definition of a united base of implementation of the substantive regulation. Doctrinal opinion on the concept of a general part and overall framework of the sector does not always coincide with the ideas and political needs of the proposers of the regulation and the legislator itself.

4 Code of Financial Procedural Law

In the incorporated sectors of derivatives of administrative law we are witnesses of at least a partial codification of procedural law in the form of Administrative Procedure Code[23], which serves as a *lex generalis* to special procedural regulations, even in cases where the legislator tried to exclude the general Administrative Procedure Code.

If we consider the existence of financial procedural law as a coherent sector of the procedural regulation, by which the financial substantive law is realized, then in the Czech Republic we can say that this currently does not exist. There is a question whether we can and should come to a unification of financial-legal process.

Environmental complexity of implementing public financial activities and the diversity of direct and indirect ways of dealing with the monetary mass require customization of tools of behavior regulation in these social relations. The extent of use of methods and forms of public administration will be also different. Instead of decisions of public power, contract (public or private) can occur.

And also the method of the two-phase implementation of financial law and especially tax law has its place there. In the first phase the responsibility for the implementation of the financial law is entrusted to a subject, which is not a public authority and does not have competency of the authority. In this phase, the subject either applied norms of financial law on himself and on his own responsibility or in relation to another subject he has a status *potentior persona*, i.e. person legally superior to the other person, who is obliged to tolerate the fulfillment of obligations not based on contract, but resulting directly from the act. A typical example of *potentior persona* is a person who actually pays the tax in in relation to the taxpayer or a financial institution in relation to his client under the Act on certain measures against the legalization of proceeds from crime and terrorist financing.[24]

Financial Law in the Czech Republic in case of procedural regulation is in a strange situation. The general Administrative Procedure Code does

23 Act no. 500/2004 Sb.
24 Act no. 253/2008 Sb., as amended.

not fulfill the function of connecting link for all its components. The Administrative Procedure Code is applied particularly in those subsystems of financial law, which are collectively referred as nonfiscal part of financial law. It is part of the financial law, which is not directly related to the creation, distribution and use of public money funds, therefore traditional public finances, but related to currency and financial markets. Due to the use of public administration in non-fiscal part of financial law the key role is played by the central bank. In the Czech Republic the central bank is monetary policy maker and manager of currencies and also the supervisor of the financial market. The Czech National Bank has the competence of an independent administrative authority[25] and in its proceedings the Administrative Procedure Code is used subsidiary. On the other hand, within the fiscal part of financial law, the situation is complicated. Fiscal part is contained by budgetary law (Marková, 2015; Paul, 2015), broad-based tax law and legal regulation of public expenditure (by a new designation of "subsidy" law). The budgetary process is a process sui generis and the subsidiary use of the Administrative Procedure Code shall be limited to a minimum. In the case of the subsidy law the use Administrative Procedure Code is discussed in a situation where the current legislation excludes its use, but the corresponding procedural regulation is missing.[26] Broad-based tax law, including legislation of taxes, fees and other similar public revenues, has its own peculiar procedural and administrative code – Tax Procedure Code[27], which is relatively independent on the Administrative Procedure Code[28]. The Tax Code is *lex generalis*, while individual tax acts contain special procedural or administrative regulation which correspond the environment in which the tax is realized, the tax construction and technique of taxation.[29] The intention of the legislator in the case of the Administrative Procedure Code was to create a common code of public administration. It contains the basic principles of public administration[30]. These principles should be also applied in cases

25 See Art. 1/3 of Act no. 6/1993 Sb., on Czech National Bank, as amended.
26 See Act no. 218/2000 Sb., on Budgetary Rules, as amended and Act no. 250/2000 Sb., on Budgetary Rules of Territorial Budgets, as amended.
27 Act no. 280/2009 Sb.
28 See Art. 262 of Tax procedure Code.
29 See Art. 4 of Tax procedure Code.
30 See Art. 2–8 of Administrative Procedure Code.

when the use of Administrative Procedure Code is excluded[31] by the special act but the special act does not contain adequate principles.[32] The case law of administrative justice goes further and gives the possibility of use of the Administrative Procedure Code, particularly where the regulation contained in the Administrative Procedure Act is missing in the special act which is "independent" on the Administrative Procedure Code but which regulates public administration. It is exactly according to the general statement, that the Administrative Procedure Code is the Bible of the public administration. Neither the Administrative Procedure Code nor the Tax Procedure Code are designed as a general code of administrative law, respectively tax law, and contains basic framework for substantive regulation of the sector.

In the mentioned types of realization of financial law the classically conceived administrative process can be applied with difficulty. Excessive regulation can be also counterproductive. It is possible to get by with general principles of the realization of the obligations and leave the rest to the expression of autonomous will of stakeholders.

5 Partial Codification – "Paracodes"

The partial purpose-built codification and finding formal parallel in financial law according to Construction Act, which is a typical "paracode" in non-codified administrative law, are special issues. There are many hypothetical possibilities, but the reality is different. Try to find examples of partial codification in accepted subsystems of financial law.

In 2000 the dissolution of suggestion of partial codification occurred. It was the case of partial codification of budgetary law, which was included in the Act on Rules of Management of Budgetary Resources of Czech Republic and Municipalities in Czech Republic (Budgetary Rules of Republic).[33] In accordance with the application of the principle of fiscal federalism in public finances, the independent regulation of the financial management of the state was included in one act and regulation of budgetary rules od municipalities, regions and voluntary associations of municipalities was

31 For example Tax Procedure Code.
32 Art. 177/1 of Administrative Procedure Code.
33 Act no. 576/1990 Sb., as amended.

included in other act. The budgetary rules of other public corporations such as professional chamber (established by law and with mandatory membership) and public universities are kept out. The Czech Republic went in the opposite direction in the budget law than other states, which have established codes of public finances, although they are not directly called codes, but serves as a partial code. It is worth mentioning that in case of Czech acts on budgetary rules there is no relationship of subsidiarity between those two acts. The budget law is closely related to the subsidy law. The subsidy law is a set of legal norms which are connected by similar purpose of existence. That means to regulate behavior in connection with the use of public funds. Trace elements of general regulation can be found in the relevant acts on budgetary rules, but a substantial portion of the matter is located in a large number of other regulations. This is mainly due to the diversity of conditions of financing set in the various ministries. In the area of taxes, fees and similar charges, except the general Tax Procedure Code, the Czech legal system does not have general tax code. There is the tendency to regulate each tax, fee of other payment in a separate act. There is no effort to follow the example of partial codification of direct taxes, which functioned in Czechoslovakia in the form of the Act on Direct Taxes[34] in the years 1927–1953. National customs law is already naked torso of extensive regulations of duties and customs in the fundamental source – the Customs Act. The Customs Act since so-called Martincov Customs Act[35] of 1927 had a character of customs law code because of the scope and manner of the regulation.

In essence, with the exception of the Tax Procedure Code, the financial law in the Czech Republic is the branch of law without partial codification. The "paracodes" in the form of, for example, the Exchange Act or the Customs Act no longer occurs. The subsector has no fundamental link, no central act which fulfills the function of *lex generelis* to other norms of this subsector. This situation leads to disintegration of the subsector and thus to difficult argumentation for a comprehensive understanding of functioning of concrete financial phenomenon within the whole. The basic principles applicable to that part of the financial law, legal definitions and other general principles

34 Act no. 76/1927 Sb.
35 Act no. 114/1927 Sb.

should be included in the general part of such "paracode". Until recently in the foreign exchange law this function was fulfilled by the Exchange Act.[36] The legal regulation of different ways dealing with foreign exchange values was gradually taken out and then regulated separately (foreign exchange[37]) or in association with domestic regulations of payments[38] or circulation of banknotes and coins[39]. Some obligations and procedures were found to be unnecessary due to the liberalization of the foreign exchange management. Crisis management in the foreign exchange was included in the general Crisis Act.[40] Definitions of terms and principles of the foreign exchange law were with the torso of the Exchange Act repealed in 2016.[41]

6 Constitutionalisation

The basic general framework of Czech financial law is not expressed in any code. The public financial activities are governed by countless acts and regulations of various legal force. Many states are in a similar situation. Some states use the possibility of regulation of the most important principles, on which the monetary and fiscal establishment of the state is based on, directly in the constitution. The reason is the stability of law regulating public financial activity. The constitution also contains the legislative-technical principles.

Constitutionalisation of particular legal sector requires a higher degree of political consensus in Parliament because a quorum for approval of the constitution or its changes often goes beyond the ability of the coalition. Application of constitutionalisation in the financial law makes allows:

- Stability of the financial establishment of the state, namely monetary and fiscal establishment;
- Preservation of the principles of behavior of the subjects of financial-legal relations, by achieving some stability of model of behavior of public-sector performance, even in the case of changes in the political composition of the government;

36 Act no. 219/1995 Sb., as amended.
37 Act no. 277/2013 Sb.
38 Act no. 284/2009 Sb.
39 Act no. 136/2011 Sb.
40 Act no. 240/2000 Sb., as amended by Act no. 323/2016 Sb.
41 See Act no. 323/2016 Sb.

- Constitutional regulation of financial-legal institutes including the definition of their content is a guarantee of a stable interpretation; this applies also for defining of the general framework of institutions that are major players in the realization of public financial activities;
- Constitutionalisation of financial law is finally a confirmation of the financial sovereignty of the state. (Mrkývka, P. 2012)

The range of financial law constitutionalisation may be different. Many states implement minimum constitutionalisation. This includes mainly existence of institutions such as the central bank and an independent audit institution, their definition, competence and guarantee of their independence. Furthermore, in the area of fiscal establishment the constitution include definition of existence of the state budget, final balancing of the budget and the principles of the budgetary legislative process. Finally there can be the basic principle of tax law: taxes can be imposed only through law. It is obvious that constitutionalisation of financial law can be divided into three spheres:

- Constitutionalisation of fiscal establishment;
- Constitutionalisation of tax law;
- Constitutionalisation of currency a central banking.

During the crisis of public finances in the European Union the Czech Republic also dealt with the way of achieving fiscal responsibility. The Czech Republic failed to adopt the EU model of responsibility and confidently declared the ability to define own limits of the public deficit and even stricter than EU. The original intention to regulate this by the constitutional law (so-called Financial Constitution) did not find appropriate support in Parliament and regulation is adopted in the form of ordinary act.

Financial Constitution meant guarantees of economic stability of public finances and the stability of public finance law. Rejecting of the Financial Constitution primarily means ignoring the need of financial stability and remaining in a state of potential danger of legislative turmoil after the next election.

The inspiration from the constitutions of states with significant constitutionalisation of financial law has not been used. It is striking that these are the constitutions the close Czech neighbours such as Germany[42], Poland[43] and Austria[44].

7 Conclusion

The current situation of financial law in the Czech Republic is not too favorable, and any positive change, which would tend to ensure its stability, could not be expected in the near future. Favorable macroeconomic results, surplus final account of state budget in 2016 and higher tax revenues are far from being the result of the right quality. Breakage of legal financial "paracodes" and tendency to unsystematic partial regulations makes from the Czech financial law an uncompact mixture of legal norms. It will be continually "fine-tuning" by partial casuistic interventions. Lack of general codification of public financial activities, respectively lack of codified general part of the financial law gives space for the judicial creation of law and thus trampling the principle of triple power.

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THE PRINCIPLE OF SUBSTANTIAL TRANSPARENCY OF PUBLIC FINANCE AND THE CREATION OF THE ACTIVE CITIZENSHIP

Joanna M. Salachna, Marcin Tyniewicki[1]

Abstract

This article endeavours to analyse what impact of substantial transparency of public finance (i.e. a reliable means of providing information on state sector finances) has on shaping active citizenship in society. The aim is based on critical question on how the public authority should inform citizens on the process of collecting and spending public sector income; moreover, the complicated nature of public finances and varying educational backgrounds of recipients who form the society need to be considered.

The authors claim that principle of substantial transparency of public finance (i.e. informing citizens on public funding) has been inadequately implemented and it might be incomprehensible from the social addressee's perspective. Currently in Poland this principle is primarily focused on a rather professional level, although its social aspect is not ignored by the doctrine either. The authors believe that reporting on the state finances should be adjusted to the educational level of the audience as they are the principals of public authority.

This paper constitutes a part of the extensive research initiated by the authors, which examines the role of moral values in distributing public

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resources by the authorities. Non-reactive (non-empirical) research methods have been utilised in the paper, which encompass a literature review, including legal acts currently in force in Poland.

Keywords: Substantial Transparency; Public Finance; Financial Decisions; Democracy; Education; Active Citizenship; Civil Society.

JEL Classification: A13, A20, E62, H50

1 Introduction

The main aim of the article is to analyse how the principle of substantial transparency of public finance (i.e. providing proper information to society) affects the shaping of active citizenship. The aim is based on the critical question on how the public authority should inform citizens on the process of collecting and spending public sector income; moreover, the complicated nature of public finances and varying educational backgrounds of stakeholders in society need to be considered. Thus the authors hypothesise that the principle of substantial transparency has been inadequately implemented and it might be incomprehensible to its target audience. This principle in Poland is mainly focused towards a professional level i.e. people who possess relevant expertise (Kosikowski, Ruśkowski, 2008: 301); however its social aspect has also been highlighted (Kornberger-Sokołowska, 2010: 254; Malinowska-Misiąg, Misiąg, 2007: 46–47). The principle of substantial transparency of public finance as a theoretical assumption has been distorted away from the perspective of a democratic model of the functioning of the state and civil society; according to which, proper information on financial matters should be supplied by collating data appropriately, and making it publicly accessible and appropriate to their age and educational level.

The Principal – Agent theory for the public sector (Weingast, Moran, 1984: 147–192; Moe, 1984: 739–777) was considered first in order to thoroughly examine the problem of informing citizens about financial policy and financial decisions taken by the authorities. In this concept, the "principal" is society or citizenry, whereas the public authority (politicians) is the "agent".

The authors assume that the principal (society) takes responsibility for public matters, hence civil society must act as the motivation for state authority (politicians) to effectively take and reconsider their decisions. The fundamental basis of civil society in democratic states is / should be relevant education and accurate dissemination of public affairs and finance. This coincides with transparency, which includes clear and intelligible presentation of the most relevant and crucial information and data.[2] It must be highlighted that without real transparency of an authority's public finance activity, neither citizenship education nor real engaged citizenship can exist. On the other hand, a regular and accurate (transparent, intelligible) flow of information and consistent education gives rise to a gradual comprehension of the information by citizens (substantial transparency). The fact that civil society is properly, not just superficially developed, makes citizens feel responsible for public affairs, and for public finance (global responsibility of society).

In conclusion, the authors would like to highlight that this problem constitutes just one part of the extensive research initiated by the authors, examining the role of moral values in the distribution of public resources by state authorities. The research methods include, inter alia, the analysis of the data obtained from questionnaires (empirical) but also some non-reactive (non-empirical) research methods, including a literature review and the relevant legal acts which are in force now in Poland.

2 Determinants of Taking Financial Decisions by Public Authority. The Role of Communication

Analysing the decisions of state authority, which are financial in character/dimension (as they lead to far-reaching consequences), is a common and contemporary phenomenon. They frequently provoke deep emotions not only among academia, experts or politicians, but also among citizens. These types of decisions include, inter alia:

- Providing the coverage of free health benefits which are guaranteed (financed) by the state;

2 Formal transparency, on the other hand, means presenting the information and data in a free form or sequence etc. Although the information and data are provided this transparency is frequently in a specialised or *de facto* superficial nature.

- Setting out the amount and conditions for obtaining social benefits (e.g. aids, allowances etc.), which are financed from public resources;
- Formulating the rules of financing social security and determining the prerequisites (e.g. age, years of experience, the level of health detriment) which authorise a person to receive a pension or a disability pension);
- Modification of the tax system, which may also include formulation of the taxation rules in reference to the income of natural persons and corporations.

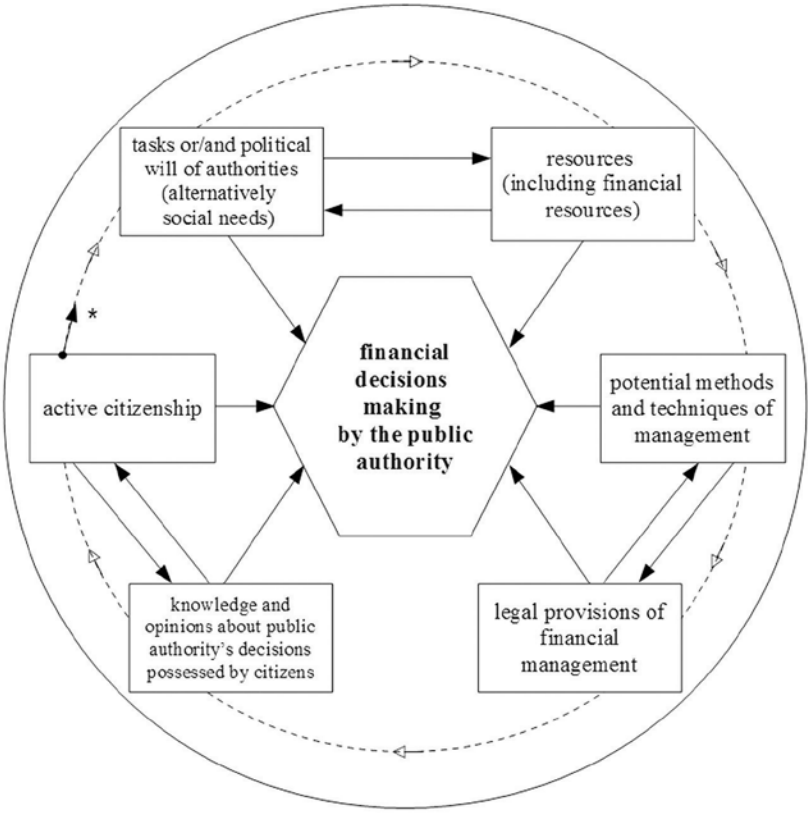
The aforementioned types of financial decisions, which are taken under particular circumstances and within a specified time frame by public authorities, in most cases cannot be assessed as either unequivocally positive or negative; this is due to the perspective of those making an assessment. Thus, for example, the social consequences of decisions are evaluated according to how they affect the standards of living (the rights and obligations of citizens and entrepreneurs) in a particular country. Nevertheless, their impact (either positive or negative) might also be different under certain categories. Financial / budgetary capacity (efficiency) of a particular country (most often, current and sometimes only prospective) is another point of reference. In this case, regardless of experts' calculations and forecasts, the consequences of the decision always differ (below/above the forecast) from the expected intentions and plans. The reform of healthcare in the USA (so-called *Obamacare*[3]) can be an example here. The consequences of the reform both for those who are covered by this healthcare and the budget of the USA, are far from the intended effects. (*c.f.* Kaiser Health Tracking Poll: December 2013. The Henry Keiser Family Foundation 2013. http://kff.org/health-reform/poll-finding/kaiser-health-tracking-poll-december-2013; Cornwell, Morgan: Obamacare website gets new tech experts; oversight pressure grows, Reuters: 2013. http://www. reuters.com/article/2013/10/31/us-usa-healthcare-surgeidUSBRE99U16R20131031).

The figure which is presented below depicts six key factors which, as the authors believe, affect the financial decision making process by public

3 *Patient Protection and Affordable Care Act* signed by the President of the USA in 2010 and progressively entered into force since 1 October 2013.

authorities, hence they create a specific environment in which management processes occur. Even more importantly, there are various correlations (two-way feedback) among particular determinants presented in the figure, which apart from different categories of determinants, is considered an additional factor which has an impact on the decision making process.

Figure 1. The determinants (environment) of financial decision making by a public authority



Source: own study

This approach can be described further. Namely, in all "pairs of factors" this marked co-variance, under certain circumstances and within a specific time frame, establishes a framework of the possible decisions. Despite the fact that the particular categories of factors might be discussed separately or jointly when viewed in the abstract, in reality, the decision making process is determined not by specific groups of factors, but the *de facto* results from the correlations existing among them. Every correlation has a different meaning in influencing the conditions i.e.:

1. Correlation: **Tasks/Political Will of Authorities vs. Resources** forces authorities to define their priority expenditures and to justify them (which may take different forms, as well as intensifying efforts aimed at increasing the financial potential (for example by obtaining new income sources). However, specific financial resources may limit both the scope of those actions or prevent their performance, despite prior declarations of politicians (political will), such as during political campaigns;
2. Correlation: **Potential Methods and Techniques of Management vs. Legal Provisions on Financial Management** determines the possible forms of actions and decisions within the scope of financial management, and its direction under certain circumstances and within a specific time frame. Although the models may serve to improve the quality of management, their application is not always possible due to legal restrictions which establish the management framework;[4]
3. Correlation: **Active Citizenship vs. Knowledge and Opinions about a Public Authority's Decisions possessed by Citizens** ultimately determines the framework of the decision making process and therefore the responsibility of public authorities. This correlation can be discussed from different viewpoints (Stiglitz, 2004: 184; Buchanan, Musgrave, 2005: 55–124, 163).[5] In respect to this consideration, however, it is worth highlighting that the authorities should not only take into consideration the preferences and attitudes of citi-

4 As a side note, a universal principle stating that public authorities act only on the basis and within the law needs to be highlighted here. It means that the principle which is applied in the private sector and which considers any acts that are not prohibited cannot be implemented in this context to be legal.

5 Management decisions might be considered, inter alia, with the application of transaction costs theory, the theory of agency and most often emphasised with the theory of public choice.

zens, (voters) but simultaneously they should effectively communicate with them through the decision making process. It is one of the conditions for social acceptance of the authorities' financial policy.

All of these relations, despite the fact that correlations of the elements (pairs of factors) are different, form a somewhat closed and recurrent cycle, creating the decision making process in question, which is represented in the figure by the dotted line following a clockwise direction. Recurrence of the cycles does not, however, denote that they are identical as every pair of the determinants, as a result of preceding decision making process, may be modified, which means that also subsequent financial decisions will differ. This is natural if the volatility of both citizens' political choices and financial policy is taken into consideration.

It is worth highlighting that the cycle itself commences with active citizenship, which is specifically manifested by citizens' participation in the electoral process of choosing their representatives in local and general elections (i.e. public authorities). These public authorities most frequently analyse/evaluate financial decisions, mainly taking into account the possibility of shaping and exploiting the financial potential to perform a steadily increasing number of public tasks (Correlation: Tasks/Political Will of Authorities vs. Resources). This is a natural consequence, as financial resources accompanied by an efficient and effective management system, and legal provisions (Correlation: potential methods and techniques of management vs. legal provisions on financial management) primarily determine the possibility of achieving their objectives. The authors, however, will further focus on the issues concerning the problem of communication between public authorities and citizens, particularly on its substantial transparency. Unfortunately, this question has not been widely researched in the area of public finance to date,[6] although the authors believe that this matter is an indispensable element of the functioning of contemporary (modern) democratic society, which also includes shaping (and changing) of active citizenship. Consequently this active citizenship should have an impact on the accountability of public authorities, as well as motivating the authorities to take certain actions.

6 Academics (who indicated support for the need to regulate the issue) have concentrated on the analysis of the formal/legal principles of transparency of public finance cf. point 4 of the article.

3 The Information Flow between a Public Authority and Citizens (Transparency of Intentions and Activities) – Reasons, Role, Distorting Effects

As mentioned above, an appropriate flow of information is of key importance for shaping adequate active citizenship under certain conditions and within a specified time frame. It means that a public authority should truly (not just superficially) communicate with society, because only then can active citizenship be shaped, and a civil society will exist. In addition, society may more consciously (on the basis of knowledge and opinions) affect public authority (politicians). In other words, public authorities should provide transparent (i.e. intelligible) information (this is discussed in more detail in section 4) about their intentions, anticipated effects, as well as current or prospective (also financial) outcomes of the actions taken. However, in practice this does not happen because public authorities (politicians), for various reasons, lack sufficient determination to take decisions which may rationalise the financial management of the state (this problem is more described by: Buchanan, Tollison, 1972).

Citizens are not properly informed about other matters due to the fact that the flow of information is distorted. This stems from both objective and subjective factors. In accordance with the aforesaid theory of agency, the objective factors of an incomplete and non-transparent information flow between a public authority and citizens (principal) relate to the fact that an entity that provides information possesses only limited knowledge on a particular matter.[7] "Non-transparency" is understood here, *inter alia*, as providing copious, fragmented bits of information, therefore the most important issues are not mentioned at all or, less frequently, "disappear" in the wealth of information provided. The subjective factors encompass intentional non-disclosure (non-publication) of information, which is frequently based on the fact that such disclosure might generate a negative rating of a public authority's performance by citizens (voters) – thus it might result in increasing their political accountability before voters (principal).

7 This state might result both from a lack or a distortion of information provided to the authority from the lower levels of management, or result from a lack of sufficient awareness of the importance of given data by the authorities.

Without any doubt it can be stated that efficiency incentives of a public authority (politicians) will not and cannot coincide completely with the interests of their principal (society), but regardless of that, the scrutiny of public authorities' (politicians') activities is necessary and undisputed. In addition, this transparency of information and shaping citizens' knowledge and awareness results in a partial devolution of power (Fukuyama, 2005: 69), as the indicated correlations between accurate information and active citizenship are indeed reciprocal. The decisions of public authorities (politicians), including financial decisions, have an impact on politicians' accountability, on the shaping of citizens' responsibility and on the reinforcement of the institution of civil society (Salachna, Tyniewicki, 2016: 16–17).

4 The Principle of Substantial Transparency in Poland – Information or Disinformation?

The principle of transparency of public finance *sensu largo,* which includes the principle of substantial transparency, has been anchored in the doctrine and it is also reflected in the legal acts in Poland currently in force. It is expressly stated under Art. 33/1 of the Public Finance Act of the 27 August 2009, and its formal application is considered as the obligation to publish particular data or to follow transparent financial procedures is grounded in Art. 34–38c of the said Act. Moreover, transparency is a value protected by the Constitution (Art. 61 of the Polish Constitution).

In a broader context, transparency of public finances ensures parliamentary and social control over the collection and spending of public resources (Gaudemet, Molinier, 2000: 238–239; Weralski, 1981: 65–71, 183–184). As it is highlighted *"social pressure seems to be a more powerful instrument than a very thorough internal audit"* (Malinowska-Misiąg, Misiąg, 2007: 46–47). This transparency safeguards the actual functioning of a democratic state based on the rule of law, whose important element is civil society.

Nevertheless, the fact that some obligations to publish (i.e. public disclosure of the state's finances and its financial management) are imposed on a public authority does guarantee that this authority will implement this transparency directive effectively. In this context, the effectiveness of transparency (substantial transparency) should refer to an accurate (clear) flow of information

between the authority and various stakeholders. Western scholars, however, exploit the notion of the principle of specification more frequently (Strasser, 1992: 55; Gaudemet, 2000: 238).

Although the financial doctrine also highlights the principle of substantial transparency, apart from formal transparency, and emphasises its social and audit roles, one might have an impression that these are merely conjectures rather than practical actions. The legislator itself and the authorities seem to underestimate the social dimension of the principle of substantial transparency. Moreover, instruction on public finances at law, economic or administrative studies leaves much to be desired as it is essentially limited to the presentation of legal acts including instruments of its implementation, which is in fact done by the representatives of the doctrine. These instruments encompass:

1. The appropriate details of public income and expenditure allocation;
2. Keeping budgetary accountancy;
3. Submitting relevant reports on public finance operations.

The issue of effectiveness (comprehension) of the published data has not been much explored by the doctrine.

As a consequence, the principle of substantial transparency is applied rather from the perspective of professional recipients (i.e. people who possess some expertise on public finance) even though they, given the way the data is presented, might have problems to accurately identify and assess the financial situation and policy of the country.

Thus, this flow of information leads to the situation that a stakeholder who has a different level of education and knowledge, and bears public burdens is somehow deprived of the access to public information. Paradoxically, s/he has access to information on public finance, but the obtained data is incomprehensible to them due to various reasons. It is worth noting that stakeholders also include non-governmental organisations, who are interested in receiving public expenditure for their activities, and who might be much more efficient than individuals in scrutinising public authorities.

From the perspective of the interests of a citizen who lacks professional knowledge on the financial management process, it is possible to indicate

certain barriers which distort the efficient and accurate flow of information (i.e. the application of the principle of substantial transparency of public finance) although some of these might be objective in character:

- The concentration and wealth of published data, which is frequently very detailed, and selected without taking into consideration the stakeholder's perspective;
- Non-transparent method of data presentation which makes obtaining the information, on for example, total expenditure to fund some key projects (programmes) carried out by the state, difficult;
- Application of diverse terms to publish the same statistical data, for example, public debt vs. the state treasury debt.

5 The Impact of Substantial Transparency of Public Finance on Moral Attitudes. The Essence of the Mechanism and Prerequisites of Its Proper Functioning

The abovementioned correlations between informing society (also on public finances) and shaping citizens' responsibility and reinforcing the institution of civil society, are based on the feedback effect. It is a kind of interaction between these two factors that makes the whole system dynamic and subject to constant changes. It cannot be stated, however, that if informing/educating society on financial management was at a sufficient level (how to measure the level of sufficiency is another question), it would generate active citizenship among all citizens. It can, perversely, be stated that "the dynamics of the system is constant", which results from continuous changes occurring in the area of public finances.

The feedback effect in the context of the correlation: active citizenship vs. knowledge on public finance, will be discussed further but it is worth noting that this effect also occurs in the other pairs of factors which determine financial decisions taken by public authorities.

Particular moral values should also determine the reliability (transparency) of information provided to society. It needs to be highlighted that substantial transparency of public finance will not only constitute an element of the decision making process but, apart from moral values, will be the background (indicator) for all stages of proper functioning of the public sector,

whose model was suggested by Salachna and Tyniewicki (2016: 12).[8] This model proves that the basis of the proper functioning of the public sector are the methods deployed, the quality of educational services, together with the information supplied to society, and that these should be provided on the basis of moral values; hence the condition of real (not only apparent/ formal) transparency, includingthe area of public finance, is met. In this case interactions occur not only between morality and education, but also between morality and substantial transparency.

The analysis of the aforementioned feedback effect can be commenced both with the process of communication/ information and active citizenship performed by members of society. The interaction which occurs between these factors makes this system complete in the sense that the determinants continuously affect one another; however, they are subject to constant change. Namely, proper (comprehensible) instruction and informing on public finance have an impact on citizens' awareness and their assessment concerning these finances. Non-governmental organisations, who are both beneficiaries of the information and who serve an educational role in society, are of key importance in this process too.

Disseminating knowledge (information and data) in its broad meaning, *inter alia*, the knowledge on the finances of the state and local governmental units or taxes as well as the impact (possibilities, outcomes) that citizens might have on public expenditure through social control stimulates, shapes, or changes active citizenship of the individuals. In this case we may say that some kind of stimulation of active citizenship occurs, for example, by:

- Mobilising citizens to take part in elections (it is worth noting that lack of approval for the state financial policy may lead to changes in political preferences);
- Willingness to actively participate in the process of social scrutiny by involvement in non-governmental organisations;
- A sense of obligation to shoulder public (tax) burdens in the event of the approval for financial policy implemented by the authorities;
- Concern for the public good, identifying with the goals pursued by the state (solidarity with the country and taking patriotic attitudes).

8 The model was developed by J.M. Salachna, M. Tyniewicki, U. Zawadzka-Pąk and E. Lotko.

One question might be posed in this context. How should these processes of informing and instructing citizens be conducted in order to implement the principle of substantial transparency of public finance? The issue in question is extremely broad and definitely goes beyond the present paper, but it is worth noting that the principle of adequacy should be applied here. Firstly, this principle should be implemented taking into account various educational and attainment levels (educational adequacy) hence it should not be merely limited to tertiary or universal education for social organisations to play a key role in this process as well. Secondly, the information should be provided with consideration to the educational level of various non-professional stakeholders i.e. people who do not have broad knowledge of public finances (adequacy of addressees), which means providing data of varying scope and degree of detail.

6 Conclusion

It is also important to stress that the analysed correlation between the principle of substantial transparency of public finance (providing proper instruction / information on these finances) and active citizenship might create a kind of cognitive dissonance. In theory the said correlation (the feedback effect) seems to raise no reservations – at least the authors endeavoured to prove its existence. This seems "obvious", given the fact that we agree with the statement that knowledge shapes an individual's awareness and behaviour. In practice, however, in the face of excessive amount of data on, for example, financial management of the country, as well as the complexity of the issue in question (multiplicity of terms, elaborateness of mechanisms of collecting and spending public resources, abundance of legal acts etc.), the shaping of active citizenship is effectively extremely difficult or practically does not occur, which, as the authors highlight, does not discredit the whole mechanism of the interactions but exposes the underlying problem, which is reflected in two main and interrelated issues:

- How should the information on public finances be provided?
- How should the financial decisions taken by public authorities be properly interpreted?

One should bear in mind, however, that the reluctance of public authorities, who are directly authorised to manage public resources and who derive some advantages therefrom, might present a certain barrier to properly informing the public on public finance as well. Paradoxically, the authority itself might be a beneficiary of the proper application of the principle of substantial transparency. Even though the pressure of society's awareness in assessing the way the public resources are spent forces the authority to justify (convince) that their financial decisions were appropriate, it promotes social acceptance of these decisions and subsequently provides approval of the implemented policy and ensures a continuity in holding office.

On the basis of the assumptions presented above, the authors believe that, instead of examining the correlation between substantial transparency of public finance and active citizenship, the methods and instruments implementing this principle should be researched in more detail. In other words the question of how knowledge on financial mechanism in the state should be provided becomes of key importance. The hitherto functioning of the principle of substantial transparency, focusing only on its formal/legal aspect, as well as targeting it at less or more professional stakeholders who have certain knowledge on the issue of public finances, needs to be modified. Namely, this principle, which was at the core of the theoretical dimension, should take into account the social aspect of scrutinising public resource management. In addition, as indicated above, even professionals tend to encounter problems with the appropriate interpretation of published financial data.

The question which has been posed above i.e. how to provide proper (accurate) information on public finance raises the need to completely re-define the principle of substantial transparency in the area of public finance. It seems that the fundamental condition for its effective application, from the citizen's point of view, is the motion to maintain adequacy i.e. to supply information appropriate to a stakeholder's educational level so that this information is comprehensible to them, which again raises the need to preserve the relevant scope and degree of detail, hence the need for financial education at various educational levels, as well as the education provided by non-governmental organisations.

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MONETARY POLICY IN THE TWENTY-FIRST CENTURY

Johan Schweigl, Jiří Blažek[1]

Abstract

The central banks carrying out monetary policy have already faced numerous extraordinary challenges in the Twenty-first century. As it is with many issues in the economy, most of these challenges are interconnected. Having to deal with the financial crises of 2007–2009, euro area sovereign debt crises, or low inflation or even deflation pressures, the central banks had to adopt certain unconventional monetary policy tools. In this paper, after presenting a brief overview of some the recent monetary policy actions taken by the central banks, the author ponders over the following questions: What is going to happen after the inflation target is reached? Will the central banks return to using the conventional tools only? What may be the other challenges of monetary policy in the Twenty-first century? The authors come to conclusion that the monetary policy is not going to return to the one prior to 2008. The future monetary policy will be strongly influenced by the macroprudential policy and new central bank issued "digital currency".

Keywords: Monetary Policy; Financial Crises of 2007–2009; Euro Area Sovereign Debt Crises; Central Banks; ECB; Federal Reserve System; Bank of England; Czech National Bank; Quantitative Easing; Negative Key Rates; FX Intervention; Interbank Market; Key Rates.

JEL Classification: E52

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1 Monetary Policy in General

In this paper, after presenting a brief overview of some the recent monetary policy actions taken by the central banks, I will try to ponder over some of the aspects that the central banks will have to deal with when conducting monetary policy in the Twenty-first century.

The objectives of monetary policy throughout the world are similar; the core objective of the monetary policy in the last decades is – in many countries – to maintain price stability. In the European Union, the primary objective of the European System of Central Banks (ESCB) is to maintain price stability (Art. 127 of the Treaty on the Functioning of the European Union). The European Central Bank's (ECB) Governing Council has announced a quantitative definition of price stability: *"Price stability is defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2 %."* (ECB, 2016, The definition of price stability). The inflation target is below, but close to 2 %. The American Federal Reserve System's (Fed) objectives in conducting monetary policy is to *"maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates."* (Section 2 A, Federal Reserve Act of 1913. 12 USC 225a. As added by act of November 16, 1977 (91 Stat. 1387) and amended by acts of October 27, 1978 (92 Stat. 1897); Aug. 23, 1988 (102 Stat. 1375); and Dec. 27, 2000 (114 Stat. 3028)). Fed's inflation target is 2 %. The Bank of England's (BoE) monetary policy objective is to deliver price stability – low inflation – and, subject to that, to support the Government's economic objectives including those for growth and employment. Price stability is defined by the Government's inflation target of 2 % (BoE, 2016, Monetary Policy Framework) The Czech national bank's (CNB) main objective in conducting monetary policy is to maintain price stability. As from January 2010, the inflation target of CNB is 2 %.

As we can see, the monetary policy objective of the central banks (in most of the "western" countries) is more or less similar – to maintain price stability (which is usually accompanied with support of the general economic policies, or low unemployment rate). Price stability is understood as 2 % inflation.

The central banks thus, by adjusting the supply of money in the economy, try to achieve some combination of inflation and output stabilization. It is generally believed that that in the long run output is fixed. Hence, any changes in the money supply cause prices to change, i.e. to increase or decrease. In the short run, however, prices (and mainly wages) usually do not adjust immediately; therefore, the changes in the money supply can also affect the actual production of goods and services (Mathai, 2009: 1). Therefore, monetary policy is usually able to influence both inflation and economic growth.

Money supply is – both directly and indirectly – influenced by the central banks. As the central banks are (in the modern countries) the sole issuers of banknotes (and often coins, too) and bank reserves, i.e. it is the monopoly supplier of the monetary base (comp. e.g. ECB. Monetary Policy of ECB, 2011: 55). These are thus created by central banks. Money supply, however, is a broader term than monetary base. Money supply[2] is *"total amount of money available in a particular economy at a particular point in time."* (Johnson, web, 2016). It also includes bank deposits.[3] Most of the bank deposits, as part of the money supply (money), are created by commercial banks during the process of lending (for more, see, e.g. Tobin, 1963). Thus, the amount of this form of money – bank deposits – is influenced by the central banks rather indirectly, for instance, mainly by setting the key interest rates or by some prudential requirements.

By means of monetary policy, the short-term interest rates are set by the central bank to "stabilize inflation". That is the core of monetary policy. Monetary policy can only exist in market-oriented countries, as prices in centrally planned economies are subject to direct regulation (Jílek, 2006: 146).

2 Monetary Policy of the Early Twenty-First Century

The early Twenty-first Century brought significant challenges to the authorities conducting monetary policy. The "stressed" interbank lending market at the wake of the financial crises of 2008 (for more, see, e.g. Alfonso et al., 2009), euro area sovereign debt crises (mainly 2011–2012), (for more, see, e.g. Rixtel et al, 2013. Frutos et al. 2016 or Allen, 2013) low inflation or even

2 Or sometimes referred to as 'money stock'.

3 The notion of money supply covers more types of monetary assets or monetary aggregates. For more, see, e.g. Mishkin, 2004: 1.

deflation pressures, are all more or less interconnected challenges which the central bankers had to deal with. Recent experience in sovereign debt crises has again demonstrated the strong interconnection between financial crises and bank funding (Rixtel et al, 2013). In the times of stress in the interbank market, the conventional monetary policy tools no longer work effectively, so the central banks had to start using so-called unconventional tools. ECB, Fed and BoE tackled numerous programs of quantitative easing (QE), ECB and Bank of Japan (BoJ) started setting negative rates (for more, see, e.g. Rejnuš 2016: 160), and CNB, after setting the key rates to "technical zero", started using the exchange rate as a monetary policy instrument.

Generally speaking, QE is to inject liquidity into the markets and help financial institutions, such as pension funds or insurance companies, get rid of some forms of assets they held, or to be more precise to transform it into other types of assets. QE has a direct effect on the quantities of both base and broad money, which is caused by the way QE is carried out. The respective central bank purchases "directly" assets from a financial institution, but the commercial bank at which the respective institution selling its assets to the central bank has its bank account is used as intermediary. The commercial bank credits the respective financial institution's bank account, whereas the central bank credits the reserve account of that commercial bank. In this way, new reserves (of the commercial bank) created are matched with new bank deposits (of the institution selling the assets). The central bank's balance sheet thus expended. It is expected that the new deposits of the financial institution may be used, for instance, for purchasing some low risk assets, such as government bonds, and the higher demand for the government bonds will consequently lead to reduction of yield on that bonds and will make it cheaper for the government to borrow in the capital markets.

Negative rates are also an unconventional instrument. Some consider them as an "experiment" of the monetary policy of the early Twenty-first century.[4] Negative interest rates have joined the long list of central banks' unconventional policies to deal with deflation and revive economic growth. In June 2014, ECB set the interest rate on deposit facility to below zero. Further cuts

4 For instance, see newspaper articles http://www.wsj.com/articles/japans-negative-rate-experiment-is-floundering-1460644639 or https://origin-www.bloombergview.com/articles/2016–04-13/lessons-from-japan-s-experiment-with-negative-rates.

followed soon, the latest took place in March 2016 (set at -0.4 %) (ECB. Key ECB interest rates, 2016). Central banks in Switzerland, Sweden, and Denmark have also followed this approach by cutting interest rates to negative territory. In January 2016, the Bank of Japan (BOJ) also joined, when announcing it would charge banks for excess reserves (Barua and Majumdar, 2016). Setting the interest rates on deposit facility below zero, the central banks try to motivate commercial banks to reduce their excess reserves and lend more. The rise in lending should support aggregate demand and consequently push prices up. Aside from that, as Barua and Majumdar underline, the ECB and BOJ are also concerned that low inflation, or deflation, could raise real interest rates (Barua, A., Majumdar, R., 2016).[5] Negative interest rates, they believe, will stem any rise in real rates (Barua, A., Majumdar, R., 2016: 23). In general, the idea of setting negative deposit facility interest rates is to induce commercial banks to extend more credit. Central banks usually pay interest on the excess reserves, i.e. the reserve that are held by the commercial banks in excess of the minimum reserves set by law. As the interest rates offered by the central banks are usually lower than money market rates, commercial banks prefer not to hold any excess reserves at their reserve accounts with central bank. Nevertheless, in the situation of higher risks – usually the counterparty risk – is on rise and the rates on interbank market are low, commercial banks usually choose to hold higher reserves on their reserves accounts. This leads to drops in credit extension. As Barua and Majumdar put it, *"the thinking behind negative interest rates on excess reserves is that banks will likely be forced to cut down on excess reserves and lend instead of incurring costs. This, in turn, will likely boost domestic demand.* (Barua, A., Majumdar, R., 2016: 24). There are, however, questions on the effectiveness of the negative rates. For instance, several members of the Board of Governors of CNB stated that although not excluding the use of the negative rates in the future, they would prefer not having to get to this negative territory (see, e.g. Benda, 2016, or Lízal, 2016). The most common arguments against the negative interest rates state that it is clear that the negative interest rates may force banks to change their portfolios significantly,

5 The real interest rate equals to the nominal interest rate minus inflation. If inflation is higher than the nominal interest rate, the real rate goes below zero. This means that in such a scenario, borrowers benefit at the expense of lenders, since although they pay nominal interest, their purchasing power increases. BARUA, Akrur. MAJUMDAR, Rumki, 2016).

often in a rather chaotic manner. They should not be understood as "further lowering of interest rates", as they are of very different nature. Aside from that, they can initiate higher demand for holdings of cash or they can lead banks to look for more risky assets.

Finally, CNB, when deciding what type of unconventional instrument to use, it started using exchange rate as a monetary policy instrument. When the key interest rates were cut to technical "zero" in November 2012, CNB stated that *"it emerged from the discussion that, given the zero lower bound on interest rates, a further easing of the monetary conditions – as assumed by the forecast for 2013 – could be achieved by influencing the exchange rate of the koruna". (*ČNB, 2012). This approach came to realization about a year later, when the Board of Governors of CNB decided to start using the exchange rate as an additional instrument for easing the monetary conditions. CNB stated that it will intervene on the foreign exchange market to weaken the koruna so as to keep the exchange rate of the koruna against the euro close to CZK 27/EUR (ČNB, 2013). The governor Singer explained that *given the zero lower bound on monetary policy interest rates, the forecast points to a need to ease monetary policy using other instruments. An alternative scenario quantifying the use of the exchange rate of the koruna confirms that a sustained weakening of the exchange rate is an effective instrument for accelerating the return of inflation towards the target."* ČNB, 2013).

It is known that although there are various stimulating monetary policy actions possible even when nominal interest rates are at – or close to – zero, the unconventional policies can be very costly. Hence, it is surely more difficult for monetary policy to deal with deflation than to fight inflation (ECB, 2011).

3 Considering the Possible Future Monetary Policies of the Central Banks

3.1 Macroprudential Influence on Monetary Policy

What is going to happen after the objectives of the monetary policy are met? Are the central banks going to smoothly return to using the conventional monetary policy tools? Before we try to draft possible answers to these questions, there is at least one more term to which we should pay

attention, i.e. financial stability. The crises of 2008 not only instigated the use of unconventional instruments of the monetary policy, but also brought attention to supervising activities of financial institutions that could have influence on financial stability. There was a relatively new term of "macroprudential" regulation or "macroprudential" policy. Although this term started to be used very often after the 2008 crises, its origins can be traced to late 1970 s, when it was mentioned in the meetings of a so-called Cooke commission at the Bank for International Settlements (BIS) and, also in late 1970 s, in the minutes of working group at the BoE led by Alexander Lamfalussy (comp. Gray, 2011).

Macroprudential policy may be defined as an *"application of a set of instruments whose aim is to reduce the vulnerability (or increase the resilience) of the financial system by containing the risks that individual financial institutions or the links between them may create for the system as a whole."*(ČNB, Macroprudential Policy, 2016). Thus, macroprudential regulation and supervision aims rather at the financial system as a whole, whereas "microprudential" regulation and supervision targets each financial institution as an individual.

Macroprudential policy may, thus, aim at slowing banks in "reckless" extension of credit. This goal may, however, seem to be in contrary to the monetary policy objective in times of low inflation, when central banks try to induce banks into more lending. Tomšík and Frait explain that finding an ideal mixture of the two policies is easier in clearly "good" times or evidently "bad" times. It is beneficial to loosen both these policies if economy is in strong recession. Low interest rates reduce the burden connected with debt service and contribute to keeping and reviving costs. Less impediments on credit expansion by loosening the macroprudential requirements also helps to avoid defects in financing production and avoid a steep drop in asset prices (Tomšík, Frait, 2015). There is, nevertheless, a specific problem, when the economy grows, output is close to its potential, but inflation is still far below the inflation target. If such a situation persists longer, it is likely that credit dynamics will rise in connection with higher demand for risky assets leading to price raise of such assets (Tomšík, Frait, 2015). Monetary authorities and macroprudential authorities (often the central banks) then find a mixture covering both loosen monetary policy and tight macroprudential

policy. In the Czech Republic, the central bank decided to stick to the loosen monetary policy, and simultaneously to partially tighten macroprudential policy (by setting higher rate of counter cyclical capital buffer).[6]

The abovementioned dilemma of central bankers is clearly not limited to the Czech Republic, but may be found in similar forms in other economies. It is thus clear that even after the deflation or low inflation pressures vanish, monetary policy will remain influenced by the new objective of macroprudential policy, i.e. to maintain financial stability. Shaping the correct mixture of the two policies might be more difficult in the countries, in which there are two independent bodies carrying out the two policies. Hence, it may be one of the supporting arguments for keeping the conduct of both, the monetary policy and macroprudential policy, within the hands of a single authority – most likely a central bank.

3.2 New Central Bank "Electronic" Money

Aside from this new regulatory framework and the "new" objective of financial stability, the central banks will deal with numerous other issues in the Twenty-first century. In this paper, I will shortly outline at least one additional issue that might become more discussed in the years to come. As we witnessed recently with the Swedish Riksbank (Skingsley, 2016: 1) there might be more talks about reduction of the use of cash. In her speech of November 16, 2016, Riksbank's Deputy Governor Cecilia Skingsley introduced the Riksbank's recent idea of issuing electronic means of payment, e-krona. Skingsley explained that cash is no longer as easily accessible as before means that the general public finds it more difficult to get hold of money issued by the Riksbank and instead often has to use money in bank accounts with the commercial banks. In other words, the use of central bank money in form of cash is declining, most of the means used by general public are commercial bank money (holding in accounts with the commercial banks). As it was discussed above, there are several ways in which the central bank may influence the credit expansion made by the commercial banks.[7] The current "electronic money" issued by the central banks is money that

6 As introduced in Basel III.

7 To mention a few, they are capital requirements and liquidity requirements.

can only be held at reserve accounts at the central bank; thus, only those required to have reserve accounts at the central bank can hold this type of money. Reserve account holders are credit institutions, mainly banks.

To make it short, the new idea introduced by Riksbanks is to start issuing "electronic money" for general public. It is still not clear what features this new type of money should have. The first question to deal with is whether e-krona should be booked in accounts or whether it should be some form of digitally transferable *"unit that does not need an underlying account structure, roughly like cash."* (Skingsley, 2016: 3) If the an account option prevailed, would the account have to be with the Riksbank? If not, where would it be? How could the central bank "electronic" money for general public be distinguished from the commercial banks money? Another important question, Riksbank put down for discussion, is whether e-krona should be issued directly to the general public or go via the banks; the banks would buy e-krona from the Riksbank and then give their customers access to them (Skingsley, 2016: 3). The idea of issuing digital currency was also studied by the Bank of England in 2016 (Bardear, Kumhoff, 2016).

There are definitely more questions that have to be answered and many challenges to deal with, but this recently introduced idea of Riksbank will sure form a more complex question for the central bank around the world. The vice governor of CNB commented on this idea that *"it is the same as if a new play that had been conducted only on the stages of small theatres, finally got to be in the National theatre."* (Skingsley, 2016: 3)

4 Conclusion

Monetary policy has been dealing with numerous challenges in the Twenty-first century. Some might to be partially overcome already, some are to come, yet. These extraordinary challenges forced central banks to start using unconditional monetary policy instruments, such as quantitative easing, negative key interest rates or start using exchange rate as a monetary policy instrument. Aside from the primary objective of most of the central banks, which is to maintain price stability (together with other tasks, as it was shown above), there is a „new" very important objective, which the central banks have to keep in mind when targeting inflation, they should also

maintain financial stability. This macroprudential goal will thus influence the monetary policy conducted by the central banks. Next, there are definitely more issues that the central banks will have to deal with in the Twenty-first century. One of them might be issuance of central bank "electronic" money for general public, as it is planned in Sweden. One of them might be issuance of central bank "digital" money for general public, as it is planned in Sweden, and as it was already studied by the Bank of England.

These new challenges will probably modify some of the monetary policy aspects that we had known in the Twentieth century.

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FREE MOVEMENT AND DIRECT TAXATION RESCTRICTIONS OF INDIVIDUALS

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Abstract

This contribution deals with free movement and direct taxation restrictions of individuals. The aim of this article is to present case studies of the CJEU in a scope of interaction between free movement of persons and freedom of establishment and the direct taxation of individuals and to answer whether share competences between the EU and Member States in direct taxation area causes problems of interpretation in Member States. Because of the fact that this article analyze the internal states' regulations in the sphere of exit taxation and its influence on free movement of person, the basic science method is the CJEU case law.

Keywords: Tax; Law, Tax Restrictions, Direct Taxation, Free Movement of Persons, Freedom of Establishment.

JEL Classification: K34

1 Introduction

The issue of direct taxation is sovereign power of European Union Member States. It is however limited as EU countries have to respect primary and secondary EU law when implementing domestic regulations. This means that in a certain sense the competence of Member States in the sphere of direct taxation is restricted by the Treaty of Functioning the European Union (TFEU) in which the concept of free movement is crucial (Lefevre, 2004: 501–516). This has been articulated by the Court of Justice of the European Union (CJEU) former the European Court of Justice (ECJ) which has stated that "although direct taxation falls within their competence, the Member States must none the less exercise that competence consistently

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with Community law" (ECJ: C-80/94, Wielock; C-175/88 Biehl; C-311/97 Royal Bank of Scotland; C-279/93 Schumacker; C-294/97 Eurowings).

This article has two primary aims. Firstly to present case studies of the CJEU in a scope of the interaction between free movement and the direct taxation of individuals. This area of research relates to the discord in the interests of Member States (disputes between states) as well as Members States and taxpayers (disputes between a state and a taxpayer). Secondly to answer the question whether the share competences between the EU and Member States in direct taxation area causes problems of interpretation in Member States. This is an essential question because sovereign authority in the area of direct taxation is closely related to budgetary revenues. Thus Member States can be tempted to implement various fiscal restrictions, which in turn can lead to an infringement on the free movement of people and as a consequence to a distortion of the single market. The freedoms of the single market do not operate in isolation from each other. Therefore an infringement of the free movement of people brings with it violation of the freedom of establishment.

This article is divided into competence in the sphere of direct taxation, free movement of persons, tax restrictions within the EU and finally the CJEU rulings in individual exit taxation cases.

Because of the fact that this article analyze the internal states' regulations in the sphere of exit taxation and its influence on free movement of person, the basic science method is the CJEU case law. The question of free movement of persons and income tax law was the subject of research carried out by prof. van Thiel, 2001: 1–645 which constitutes the most important source in this field. Other publications also study this subjected for example, Barents, 2009: 181–198; Raitio, 2012: 569–585.

2 The relationship between Free Movement of Person and Direct Taxation

2.1 The Division of Competence between the EU Member States in Direct Taxation

The EU is an organization within the framework of which Member States are obliged to conform to its decisions or can also decide individually.

Article 5 of the Treaty of European Union (TEU) defines competence as the principle of conferral, whether this is exclusive or shared. Preemption can be an element or not of shared competence. Direct taxation has an influence on trade between Member States and is an integral part of the internal market being a shared competence with preemption. As a consequence the Member States can no longer regulate a tax issue in area, ones the EU has carried out its competence (Raitio, 2012: 570).

The issue is extremely complicated because on the one hand the EU is not entitled to raise taxes. The only possibility of introducing a new direct tax is with the unanimous agreement of all Member States which has always been difficult to achieve and in the present climate almost impossible. For this reason there are no direct taxes imposed by the EU apart from a very miner one on the income of EU officials. On the other hand the role of the European Parliament is severely limited in this sphere, because of the fact, that it has no power to impose, change or reject taxes which could be introduced at the EU level (van Thiel, 2001: 12–13). However the EU and Member States do share competences in the area of direct taxation which is a result of the legislative and treaty making powers. As far as indirect taxation is concerned, there are no specific norms to harmonize direct taxation in the TFEU. There are, however, regulations of internal market which provide a legal basis for the introduction of direct tax norm to assist in the further economic integration. This is especially the case in the area of facilitating the elimination of trade barriers which are incompatible with a competitive market. Because of the above reasons, individual Member States introduce their own direct legislation with the EU taking on a supervisory role to ensure that internal Member State regulations do not infringe on Treaty provisions.

2.2 Free Movement of Persons

The free movement of persons is one of the four economic freedoms: free movements of goods, services and capital within the EU. It is an integral element of the internal market and forms the basis of European integration. The free movement of persons was set out in the Treaty of Rome of 1958and expanded in the Schengen Agreements of 1985.

Today the legal basis of the free movement of persons is Article 45–48 of the TFEU[2] which means that the right of free movement of persons within the internal market is understood as the right to exit one's home state and access or enter a host state. Currently the right to the free movement of persons is an element of EU citizenship although initially it was presented exclusively in economic categories as the freedom of movement of workers (Borawska, Kędzierska, 2007: 31).

2.3 Tax Restriction within the EU

In some cases CJEU did not concentrate on discrimination but rather on restrictions. It is worth emphasizing that notion of restrictions of the CJEU is too broad. This results that its interpretation in direct tax context is difficult and causes practical problems (Douma S.: 2011: 10). Tax restrictions are bound with the differences which exist between the legal systems of individual Member States. It is necessary to pose the question whether the lack of harmonization of direct taxation does not cause a distortion of the internal market since all Member States implement internal regulations which are binding only in certain areas. It seems to me that the lack of harmonization itself does not cause any distortion because the TFUE covers the principle of non discrimination as well as free movement. The most important thing is that each Member State respects these regulations to further EU integration.

The free movement of persons means that individuals have the right to enter and move around within the territory of another Member State as well as the right to stay there in order to work and live under certain conditions, after having worked there. As a consequence, generally, domestic regulations contain measures which create barriers to an influx of people for example workers. For this reason EU law concentrates on barriers limiting access to individual markets and not on exit restrictions. The similar situation

2 There are also Articles 4(2)(a), 20, 26 TFEU, Article 3(2) of the Treaty on European Union (TEU); Directive 2004/38/EC on the right of citizens of the Union and their family members to move and reside freely within the territory of the Member State and other sources such as: Regulation (EU) No 492/2011 on freedom of movement for workers within the Union and Regulation (EC) No 883/2004 on the coordination of social security systems and its implementing Regulation (EC) No 987/2009 and case law of the CJEU.

is regulated by the TFEU in the free movement of goods which above all focus on measures discriminating imported goods and not exported ones.

The tax issue of the right to exit ones country of residence in order to move around in the territory of another Member State can be treated as a controversial tax burden. Exit tax is closely bound up with the principle of territoriality (Világi, 2012: 346) because the sovereignty of a Member State allows for the taxation of unrealized capital gains, hidden reserves and value increases of an individual's assets (Govind, 2016: 554). As the extend of a State's income is derived from taxes levied it is in the interests of the State to ensure the widest possible tax base. Therefore an exit tax derived from a change residency or a transfer of assets is one of the measures used by a state to protect its interest. Fernando de Man and Tiiu Albin, amongs others, consider that primarily a tax can be treated as an exit tax when a taxpayer leaves his country of residency and the value of his capital gains is unrealized (Man, Albin, 2011: 613). Normally, capital gains or increases in value are taxed when they are realized, whereas exit taxes are understood to be realized when the taxpayer exits the country of origin. According to R. Betten, states raise exit taxes exclusively for fiscal reason (Betten, 1998). In my opinion this is correct and there is no need to seek further regulations. This kind of tax is a practical problem as it does exist in countries such as France and the Netherlands and outside of the EU in Australia and Canada (De Broe, 2002: 23–29). This tax burden must be paid at the moment the taxpayer relocates to another country.

Internal regulations which tax movement of people and the transfer of assets to another Member State can infringe on freedom of establishment. This results from the fact that it based on the same principles as the Treaty regulations concerned with the free movement of workers. (ECJ: C-107/94 P.H. Asscher). It is crucial that both freedoms always involve an economic interest (Helminen, 2011: 64).

Freedom of establishment is included in Article 49 of the TFEU, which states " within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any

Member State established in the territory of any Member State. Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital". This means that this freedom applies to EU citizenship and contains not only market access but market equality as well.

It is not advisable to generalize on the subject of the exit taxation. It is not the case that every tax implemented by a state is prohibited. Two different situations are to be defined here. The first is when the state of residency expresses its disapproval that its taxpayer intends to exit its territory. In order to do so effectively it levies a tax which takes on the form of a sanction. In the second instance a tax is treated as an element of the tax system. And therefore occurs more often than the first case because it comprises not only taxpayers who take advantage of the exit right but also residents who remain within the borders of a Member State. Consequently the real intention of the state in both instances is of utmost importance: in the first example the penalty is treated as a tax even though it is not and is prohibited. In the second example it is permitted unless it leads to discrimination.

The right to enter is an elementary right of each citizen within the framework of the free movement of persons. This is defined as the possibility of freely moving around and between the Member States of the EU for its citizens. This right is also enjoyed by family members of EU citizens who are not citizens themselves of one of the Member States. This right is not absolute. Permitted limitations on the freedom of movement of persons result from the CJEU and must be justified in accordance with public order, public safety or public health. The CJEU has also ruled that necessary requirements implemented by Member States are also permitted. Amongst these there are three kinds of tax restrictions: firstly limitations in the form of direct taxation on entry to a Member State (direct entry restrictions), secondly indirect taxation on access to the market (indirect limitations on access to the market) and thirdly limitations such as non discriminatory taxation on access to the market.

Direct entry restrictions are understood as any difficulties imposed on non residence when crossing the state borders of a host nation. These are formal limitations other than a valid identity card, passport or monetary requirement when crossing the border of a Member State. Currently the category of taxes levied on entry to the territory of a host state is purely theoretical and does not occur in any EU Member State.

Indirect limitations on access to the market include any restrictions of a host nation which hinders the free movement of people. These can be higher tax rates for non residence leading to higher cost of conducting cross border business which is regarded in the TFEU as discrimination.

Non discriminatory taxation on access to the market has not been clearly defined in the rulings of the CJEU. This results from the fact that the CJEU has not been unequivocal in its position on the question of whether non discriminatory tax barriers are at variance with EU law. For example in the case of Biehl General-Advocate Darmon pinpointed non discriminatory exit restrictions but the ECJ did not take his arguments into considerations. Also in the case of Bachmann (ECJ: C-204/90 Bachmann) the Commission stated that Belgian tax regulations limited the free movement of workers (including Belgian citizens), which is prohibited by the Treaty. In this case General-Advocate Mischo stated that limitations on free movement of persons do not result from a discrepancy in an understanding of the rights of Member States and nor are they justified by public safety concerns. Furthermore the ECJ agreed with General-Advocate Mischo argumentation but did not go so far as to state that these measures constitute prohibited non discriminatory restrictions.

2.4 The CJEU Rulings in Individual Exit Taxation Cases

From my point of view Member States can take advantage of the sovereignty by imposing an exit tax to discourage transfers of residency and assets. This however constitutes barriers to freedom of establishment and as a result can distort the correct functioning of single market. Hence, I would like to review the decisions of the CJEU in this area to identify whether Member States really do introduce an exit tax on a regular basis to create barrier.

The first case in which the CJEU dealt with exit taxation on individuals was that of Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie (De Lasteyrie de Saillant) (ECJ: C-9/02). This is of particular interest as it is the only time when a Member State has tried to justify the imposition of an exit tax in order to prevent tax avoidance.

In this specific case a French citizen moved his fiscal residency to Belgium. According to Article 167 a the French CGI a taxpayer who intends to transfer his place of residency outside France for tax purposes is due to pay a tax on unrealized income unless the taxpayer retains his place of residence. The French State then taxed the individual on the unrealized capital gains of his shares in a French company. The justification of the French government was that the imposition of an exit tax was necessary to protect its tax base and to prevent tax avoidance. The Danish, Dutch and German governments stated that this regulation does not constitute a barrier for the free movement of establishment and thus there is no discrimination. The Portuguese government claimed the opposite stating that Article 167 a CGI should be interpreted as a barrier in the area of freedom of establishment. A taxpayer who intends to change his tax residence is due to pay tax on unrealized income, whereas for a taxpayer who stays in France the subject of tax is so-called realized income. Therefore the French regulation constitutes a typical example of restrictions resulting from exit from a territory. In the face of such divergent viewpoints represented by different Member States it has been crucial for the CJEU to make rulings beneficial for further EU integration. In fact the CJEU has stated that this regulation does limit the free movement of establishment and all restrictions, even those of a limited range are prohibited. Direct taxation is also included in this subject, even though it belongs to the sovereignty of Member States.

Another case, N v. Inspecteur (ECJ: case C-470/04), although similar to the proceeding one, does not taken into consideration capital losses after transfer losses. This case involved a Dutch resident who emigrated to the United Kingdom. He took with him a substantial shareholding in three Dutch companies, which interestingly were managed from the Netherlands Antilles. He was registered as a sole owner. According to Dutch tax regulations, a taxpayer is granted 10 years to pay tax. This tax is, however, waived if no shares

are sold within this period time. However this system was not granted automatically and unconditionally. According to N. the internal regulations were unacceptable. To resolve this dispute The ECJ stated that conditional conservatory assessment with extension of payment was in itself acceptable under freedom of establishment but the security requirement was not. The Dutch authorities acquiesced to the decision of the ECJ and canceled the requirement of a bank guarantee a security. This decision was not satisfactory to N as he believed that the imposition of a bank guarantee was unlawful at the time it was imposed. The ECJ ruled that the taxpayers right to enjoy his assets given as a guarantee were restricted and that decreases in value of his assets were not considered meaning that the tax was unfairly set at the moment of transfer. Additionally, the ECJ ruled that the requirement of N to make a tax declaration at the moment he transferred his residence was additional formality which limited his freedom of establishment.

To summarize, the last two cases as described above were dealt with by the ECJ quite differently. The Dutch system was justified in its approach to ensure a balanced allocation of taxing powers, but the French exit tax was found to be unjustified.

The third case illustrates the Commission's interest in ensuring smooth EU integration, particularly in relation to the freedom of movement between Member States. In the case of Commission v. Spain (CJEU: C-269/09) the issue concerned whether national regulations discriminate against tax payers wishing to transfer their residence in comparison with those who retain the Spanish residency. Internal tax regulations of the Kingdom of Spain stipulate that individuals leaving its territory have been obliged to pay a tax on future unrealized income based on the amount of tax paid by them in a previous fiscal year. This necessity has not been binding for tax payers who plan to retain the Spanish residency. The CJEU found that this legislation constitutes a barrier to the freedom of movement and to the freedom of establishment. In its ruling the CJEU stated furthermore that income is taxed there were it is generated which means that the Kingdom of Spain can not anticipate tax generated from income in the future host state of the individual tax payer. I am convinced that the ruling of the CJEU was fully justified because a Member State cannot put its own tax jurisdiction above the fundamental EU free movement

of persons and freedom of establishment. A Member State's sovereignty cannot interfere in an individual's right to generate income simply by transferring his activities or assets to another Member State. I also agree with the CJEU when it stated that the Kingdom of Spain has violated Article 18 of the TFEU and has thus acted in a discriminatory manner.

The most recent case, Commission v. Portugal (CJEU: C-503/14) involves the issue of a taxable persons cash flow. The Republic of Portugal imposed a capital gains tax on unrealized income for individuals wanting to transfer their residence outside Portugal whereas taxable individuals maintaining their residence in the country would only pay the tax after the capital gains had been realized. The CJEU ruled that this regulations also constituted a barrier to the free movement of individuals and to the freedom to establishment. It is worth noting that in this case Portugal defended its position in a similar way to other Member States in similar cases I have already discussed, even thought the CJEU has clearly ruled that this practice of imposing an exit tax is at variance with the basic freedoms of the EU Member States still try to take advantage of their sovereignty in this matter.

3 Conclusion

Tax matters have been always crucial, ever since the foundation of the EU. However, they are closely related to the sovereignty of Member States. This results from their sensitive character as they concern budgetary revenues. Direct taxation is not mentioned in the TFUE and is therefore not as harmonized in such an advanced way as indirect ones. Nevertheless, the free movement of regulations has raised taxes to the concept of the single market. The strong nature of the sovereignty of Member States in this area means that direct taxation remains the competence of Member States, but it is necessary to remember that the existence of shared competences means that the EU could also implement regulations in this sphere. In practice, however, there is little probability that all Member States would agree to the introduction of new direct tax in a special legislative procedure within the framework of the EU. Likewise, the role of the European Parliament has little significance in this matter. Thus, on the one hand Member States are free to set the concept of direct tax system, but on the other do not do so in an absolute way as this has to meet single market provisions.

The issue of exit taxes is a practical example of how Member States exercise the power of sovereign territory and are often employed when a taxpayer intends to change his residency. This kind of levy is associated with the depletion of budgetary income tax revenues. The state, in order to prevent the loss of untaxed assets from its jurisdiction, obliges an individual to pay a tax. As a result such actions always have a fiscal character. This is due to the fact that exit taxes are linked to free movement of persons and are often related to the restriction of free movement of establishment. From my point of view an analysis of tax disputes such as: Lasteyrie de Saillant, N v. Inspecteur, Commission v. Spain and Commission v. Portugal shows that Member States have tried to do two things: firstly, to interpret exit taxes in various ways, and secondly to create barriers to free movement. This shows that the issue of shared competences between the EU and Member States in the tax sphere has caused problems of interpretation and that there is an urgent need to seek a solution to this problem at the level of EU secondary law. I am convinced that due to regionalization and globalization there will be an ever increasing number of cases related to exit taxation.

The above research indicates that the CJEU is at the forefront of the issue of exit taxes. It is involved in the infringement procedure, where many national regulations are incompatible with EU law and preliminary rulings which allow supervision of the proper application of the law. The CJEU has to interpret which national direct tax regulations are for EU legislation and which are not. This means that its judicatory activity is to issue rulings on whether Member States exercise their sovereign power in accordance with the EU or violate it. Therefore, the CJEU has a responsible task in pointing out the limits of fiscal sovereignty and in every single tax dispute.

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LEGAL AND ETHICAL ASPECTS OF FISCAL RULES IN POLAND

Urszula Kinga Zawadzka-Pąk[1]

Abstract

Aim of this paper is to analyse whether the fiscal rules resulting from binding EU and national legal regulations are sufficient to ensure the sustainability of public finances. A case study of fiscal rules binding for Poland (the EU rules and the national ones) is conducted here to test the hypothesis that the legal provisions are not sufficient to effectively reduce the level of the general debt and deficit. The statistical and substantial analyse indicate the examples of the creation and the application of legal norms where moral norms are missing. The confirmation of the hypothesis suggests the need of further research on the moral values and the internal motivation of the politicians (the legislator) and the citizens (the civil society) to ensure the sustainability of public finances. The research is based on the unobtrusive method consisting in the content analysis of EU and Polish legal regulations and the existing statistics analysis.

Keywords: Fiscal Rules; Effectiveness; General Government; Debt; Deficit; Moral Values.

JEL Classification: H30, H60

1 Introduction

The fiscal rules are the permanent constraint on fiscal policy, typically defined in terms of an indicator of overall fiscal performance. These rules cover summary fiscal indicators, such as the government budget deficit, borrowing, debt, or major components thereof – expressed as a numerical ceiling

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or target, in proportion to the gross domestic product, GDP or being procedural limitations (Kopits, Symansky, 1998: 15; Corbacho, Ter-Minassian, 2013: 40). The aim of the fiscal rules is to ensure the fiscal sustainability that "relates to the ability of a government to assume the financial burden of its debt in the future. (…) There is no defined upper limit of sustainable debt levels. Sustainability limits differ across countries and over time" (Fiscal, 2012: VII).

In context of the sustainability of public finances, the question arises whether the public authorities must be empowered to conduct discretionary fiscal policy or, on the contrary, limits to this one must be defined (Riou, Zawadzka-Pąk, 2015: 4). Some of the economic theories critical in this regard, especially (neo) liberal ones consider the controlling the fiscal policy by Constitution, treaties, and acts as indispensable. This idea was developed in particular by Kydland and Prescott who have found that "*a discretionary policy for which policymakers select the best actions, given the current situation, will not typically result in the social objective functions being maximized. Rather, by relying on some policy rules, economic performance can be improved*" (Kydland and Prescott, 1977: 473–474).

The aim of the paper is to analyse whether the fiscal rules resulting from binding EU and national legal regulations are sufficient to ensure the sustainability of public finances. A case study of fiscal rules binding for Poland (the EU and the national ones) is conducted here to test the hypothesis that the legal provisions are not sufficient to effectively reduce the level of the general debt and deficit. The statistical and substantial analyse indicate the examples of the creation and application of legal norms where moral norms are missing. The confirmation of the hypothesis will suggest the need of further research on the moral values and the internal motivation of the politicians (the legislator) and the citizens (the civil society) to ensure the sustainability of public finances. The research is based on the unobtrusive method consisting in the content analysis of EU and Polish legal regulations and the existing statistics analysis.[2]

[2] The paper contains selected issues presented during the European Group for Public Administration (EGPA) Conference that took place in August 2015 in Toulouse (France). Presented and published paper: C. Riou, U.K. Zawadzka-Pąk, Failure or Success of Fiscal Governance Rules? Case Studies of France, Poland, and Switzerland (2015).

2 EU and National Fiscal Rules

2.1 EU Fiscal Rules

The participation in the European Union has required some coordination of national fiscal policies. Thus, the Treaty on the EU, signed on 7 February 1992, known as Treaty of Maastricht, has conditioned eligibility for Euro at compliance by the states of a number of criteria that were later included in the Stability and Growth Pact of 7 July 1997 (originally comprising a resolution and two regulations). Since then, EU member states shall avoid excessive general government deficits and respect the reference values set to 3 % for the ratio of the planned or actual general government deficit to the GDP and 60 % for the ratio of the general government debt to the GDP.

Since 2010, the public debt crisis in Europe has revealed the need for a better coordination of economic and budgetary decisions. In consequence, the "Six-pack" (including six legislative acts: five regulations and Directive 2011/85/EU which entered into force on 13 December 2011) and the "Two-Pack" (including two regulations, which entered into force on 30 May 2013), have reformed the rules of Stability and Growth Pact. The measures aim to increase budgetary discipline of the member states and to reinforce the governance of the EU in regard to surveillance of national budgetary policies, in particular by introducing more coercive measures. Moreover, the international agreement between members states, called "Fiscal Compact" was signed on 2 March 2012, strengthening the rules on public finances of the member states.

Poland having accessed the EU structures in 2004 adopted the provisions of the Treaty and the Stability and Growth Pact, however, contrary to the Eurozone members only its preventive, and not repressive arm applies. In consequence, due to exceeding the accepted limit of the deficit, in years 2004–2008 and 2009–2015 Poland was covered by the EU excessive deficit procedure. Poland is partially bounded by the provisions of the "Six-pact" (but not by the "Two-pack") and also signed the Fiscal Compact, however, the majority of its provisions will be bounding for Poland after the Eurozone accession. (Riou, Zawadzka-Pąk, 2015: 8–11).

2.2 National Fiscal Rules

The Polish Constitution contains two fiscal rules: the budgetary deficit rule and the public debt rule. According to the first one, having a procedural character, the increase in expenditure or the reduction in income from those one planned by the Council of Ministers may not lead to the adoption by the parliament of a budget deficit exceeding the level provided in the Budget Bill (Constitution, art 220/8). In turn, the public debt rule prohibits to contract loans or to provide guarantees and financial sureties which would engender public debt exceeding three-fifths of the GDP (Constitution, Art. 216/5). Setting the limit of 60 %[3] constituted unprecedented transposition of the EU regulations to the Constitution of the EU member, even if it was not mandatory (Constitutional Court: K 40/02). The constitutional legislator, giving the constitutional character to the EU disposition could be too zealous (Granat, 2013: 404–405), however, constitutional debt rule generally is assessed as the exceptional and innovatory solutions protecting the Polish public finances (Dębowska-Romanowska, 2010: 120).

Following the covering Poland by the EU excessive deficit procedure, in 2009 the disciplining expenditure rule was introduced. It covered a major part of the flexible state budget spending but not the legally determined ones. Thus, the effectiveness of this rule was limited. It assumed a moderate increase of a part of the state budget expenditure: its maximum level was calculated by adding the inflation forecast and one percent to the expenditure planned for the previous year.

This disciplining expenditure rule was abolished and replaced in 2014 by the stabilizing expenditure rule as a part of the process of the implementation of the Council Directive 2011/85/EU. Contrary to the previous rule, this one covers the whole general government sector. However, the complexity and non-transparent manner of the formulation of the rule make it incredibly difficult to parliament and to citizens to monitor the compliance with the restrictions in practice. It is enough to say that the mathematical formulas, the explanation of abbreviations used there, the exceptions from the rule and the description of the expenditure limit correction mechanism take

3 This constitutional limit was introduced when the public debt amounted to 42 % of the GDP.

almost five pages. Substantially, the rule sets a limit of expenditure increase of general government expenditure. In the stable public finances situation, the expenditure limit will be derived from the medium-term of the GDP growth and the situation of excessive debt or deficit, this growth will automatically be reduced, to prevent pro-cyclical fiscal policy. The rule contains in its construction the correction mechanism aiming at automatic correction of imbalances in public finances in three cases: the general government deficit is above the reference value of 3 % of the GDP, the level of public debt exceeds 43 % or 48 % of the GDP, the sum of the differences of deviations from the nominal medium-term budgetary objective exceeds +/- 6 % of the GDP.

The disciplining expenditure rule should help to respect the constitutional debt rule. Similar function has been realized by the recovery procedures obligatorily implemented when the level of public sector[4] debt in relation to the GDP: 1) is higher than 50 % but not higher than 55 %, 2) is higher than 55 % but smaller than 60 %, 3) is equal or higher than 60 %. These procedures contain the fiscal policy restrictions becoming more and more severe from the first procedure to the third one. The first procedure (already abrogated, compare below) obliged the Council of Ministers to adopt for a next year the Budget Bill in which the relation of the budgetary deficit to the budgetary revenues was not higher than the relation of the same values adopted in the currently binding Budget Act. Due to exceeding public debt limit, the restrictions of this procedure must have been implemented to the preparation of the Budget Bill for 2012 and 2013. However, Polish authorities during the preparation of the budget bill for 2014, instead of trying to respect the

4 Even if Poland joined the EU in 2004, still two methodologies of public debt and deficit calculation are used: the national and the EU one (previously ESA 95 and currently ESA 2010). They differ not only by the method of calculating (the cash method in the national methodology, and accrual basis in the EU one) but by the scope of entities included or not in the public finances sector). The differences are important. Over time only some methodological differences were eliminated, unfortunately, the new ones were introduced. Such dualism surely does not promote the transparency and credibility of the system on the one hand, and increase the risk of manipulations on the other hand. For instance, within the Polish Development Bank (Pol. *Bank Gospodarstwa Krajowego*) exists the highly indebted Road Fund, which according to the national methodology is beyond the public finance sector (contrary to the EU one). It is why, the public debt level applied to decide about the necessity of recovery procedure application is lower by a several percentage points than the public debt according to the EU methodology (the ratio of public debt to the GDP in 2014 according to Polish methodology amounted to 47.8 % of GDP and according to the EU one, i.e. general government debt – 50.1 % of GDP).

limitation, firstly suspended and next repealed this procedure. Therefore, currently, there are only two recovery procedures. The most severe restrictions of the first existing one concern: planning the budget deficit (it is possible only if the adopted deficit guarantees at the end of the budgetary year a ratio of the state Treasury sector debt to GDP smaller than in the previous year), raising public administration remunerations, indexation of pensions, investments financing, local government units deficit planning. The above-mentioned restriction must be applied as well in the case of starting the last procedure. Additionally, it prohibits to issue any guaranties from the state budget, the interdiction of voting local budgets with the deficit has an absolute character. Although so far there was no obligation to start these two procedures, it should be noted that if to the calculation of public debt the EU methodology (and not the Polish internal one) had been used, the first currently existing procedure should have been applied in relation to the Budget Bill for 2013 and 2014 as well, but they were not.

Finally, there are two four-year plans aiming to realize the fiscal policy.

Firstly, the State's Multiannual Financial Plan (SMFP) was conceived as an instrument of the Council Directive 2011/85/EU implementation. The first four plans[5], annually actualised, contained the data about the whole public sector (the objectives of the socio-economic and fiscal policy, the forecasts of public debt) as well as the forecasts concerning exclusively state budget in its traditional and performance approaches. However currently, the SMFP consists of convergence program and objectives and indicators of the main state functions of performance budget. In consequence, it can be said that, previously existed separate national multiannual planning was eliminated and conserving the name of SMFP, and replaced by the document obligatorily prepared for the EU institutions. Moreover, there is no legal obligation to respect the planned values and in consequence, there is no sanction in case of failure to respect them. The SMFP is not executed (contrary to the Budget Act) so the planned values can be (and sometimes are) quite pessimistic, and then in the reports on the MFSP realisation it is presented that the public deficit reached in the first year of MFSP only the level of 86 % of the planned value (plan for 2012–2015), or even 62 % (plan for 2011–2014).

5 I.e. for the following periods: 2010–2013, 2011–2014, 2012–2015, 2013–2016.

Secondly, the Minister of Finance draws up a four-year strategy, non-actualised, for public debt managing, taking into consideration in particular the following: conditions of debt management connected with the macroeconomic stability of the economy, an analysis of public debt level, forecasts of public debt level and the state Treasury debt, forecasts of the costs of servicing the state Treasury debt, shaping the debt structure, forecasts and analysis of liabilities on account of the guarantees of the state Treasury. The Minister of Finance submits the strategy to the Council of Ministers for approval, then the approved document is submitted to the parliament together with a justification of the Budget Bill. The strategy is not voted by the parliament, there is no legal consequence when the planned valued are not achieved. There is no report about the strategies realization.

3 Effectiveness of Fiscal Rules in Poland

3.1 Statistical Approach

The effectiveness of fiscal rules in ensuring the fiscal sustainability can be appreciated using the level of public deficit and debt. The scope of the general government sector and the method of calculation of general government deficit and debt result from European Accounting System (ESA) 2010 regulated by the EU regulation. The figure no 1. presents the general government debt and deficit in Poland starting from 2004, i.e. the year when Poland became the EU member.

Figure 1. General government deficit and debt in Poland in the period 2004–2015 in relation to gross domestic product (GDP)

Year	General government debt	General government deficit
2004	45.0 %	- 5.0 %
2005	46.4 %	- 4.0 %
2006	46.9 %	- 3.6 %
2007	44.2 %	- 1.9 %
2008	46.3 %	- 3.6 %
2009	49.4 %	- 7.3 %
2010	53.1 %	- 7.3 %
2011	54.1 %	- 4.8 %
2012	53.7 %	- 3.7 %
2013	55.7 %	- 4.1 %
2014	50.2 %	- 3.4 %
2015	51.1 %	- 2.6 %

Source: Eurostat

Even if there is no common criterion of the sustainable (safe) level of debt and deficit, "the less criticized" criterion are the general government deficit and debt ratios required by the EU regulations, that amount to 3 % of GDP and 60 % of GDP, respectively. Concerning the general government debt, Poland has never exceeded the accepted level, even due to the last financial and economic crisis that started in 2007 the debt threshold was not exceeded. The situation is different in the case of the general government deficit. The acceptable level was exceeded ten times in Poland's twelve years history of the adherence to EU structures. Even the existence of the EU excessive deficit procedure did not prevent Poland to plan or realize the general budget deficit above the acceptable threshold.

3.2 Substantial Approach

The analysis of the application of fiscal rules, both, the EU and the national ones is not fully effective, leading to the excessive deficits, threading to the public finances sustainability.

First, even if the EU provisions oblige to respect the thresholds of the general government deficit, as mentioned above, during ten out of twelve years of Poland's membership in EU structures, the deficit exceeded 3 % of GDP. Moreover, taking into consideration the decided level of budgetary revenues and expenditure set in state budget bill for 2017 and the revenues and expenditure of other units, the sold thereof is taken into account into general government deficit calculations, the Ministry of Finances forecasts that the general government deficit in 2017 will amount to 2.9 % of GDP, so close to the accepted level. However, as many experts speculate, the revenue forecasts are overly optimistic and in consequence, at the end of 2017, the general government deficit will be much above 3.0 % of GDP. Hence, probably Poland again will not respect the accepted general government threshold and in consequence, will be covered the third time by the excessive deficit procedure, the Polish authorities being aware of these consequences.

Second, one of the most important national fiscal rules in Poland is the constitutional, quantitative public debt rule, that not only prohibits to contract loans or to provide guarantees which would engender the public debt exceeding the three-fifths of the GDP, but it obliges to conduct the fiscal

policy in such a way that the debt of all public sector never exceeds 60 % of the GDP threshold (Panfil, 2011: 232). To ensure compliance with the Constitution, three recovery procedures were introduced being in some sense "inscribed" in the Constitution as well (Dębowska-Romanowska, 2010: 120) However, when the first of them was applied and effectively restricted the level of budget deficit, the legislator decided to abrogate it. There was not enough determination to act in compliance with the fiscal rule. Even if the government tried to explained that the reason of the abrogation of the first prudential procedure (and of the temporary expenditure rule) was its replacement with a new instrument, i.e. stabilising expenditures rule, it is disturbed that the Polish parliament, having exceeded the prudential threshold, abrogates the procedure and adopts a budget for the next year with a higher deficit. Such action should be assessed negatively, even if we can only presume that the government at all costs wanted to avoid starting once again prudential procedure (limiting the deficit level and consequently the expenditures one), perhaps in fear of the consequences of political and social assessment expressed during the parliamentary elections that approached then. The example showed that the parliamentary majority can abolish every fiscal rule becoming too restrictive for their actions by simple modification of binding act. (Lotko, Zawadzka-Pąk, 2014: 102).

Third, the mentioned above stabilizing expenditure rule was applied for the first time to the budget for 2014. Respecting of this rule depends on the expenditure values planned in the Budget Act and then executed ones. However, the calculated amount of the limit was not indicated nor in the Budget Act nor it its justification, whereas the mathematical formula is so sophisticated that only a specialist in the economy can calculate the admissible sum of expenditure. The execution of the state budget, including the verification of observance of the rule is controlled by the Court of Auditors. As we can read in its report on the budget execution, in the Budget Act for 2014 the planned limit for expenditure rule amounted to PLN 325.3 billion and the realized amount was PLN 335 billion. There are no legal consequences of such a difference between the planned and executed values. Moreover, the citizens do not know if the required limit was respected. Although there is the obligation to provide the information

about the maximum accepted level of expenditure for the units covered by the rule, however, as a limit provided in the budget can be lower that the maximal limit resulting from the law, still the citizens do not know if the fiscal rule was respected

Fourth, Poland due to exceeding the accepted general government deficit level since 2009 was covered by the excessive deficit procedures that have been on 19 June 2015, has been closed because the general government deficit decreased from 4.0 % of the GDP at the end of 2013 to 3.2 % of the GDP at the end of 2014 and the general government debt decreased from 55.7 % of the GDP to 50.1 % of the GDP, respectively. However, the reductions did not resulted from a reform concerning the expenditure structure but mainly from the highly controversial reform consisting in transferring at the end of the year PLN 153 billion from open pension funds to the state Social Insurance Fund (this amount constituted the equivalent of 40 % of all revenues planned in the Budget Act for 2013). The government officially admitted this reform, prepared in a hurry, was mainly aimed at the public debt reduction in order to avoid entrance into recovery procedure and at the general government deficit reduction that enabled abrogation of the EU excessive deficit procedure. Therefore, the question arises why the previously existing fiscal governance rules and the new ones had not enabled to ensure the acceptable level of public debt and deficit without this expensive, controversial and probably detrimental, as it is already raised, for Polish public finances reform.

Fifth, the Directive 2011/85/EU provides a series of measures aiming to reinforce fiscal governance of the EU members. Even if Poland has implemented its provisions, it was made complying with the minimal requirements. First, the numerical fiscal rule was introduced as the stabilizing expenditure rule, however being incomprehensible not only for citizens but also for politicians voting it, is difficult to control and in consequence has a low credibility level. Second, medium-term budgetary frameworks were introduced, however, the State Multiannual Financial Plans actualised every year, having a form of a simple government resolution and without sanctions for non-compliance of its provisions are deprived of binding force. Third, to enforce fiscal policy foreseeing, the Directive encourages

to create independent bodies (fiscal councils). Even if the Commission still recommends it to Poland, no legal actions are even planned. At the beginning of 2015, the Minister of Finance during a press conference argued that: "functions provided for such a body are already distributed in Poland for the Court of Auditors, the regional courts of Auditors and the Tripartite Commission representing the government, employees, and employers". He stated as well that "any duplication of these actions by a new entity would have a little added value, would require additional functioning costs and would have the negative influence on the public finances transparency".

4 Conclusion

The statistical and substantial approach to the effectiveness of the fiscal rules established in EU and Polish legal acts lead to the conclusion that the legal provisions in this field only partially were effective. The EU limits of general government deficit are not respected, the binding national rules are abolished or legally not-respected becoming too restrictive for the discretionary policy of decision-makers.

Unfortunately, there is no simple answer about the content and the application of legal provisions that would lead to the effective reduction of the general government deficit and debt. In consequence, the implications *de lege lata* and *de lege ferenda* cannot be simply presented. The reason is that our analysis leads to the conclusion that legal regulations at some point become at least partially ineffective – helpless in some sense – in maintaining the public finances sustainability. Thus is seems crucial to start to approach the problem of the reduction of the deficit and debt from the point of view of the moral values (Huberts, 2014) and the internal motivation (Perry, Hondeghem, 2008) for looking for common good, that is in our case, the sustainability of public finances. Moreover, more, generally speaking, it seems important to concentrate the future research in different aspects of public finances on shaping moral responsibility aimed at protection and looking for the state of public finances. The combination of legal and moral responsibility would lead to the responsible public finances management understood as "public resource mobilization and public expenditure management based

on public expenditures and revenues balance, effectiveness, efficiency, realism, sincerity, transparency, and democracy (civic participation and democratic procedures" (Zawadzka-Pąk, 2017).

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PART 2
PUBLIC FINANCIAL LAW - SELECTED PROBLEMS

NEW POLISH CODIFICATION OF GENERAL TAX LAW AND THE NEEDS OF TAX AUTHORITIES OF LOCAL GOVERNMENT UNITS

Rafał Dowgier[1]

Abstract

This contribution deals with a presentation of legal solutions being drafted in Poland with regard to general tax law in the aspect of the needs of tax authorities representing local government. The General Taxation Law Codification Committee appointed by the Prime Minister of the Republic of Poland is currently carrying out works on the codification of general tax law in Poland. The Committee has already collected and analyzed rich primary resources, which allows to draw specific conclusions. The main aim of the contribution is to indicate directions of solutions which, in the new Polish codification of tax law, will embrace specificity of tax assessment and collection generating income of local government units.

Keywords: Tax; Law; Tax Code; General Tax Law; Local Taxes; Municipal Tax Authorities.

JEL Classification: H34

1 Introduction

The year 2017 marks the twentieth anniversary of passing first Polish codification of general tax law in post-communist conditions. The Act of 29 August, 1997 – Tax Ordinance[2] has been amended over one hundred times since it came into force, and this fact itself already speaks for the need to prepare a new regulation. This task has been undertaken by the General Taxation Law Codification Committee appointed in November 2014 by Prime Minister (fereinafter referred to as the Committee).

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2 Uniform text: Journal of Laws of 2015, item 613, as amended.

The objective of the Committee is to prepare a draft of a new Act regulating general tax law in Poland. The time to fulfill this task is not long. In August 2015 the Committee presented directions of the new codification's assumptions[3] and since then, a two-year long period to prepare the Act has started to run. Thus, according to the schedule, in September 2017, the Committee should present both a draft of the new Tax Ordinance (since this name has already been persistent in Polish conditions, it has been preserved) and appropriate implementing acts.

As part of the introduction, it is worth emphasizing that Poland follows tendencies that are recently visible with regard to the transformations of tax law systems in other Central and East European countries (Etel, Popławski, 2016; Radvan, 2015). Generally, two models are dominant within this scope: codification of entire tax law, which occurs in Russia, Ukraine and Belarus, and codification of only a general part of tax law (the Czech Republic, Slovakia and Hungary). In Poland, mostly due to the lack of reforms on taxing income or property, a comprehensive codification has not been selected. Therefore it will not encompass, above all, acts regulating structures of individual taxes. Moreover, this act will not regulate the issues of the system and operation of tax authorities. Within this scope, with regard to tax authorities responsible for the implementation of revenues supplying the State budget, a key role will be played by just introduced Act of 16 November, 2016 on National Fiscal Administration[4]. Pursuant to Art. 1/2 of the above Act, National Fiscal Administration is an entity of specialized government administration performing tasks within the scope of the implementation of revenues generated from taxes, customs duties, fees and non-tax budget receivables, protection of State Treasury interests and the European Union customs territory as well as providing a taxpayer and tax remitter with service and support in the correct fulfillment of tax obligations as well as an entrepreneur with service and support in the correct fulfillment of customs obligations.

3 They have been comprehensively presented in the studies by Etel (Etel, 2015 Ordynacja ...; Etel, 2015 Tax …).

4 Journal of Laws of 2016, item 1947.

It should be emphasized that uniform fiscal administration does not embrace entities which are responsible for the collection and assessment of taxes generating income of local government units. In the Polish legal system, one of the pillars of the local government reform of 1990 was providing local government units (municipalities, counties (*powiats*) and provinces (*voivodeships*)) with financial independence, which is based on the constitutionally enshrined right to pass their own budgets that are supplied from local taxes in particular.

The reform of national fiscal administration carried out in Poland, which has excluded local government tax authorities within the above scope, follows a tendency that has been observed in the past few years which clearly distinguishes those two categories of entities. However, it is visible not only in the aspect of the structures and principles of their operation; its roots go much deeper. General tax law, including the procedure connected with tax assessment, perceives the specificity of local government tax authorities merely marginally. For this reason, the above subject matter deserves particular attention, and it has become a topic of discussion within works of the General Taxation Law Codification Committee.

The main aim of the contribution is to indicate directions of solutions which, in the new Polish codification of tax law, will embrace specificity of tax assessment and collection generating income of local government units. The scientific methods as description, analysis, comparison, and synthesis are used to achieve the aim.

2 Local Government Tax Authorities

In its current reading, the Tax Ordinance Act enlists the following local government tax authorities of a first instance (tier): village mayors (*wójts*), mayors (city presidents), district heads (starosts), and province marshals. This division reflects a territorial structure of Poland divided into municipalities, counties (*powiats*) and provinces (*voivodeships*). A role of the bodies examining appeals against first instance decisions issued by the above listed entities is played by Local Government Appeal Boards. The catalogue of tax authorities developed in Poland in this way leads to one univocal conclusion, i.e. that local government bodies prevail in it. It results from the fact

that in Poland there are nearly 2,500 municipalities, over 300 counties and 16 provinces. Even if counties and provinces that do not have their own taxes in the current legal state are omitted, and which are mainly financed directly from the central budget including their participation in income tax revenues, there remain app. 2,500 municipalities which have their own taxes as well as 49 Local Government Appeal Boards. Just to compare, in 2016, still before the reform of national fiscal administration, app. 400 Revenue Offices and 16 Fiscal Chambers operated in Poland. The system of state tax authorities was additionally completed by 45 Customs Agencies and 16 Customs Chambers.

Therefore, it clearly results from the above that in Poland we deal with two separate systems of tax authorities: state government and local government. As far as their number is concerned, local government bodies absolutely prevail due to the administrative division of the country. Another comment that should be made here is the fact that local government tax authorities are actually independent in their activities, which results directly from the constitutionally enshrined independence of local government units. The fact that Minister of Finance generally supervises tax matters does not change much within the above scope since s/he does not essentially have a direct impact on settlements issued by local government tax authorities. The Minister is not a supreme body that may verify the validity of their decisions. Thirdly, even though the state does not interfere in the activity of local government tax authorities through the authorized Minister of Finance, it indirectly controls their activities through Local Government Appeal Boards, which are tax authorities of a second instance with regard to local government matters. Local Government Appeal Boards are state budget entities supervised by Prime Minister. Thus we deal with a situation where government administration has been entrusted with supervising decisions in tax matters (Smoleń, 2009: 313). Practice shows that this fact is of key importance for the operation of the Polish system of tax authorities itself and for local government authorities in particular. It should be indicated that in case of individual decisions issued on tax matters by state tax authorities of a first instance, second instance decisions are passed by appeal bodies that also belong to the government administration. It is argued sometimes that this is the reason for the outward appearance of two-tier proceedings

where tax authorities subordinate to Minister of Finance adjudicate in both instances. On the other hand, as far as local government tax authorities are concerned, we deal with a situation where first instance decisions are subject to instance control of Local Government Appeal Boards, which generally have nothing in common with the local government sphere (apart from the name). Theoretically, such a model of control based on two independent bodies should not raise objections. In practice, however, a vital problem is the fact that local government units are deprived of a possibility of challenging decisions of appeal boards themselves. It leads to the situation where a faulty settlement of an appeal board may be challenged and sued by a taxpayer who is a party to the proceeding, but neither a first instance tax authority nor local government unit whose revenues are directly affected by it may do this.

3 The Scope of Fiscal Jurisdiction of Local Government Units

In order to understand basic assumptions that have been adopted during works on the new codification of tax law in the context of local government tax authorities, it should be indicated that pursuant to Art. 167/ 1 of the Constitution of the Republic of Poland,[5] the principle has been expressed therein according to which local government units shall be assured public funds adequate for the performance of the duties assigned to them. Local taxes supplying municipal budgets are of particular importance among these revenues since in the Polish legal order, at present, only municipalities have their own tax revenues. Pursuant to Art. 168 of the Constitution of the Republic of Poland, units of local government shall have the right to set the level of local taxes and charges to the extent established by statute. This entails that fiscal jurisdiction of municipalities is limited because they may act solely within the limits of the statute (Dowgier, 2015: 77). In Poland, both introduction and abolition of taxes are possible solely by a statutory procedure (Art. 84 of the Constitution). The rights of local government units with regard to taxes are in fact limited to establishing their rates (most

5 The Act of 2 April 1997 – the Constitution of the Republic of Poland (Journal of Laws No. 78, item 483).

often within statutory limits) and introducing tax exemptions and reliefs. Only exceptionally the legislator introduces a possibility of independent decision-making by local government, i.e. whether they intend to collect a certain benefit, as it occurs with regard to local charges for dog registration, city tax, health resort fee and market levy.[6]

A consequence of the Polish tax system developed in such a way is the principle of distinctiveness of tax revenues of local government units and the State. Central budget by no means participates in local government's own revenues generated from their taxes. This fact may justify little interest of the legislator to create regulations in the scope of general tax law that would include local government needs. To put it more bluntly, tax independence of local government units in Poland is manifested not only in the separateness of their budgets and their own system of revenues but also in the lack of interest of the legislator to introduce legal solutions which would include the specificity of tax authorities represented by them. Ignorance within this scope is apparent within general tax law, which is currently regulated by the Tax Ordinance Act, as well as in archaic acts regulating the structure of local government taxes and charges that contain numerous defects (Etel, Dowgier, 2013).

4 Basic Assumptions of the New Codification of General Tax Law in the Aspect of Local Government Tax Authorities

In the assumptions of a new Tax Ordinance, a starting point adopted by the General Taxation Law Codification Committee was a postulate according to which all categories of tax authorities should have similar powers under Tax Ordinance provisions. This will mean that a taxpayer could expect, regardless of the fact whether they are obliged to pay a state or local government tax, that their rights and duties will be developed in a similar way in the general tax law. Currently, such symmetry does not exist in some legal solutions because, e.g., separate principles of paying state and local government tax have been introduced. State tax may, as a rule, be paid by a debit card whereas local government tax may not. Moreover, if the approval of the

6 These benefits are regulated by the Act of 12 January 1991 on Local Taxes and Charges (uniform text: Journal of Laws of 2016, item 716 as amended).

deferment of payment is granted or payment will be made in installments, a taxpayer is obliged to pay an additional fee, the so-called prolongation fee, solely in case of a state tax whereas a local government tax does not, in principle, envisage such an obligation.

Unification of tax authorities' powers in the new codification is not an absolute principle. Departing from it, however, must be reasonably justified (the principle of adequacy) (Dowgier, 2015: 64), in particular by the specificity of a given tax. In this context, we should point out that in the Polish tax system local government tax is assessed by a decision, and this rule is prevalent therein. Whereas with regard to state taxes, they are generally calculated by taxpayers themselves. Bearing the above in mind, general tax law must provide rapidity, cheapness and efficiency of proceedings aiming at determination of the amount of tax obligation. We should not encounter situations when the costs of tax assessment are higher than its amount, which is now not at all exceptional in Poland.

Financial independence of local government units should be manifested procedurally as well. It entails, most of all, their powers to independent settlement of tax matters, which are presently violated in those legal solutions which grant state tax authorities the rights to apply reliefs in the form of duty remission, the deferment of payment or payment in installments with regard to local government taxes and charges too. In another important aspect, we should strive for providing local government units, even to the smallest degree, with a possibility of challenging activities undertaken by Local Government Appeal Boards, which operate as government administration bodies. At present, the activity of these boards from the perspective of local government units is evaluated very negatively even though direct activities of these bodies are not always the cause of this. It seems that a key problem is overwork of some boards, which results in settling matters even with a three or four year delay. Perhaps, we could defend a thesis saying that if these bodies were responsible for controlling decisions on state taxes, such a situation would have never taken place. Therefore, perceiving resistance and, unfortunately, lack of understanding of the problem of admissibility of challenging decisions issued by Local Government Appeal Boards by local government units, we should attempt to grant them

a status of a party in administrative proceedings since in the Polish legal order final decisions are appealed to administrative courts. But even there, local government units are commonly refused the right to question decisions issued by Local Government Appeal Boards. Without going into detail, defective identification of a local government unit holding a legal personality with its tax authority that issues a decision is the root of the current state of affairs. However, in this case a tax authority does not act as a representative of a local government unit but as a body of public administration – and these two roles cannot be identified as the same (Dembczyńska, Pietrasz, 2009).

5 Selected Detailed Solutions Including the Specificity of Local Government Tax Authorities

The above-mentioned general presumptions have assumed a form of specific proposals of legal regulations during works pursued by the Committee. Their content is not final yet because works are still in progress. Nevertheless, certain detailed solutions the Committee will recommend in the future may be already presented here.

As it has been indicated in the introduction, the assessment of local government taxes in Poland is mainly based on administrative decisions. Therefore, a tax authority must carry out a formalized and quite expensive tax proceeding in order to assess more often than not a small tax. Nevertheless, it should not entail a situation when a tax will not fulfill its basic function, which is a supply of revenues to the budget. This function is questioned when the cost of tax assessment and collection is higher than the tax itself. That is why the so-called general rule of pragmatism has been introduced into the new codification, according to which tax authorities may waive the performance of activities required by the law if they are connected with the costs that are disproportionate to the result that can be achieved through their application. However, there is a binding reservation here that such omission may not limit taxpayer's rights or impose any obligation on him/her.

In the context of the above, it is proposed to entitle bodies being local government units to indicate a threshold of obligation up to which their tax authorities would not have to carry out tax proceedings. With regard to state

taxes, this threshold is proposed to be app. EUR 10. If a tax or charge constitutes local government revenue, the threshold may not be higher, but it may be lower. Thus, a situation when a tax authority spends, e.g, EUR 50 on a tax proceeding where a decision closing it adjudicates tax amounting to EUR 5 will be eliminated.

Legal tools consistent with the principle of pragmatism are also such detailed solutions which exempt a local government tax authority from an obligation to issue and serve decisions in the matter of initiating tax proceedings when a taxpayer submits tax information correctly. If a tax authority accepts the data they have been provided with, a proceeding, in principle, is restricted solely to serving a decision (if the tax resulting from it exceeds a minimal amount that justifies its issue, of course).

The postulate of providing local government with greater influence on their tax revenues embraces granting their tax authorities exclusive powers to apply reliefs to pay their taxes. At present, some local government taxes are collected by state tax authorities, which means that they are also entitled to apply such reliefs (remission of duty, payment in installments, and deferral of payment). In the Committee's opinion, even if it is assumed that the application of a relief requires a consent of an appropriate executive body of a local government unit whose revenue it concerns, such a solution is not sufficient. For this reason, it is proposed that tax authorities of local government units are solely entitled to apply reliefs within the scope of their revenues.

Apparently, a proposal to centralize individual interpretations of tax law provisions issued by local government tax authorities does not go along this route of changes. In Poland, there is a mechanism that provides a possibility of obtaining interpretations about the application of tax law provisions regarding a past as well as a future case for a small fee (Morawski, 2012). As far as state taxes are concerned, the issue of interpretations is centralized, which assures their relative uniformity. It is different in case of local government taxes, where interpretations are issued by nearly 2,500 tax authorities. Due to this, it is unlikely to presume the interpretations will be uniform. What is more, it is even problematic to establish their actual number. That is why the Committee has decided that a foremost value should be the assurance of uniformity in interpreting tax law provisions regarding local

government taxes with local government exerting influence upon the content of such interpretations. Consequently, it is proposed to centralize the issue of any kinds of interpretations with a reservation that with regard to local government taxes, before the issue of the interpretation, an appropriate local government tax authority is informed about a submitted motion and is entitled to express their opinion on a given matter.

In the Polish system of tax law, local government taxes are characterized by joint and several liabilities. It regards situations where there are several entities obliged to pay tax (e.g. co-owners of the property). Then, a creditor may claim his/her liabilities from each of them separately in total or a part whereas the fulfillment of performance by any of them ensues the expiry of a tax obligation. This is a transfer of the Polish civil law principle into the tax law[7]. Currently, general tax law provisions include only a reference to the appropriate application of civil law regulations with regard to taxes, which is insufficient and, in practice, causes many interpretative problems. In consequence, the principle of joint and several liabilities should be adapted to the specificity of tax law, which turned out to be not such a simple task during the Committee's works. In particular, problems signaled in administrative courts' case-law connected with the application of tax reliefs and exemptions with regard to joint and several tax liabilities should be resolved. At present, this problem is solved differently and these solutions sometimes ensue deprivation of the right to a relief or exemption only due to the fact that tax liability is joint and several.

As it has already been mentioned, the Polish system of tax authorities embraces Local Government Appeal Boards, which adjudicate as appeal bodies in the matters settled in a first instance by local government tax authorities. Independence of the Boards and their inefficiency connected with insufficient human resources and a large number of cases they are to resolve have a negative impact on tax revenues of local government units. In the most extreme situations, cases conducted before the Boards for years

7 Pursuant to Art. 366 of the Act of 23 April, 1964 – Civil Code (uniform text: Journal of Laws of 2016, item 380), "§ 1. Several debtors may be obliged in such a manner that the creditor may demand the whole or part of a performance from all the debtors jointly, from several of them, or from each of them individually, and satisfaction of the creditor by any of the debtors releases the other debtors (joint and several liability of debtors).

expire, which means that it is necessary to return tax previously collected by the local government. For this reason, the Committee has decided that local government units which are beneficiaries of taxes within the scope of which the Boards adjudicate should be also informed about cases not settled by the Boards in due time. What is more, local government units should be entitled to submit a reminder on protracting proceedings by Local Government Appeal Boards. In the Committee's opinion, providing local government units with such an instrument may be an efficient tool to motivate Local Government Appeal Boards to settle cases in due time specified in the statute. Nevertheless, the Committee is aware of the fact that an optimal solution here would be granting local government units a status of a party in administrative proceedings, which would allow them to appeal against the Boards' settlements. Currently, local government units are denied such a right which, in practice, entails that, in principle, only a taxpayer may challenge a decision issued by Local Government Appeal Boards to the administrative court. Thus, local government's interests are not duly protected within the above scope.

6 Conclusion

Works on the reform of general tax law carried out in Poland comply with the tendencies noticeable within the territory of Central and Eastern Europe. It should be emphasized that the appointment of General Taxation Law Codification Committee is an innovative initiative, which has not occurred yet in the history of creating tax law in Poland. The results of the Committee's works will be presented already before the end of 2017, and we should hope that they will introduce a new quality to the Polish legal order.

Another undeniably considerable novelty in the Committee's works is the fact that one of the fundamental objectives adopted therein was the need to include the specificity of local government tax assessment and collection. This issue has been usually marginalized so far. By all means, specificity of this tax and the needs of almost 2,500 tax authorities representing local government units cannot simply be omitted. For this reason, it is so significant that new codification of general tax law perceives this problem.

Perhaps the codification does not introduce revolutionary solutions, but some of them will certainly be of crucial importance for the application of tax law by local government tax authorities.

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POSITION OF FINANCIAL MARKET SUPERVISION IN THE SYSTEM OF CZECH LAW

Michal Janovec[1]

Abstract

This contribution deals with theoretical placement of Financial market supervision within the Financial law and more generally within system of law. This field is only partly independent, but in general it is still part of Financial law in the Czech Republic. The aim of this article is to validate stable position of Financial market supervision in the system of law and confirm, that financial market supervision is still part of more general field of law which is called Financial law.

Keywords: Financial market; law; system of financial law; financial market supervision; Czech Republic

JEL Classification: G20

1 Introduction – Financial Market and Its Supervision

This article introduces the concept of a financial market and its supervision. In addition, it considers its position within the system of law and society alike. It deals with general legal norms and it also analyses the reasons for financial market supervision including its actual realisations. It is important to analyse the theoretical possibilities and arrangements about law of financial market first. I attempt to classify financial market supervision within the system of law to make clear at the very beginning of the chapter where the topic selected for this dissertation finds itself within the legal system and which part of the system is being dealt with here. In this article is used the method of analysis, which leads to a general understanding of the issues within the field and analytical method is used too. Another used method

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is method of Induction which is reasoning that derives general principles from specific observations. The hypothesis for this article that is to be verified is: "Financial market supervision has its own independent place, but still in the system of financial law".

2 The Position of Financial Market Supervision in the System of Law

I try to classify financial market supervision in the system of law; in other words, I want to find and delineate the place it occupies there.

This is a vital thing to do with every legal norm and financial market supervision is no exception whatsoever. Norms that occupy the same position in the system of law share several common features. The classification within the system of law itself reveals common features that the norm under investigation shares with the others in the same position - that is the right platform for deeper understanding and a more accurate analysis of the system and the norms within. It goes without saying that financial market supervision is directly linked to financial law, but financial law is not such a small field to make unnecessary the exact placement of the norms within the system. Financial law is a rather young discipline which has broken free from administrative law with which it still maintains the closest bond. Its independence and its exact classification are described below.

It would theoretically also make sense to place financial market supervision into the system of administrative law not only because financial law separated from administrative law but also because financial market supervision processes are, since they are in fact administrative procedures, under the authority of Administrative Procedure Code. Thus, supervision becomes part of administrative law (e.g. an administrative procedure to acquire a banking licence according to Art. 4a of the Act no. 21/1992 Sb., on Banks) (Nazarov, 2015; Tsindeliani, 2015).

Nonetheless, there is one strong argument for the inclusion of financial market supervision into the system of financial law: the subject of legal regulation of financial markets is social relations connected with the creation and distribution of funds, which is in accordance with the subject of legal regulation of financial law (as is discussed below). There is a small anomaly

though: the subject of legal regulation of financial law is social relations created and maintained through those funds which are in the public interest. That is not always the case when it comes to legal regulation of financial markets. This anomaly is compensated with the fact that it is undoubtedly in the public interest to regulate and supervise financial markets due to their importance for the integrity of the economic system. Given the fact that money relations are not the focal point of legal regulation of administrative law, it is, in my view, demonstrated (by finding the common core in the subject of legal regulation of financial markets and financial law) that financial market supervision falls within the realm of financial law.

Another necessary step is to delimit the notion of financial market supervision (from now on also just 'supervision'), for its correct placement within the system of financial law is unthinkable without realising what supervision entails.

3 The System of Financial Law

Before delimiting the system of a legal discipline, it is necessary to defend the independence of the given discipline. Financial law undoubtedly is an independent discipline as it fulfils the establishing criteria which generally justify the existence of an independent legal discipline.

According to Mrkývka (Mrkývka, 2004: 32) these criteria include

- Independent and specific subject of legal regulation;
- Methods of legal regulation; (Mrkývka, 2004: 30)
- Internal cohesion of legal norms;
- Social acceptance of the discipline.

All these criteria are met by the discipline of financial law, thereby setting itself free from other legal disciplines.

The subject of financial law is specific social relations involved in various financial activities and reflecting several financial phenomena. Financial law governs those relations in which the state is involved and which indirectly or not affect the base money or its parts (Bakes, 2012: 12). To put it simply, financial law is not concerned with relations with a contractual basis - these rather belong to civil or commercial law.[2]

2 This does not apply without exception, however, because financial law also deals with state loans and the sale of the state property.

Financial law is a specific public-law discipline with close bonds with administrative law; in fact it broke free from it. But financial law also has a lot in common with private-law disciplines, which deal with legal relations involving payments and money - the contractual positions of the subjects are, however, equal.

Experts and the lay public alike accept and respect financial law as an independent discipline. Discussions surrounding its position are a thing of the past and to cast doubt on this discipline as public-law part of the Czech legal system is now virtually unheard-of.

For the classification of supervision within the system of financial law is crucial the discipline-defining criterion of internal cohesion of legal norms - the uniqueness of the system of financial law. The defining systemic features are:

- A higher rate of mutual legal norms in contrast with norms from other legal disciplines;
- A relative autonomy of the given set of legal norms from the norms of the other disciplines (Průcha, 1994: 34).

Despite the unquestionable existence of the system of financial law, financial law is not codified in a unified way and is instead fragmented into several independent acts. As a result, there is a wide range of norms with not so rigid links between them. I hold that financial law defies entire codification, mainly due to the vast scope of interest of all its sub disciplines.

The closest bonds exist between individual sub disciplines of financial law and then also between mutually close sub disciplines which form two different systems based on their purpose and their character: fiscal and non-fiscal parts of financial law. The system of financial law is defined by the internal differentiation of its branches into coherent groups of financial-law norms about their content and the similarity of the social relations that they govern (Mrkývka, 2004: 56). With the increasing rate of globalisation the range of public financial activities changes, thereby creating new limits to the scope of financial law.

The scope of financial law naturally increases with the increase in financial activities of the public sector and with the increasing number of state

interventions into economy. It means that financial law has a wider scope in those countries where economic interventions are frequent; this subsequently influences the system of financial law there, too.

Most experts in financial law divide the system into two parts: the general and the specific part (e.g. Bakes, 2012:12), though there is hardly a consensus about the existence of the general part because it is only with great difficulty that one can find a common core for all sub disciplines of financial law. Likewise, there are no common sources of law in the technical meaning of the word; yet, I am convinced that the general part of financial law can be accepted – chiefly because there is a common characteristic for all financial-law norms: they govern financial relations.

The main division within the system of financial law is to be found in the specific part, namely the division into the fiscal and non-fiscal parts. The former is defined by those social relations in which the primary interest is to regulate the cash flow. The non-fiscal part, on the other hand, regulates social relations in which the cash flow is only secondary because the main point of interest is the regulation of money itself and of the monetary system as well. This division is essential for those common notions and principles on which the general basis of both sub disciplines is formed. This in turn enables a better and a more transparent interpretation and application of financial-law norms. The fiscal part of financial law includes the arrangement of budget law, tax law, and customs law. The non-fiscal part then deals with currency law, foreign exchange law, public banking and insurance law, the legal regulation of supervision of the capital market and credit unions, and, finally, the hallmarking law (Mrkývka, 2014: 219; Radvan, 2014).

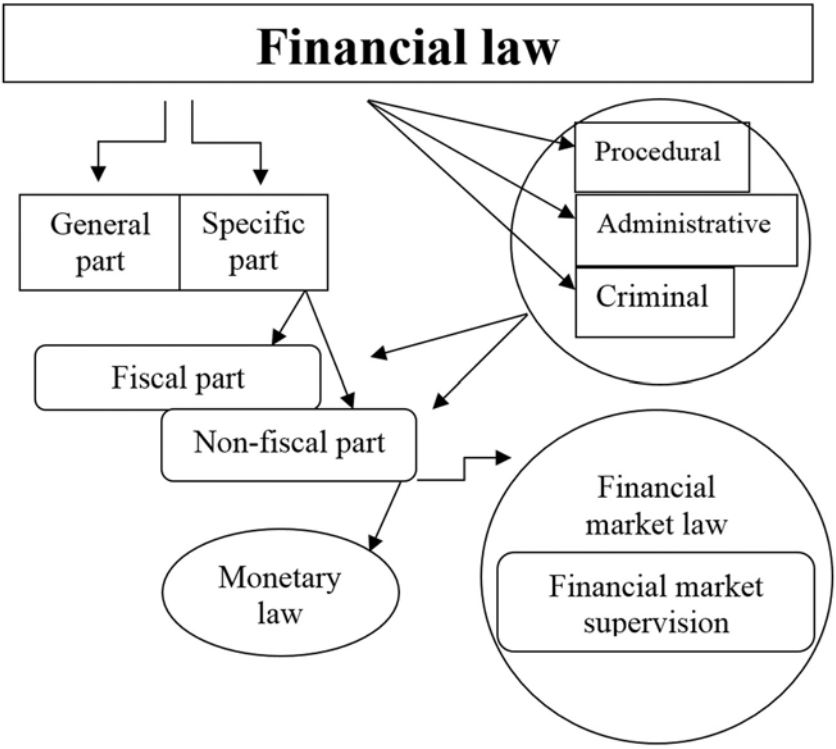
Financial law can also be divided (apart from the abovementioned division into the general and specific parts) into procedural financial law (norms of procedurally legal character[3]), administrative financial law and criminal financial law. These sub disciplines however exceed the scope of this work and will not be discussed in any greater detail.

3 The procedural position of subjects, the procedural actions when deciding the matters of superiority and inferiority and the procedural actions of subjected entities – e.g. self-application within the system of tax law and the legislative process, too.

If we accept the idea that financial market supervision entails supervision of the banking sector, credit unions, the capital market, insurance industry, pension savings companies, pension funds, exchange offices and, finally, institutions in the area of payments, then it is, beyond any doubt, true that financial market consists of basically the same areas as the non-fiscal part of financial law, the only exception being the presence of financial market law in place of currency law (for more information see the subchapter below). Yet, it would be wrong to claim that the financial market is the same entity as the non-fiscal part of financial law; however, it is possible to say that financial market law falls within the realm of the non-fiscal part of financial law. This statement hints at the independence of financial market law; it indeed meets the discipline-defining criteria of independence and specificity of the subject of legal regulation. The subject of legal regulation here is legal relations which are formed within financial markets, i.e. within their various branches. The other discipline-defining criteria of financial market are identical with those met by financial law. Therefore, I do not think that it would be correct to call for a complete independence of the discipline of financial market law; it is nonetheless not erroneous to accept the existence of financial market law within the realm of financial law, i.e. in its non-fiscal part. Financial market supervision is then conceived of as a branch of financial market law. This theoretical assessment of financial market law enables a more transparent and easier understanding of the structure of financial law, but it also enables a more accurate classification of what this article deals with, namely the issue of financial market supervision. If it is clearly stated what financial market law is and where it belongs within the legal system, it is then much easier to delineate the area of financial market supervision and to determine by which means it is performed and what is the nature of the legal relations under supervision.

It is now time to turn our attention to a branch of financial law which comprises the subject of this article: financial market supervision, which is a section of legal regulation in the non-fiscal part of financial law as the following diagram illustrates.

Diagram 1. A schematic classification of financial market supervision within the system of financial law



Source: author

4 Financial Market

The financial market in almost all its areas (including that of the capital market in the form of money and capital) has developed rapidly in the past decade. The effects can be seen in the increasingly more and more interwoven web of national markets and the diminishing differences between individual financial sectors. Big financial groups' importance and influence has been on the increase and, in general, the world has witnessed international financial globalisation. This all called for gradual changes to financial

supervision and its organisation. For example in the Czech Republic there used to be four supervisory authorities – conceivably too many for such a small financial market.[4]

The financial market is a system of relations, instruments, entities, and institutions that enable the accumulation, distribution and allocation of temporarily available financial funds on the basis of supply and demand. The financial market makes it possible to redistribute available funds on a voluntary contractual basis (Kotáb, 2012: 102).

The financial market is primarily used to trade financial instruments, most notably securities and other entities. Most of the trade deals with financial instruments with a long payback period – more than a year. In this case we talk about the capital market. Scheffrin has it that the capital market is a market where money is provided for a period longer than one year. (Shefferin, 2013: 283) Finances from the capital market are obtained with a view to financing long-term investments of trading companies, households but also governments. Typical financing instruments include long-term bonds, bank and consortium loans, mortgage loans and mortgage bonds. The capital market also makes use of equity securities (shares and profit participation certificates), which have basically no fixed payback date. Short-term markets are those financial markets where instruments have paybacks periods of days, months, or the maximum of one year. Typical instruments include short-term securities, loans, credits, and deposits to be paid back within one year, e.g. bills of exchange, short-term bonds, deposit certificates (deposit slips), interbank deposits, short-term bank deposits etc. Sheffrin concludes that financial markets are used for short-term financing, sometimes for loans to be paid almost 'overnight'. Capital markets, on the other hand, are used for long-term financing, such as the purchase of shares or credits where the payback date is not expected in less than a year (Shefferin, 2013: 283).

4 It was a supervisory model divided into sectors – each sector took charge of a different segment of the financial market. The CNB was responsible for banks, the Commission for Securities for the capital market, the Ministry of Finance for insurance companies and pension funds, and the Office for Supervision over Credit Unions for savings and credit unions.

According to the author of this article, Financial market consist of six parts, for which I suggest the term 'the classification of financial market disciplines':

- Credit market (including banking and co-operative banking);
- Capital market;
- Monetary market;
- Insurance market;
- Foreign exchange market;
- Commodity market.

When assessing the importance of the financial market and its segments' influence on the economic situation, I would like to express my conviction that they affect society and economy enormously; that is why their proper working order and their correct setting play a key role in achieving economic stability and prosperity. Given the fact that the workings of the financial market (and its segments) are not merely customary—the financial market is regulated, i.e. it is delimited by legal norms and then through legal norms supervision is carried out over its activities—it is therefore crucial to set the 'rules of the game' and to anchor them in the system of law. In practice, it means delimiting regulation (the rules for entrance into the market and the code of behaviour there as well as the subsequent application of supervision and inspection). All segments of the financial market have existed for some time; they keep developing and so do regulatory and supervisory mechanisms. The very fact that individual segments have evolved, separated and, to a certain degree, standardised in various forms (as part of legal norms) to be later accepted by society is a relevant justification of the existence of regulation and supervision of the financial market. If the financial market existed without regulation and supervision, it would be nothing more than a mere chaotic grouping of entities and their activities without proper rules; this would, no doubt, result in a system of total economic instability.

5 Financial Market Supervision and Its Position in the System of Financial Law

Financial market supervision can be described as a role performed by a public authority. It is a power supported by the state which guarantees potential sanctioning of subjects if financial market rules set by the regulatory bodies are broken.

Supervision and regulation set rules which protect the stability of the banking sector, the capital market, the insurance industry, and pension funds. These entities are systematically regulated, subsequently supervised and, if necessary, sanctioned if the rules are not properly observed. I dare say that in the Czech Republic regulation is in fact a subset of supervision since the former has been largely integrated into the latter. I view supervision as a process that consists of three stages: 1/ regulation, 2/ proper supervision, and 3/ possible sanctions. To justify this bold claim, I would like to point out that all three stages have been integrated into one authority, namely the CNB (Czech National Bank).

Legal norms about financial markets comprise acts prepared by the Ministry of Finance or the Ministry of Justice, as well as implementing regulations and orders issued typically by the CNB. The same institution also provides help to those involved in financial markets by means of interpretative and explanatory materials (e.g. official notices and answers to questions). Obligatory rules and interpretative materials are more and more often issued directly by the EU authorities (CNB – Legal norms and methodical materials of Financial Market Law, 2016).

Financial market supervision in the Czech Republic is performed by the CNB.[5] Because the supervision covers a wide range of areas, powers and duties in individual sectors are modified within sectoral laws.[6] The main supervisory objective and supervisory principles are very similar in all those areas; yet, there are some particularities stemming from the diversity of activities in individual institutions of the financial market. It thus seems apposite to shed more light on them now.

To maintain the perfect working order, credibility and stability of the financial market is not and cannot be just a question of free marketing mechanisms; thus, there are a great number of regulatory and prescriptive rules – mainly in the form of legal norms. The range of legal norms is rather diverse and to supervise the whole system of rules and to reach conclusions

5 On the basis of Act no. 6/1993 Sb. on Czech National Bank, as amended (from now on just 'CNB Act').

6 The capital market and its supervision is also regulated by Act no. 15/1998 Sb. on Supervision in the Capital Market Area and on the Amendment of other Acts.

and administer sanctions (if the rules are broken) is called financial market supervision. This supervision covers all institutions within a financial market.

Financial institutions are supervised to maintain the stability of the financial system in the Czech Republic. Other top priorities include: support of development, discipline and competitiveness of financial institutions, prevention of crisis, protection of investors and clients and strengthening public credibility, about the banking system, the credibility of which seems to be of vital importance to the entire system.

Banking regulation is a preventive measure consisting of the creation and enforcement of conditions, rules, and limits for the activities of banking institutions (Mrkývka, 2014: 219). Supervision of financial market institutions is not motivated by a desire to interfere in private-law relations between institutions and their clients, nor is it motivated by a wish to substitute the work of courts and criminal justice. It is not to be expected that supervision will prevent institutions from making some poor strategic or investment decisions. It cannot prevent the failure of an individual either. What it can do, though, is to regulate and examine the effectiveness and functionality of the governing and inspecting systems of financial institutions, for which are responsible the leading authorities in those financial institutions. There are a lot of demands placed on them regarding their professionality, expertise, and experience. The main function of supervision is to use its public-law bodies to intervene in case there are some imperfections—it can impose receivership or revoke the licence. Above all, it offers protection of the system of financial institutions and the financial market in its entirety as well as prevention of future failures or illegal conduct.

Supervision of a financial market and its institutions involves decisions about requests and granting licences, permissions, registrations and prior consents according to special legal norms, the inspection of rules observing in accordance with the issued licence or permission, the inspection of obedience to the law (to which the CNB is authorised through acts or special legal norms), the inspection of obedience to the regulations and orders issued by the CNB, the acquisition of information necessary for supervision and its subsequent enforcement, but also checking its credibility,

completeness and topicality, the infliction of corrective measures and sanctions and procedures about administrative offences and misdemeanours (CNB – Supervision of credit institutions, 2016).

6 Conclusions

Financial market supervision has its firm place not only within the system of financial law but in the entire legal system of the Czech Republic, and, indeed, globally as part of financial market law. I am convinced that to integrate supervision into the system of financial law (and financial market law) is logical and hardly to be disputed; equally, it makes it possible to stabilise the economic system by means of supervising the institutions active in the financial market, their entrance to the market and their activities there, but also by means of increasing the credibility of the financial market (and its individual segments) in the public eye.

The financial market is an area into which enter not only a high number of financial institutions, but also members of the public (equipped with varying degrees of professional knowledge): these include investors, individual savers, or one-time participants. Therefore, any instability or frequent threats in the form of possible bankruptcies of some major institutions in the financial market could have devastating economic consequences for individuals and the whole system and its stability, too.

The classification of financial law may not appear standard in comparison with some other (older) legal disciplines, but it has long defended its independent position within the system of law thanks to its clear classification, its acceptance by the public and its possibilities to react to emerging public needs. The system of financial law is a prerequisite for further academic exploration and for moving financial-law theory into practice, often with up-to-date modifications to ensure that current societal and economic demands are met. Supervision is firmly anchored in this system and it is hard to imagine that there should be any significant changes or shifts regarding its position in the system of financial law, which in turn enables its development and stabilisation, thereby strengthening not only the credibility of financial market supervision itself, but also of the existence of financial law as an independent legal discipline.

The hypothesis set up at the beginning of this article was surely confirmed, because supervision of the financial market is quite specific part of law (so its independent part), but main determinants for this part are same as for the financial law in general. Thus, financial market supervision must be part of greater and more general field of law, which is financial law.

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A REVIEW OF CURRENT CASE LAW IN THE MATTER OF MISCLASSIFICATION OF EMPLOYEES AS INDEPENDENT CONTRACTORS IN THE CZECH REPUBLIC

Michal Liška[1]

Abstract

This contribution deals with problem of misclassification of employees as independent contractors and new points of view recently presented by Supreme Administrative Court of Czech Republic. The main aim of the contribution is to confirm or disprove the hypothesis that generalization of based work and making relevant private will is the correct way for judging cases of misclassification of employees as independent contractors. To confirm or disprove the hypotheses author will use analytics methods of qualitative research typical for law as several ways of interpretations of law. To confirm or disprove of the hypothesis author will use scientific methods such as analysis, implementation of premises for the purpose of testing it in legal approach of Czech legal order and others. There is no integrated publication dealing with misclassification of employees as independent contractors.

Keywords: Misclassification of Employees; Independent Contractor; Based Work; Undeclared Work.

JEL Classification: K34

1 Introduction

In the Czech legal environment is the misclassification of employees as independent contractors (so called Švarcsystém in the Czech Republic) known as a product of the last century (the history of this institute is described

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in Liška, 2016: 103–126) and it's connected with the issue of employment. First Act's prohibition was enshrined in the Act no.1/1991 Sb., on Employment, as amended, Art 1/4. Currently this institute is, however, associated with the issue of assertion of private law over public one or more precisely it could be said the issue of assertion of private will to public law. This article will try to briefly summarize the conclusions made by the courts recently and to evaluate the germs of the ideological shift in the administrative judiciary in terms of generalization of based work.

2 Misclassification of Employees

2.1 National Case Law

At the beginning the author affords to recap national case law regarding the long-held line of opinions that existence of misclassification of employees as independent contractors (i.e. dependent activity within the meaning of the Act no. 586/1992 Sb., on Income Taxes, as amended (hereinafter "the Income Tax Act"), Art. 6) is examined through the fulfilment of certain indicative characters.

The Supreme Administrative Court in its judgment of 27 July 2006, 2 Afs 173/2005–69, pronounce with links to precedents that *"[i]f the Parties decide, in accordance with the general principles of contract law (freedom of contract, good faith, the abolition of economic empowerment, etc.), to (…) enter to the contractual relationship and it will be its actual implementation, it is not a blurred legal act. It would have been, however, if the applicant forced contractors the closure (…) [contract] with the help of economic pressure, abusing their de facto economic dependence on them, and caused them to conclude such an agreement so they did not really have an interest in concluding."*

In a decision dated 31 March 2004, 5 Afs 22/2003–55, the Supreme Administrative Court concludes that *"[t]o the income tax from dependent activity are subjected not only revenues arising from employment relations established under the Labour Code, respectively from the membership or service relations, but under such a method of taxation legislator also included the income* ***from similar relations****, while this has not be defined any further, it was* ***clearly*** *defined as the relationship of the payer and the taxpayer, and as the taxpayer's responsibility* ***to heed the instructions of the payer*** */Article 6 paragraph 1 point a) of the Income Tax Act/.*

*As revenues from dependent activity for purposes of taxation, among other things, the law stated a wide range of income, and regardless of the legal facts, based on which the income was formed. Examples include revenues of partners and managing directors of limited liability companies and limited partners of limited partnership companies, remuneration of members of statutory bodies and other corporate bodies or receipts for the work of students and pupils from practical training. According to Article 6 paragraph 2 of the Income Tax Act a taxpayer with revenues from dependent activity and functional benefits is hereafter referred to as "***employee***" and payer as "***employer***", whereby such indication itself* ***in any way does not define the legal status of employees****. By using the legislative shortcuts so there were defined by the law circle of persons, which are for income tax purposes* ***subjected to certain method of taxation, whether the income flows from a legal relationship of any kind - civil, commercial, employment or other else****."*

In a decision dated 24 February 2005, 2 Afs 62/2004–70, Supreme Administrative Court particularly emphasizes this: *"It is obvious by definition that to fill the orders (or guidelines) occur in virtually every case entering the work and activities, i.e. not only in the employment relations. Definition of the legal term "dependent activity" cannot be reduced only to acts performed under the relevant guidelines, but it must be an activity which is* ***actually dependent on the payer****. Definitional element of addiction will be given mainly by the nature of the performed activity (****typically*** *work performed at one place only for one employer) and even if it will be a long-term activity and when the entering into* ***an employment relationship*** *should be primarily in the interest of the person who is performing this activity, since the non-completion of this relationship ultimately harms its legal sphere. On the contrary, it is not* ***usually*** *a dependent activity, unless it is a specialized activity performed only for a short time or uncontinuously, and when its performance is conditioned on factors largely independent of the will of the contracting authority (e.g. it is a seasonal work, work dependent on the weather, work conditioned on realization of* ***a single-obtained contract*** *etc.). These facts must also accept the application of tax legislation, since otherwise they would constitute* ***illegitimate burdensome element of private sector outlined in the above sense****. In other words, increasing employment by instruments of state action, including tax ones,* ***cannot, in effect, lead to situation when it will be considered as desirable to enter into labour relations****, even if their completion is not given by the mutual interest. Such an interpretation would, moreover, deny even the very private nature of labour law."*

Later in a decision dated 27 July 2006, 2 Afs 173/2005–69, the Supreme Administrative Court stated as follows: *"Similar relation as defined in Article 6 paragraph 1 point a) of the Income Tax Act is a relationship that is not employment, service or member relationship, but which corresponds to specified circumstances because of its nature and functions, i.e. its basic characteristics are the same as for these relations.*

Employment, service and member relationship is common in the first place that it is a legal relationship, usually the relationship of private nature, but often also the relationship of the public nature (especially the service relationship). This legal relationship arises between the concerned parties, and it mostly based on bilateral legal act (typically employment contract), i.e. the identical expression of the will of parties… Another important feature of employment, service or member relationship is that it is founded as a relationship of lasting nature, which is characterized by the fact that ***it is not consumed once-only****, by the fulfilment of certain materially defined obligation with the desired outcome by the one who has to provide specific performance (i.e. a work activity in the case of those relationships), but by the fact that this person is committed to provide this activity* ***repeatedly*** *for fixed period of time (which may be under certain circumstances* ***even quite short****) or indefinitely.*

Another important feature of employment, service or member relationship is that the person who provides ***specific performance*** *(i.e. a work activity in the case of those relationships) is principally obliged to follow the instructions of the person to which is bound by this work, service or member relationship. This obligation must be established directly, i.e. by the content of the legal relationship between both parties.*

An important feature of employment, service or member relationship also is that the relationship is subject to consideration and it is mutual from economic point of view - a person who provides specific performance, i.e. a work activity, receives for it reward usually in money (and possibly in other asset values and pleasures) from the other side of the legal relationship, while the value of the remuneration principally corresponds to the value of work which the employee provides.

The above-described characteristics must be fulfilled simultaneously at relationship similar to the employment, service and member relationship; if only one of them absent for a certain relation in substantial degree, it cannot be spoken about this relation as relationship similar to employment, service or member relationship."

It need to be concluded that the above-mentioned conclusions made by courts were later corrected in the sense of creating a formula for review and investigation misclassification of employees as independent contractors. The Supreme Administrative Court came to conclusion about prejudice of the need to monitor the fulfilment of quasi essential criteria established by judicial practice and in the decisions dated 26 May 2016, 6 Afs 208/2015 set that *"the criteria and their fulfilment is need to be considered* ***in mutual relations*** *and always in the shape of a particular case. While the fulfilment of characters of one of the criteria still cannot be assumed that it means dependent activity (e.g. subordination to the instructions of complainant), it can already be assumed in connection with the fulfilment of other criteria (see the criteria above). Administrative authorities and regional court were aware that* ***not every criterion is hundred percent fulfilled****; they assess, however, all the criteria in mutual relations, though noted in detail a string that filled the criteria on the basis of which is possible to make a definite conclusion about the nature of performed work."* The Supreme Administrative Court in this case relativized the conclusiveness of the individual criteria and pointed out that for the conclusion about the nature of performed work is primarily needed to assess essential and indicative criteria of depending work in relation to the circumstances of the case. Then the Supreme Administrative Court in its judgment dated 26 February 2016 2 Ads 151/2016 on the issue of assessment of dependent activity notes that *"[a]ssesement if there were filled the individual signs, yet would not lend itself to a purely formal 'pigeonholing', but it should be based on* ***the substantive assessment of performed work and nature of private relationship*** *(whether contractual parties are against each other effectively in the position of two equal partners, etc.)."*

2.2 Essential Signs of Dependent Activity (Work)

Within the meaning of Ar. 6 of the Income Tax Act therefore the dependent activity consists of the essential and indicative signs where the essential ones are fulfilled through the circumstances of the case and indicative signs.

Essential sign, therefore necessary, is according to the law a single character, to heed the instructions of the payer. This character of dependent activity is also need to be seen through the prism of the negative definition of addiction, i.e. independence or autonomy under the meaning of the

Income Tax Act, Art. 7. The performance of the activity is independent, if it is performed usually entrepreneurially, i.e. independently on its own account and responsibility, by a trade or similar mode with the intention to do it consistently to achieve a profit (closer Act no. 89/2012 Sb., Civil Code, as amended, Art. 420).

The problem in the Czech legal environment occurred in situations where the professional community (and also sometimes the Supreme Administrative Court) found as another essential sign of dependent activity a mutual interest, respectively a will of the parties, to conclude other than an employment relationship (Šimka, 2014: 6–13). Thus there was a shift in the case of examining of criteria for a finding of the existence or absence of misclassification of employees as independent contractors.

At this point, the author refers to the autonomy of the definition of dependent activity pursuant to Art. 6 of the Income Tax Act, inadmissibility of lifting of the ban of misclassification of employees as independent contractors simply by the will of the parties (non-respectful of the meaning and purpose of its establishment and existence) and the impossibility of intentions of the parties to change the mandatory rules and assess the tax liability independently on legal provisions (de facto possibility of choice between the provisions of the Income Tax Act, Art. 6 and 7). Thus defined another essential sign, however, does not reflect the scheme of the Act. The principle on which the assessment of individual types of revenue in the Income Tax Act is based, consists in the fact that the exclusion method is used while the income is subsumed under the relevant provisions of the Act. Priority is assessing whether the revenue is the income from dependent activity (Income Tax Act, Art. 6) and the related provisions of the Act (Income Tax Act, Art. 7, 8, 9 and 10) are eventually applied only when it cannot be subordinate under the Art. 6 of the Income Tax Act.

These conclusions are confirmed by the case law of the Constitutional Court in relation to the review of the constitutionality of the decision of Supreme Administrative Court dated 21 March 2004, 5 Afs 22/2003–55 (confirmed by the resolution of Constitutional Court dated 12 January 2005, I. ÚS 352/04). In mentioned decision the Supreme Administrative Court stated: *"for establishing public tax liability is not decisive what type of contract*

participants chose in the sphere of private law; decisive is how the content of the act is defined for purposes of taxation in public law. While regulations of private law allowing to parties to choose legal act which establishes intended legal relationship (e.g. if the contract will be a contract for work done, a contract for the procurement of a thing, a contract of mandate, an agreement for the performance of work, agreement to perform a job, etc.), public regulations of tax law yet do not giving a choice to subjects how they may to tax the income from the concluded legal relationship". The Supreme Administrative Court expressed similarly in a decision dated 24 October 2013, 5 Afs 6/2012–30, in a decision dated 28 August 2009 5 Afs 26/2009–110, or in the decision of 17 January 2008 9 Afs 111/2007–102. For the purposes of income tax collection therefore is relevant whether in this particular case it is the relationship of its nature dependent, not what kind of contract established this relationship. The thesis about possibility that the will of the parties can affect the nature of dependent activity is then completely mistaken, because it would mean that tax payers could substituted the will of legislator, and it must therefore be rejected as an incorrect.

Clingy point of interest is then also the fact that "Czech tax law" treated with the relationship of financial law and private law strictly apart as well as regards compensation for damage caused by the higher tax liability with respect to legal financial limitation periods (see Supreme Administrative Court: 6 As 40/2006–87). Recently, with the change of "objective of tax administration", as proclaims the explanatory report, although the case law has always been more sympathetic towards standpoint of correctness of tax collection, are enforced views contrary and private law within the tax law getting stronger on its influence (see Supreme Administrative Court: 3 Afs 243/2015–28).

The Supreme Administrative Court, however, instead of the examination and the consideration of all signs (Šubrt, 2012: 16–22; Britz, 2011) in the mutual coherence in recent years successively pushed through another novelty in the form of generalization of economic activities to the activities of its nature purely dependent, independent or ambiguous/undecided (Supreme Administrative Court: 2 Afs 265/2015–114).

However, the above-mentioned may in practice break up "just need" of exploration of the indicative signs with the conclusion for the (non)

existence of the essential one. This judicial shift can cause problems because of the implications for inclusion of certain activity into the category of activity independent or for elimination of some activity from category purely dependent. For tax administration, and later for the court, in the end in fact comes to the fact that they will have to assess not only the circumstances of the case (i.e. de facto determine/define indicative signs), but also assess the expressions of will and potential misuses of criteria deduced in certain previous case for compartmentalizment into one of the categories. The Supreme Administrative Court therefore knits only the proverbial whip on itself by this step.

2.3 Brief Comparative Insight – Conclusions of the Austrian Doctrine

On this point it is appropriate to recall the conclusions of the Austrian doctrine on the matter of generalization and determination of signs for the misclassification of employees as independent contractors. Austrian case law and by that created doctrine, unlike the current Czech one, concluded that the crucial are the circumstances of each case and the indicative signs may not always be "absolutely fulfilled" (Engelbrecht, 2002: 29–30). Austrian doctrine concluded not only aforementioned but also strongly pointed out rigidity of some ad hoc – fulfilling institutes would lead to their abuse (Rebhahn, 2011: 1093). By the opinion of the author Czech administrative courts should follow the same pattern.

3 Conclusion

The based work still should be, by the author's opinion, consider for purely tax law institute. This sui generis phenomenon is advisable to examine within the established facts of the case and the degree of clarification of the facts (standards of the burden of persuasion) should be crucial criterion for decision on fulfilling or not the burden of proof. An important part of the search for properly assessed taxes is a discretion on the alternative ways of legal relationship and on the actual content of the obligation between the parties. Summarizing aforementioned author disproved hypothesis that generalization of based (dependant) work is positive and simplify judging

of court and also disproved hypothesis considering idea of approving the possibility of private will impacting matters of case.

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SUPERVISION OF THE METROPOLITAN UNION'S FINANCIAL ISSUES IN POLAND

Małgorzata Ofiarska [1]

Abstract

The law on metropolitan unions does not regulate the issues of their activity supervision and only lists the supervision organs (Prime Minister, voivodes and regional accounting chambers in relation to financial issues). The reference to the provisions of the Act on the Voivodeship Local Government shall be negatively evaluated, since this shall not take into account the special legal status of the supervision in relation to metropolitan unions' financial issues. The subject and object scope of the supervision in relation to financial issues shall be determined by the law on regional accounting chambers. The supervision includes not only the metropolitan union, but also organizational units formed by the union, such as metropolitan budgetary units and budgetary establishments. In the aspect the subject supervision covers above all resolutions and orders of the union's organs related to the formation and implementation of its budget and long-term financial forecast. The goal of this work is to analyze existing legislature in scope of the performance of the metropolitan unions' supervision of financial issues as well as revealing the necessity of an external authority's interference in the area of the financial independence of the units. The basic research method shall be dogmatic-legal method supplemented by the analytical and empirical methods. The researches included the valid legislature, legal doctrine and judicial practice in scope of the supervision of local government financial issues, metropolitan unions in particular.

Keywords: Metropolitan union; financial issues; supervision; regional accounting chamber

JEL Classification: H70, H79

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1 Introduction

The goal of this work is to analyze existing legislature in scope of the performance of the metropolitan unions' supervision of financial issues as well as revealing the necessity of an external authority's interference in the area of the financial independence of the units. According to the made assumption, all the entities of the public finances sector, including the organizational units of the local government, shall be treated equally by the law of public finances. The equal treatment shall also be expressed in the solutions considering the supervision of the financial issues of the local government units and various organizational units formed by local government units, including metropolitan unions. The basic research method shall be dogmatic-legal method supplemented by the analytical and empirical methods. The researches included the valid legislature, legal doctrine and judicial practice in scope of the supervision of local government financial issues, metropolitan unions in particular.

Since 1 January 2016 the Act on Metropolitan Unions of 9 October 2015 has been valid.[2] It is not of comprehensive nature and shall not include satisfactory regulations referring to various areas of metropolitan unions' functioning. The internal structure of this legal act shall refer to the concept adopted in so called system laws on local governments[3] regulating in general way, among others the scope of actions and tasks of local government units, the structure and competence of their organs, rules of making provisions of local law, property and funds of local government units, supervision of local government units' activity. Metropolitan unions, being entities included in the local government sector, have been regulated in a similar way in a separate law.

The legal status of the metropolitan union is determined by the regulations of Art. 1, 2 and 5 of the Act on Metropolitan Unions and Art. 9.2a of the Act as of 27 August 2009 on Public Finances.[4] According to the provisions,

2 Journal of Laws of 2015, item 1890.

3 Act of 8 March 1990 on Municipal Self-Government (uniform text: Journal of Laws 2016, item 446 as amended); Act of 5 June 1998 on Poviat Self-Government (uniform text: Journal of Laws of 2016, item 814 as amended); Act of 5 June 1998 on Voivodeship Self-Government (uniform text: Journal of Laws of 2016, item 486 as amended).

4 Uniform text Journal of Laws of 2016, item 1870 as amended.

the metropolitan union is an association of local government units situated in a given metropolitan area, that constitutes spatially coherent influence zone of a city where a voivode or a local government of the voivodeship reside, with strong functional connections and advanced urban processes, with at least 500.000 residents. A metropolitan union includes municipalities situated within the limits of the metropolitan union and poviats, with at least one municipality situated within the limits of the metropolitan area. The metropolitan union shall be a legal person undertaking public tasks in own name and in sole responsibility, and its independence shall be subject to court protection.

The adoption of the Act on Metropolitan Unions has resulted from the diagnosed by the practice and doctrine necessity to supplement the existing public administration structure in its local government area with elements, i.e. entities capable of efficient satisfaction of mutual needs of the residents of municipalities combined in one organism with neighboring local government units with mutual relations resulting from functional, social, economic and cultural relations (Dolnicki, 2016: 563).

According to the Act on Public Finances, the metropolitan unions are units of public finances sector and according to Art. 4/2 of the Act on Public Finances, the regulations considering local government units shall be applied to the unions, including the regulation of: opinion making by regional accounting chambers of the possibility to finance a deficit presented by a metropolitan union; rules and mode of opinion making by regional accounting chambers in relation to the yearly reports on budget realization as well as financial statements of metropolitan unions; acceptance of notifications from treasurers, who refused countersignature; substitute determination by regional accounting chambers of the metropolitan union's budget in case to adopting such budget by the congregation of the metropolitan union in due time.

2 Legal Basis and the Essence of the Supervision of Metropolitan Unions' Financial Issues

The scope and rules of the supervision of metropolitan unions' financial issues is similar to the one applied in relation to local government units and

to the associations of municipalities and associations of poviats. General frameworks of the local government supervision are determined by the provisions of Art. 148/6 and Art. 171 of the Constitution of the Republic of Poland[5]. The legislator states that Prime Minister shall conduct supervisionof the local government within the limits and forms specified in the Constitution and laws, and the activity of the local government shall be subjectto the supervisionsin scope of its lawfulness. This is the only supervision measure listed in the Constitution of the Republic of Poland. Simultaneously, there is a determination of organs supervisingactivity of local government units, which are: Prime Minister and voivodes, and regional accounting chambers in scope of the financial issues. Provisions of Art. 171/2 of the Constitution of the Republic of Poland specify that regional accounting chambers shall be competent for every act in a financial issue and possible statutory indication of a voivode as an organ competent to supervise an act undertaken by local government units organ in a financial issue shall be unconstitutional (Wilk, 2012: 2).

The Constitution of the Republic of Poland shall determine only one, but very radical (ultimate) supervision measure. Sejm, upon a motion of Prime Minister, may resolve a decision making body of a local government in case of the body's gross violation of the Constitution or laws (Dudek, 2016: 782). The supervision performed by regional accounting chambers is of verifying nature and its goal is to eliminate from legal transactions those resolutions and orders of a local government that are illegal (Celarek, 2015: 257).

The Act on Metropolitan Unions shall not regulate the issue of their supervision and only Art. 16/1 shall list the supervision organs, which are: Prime Minister, a voivode, and regional accounting chambers in scope of the financial issues. This is an *in extenso* repetition of Art. 171/2 of the Constitution of the Republic of Poland. Crucial substantive decisions are included in Art. 16/2 of the Act on Metropolitan Unions with an enforcing notice of appropriate application of the regulations of chapter 7 of the Act on Voivodeship Local Government for the supervision of the metropolitan union's activity. The content of Art. 78/1 of the Act on Voivodeship Local

5 The Constitution of the Republic of Poland of 2 April 1997 (Journal of Laws No. 78, item 483 as amended).

Government is identical with the above cited provisions of Art. 171/2 of the Constitution of the Republic of Poland and Art. 16 of the Act on Metropolitan Unions.

Each of the regulations shall use an expression "financial issues". It is not defined by the legislator. The problem has already been the subject of the interest for the doctrine representatives. It has been stressed that the nature of the financial issues supervision is of a different nature than general supervision of local government's activity. It has been assessed that the supervision in scope of financial issues is the supervision of the way of using patrimonial rights for collecting and gathering public income in order to use them for public expenditures pursuant to political decisions. Thus this is the supervisions of the local government's "own financial issues" and financial issues in relation to which the local government takes co responsibility, for example financial issues related to the implementation of ordered tasks. This way, the supervision of the financial issues has also become the supervision of performing representative functions by local government organs (Dębowska-Romanowska, 2007: 47–48).

The legal meaning of the expression "financial issues" shall include the issues of taking care for the condition of the local government's property in the part expressed in money, its proper use and appropriate conducting the affairs (Dębowska-Romanowska, 2007: 50). The conclusion has revealed that pursuant to Art. 171 of the Constitution of the Republic of Poland the "financial issues", as the subject of supervision, have been separated from the local government's activity and the legislator has undertaken a crucial political decision by expanding the scope of authority's interference. However this has been balanced with the introduction of guarantees that regional accounting chambers shall by the supervision organs, since they are organs separate and from a different system than other supervision organs. This way the supervision in scope of "financial issues" shall by conducted differently from the general supervision (Dębowska-Romanowska, 2010: 249).

The nature of the supervision and its scope are regulated by the provisions of the Act of 7 October 1992 on Regional Accounting Chambers[6]. The

6 Uniform text: Journal of Laws of 2016, item 561, as amended.

scope of the expression "financial issues", used in Art. 16/1 of the Act on Metropolitan Unions and Art. 78/1 of the Act on Voivodeship Local Government shall be determined in the context of Art. 11/1 of the Act on regional accounting chambers These regulations enable the statement that the legislator's intention has been that the expression shall determine the scope of regional accounting chambers' competence within the supervision of the law-making activity of the metropolitan union's organs (WSA in Warszawa: II SA/Wa 213/14). The doctrine includes the view that the system laws of local governments specify the scope of the governmental supervisions of local government units, which shall simultaneously determine the system positions of local government units (Czerw, 2015: 239 and next). However the view may be referred to the general supervision of local government units conducted above all by the Prime Minister and voivodes. In relation to the supervision of the financial issues, conducted by regional accounting chambers, the scope of the supervision shall be determined above all by the provisions of the Act on Regional Accounting Chambers.

The metropolitan union is a public entity. The conduction of financial economy by the entity of such legal status shall take place pursuant to and within the limits of the valid law. The control of gathering and expenditure of financial resources shall be a crucial element of conducting the economy, enabling evaluation of the means usage and possibly undertaking correcting actions, whereas the supervisions of the local government shall be a legal institution that directly decides on the actual scope of independence of its actions. Only the law shall give grounds for such interference and only in cases and forms specified therein (Glumińska-Pawlic, 2013: 147–148).

3 The Limits of Regional Accounting Chambers' Supervision of Metropolitan Unions

The legal limits and means of regional accounting chambers supervision of metropolitan unions are specified above all by the regulation of the Act on Regional Accounting Chambers and additionally the regulations of the Act on Public Finances. The Act on Metropolitan Unions has amended Art. 1 of the Act on Regional Accounting Chambers adding the metropolitan unions to the catalog of the entities controlled and supervised

by regional accounting chambers This has defined the subject limits of the regional accounting chambers' control and supervision of various entities of the local government sector, as well as other entities but only in the scope of the entities' use of subsidies provided from the budgets of local government units This is an exhaustive catalog, but the specification of the last subject category in the catalog shall be possible only after a detailed analysis of the regulations of the separate laws regulating the provision of subsidies (subject, object and goal) from the budgets of local government units to other entities.

The legislator's indication of metropolitan unions in Art, 1/2.1a of the Act on Regional Accounting Chambers as the entities subject to the supervision by regional accounting chambers should be understood in a broad sense. Regional accounting chambers shall supervise not only "financial issues" of the metropolitan unions, but also the financial issues of the organizational units formed by the unions, provided that such organizational units have been listed in the catalog in Art. 1/2 of the Act on Regional Accounting Chambers. Thus it is crucial to establish, based on the provisions of the Act on the Metropolitan Unions, what organizational units may be formed by the unions. Additionally, in view of the regulations of Art.4/2 of the Act on the Public Finances ordering to treat the metropolitan unions equally with local government units, regional accounting chambers shall also supervise entities using subsidies granted from the metropolitan union's budget.

Pursuant to Art. 13 of the Act on Metropolitan Unions in order to implement tasks specified by law the metropolitan union may, among others, form organizational units and their formation and function is subject to appropriate regulations considering self-government organizational units of voivodeship. The comprehensive analysis of the provisions of Art. 13 of the Act on Metropolitan Unions, Art. 41 of the Act on Metropolitan Unions and Art. 8 of the Act on Voivodeship Local Government reveals that the metropolitan union may form both organizational units without legal personality and organizational units being legal persons. The formation of such organizational units is optional, unless the provisions of the law shall impose an obligation to form a specific category of an organizational unit (Bandarzewski, 2005: 82). In particular, the congregation

of the metropolitan union may form budgetary units and budgetary companies, the functioning rules of which shall be specified by the provisions of the Act on Public Finances. It may also form commercial companies and co-operative companies. The diversified legal nature of metropolitan organizational units shall determine the method of bearing responsibility for the outcomes of the units' activity. If they do not have legal personality, they operate within the legal personality of the metropolitan union that bears responsibility for their financial obligations. The metropolitan union shall not bear responsibility for the obligations of legal persons formed by the metropolitan union, unless otherwise decided in a special regulation (Szlachetko, 2016 Comment to Art. 13: 62–63).

Art. 45 of the Act on Metropolitan Unions states that the subsidies may be granted from the budget of the metropolitan union and list of the granted subsidies shall be open. With a proper application of the provisions of Art. 218–220 of the Act on Public Finances it should be stated that the metropolitan union's budget may be the source of specified user subsidies (if stated in separate laws), product subsidies to self-governmental budgetary companies and to other entities (if stated in separate regulations), as well as designated subsidies. However granting subsidies from the metropolitan union's budget may take place with the consideration of the union's scope of tasks specified in Art. 12 of the Act on Metropolitan Unions (the tasks include: formation of spatial order, development of the union's area, public transport on the union's territory, cooperation in determining location of national and regional roads on the territory of the union, promotion of the metropolitan area, and based on the agreement with local government units the metropolitan union may implement public tasks included in the scope of action of a municipality, poviat or voivodeship's local government or to coordinate the implementation of the tasks, and based on an agreement with a governmental administration organ, it may implement public tasks included in the scope of the governmental administration's actions).

To sum up, the interpretation of the provision of Art. 1/2 of the Act on Regional Accounting Chambers, aiming at the determination of subject limits of the supervision performed by regional accounting chambers in scope of the metropolitan union's financial issues shall bring to the

conclusion that such supervision includes financial issues of the union and financial issues of the metropolitan organizational units, including the metropolitan legal persons, and other entities (in the latter case only in scope of their use of subsidies granted from the metropolitan union's budget).

The determination of the subject limits of the supervision performed by regional accounting chambers in relation to the metropolitan unions and organizational units formed by the union and the entities using the subsidies granted from the union's budget requires the analysis of the provisions of Art. 11/1 of the Act on Regional Accounting Chambers, reference to which is included in Art.1/2 of the Act on Regional Accounting Chambers. This way it is possible to determine subject limits of the expression "financial issues" applied in the context of the supervision performed by regional accounting chambers The unclear expression (Srocki, 2010: 90) "financial issues" has been specified by extensive list of such issues in Art. 11/1 of the Act on Regional Accounting Chambers (Kania, 2002: 143). The doctrine includes a view that the list of the cases subject to the supervision by regional accounting chambers based on Art. 11 of the Act on regional accounting chambers may be considered exhaustive, but only in relation to basic financial issues (mostly budgetary) of the local self-government (NSA: II GSK 261/07). The lack of the legal definition of "financial issues" shall not make the catalog completely closed (Dytko, 2005: 67), so Art. 11/1 of the Act on Regional Accounting Chambers shall not include all types of legal acts that should or may be included to the acts regarding "financial issues" (Stasikowski, 2006: 45). However the catalog may not be interpreted in an expanding way, since this could lead to a situation where each task regarding the competence of a municipal government's entity, implementation of which shall result in financial outcomes, should be considered as "financial issue". Thus the legislator shall form a catalog of issues included in the subject matter of regional accounting chambers, with Art. 11/1 of the Act on Regional Accounting Chambers specifying the subject of the regulations and orders made by local government organs, the legality of which is supervised by regional accounting chambers (WSA in Białystok: II SA/Bk 476/05).

In scope of the supervisory activity the subject matter of regional accounting chambers shall include the regulations and orders made by the organs of the metropolitan union in the following cases: the procedures of adopting the budgets and its amendments; the budget and its changes; making obligations influencing the amount of the metropolitan union's public debt and providing loans; regulations and the scope of granting subsidies from the metropolitan union's budget; taxes and local fees subject to the provisions of the Act – Tax ordinance;[7] a discharge; long-term finance forecast and its changes. The catalog of the metropolitan union's financing sources, included in Art. 51a of the Act on Local Government Units Income,[8] does not include taxes and local fees, thus this category of financial issues does not exist in the financial activity of the metropolitan union and performance of regional accounting chambers' supervision in this scope in relation to the subject is groundless.

The amendment of Art. 11/1 of the Act on Regional Accounting Chambers made on 29 November 2003[9] should be positively evaluated, since it provides a detailed information that the catalog of the cases specified in the regulation shall be subject to the supervision by regional accounting chambers From the moment of introducing the provisions of the Act on Regional Accounting Chambers to the moment of the above-mentioned amendment of Art. 11/1 of the Act on Regional Accounting Chambers the expression "chamber examines" resolutions and orders made by the organs of local government units in cases specified in the regulation was applied. The expression "chamber examines" should not be treated as a synonym of the expression "is subject to supervision". The lack of the specified regulatory coherence between Art. 1/2 and Art. 11/1 of the Act on Regional Accounting Chambers could form a substantive barrier in a determination of unambiguous subject limits of the supervision made by regional accounting chambers After the amendment of Art. 11/1 of the Act on Regional

7 Act of 29 August 1997 Tax Ordinance (uniform text: Journal of Laws of 2015, item 613, as amended).

8 Act of 13 November 2003 on the Income of Local Government Units (uniform text: Journal of Laws of 2016, item 198, as amended).

9 Act of 24 July 2003 on the Change of the Law on Regional Accounting Chambers, Law on Remuneration Formation in the State Budget Area and on the Change of Some Laws (Journal of Laws No. 149, item 1454).

Accounting Chambers, even despite the lack of the legal definition of the expression "financial issue", it may be stated that the system law on regional accounting chambers shall determine the subject scope of the supervision in financial cases of various self-governmental entities (NSA: FSK 1748/04), including metropolitan unions since 1 January 2016.

4 The Criteria and Means of Regional Accounting Chambers' Supervision in Financial Issues of the Metropolitan Union

Pursuant to Art. 171.1 of the Constitution of the Republic of Poland the activity of local government is subject to supervision in relation to legality. This shall be the only criterion of the supervision. It is repeated in Art. 79 of the Act on Voivodeship Local Government included in chapter seven of the law, with reference in Art. 16/2 of the Act Metropolitan Unions in scope of the supervision of the metropolitan union's activity. Pursuant to Art. 80 of the Act on Voivodeship Local Government, the supervision organs, including regional accounting chambers have the right to demand information and data considering organization and functioning of the metropolitan union, which are necessary for the performance of the entitled supervisory rights. This means that the execution of the competences by regional accounting chambers by its nature has to include the analysis of not only the provisions of law and the researched resolution of the union's congregation, but also other documents enabling the evaluation if there was a situation justifying the rescission of the resolution (WSA in Rzeszów: I SA/Rz 647/06).

The provisions of Art. 81 of the Act on Voivodeship Local Government safeguard appropriate implementation of the above-mentioned supervision organ's obligation. The provisions, when applied appropriately to the metropolitan union, create an addressed to the head of the union's management, obligation to provide regional accounting chambers with resolutions covered by the scope of supervision by regional accounting chambers, within 7 days from the moment of their adoption. The catalog of the supervision means applicable by regional accounting chambers in relation to the metropolitan union shall result from the provisions of the Act on Voivodeship

Local Government (Szlachetko, 2016 Comment to Art. 16: 75). Thus the supervision organ shall be entitled to:

- Adjudications (consolidated or in part) on invalidity of the union congregation's or management's resolution which is against the law, within the time not exceeding 30 days from the moment of delivering the resolution (The Act on Voivodeship Local Government, Art. 82.1);
- Stop implementation of a resolution on the moment of initiating an investigation related to a decision on the invalidity of the resolution or when the investigation is in progress (The Act on Voivodeship Local Government, Art. 82.2);
- Indicate (without stating invalidity of the resolution), in case of minor violation of the provisions of law, that the resolution has been issued in breach of law (The Act on Voivodeship Local Government, Art. 82.5).

The expression "against the law" should be understood as a condition of "nonconformity with law", that authorizes a supervisory intervention, in this case application of a specific decision. The criterion of "significance" of violating the law is meant to grade between the violation scale and the results of stating the violation, not to select the violations of law of obvious nature. Thus it is not possible to eliminate the cases where the statement of "significant" violation of law is preceded by an extensive analysis of many regulations and adjudications and as a result by a sophisticated legal elaboration addressing various law categories (Węgrzyn, 2014: 80 and next). Pursuant to Art. 82/1 of the Act on Voivodeship Local Government a significant violation of law shall be the situation where the content of the regulation in question would have a different letter when formed in compliance with the provisions of law (WSA in Białystok: II SA/Bk 855/13). However a significant violation of law should not be considered a gross violation of law, since not every significant violation of law should consist in a gross violation (WSA in Olsztyn: I SA/Ol 185/12).

The catalog of the supervision means takes into consideration the rule of the supervision proportionality, according to which the statement of the resolution's invalidity requires a significant violation of law, and in case of a minor violation of law the invalidity of such act shall not be stated,

with the limitation to the indication that it has been issued in violation of law. The legislator has made the supervision organ obliged to moderate the supervision actions, minimize the supervision interference and gradate the supervision measures. The supervision organ in their supervision activity should take into consideration the orders when the valid legal regulations give a possibility to select a supervision mean appropriate for the protection of a goal, for which the supervision is established, which is the function of only lawful legal acts, and the protection of the local government's independence (Chlipała, 2014: 27–29).

5 Conclusion

During the first year of its functioning, the Act on Metropolitan Unions has not resulted in a formation of a single such union. The law stands that the creation of a metropolitan union depends on the initiative of the Council of Ministers and their regulation in which the limits of individual metropolitan areas are determined for the needs of forming the metropolitan unions, in individual metropolitan areas such metropolitan unions are formed and they are named. Such mode of the unions' formation should be negatively evaluated, since they should be treated as another form of cooperation of local government units (municipalities in this case). Similarly to other forms of cooperation (e.g. unions of municipalities, municipal agreements) they should be undertaken as a result of the interested entities' initiative, i.e. municipalities. The future legal acts could include a determination of the criteria (e.g. area, population and other) to be fulfilled by the created metropolitan union. The Council of Minister or a minister proper for the administrative cases should only verify fulfilling the criteria by municipalities forming such union and would enter the union into a proper register.

The internal structure of the Act on Municipal Unions is a continuation of the concepts applied in the valid system laws on local governments. None of them provides a comprehensive regulation on the formation and functioning rules of municipalities, poviats and voivodeships. Thus there is a need to apply numerous references to the provisions of separate laws, and simultaneously the legislator has not avoided many repetitions in the

system laws on local governments. Similar defects are included in the Act on Metropolitan Unions. This evaluation also considers the regulation of the supervision of such unions' activity.

The legislator should pass one Act on Local Government (Bukowski, 2014: 54–66) would have a status of a local government code, with an exhausting regulation of all areas related to the formation and functioning of local government units, including various cooperation forms of local government units and the supervision of their activity (also in scope of the financial issues). However the implementation of the concept requires long-term legislative works and persuading the legislator. There is also a possibility to suggest the work mode consisting in the gradual codification of the regulations of the local government law. The first decisions should include gathering in one law all the aspects considering the system of municipalities and poviats, their tasks, income sources and cooperation forms. Metropolitan unions constitute the form of the interested municipalities' and poviats' cooperation and the codification of their functioning rules, including cooperation within such an organizational structure, is fully justified.

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THE BUDGETARY PROCESS OF TERRITORIAL SELF-GOVERNING UNITS IN THE CZECH REPUBLIC

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Abstract

This paper deals with the contemporary issue of financing territorial self-governing units and the functioning of the municipal financial system in the Czech Republic. Attention focuses on legislation of the budgetary process in the framework of economic management of municipalities and regions, especially on its individual stages. It also examines long-term planning, special purpose use of funds, funding for economic management and financial control.

The first aim of this paper is to describe the budgetary process and its importance for general and regional budgets in the Czech Republic. The main aim is, based on a description and critical analysis or through comparison, as well as synthesis of gained findings, to confirm or reject the hypothesis that the budgetary process of territorial self-governing units as regulated by budgetary rules is satisfactory, or on the contrary, unsatisfactory.

Keywords: Budget; Process; Budgetary Process; Municipalities; Regions; Self-Governing Units; Principles; Budgetary Funds; Draft Budget; Financial Outlook.

JEL Classification: O17

1 Introduction – Generally Regarding the Budgetary Process

Budgets of territorial self-governing units are formed of budgets of municipalities, regions, voluntary associations of municipalities, whereas we also include into this system statutory cities, the city of Prague, boroughs and

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districts and the budgets of Regional Councils of Cohesion Regions. We may speak of these budgets as budgets of territorial self-governing units or as local or possibly municipal budgets as certain authors do in technical literature.

Municipal, i.e. local budgets, are among public budgets of the lowest level in terms of individual levels of government. We infer their public nature by the fact that municipalities and regions are public corporations and these budgets are approved at meetings of their respective councils, which are public.

We may state in general that the budgetary process inherently involves work procedures by which annual activity relating to budgetary management should be conducted (Mrkývka, Pařízková, 2009: 228).

The basic legal regulation for the creation, content and function of budgets of territorial self-governing units, but also the budgetary outlook, budgetary management, the budgetary process and the final account, is Act no. 250/2000 Sb., on Budgetary Rules of Territorial Budgets, as amended (Budgetary Rules of Territorial Budgets Act). Further legislation relating to economic management of territorial self-governing units are Act no. 128/2000 Sb., on Municipalities, as amended, Act no. 129/2000 Sb., on Regions, as amended, and Act no. 131/2000 Sb., on the Capital City of Prague, as amended, which augment budgetary rules mainly for the circle of entities engaged in part in compilation of the budget and its approval, and in part in compilation of the final account, and simultaneously in the framework of economic management itself. Of course however, budgetary management cannot avoid legislation regulating control mechanisms. These mainly include Act no. 320/2001 Sb., Financial Control in Public Administration, as amended (Financial Control in Public Administration Act), and Act no. 420/2004 Sb., on Reviews of Economic Management of Territorial Self-Governing Units, as amended (Act on Reviews of Economic Management of Territorial Self-Governing Units), including implementing regulations to these acts.

The budgetary process at the level of territorial budgets involves financial and administrative proceedings sui generis, i.e. a legally established work procedure of state bodies valid for compilation, approval, performance and control of budgets. In all these phases of the budgetary process, it is necessary to uphold certain rules and principles (Pařízková, 2008: 152). These

principles can be broken down based on where they will be applied, either in the actual budgetary process or when managing budgetary funds.

Principles applied in the budgetary process:

a) The principle of annual compilation and approval of the budget, often indicated as the principle of limited time use of funds. This concerns indication of such a fact that budgetary funds can be used only in the relevant budgetary year for which they were approved;
b) The principle of reality and truthfulness of the budget should mean compilation of such a budget that comes from analyzing economic processes, the ability to estimate future potential development. Also used for calculation is the method of expressing the minimum necessary revenues and maximum amount of expenditures;
c) The principle of expediency expresses the fact that budgetary funds may only be used for purposes to which they were earmarked, to cover essential needs, for measures founded on legislation and for ensuring the uninterrupted running of municipalities;
d) The principle of completeness and unity of the budget is implemented by means of the budgetary structure, which ensures clarity of the entire budgetary system;
e) The principle of long-term balance means that it is possible in the short term to apply deficit financing according to aims of the financial policy.
f) The principle of publicity is expressed in part by the fact that the budget is negotiated publicly, and in part that it is publicly approved by representative bodies (Bakeš, Karfíková, Kotáb, Marková a kol., 2009: 128–129).

Principles applied in economic management of budgetary funds:

a) The principle of clarity of expenditures before revenues expresses the fact that expenditures should be used for economic growth, for which it is necessary to ascertain the relevant funds. Budgetary revenues should therefore stabilize the economy in order to facilitate its growth;
b) The principle of efficiency and economy, which determines the most economic use of budgetary funds. This means that it is necessary to achieve as high a level of revenues as possible, and economically and efficiently utilize budgetary funds, which can also be specifically

earmarked, so it is necessary to see to it that their expenditure is in line with the aim that led to their provision. The time aspect may also be important sometimes;

c) The principle of limiting movements in the budget and payment of needs not secured in the budget is specified in our country in the Budgetary Rules Act (Act no. 218/2000 Sb., on Budgetary Rules, as amended), which determines that only based on statutory authorization is it possible in certain measure and under specifically determined conditions to implement movements in the framework the given budget;

d) The principle of determining rules in case of a provisional budget means that for the period when the budget has not been approved or has not yet been compiled, such period must be made subject to certain rules, and these must also be determined in a legal standard so they could be applied in case of need (Pařízková, 2008: 154).

Individual budgetary principles act comprehensively, and mostly concern requirements for construction of public budgets also enabling democratic control by the elected representatives of the citizens. The entire budgetary process should be run by budgetary principles in all its phases, meaning from the compilation of the draft budget to consequent control until the very end of the budget period.

The actual budgetary process for all budgets is managed by these rules, and includes six basic circles of activity, which must be secured by a determined team of employees – bodies of the budgetary system (Mrkývka, Pařízková, 2009: 229).

2 Budgetary Process of Territorial Budgets

The budgetary process can also be generally considered as a group of special regulatory processes, mainly for the state budget, comprised of the following stages:

1. Compilation of the draft budget and budgetary outlooks;
2. Approval of the budget and budgetary outlooks;
3. Disclosure and publication (publicity);
4. Budgetary structure;
5. Provisional budget;

6. Breakdown of the budget;
7. Economic management according to the approved budget;
8. Changes in the budget;
9. Control of budgetary management- internal and external;
10. Time use of the budget;
11. Expediency of budgetary funds;
12. Breach of budgetary discipline;
13. Assessment of the budget and compilation of the final account (Mrkývka, 1997: 77).

The budgetary process at the level of territorial self-governing units ("TSGUs") represents activity of municipal and regional bodies, both elected and executive, affiliated with compilation of the draft budget, its approval and implementation during the budget period, and regular and consequent control of its performance.

In practice, it will therefore concern compilation of budgetary outlooks and the budget itself according to the budgetary structure, or compilation of a provisional budget, also creation of a breakdown of the budget after its approval, followed by the actual economic management according to the budget, or performance of changes in the budget, and following completion of the fiscal year, compilation and approval of the final account. Still affiliated with this is the time use of the budget, expediency of budgetary funds and breach of budgetary discipline.

We can see the stages of the budgetary process in the following steps:

- Compilation of the draft budget and budgetary outlooks,
- Negotiation on and approval of this draft budget and budgetary outlooks,
- Regular performance of the budget and regular control of performance,
- Consequent control and compilation of an overview of the true development of performance of the budget over the past budget period (Pařízková, 1998: 92).

Individual stages of the budgetary process are similarly applied in the entire budgetary system, and though the budget period is one year and is referred to as the fiscal year, the process normally last a year and a half to two years (Mrkývka, Pařízková, 2009: 230–231).

2.1 Draft of the TSGU Budget and Budgetary Outlooks

The first phase of the budgetary process is compilation of the draft budget and budgetary outlook and affiliated work, which must be commenced in time – perhaps in mid-year prior to the given fiscal year – in order to elaborate all information and requirements and discuss them. This stage appears to be the most complicated and most difficult, because both planned revenues, either its own or from various entities, e.g. in the form of gifts, and planned expenditures for public goods and spending programs, were realistic. The budget must be compiled in relation to the relevant budgetary outlook and must respect data from the breakdown of the valid state budget or of a provisional budget, and in relation to the budget of the relevant region (Marková, 2000: 141–142). In this phase of work, mainly the following estimates are taken into account:

1. Revenue from local taxes, fees, shares in state taxes and subsidies;
2. Expenditures at the municipal level, which represents development of the public sector;
3. Expenditures for considered or intended socio-economic development of the given area (Pařízková, 2008: 154–155).

The problem of compiling a budget and budgetary outlooks falls within performance of its separate powers just like the other stages of the budgetary process. Neither the respective Acts on Municipalities and Regions nor budgetary rules are determined by bodies, into whose competencies the draft budget and budgetary outlook would belong, but taking into account the tasks of the municipal and regional boards defined in the proceedings, among which is also securing economic management of municipalities and regions according to the approved budget, and with regard to others, it will be in the competency of the municipal board and regional board to see to the draft budget directly in cooperation with the financial department or financial committee or by means of a specialized, e.g. financial work group or committee if established. However it is only a certain recommendation, because each municipality and region adjusts creation of the budget to its own conditions, and in practice for example, the chief economist may compile the draft budget in cooperation with the mayor or council members, or a financial committee, and it is only up to the municipality and region.

2.1.1 Budgetary outlook

Based on Budgetary Rules of Territorial Budgets Act, TSGUs are obliged to compile not only annual budgets, but also budgetary outlooks for the period of 2 to 5 years following the year for which the annual budget is compiled.

The law makes no mention of a procedure for compiling the budgetary outlook, nor does it determine the circle of entities forming its structure. It normally comes from the facts of previous years, and takes into account the future aims of territorial self-governing units. Its compilation is mainly based on concluded contractual relationships and accepted obligations. To ascertain the realistic nature of the budgetary outlook, the principle applies that it is not possible to over-appreciate revenues and under-appreciate expenditures of future years. In addition, the internal structure of budgetary outlooks is not prescribed by budgetary rules. In terms of revenues, it is important to estimate the development of tax revenues based on budgetary determination of taxes and development of its own non-tax revenues from provided services, from rental of assets, etc. It is further possible to include non-recurring revenues for example from sale of municipal assets. Also possible to include into the budgetary outlook are subsidies that TSGUs have a realistic chance of obtaining.

Into expenditures it will be necessary primarily to include securing of tasks arising from the mission of the organization (e.g. public lighting, communal waste removal), performance of state administration and further obligations arising from the law. It is furthermore necessary to include obligations from concluded contracts, installments and interest on credit and loans, expenditures affiliated with care of its own assets, contributions to operating established or founded organizations, expenditures in investments that have already started in previous years, and only then expenditures on new investments (Budgetary Rules of Territorial Budgets Act, Art. 3). Deficit financing operations may be secured by a financial surplus of previous years or repayable financial resources, for whose future payment the municipality will have sufficient available funds.

The budgetary outlook may be approved in detailed breakdown according to individual paragraphs and items of the budgetary structure, but this is not

an obligation as it is not required by law, and it may easily just be a summarized overview of future revenues and expenditures. What is of course most important is that budgetary outlooks must be approved annually pursuant to Art. 3 of Budgetary Rules of Territorial Budgets Act.

2.1.2 Compilation of the municipal draft budget

The budget of TSGUs is a financial plan by which its economic management is governed. It is compiled only for a period of one calendar year in relation to the budgetary outlook, and further based on data from the breakdown of the state budget for the relevant year and in relation to other public budgets, with which the territorial self-governing unit has a financial relationship.

Draft budgets of territorial self-governing units are compiled by executive bodies, in the CR this generally means the finance department (Provazníková, 2007: 64–65) or the finance committee. This is one of the most difficult phases. The point is for planned revenues, both its own and revenues flowing into local budgets in the form of transfers from the state budget or other public budgets, or from state specific-purpose funds or various other entities (gifts, etc), as well as planned expenditures for securing and financing public goods, in a number of countries even financing of municipal expenditure programs arising mainly from election campaigns, to be realistic and capable of being fulfilled.

The budget is generally compiled as balanced**,** but it may be approved as surplus**,** if certain revenues of the given year are determined for use in consequent years, or if they are determined for paying the principle on a loan. The budget may be also approved as deficit and only in case it will be possible to pay the deficit from one of the following possibilities:

- Funds from previous years;
- Contractually secured loan, credit, repayable financial assistance or revenue from sale of its own bonds;
- By sale of financial assets bound in a different form than funds in a bank account (debt or equity securities) (Budgetary Rules of Territorial Budgets Act, Art. 4).

From this it arises that a deficit budget that does not have funds to cover the deficit cannot be approved.

A bank account balance should be included into the draft budget if it is not necessary to cover a deficit in economic management. Certain TSGUs have a tendency to use this balance in full, including the part that they do not need to cover the deficit, i.e. they do not expect true consumption in the given budget year and categorize it as an expenditure reserve. But it is always necessary to give priority to and compile a realistic budget, and only then in case of a lack of funds of the budget year, to use the balance from previous years and incorporate them into the budget. The draft budget is prepared so that afterwards, the approved budget would express binding indicators, to which executive bodies of the territorial self-governing unit are bound in their economic management, as are legal entities created or founded by TSGUs and by other persons that are supposed to be or become recipients of subsidies or contributions from the budget. Besides the budget, we also monitor financial operations concerning the foreign funds account, the account of associated funds and commercial activity. The profit or loss of commercial activity appears in the budget by no later than the end of the calendar year so that it could be discussed in the framework of the final account of the municipality.

The law provides no obligation to wait for the approval of the budget of the TSGU until the moment when approval occurs of the state budget by the Chamber of Deputies. It may be approved even prior to this, of course without subsidy relationships. After approval of other public budgets, the territorial self-governing unit must remove differences in subsidy relationships by an obligatory budgetary measure (e.g. a contribution to the state administration, subsidy for social benefits, etc.). The act also states that if TSGUs take part in implementing a program or project co-financed from the European Union budget, its budget for the relevant calendar year must contain the determined volume of funds earmarked for its co-financing (Provazníková, 2007: 64–65).

As opposed for example to the state budget, the draft budget of TSGUs must be adequately published at least 15 days prior to its deliberation by the municipal council, specifically on their notice board and in a manner enabling remote access. The draft budget may be published on the notice board in narrower scope, which contains at least information on revenues

and expenditures of the budget in classification according to the highest units of type classification of the budgetary structure. The complete wording of the draft budget is published in a manner enabling remote access. Other options include publishing by means of the TSGU's Website, its local magazine, etc., so that citizens could express themselves regarding the budget. Citizens of the municipality may make comments to the draft budget either in writing within the established term or orally at the council meeting, because the law states that budget negotiations are a public affair (Pařízková, 2008: 156).

2.2 Discussion and Approval of Budgets

The budget approval stage is comprised of discussing the draft proposal and actual budget approval. Negotiation and approval of the budget are realized at the local level, i.e. in the CR in the municipal and regional council. The stated body also is obliged to regularly check the material and cash basis performance of the budget, to analyze possible causes of non-performance of the budget and search for adequate measures, which would remove the effects of negative influences in budgetary management. The structure of revenues and expenditures is approved as well as the total budget amount. If the budget is not approved prior to the start of the relevant budget period, i.e. prior to January 1 of the budget year, the territorial self-governing unit shall manage from January 1 of the budget year until approval of the budget according to the reality of the same period in the previous budgetary period (calendar year) – this concerns a provisional budget, as a consequence of a provisional budget at the state budget or due to underlying causes of individual articles of territorial budgets. Such rules arise either from implementation of tasks imposed for such a case by the law governing budgetary rules of the CR, or the council of the territorial self-governing unit must determine them. Budgetary revenues and expenditures implemented in the period of a provisional budget become revenues and expenditures of the budget after its approval (Budgetary Rules of Territorial Budgets Act, Art. 13/3). The approved budget includes planned subsidies from the state budget. Since at the start of the budget period, TSGUs need not yet know the volume of subsidies that they will obtain from the state

budget, or from other budgets and funds in the budgetary system, provisional budgets are formed rather frequently, though they not necessarily for very long, where in developed countries they generally do not exceed one month, and here in the Czech Republic generally two to three months (Pařízková, 2008: 157).

Neither municipal or regional establishment nor budgetary rules mention in what form the budget of TSGUs should be approved, for example a generally binding ordinance of municipalities with independent competency (Pařízková, 2008: 17–28). Approval of the budget of the territorial self-governing unit in current conditions of the Czech Republic thus occurs only by resolution of the council.

The budget may be approved in these classifications:

- Classification only into paragraphs;
- Classification of revenues according to items and expenditures according to paragraphs;
- Classification of revenues and expenditures according to items and paragraphs, etc.

2.3 Budget Breakdown, Performance and Its Control

Linking to the budget approval stage is the next part of the budgetary process, i.e. breakdown of the budget, a part of which is sharing the binding indicators of the budget to those entities obliged to abide by them, e.g. contributory organizations created by the TSGU. The breakdown of the budget is performed without undue delay following approval of the budget in the council, and it is now only an administrative act not approved by any particular body. Economic management in the framework of the budget represents a complicated process of revenues and expenditures, so it concerns the gathering of funds, their allocation and redistribution, and final use in the framework of creation and consumption of material production of public goods at the local level.

2.3.1 Changes in Budgets

After approval of the budget, the need may arise to perform changes or modifications in the approved budget. The reason may be organizational

changes, either methodical or material. Organizational changes (by decision of a higher body) may be e.g. creation of contributory organizations or on the contrary, termination of already existing contributory organizations, establishing a limited liability company, transfer of certain activities into newly formed economic (commercial) activity, etc. Methodical changes (change in competency of a legal regulation, change in price) are evoked by changes in legislation influencing financial management of municipalities, for example a change in the VAT rate, a change in budgetary determination of taxes, etc. Material changes occur from facts objectively affecting economic management, thanks to which changes may occur in budget indicators, for example failure to realize an investment, unexpected increase in costs of supplies of electricity, lower performance of tax revenues than expected, etc.

Therefore, such changes of the budget are distinguished, which must be performed compulsorily, as opposed to other changes arising rather only as a logical consequence of the arising situation. It is obligatory for example to prevent the origin of a budgetary deficit. On the other hand, if a surplus forms by budgetary revenues being exceeded, it is not necessary to react by increasing budget expenditures. Changes of the budget are performed by means of budgetary measures**,** which are registered according to a time sequence in order to preserve the overview of the currently valid and approved budget, and for their compilation the same rules apply as for the budget in general (Pařízková, 2008: 159).

Budgetary measures include:

1. Movement of budgetary funds, during which individual revenues or expenditures influence one another without changing their overall volume or approved difference of total revenues and expenditures;
2. Use of new revenues not anticipated by the budget to pay new expenditures unsecured by the budget, thereby increasing the overall volume of the budget;
3. Binding budget expenditures, if their coverage is threatened by nonperformance of budget revenues, by which the budget volume decreases.

Budgetary measures are performed compulsorily under the law:

a) If it concerns changes in financial relationships to a different budget (e.g. subsidies from another public budget were later increased or decreased);
b) If it concerns changes of binding indicators towards other persons (if different allocation of funds is to occur);
c) If the threat of a budgetary deficit arising exists (necessary to limit expenditures or use new sources of financing) (Budgetary Rules of Territorial Budgets Act, Art. 16).

It is also appropriate to perform a change in the budget if:

1. The option arises of more efficient use of its own revenues in comparison with the approved budget;
2. Further redistribution of budget expenditures is to occur (Rektořík, Šelešovský, 2002: 49).

The obligation currently applies to perform every budgetary measure prior to performing an expenditure not secured by the budget. After performing an expenditure not secured by the budget, it is possible to perform the budgetary measure only upon a natural disaster or accident threatening lives and property, during performance of a monitoring obligation imposed by legal decision, upon obtaining a subsidy prior to the end of the calendar year, or if it concerns funds regulated in Art 28/12 of the budgetary rules of territorial budgets (Budgetary Rules of Territorial Budgets Act, Art. 16).

2.3.2 Control of Budgetary Management

Elected and executive bodies of TSGUs regularly control the regular performance of the budget during the budget period, specifically material and cash basis performance, they analyze the causes of non-performance of the budget and search for adequate and effective measures that would remove the effects of negative influences in budgetary management. Also important besides regular control of performance of budgets is consequent control by both elected and executive bodies of the territorial self-governing unit of performances implemented after the end of the budget period. Emphasis is placed mainly on analyzing economic management and possible causes of a budget deficit. The outcome should be a proposal for measures leading

to further quality improvement of budgetary planning and budgetary management of the territorial self-governing unit, specifically in relation to further specification of the budgetary prognosis.

Rules for control, frequency in the given year, the specific purpose of control, etc., are established by the council, which is a part of its exclusive authority based on the respective Acts on Municipalities (Mrkývka, 2004: 376) and Regions. Furthermore, performance of financial control is ensured pursuant to Financial Control in Public Administration Act.

This concerns financial control formed of three types of control systems (types of control):

1. The financial control system performed by control authorities, which inherently includes financial control of facts decisive for managing public funds mainly when handling public expenditures including public financial support for controlled persons, prior to their provision, in the course of their use and consequently after their use. This type of control is indicated as public control;
2. The financial control system performed according to international treaties, which inherently includes financial control of foreign funds performed by international organizations according to declared international treaties, by which the Czech Republic is bound;
3. Internal control system in public administration bodies. This system includes two control mechanisms:

a) Financial control ascertained by responsible managers as a part of internal management of the public administration body upon preparing operations prior to their approval, upon regular monitoring of implemented operations until their final settlement and accounting, and consequent verification of selected operations in the framework of assessing attained results and the correctness of economic management. We call this control "managing control";

b) Organizationally separate and functionally independent review and assessment of the adequacy and effectiveness of managing control, including verification of the accuracy of selected operations. This control is called an "internal audit" (Mrkývka, Pařízková, Tomášková, 2014: 77).

2.4 Final Account

After the calendar year ends, data on the annual economic management is collectively elaborated into the final account. The final account of the territorial self-governing unit contains all data on budget revenues and expenditures, where they are broken down in the budgetary structure, and still contain data on further financial operations, including creation and use of funds in detailed breakdown and content, so that it would be possible to assess the financial management of municipalities of regions and their created or founded legal entities and economic management of their assets. A part of this is accounting of financial relationships to the state budget, budgets of regions, municipalities, state funds, the National Fund and other budgets, and to economic management of other persons (Budgetary Rules of Territorial Budgets Act, Art. 17). The procedure of financial settlement to other public budgets is stated in the Decree of MF no. 551/2004 Sb., a decree by which principles and terms of financial settlement of relationships are settled with the state budget, state financial activity or the National Fund, and concern the obligatory terms for submitting data and ensuring the return of unused funds. The municipality and region themselves determine the procedure of financial settlement in the framework of their own budget, e.g. towards their own contributory organizations or towards other entities financed from the budget.

At the moment when the municipality or region does not transfer undrawn funds to the account of a different public budget in the relevant terms based on the aforementioned decree, breach occurs of budgetary discipline. Undrawn special-purpose funds, which the municipality and region transfer after a term determined by the decree, become withheld budgetary funds of the state budget and thus concern a breach of budgetary discipline by the relevant TSGU, and it is obliged to transfer these funds to the locally competent financial authority (Budgetary Rules Act, Art. 44/1 b).

Existing legislation leaves the obligation to territorial self-governing units to have their economic management reviewed for the past fiscal calendar year. Municipalities and regions based on Act on Reviews of Economic Management of Territorial Self-Governing Units may request either a regional authority to perform review of economic management by June 30

of each calendar year, or within the same term, they may notify the regional authority that they have decided to award the review to an independent auditor. After that however, the municipality must inform the relevant regional authority about its conclusion of an agreement with an auditor by January 31 of the following year. It is up to each municipality whether to have the final account verified by an auditor, which is of course a paid service, or if it selects free verification by the relevant regional authority. For regions, there is no choice and review is performed by the Ministry of Financial within the same terms as for municipalities (Mrkývka, 2004: 376). The report on the result of the review of economic management is a part of the final account during negotiations on it in the TSGU.

It is appropriate for the draft of the final account of the territorial self-governing unit to be first discussed in the finance committee and in the board, whereas here too, it is necessary to preserve the procedural element of publishing the draft of the final account for a period of at least 15 days prior to it being taken up in the council of the municipality and region. Citizens may comment on the final account either in writing within a term determined upon its publishing, or orally at the meeting of the council. Negotiations on the final account must take place by June 30 of the following year, and it is concluded by expression of consent without objections or consent with objections, based on which the municipality and region will adopt measures necessary for remedying ascertained flaws and deficiencies. If deficiencies emerge from the review report, even if not serious in nature, the council of the municipality and region is obliged to adopt corrective actions**.** If ascertained deficiencies are not removed by the next review, its result may also be influenced thereby.

Budgetary management and use of budgetary funds for the given year should basically correspond to contribution in kind, with which revenues and expenditures relate. The basis of fluid financing of economic management is the requirement that payment by deposit or installment of provided performance would occur in contractual relationships between business partners. We must therefore concede that the timing of revenues and expenditures differs, as opposed to material performance. In any event however, one must point out that what is important for inclusion into the relevant

fiscal year is the date by which the given financial operation is registered and appears in the status of funds in relevant bank accounts. Temporal application of budgetary funds upon provision of a subsidy or contributions may be determined not only to the end of the year, but either to a previous term, or, on the contrary, to a later term, e.g. for longer lasting terms. The body providing funds always selects the application methods, but the territorial self-governing unit may select the method it finds most effective when deciding on using its own funds among their recipients.

Expediency of use of budgetary funds is determined individually in relation to a specific goal, for example for building gas installations, for repairing a municipal building, for forestation, etc., or based on sector in relation to the needs of the given sector, for example for senior citizens' homes, for education, culture, fire fighters, etc., or regionally in relation to the needs of the defined territory or its part or areas, for example for a certain municipality or region (Budgetary Rules of Territorial Budgets Act, Art. 19). These stated criteria in practice are very frequently combined together. The recipient of specific funds is obliged to uphold the determined method of specific use, because otherwise it would breach budgetary discipline or would fail to fulfill a contractually accepted obligation, whereas in both cases, this would form a reason for sanctioning. Expediency may concern a municipality and region in both the role of recipient of foreign funds, in which case it must respect this, but simultaneously in the role of provider. Time or purposefully limited applicability of funds is usually affiliated with their return on investment in the form of an unconsumed remainder; for other cases it applies that after the fiscal year, they are transferred to the next year, when their possible expediency is preserved. They are transferred into a financial fund or directly into budget resources for the following budget year (Pařízková, 2008: 161). The principle of expediency especially applies in managing state special-purpose subsidies, which municipalities and regions receive either upon budget approval or later over the course of the budget year.

2.5 Drawing Money from TSGU Funds

If the municipality and region create a financial fund or funds – for example a social fond, in relation to empowerment contained in Art. 5 of Budgetary Rules of Territorial Budgets Act, it may establish for itself the conditions of allocation into this fund and its use, including the circle of recipients of these funds.

Creation of special-purpose or non-purpose financial funds, whether permanent or temporary, is the exclusive competence of the municipal council, in the framework of their powers contained in the respective Acts on Municipalities and on Regions. Upon creation of a social fund, the council municipalities and regions should also determine the source of this fund and principles of its use. There exists no special legislation for use of funds of a social fund created by territorial self-governing units in the framework of care for their employees. Therefore, it depends on the decision of the council regarding what purposes under which money from the social fund will be used.

3 Conclusion

The budgetary principle of publicity is most simply and efficiently applied in the very level of territorial self-government, where feedback between bodies of territorial self-government and the population is very intense, and simultaneously we can see it in all stages of the budgetary process. Mainly the activities of municipal and regional bodies are immediately controlled by citizens, i.e. even by taxpayers and voters, in developed countries voluntarily and for no pay by citizens working in various committees, as advisory elected bodies, or possibly of executive bodies of municipalities and regions.

Economic management of territorial self-governing units, the draft budget and its performance is discussed at public meetings of elected bodies of TSGUs with the active participation of their citizens. Public meetings of elected bodies enable us to find out how citizens view the activity of elected and executive bodies, how they assess not only the fulfillment of election programs, but mainly the economic management of territorial self-government and the budget of municipalities and regions, because the population generally requests explanation of negative tendencies

in economic management of municipalities or regions and problems with performance of the budget. It is thereby possible to achieve much better feedback and reverse control between elected and executive bodies on one hand and the population on the other hand (Pařízková, 2008: 162).

From all this it is clear that legislation regulating the budgetary process in the Czech Republic is positive, so based on the aforementioned it can be stated that the hypothesis stated in the introduction was confirmed.

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PRACTICAL PROBLEMS IN THE AREA OF RESEARCH AND DEVELOPMENT IN THE CZECH REPUBLIC

Petra Snopková[1]

Abstract

This contribution deals with matter of research and development and its practical problems in the Czech law system. The main aim of the paper is to confirm or disprove the hypothesis that effective legal regulation provides sufficient legal certainty for taxpayers to its investments to research and development and connected possibilities of tax deductible expenses. In the paper several legal (scientific) methods will be used such as comparison of science disciplines, implementation and analysis of premises and others. There is no integrated publication dealing with research and development in income tax law. For insight to problem of core matter judgements must be used.

Keywords: Income Tax; Research and Development; Innovation; Expert's Opinion.

JEL Classification: K43

1 Introduction

In 2002 (before the Czech Republic joined EU) the European Council approved the Lisbon Strategy, which included the support of research and development. This is one of the priority areas leading to smart and sustainable growth of the European area. In this work, the author tries to summarize the problems of application of indirect support of research

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and development, thus amounts deductible from the tax base to support research and development and to point out the appropriate solution "gap of expertise" in financial administration.

With the support of research and development is possible in the Czech legal order to connect direct support in the form of grants, subsidies or direct cash support from the public authorities or indirect support in the form of investment incentives (Radvan, Šramková, 2017) or tax advantages, even in the form of a deduction under Art. 34 of the Act no. 586/1992 Sb., on income taxes, as amended (hereinafter the "the Income Tax Act"). The advantage of a tax advantage lies not only in the possibility to apply the costs (expenses) on research and development within the provisions of Art. 34/4 and 5 of the Income Tax Act, as well as current costs (expenses) pursuant to Art. 24 of the Income Tax Act. Moreover, in the event that investments made by tax entity on research and development will increase, the Income Tax Act counts in its Art. 34a with a 10 % increase of the deduction for research and development support. This mean that every spent crown thus returning the tax entity twice with ten percent "surcharge" (Snopková, 2016: 143–163).

The legislative framework to support of research and development has been formulated by the legislator meanly, because it found its place only in the Income Tax Act and in the Act no. 130/2002 Sb., on Support of Research, experimental development and innovation from public resources and on amending certain related laws (Act on support of research, experimental development and innovation). Because of more detailed definition of this legal institute, the Ministry of Finance issued non-normative act of heteronomous nature (non-binding for taxpayers) in the form of instruction D-288 dated 3 October 2005. Currently is in the area of research and development and its projection into the practical application needed to know as recent and stable case law of administrative courts.

Within the application practice appear four problematic areas:

1. Formal elements for possibility to apply the deduction for research and development support (in particular project);
2. Differentiation of research and development support from the "other" reporting and economic activities of taxpayer;

3. Expenses not included into the framework of the provisions of Art. 34 paragraph 4 and 5 of the income tax act;
4. Fulfillment of material requirements for the deduction to research and development support and their assessment.

Before approaching the fundamental problematic areas the author allows to draw attention to the fact that under the interpretation of Art. 34 of the Income Tax Act taxpayer must count with the fact that this is an exception that used interpretation will be a restrictive interpretation. This is based on the ancient Roman principle of singularia (exceptiones) non sunt extendenda, that recalled, among others, the Constitutional Court in its judgment I. ÚS 394/04 dated 27 September 2005, or the European Court in the form of 30 decisions T-124/14 dated 11 December 2015 (ECLI: EU: T: 2015: 955). This would then be reflected in the assessment of possible abuse of rights (see Liška, M., 2015: 36–45).

2 Formal Elements for Possibility to Apply the Deduction for Research and Development Support

The first practical problem of admissible of deduction for research and development support is related to the nature of the project, which is needed to be prepared before the research and development starts and in accordance with statutory requirements of project. With regard to the prospective nature of this document is necessary to point out that it must be drafted and approved before the commencement of research and development. The above-mentioned was sum-up by Supreme Administrative Court in its decision 6 Afs 60/2014–55 dated 26 August 2014 as follows: *"Research and development project serves as a fundamental and comprehensive document in which the taxpayer will establish in future to tax administrator his entitlement of claiming the deduction of costs for research and development. Legal condition resulting from the nature of thing (from the Latin proiectum - plan, motion, future actions schedule) is that the project has to be drawn up before the start of the project, so it could be a prospective document. So definitely it is not task of the tax administration and judges of administrative courts to take an active and subsequently connect otherwise unrelated documents and inference from these formal and content requirements of the project."*

The second problematic area of formal elements was a form of copy of the project. After the one of many amendments to the Income Tax Act the form of project was established as requisitely written. After that the tax administration and subsequently the Court faced the question of whether the project passed on a permanent medium also meets the requirements of the written form of the document. The Regional Court based on interpretations by the meaning of procedural rules, which strictly command that the project has to be drown up in writing form. The Supreme Administrative Court in its decision 2 Afs 24/2012 dated 29 November 2013 corrected the opinion of the Regional Court and interpreted the writing form extensively so it actually limited the form to oral form (other form beside the oral form is considered as writing form). After the effectiveness of the Act no. 89/2012 Sb., Civil Code, as amended, it is sufficient to refer to its Art. 562, which ranks among the writing form also the capture of information electronically or by other technical devices.

3 Differentiation of Research and Development Support from the "Other" Reporting and Economic Activities of Taxpayer

The legislator put research and development support into a separate, tax "distinguished" category of activities of taxpayers. The requirements of strict compliance of statutory elements of report of this activity are then linked with significant advantages of such as activity. The taxpayer is obliged to report about the expenses (costs) on research and development fully, correctly and conclusively. This obligation can be in practice fulfilled usually by administration of separate accounting records, particularly in situation when the taxpayer use its employees specialized on research and development for normal economic activity too.

4 Expenses Not Included into the Framework of the Provisions of Art. 34/4 and 5 of the Income Tax Act

Income taxes generally based on the principle of fiscal symmetry. So as tax deductible expenses can be claimed only expenses associated with the area of research and development which are connected with effective taxable

incomes materially and by time. This close connection between the expenditure and the case of income (result) is manifested especially in terms of the inability to deduct the research and development support to incomes which are serving not only for research and development.

Courts currently deal with the possibility of applying of paid expenditures on holiday within the deduction on research and development. In that question, two different scenarios are possible. The first one is situation when workers are employed only for research and development. In this case it is necessary to take into account the fact that within the research and development is not just a deduction that matter, but taxpayers also applying "classic" expenses (costs) pursuant to the Art. 24 of the Income Tax Act. The above mentioned is then based on the fact that deduction on research and development is an exception, which necessarily follows its meaning and purpose, and so it is necessary to investigate whether during the time of holiday is realizing the meaning and purpose of deductible item – research and development. Since the answer is negative, the deduction cannot be in this case recognizable.

The second model is modified to the intent that workers work partly on research and development and in part on other activities. In this case it is necessary to consider whether the holiday is collected by the employee proportionally of whether it is de facto only for one of these jobs. This is necessary also for non-duplicity of potential costs pursuant to the Art. 24 of the Income Tax Act.

Among the expenditures which cannot be eligible to deduction on research and development of course belong those that have been made by foreign entities, respectively those which have not been made from its own resources and by its own staff (these workers are defined already in the project). This opinion was later confirmed by the Supreme Administrative Court in its judgement 8 Afs 13/2011–81 dated 29 July 2011.

5 Fulfilment of Material Requirements for the Deduction to Research and Development Support and Their Assessment

In all jurisdictions, a major problem in the area of research and development support is question of what is already research and development and what is not yet. With the research and development is connected: the presence of a valuable element of novelty and clarification of research or technical uncertainty. If one of these elements is present within the performed activity, we can talk about research and development.

About the presence of a valuable element of novelty gave Regional Court in Ostrava in the judgement 22 Ca 332/2007–52 dated 5 November 2008 following explanation: *"By this important element of novelty is cannot be understood only a simple improvement of performance characteristics of assessed machines that improving their operation in terms of control, in terms of safety of work etc. As important element of novelty is needed to be meant such an element that does not mean mere improvement (raising) of the scope of an existing product to higher level or its improvement by using more efficient components or material of more complicated product by partial modifications of some integrated technical subsystem, in which case it is a "innovation" of existing product which cannot be proceed according to Article 34 paragraph 4 IIA (Income Tax Act – Ed.). If there exists a significant element of novelty, however, must be in accordance with Article 2 paragraph 1 point b) ASRD (Act on support for research and development – Ed.) such of product improvement that significantly exceeds this level, existing product obtained for example new characters, it is able to perform other important activities that were previously unable to perform etc."*

An element of technical uncertainty can be exemplify on a classic innovation circle. To achieve the result it must be "passed" through suggestion of solution, prototype realization, prototype verification, change of suggestion and potential repetition of this "circle". It is necessary mostly in situation where the path, respectively way to achieve the result is unknown or still untested. With research and development is connected not only the result achievement but also uncover the way to it. This process can fulfil definition of research and development and it can be even with negative results that could not be known without the research and development experiment.

As a turning point for Czech law was proved the review of afore-mentioned. It is a general true that in terms of tax administration there are not enough qualified employees who can expertly assess aforementioned elements of research and development. For that it can be use the expert's opinion or professional assessment drawn up by the so-called expert person (e.g. Technology Agency of the Czech Republic).

The Constitutional Court pointed out in its judgement 1. ÚS 4457/12 dated 24 July 2013 that: *"It is necessary to rate complete the process of formation of the expert's opinion, including the preparation of an expert examination, procurement of documents for an expert, progress of expert examining, the credibility of theoretical assumptions which justify the expert's conclusions, the reliability of methods used by an expert and the of extrapolation of his conclusions."* The tax administrator so handle with expert's opinion equally as with "ordinary" evidence and in extreme cases he can declare as untrustworthy and thus call into question expert's opinion itself and its relevance to the merits of the dispute.

For clarity, expert or professional person should indicate in the beginning the progress and results of the current exact sciences on issues related to the research and development that is solved. Then a description of the properties and elements should follow, all without assessing whether it is research and development or not, because this legal question is given only to assess to the tax administration and it is result of syntactic-analytical evaluation considerations.

From the above, then comes the most serious problem of research and development, and that is a delegation of the burden of proof as to the assessment expertise on tax administration. In case of an absence of sufficiently qualified employees, tax administrator must use experts or professional persons for assessment of expert questions, otherwise it could not bear the burden of proof.

6 Conclusion

According to the author, it is necessary to change the afore-mentioned. The obligation to prove the existence of a valuable element of novelty and technical uncertainty, i.e. if it is indeed research and development, should be passed on to the taxpayer by the legislator, even taking into account the

fact that by deduction the taxpayer is allowed to bring expenditures incurred on research and development de facto twice. Thus by that the problem of outsourcing of expertise falls away from tax administration. So aforementioned disprove author's hypothesis.

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THE PENSION SYSTEM OF THE UNITED STATES OF AMERICA. SELECTED LEGAL AND FINANCIAL ASPECTS

Tomasz Sowiński[1]

Abstract

The world-wide search for the ideal model of pension security has been ongoing now for more than thirty years and has not been concluded successfully so far. The problem of demography has grown to become a disaster of a historical range, to such an extent that the report of the World Bank was entitled "Averting The Old Age Crisis". It is also quite impossible to develop any concept of pension security, because together with the development of the societies, welfare and medicine, people, as if to make it even more difficult for the creators of the concepts, live longer, which makes it even more complicated to create the suitable model of a pension system. Either the contributions are too small, or people are retiring too early, or they expect their pensions to be too big, problems around every corner…

In this article, the system functioning in the United States of America is presented. Numerous pension plans are result of many years of the state efforts leading into the direction of promoting the foresightedness of the citizens and providing them with legal solutions convenient for that purpose and wise state's care. An in-depth analysis of the pension system of the United States requires of course a much more extensive study and many simulations of economic, legal, and financial analyses.

Intention of the author is to encourage such studies, because the pension system of the United States of America is worth attention and a precise analysis, which may turn out to be useful for the search of an appropriate structure of the universal system of pension security.

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Keywords: Social Insurance; Pension Security; Public Finances; Contribution.

JEL Classification: I13, H51

1 Introduction

Many mistaken ideas about the pension system of the United States of America exist. On the one hand, it is considered to be absolutely "free" of the state interferences, therefore, in that sense – voluntary. On the other hand, however, it is considered to be extremely complex and complicated, with almost several hundred versions or, as preferred, several hundred [!] pension systems, which depending on the state, profession, degree of complexity or mutual complementarity or conflicting of the state and federal solutions and many other factors, make up the extreme complexity of that system.

Regardless of the fact which of the sides is closer to truth, the pension system of the world's largest superpower, which has 325,005,117 inhabitants, of the average life expectancy of 78.74 years (United States Census Bureau), thus, the third country in the world regarding its population, undoubtedly deserves attention and an at least preliminary analysis. Taking into consideration the size of this study, it would hard indeed to provide a more detailed one.

Research and reports, including the already mentioned report of the World Bank (Muszalski, 1999: 12–15; Sowiński, Finanse…, 2009: 326–333), multiply contradictory conclusions[2] and unverified concepts, which often crum-

[2] For example, a quite critical approach to the analysis contained in the report of the World Bank is assumed by W. Muszalski (Muszalski, 1999: 12-15;). He questions the sense of the implementation of the funded pension scheme in Poland and other countries of Central Europe, indicating, among others, the excessive diversification of the economic status of the society, which in his opinion puts the poorest part of society *de facto* outside the system. He also draws attention to the lack of consistency in the terminology and mixing of the notions of "social insurance", "social security" and "pension system". Also the following authors have serious doubts about this concept: U. Kalina-Prasznic (Kalina-Prasznic, 1997: 2-6) who claims that such solutions will significantly affect the weakening of the social safety in Poland; Similarly J. Jończyk (Jończyk, 1999: 34.) is of the opinion that there is no proof for the superiority of the funded scheme method, and the efficiency of both methods is similar. J. van Langendock in her opinion for the European Commission (Langendock, 1997), concludes that in the countries of the Central and Eastern Europe many naively believe in the superiority of the funded system, in which the profit from the investing of the capital will give a higher pension, and in reality the results of the PAYG and funded systems are comparable.

ble into pieces when someone tries to implement them in some country. Admittedly, the Swedes have called their pension system "perfect", which is not very modest of them (Sowiński, Contenporary…, 2016: 118), however, despite its quite high efficiency and its comprehensive approach to the questions of the pension security, it has a one very important fault – it is too Swedish. It would be extremely difficult to make this system universal.

What is interesting, the system functioning in the United States of America presented in this article clearly resembles that Swedish system. However, it has some very interesting solutions, which are worth considering and possibly implementing in other countries.

First of all, solutions concerning so-called middle class are interesting. They are characterized by trust in the citizen and a considerable, although clearly defined, deregulation of the state coercion.

The intention of the author is to dispel the most incredible ideas about the USA pension system, and also to bring closer the solutions that are in force, hoping that it will encourage some people to study that pension system more closely and thoroughly, because it undoubtedly deserves it.

2 General Structure of the Pension System

The pension system functioning in the United States has, similarly to Sweden, three pillars, in which the first pillar is a mandatory pension scheme [social security], which was introduced already in 1937 as a PAYG model of pension insurance. The second pillar is the complementary benefit in the system of pensions insurance, although it is important to underline that most of the employed use it. In contrast the third pillar similarly to the recommendations of the World Bank is a voluntary element of the insurance system in USA, as part of the Individual Retirement Account (IRA).

The first pillar of the pension insurance in USA is a kind of compilation of the Bismarck and Beveridge insurance. Bismarck insurance because it is directed to the employed, in particular those of lower remuneration. The basic pension in the PAYG model comes from it. Also the more wealthy people are present within this model, who receive pension benefit from the individual pension insurance, and if they were employed at any moment during their life, also from those employees.

However, regardless of their professional path, persons who have reached 65 years of age, and have not obtained the right to pension benefits are covered by the state system of social benefits, which guarantee pension benefits in the minimal amount and also medical care.

The system cannot differentiate between benefits for women and men. Regardless of gender, after reaching 62 years of age, people obtain the right to early retirement, although in case they use this opportunity they are entitled to lower pension benefit. In principle there is no upper age limit for retirement, because the previously applicable maximal age of 70 years has been abolished, because it was recognized as a manifestation of age discrimination. However, in the insurance conducted by employers, the minimal age for retirement is usually 55 years and similarly as with other aspects connected to the obtaining of pension rights, it constitutes the subject matter of contract between the employer and the employee.

The basis for the determination of the amount of pension benefit are two factors, mainly seniority and remuneration. One is entitled to receive pension benefit in the first pillar after having worked for a minimum of 40 quarters. The lowest pension benefit from the first pillar is USD 500 and the highest USD 1,500 (Dziubińska-Michalewicz, 2005: 1).

In addition, this amount is supplemented with the benefit from the second pillar - employee retirement plans, run by employers, which one can join voluntarily, choosing also the option of Defined Benefit (DBP) or Defined Contribution (DCP). The maximal contribution cannot exceed 18 % of the employee's remuneration, 3–10 % of which is paid by the employer into the employee's account and the rest can be supplemented by the employee. The means from the contributions are invested. The investment risk is borne by the employer (Loeper, 2009: 3).

The benefit from the second pillar is dependent on the employee's income and years of professional experience, as is the case with first pillar. The employee is entitled to 1.5–2.0 % of their last salary for each completed year of employment at a particular employer, which gives in total even 80 % of that salary after 40 years of employment.

3 Pension Plans

In the American pension system, crucial is the role of the state, which actively encourages both the employees, as well as the employers, to participate in the second pillar, even guaranteeing the payment of their salaries to certain amount. The state has determined the limit of the employers' contributions, which are deduced from the tax, and the employees' contributions and profits from the investing of means coming from the contributions are in turn exempt from tax. All this has contributed to the emergence of approximately 650,000 of pension plans, encompassing both defined benefit, as well as defined contribution plans. All employees' pension plans are run by employers as voluntary (Dziubińska-Michalewicz, 2005: 1–2).

Pension plans based on the defined benefit plans can be characterized as: "traditional pension plans which contain the pledge of strictly defined payments, securing their participants against the investment risk" (Pisarewicz**,** 2009: 94, as in Loeper, 2009: 3). Their main principle is therefore the pledge of the employer to pay specified benefits the moment the retirement age is reached (Department of Labor, Employee Benefits Security Administration; 2006: 3). Cash-flow is generated by the cyclical payments from employers who run a certain plan and payment of benefits for participants who have reached the retirement age (Fabozzi, 2002: 42).

This solution is connected to the necessity to conduct complex actuarial calculations, which take into account many variables concerning both the employees, as well as the market data. Plans of this kind are additionally protected by the Pension Benefit Guaranty Corporation (Baily, Kirkegaard, 2009: 371).

Pension plans based on the defined contribution can be characterized as: "traditional pension plans which contain the guarantee and pledge concerning the strictly determined payments, which do not secure their participants against the investment risk" (Loeper, 2009: 3).

This means that the employer does not guarantee a predetermined pension benefit, which is dependent on the sum of capital accumulated from the contributions (Department of Labor, Employee Benefits Security Administration; 2006: 3) This solution, and rather pension plans based

on schemes of defined contribution have a significant quantitative advantage among the pension plans in the USA. It seems that this solution is first of all a more safe and rational and a more equitable one, because the size of the future benefit is dependable on the size of the contribution.

The only guaranteed value within the framework of this type of plans is the strictly defined level of payments into the employee's account, which does not translate directly to the ensuring of payment of benefits in the specified amount (Pisarewicz**,** 2009: 96).

The pension plans based on the defined contribution schemes are also called, in compliance with the (*Employee Retirement Income Security Act (ERISA) 1974*), Individual Account Plans, because individual accounts for every plan participant are assigned to them. All crucial parameters related to the operation of the plan: contributions, expenses, profits, losses, etc. (Purcell, Staman, 2008: 67)

Within the last several decades we are observing the constant phenomenon of the decrease of share of the defined benefits plan in comparison to the defined contribution plans. For example, in 1985 the market share of the defined benefit plans (regarding the value of assets) was 35 %, and until 2008 it dropped to the level of 14 %. Whereas, the defined contribution plans have indicated a reverse trend. In 1985 their share in the market was 23 %, whereas in 2008 it increased to 25 %. This shows that employers more eagerly select solutions, in which they will not take the risk connected to the guaranteeing of certain amounts of benefits. It seem, from their point of view, to be rational solution, however, from the point of view of employees who participate in them, it may be perceived differently (Pisarewicz**,** 2009: 101).

3.1 Similarities and Differences of Pension Plans of Defined Contribution and Defined Benefit

In order to illustrate the both pension schemes, as well as to indicate similarities and differences that occur between them, it is worth making a table which will facilitate the analysis of both plans, their crucial contents and features and will enable a comparison.

Table 1. Features of the pension plans in the USA of defined benefit and defined contribution

Position	Defined Benefit Plans	Defined Contribution Plans
Employer Contributions (and/or Matching Contributions)	Paid in full by the employer. Federal rules determine the amounts, which the employees must pay into the plan account, in order to ensure sufficient funds for the payment of the future pension benefits. There are certain sanctions for exceeding the statutory requirements in that scope.	There are no requirements regarding the level of payments from employees. Plans of the following type are an exception: SIMPLE 401(k), Safe Harbor 401(k), money purchase plans, SIMPLE IRA and SEP plans. The employer can choose an option in terms of payments to the account of the employees, as part of the amounts paid by them or an independent crediting of accounts unpaid by employees. In some of the plans the employer credits accounts in the form of employees shares.
Employee Contributions	As a rule, employees do not make payments to plans of this type.	In compliance with many plans employees are obliged to make payments, which is a necessary condition for opening an account.
Managing Investments	The managers of the plan invest means accumulated within its framework. Employer is responsible for ensuring an appropriate value of the assets, which considering the increase of value of the invested means, will secure the complex values of benefits.	The employee can usually select the investment option from among the ones offered within the framework of a particular pension plan. In some types of plans, the managers of the plan are responsible for all conducted investments (without the possibility of option selection by the employees).
Amount of Benefits paid upon retirement	The guaranteed benefits are calculated on the basis of actuarial formulas which usually take into consideration the employee's age, years of employment and/or height of remuneration.	Benefits are dependent on the height of payments made by the employees and/or employers, investment results and height of payments and management costs.
Types of retirement benefit payments	Usually, benefits are paid in the form of monthly installments during the entire retirement period until the employee's death. Some plans offer also other options of payments.	Employees can transfer means to Individual Retirement Account (IRA). Next, they can pay out the means in the form of installments or a single payment. Some of the plans offer the pay out in the form of lifetime annuity installments.

Position	Defined Benefit Plans	Defined Contribution Plans
Guarantee of Benefits	The federal government guarantees payments of benefits with the Pension Benefit Guaranty Corporation (PBGC).	There is no guarantee of the height of benefits.
Leaving the company before the retirement age	If an employee leaves the company after they have obtained the right to benefits, but before retirement age, the value of the benefit usually remains within the framework of the plan until the retirement age is reached. Some of the plans offer the possibility of earlier payment of benefits.	Employee can make a transfer of the accumulated means to Individual Retirement Account (IRA) or in some cases to another pension plan. They can also pay out the accumulated means. However, in such cases, this may involve the necessity to pay tax or additional penalties, which will reduce the amount of benefits.

Source: Pisarewicz**,** 2009: 97–98, on the basis of: U.S. Department of Labor, 2006: 4.

On the basis of the content of table 1, the following conclusions can be made:

1. The general note concerns the much greater freedom of making decisions, but also the right to make them within the pension plans based on schemes with defined contribution;
2. The pool of options of payouts execution is greater in the DCP plans;
3. Potentially, one can obtain higher additional pension from the DCP plans;
4. The employee, so the future beneficiary, usually selects the investment option from among the ones offered within the framework of a particular pension plan;
5. However, presenting the faults of the DCP system, we must indicate that the payout of benefits from this plan is not guaranteed by the state;
6. Although, it is generally difficult to consider this as a fault, however, for some of the insured it is crucial that the amount of the future benefit cannot be specified, although potentially it can be higher than in case of DBP;
7. Pension plans based on defined benefit schemes have this advantage that the amount of the benefit is known;

8. What is more, DBP in contrast to benefit plans based on defined contribution schemes have the state guarantee of their payout in the specified amount;
9. The guarantee is granted by the Federal government through the Pension Benefit Guaranty Corporation (PBGC).
10. Both types of plans envisage the possibility of their continuation in case the employee changes company.

An important option of both pension plans is the one enabling their continuation in case of change of workplace by the employee, even regardless of the reason for that change and the place of change, including the entire state, as well as the entire country. In case of DBP the specified amount of benefits payouts by PBGC is guaranteed. In turn, the substantial freedom of making decisions and the right to make them by their participants, within the pension plans based on schemes with defined contribution. It could be argued that the abundance of options in the employee pension plans, can, in its own way, compensate the principles that refer to the remaining pillars. It can be the opportunity for a specific supplementation of what a particular person is lacking in the remaining part of the pension system.

3.2 Advantages and Faults of Pension Plans of Defined Contribution and Defined Benefit

Each type of pension plans has its advantages and faults. It can be concluded that many of them are subjective, and that they are dependent on the preferences of the employer who undertakes to execute them, or the employee who may and sometimes does not participate in the selection of their type and options. Something that is an advantage for some, may be a major flaw for others.

P. Pisarewicz has undertaken the attempts to objectify and systematize the flaws and advantages of both types of plans, comparing both of them (Pisarewicz**,** 4/2009: 98–100, on the basis of: Sonnanstine, Murphy, Zorn, 2003), which can be presented with the use of table 2.

Table 2. Comparison of the advantages and flaws of the Defined Benefit Plans and Defined Contribution Plans

	Defined Benefit Plans	Defined Contribution Plans
Advantages	1) Ensure the guaranteed amount of benefit until the end of life of the person covered by the plan. 2) In practice, such solution is less costly than a comparable plan based on the defined contribution scheme. In defined contribution plans, participants need more conservative investments with time, in order to accumulate appropriate means for the longest possible period of time. Plans based on the defined benefit scheme does not have to fulfill this type of requirements, because they are based on the dispersion of the risk of death and the investment risk between many participants of the plan. In consequence, the paid out nominal value of benefits is often less costly from the point of view of the employer (sponsor) than in the case of defined contribution plans. This concerns in particular the final stage of the plan operation. 3) Some governmental employees are not covered by the social security insurance. In such cases, defined benefit plans turn out to be an optimal and very profitable solution securing the payouts of the future pensions. 4) Motivate to continue employment at a single employer, who operates a beneficial pension plan which secures high benefits. They often provide higher income for employees. 5) They guarantee measurable benefits, which are very transparent for employees, providing them with a high sense of security. 6) Automatically, ensure protection against inflation during the entire time of employment. 7) Coverage of living costs after the retirement age is reached can be ensure through cyclical, percentage increases of the predicted financial ratios at the stage of actuarial calculations. 8) Payments for the managing of the pension plan are usually lower than in case of defined contribution plans. 9) Financial risk related to the operation of plans are borne by the employer, which is an advantage from the point of view of the participants of the plan, and a fault from the point of view of the entrepreneurs (sponsors).	1) The value of the contribution transferred to a particular plan is clearly defined and easy to understand by the employees themselves. Moreover, the general principles, which determine the amount of the contribution are usually constant within a given plan. 2) They ensure usually a higher level of future benefits for employees of an unstable professional position. 3) Assets accumulated on the accounts of the plans of this type, can be transferred to other pension plans in case of change of workplace. They are usually more flexible in this regard in comparison to the defined benefit plans. 4) Contributions are allocated on separate, individual employees' accounts. Thus, they can control on a current basis the value of the transferred means and the quality of management. 5) Administration costs are usually lower than in case of defined benefit plans. 6) They may contribute to the significant increase of the pension benefits in case of a very favorable market conditions and a skillful management of the assets.

	Defined Benefit Plans	Defined Contribution Plans
Disadvatnages	1) Defined Benefit Plans were not designed at the beginning with the intension of their transfer or converting in case of change of employment. Nevertheless, in the recent years, as a result of the changes in the federal law, more and more plans of this type have such conveniences. 2) The costs of operating such plans are changeable in time and difficult to evaluate, as a result of changes of the actuarial assumptions and the economic environment. 3) From the point of view of the employee, their mechanism is more difficult to understand in comparison with the defined contribution plans. The fact to what extent the employer participates in the future pension in favor of a particular plan participant is not easy to identify. 4) As a rule those plans are of a more complicated administration and management than the defined contribution plans, among others, due to the necessity of conducting cyclical actuarial calculations and estimations of the remaining financial ratios.	1) Finally, benefits cannot be correlated with the height of the obtained remuneration, especially at the pre-retirement age. 2) The costs of the paid out benefits in plans of this type are usually higher than the benefits in defined benefit plans. 3) Employees bear the financial risk of unfavorable investments. Particularly important are the initial and final periods, which in case of negative rates of return can decide upon the significant reduction of the future pension benefits. 4) The level of the future benefits can be significantly understated in case the manager will be investing the means too conservatively. 5) During the periods of high inflation, the accumulated means can be insufficient to secure the future benefits in the amount that will cover the living costs after retirement. 6) Plans of this type can contribute to the loss of financial security in case of unfavorable market trends, and in particular for the employees not included in the Social Security scheme. 7) Flexibiloty of plans of this type can turn out to be a significant flaw in case the employees decide to consume the accumulated means earlier when they change the employer. 8) After retirement, there is higher tendency of the employees towards single payouts rather than payouts in the form of installments, which as a rule better secure the benefits in the long run. 9) No motivation of the employees to employment stability, among others, due to the flexibility in the transferring of assets to other plans.

Source: Pisarewicz**,** 4/2009: 98–100. A comparison of the advantages and flaws of both types of analyzed pension plans on the basis of Sonnanstine, Murphy, Zorn, 2003.

On the basis of the content of table 2, it may be concluded that there is significant convergence of the conclusions contained therein with the conclusions resulting from the analysis of the content of table 1.

Undoubtedly, the size and diversity of the offers in the scope of employee pension plans in the United States of America should be underlined. They constitute an effective support of benefits in the field of Social Security

basic pension, and their legal and organizational structure together with the incentives of the state and those incentives have a real financial dimension, for the employer operating the pension plan, as well as the participating employee. As a result, the participation in the second pillar of insurance in the USA is not particularly burdensome neither for its operator, nor for its participant, providing a significant space for choice, and also significantly eliminating the financial burdens of the operators and participants of the pension plans.

As a result, a considerable interest in the discussed solution was achieved, and also the social and economic objectives were achieved, socially, as well as economically. In the opinion of the author, the key to success are various factors, but two of them deserve special attention, namely:

1. Real, and not only declarative, as is commonly the case in Europe, involvement of the state in the process of shaping, as well asf u n c - tioning of PPE in the USA;
2. Mental preparation of the American society, the awareness of which of the necessity of their own foresightedness and personal involvement is significantly higher than in Europe excessively filled with social solutions, although one can find some of the latter in the USA, as well.

To the two already described pillars the third pillar should be added, which is a voluntary element of the insurance system in the USA, as part of the Individual Retirement Account (IRA), which completes the pension system of the United States of America. It can be recognized that many of the less wealthy citizens of the USA do not make use of this possibility. Many others, in particular from the middle class, who use the possibility of personal insurance outside the Social Security system, in turn, treat the third pillar as a certain kind of second pillar of their personal insurance and in that way the achieve the risk diversification, as well as the real complementation of the pension benefit after they reach a certain age, which they can very often specify themselves.

What significantly distinguishes the American system from the European system (Sowiński, Contenporary…, 2016: 110–132) is the opening of the state the possibilities of the citizens' individual foresightedness and not only

within the framework of complementary insurance, but also in the pillar of the basic pension insurance, of a significant social group. At the moment, such approach seems difficult to implement in Europe, where even the Swedish perfect system[3] is indisputable and imposed in the form of mandatory insurance on the society. So far, Europe is unable to go beyond one of the most characteristic features (Sowiński, Zasady i cechy…, 2006: 635–659) of the pension insurance, which is the mandatory character of insurance.

4 Conclusion

The Pension System of the United States of America reminds somewhat the model recommended in the already mentioned report „*Averting The Old Age Crisis"* (World Bank, New York: 1994) developed by the World Bank, because it is similar to the Swedish "perfect system". The similarity of the structure of pillars and their content, and also the ideas behind their functioning indicate that on the both sides of the Atlantic some issues are perceived similarly.

Undoubtedly, the functioning of the approximately 650,000 of pension plans, encompassing both defined benefit plans, as well as the defined contribution plans, distinguishes that system from among the others, and in particular the European one, but on the other hand, it is worth underlining that we are dealing with the third country in the world when it comes to population, which has been for generations, evolutionally shaping its pension

3 Swedes have used the concept of "perfect account" to describe the triple-pillar model. It is crucial that more and more countries are copying that solution. A very important feature of the structure of the Swedish pension system is its autonomy with regard to the state budget and functioning independent from the changing economic and demographic situation. It minimizes the risk of an unfavorable intergenerational redistribution of revenues, which additionally enhances the credibility and transparency of the future benefits (Szumlicz, 2004: 304.). The system of pension insurance in Sweden guarantees pension to all its residents. It was constructed as the compilation of the PAYG model and the funded model of the general character of the defined contribution. It is mandatory for all residents with the option of voluntary complementation of the insurance in the third pillar. The retirement age in Sweden for both genders is 65 years. There are no early retirements, however, it is possible to postpone retirement. In order to obtain pension in its full amount, a person must be resident in Sweden for 40 years. If this condition is not fulfilled, the amount of the benefit is reduced. The amount of the pension is directly dependent on the contributions, which were paid by the employers with reference to the payroll fund (Szumlicz, 2002*:* 362–371). In case the pension benefit does not achieve the level specified by law, the persons who receive them are entitled to tax exemptions (Świątkowski, 2000: 254).

system. It is also worth underlining that all of those 650,000 employees; pension programs are operated by employers as voluntary.

The model of pension insurance in the USA should be considered a mixed system, however, it has many elements of the citizens' model and features that are characteristic for it. This concerns in particular the group defined as middle class, the impact of which on the shape and manner of pension security is almost total, and the state trusts its citizens, and they in turn, in majority of cases, do not betray that trust.

In the context of extremely strictly formulated pension systems on the old continent, but also in the majority of the countries in the South America, it gives a completely new view on the possibility to shape, in the realm of pension security, the relations between the state and the citizen, for whom the pension system is constructed in individual countries after all.

Taking into consideration the fact that since the seventies of the last century many countries in the world, and almost all on the old continent (Sowiński, Quo vadis…, 2006: 467–492), are struggling with the issues related to the functioning of their pension systems and are constantly modifying and improving them, and also that the majority of societies and the economically developed countries base their development and stability exactly on the middle class, the more the pension system of the United States of America is worth attention and precise analysis.

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REGISTRATION OF SALES IN THE CZECH REPUBLIC – A FEW MONTHS AFTER THE EFFECTIVENESS OF THE ACT

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Abstract

The paper deals with the registration of sales according to the Act. no 112/2016 Sb., on Registration of Sales. The objective of this paper is to present a new Act and related obligations of taxpayers. The main aim of the new legislation is to provide the tax authority the relevant data on cash transactions for the purpose to minimize the data distortion concerning the tax obligations of taxpayers. In the first part of the article, there is an analysis of the legislation regarding the registration of sales and evidence of payments. The second part of the article is focused on the Act on Registration of Sales, its subject and subject-matter. Third part is concerned with the concrete obligations of taxpayer. Some of these obligations are related to assignment, use and protection of authentication data together with information obligation. Finally, the receipt lottery and administrative offences and misdemeanours are presented.

Keywords: Registration of Sales; Receipt; Taxpayer; Consumer.

JEL Classification: K34

1 Introduction

The Act no. 112/2016 Sb., on Registration of Sales, as subsequently amended (Registration of Sales), entered into effect in September 2016. Since December, the first group of taxpayers shall proceed in compliance with the Act on Registration of Sales. Such group entails two classes of taxpayers working in services, namely in accommodation and food services.

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The main aim of the new legislation is to provide an effective administration of taxes which means to ensure tax authority the relevant data on cash transactions for the purpose to minimize the data distortion concerning the tax obligations of taxpayers. The Act on Registration of Sales does not create a new obligation of the taxpayer, however, it stipulates a new method how the tax authority could obtain the information from taxpayers directly and online after a payment (that meets the formal requirements for a registered sale). At the moment the tax authority obtains such information *ex post*, e.g. after the tax inspection.

According to the Czech statistical office, unrecognized incomes amount to CZK 170 bn. annually, which represents the state budget deficit twice. The registration of sales should intend to a significant reduction of unrecognized incomes.

2 Legislation of the Registration of Sales and Issuance of Receipts

The Act on Registration of Sales is not the first legislation regulating the registration obligation of taxpayers. This act governs the rights, obligations and procedures applicable to the registration of sales and procedures related thereto. Another act stipulating the duty of a registration of sales or an evidence of sales is as follows.

Firstly, it is necessary to mention the Act no. 563/1991 Sb., on Accounting, as subsequently amended (Accounting Act), which specifies forms of the evidence. The subject-matter of the accounting is monitoring of the status and movement of property and other assets, liabilities including debt and other liabilities, the costs and revenues and profit. The Accounting Act also defines the basic requirements for preparing and publishing annual reports and the conditions that trigger the need for a mandatory statutory audit of financial statements.

Secondly, the Act no. 280/2009 Sb., Tax Procedural Code, as amended (Tax Code) Tax Code, prescribes that the taxpayer is obliged to recording duty. This obligation refers especially to merchants receiving the payments in cash especially in the area of accommodation and food services. Thus, the Tax code lays down an obligation to register the sales provided this obligation

is not a subject to tax under another act. Beside this obligation *ex lege,* the tax authority could decide to prescribe that in order to assess the tax obligation, the taxpayer is obliged to administer a special record.

The Act no. 215/2005 Sb., on Cash Registers, as amended (Cash Registers) could be considered as a predecessor of the Act on Registration of Sales. The Act on Cash Registers involved the registration of payments conducted by natural and legal persons in the area of catering and retail business on the grounds of trade license. Registration of individual payment in form of banknotes and coins, or via electronic payment, valuables or checks was one of the obligations imposed by this act to the merchants.

It was already mentioned that the issuance of receipt is related to the registration of sales. In general, requirements for the receipt are regulated by the Act no. 634/1992 Sb., On Consumer Protection, which stipulates some terms and conditions for business important to consumer protection during the sale of goods or products and the provision of services. The act simply says that at the request of a consumer, a seller shall issue a receipt confirming purchase of a product or provision of a service, stating the date of sale of the product or provision of the service, the type of product or service, and the price for which such product was sold or service provided, together with details identifying the seller, i.e. the first name and family name or designation or business name, unless otherwise stipulated by a special law.

3 Registration of Sales

The contemporary Czech legal system of registration of sales was inspired by the Croatian legislation because it is very simple, effective and reliable, without great expenses of taxpayers. On the basis of the explanatory notes to the Act on Registration of sales, the intention of the Ministry of Finance is not the introduction of cash registers with fiscal memory, but the trader himself could choose on which device will register the payments (this device could be a cashier, a cashier system, a tablet or any other device connected to the printer and internet access regardless of hardware or software since it also depends on the decision of the merchant). The only requirement for this device is that it must be able to send immediately a data message to the tax authority containing information concerning this registered sale.

Thus, the taxpayer is required to include the following in the receipt; the fiscal identification code, his tax identification number, the identification of the business premises in which the sale is carried out, the identification of the terminal (or simply says the device) in which the sale is registered, the serial number of the receipt, the date and time the sale was received, or the receipt was issued, if it was issued earlier, the total amount of the sale, the taxpayer's security code, information on whether the sale was registered under the standard or the simplified regime.

The registration of sales in terms of the act is in breach of the principle of auto-application on which the tax law is based. The principle of auto-application means that the taxpayer applies the tax rules in the tax return, i.e. the taxpayer is obliged to calculate the tax base, determine the appropriate tax rate and apply corrective elements. After that, the tax authority assesses the tax implicitly provided the assessed tax is the same as the tax indicated in the tax return. It is usual that there is not any contact between the tax authorities to the taxpayer. The principle of auto-application reflects great confidence in taxpayers who themselves determine and calculate the tax.

4 How the System of Registration of Sales Works

Generally, the taxpayer of income tax, i.e. a merchant, sends a date message to the tax authority containing information concerning this registered sale. Consequently, the tax authority generates a unique code which is sent back to the merchant as a certificate of received registered sale. This unique code is printed on the issued receipt which the merchant gives to the customers who can verify that their payment was actually registered in the system of tax administration

4.1 Subject of Sales Registration

The subject of sales registration is the taxpayer of personal income tax and corporate income tax. Terms „taxpayer of personal income and taxpayer of corporate income" are defined by the Act no. 586/1992 Sb., on Personal Income, as amended (Personal Income) which prescribes that taxpayers of corporate income are persons who are not individuals or who are organizational components of the state according to special legal regulation.

4.2 Subject Matter-Matter of Sales Registration

The subject-matter of sales registration are the taxpayer's registered sales, i.e. payments that meet the formal requirements for a registered sale and constitutes a material income. A registered sale is also a payment that meets the formal requirements for a registered sale and is intended to be subsequently drawn or settled to constitute a material income at this subsequent date or represents the subsequent drawing or settlement of such a payment to constitute material income.

Generally, the subjects of sales registration are incomes from the business. It is difficult to define the business. However, in section 420 of the Civil Code, there is a definition of an entrepreneur (or a merchant) who is a person who performs independently on their own account and responsibility with the intention to do it consistently and to get profit.

The transaction, to be considered as the registered sale, has to meet both requirements cumulatively, i.e. the formal characteristics specified in section 5 of the Act on Registration of Sales as well as material characteristic determined in section 6 of the Act on Registration of Sales as material income.

Formal requirements for the registered sale are as follows:

- Payment is made in cash;
- By a cashless transfer of funds based on an instruction by the payer to the beneficiary;
- By cheque;
- By promissory note;
- In other forms which are similar in nature to the forms listed above;
- As a credit for a deposit or similar security.

Material income is an income from independent business activities with the exception of income exempted from income tax, income which is exceptional and income which is subject to the withholding tax under a special tax rate. The taxpayer of corporate income tax has another exception, the material income is not the income from a business subjected to the tax from

individual tax bases. It would be pointless to register sales according to the Act on Registration of Sales which according to the Act on Personal Income are not a subject to tax.

In section 12 of the on Registration of Sales are listed the sales which are excluded from the registration of sales. I mention as examples the sales achieved by the State, territorial self-governing authorities, state-funded organizations, the Czech National Bank or a holder of the postal license. In the next paragraph are other exempted sales achieved by banks, savings or credit cooperative, an insurance or investment company, a pension fund or company or income from a business as a result of its activity in the energy sectors on the basis of a license granted under the Energy Act (Act no. 458/2000 Sb., Energy Act). The third paragraph excludes sales from another reason than those already mentioned. The reasons for the exclusion are related to the making of payments; i.e. sales from a relationship related to a labour law, from catering and accommodation provided to pupils and students provided by a school, university or school facilities, from a fare or related payment made in vehicles used for regular public transport of persons, on board an aircraft, from passenger railway transportation, from goods or services provided by way of a vending machine or from the operation of public toilets.

4.3 Obligations of the Taxpayer

Request for authentication data

According to the Registration of Sales Act the taxpayer is obliged to submit a request for authentication data before receiving the first registered sale. Authentication data are used to access the tax authority's common technical equipment, enabling the taxpayer to administer the certificate of the registration of sales and data for the administration of the registration of sales, even making cancellations or corrections.

Assignment and use of authentication data

The taxpayer is obliged to request for authentication date. If the request is made properly according to the Registration of Sales Act, which means that the request is submitted by authorized person, the data box is enabled

no technical problems occur, the tax authority would assign these data without any undue delay (which means in order of days, about three days). According to the explanatory notes to the Registration of Sales Act, when the taxpayer did not receive the authentication data within one week, it is appropriate to contact a local tax authority and demand the reason of non-assignment. At the moment it is obvious the system of assignment works without any troubles. Moreover, the taxpayer has a possibility to request for the data in a verbal form, confirmed by a written protocol; the tax authority would assign the data as a part of this acting.

Protection of authentication data and the certificate for the registration of sales

The taxpayer shall handle authentication data and the certificate of the registration of sales in a manner that prevents the misuse. The taxpayer is responsible for negative consequences related to personal data used for sales registration. If the taxpayer does not fulfill their obligation of protection of these data, he or she could be fined up to CZK 50,000.

Obligation to register sales

The main obligation of the taxpayer is that at the latest upon the realization of the registered sale, the tax payer shall send a data message to the tax authority containing information concerning this registered sale and issue a receipt to the entity from which the registered sales originate. The consumer does not have an obligation to accept and keep a receipt. Nevertheless, the Croatian legislation lays down this obligation. Fortunately, this controversial duty of consumer to keep a receipt has not been implemented to Registration of Sales Act (Radvan, Kappel, 2015). Moreover, it is almost impossible to control this obligation. Janovec agrees with this approach, because "*a supervision over this obligating is practically unrealistic and a customer cannot be blamed that e.g. he does not have enough time to wait for a receipt*" (Janovec, 2015)

The consumer is allowed to verify the authenticity of the receipt by the tax portal: https://adisspr.mfcr.cz/adistc/adis/idpr_pub/eet/eet_sluzby.faces, however it is necessary to fill in the taxpayer's identification number, the date and time of the sale, the total amount, the fiscal identification code and

the taxpayer's security code. If the system does not find a registered sale, the consumer could fill in additional information which is, for example, a place of business and a type of service and send this information for verifying.

Given that the Registration of Sales Act implements an electronic registration of sales, it was crucial to regulating the response time of the system. The response time is the time between the attempt to send information on the registered sale from the taxpayer's POS terminal and the receipt of the fiscal identification code on the taxpayer's POS terminal. The minimum response time is determined under the Registration of Sales Act as 2 seconds. If the response time limit is exceeded during the registration of sale e.g. due to a technical failure, a connection failure or a deterioration in the quality of transmission, then the taxpayer shall send a data message containing information on the registered sale to the tax authority immediately after the event which caused the response time limit to be exceeded terminates, but at the latest within 48 hours of completion of the registered sale and in that case the taxpayer is not obliged to enter the fiscal identification code in the receipt.

Information obligation of the taxpayer

The taxpayer is obliged to inform the consumers in the place of the business with the information notice, which will be sufficiently visible and legible, provided this is not made impossible due to the nature of the goods. The taxpayer shall put a notice with information on the website on which goods or services are offered. The taxpayer who fails to inform the consumers could be fined up to CZK 50,000.

4.4 Receipt Lottery

The receipt lottery is related to the obligation of issuance of receipts. It is a game (a lottery) which is organized by the Czech Republic, more exactly by the Ministry of Finance of the Czech Republic and is financed from the state budget. The only rule for participation in this "Czech game" is a sending in data from the receipts to the tax authority. This lottery should serve as a motivation for the public to require receipts for all payments, then

the purpose of this provision is to allow the public to check the authenticity of receipts. The nature of the lottery is that the consumers could win cash and material prizes with their receipts.

The Act regulating hazardous games (the Act no. 186/2016 Sb., on Hazardous Games) shall not apply to the receipt lottery which means i.e. for its operation it is not necessary to get a permit to operate a lottery and therefore it is not necessary to maintain sufficient distance from schools etc., because this lottery could not have an impact on moral development of youth. The lottery is generally conform to the provisions of the Act no. 89/2012 Sb., Civil Code, especially the section § 2883, which regulates bets, games and lotteries operated by the state.

Regarding the ensuring of the lottery, the Ministry of Finance announced a public tender for the whole lottery with the deadline for submission of tenders to 10. 1. 2017. Thus, at this moment the award procedure has not been finished. According to the informal information[2], the only supplier Sazka submitted an offer. Following the proposal of a public contract, it is evident that the Ministry of Finance plans to launch the lottery in the summer of 2017 because the contract stipulates that the contractor will provide performance up to 180 calendar days from the date of signing the contract.

5 Administrative Offences and Misdemeanours

The Registration of Sales Act distinguishes the misdemeanours (or administrative offences) committed by the natural or legal person. Under the Registration of Sales Act, administrative offences are dealt with by the tax authority or the customs authority.

In general, a legal entity or natural person engaged in business commits an administrative offence if he intentionally causes a serious obstruction to or frustrates the registration of sales; or if he, as the person who registers sales, violates the obligation to send a data message containing information

2 Idnes.cz. Miliony za účtenku. Do tendru na loterii EET se přihlásila jen Sazka. Dostupný z: http://ekonomika.idnes.cz/euro-cz-do-tendru-na-uctenkovou-loterii-se-prihlasila-sazka-pqj-/ekonomika.aspx?c=A170112_165508_ekonomika_rts

concerning a registered sale to the tax authority; or if he or she does not issue a receipt to the consumer. These administrative offences are subject to a fine up to CZK 500,000.

6 Conclusion

The the Registration of Sales Act has not been efficient enough time to evaluate its effectiveness, particularly in view of the fact of mitigation of illegal tax evasion. Unfortunately, it is possible to consider the attitude of many merchants (or entrepreneurs or businessmen) working in catering, accommodation and food services who benefited from the new legislation because they have raised the prices explaining their cost were increasing as a result of the new obligations related to the Act on Registration of Sales etc. The most common argument is that they were obliged to buy a new device which will register the payments and that they have to invest in the internet, even that they have to hire the new staff etc.

What I find important to mention, that is evident that with the registration of sales are connected increased costs. However, at the same time, the taxpayer could apply a reduction of income tax up to CZK 5,000, in the period when he or she registered a first registered sale. Furthermore, in connection with the registration of sales, the rate of VAT was reduced for catering and beverages services (excluding alcohol) from 21 to 15 percent.

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EFFICIENCY OF PUBLIC EXPENDITURES AT EDUCATION (CZECH CASE)

Eva Tomášková [1]

Abstract

The contribution deals with efficiency at public expenditures at education. The aim of the contribution is to apply measuring of efficiency at one part of public sector. The paper involves few parts. First part includes characteristics of public sector. Second part involves specification of measuring in public sector. Methods for measuring efficiency in public sector are described in the third part. Application of measuring efficiency at education is shown in the end of the text. Compilation, comparison, analysis and synthesis were method used for writing this contribution.

Keywords: Public Sector; Public Expenditures; Efficiency; Effectiveness; Measurement; Education; OECD-PISA Indicator.

JEL Classification: H30, H50

1 Introduction

Public expenditures are still in the centre of view. The most attention is paid to public spending by different groups, especially journalists, independent organisations, opposition politicians, lawyers or economists. The reason is effectiveness and transparency of public spending and large of public sector in the most of the countries. Public sector is large enough to constitute an important part of the economy as a whole. Public sector plays a significant role for economic increasing because public sector ensure economic environment (education, science, infrastructure etc.). Financing of public sector is realized by private sector; it means that resources are reallocated from private users to public users.

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Efficiency could be realized with two ways. First, output is producing large with using the same resources. Second, output is producing with using smaller resources. The first step for improving efficiency is to detect and analyse inefficiencies and after then it is possible to eliminate it. Efficiency could be marked as a possible measurement of performance in the public sector. However, measuring efficiency in public sector is more complicated than in private sector because it cannot use business performance as the main criterion of success.

The issue dealing with efficiency of public spending is complicated. The reasons are unclear definitions, difficult measuring and evaluation of some criteria of public spending efficiency and specific environments of the countries.

The contribution involves specification of public sector, specification measuring in public sector, methods for measuring efficiency in public sector and application of measuring efficiency at education. The aim of the contribution is to apply measuring of efficiency at one part of public sector. Compilation, comparison, analysis and synthesis were method used for writing this contribution

2 Specifications of Public Sectors

Public sector is characterized by several differences to private sector. There are different ownership, different objectives and constrains and different competitive conditions. From this reason, measurement of public sector efficiency is more complicated in comparison with private sector.

Wintrobe (1997) notice that motivation of public sector to be more efficiency in public spending is low because there are not noticed sanctions for managers or directors. Stakeholders in private sectors do the business for them but managers in public sectors are low motivated for improving the efficiency. Owners in private sectors read in detail the financial analysis about the company prepared by financial experts. The analyses in public sector are realized sporadically by academic researchers or specialized government agencies. Stakeholders in public sector are not so high motivated in monitoring the activities of public producers.

Public sector is characterized with different objectives than at private sectors. The most companies try to profit maximization, this objective is irrelevant for the most public companies. Fox (1999) argues that mangers in public sector have less control over a combination of outputs than the managers in private sector. Managers in public sector have limited possibilities to find a way of efficient resources. Only correct identification of relevant objectives can lead to efficiency analysis. This all is relevant for constraints as well.

Competitive conditions are the last mentioned reason for specifications of efficiency in public sectors. Only greater competition in the market should lead to increasing performance (high quality, low prices and new terotechnological approaches). Companies of public sector operate in less competitive markets than private companies, sometimes are monopoly. Niskanen (1971) notices that public sector managers try to utility-seeking budget maximize instead of output maximize. According to him, efficiency in public sector can increase through increasing of competitive environment, better controlling and sanctioning system.

3 Measuring in Public Sector

There are a lot of methods which measure objective in private sectors. These methods are difficult to implement in public sector because these methods are based on profit or business performance. According to Lebovič (2010), profit in public sector might be irrelevant and there are no information about input and output prices. Likewise, different parts of public sector might have different ideas about optimal combinations and quantities of outputs and it is not clear ideas which of these combinations and quantity of outputs are the right. Measurement of efficiency needs to define optimal way. The second problem is that public sector has multiple objectives.

The base for measuring is to gaining reasonable data. Obtaining the data can be problem at public companies. First, the data cannot be available for its specifics and for public expenditure monitoring standards. The issue can be problematic identification the information which are need for the measurement. Second, every measuring is based on comparison. Comparison can offer information about the score of a company in comparison with the companies with similar characteristic doing business in the same sector.

Often compared data are costs, revenues and other indicators of financial analysis. This knowledge is not implement in public sector or it is hardy applicable. As well, it is difficult to realize international comparisons because the data show minimum level of homogeneity. However, it is possible to realize international comparison through creating partial groups of public sector and measure concrete efficiency public expenditures at this groups, e. g. class size (Nandl, Dierx and Ilzkovitz, 2008)

Services are often output of public sector. How was mentioned above, one of the main criteria for measuring outputs are quality. Quality is a very important aspect of a service but it is difficult to measure. The quality of services is based as well on willingness of providers, flexibility etc. Every subject can perceive different value or quality of offered services. From this reason, it is very difficult to measure quality of services and value of services at subjects. The next characteristics of services except above mentioned are passing nature, absence of samples and inseparability with the person who provides the service. (Kaňovská and Tomášková, 2009) Quality of different services in private sector can reflect through different prices. This possibility is not at public sector.

Simpson (2008) shows that measuring output of a public service needs to involve all factors valued by the society, not only quality and quantity. Society can value the services provided by public sector with different socio-economic or demographic characteristics (e. g. using of hospital care, health condition). It is very difficult to construct useful output indicators for measuring efficiency of public expenditures. Nandl, Dierx and Ilzkovitz (2008) stress that the output of the public sector has to be defined. It is not a good solution to increase outputs only with increasing number of employees.

The next problem is to choice relevant weights for the quantity indicators, e. g. relatively cheaper output has smaller weight than the more expensive one. Optimally, the weights of indicators should present marginal social benefits that are associated with each output. It is obvious that these values can differ for different groups or individuals. Afonso et al. (2006) offer to use relative costs related to individual outputs. Although this method is common in practice for data availability, it involves a few difficulties. This method needs to define costs to each individual output. The problem can be if single input

is used to produce more than one type of output, especially at labour inputs. Inputs in this case are information about wages but it is necessary to attribute the costs to all outputs because the labour is often shared between a lots of outputs. The same situation is at capital or property.

Nandl, Dierx and Ilzkovitz (2008) stress problem with identification of inputs and outputs because many public services are interlinked, e. g. when the outputs of one public service is used as input by another public service. For example research is output of public research institutions and it is an input for research and development activities at universities at the same time.

Further issue is connected with dynamic effects. According to Silva and Stefanou (2007), dynamic effect is based on management decisions in past (as past investments). From this reason, it is necessary to involve dynamic effect in measuring of efficiency. Some current outputs can be caused immediate decisions. This dynamic effect is really difficult to add to the right period.

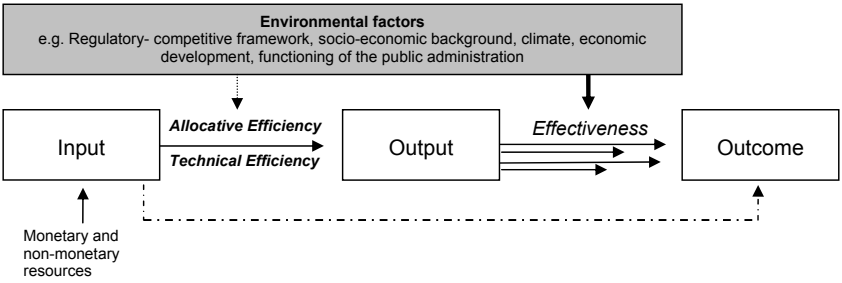
4 Efficiency and Effectiveness

Relationship between efficiency and effectiveness was analysed by Nandl, Dierx and Ilzkovitz (2008). Effectiveness creates input or output to the final objective to be achieved. Final objective is often marked as outcome. Efficiency means to find out optimal values of inputs and outputs. It is marked as one of the characteristics of productivity. Effectiveness as well efficiency can be influenced by environmental factors. These environmental factors are very various, like institutional and structural factors or country-specific factors. These factors are usually beyond the control of public authorities. Environmental factors can be influenced only with regulatory environment, the institutional setting or even climate. According to Wilson (2005), these factors can help to improve efficiency and effectiveness of public sector.

It is more difficult to assess effectiveness than efficiency because it is influenced by political choice. The outcomes are influenced by long-term effects of public programmes. It is possible to meet with delays between the

implementation and their actual impacts. Politicians are interested in the final outcomes of their policies, however the outcome is usual only partly in one political cycle, see Figure 1.

Figure 1. Conception of efficiency and effectiveness



Source: Nandl, Dierx and Ilzkovitz, 2008

There are two kinds of efficiency. The first one is named as technical efficiency. Technical efficiency means that the economics produce a maximal possible amount of output from given amount of input or the level of output is realized with minimal possible amount of input. The economics is on the production possibility frontier and output cannot be increased without increasing inputs it cannot decrease any input without decreasing output. Technical efficiency is based on the approach of "the best practice". (Koopmans, 1951).

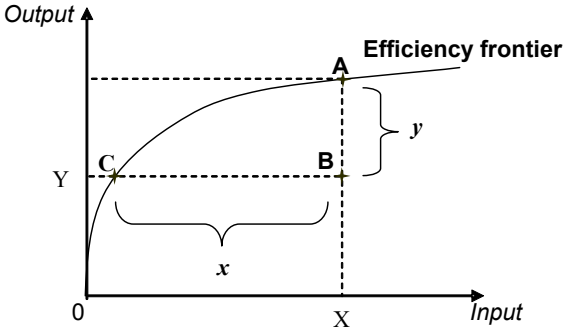
Second kind of efficiency is named allocative efficiency. It reflects the link between the optimal combination of inputs taking into account costs and benefits and the output achieved. The sense of this kind of efficiency is that efficiency is necessary to have attention to allocation. Effective allocation is only if output cannot be achieved by choosing a different set of inputs, it was chosen the best one combination of inputs. Another word, "a high degree of technical efficiency achieved at the level of each individual input does not guarantee an efficient functioning of public sector activities if alternative combinations of inputs would result in higher outputs." (Nandl, Dierx, Ilzkovitz, 2008).

5 Methods for Measurement of Efficiency In Public Sector

Efficiency is very complicated and it is not possible to direct measure it. Some researchers had lack in methodology and used performance indicators for measuring performance of public sector, though this measurements are suitable for productivity. These measurements can help to increasing of productivity but do not involve information about the maximum possible achievements which is the core of efficiency analyses.

According to Nandl, Dierx and Ilzkovitz (2008), model which is very often mentioned and used is the model based on concept of efficiency frontier (that are productivity possibility frontier). The model is based on two variables – input and output. Two countries A and B reach the same level of input (public expenditures), but country A achieves a higher output and from this reason this country is more efficient, it is considered to be on the efficiency frontier. Country C has lower input and from this reason reaches lower output. Nevertheless, country C reaches on efficiency frontier. Efficiency at country A and C is on the same level – on efficiency frontier and they achieve the maximum of output that is achievable with the given amount of inputs. Country B can choose from two alternatives to increasing its efficiency. Country B increase output to the level A with the current input or decrease input to the level C and output keep on the same level. Increasing output is called output-efficiency and decreasing input is marked as input-efficiency, see Figure 2.

Figure 2. The efficiency frontier



Source: Nandl, Dierx and Ilzkovitz. 2008

Although there are a lot of problems connected with measuring in public sector, there are a few approaches offer measurement efficiency in public sector.

Charnes, Cooper and Rhodes (1978) formulated the first one named Data envelopment analysis or DEA. This approach is marked as non-parametric as well. Authors deal with non-profit-entities and emphasize situation when the data is not weighted by market prices. The model has to solve problems of weighting inputs and outputs when market prices are not available or distorted. The data were gained with using of empirical research. By assumption, the frontier determines the best practices (like country A or C in Figure 2) and all other countries can measure their potential efficiency gains by the distance to the frontier. This efficiency analysis is based on mathematical programming and provide comeback into economics. Advantage of this approach is its transparency and facility. Disadvantage of this model consists in its deterministic nature. It do not involve the statistical noise. From this reason, it is possible to add noise to efficiency or this model can be used for statistical analysis.

During the years, a lot of authors try to improve this model as well. Cooper, Seiford and Tone (2007) remind some issues connected with DEA. First, different models involve different assumption about returns of scale. Second, choice of inputs and outputs has to be involve in the analysis. From this reason, researchers do not apply standard statistical tools for testing DEA models in order to its correct suitability. Results of DEA model might be sensitive to opinion of researchers (according to size of the sample as well as the selection of used inputs and outputs variables). Generally, methods based on DEA are sensitive to measurement errors and statistical noise.

The second type of model is based on econometric approach. The first author analysed this topic was Farrell (1957). The origin concept was that efficiency is measured as a realized deviation from a hypothetical production frontier isoquant. This approach is named as stochastic frontier model (SFA) by Aigner, Lovell and Smith (1977) and Meeusen and van den Broeck (1977). During the years, a lot of authors try to improve this model. Fried, Lovell and Schmidt (2008) notice that SFA models have great flexibility when the exogenous factors change. They allow comparisons of efficiency of various producers. Advantage is that it can isolate the effects of statistical

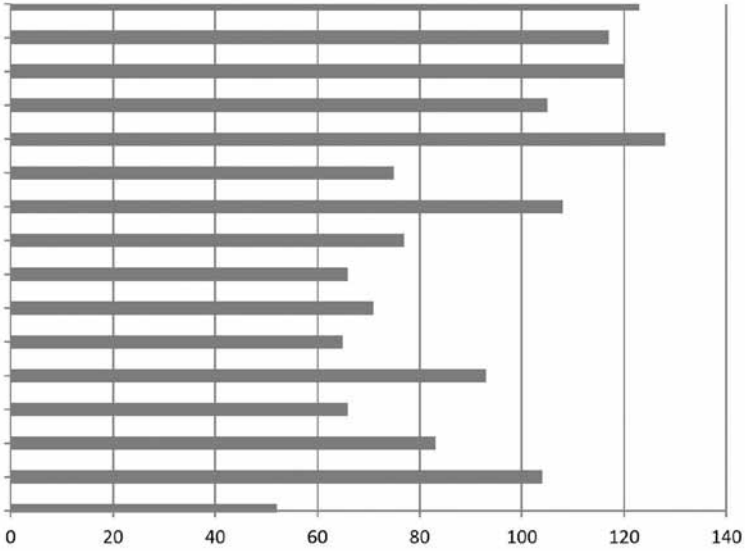
noise. Disadvantage is that it needs to be modified in order to become a suitable tool for efficiency measurement.

Both of these methods are used for measuring efficiency in public sector. Choosing the right methods depends on specific factors of economic environment. Successful measurement of efficiency of public expenditures depends on keeping the mind all advantages and disadvantages both types of methods.

6 Efficiency at Education

Public expenditure on education are often mentioned and monitored because qualified labours are a significant determinant of economic growth. Gonand (2007) stress that efficiency at education has long term effect. According to him, increasing on 10 % in education might increase GDP by an estimated 3–6 % in the long-term period. Public expenditures on education have not direct influence on increase GDP, see Figure 3.

Figure 3. Relation between spending on education and GDP per capita at selected countries in 2011[2]



Source: Eurostat

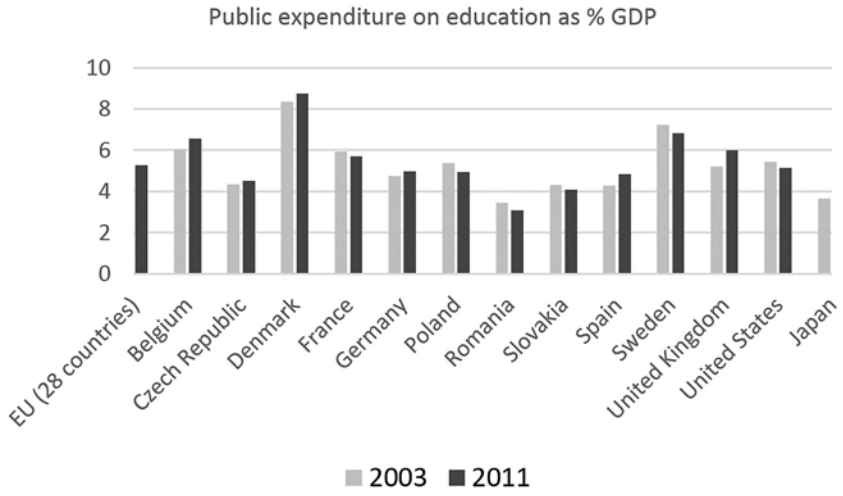
2 Figure 3 involves data from 2011 because Eurostat offer on your websites data from this year as the latest.

Notice: x-half-axis shows GDP per capita – EU 28 = 100; y-half-axis shows expenditures on education as % of GDP

There are two groups of countries – countries with a high GDP/capita and countries with low GDP/capita. Both of these groups (countries with high GDP/capita as FI, BE, AT and countries with low GDP/capita as SK, PT, LI) devote a large share of their GDP to education. Only Romania varies.

Traditionally, education system in the EU countries is financed mainly by public expenditures. Many countries try to increase public expenditures for education as a percentage of GDP during the period; however, these expenditures have decreased at some countries, see Figure 4.

Figure 4. Public expenditures on education as % of GDP at selected countries



Source: Eurostat

The reason might cause impacts of economic crisis in 2011 or the decrease has occurred mainly in terms of public expenditures.

The OECD-PISA scores is used for measuring efficiency of public expenditures on education. This indicator measures output of the education system. It involves information about 15-year-old-adults how to meet the real-life changes as basic skills of reading, mathematics and science. It does

not aim on the extent to which the young people have mastered a specific school programme. It measure only educational output. (Nandl, Dierx and Ilzkovitz, 2008) Table 1 show the results OECD-PISA at lower secondary education and upper secondary education in selected countries.

Table 1. OECD-PISA results at lower secondary education and upper secondary education in 2012[3]

	Lower secondary education		Upper secondary education	
	Average	Standard Error	Average	Standard Error
Belgium	387	4,8	519	2,2
Czech Republic	476	3,4	511	3,1
Finland	511	2,3	x	x
Estonia	519	2	552	13,1
France	400	4,1	522	2,3
Germany	505	2,9	523	11,7
Hungary	395	8,7	486	2,6
Italy	366	14,7	491	2,9
Poland	504	2,4	x	x
Portugal	412	2,6	534	2,2
Slovak Republic	452	3,6	496	3,4
Spain	486	2,2	x	x
United Kingdom	452	10,8	493	2,5
Austria	376	14,8	499	2,8
Average OECD	451	1,1	510	2,1

Source: OECD

High value of PISA indicator is at these countries: Estonia, Germany and Finland or Poland (however, at these both countries it is not available the value for upper secondary education). Low value of PISA indicator is at these countries: Belgium (at lower secondary education), Hungary, Italy or Austria.

3 Table 1 involves data from 2012 for keeping the uniformity because public expenditures on education mentioned above was from 2011.

For instance, Germany spend 4.98 % expenditures on education (Figure 3) and belong to the best countries according to PISA indicator. The same situation is in Poland. Different situation is in Spain. Spain has similar share public expenditures on education; however, PISA indicator is lower than in two named countries. According to Nandl, Dierx and Ilzkovitz (2008) this difference may be explained by non-monetary determinants of education performance or education expenditures are used inefficiently.

This comparison is very simple and the efficiency is not properly measured. However, this is practical application measuring efficiency in public sector and it enables for comparison in many different countries. It is supposed that the methodology will be improved in the next years.

7 Conclusion

The contribution fulfil the aim of the paper. It is described characteristics of public sector and specification measuring in public sector, introduced methods for measuring efficiency in public sector and shown application measuring efficiency of public expenditures at education.

Public expenditures have to be characterized as simplicity, transparency, fairness and efficiency. As it's mentioned above, public sector show same characteristics which are differ from private sector. From this reason, it is not possible to use methods of measurement efficiency applied in private sector. Researchers try to find out the best one method for measuring efficiency in public sector; however, many variables, changing the environment and specification of every country make this willingness very complicated.

Generally, a lot of scientific papers and practical applications show that efficiency at public expenditures is one of important issue. Monitoring the performance of public sector can help to improve value offered by public sector and economic environment.

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THE MODERN SYSTEM OF RUSSIAN FINANCIAL LAW: CONCEPTUAL APPROACHES

Imeda Anatolevich Tsindeliani[1]

Abstract

The prevailing today conceptual approaches to the definition of the system of financial law as a branch of law are discussed in the article. Modern approaches to the systematization of financial law and criteria on the basis of which this systematization has been carried out are analyzed. This article touches upon the problems of the modern conception of the subject of Russian financial law. The problem of constructing of the financial law according institutional system and classification of law based on the pandects of Justinian is considered. The approaches to the allocation of the system of financial law of the formation of a fiscal law and the emission rights and the rights of monetary circulation and the problem of allocation of general and special parts of the financial system of law have also been considered. The article is concluded with the author's understanding of the subject and finance system.

Keywords: Financial Law; Budget Law; Tax Law; Banking Law; Foreign Exchange Law; the Institute; Subsector; System of Branches of Law; Rules of Financial Law.

JEL Classification: H50, K34

1 Introduction

The problem of the definition of the system of financial law as a branch of the law has been remaining the subject of extensive scientific debate in the contemporary literature (Karfíková, Boháč, 2015). First of all, this is due to developing the legal framework and generally accepted scientific review of earlier approaches. The problem financial legal system is closely linked with the problem of the definition of the object of financial law as a whole today.

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We have previously focused on the history of the scientific debates on the system of the Russian financial law (Tsindeliani, 2015: 58–83). If we consider the Soviet period of development of the scientific conceptions of the system of financial law, it should be noted a variety of approaches to structural elements of the branch of law, that leads to the following conclusions:

- There were no uniform criteria for selection institutions and sub sectors in the structure of the branch of law;
- It was rejected the presence in the structure of the sub-sectors of the law, and instead of them justified the existence of the partitions, in order to prevent the extraction of the sub-sectors from the financial law;

There were conflicting conclusions about the inclusion or exclusion of certain institutions in the system of the financial law;

- Most scientists linked the existence of financial – legal institutions with the presence of the relevant financial – economic institutions. They denied the possibility of the existence of financial – legal institution without the existence of a similar financial – economic institute.

Despite the fact that many of the expressed opinions were of a controversial nature, it is impossible not to recognize the importance of the scientific debate held on the subject and the system of financial law. In fact, thanks to this debate, financial law has received a serious scientific foundation that allows now the branch of law to develop.

Changes in the political and economic system of the State, couldn't touch the basic categories of financial law, and, in particular, the object and the financial law system. The transformation of pre-existing elements of the financial system, the emergence of new elements of the financial system have largely influenced at the present stage of development of financial law. In general, there are two directions in the modern financial and legal literature, considering the development of financial law, and giving the definition of the objective of regulation and institutionalization of the field of law. The first direction can be described as traditional, in which the tendency of the modernization of the existing rich theoretical heritage of the Soviet financial and legal science. The second direction can be described as revolutionary, since it actually t actually declines to a complete revision of traditional approaches of consideration of the fundamental categories of financial law. Attempts to consider

the financial law in the new political and economic environment have led to a highly original tendencies in the financial law theory.

GA Tosunyan and AY Vikulin have hypothesized the formation of a new profiling branch of law, which has as a subject both public and private (corporate) finances. Noting the association of public and corporate finances in the same branch, they base on the fact that the relations arising about finances have always marked public character. The new financial law, as was identified by these authors, the emergence of a new profiling branch of law, has its own specific system, namely the budget law, tax law, banking law, insurance law, currency law, investment law, securities law, the law on protection of competition on the market financial services, legislation on securities market legislation on financial control and auditing, legislation on laundering of proceeds of crime (Tosunjan, Vikulin, 2003: 7–11). In turn, NM Kazantsev proposed a new concept of financial law, which is intended to be interpreted as the right, i.e. the right to perform legal actions with respect to or through finances and financial evaluations, under certain jurisdictional protection of the State or other subject of financial jurisdiction (Kazancev, 2009: 29). The author considers the financial law, not only as a public, but also as an individual law. He defines the substantive law as part of the financial powers of the acquisition of real assets of national heritage in a certain amount of their value. Of great interest is the opinion of this author on the financial system of law. In his opinion, the financial structure of the rights can't be reduced to a tree -type. The system of financial law is a network structure, in which a lot of different hierarchical subsystems can be fleshed out.

A review of the views of leading experts of financial law allows us to do a whole number of conclusions on the subject of the problem and the system of financial law at the present stage.

The concept that underlies the definition of the object of financial law through the financial activity of public law entities in the field of the formation, distribution and use of funds, now can't reveal the full potential of financial law. It is inherited from the Soviet past and doesn't allow in new economic relations to see that the financial law in a market economy acquires other qualities and properties. New features of financial law lie in the fact

that out of control of public finances, it has become a regulator of the relations existing in parallel with the public and related private finances.

It should recognize that in a market economy relations connected with the finances of the State are diverse in nature. It is almost impossible to see net financial relations. Accordingly, the subject of financial law currently covered not only "pure" financial relationships. In fact, we should recognize that relationships in the financial sphere are complex. The financial – legal regulation involve complex social relations covering almost full range of both public and private finances.

Preservation of the concept of financial activity of the State and municipalities in the theory of financial law can't explain how these or other institutions, currently being considered as the financial and legal, in general may be in the system of financial law.

The current state of the legal theory that is also burdened with the Soviet past, relating to branch specialization, can't overcome their rigidity. Unfortunately, traditional approaches to determination of the branch of law through the subject and method of regulation now don't explain many of the phenomena of legal reality. Modern financial law, with its deep roots in the Soviet era of development of the law, does not explain many of the phenomena actually existing legal reality.

The fear of the transformation of the financial law in a comprehensive branch is far-fetched, because the place in the legal system is determined by social need, which is based in the fact that there shouldn't be a priority of public law entities in the financial sector. Private entities in the financial sector should also get decent tools of interaction and realization of their interests in the field of finances. Modern financial law is burdened by the priority of public interests under cover of the common good for all, which in itself is good, but the reality is that the interest of public legal entities becomes absolute. The situation in the budget and tax spheres of the State is clear evidence of this fact.

2 Discussion

The discussion arose around the proposal for the formation in the financial system of law of emission law is of great interest. There is no consensus

among scientists about how to identify in the system financial law a set of rules governing the monetary relations. There are suggestions in the literature, that it is possible to allocate in the financial law system a separate subsector, named as the right of circulation of money, which is a set of legal norms regulating social relations that arise during the process of the movement of cash and non-cash (Towmasyan: 2009: 24). The authors motivate the very possibility of formation of such sub-sector by the presence of its subject and method of legal regulation, the adequacy of legal provisions allowing them to allocate a separate entity, their certain specifics, etc. it seems rather simplistic approach to the issue of the formation of structure in the sub-sectors of financial law. It seems that this is quite a simplistic approach to the issue of the formation of sub-sectors in the structure of financial law. For example, the authors define the subject of this sub-sector as a public relations arising during the process of cash flow. However, the process of cash flow is the subject of regulation by not only finance law, but also administrative and civil law. How to separate these rules of the appointed branches of law from regulating this process? Another example of relationships generated by this sub-sector – social relations arising about the establishment and execution of the process (order) handling in the territory of a particular State of cash and non-cash in national and foreign currency and regulated by the rules of law. However, the circulation in the territory of a particular State of cash and non-cash foreign currency is also in contact with the institute of currency regulation.

The very subject of the proposed sub-sector is defined by the mentioned author as specified public relations arising on the process (order) of cash flow. And the method of the law of money circulation coincides with the method of the financial law – a method of government regulations, based on the imperative regulation of social relations.

We believe that social relations in the process of functioning of the monetary system of the State define the subject of regulation of the monetary (emission) law.

To-day, the monetary system of the State consists of the following interrelated and interdependent elements:

- The monetary unit of the State;

- Principles of the organization of the monetary system;
- Types and order of maintenance money;
- Emission mechanism;
- Money supply structure;
- Forecasting and planning of cash circulation;
- Monetary Regulation of economy;
- The order of determining of currency circulation;
- The order of cash discipline.

Accordingly, the public relations arising in the process of the operation of each of the above elements of the monetary system of the State, form the subject of monetary (emission) law. It is necessary to proceed from the fact that they are interrelated elements, which ensure the functioning of the monetary system of the State in the result direct interaction. As a consequence, it is necessary to determine which rules of financial law form the structure of the monetary (emission) law. There is no consensus on the financial system of law in the modern financial and legal literature. Nevertheless, we believe that the financial rules of the system can be divided into four sub-sectors, namely the budget law, tax law, monetary (emission) law, financial – control law. Each of these sub-sectors incorporates a large group of financial – legal norms, which, in turn, are combined in the financial – legal institutions. In our opinion, the monetary (emission) law is formed by the following financial – legal institutions:

- Circulation of money;
- Currency regulation;
- Public banking law.

Almost publicly, the said financial – legal institutes cover of the functioning of the legal components of the elements of the State monetary system. It should be considered that the actual elements of the monetary system of the State are in the process of development and modernization. For example, the modern monetary system of the State is unthinkable without such institutions are actively developing electronic payment systems and electronic money. That in itself raises the question about the limits of the financial and legal regulation of relations in the field of electronic money. Money turnover, as the sphere of the financial – legal regulation is essential, because

in its essence not only the public finance sector, but also the entire sphere of private finance depend from its effective functioning. The functioning of all elements of the financial system of the State is in direct dependence on the cash flows and mechanisms, both economic and legal, to ensure such a movement. The critical role of regulation of the monetary system of the State belongs to the standards of other financially – legal institute – public banking law. We agree with the fact that the banking activity – a very complex phenomenon. However, for the State, well-functioning banking system is a major priority, and it is caused, first of all, not only the interests of the State, but also the interests of individuals. In fact, by far the most reliable investment people are investing in bank deposits. Providing property interests of individuals prompted the government to develop a system of deposit insurance in banks. As a consequence, the State reinforces the public regulatory regime of banking activity that acquires a variety of forms. Given that the process of functioning of the monetary system today is unthinkable without the most important economic institutions – banks and non-bank credit organizations, public banking law is an institution to be included into the emission (monetary) law. So far, the problem of assigning emission law to the general or special part of the financial law system is debatable. The rules incorporated in sub-sector "emission(monetary)law" in the system of financial law governing relations in the process of functioning of the monetary system of the State, are links that provide implementation of standards such as sub-sectors and finance institutions as the budget law, tax law, financial control law, public credit, public debt, and others.

Thus we believe that the monetary (emission) law has been emerged in the system financial law as sub-sector, which should be included into the general part of the financial law. The structure of it includes such financial and legal institutions as currency law, public banking law, monetary circulation.

2.1 Separation of Fiscal Law

The idea of separation of fiscal law or law of public revenues in the system of financial law seems no less controversial. According to Vasyanina E. forming a single legal sphere, treasury is covered by the fiscal law, whose place in the system of financial law is destined to exercise the activities of the

State management of financial resources and public revenues. Formation of public law of State revenue is connected with the legal technique of systematization of normative legal acts establishing fiscal levy (collection). It will create a single legal framework of fiscal activity of the State. These authors believe that fiscal law has its own system. Assuming pandects structure of law it is possible to identify a General Part of the fiscal law, including general provisions applicable during the fiscal system regulation, and special parts, covering individual parts of treasury. The general part of the fiscal law should contain provisions on profitable financial obligations relations, principles of regulation that are emerging in the area of formation of the public purse, the general conditions for the establishment of fiscal levying, the mechanism of their administration, the provisions on the monitoring of the performance by the debtor obligations on forming public purse, as well as the institute protecting the rights of participants of the fiscal relations. Special Part of fiscal law is intended to cover certain types of fiscal levying, institute of fiscal tort law, under which establishes the legal regime of financial obligations arising from the wrongdoings. According to Vasyanina's concept the fiscal law (the law of public revenues) covers a wide scope of specific financial institutions which require subsequent classification and their subsequent systematization, such as: 1) taxes; 2) fiscal charges; 3) parafiskalitets; 4) insurance premiums; 5) measures, having the character of punishment (fines, confiscation, seizure of other compulsory withdrawals); 6) fiscal payments, which are measures of tariff regulation (for example, customs duty, recycling); 7) actions which are protective measures of non-tariff regulation (countervailing, anti-dumping duties); 8) natural resource payments; 9) "hidden" fiscal levy; etc. (Vasyanina, 2016: 10–17).

It seems that this concept is artificial and lacks a regulatory framework, not taking into account the basic structural elements of the financial law forming the framework of its system – the budget and tax law. At the same time the concept of a financial liability laid into the basis of the theory of fiscal law hasn't a legal regulatory framework. Accordingly, we can now only talk about some theoretical structure.

3 Conclusion

A traditional approach to the structural elements of the system of financial law as a branch of law is reproduced in the vast majority of financial and legal studies. There are also represented the emergence of new institutions and sub-sectors of financial law, proposals to remove the traditional institutions of the financial system of law, justification for the transformation of institutions and sub-sectors in the new independent branch of law, or a new complex area of law. However, the development of criteria for the systematization of financial and legal provisions in the respective structural elements of financial law has not received significant theoretical development. The elemental composition of both General and Special Parts of financial law remain without significant theoretical development and coverage in most textbooks on financial law. What institutions and sub-sectors are universal for the financial law and form a General Part and which the institutions form the Special Part, and what are the criteria to the present in the light receive occasional interpretation? In our opinion, all of the Special Part of financial law consists of a large number of inter-sectoral institutions. In fact, it can be argued that public relations in the field of public and private finances are subject to regulation by branches of public and private law. As a consequence, the inevitability of the formation of inter-sectoral entities, including in the area of financial regulation.

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LEGAL AND FINANCIAL ASPECTS OF FINANCING TASKS OF LOCAL GOVERNMENT UNITS FROM FINANCIAL RESOURCES OBTAINED ON BANKING AND NON-BANKING MARKETS – ISSUES CONNECTED WITH THE NEGATIVE IMPACT OF CURRENT PROVISIONS OF LAW ON THE STABILITY OF PUBLIC FINANCES (POLISH CASE)

Anna Zalcewicz[1]

Abstract

Subject of this paper are rules, selected and defined by law, obtaining financial resources from banking and non-banking markets for financing tasks of local government units, as well as the protection of budget resources of local government units deposited in bank accounts. In particular, the Author's intention is to prove, based on a dogmatic-legal method, that legal solutions currently in force do not guarantee a necessary level of protection against over-indebtedness of local government units and loss of resources deposited in bank accounts, which has a negative impact on the stability of public finance.

Keywords: Deficit; Law; Banking And Non-banking Services for Local Government Units; Stability of Public Finances.

JEL Classification: H50, H62, H63, H74

1 Introduction

Pursuing public tasks is a constitutional and statutory obligation of local government units. At the same time, the problem of proper regulation

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of an area of their proper financing is a very important issue; as with no appropriate resources designated for this purpose, it may turn out that pursuing public tasks will be impeded or even impossible. At the same time, as is known, this issue requires a multifaceted approach as it concerns not only legal regulation of the sources of proceeds and revenues and the rules of spending public funds on financing tasks, but also the introduction of solutions preventing over-indebtedness of local government units. There is the necessity of existence of effective solutions preventing the increase of indebtedness up to the level where it is impossible for the local government units to fulfil their financial obligations.

In Poland, the rules of: ensuring appropriate relationships between income and spending; defining the limits of indebtedness, bank services with respect to budget, sources of financing deficit, etc. regulated by subsequent acts on public finance are subject to frequent change. It is declared that the aim of such changes made is usually the intention to increase discipline of spending public funds, improvement of state finances, or implementation of stable solutions fostering the carrying out of rational resource management with respect to budgets of local government units. However, appraising the legal provisions currently in force, it may be said that the current solutions do not provide an appropriate level of protection against over-indebtedness of local government units, or even foster circumventing indebtedness indicators. Therefore, prudential regulations and legal mechanisms, among others: those introduced from 2014 through the provisions of Public Finance Law, do not fulfil their functions effectively. Furthermore, the current wording of many other provisions fosters "concealment" of the actual level of indebtedness of local government units.

The second identifiable problem in the area of law regulating financial management of local government units is providing appropriate protection of public money owned by these units, in particular those deposited in bank accounts. It may be said that this protection was not provided even though loss of resources may destabilise the finances of local government units.

The purpose of this paper is to show, mostly with the use of dogmatic-legal method and information on results of checks carried out in local government units as available, that many of the legal provisions related to financing

tasks of local government units from banking and non-banking markets[2] as currently in force, do not meet the purpose as targeted by the legislator within the scope of securing the stability of public finances, effectiveness of spending public resources or protection of resources deposited in bank accounts.

2 Qualification of an entity as a public finance sector unit and the issue of "concealing" the actual level of indebtedness of local government units

The total amount of indebtedness of a local government unit is defined by the sum of external obligations of its particular organisational units classified as public finance sector units (among others: budgetary entity and local government budgetary units). The subjective scope of the public finances sector as defined in Art. 9 of Public Finance Law of 27 August 2009 does not extend, however, to some public sector entities. As results from its wording, public entities like: enterprises, research institutes, banks and companies operates on the basis of the Commercial Companies Code do not constitute the public finance sector, thus their debts are not included in the budget debt limits of, among others, local government (Borodo, 2012: 52). With regard also to the fact that regulations contained in Art. 242–243 of Public Finance Law of 27 August 2009, and also the rules established under prudential procedures (Public Finance Law of 27 August 2009, Art. 86/1/2/d and 86/1/3/c), refer only to budgets of local government units, not the whole local government sector, a conclusion may be drawn that public debt prudential regulations in the financial system serve the purpose related to limiting the negative impact of activities undertaken by local government units on the stability of public finance[3] to a limited extent only (Szmaj, 2015: 49–68). As results from controls of the Supreme Audit Office ("NIK"), local government units have often in a way "concealed" real indebtedness in communal liabilities of legal persons (NIK, 2015:6). Statutory limitation of the category of entities included in the public finance sector result

2 More about non-bank institutions regulations in Kerlinová, Tomášková, 2015.

3 As results from research, e.g, in 2011, 11 out of 18 cities examined would have exceed the 60 % statutory limit of debt as binding back then if debts of utilities companies was taken into account (Franek, 2012: 79).

in pathological behaviours as some of the local government units establish commercial companies not for the purpose of better fulfilling public tasks, but to obtain better indicators for calculating the amount of debt of a given local government unit (Borodo, 2012:52).

3 Agreements concluded for the purpose of obtaining resources for financing public tasks in the context of circumventing indebtedness indicators

Attempts of local government units to circumvent fiscal rules aimed at limiting the level of their indebtedness date back to the Public Finance Law of 30 June 2005 being in force, though, among others, entering into innominate contracts. The tendency to finance public expenditure not with use of resources obtained from loans and credits, but from other contracts such as, for example, *forfaiting* became noticeable. This was possible due to the fact that the legislator did not include them in the catalogue of debt titles (Panfil, 2014: 195–196). This situation was not changed by the Public Finance Law of 27 August 2009 or the introduction of a prudential indicator (individual local government debt ratio the so called "IWZ") as biding pursuant to Art. 243 of Public Finance Law of 27 August 2009 from 2014. Local government units still obtain financial resources through entering into agreements allowing them to show lower indebtedness (such as, for example, sale and leaseback) even if it is less profitable than credit or loan agreement and is likely to increase additionally indebtedness in the future[4]. With reference to the fact that the costs of entering into these types of contracts are usually significantly higher than the costs of settling bank loans and credits or redemption of bonds, it will affect negatively the financial situation of local government units and in a longer perspective, probably also the stability of public finances. Lack of obligation to take into account liabilities

4 According to the Information on results of NIK inspection "the results of the inspection indicate that the scope of non-standard financial operations used by local governments was connected with their financial situation. The more difficult it was, the greater the scope and scale of non-standard financial operations employed" (NIK, 2016: 10). It should be also emphasised that credits and loans still constitute the biggest share of debt of local government units and their associations. As results from data as of the end of June 2015 it was 94 % (Strategia zarządzania długiem sektora finansów publicznych w latach 2016–2019, 2015: 15).

resulting from these kinds of contracts while calculating the IWZ causes ineffective security before over-indebtedness of local government units[5]. It should also be noted that the NIK's inspections showed additionally that after cancelling a statutory (60 %) limit reducing the level of debt as set forth in Art. 170/1 of Public Finance Law of 30 June 2005, local government units engaging in financial operations leading to over-indebtedness became visible (NIK, 2016: 12). So changes to the law and implementation of new solutions did not eliminate negative occurrences, or even brought about their increase in the period analysed by the NIK.

4 Contracts for the purpose of obtaining resources made with entities which do not have the status of banks in the light of the remaining aspects affecting the stability of public finances

Provisions of law do not limit the range of entities which may provide financial resources to local governments, with the exclusion of the contract of credit, which in line with banking law, may be made with a local government unit by a bank only. Therefore it is allowed to incur liabilities not only with banks but also with other entities.[6] However, obtaining financial resources depends on various, different requirements determined, among others, by the entity with which a local government unit is making a contract. The question could thus be raised whether the selection of an entity with which a local government unit makes a contract may influence the value of its indebtedness?

While analysing this problem, attention should be drawn most of all to the fact that obtaining financial resources under a contract with a bank requires that the local government unit has so-called credit rating. This equals a bank's verification of the level of indebtedness and the possibility of payment of the obligations and also a verification by a Regional Chamber

5 It should also be noted that according to data contained in resolutions of local government units on long term financial forecasts in 2014, 64 local government units, that is, 47 counties, 16 municipalities and 1 city county were not within the limits set by the individual local government debt ratio (Strategia zarządzania długiem sektora finansów publicznych w latach 2016–2019, 2015: 15).

6 Even though in fact, a prevailing instrument in financing credit needs of local government units are loans obtained from commercial banks on the domestic market (Strategia zarządzania długiem sektora finansów publicznych w latach 2016–2019, 2015: 36).

of Audit, which issues an opinion on the possibility of repayment of a loan or credit or redemption of bonds, if the resources are designated for financing a local government unit's planned budget deficit, payment of previous obligations on issuing securities and payment of loans and credits as well as advance financing of tasks financed by the European Union's budget (Public Finance Law of 27 August 2009, Art. 91/2). This enables an objective analysis of potential capacities of payment of debts by a local government unit and a verification by it of its aims depending on the findings of a Regional Chamber of Audit or a bank. However, entities which do not have the status of a bank verify to a limited extent the possibility of payment by a local government unit of its obligations and usually do not require providing them with an opinion of a Regional Chamber of Audit on the capacity to repay the loan as mentioned in Art. 91/2 of Pubic Finance Law of 27 August 2009. This often allows for incurring liabilities which may lead to a loss of the possibility of discharging the obligations by a local government unit in the longer run.

We cannot overlook the fact that a legal basis for supplementing the budget with bank credits and loans, as well as issuing bonds, is Art. 264/1 of Public Finance Law of 27 August 2009, which requires that a bank be chosen according to regulations as defined in public procurement law. However, as results from the wording of clause 4 of this article, the management of a local government unit may take credits from banks chosen at its discretion in line with the provisions of public procurement law. Public Finance Law of 27 August 2009 does not regulate issues of entering into innominate contracts. Even though, as a rule, they should be entered into in line with the act – Public Procurement Law, this act, however, contains certain exceptions. Thus it is possible that local government units will not choose the best offer albeit for this very reason.

5 Protection of funds entrusted by local government units to banks

While analysing the issues of the stabilising or destabilising influence of current provisions of law on local government finances, it is possible to point out a problem resulting from entrusting funds to banks. This results from the lack of protection of funds deposited in a bank. Pursuant to Art. 22

of the Act on the Bank Guarantee Fund, Deposit Guarantee Scheme and Resolution, which came into force on 9 October 2016, guarantee protection coverage does not extend now to funds and claims of local government units. Thus, a bankruptcy of a bank may destabilise the financial situation of a local government unit. It is worth noticing that pursuant to the act as previously in force, that is, the Act on the Bank Guarantee Fund, these funds had guaranteed coverage even though in practice, based on the provisions of the Act on the Bank Guarantee Fund, it was not sufficient due to the limit of the amount guaranteed. Therefore, it was suggested in legal writings that local government units be covered by a public-law system of protection regulated by a separate act of law (Góral, 2010: 10). Currently, as it has already been pointed out, even though in line with Art. 6 of the Directive 2014/49/EU at least deposits held by local government units with an annual budget of up to EUR 500,000 could be guaranteed, the Polish legislator did not introduce such a solution. This leads to a situation when in the case of a bank losing the ability to settle liabilities and being declared bankrupt, a local government unit, as any other creditor, will have to take part in insolvency proceedings and the probability of receiving money back is not high. Thus it would be advisable at least to extend the contents of Art. 264 of the Public Finance Law of 27 August 2009 and allow local governments to hold accounts in more than one bank to limit the risk of their losing the funds left in the account, should a bank providing services to it go bankrupt.

6 Conclusion

As result from legal writing on this subject "a crisis of public finances reveals itself when the state of public finances does not allow the full exercise of public tasks by state and local government" (Kosikowski, 2011: 50) and its external indicator is, among others, increasing deficit and public debt (Kosikowski, 2011: 50). We are dealing with these phenomena now and a deficit of public finances necessary for performing tasks imposed on local government units leads to an increase of negative occurrences within the scope of financial management.

In this paper it has been shown that the legal solutions implemented with the aim of preventing excessive deficit in fact proved to be inefficient among

others, due to the possibility of the "circumvention" of existing norms and limits of indebtedness as defined in binding provisions of law. The fact that current solutions do not guarantee a sufficient level of protection against over-indebtedness of local government units and do not fulfil their functions effectively is evidenced by the exceeding to a large extent of the level of indebtedness as allowed. In the case of counties with the biggest debt, it is as much as 258.8 % – Rewal county and 233.8 % – Ostrowice (counted against the income of these counties – as of the end of III quarter of 2014). Even though such a significant increase of indebtedness does not result only from the fact of concluding innominate contracts, inspections of Regional Chamber of Audit and Supreme Audit Office clearly revealed a relationship between the financial situation of local government units and the conclusion of such contracts. As results of the inspections prove, the more difficult the situation was, the larger was the scope and scale of contracts made with entities which are not banks.

In this context, it is necessary to consider, first of all, systemic changes within the scope of division of public resources between state and local government in accordance with the constitutional rule of adequacy, in such a way as to ensure an appropriate level of own income for local government units without the necessity of them relying on external financing to such an extent; in particular due to the fact that in recent years the tendency of extending the scope of tasks imposed on local government units was clearly noticeable, while at the same time their income was limited (for example through introducing additional exemptions in taxes constituting a source of income of communal budgets). Secondly, the introduction of really effective solutions preventing over-indebtedness of local government units and its destabilising impact on public finances. In this second area, an obligation to take into account while calculating IWZ liabilities, which are connected with incurring costs of both their repayment and settlement, resulting from contracts on debt restructuring or sale back contracts, as well as other innominate contracts, may be suggested. Furthermore, that incurring such an obligation was preceded necessarily by obtaining an opinion of Regional Chamber of Audit on the possibility of its repayment. Despite the fact that these liabilities are not significant for the whole sector (over particular years, as results from the data as of the end of 2015, they did not

exceed 2 %), they may be significant for particular local government units. Local government units should consider themselves using other less costly and risky sources of financing, e.g. offered by public entities such as Bank Gospodarstwa Krajowego, within the scope of financing on market terms investments intended to realise tasks of local government units through a Municipal FIZ (a closed investment fund, whose operation is regulated by the provisions of the Act of 27 May 2007 on Investment Funds and the Management of Alternative Investment Funds and which is supervised by the Polish Financial Supervision Authority).

A separate issue which also affects the increase of indebtedness of local government units is ineffective supervision over local government units. For example, Regional Chamber of Audit does not have appropriate instruments to effectively counteract over-indebtedness of local government units. Often, local authorities, despite increasing indebtedness, do not follow the inferences resulting from reports on the condition of financial management and follow-up statements.

Referring in this context to current legislative activity, it may be stated that taking into account that in Poland the deficit is of a chronic nature and, as results from economic data, quite quickly growing indebtedness over past years and also in connection to Polish obligations resulting from Fiscal Pact, a group of MPs suggested a change to Pubic Finance Law and the replacement of the so-called stabilising expenditure rule with the rule of structural balance of income and expenditure for the whole public finance sector. A new mechanism disciplining public finance would have the form of a rule that structural balance of the general government (i.e. cyclically adjusted and without one-off measures) should as a rule amount to at least 0 % of GDP (MP's bill on amendments to Public Finance Law). This bill is now subject to deliberations in the Sejm. However, it was appraised negatively by the government.[7]

[7] Against this background it is possible to point to the fact that the position of the government is often significantly different from the actual current state within the scope of indebtedness. For example, it was assumed in the Strategy for years 2017–2020 that the indebtedness of local government units and their associations will be decreased as a result of the budget surplus of this group of units (the Strategy of managing debt of the public finance sector in years 2017–2020, 2016:31). It is difficult to say though, what in the government's opinion could lead to a budget surplus as, apart from such a statement no arguments supporting such an occurrence and factors contributing to it were given.

In summary, it must be emphasised that this study revolves around one of the current problems related to an increase of debt of the local government sector units. However, the causes of this occurrence should be considered in a wider legal context. Changes to the law in force made over the past 25 years, which resulted from misconceived communalisation of public tasks and lack of stability of solutions within the scope of financial management of local government units (changes to Public Finance Law, provisions affecting the amount of income of local government units) are its contributing factors.

A separate factor which may have a destabilising effect on public finance is the threat to a local government unit resulting from the possibility of losing resources in connection with the bankruptcy of a bank which provided banking services to the local government unit. Two solutions in this respect may be proposed. Firstly, allowing the possibility for a local government unit's budget to have banking services provided by more than one bank. Secondly, the introduction of a separate public-law protection system which would guarantee the return of funds which have been entrusted to the bank by a local government unit. In the Author's opinion, the latter solution would be more appropriate.

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PART 3
TAX LAW

THE INFLUENCE OF TAX LAW ON THE SLOVAK BUSINESS ENVIRONMENT

Vladimír Babčák[1]

Abstract

Author deals with some theoretical and practical issues on how tax law could influence the business environment in this article. With respect to the scope of the article the attention of the author is limited by the issue of income taxation despite the fact that general thoughts on possibilities if tax law are applicable within the other taxes as well.

Author focuses his attention particularly on the possibilities of tax law in improving of business environment, strengthening the legal certainty of entrepreneurs by taxation, motivation of tax subjects to respect tax discipline and on the application of the tax fairness principle. Apart from that, author is of the opinion that the elimination of aggressive tax planning together with the combat against tax evasions, tax frauds and tax avoidance falls within the scope of application of tax law.[2]

Keywords: Tax law; developing the business environment; strengthening the legal certainty of entrepreneurs; motivation in tax law; the principle of tax fairness

JEL Classification: H34

1 Introduction

Business environment together with relations arising thereof is subject of legal regulation of private law norms at the first place. This refers mostly to regulatory application of commercial law and civil law as well. After its renaissance in 1989, entrepreneurship has found a solid ground in the private law norms in relation with the fact that business relations are in their

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nature characterized by consensual approach with a relatively equal position of involved subjects.

The branches of public law participate at the same time on the formation and development of business environment by its regulatory and sanction mechanism. This could be represented in a positive way by creating fair conditions for business activities without a significant interference into its performance. Adversely, the development of business relations could be restricted by undue administrative constraints so entrepreneurs could be directly or indirectly discouraged from conducting business activities at the end of the day.

One of the branches of public law which influences the preparation and realization of business relations is represented by tax law with its legal rules and instruments complex. As a branch of public law has its role in expressing priority of public powers against subjects of business activities which are performed in the economy and in the social structure of society and in presenting dominant position against private interests of entrepreneurs at the first place.

The legal expressions of tax law instruments, which influence business environment are diverse and extensive. Due to their extent, the article deals only with some of them.

2 Tax Law vs. Business Environment

The fact that legal regulation of taxes significantly influences the business environment is well respected by representatives of commercial law science in the Slovakia who emphasize the idea that taxes in itself, their extent, way of their payment, tax allowances or disadvantageous treatment of various business activities etc. influences decisions of entrepreneurs on their business activities. This means that tax law norms posses the ability to create a positive economic environment for business development, but on the other side they are able to influence business environment in a negative way so they could „destroy" favorable business conditions (Suchoža, Husár, 2009: 50, 71; Husár, 2007: 25, 2009: 50).

Tax law instruments which are imposed and used by state in social relations should be derived from the particular economic policy of the state

in the specified period. With respect to the fact that economic and social processes that are held in the economy of our state depend on the applied economic policy (whether restrictive or expansive), even tax law has to adapt to these processes or to directly create conditions for their development. There is a current opinion presented worldwide, according to which the success of the every economic policy depends on tax policy with its inevitable realization component – tax law.

For more effective application of tax law relations within the development of the business environment, **the requirement of conformity** with the norms of the other branches of law has to be ensured, mostly in relation with commercial law. The requirement of the effectiveness of their application together with their ability to create fair business conditions is the priority for the whole business environment. Apart from that, their role in protection of the Slovak economy against negative consequences of the worldwide economic and financial crisis is needed as well.

The instruments of the influence of the business environment are determined by everyday economic reality which is formed and influenced by activities and manners of particular entrepreneurs. Within tax law area these subjects become tax law subjects at the same time. Their tax law status is dependent from many circumstances such as are tax domicile of the particular person, the kind of the activity that is object of the taxation, business activities within the state/cross-borders transactions, the qualification of the income and the existence of the property that is taxed, defining the scope of the income that is not the subject of the taxation, defining the possible tax releases, rules for determining tax base etc. Many indicators which form the particular tax law status of the person are involved. After all, tax law should in every case:

1. Create conditions for **more qualitative business environment**;
2. Strengthen **the legal certainty** of entrepreneurs within the taxation;
3. **Motivate** tax subjects **in respecting tax discipline**;
4. Apply **the requirement of the tax fairness**;
5. Eliminate **aggressive tax planning**;
6. Limit **tax evasions, tax frauds and unjustified tax avoidance**.

Abovementioned aspects are mutually connected so their application in the whole is needed. For example developing the business environment without strengthening the legal certainty by taxation is not possible at the same time.

A thesis on **necessity of development of business environment** is a well repeated phrase of the every single government from the autonomous Slovak republic existence. Such a thesis, if it would have its real basis in the economy and social relations of our state would mean at the same time that one of the mentioned aspects under the focus of tax law would not be current now. The reality is however, different.

The measures of systematic, organizational, as well as legislative nature in the field of tax law which follow creation of the more qualitative business environment include:

1. **The simplification of legal regulation of tax duties**

   The current legal regulation of taxation of tax subjects who are entrepreneurs is year by year more precise and complicated as well. This is signalized by the legislative practice within the field of taxation. A very detail legal regulation does not mean in itself a presumption of its quality. On the other side one important fact could not be excluded – if detailed legal regulation would stipulate the punctual, unambiguous, systematic and long-term valid legal rules, which would contribute to the requirement of the legal certainty, the business environment could benefit thereof.

   Tax law norms remind currently less than ever classic legal norms, as they are perceived by legal theory and are becoming more technical at the same time. Tax law norms are currently characterized by an extraordinary complexity of particular tax law institutes, by enlarged legal text together with an excessive administrative without previous experiences of tax subjects and tax administrations with abovementioned phenomena. A very negative role could be assigned to the EU legislative with it uselessly purposeful and ambiguous terminology. In some cases it could seem like particular EU institutions do not have clear imaginations on abilities of efficient application of their legislative acts.

   Tax law subjects irrespective of their legal form by particular taxes have a problem to understand tax law regulation which is more

precise compared to what they are used within their business practice. Another negative trend is however, represented by the number of references to the other legal norms from the other branches of law, what leads in consequence to resignation on the try to study the complicated tax law norms. Trying to be objective, even experts from the field of tax law have often serious problems to understand the purpose and philosophy of the particular tax law norms (novelizations of legal regulation), especially when the explanatory report of the law only describes particular provision without providing the view on the intent of the law maker. The idea of the non-existence of such a purpose is present in many cases.

The simplification of legal regulation of taxes and tax system is under the European Tax Survey 2015 (Deloitte, 2015) the most important factor for competitiveness.

The complexity of the legal regulation of taxation is supported by the complexity of procedural rules that are valid for tax administration. Ongoing (even if slow) electronisation of public administration which includes novelizations of Tax Ordinance Act (Act no. 563/2009 Zb., as amended) referring to delivering by electronic means, electronic personal account of the tax subject[3] however implies, that the complexity of the procedural rules could be partially reduced at the end of the day.;

2. **The transparency of existing legal regulation of taxation**

   This requirement could be achieved by following legislative measures/steps:

   a) Novelizations of tax law norms should be performed with efficiency only from 1. January of the following year;

   b) Tax law acts, having on the mind their role in economic policy of the state, should not be changed and supplemented by the other legal acts, at least from the following reasons: (1) the whole non-transparency of novelizations and supplements of tax law norms, which are part of the other legal regulations from the other fields of legal order mostly at the end of the year; (2) the

3 Under National Agency for Network and Electronic Services 322 974 electronic accounts for legal persons were established up to the 1. August 2016 (Deputy Prime Minister's Office for Investments and Informatization of the Slovak Republic, 2016).

importance, which is currently assigned to taxes and their legal regulation; (3) tax law norms are of the negative impact on financial status of tax subjects and therefore interfere into the legal certainty of tax subjects;

3. **The instability of the tax law as a whole and some tax laws norms in particular**

   For example the law on income tax from 2003 has been novelized more than 75 times and the law on VAT more than 25 times.

   The often novelizations of tax law norms lead to the conclusion that there is an absence of strategic objectives of the tax policy as required by the law (Art. 3/1/a of the Act on State Administration Bodies in the Area of Taxes, Fees and customs, as amended). These strategic objectives shall include the requirement of stability of taxation of tax subjects as well as setting the limit of economically effective taxation for the public and entrepreneurs. One of the consequences of absence of such strategy is represented by non-stability of tax law, what has a negative impact on economy, economic growing of the state and the development of business activities with following growing of household consumption (Babčák, 2014: 9–26).

The issue of **strengthening of the legal certainty of entrepreneurs in the field of taxation** refers mostly to the fact that tax law measures should not interfere into the legal certainty of entrepreneurs **in an inappropriate way**. Tax law shall provide certainty on the issue of the legality of imposing tax duties for taxpayers and not to make them unsure by their deciding. However, current tax law does not provide such a legal certainty. Information on these subjects are mandatory published on the internet and are becoming a fertile ground for blackmail or for concurrence fights over the limits of the law. These mandatory published information include for example the information on the amount of shares in the company or information from the mandatory published financial statements. Apart from that, the excessive bureaucracy leads to registration of domiciles of the companies abroad. This is one of the reasons for transfer of the entrepreneur into tax heaven as well (Babčák, 2014: 9–26).

Interferences into legal certainty of entrepreneurs are represented by often novelizations of some instruments of systematic character. This refers

to **unstable regulation of rules for depreciation** of tangible and intangible property in general and particularly with respect to some categories of tangible property (assets). Within the legal regulation of income taxation following changes had been performed from the establishment of the autonomous Slovak republic:

1. Changes in the amount of depreciation groups;
2. Changes in the period of depreciation (in years);
3. Changes in setting the limit for depreciation of particular kinds of tangible property;
4. Changes in the amount of depreciation rates per year.

Mostly changes of the amount of depreciation groups and years for depreciation were (and still are) subject of the criticism from the entrepreneurs and the public. The development from 1993 up till now could be illustrated by following table:

Table 1. The amount of depreciation groups

period (from – to)	the amount of depreciation groups	the period of depreciation (in years)
1993 to 1996	5	4, 8, 15, 30 and 50
1997 to 2002	5	4, 8, 15, 30 and 40
2003	5	4, 6, 12, 20 and 30
2004 to 2014	4	4, 6, 12 and 20
from 2015	6	4, 6, 8, 12, 20 and 40

Source: author

Demonstrating the legal uncertainty of entrepreneurs, the often changes in legal regulation of **the possibility of tax loss deduction** could be illustrated as well. This is clear under the legal regulation presented by the current law on income tax (Act. no. 595/2003 Zb., Income Taxes Act, as amended), by which from 2004 the rules for tax loss redemption were constantly changed. These differences are presented under the following table:

Table 2. The possibility of tax loss deduction

years	regularity in deductions	the exact amount of years	maximum amount of years for deductions
2004–2009	no	no	5
2010–2011	no	no	7
2012–2013	no	no	7
2014	yes	-	4
from 2015	yes	4 years	-

Source: author

One of the interferences into legal certainty of tax subjects (entrepreneurs) is represented by **changes in tax rates**. This refers to both direct and indirect taxes and has its practical importance not only by increasing of tax rates, but by its decreasing as well. However, the second case is a very rare in the tax practice. With this understanding such interference has its primary importance in developing the business environment and in motivating tax subjects to due fulfil their tax duties.

An accompanying negative phenomenon of the absence of the legal certainty of business environment is represented by the transfer of Slovak companies into tax heavens as well. The number of business companies in tax heavens increased within the first three months of 2016 up to the amount of 4,719. Compared with the state at the end of 2015, there are 18 firms more (in 2013 the number of 3,853 companies were registered in tax heavens, the increase is therefore represented by the number of 866 business companies) (bisnode.sk, webnoviny.sk). Alarming is as well the trend in decrease of licence traders and firms in 2015. This year ended up with the negative balance (statistic) of 7,762 licence traders and more than 700 business companies (mostly limited liability company form), which were cancelled (podnikajte.sk).

The motivation of tax subjects to fulfil their tax duties is a significant indicator of the influence of the tax law on the business environment.

The particular term „motivation" is of its psychological grounds. Motivation represents an inside motive that stimulates the action of particular person (in our case tax subject – both natural persons and legal persons). The motivation is activated by using various stimulation and motivation factors which could be basically divided into **positive** and **negative** factors (Management Mania, 2016).

Tax law uses, under our opinion, both kinds of motivation. Rightfully could be claimed, that the state draws more of its attention to the regulation of negative stimulation. At the same time a negative stimulation on the side of tax subject might be seen as a positive stimulation from the state point of view etc. However, only in some cases the interests of the state and tax subjects in the issue of application of motivation factors meet the same opinion.

The negative stimulation of tax subjects from the state's point of view is manifested in tax law by:

a) **imposing new taxes/increasing the tax rate**, the amount of which will lose the concurrence advantage against the other states, resp. will mean such a tax burden for entrepreneur that he loses his interest in conducting business activity;

b) high **administrative burden** of tax subjects and high administrative costs connected therewith;

c) **defining the subject of taxation**. If such a subject is widely defined within the respective tax law legal act, with the interest of the state to tax such an income, supplies of goods or services by which exemptions of such income, supplies of goods or services is applied in concurrence states, then business activity from the point of view of tax subject could be reduced. Such a tax subject loses his motivation to conduct business activity. Similar consequences could be brought by **restricting of the legal framework for exemption** of particular income, supply of good or service from taxation compared to former legal state or compared to tax jurisdictions of the other states. This all only opens the door for aggressive tax planning;

d) **defining the non-taxable expenses**, what means expenses which are connected with the business activities of tax subject, but are rather not included within tax expenses by the particular law from various reasons (for example some speculative expenses on artificial

tax base decrease, or expenses which do not have an economic reality could be included etc.);

e) **shortening the time period for the possibility to redeem tax loss**, what is incorporated in the law on income tax from the time of its efficiency up till now;

f) **limitation of the possibilities of lump sum expenses** with respect to the natural persons – entrepreneurs. The current law on the income tax is not really consistent within dealing with this issue. Apart from the first year of the efficiency of the law (year 2004), when the possibility to apply lump sum expenses applied only to persons which are VAT payers during the whole year, from 2005 the prohibition to apply lump sum expenses started to apply to those taxpayers who were/are VAT payers only for the part of the year. As concerns the amount of lump sum expenses, it was different under the particular time periods:
   - During years 2004 and 2005 in the amount 25 % and by craftsmen up to amount 60 %;
   - From 1. January 2006 until the end of year 2010 in the amount 40 % and by craftsmen up to amount 60 %;
   - From 1. January 2011 until the end of the year 2012 in the amount 40 %, irrespective of the type of the business activity;
   - From 1. January 2013 in the amount 40 %, with limitation of the sum EUR 5,040 per year (EUR 420 per month),
   - From 1. January 2017 in the amount 60 %, with limitation of the sum EUR 20,000 per year. Under our opinion, this is the case of the positive motivation of tax subjects to conduct business activity.

Tax law can even **motivate** tax subjects to fulfil their tax duties **in the positive way**. The positive motivation should be the basis for the motivation factors of taxation.

The positive motivation could be in general under our opinion achieved by following legislative measures:

1. **By restricting the subject of the taxation and by widening tax exemptions**. Such an approach depends on the particular political governing authority and by needs of the economy and social development of the state in the particular period and varies with respect to the particular tax that is object of the taxation;

2. **By introducing the wide, universal tax base** instead of variety of exceptions, allowances and exemptions what is contrary to the requirement of the tax fairness in consequence;
3. **By reducing tax rates**. There is a general opinion that taxes and their amount influence the behavior of tax subjects. With this respect, tax subjects can be through the tax rate not only positively motivated, but rather disappointed. The disappointment is caused by the construction of the tax rate which leads to compensation of the income irregularities. This happens in the tax practice when state increases tax rates. For example business environment accept in a positive way the fact that with efficiency from 1. January 2017 corporate tax rate will be reduced from 22 % to 21 %;
4. **By permitting tax allowance** or **by granting the remittance to tax arrears,** resp. **to tax sanctions**;
5. **By granting suspension in paying tax or by authorizing paying taxes in instalments** under the request of tax subject and under the conditions that are stipulated by law;
6. **By tax equalizing** of the legal status of employees and entrepreneurs – natural persons by taxation under income tax. There are significant differences in taxation between these two groups of taxpayers which are manifested for example by taxable and non-taxable expenses as expenses which could/could not be transferred into expenses on achieving, keeping and securing taxable income etc. With this respect we could agree with the opinion presented in the literature that there is rather a higher risk for achieving income which should be compensated by the way of taxation. This leads to the conclusion that such a state is not wholly in accordance with the requirement of tax fairness (Bakeš, 2010: 13);
7. **By the possibility of distribution of tangible property (assets) into particular separated compositions (parts)** in the case that entry price of the particular separated parts is higher than EUR 1,700;
8. **By the possibility of transfer of some selected kinds of tangible property** from the higher into the lower depreciation groups, as well as by increasing of the entry price of the tangible property. The period of 6 years has already passed from the last increasing of the entry price without re-evaluation the need of increasing the entry price by Ministry of Finance of SR.

The issue of **the tax fairness** is a very sensitively perceived by the entire public and is considered for the part of the justice (fairness) phenomenon. The justice in general is a very narrowly connected with respecting the law in the society. Despite of that tax fairness **is a very vague, flexible and uncertain concept of the tax law science**. Therefore it is not particularly clear what is represented by tax fairness, what should it be compared with, how should it be assessed, what is and what is already not fair in tax law and up to what extent and by which measures is/should b such a fairness ensured.

There are still disputes about the tax fairness after introducing so called equal tax in 2004 in Slovakia, by which progressive income taxation has been replaced. Within the course of few years it is clear that such a discussion had more political direction and did not take into account economic and legal arguments. The basis of the criticism of the equal tax from former opposition politics was presented by the thesis that „equal tax = (means) equal taxes for all" and is aimed towards the poor citizens in favor of wealthy citizens. Positive signs of such a measure (such as limitation of bureaucracy, limitation in variety of exemptions, partial prevention by tax evasions and tax avoidance, motivation to work etc.) were however hidden. All in all, the issue of the tax fairness has been actually abused within the election campaign, since the former opposition politics after winning the election did not repeal the equal tax (despite their promises) and subsequently performed only partial changes in the system of taxation, but rather really late (from 2013). Such a clear example shows how could be the phenomenon of the tax fairness abused and how can be the public manipulated with it.

It should be however emphasized that the particular principle of tax fairness does not deal with the problem of collection of taxes, but rather with the way by which taxes are imposed/levied.

Compared to the other principles, which are essential for the optimal/good/objective tax system, the nature of the principle/concept/idea of tax fairness is rather **ethic and moral** and is not **a legal phenomenon** in itself. Tax law, on the one side is able to reflect the major opinions of experts on how should be particular income/consumption taxed through tax rate etc. so it can meet in some points with opinions of the whole public. That

however, does not express a satisfaction of the major part of the society on the issue of the way and the amount of tax by optional tax (most often by income tax, less by VAT or any other consumption tax) is close to the imagination on how the fair taxation should look like.

And how it works with the understanding of the tax fairness in the business environment where employees are included? It should be, most probably, much easier to come up with a general imagination on tax fairness in relation with employees conducting dependent work compared to assessment of the tax fairness in the business environment.

There are some common features that are typical for dependent work which are guaranteed by the law (the relation between employee and employer in which employee needs to follow directions and orders of employer, who is in the position of income payer and tax payer at the same time, the legal relation between them is established by the contract of employment or any other agreement, there is a labor-law and social protection of employees, the absence of the business risk, the claim for vacation time, etc.). The business environment is, on the other side, a very diverse and multi-spectral from many points of view, such as are kinds of entrepreneurial activity, legal forms of entrepreneurship, the variable extent of the entrepreneurial risk, so the issue of tax fairness could be a very relative with this respect.

The understanding of the tax fairness in the society is significantly determined by the fact that the law is always more and more influenced by political and economic interests of political parties and organizations, diverse lobbing groups, business community (sphere) as well as by populist statements of politicians who would like to attract voters (Babčák, 2012: 335). The particular fulfillment of the idea of tax fairness is therefore dependent on the objectives of the tax policy of the state, moreover on the intentions and the willingness of the law maker to reflect what is perceived to be fair by the public into tax legislative. The final result of the factual state is represented by the fact, that the more taxpayers perceive tax law legal acts as unfair, the less are their chances to conduct tax evasion (Babčák, 2015: 55). To sum it up, the issue of the tax fairness is perceived mostly through the perception of feelings of tax subjects in the matter of the fairness/non-fairness of the particular tax, its amount and way of imposing.

3 Conclusion

The basic requirements on the form and the content of tax law norms have to be represented by their **stability, unambiguity and understandability**. Only by respecting of such a prerequisites tax law will be able to positively influence the development of the business environment. Slovak tax law is currently, on the other side unstable and rather complicated and unclear for the majority of entrepreneurs, for the whole public as well as for the part of the professional community. In some cases, mostly by need to implement tax law directives of the EU into the national legal order, it could be clearly seen that particular explanatory reports on the proposals of the particular legal acts are rather a very vague, like they are prepared by persons having troubles by themselves with understanding and transforming of the nature and objective of these directives into the proposal (novelization) of the particular tax law acts.

There is a direct correlation (proportion) between the tax law on the one side and the business environment on the other side: the more unstable the entrepreneurial environment is, the shakier the tax legislative (and subsequently the tax law in itself) is. Such an unstable economic environment causes the unstableness of the law in whole with the particular respect to the tax law. Moreover, the other negative externalities are included after that, such as are absenting conceptuality within this field of legal relations. It becomes really sad that so called tax reform is under preparation and realization usually within every four years (sometimes even less) under the changes in government composition by elected politics (Babčák, 2016: 8–34).

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TAX LAW AND ITS STATUS WITHIN A LEGAL SYSTEM

Mária Bujňáková[1]

Abstract

The author examines the position of tax law as a separate branch of law. Specific institutes of tax law and the legitimacy of tax law within the legal order are deeper analysed. Special attention is paid to the position of tax law in the legal order of Slovak Republic. The paper is also focused on issues of the eternal legal dualism of public and private law, while more attention is paid to the effects of assorted public law branches. It analyses the institute of tax not only from the legal point of view but according to its economic importance as well. Notions of "tax system" and "tax administration" are distinguished and the author emphasizes the necessity to perceive the tax law as a separate branch of law, its exclusion from the financial law as well as the impact of tax law (as a branch of public law) on private law, especially those which are considered as codified and whose institutes are affected by tax law to a large extent.[2]

Keywords: Tax law; financial law; historical development of tax relations; branches of law; distinct features of tax norms

JEL Classification: K34

LEGES BONAE EX MALIS MORIBUS PROCREANTUR – FOR BAD MORAL GOOD LAWS ARE PRODUCED /Macrobius/

1 Introduction

Although the aforementioned statement was made by the ancient Roman scholar, it still correctly reflects nature of our modern society. Old truths

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unsurpassed by present knowledge are still worth to be remembered. Indeed it would be better if there were good laws in all branches of legal system – including financial law and tax law. Public opinion about law in that matter is not positive, although everyone accepts the importance and necessity of the law. Every society must put forward limits which provide constrains for the power of the state. The law (among others social phenomena) aims to create good social relations and to provide their development in a desired and anticipated manner.

The legal order is a regulatory system *sui generis*. Legal norms serve as its regulatory instruments (Krecht, 2002: 548). In that regards, legal norms are mandatory rules of human conduct issued by the state authority in a form that is adopted or accepted by the state so the abidance of such norms is guaranteed by the state coercion. The law aims to guarantee the formation of social relations according to prescribed purposes. The law as regulatory framework has existed since time immemorial to maintain certain level of social order (Knap, Gerloch, 2012).

In each society, the law is an instrument intended to achieve state goals, moreover it protects the well-being of each individual. We live in a community (or society) that falls under authority of the state that is exercised over certain territory. The society must provide for people sense of security, freedom and enablement, otherwise people cannot pursuit their visions and goals in life. Even in case of developed democratic society the implementation and enforcement of certain objectives, principles and ideas are not always right for society as a whole. In that regard term "public finances" resonates within general public not only as an economic category, but foremost as a means for achieving benefit of various social-groups.

Public finances increasingly become a central topic of political and scientific discussions. No wonder, since it is issue that is thematically rich and interesting. The article has two principal aims. First is to assess the status of Financial Law as independent branch of the law within the legal system. Second is to analyse taxes and public finances from legal and economic perspective.

2 Public Finances and the Tax Law

Public finances are a prominent category of finances. Public finances can be defined as a set of monetary relations concerning generation, distribution and use of monetary pool in bodies and organizations of public sector (Musgrave, Musgraveová, 1994: 54 et seq).

Public sector has important and constructive role among other as an operator that intervenes in market processes. Although the market serves as a powerful tool to organize social relations, it does not provide every social objective for democratic society. The public sector mainly contains of the state, state bodies and administrative authorities, furthermore self-governing territorial units, local authorities and other institutions. Financial activities within public sector are those which correspond to the notion of public finances.

The law is also an instrument for implementation of state policies. Notion of the law is not uniformly defined and different authors provide different answer to the question: "what is the law?" Public/private law differentiation of the law is one of the most prominent way to describe the positive law (Luby, 2002: 287). In European continental system such differentiation has its roots in the tradition based on Roman law. Despite its long history, the public/private differentiation remains foundation for the legal system even today. Therefore the Ulpianus notion about division of law into public/private laws is still relevant for contemporary jurisprudence.

The literature often states that the public law is general in comparison to the private law (which is considered to be *specialis* by nature) (Boguszak, Čapek, Gerloch, 2004: 347). Such view is based on the fact, that event though public bodies can establish binding rules and prescribe rights and duties for private individuals they are authorized to do so only by the law itself. On the other hand, private laws are sets of legal rules regulating legal relations between individuals, regardless of their relations to the state power. Public law includes financial law, other established branches of public law and newly created legal branches such as the tax law which should be considered as a separate branch of law. Notion of the tax law to be separate branch of public law is not unanimously accepted, but we will try to justify such position and put forward supporting reasons. We consider the defence

of this position helpful and necessary, because such notion does correctly represent the nature and status of the tax law. The same opinion is held by the members of so-called „Košice school" which has been established by prof. Babčák (Babčák, 2015).

Financial law in Slovakia is one of the most dynamic branches of law. By means of public finances and financial activities, state can secure fulfilment of its objective. Questions concerning financial relations, economical dependency and financial rights/duties (that are monetary in nature) is matter of interest for every citizen (Spáčil, 1970: 36 et seq.). Not only the tax law consists of substantive norms, but it consists of procedural norms as well. These legal norms are enacted in laws and decrees that prescribe rights and duties for tax payers (according to legal maxim *nullum tributum sine lege*).

The above-mentioned reasons suggest that the tax law does fulfil conditions (and has all characteristic features) to be an independent branch of law. Such conclusion is further supported by aforementioned fact that the framework for taxation is based on coherent system of substantive legal norms and statues imposing individual taxes. The sole authority to levy taxes from tax payers i.e. natural and legal persons within certain territory belongs to state (it possesses ultimate fiscal autonomy to impose taxes regardless of tax systems of other states). In case of EU member states such authority was partially limited due to transferred of powers in area of indirect taxes from member states to the EU in course of European integration (this is also a prerequisite for EU membership). EU member states retain power over direct taxes in spite of constant attempts to extend harmonization towards the area of direct taxation.

In general, we may say that taxes as legal tools are the most important revenue sources to cover state expenditures. To understand the nature and importance of taxes it is necessary to mention some historical background information.

3 Development of the Tax Law

The concept of tax is often confused with others levies of similar nature. Various levies similar to the tax were known already in Middle Age, but taxes in present day sense have appeared only much later. Taxes have gradually

developed from medieval *regals* which were monetary or non-monetary duties imposed on a property or a certain activity. Theoretical foundations of taxation were created by Thomas Aquinas in the 13th century and by Jean Bodin, latter of whom substantially influenced development in Europe at the end of the 16th century (Grúň, Králik, 1997: 43 et seq.). It is worth mentioning that different definitions of the tax proposed by several tax law scholars.

However, these definitions exhibit common features, based on which the general concept of the tax can be inferred.[3] Tax serves primarily as a revenue source that covers not only state expenditures, but also expenditures of society as a whole (including not only state needs but needs of all units within the state e.g. self-governing territorial).

Further, we analyse economic and legal aspects of tax law development. Evan Tax systems of various countries developed gradually during several decades, nowadays those tax systems reflect current standing of the particular state in globalized economy (Červená, 2007: 33–38).

There are no doubts that taxation is the cornerstone of the economy, moreover proper tax system is essential for a state to function properly. Integrated Europe can hardly face challenges of global economy without well-designed tax system. For these reasons, functions of the tax law should be assessed. Taxpayers around the world overwhelmingly prefer such tax system that is simple, stabile, and comprehensible, with relatively low tax rates and with high-quality and prompt tax services.

Arguments that go contrary to the notion of tax law being an independent branch of law are not convincing. Creation of good theoretical framework based on such notion is a way to improve our understanding of the nature of tax obligation with increase of tax revenue as a result. Therefore we strongly disagree with the notion that tax law still a sub-branch of the financial law which still somehow persists in legal doctrine.

Although jurisprudence deals with structure of legal system, it overlooks the status of the tax law within such legal system (Boguszak, Čapek, 1997;

3 Economists define tax as onerous payment prescribed by the law (Háčik, 1969: 43). Lawyers define tax as "financial category" representing financial relation between the tax payer and the state based on principles of non-equivalence and non-return (Pancák, 1967).

Harvánek et al., 1995; Prusak, 1999; Veverka, Boguszka, Čapek, 1994). Past economic development and increase in importance of taxes in global scale indicate that the tax law has already achieved independent status as separate branch of the law (Čipkár, Červená, 2012: 393–409).

Creation or establishment of separate branch of law follows from distinctive features exhibited by that particular legal branch (including logical and historical features). Its result is a change of whole legal system. Logical features of branch of law are mainly reflected in a way by which legal norm of the legal branch are constructed. Specific construction features of substantive tax norms are: object of taxation, subject to taxation, tax base and tax rate. Such features are not presented in financial norms so they differ to a great extent.

Distinct features of tax norms are even more apparent in case of procedural tax norms. Tax proceedings and tax administration follows unique fundamental tax administration principles. Furthermore, Tax Procedure Code as a codification of procedural tax norms provides highly complex regulatory framework for legal proceedings in tax matters.

4 Conclusion

The tax law also plays very important role in EU integration. For a new tax policy to be adopted, the tax proposal must be approved by all EU member states (which highlights the importance of tax law in *european acquis*). In our view, the importance of tax law at EU level should be taken into account when considering whether tax law has independent status in legal systems of EU member states. (Románová, 2012: 522–533; Červená, Hučková, 2015: 55–63; Czudek, 2015; Radvan, 2015; Radvan, 2014).

There should start nation-wide discussion about issues concerning tax law and taxation in general. Taxation is too important to be viewed only through the prism of political struggle. This topic should be further examined not only in academic discussions but also by means of research provided by national or European research grants.

Ideal tax system does not exist and maybe never will. On the other hand, it is about time for scientific community to start a discussion about emerging

tax law issues – including question of its status as an independent branch of law. Even those scholars, who currently oppose such notion, should join such discussion since these questions need to be addressed.

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ON THE GOALS OF CODIFICATION IN THE CONTEXT OF GLOBALIZATION TAX LAW

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Abstract

The article considers the paths and problems of development of codification and systematization of tax law in the context of globalization and suggests some alternative solutions. Highlighting the issue of 'inflation' of legal acts as the root cause of difficulties in law enforcement, the author suggests a concept of *permanent codification*, the structural basis of which is the expert community working as a distributed network and using legal information databases, information search and retrieval and other computer technologies. Using artificial intelligence the expert community can systematize legal acts on the basis of legal information databases, providing a systematic approach to codification. The goal of the article is to show that the system of permanent codification can provide an adequate legal framework for the social relations in the sphere of taxation, based on the availability of prompt information and legal support, as well as facilitate law enforcement at all levels.

Keywords: Tax Law; Tax Relations; Systematization and Codification; International Corporations; Large Taxpayers; Expert Community; Information Search and Retrieval Technologies; System of Permanent Codification.

JEL Classification: K34, K40

1 Introduction

The complexity of regulating tax relations in any country causes the need for recurrent improvements of tax law. The most widespread solutions

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to the given problem are systematization and codification, in the course of which the existing legal acts are not only consolidated and systematized, but also revised with the aim of eliminating any discrepancies, vagueness or ambiguous interpretation. It has been noted in the scientific literature that codification is not just one of the forms of rationalization of law, but at the same time it is a "legislator's reaction to the need for legal certainty in the regulation of social relations. As a rule, the process of codification stems either from the crisis of sources of law, related to the indiscriminate growth of their volume and the appearance of difficulties and discrepancies in law enforcement, or the arrival at a certain stage of economic upturn or downturn" (Chernikova, 2014: 11). The issue becomes particularly urgent in the period of economic crisis, when state authorities try to close the increasing budget gaps and increase the tax burden on the economy in search of extra sources of revenues.

The success of codification as a legal institute is traditionally illustrated by the introduction of the Civil Code (Cabrillac, 2002: 34–37) in France, which was able to systematize diverse and often controversial sources of law (Roman law, king's ordinances, traditional rights, decrees of the revolutionary government, etc.) in Napoleon times. We should also note here that this Code – despite some changes – is still valid, i.e. its underpinning and the mechanisms of its implementation is right and time-proven. However, it is also fair to question, whether the instrument of codification in the sphere of taxation meets all the requirements of modern times. In the fast-developing environment of the modern world the process of drafting a code takes too long, and it's not surprising that such an authority on the subject as Remy Cabrillac wonders what the prospects of codification are (Cabrillac, 2002: 55–57).

One of the problems is the so-called 'inflation' of legal acts, caused by the excessive growth of the volume of regulatory documents. In an attempt to react promptly to current economic changes the government starts generating legal acts to solve particular, sometimes, non-standard issues. The issue is particularly urgent for the sphere of taxation, where the priority of the national state over the international and non-governmental rules is obvious. In this context the maximum clarity of the procedure is a benefit for all the participants of the economic activity.

The introduction of the French Code early in 19th century enabled quite a successful regulation of tax relations of the emerging bourgeoisie and became a foundation for the development of national legislation in the countries with representative democracy and market economy for the next century. Under those conditions codification was the optimal form of systematization of the existing law, as well as for the introduction of the new law that was necessary for implementing the reforms. Let us note here that the main means of communicating information to the citizens was the official publication of the documents on paper. It was necessary to observe the principle of transparency to enact and to start lawful application of the act.

Observation of the principle of stability of law – including the tax one – is one of the conditions of efficiency of legal regulation. The certainty in terms of rates, terms and the order of payment must be provided by their legal enshrinement and an absolute availability of the legislative aggregate that contains this data for the taxpayer.

2 On the Problems of Codification in the Contemporary Context

Modern states' economies are changing quite fast. Absolutely new forms of economic entities and businesses keep appearing and call for adequate regulatory support, including the sphere of taxation. Just a few years ago it was hard to imagine the existence of such a company as, for example, Uber that provides taxi services in many cities all over the world. The activity of this company is based on a computer program that optimizes the link between the customer and the driver providing this service. The opportunity to realize this business idea became possible due to the increase in the Internet availability and the growth of computational capabilities of modern data processing machines, and today this new transportation business is run all over the world. Among other large transnational corporations, one could also mention such 'computer' companies as Microsoft and Google.

It is obvious that modern economic entities – entrepreneurs and companies – have changed considerably in terms of their organizational and legal form, their tactics and business strategy compared to the previous decades. They have become much more efficient, mobile and larger in terms

of financial and other assets that they possess, use and manage. Moreover, the activity of the largest corporations has acquired a clearly international character.

The problem is that being large consolidated taxpayers, corporations have a lot of possibilities to avoid taxation, to leave their national tax domiciles due to offshore schemes and to choose the minimal tax rates domiciles, tax havens. In this sense compared to an average taxpayer the efficiency of their taxation has decreased dramatically. However, no one has repealed the principle of tax consciousness and the presumption of tax innocence, the guarantees of protection of the taxpayer's rights. And it is the absolute and unconditional certainty of tax law that remains an urgent issue, as well as the simplicity of its application by the taxpayer and the ability of the institution of codification to meet the requirements of modern social and economic realities. The activity of the businesses mentioned above is questioned more and more by the national governments that either try to control the activity of the global companies (e.g. Uber) in some way, or introduce the so-called "Google tax", implying, for instance, an obligation to pay the VAT for software companies in the territory of the country where their products are sold. Thus, a certain insufficiency of legal regulation in the sphere of taxation is getting more obvious.

Another problem, to our mind, is the fact that large world corporations can afford to turn to highly qualified consulting companies and best lawyers in the sphere of taxation, which allows them to "beat" some states within the law, not to pay taxes and to undermine the basis of national sovereignty in this way. As a kind of intermediary, organizational measure, national tax departments prefer to negotiate with the largest taxpayers in order to receive some compensation for the uncollected taxes. It is obvious that the payment of such "fines" ruins the principles of uniformity of taxation.

3 Permanent Codification References

The facts mentioned above allow one to reflect on the possibility of such a pilot project as a system of permanent codification or an introduction of permanent codification as an institutional information and legal phenomenon that goes beyond the framework of traditional codification.

We think that the method of permanent codification could be based on the development of expert community acting as a distributed network and the application of artificial intelligence and information and retrieval systems.

One should make a caveat here that we are not talking about codification in its traditional meaning. We see permanent codification as an on-going process of systematization of the regulatory base that exists in the form of legal information systems of different kinds carried out by the expert community using the capabilities of artificial intelligence. The given process should take place before the official codification and systematization of national or transnational legislation in order to meet the following objectives:

1. Simplification of law enforcement – first of all for the conscientious taxpayers;
2. Development of full-fledged regulatory support.

At present electronic databases (Consultant plus, Garant, etc.) are almost the key sources of information that provide access to the aggregate of legislation existing in the territory of the state. Such databases allow one to form the most recent versions of these documents. Moreover, one can form the versions as of a certain time in the past or even in the future, when, for example, a tax is phased in. At present global consulting companies like PwC (Comparative modeller), Deloitte (Deloitte International Tax Source) are engaged in forming information systems that will allow one to calculate tax rates in different countries of the world.

Besides, the taxpayer has an opportunity to make calculations with the help of such specialized computer programs as 1C, Parus, Pohoda, etc. For the right maintenance of tax records, it is enough just to enter the basic information about the business of a company.

The acceptance and processing of payments can also be carried out electronically via the Internet. Thus, for instance, there is RTVAT system the adoption of which is being discussed in some European countries. It allows one to collect the VAT on a real-time basis when a payment transaction is carried out between the buyer and the seller **(**Williams, 2009: 6). Within this system, the payment from the buyer's bank goes to the seller's bank via the settlement system of a tax body (TASS – Tax Authority Settlement

System) and is analysed with the help of an analysis and fraud prevention tool (FAST – Fraud Analysis Security Tool). The relevance of the introduction of such a scheme is proved by the fact that even in the law-abiding European Union the annual gap between the calculated VAT and the actual proceedings amounts to 190 billion euro a year (Taxion and customs union).

As an example of the development of expert community for the goals of permanent codification one could take a look at IBFD information portal that unites tax consultants from all over the world (IBFD).

One can suggest that with time all these sources of information will be integrated. The legal databases will be completely integrated with the assessment ones both for the taxpayers and for the state tax bodies.

However, we believe that the role of expert community in the process of tax law codification in this modern computerized information world will keep growing more significant. As an example, one could draw the activity of the American Law Institute, which does a lot of work on the codification of the US legislation and publishes a kind of particular codifications, Restatements of the Law. Despite the fact that they are not binding authority, they are, however, part of the established practice in applying the law. In addition to the U.S. Code lawyers also use its annotated versions (United States Code Annotated) prepared by private companies. Another characteristic feature of the restatements and annotated versions of the US Code is that there are comments from the leading lawyers that contain their expert opinion.

In this context, permanent codification can be seen as an optimal, alternative direction in the development of systematization of the existing legislation. We believe that it is about the creation of a new information and legal cluster, where a voluntarily formed expert community can systematize and comment on the tax law online, thus simplifying its enforcement. The efficiency of this mechanism can be ensured by its maximum publicity, its online format and the possibility of direct communication and feedback for the user.

The author believes that in the context of globalization this approach can allow one to develop the processes of codification and systematization of tax law in an alternative way. On the one hand, it gives an opportunity

to create national codified legal acts aimed at the official regulation of, for instance, tax relations, to provide adequate regulatory impact taking into account current economic, administrative and law enforcement needs. On the other hand, it allows one to preserve national tax cultures and traditions that reflect mental peculiarities and the tax sovereignty (Raritska, 2015) of the state.

At the same time, it is an opportunity to harmonize tax relations under the conditions of ever-growing tax competition in a soft, gradual way. And it is related mainly to the member states of the European Union. The given issue is addressed in greater detail by Danuše Nerudova (Nerudova, 2014).

4 Conclusion

The question is whether it is necessary and useful to study and search for alternative forms of systematization and codification of existing legislation. To our mind, it is an objective process determined by the globalization of economy, the growing competition on the world market and the development of one global market place. All of these make European countries take the path of harmonization of both socio-economic relations and legislation. We can observe the process of development of one European market as a separate economic area in the member states of the EU. Similar processes have been going on for a few years in the territory of the post-Soviet countries, too. It is clear that to develop highly efficient and competitive economic areas in the territory of the EU as well as the CIS and EurAsEc, there is a need for a number of measures aimed at the harmonization of national systems of taxation and of the key provisions of the participating countries.

Taking into account the scale of the tasks, the varying level of economic development of the participants, the existing differences in national tax systems and the current state of legislation, the questions about the mechanism and the organization of the codification process becomes quite urgent. And in this context, the attempt to introduce the method of permanent codification seems to be quite relevant.

To our mind, the use of artificial intelligence is capable of changing the very approach to process of codification in terms of its considerable simplification. We believe that the algorithmization of regulatory acts and their

digitalization are most relevant and applicable to the voluminous and insufficiently ordered tax legislation. In this context we find it possible to allocate the task of the formation of legal databases to the expert community. The competition on the software market can be preserved without having to impose any particular programs on the user by agreeing on the data exchange protocol. The standardization of such formats will also allow one to model the estimation of tax proceedings to the budget.

The state, in its turn, will be able to concentrate on the development of key principles of tax law that underpin the system of taxation in the context of globalization and, as a result, enable the development of adequate legal support of the fast changing economic environment.

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THE QUALITY OF THE TAX LAW AS A FACTOR SHAPING THE TAXPAYER'S LEGAL POSITION

Anna Drywa [1]

Abstract

The article approaches the issues of the legal position of the taxpayer. It should be highlighted, that it is shaped not only by the range of responsibilities placed upon them and the rights they were given. The main objective of the article is indicating that an important factor that shapes the taxpayer's legal position is the quality of the tax law.

One of the most important matters to a taxpayer is the certainty of their situation, the range of the responsibilities placed upon them and the rights they were given in relation to the establishment and payment of the tax. The certainty rule should be realized by the state through well-constructed tax regulations, carrying the correct content, providing a factual protection for the taxpayer. If, however, the tax regulations are ill-constructed, the mistakes in the use of the tax law will be made not only by the taxpayers, but also by tax authorities and courts. A low quality of the tax law increases the level of taxpayer's risk and, therefore, negatively influences their situation.

Keywords: Tax Law; Tax Legislation; Legal Position of the Taxpayer.

JEL Classification: K340

1 Introduction

The subjective right indicates the place of the subject of that right in relation to other subjects of that right in a given political-legal system (Jakimowicz, 2002: 121). To simplify, it can be assumed that the legal position of the taxpayer is directly determined by responsibilities and rights. The legislator, for the public interest, places upon an individual the obligation to bear the public burdens and other supplemental responsibilities that help to fulfill that duty. On the other hand, it grants the individual rights that prevent excessive

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interference into the sphere of subjective rights. However, the legal position of the taxpayer is shaped also by indirect factors, like f. ex. the quality of the statutory tax law.

One of the most important matters to a taxpayer is the certainty of their situation, the range of the responsibilities placed upon them and the rights they were given in relation to the establishment and payment of the tax. It is worth noting, that Adam Smith had already considered the certainty of taxation as a necessity (Smith, 2007: 501). In theory, the rule of certainty of the taxation should protect the taxpayer from arbitrary actions of the tax authorities and provide a guarantee that the amount of the tax placed upon the taxpayer will be calculated on the basis of the provisions of the applicable law. However, what about a case when the provisions are unclear and complicated? The certainty rule should be realized by the state through well-constructed tax regulations, carrying the correct content, providing a factual protection for the taxpayer.

Therefore, it should be assumed that an important factor that shapes the legal position of the taxpayer is the quality of tax law.

2 The Legal Position of the Taxpayer

The Constitution of RP in Art. 84 introduces the general obligation of incurring tax liabilities. The legal relation between the taxpayer and the tax authorities is that of legal obligation. Whereas the obligation is statutory and its content is the obligation to pay the public levy (Brzeziński, 1998: 12). The subject is obligated to participate in meeting the financial needs of the state. The character of the tax law, therefore, reflects the fact that the public interest is the priority and dominates over the interest of an individual, for this reason it is necessary to provide effective guarantees for protection of the interests of the individual (Gomułowicz, 2005: 81). It should be pointed out here, that for some time a tendency of paying attention to the protection of the taxpayer's rights and to building correct relations with the tax administration has been more and more noticeable (Bouvier, 2000: 193).

Law in a democratic country should not be just an instrument for imposing obligation, but also of providing freedom, and the constitutional norms should effectively prevent the arbitrariness of the solutions introduced

by the tax legislator (Gomułowicz, 2005: 66). The rights of the taxpayer need to be secured on two levels: of lawmaking and of using the tax law. The securing of the interest of the taxpayer should, therefore, be based on introduction of such institutions that will protect the taxpayer from the risk of having their rights violated, firstly by the tax legislator and secondly by the tax authorities.

The philosophy of the rights of an individual has resulted in moving away from the model of the country that marginalizes its citizens, it has created a participatory individual that "moves out of the shadow of the authority and becomes its partner" (Koncewicz, 2010: 33). Therefore, the necessity of protection of the rights of an individual from the uncalled interference of the authorities seems obvious and fundamental. The European philosophy of the rights of an individual is characterized by looking at the individual in many dimensions, moreover, it connects the human rights of different generations, considering not only the basic ones, like life or freedom of an individual, but also the derivative ones, for example, the protection from unlawful behaviour of the tax authorities (Koncewicz, 2010: 30). Human rights serve the protection of the interests of an individual, due to their general and universal character, they became the source of formulation of many taxpayer rights (cf. Napiórkowska, 2011: 147; Zelwiański, 2003: 161).

The respect for human and citizen rights is the basis of existence of the modern democratic state. Thus, there is no doubt that the taxpayer should be foremost viewed as a human and a citizen, and only secondly as a subject obliged to bear the burden in the interest of the state (Szczurek, 2008: 39).

Legal norms in the Constitution of RP create a directory of rights and freedoms of a human and a citizen.[2] Constitutional protection of basic rights and freedoms granted to an individual requires every restriction to be done

[2] Cf. chapter II of Konstytucja RP. It should, however, be noted that the constitutional rights and freedoms are scattered throughout the entire content of the Constitution. The Constitutional Tribunal emphasizes that the basis of the constitutional rights and freedoms can be an independent norm, as well as a few norms placed in different parts of the Constitution. Cf. for example, Constitutional Tribunal' verdict from April 11, 2000, K 15/98, OTK no. 1/2000, poz. 14; The Supreme Court's verdict from January 5, 2001, III RN 38/00, OSNP no. 18/2001, poz. 546.

by way of legislation. Moreover, each introduced restriction is possible only to an extent that can be accepted in a democratic state of law and with justifiable reasons. Constitutional rights directly indicate the legal position of an individual (Tuleja, 2003: 130). The provisions of the Constitution should be a guarantee that the legislator will take the tax policy in the right direction as to protect the interest of the taxpayer (Gajl, 1996: 2).

The legal position of an individual is shaped by obligations[3] placed upon them and the right they were given[4]. However, the taxpayer's legal position is also influenced by protective measures for the rights they were given. In the case when the individual cannot realize their rights, their legal position would be limited only to the obligations placed upon them. Analogically, it should be noted that the method of carrying out their obligations influences the individual's legal position. Hence, the legal situation of the taxpayer is influenced by substantive provisions that place obligations upon them and grant them rights, and the procedural provisions that determine the methods of fulfilling the tax obligations as well as the protective measures for their rights. The term "taxpayer's rights" should be considered as a collective category, which encompasses different rights and permissions, different in source, range and character, that the taxpayer has at their disposal, with different meaning for them and their interest (Szczurek, 2008: 247). As a result of that, also the protection measures of the taxpayer are diversified.

The legal position of the taxpayer is especially influenced by provisions of Art. 84 and 217 of the Constitution. Art. 84 of the Constitution introduced the common obligation of supporting the state, among others, by incurring taxes. In the relation to taxes, it means the readiness to constantly bear the burdens but only in the case when it is introduced and specified by a proper tax legislation (Dębowska-Romanowska, 2009: 114). Ipso facto, the tax authority can compel the taxpayer to pay the tax only in the amount that ensues from the provisions of the tax law. The taxpayer

3 The behaviour of a subject is the object of an obligation if it has been ordered or prohibited by a given norm (Wronkowska, 2001: 101).

4 The term 'law' has multiple meanings. In the theory of law that term is essentially used to determine freedoms, permissions or competences (cf. Piszko, 2006: 16; Wronkowska, 2001: 103).

is compelled to pay the tax, if they find themselves in a situation, with which the hypothesis of the legal norm ties the obligation of the tax consideration, but only in the amount that ensues from the legal regulations.

The tax system is substantially based on the method of self-calculation of the tax dues by the taxpayer, what in theory should lower the cost of calculating and collecting taxes. It should be emphasized that it is a form of law application characteristic only for the tax law (Teszner, 2010: 659). As a result, the whole process of implementation of the provisions of the legislation together with the end result (calculation of tax) and all consequences resulting from it, has been transferred to the taxpayer (cf. Dębowska-Romanowska, 1998: 38; Mariański, 2011: 25; Teszner, 2010: 659). What rests upon them is the obligation to know the provisions of the law, their proper implementation and making the subsumption of the factual state to the legal state. Therefore, the taxpayer is burdened with the obligation to evaluate their tax-legal position and then to possibly calculate the amount of the tax due. The correctness of the calculations made by the taxpayer can be inspected by the tax authority. Apart from the main obligation, the taxpayer is also burdened by a number of obligation of an instrumental character, that does not influence the amount of tax due, but only serve as support that enables the tax authorities to verify the calculations of the taxpayer (cf. Bogucka, 2002: 63; Dębowska-Romanowska, 2010: 126; Mariański et al., 2006: 153).

The introduction of the method of self-calculation of the tax has resulted in the fact that the range of operation of tax authorities is relatively narrow and concentrates on tax inspections, whereas the range of operation of the taxpayer is expanded (Mastalski, 1996: 4). However, crucial for the legal position of the taxpayer is the role that will be assumed and realized by the tax authorities. The attitude of the tax authorities actually determines the course and the way the actions are taken. The problem comes down to, whether in the context of carrying out the self-calculation of the tax, will the tax authority concentrate its action on trying to expose the irregularities or will it rather define its role as a body supporting the taxpayer in correct carrying out their tax obligations (Kowalska, 2011: 96).

It seems that the new international tendency is to strengthen the legal position of an individual, the orientation of the tax administration changes,

from an organ enforcing the law to an organ oriented towards the taxpayer, a tax service (Thuronyi, 2003: 207). Of course, the reorganization of the tax administration and laws in that direction is in the interest of the taxpayer.

The need to verify the self-calculation of tax determines the range of control and procedural actions undertaken by the tax authorities (Thuronyi, 2003: 96). Those activities should be performed in accordance to the applicable provisions of law and especially to the Tax Ordinance (Act of August 29, pos. 613). It should be noted that the more complicated, changeable and unclear the tax regulations are, the harder it is for the tax administration to carry out the tasks entrusted to it (cf. Glumińska-Pawlic, 2010: 912, Napiórkowska, 2011: 142). The quality of the tax law has, therefore, an influence on the way it is used by the tax authorities. Often the tax authorities question the correctness of the calculations made by the taxpayer and by the way of a decision, make judgments regarding the rights and obligations of the taxpayer, violating with that the rights given to taxpayer by the legislator (Mariański, 2006: 155). Such a situation leads to disputes between the taxpayer and the tax authority that are often settled by the court. However, there are also situations where the taxpayer does not find protection from their rights before the court. The court can also have a problem with interpretation of unclear tax regulations. One of the factors that influence such a factual state is the law quality of tax regulations.

The method of self-calculating of tax dues carries a substantial risk to the taxpayer, that is the incorrect fulfillment of tax obligations – the risk of an error or making a mistake and possible negative consequences resulting from it (Cf. Mariański et al., 2006: 154; Teszner, 2010: 659). Whereas the risk is the higher, the more complicated and unclear are the tax regulations. Moreover, frequent changes in the applicable tax regulations are an important factor influencing the risk of making a mistake by the taxpayer and consequences connected with it. In that context, it should be clearly stated that highly complicated regulations, lack of precision and clarity and other legislative imperfections and shortcomings of the legislative technique should not lead to negative consequences for the taxpayers. As it seems, the problem has also been noticed by the legislator. They have introduced a suitable legal instrument – the evaluation of its effectiveness is, however, not an objective

of this paper, although it should be emphasized that it beneficially influences the legal position of the taxpayer. By the power of Art. 1 of the Act of 5 August 2015 about the change of the Act – Tax Ordinance, Art. 2a has been added, that introduces the rule of settling any doubts regarding the content of the tax regulations in favor of the taxpayer (*in dubio pro tributario*) (Kopyscianska, 2015). With self-calculation of tax, the tax authorities inspect the correctness of the calculations made by the taxpayer. In the light of the above remarks, the opinion of L. Bosek seems justified, as he claims that the extent of the tax obligations and the extensively complicated tax system, result in the fact that even due diligence and good faith of the taxpayer do not have to protect them from tax sanctions (Bosek, 2003: 42).

In the tax system based on the method of tax self-calculation, the legal position of the taxpayer is especially difficult. The taxpayer is burdened with additional responsibilities connected to the obligation of paying taxes in the correct amount. Additionally, the consequences of the lack of clarity, precision, stability or bad legislative practice add an additional load on the taxpayers.

The obligations placed upon the taxpayer should be carried out willingly by obliged individuals. However, if the taxpayer does not perform their obligations, they will be enforced by the tax authorities. The enforcement of the tax obligation shapes the legal position of the taxpayer to a substantial extent. Also in this the quality of the tax law is of great importance.

The tax law regulations place a number of obligations on the taxpayer. At the same time, they set up formal rules of protection of the taxpayer's rights. The realization of duties imposed on the tax player and respecting their rights depend directly on the authorities implementing the law. That means that, formally, it is the legislator that decided about the rights and obligations of the taxpayer by introducing relevant regulations. Whereas the implementation of the rights and obligations of the taxpayer fundamentally depends on the tax authorities. Therefore, it seems that the legal operation of the authorities is an insufficient factor for evaluation of the authoritarian actions of the tax authorities. The actions taken by the tax authorities should not only be legal but also fair, thus free from being arbitrary and free from harassment and excess, and also possible to rationally explain by the factual

circumstances of the specific case (Supreme Court's verdict from August 5, 1992, I PA 5/92). Not acceptable is such an action of the tax authority that can be referred to as bureaucratic legalism, what is an action formally legal, but done without an analysis whether the decision regarding the implementation of the law is right (Łętowska, 1992: 304). From the above problems the taxpayer is not protected by the institution of settling the doubts regarding the contents of the tax regulations in favour of the taxpayer, while the doubts are also a consequence of, among others, low quality of the tax law. The actions of the tax authorities can sometimes be characterized by opportunism. Although the issued decisions are compliant with the letter of the law, they are made based on "political correctness", protect only the public interest, are not adequate to the circumstances of the case that is being resolved and do not use the legal solutions beneficial for the interest of the individual (Szczurek, 2008: 33). This category included provisions of the discretionary character.

3 Quality of the Tax Law as an Element Shaping the Legal Position of the Taxpayer

It should also be emphasized that a well-constructed tax system results in an effective carrying out of the taxes' fiscal function and at the same time serves to protect the rights of the taxpayer (Leszczyńska, 2009: 524). A simple not complicated tax system guarantees, to a greater extent, the certainty of taxation to the taxpayer. Taxpayers are then able to implement the tax regulations with ease and determine the content of responsibilities placed upon them (Weisbach, 2011: 25).

The legal position of an individual is substantially shaped by the applicable law regulations. It should, however, be noted that also less tangible elements influence their situation, such as the stability and certainty of taxation, relating to both the regulations and their interpretation, good legislator technique or non-discriminating character of the taxation. Other important factors that should be indicated include the tax authorities' capabilities of understanding the tax law (also the "spirit of the law") and of using it. In the context of a lack of clarity and a high level of complication of the tax law regulations it becomes difficult, might even remain outside the range

of knowledge and skills of an average employee of the tax administration (Thuronyi, 2003: 207). Additionally, the use of the formula of settling doubts regarding the content of the tax law regulations in favour of the taxpayer (Art. 2 of the Tax Ordinance) requires indicating that the doubts cannot be removed.

The unchangeability, stability of the tax law are important factors influencing the legal position of the taxpayer. First and foremost they offer the taxpayer a sense of security (Stelmachowski, 2000: 22). The taxpayer should be able to predict the long-term tax consequences of actions they undertake. It is especially important for entrepreneurs but not only. The changing tax law also forces the taxpayers to educate themselves, to constantly track the introduced changes and to adjust their actions. Additionally, the risk of not noticing the tax change falls on the taxpayer. Another important consequence of the lack of law stability is the depreciation of the tax judicial decisions (Stelmachowski, 2000: 28). The introduction of changes into applicable regulations causes the obsolescence of opinions issued in the previous legal state. Whereas the jurisdiction is important in correcting the content of the law and adjusting it to life, hence it helps to stabilize the practice of implementing the law (Cf. Glumińska-Pawlic, 2007: 240; Mastalski, 1993: 3; Stelmachowski, 2000: 29).

The tax law should not be subjected to frequent, chaotic and unpredictable changes that complicate the existing institutions. Meanwhile, as N. Gajl noticed, "the tax system in Poland is in the state of constant reform" (Gajl, 1996: 1). Although that remark was made over a decade ago, unfortunately it is still up-to-date. One of the main factors that shape the legal position of the taxpayer is, therefore, the stability of the tax law, and in this area the taxpayers are not sufficiently protected. In this context, it should be clearly articulated, that law stability is an intrinsic value, especially in the tax law (Stelmachowski, 2000: 28).

The lack of the law stability unfavorably influences the certainty of taxation. It should be emphasized that unstable law substantially influences the lowering of the knowledge of the law, in the case of both the taxpayers and the employees of the tax apparatus, what in turn can cause a faulty implementation of the law and uncertainty regarding the future situation

of the taxpayer (Gliniecka, Harasimowicz, 1997: 2). The tax law influences the situation of the taxpayer in a direct and authoritarian way, the ailments connected to it should not be deepened by the lack of certainty or instruments that provide it (Zimmermann, 2012: 198). The lack of the certainty of law causes the feeling of a lack of security, the addressees of the law norms have no guarantee that when acting in accordance to the law, they will receive an identical and effective protection from the state (cf. Nykiel, 2009: 15; Zieliński, 1996: 43). The certainty of law is a factor that in a wider perspective beneficially influences the social calmness and order (Zieliński, 1996: 44). Whereas the lack of the certainty of law results in the lack of trust in the law in the taxpayers (Zieliński, 1996: 43).

The certainty of taxation is influenced, among others, by the clarity and good communication of the tax regulations, that should be formulated in such a way that they are understood by each addressee (Kiszka, 2003: 6). Introducing regulations difficult to understand into the tax system should not be tolerated (Mączyński, 2005: 14). It should be emphasized, that the bad situation of the taxpayer is caused by the vagueness of law, lack of understanding of the regulations. Finally, the certainty of law is also a certainty that the tax authorities operate in accordance to the applicable law regulations, and that the interpretation of the tax regulation is uniform (Zieliński, 1996: 47). The taxpayer should be sure that no matter which tax authority will resolve their case, the decision will be the same. The rule of tax law certainty encompasses, therefore, also the predictability and calculability of the decisions of the tax authorities (Zelwiański, 2003: 161). It is, however, the more difficult, the worse is the quality of the tax regulations.

4 Conclusion

The norms of the tax law have an intrusive nature, that means that they enter the sphere of a person's freedom, into a person's property (cf. Brzeziński, 1939: 208). The tax law is somewhat an authorization for the tax authorities to hold a special kind of power over a citizen, to directly enter into their sphere of property (often very deeply) in order to enforce the payment of the taxes due (Zaborek, 2008: 37). In connection to the above, the legislator should in a proper way secure the interest of the taxpayer,

so that their belief of the unavoidability of tax coincided with the belief that their rights in the process of enforcing the tax payment are properly protected (Zaborek, 2008: 37). The necessity to balance the interests of the public and the individual, also in the tax law, is articulated by the jurisdiction, both by the administrative courts and the Constitutional Court (cf. f. ex. Constitutional Tribunal's verdict from July 3, 2001, K 3/01; Supreme Administrative Court's verdict from April 26, 2000, I SA/Gd 992/99).

The guarantees protecting the interest of the taxpayer are at the same time obliging the tax authorities to act with respect towards the rights of the taxpayer (cf. Kowalska, Kowalska, 2011: 97). The legislator does not directly introduce the obligation to protect the interest of the taxpayer into the tax regulation, however they protect the interest of the taxpayer through the introduction of legal regulations, especially in the general tax law (cf. Kowalska, Kowalska, 2011: 98). On the other hand, the tax authority working in the interest of the general public cannot operate in a pro-fiscal manner, trying to satisfy an important public interest (Dębowska-Romanowska, 1998: 21) while violating the rights of the taxpayer (an individual) (Kowalska, Kowalska, 2011: 98).

The tax norms, just like all other law norms, should be built in a correct, precise and clear way (cf. f. ex. the Constitutional Tribunal's verdicts: from December 17, 2002, U 3/02; from March 21, 2001, K 24/00; from January 11, 2000, K 7/99;). It is necessary for the taxpayer to know what actions were undertaken by them will bring tax-law consequences and how will they be shaped. The language of the tax regulations should be communicative enough, so that it would be possible to read in a unequivocal way the proper behaviour and to identify the obligations and rights resulting from a given regulation. The tax regulations, in principle, infringe on the economic rights of the citizen, therefore they should be formulated in such a way that they would clearly state whose rights and freedoms can be infringed upon and in what circumstances. Precision and clarity of the text of the Act are necessary requirements for an efficient protection of constitutional rights and freedoms. On the side note, it should be emphasized that a well-designed tax system and comprehensive tax regulation influence also the achievement of set fiscal goals (Weisbach, 2011: 4). In a special way, they determine

the protection of the taxpayer's interest from being violated, from the interpretation of the tax regulations against the taxpayer's interest. The communicativeness of the legal text shapes the legal security of the taxpayer (cf. f. ex. the Constitutional Tribunal's verdicts: from May 22, 2002, K 6/02; from March 21, 2001, K 24/00; from January 11, 2000, K 7/99;).

Moreover, it should be noted that all public law obligation, including tax obligations, should be placed upon the society on the basis of the same, fair and possible to accept rules. Extralegal rules, postulates regarding placing the tax burdens, like the tax justice, commonness and equality, have an axiological justification (Kordela, 2012: 15).

Guaranteeing the taxpayer a minimum of rights and permissions protected from a possibility of their violation with the help of proper legal regulations is a necessary, but insufficient requirement for providing protection of the taxpayer's rights. For it is also important whether and to what extent are those rights observed by the tax administration, in the process of calculation and collection of taxes (Szczurek, 2008: 257). In that context, the quality of the tax law is of crucial importance, especially the level of its unequivocalness. The regulations should be clear and precise to the taxpayer. Those faults should not be counteracted by the introduction of other legal institutions, for example, of settling unremovable legal doubts in favor of the taxpayer. The only complex solution will be to work out such a technique of tax legislation that will result in creation of high quality tax law.

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THE PRINCIPLE OF RESOLVING DOUBTS IN FAVOUR OF TAXPAYERS IN THE LIGHT OF POLISH TAX LAW

Edward Juchniewicz, Małgorzata Stwoł[1]

Abstract

This contribution deals with the principle of resolving doubts in favour of taxpayers. The main aim of the contribution is to assess the impact of changes of Tax Ordinance Act on the principle of resolving doubts in favour of taxpayers. It is very common that in various publications on tax law, even when studies emphasize completely different topic, which is not related to tax law principles, authors conclude that the tax law is not certain. To be more specific, the analysis and evaluation of various institutions and mechanisms of tax law often comes down to general conclusions, in which the emphasis is reduced to the uncertainty and ambiguity of the terms used in the tax law. Authors use normative and dogmatic methodology and try to answer the question whether the regulated by the Tax Ordinance Act new principle can solve problem of tax law uncertainty in Poland.

Keywords: Tax Law Principles; Tax Law Certainty.

JEL Classification: H34

1 Introduction

Certainty of tax law has become one of the main areas of legal research in Poland and abroad. It is very common that in various publications on tax

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law, even when studies emphasize completely different topic, which is not related to tax law principles, authors conclude that the tax law is not certain. To be more specific, the analysis and evaluation of various institutions and mechanisms of tax law often comes down to general conclusions, in which the emphasis is reduced to the uncertainty and ambiguity of the terms used in the tax law. Authors confirm in their studies the violation of the principle of certainty in tax law (Givati, 2009: 5–8).[2] It should be also noted, that about certainty in tax law could be also discussed even in the historical context, which confirms the permanent interest in the research subject (Pikulska-Radomska, 2013: 150) and the meaning of law certainty is the subject of separate research (Fenwick, Wrbka, 2016, 1–6).

The problem of legal certainty in the context of taxation is not new. Even it could be stated that tax law language itself is always complicated (Cohen, 2006: 1–5). Therefore, we can ask ourselves, if it is possible to make such tax law, which will be clear and understandable for all taxpayers.

Legal norms despite their abstractness should precisely indicate to the manner of behaviour of the entities. There should be no doubt what is the appropriate behaviour of particular entities. The formal certainty of tax law should enable an appropriate organization of their tax-law relations through a precise outlining of their rights and responsibilities towards the state in terms of payment of taxes. It must be assumed that the certainty of law (certainty of tax law) is a constitutional value of many states (for example, the Republic of Poland is a state under the rule of law – Art. 2 of the Constitution of the Republic of Poland). The requirement of the certainty of law should be observed in all law branches, and the tax relations should be given special attention (constitutional Court, 2002: K 6/02). This should translate to more precise legal regulations and mechanisms of control of the state. The certainty of tax law should be treated as the foundation of every modern tax system (Kosikowski, 2007: 118–119; Woltanowski, 2012: 530–542; Kopyściańska, 2014: 457–465).

2 Topic on legal certainty in the light of taxation is rather common. Moreover, even if the studies focuses on the issues of legal certainty in taxation, they can relate to different areas of tax law and taxation, for example, relate to tax avoidance and tax evasion, limits of taxation etc.

In practice, the problem of uncertainty of tax law is even broader. Doubts may relate not only to tax regulations but also – to various facts in the tax case. Typically, the taxpayer faces such a problem at the moment of tax audits or tax disputes. Nevertheless, it should be noted, that the taxpayers might have doubts related to tax obligations at an earlier stage in order to determine what behaviour is legal in the field of taxation.

The tax law doctrine already has presented some answers regarding this problem. It is obvious that a kind of solution could be an education of taxpayers in the context of tax law or with help can come judicial review, in particular, the constitutional court, which will judge whether uncertain tax law may be legally binding (Avila, 2016, 402–405). Another quite popular mechanism that tax administration can provide taxpayers with written tax interpretations, that going to let taxpayers to reduce tax risks (Юхневич, Ствол, 2016: 23–27).

Recent changes in Polish Tax Ordinance Act (Tax Ordinance Act, Art. 2a)[3] let authors to introduce another mechanism of tax law, which is the principle of resolving doubts in favour of taxpayers. It is called in Polish literature *in dubio pro tributario*[4] (Kopyscianska, 2015). This is not something that has been developed by Polish legal doctrine or legislator. This principle was often referred to various court decisions and literature on tax law.

2 The Legal Structure of the Principle of Resolving Doubts in Favour of Taxpayers

It was stated above, that principle *expressis verbis* was regulated in 2015, when the President of the Republic of Poland, presented the main changes in the Tax Ordinance Act. The main element of the changes in Tax Ordinance Act was an introduction of the Art. 2a, according to which "doubts about the content of the tax legislation, which can not be eliminated shall be interpreted in favour of the taxpayer." It means well known principle becomes a law.

3 Tax Ordinance Act in Poland serves as the main statute in the field substentive tax law. In comparison with legal regulations from other states – it could be named as a tax code, which contains basic definitions of tax law and tax procedure. It should be added, that legal structure of vairous taxes is regulated by seperate tax statutes.

4 In this paper, both names of the principle will be used interchangeably.

The Chancellery of the President of the Republic of Poland organized a series of expert seminars on tax law and procedure. During these workshops, it was pointed out the absence of certain legal provisions in the Tax Ordinance Act, which causes significant uncertainty and additional costs in conducting business activities in Poland. For example, according to many experts and practitioners too frequent use of the provisions allowing termination and suspension of the lapse period in the tax law, is not only a limitation of the rights of the taxpayer, but even contrary to the whole concept of the protection of citizens' rights (Bogucki, Winiarski, 2015: 113–148; Banaszak, 2011: 9–18). The experts also recommended the introduction for the Tax Ordinance Act general principles of tax law, in particular, the principle *in dubio pro tributario (*the principle of resolving doubts in favour of taxpayers*)*.

The experts also concluded that one of the most important issues in the application of tax laws is a correct interpretation of the law. Poland's Constitution in Art. 84 establishes the principle of universality of taxation,[5] while Art. 217[6] – the principle of exclusivity of the law in terms of the basic elements of the tax structure. In view of these provisions will be derivable principle – *nullum tributum sine lege*[7] and the principle *in dubio pro tributario* (Mariański, 2011: 35–36; Niedojadło, 2014: 53–59). The introduction of the principle *in dubio pro tributario* should increase the protection of taxpayer rights, especially in the interpretation of the law by limiting the negative consequences of inaccurate wording of the rules by the legislator, the weight of which is now transferred to the taxpayer. It should also be noted that the principle *in dubio pro tributario* should not be considered as an order addressed to the tax authorities, and that since the entry into force of Art. 2a came into effect some provisions of the anti tax regulation. The principle of *in dubio pro tributario* should be seen as an expression of the principle of *nullum tributum sine lege* and coming from the Art. 7

5 Art. 84 – Everyone shall comply with his responsibilities and public duties, including the payment of taxes, as specified by statute.

6 Art. 217 – The imposition of taxes, as well as other public imposts, the specification of those subject to the tax and the rates of taxation, as well as the principles for granting tax reliefs and remissions, along with categories of taxpayers exempt from taxation, shall be by means of statute.

7 No tax without law. It means that all taxes could be regulated only by statute.

Polish Constitution the principle of legality,[8] which requires action of public authorities exclusively on the basis of the law. The purpose of including this principle – *expressis verbis* in the Tax Ordinance Act, is the introduction of additional rules for the interpretation according to which the tax laws will be interpreted without any disturbances that may affect the legitimate interests of the taxpayer.

Application of the principle *in dubio pro tributario* in the interpretation of the tax law is to ensure implementation of the principle of certainty in tax legislation. This principle should perform the function of clarifying and simplifying legislation, which is important from the point of view of the general state of the Polish tax law. This particularly applies to the situation when the position of regulation lead to conclusions that do not make sense, contradictory or ambiguous, then the best solution is a choice of interpretation of legal norms, which will be beneficial to the taxpayer. Application of the principle must, therefore, lead to three effects, namely the content of the structural loopholes in tax legislation, eliminating doubts about the wording of the law and the modernization of the rule of law (Draft law on amending the Tax Ordinance Act, 2014).

The principle of *in dubio pro tributario* began to be applied from 1 January 2016. It should be noted that this is a fairly short period of time, during which might appear significant problems associated with its use. However, the Minister of Finance of Poland issued on January 19 of 2016 the general interpretation, which explains how to apply this principle in practice (General Interpretation of Minister of Finance: PK4.8022. 44. 2015).

According to the interpretation, expressed in Art. 2a tax ordination of the principle *in dubio pro tributario* can be used only with respect to doubts concerning the content of the law. The principle cannot be applied to the doubts about the facts. The correct application of the law tax ordination on tax procedure and, in particular, the provisions governing the collection of evidence should provide a sufficient degree of knowledge of the facts

8 Art. 7 - The organs of public authority shall function on the basis of, and within the limits of, the law. It should be mentiond that principle of legality also regulated expressis verbis in the Tax Ordinance Act – Art. 4. Tax liability shall mean an unspecified duty, resulting from the tax acts, to bear a compulsory pecuniary performance in relation to the occurrence of an event specified by such acts.

that lead to the definition of what the facts of the case took place, and what had not. The direct recipients of the principle *in dubio pro tributario* are the tax authorities, which are tax case, and within the value of the case is accepted the provisions of the law that apply in this case. In turn, the indirect recipient of the principle can also be a taxpayer, which can refer to Art. 2a of the Tax Ordinance Act and require its application by the tax authority in a situation where in taxpayer's opinion – tax case in doubt about the content of the tax law and the tax authority has not yet been applied in the case the principle *in dubio pro tributario*.

Regarding of recipients of the principle *in dubio pro tributario* should also be emphasized that the Tax Ordinance Act law refers to its content only to the taxpayer.[9] However, there is no reason that would prevent the application of that provision in relation to other subjects of tax relations. According to the Polish tax law, for example such subjects can be – tax remitters,[10] tax collectors,[11] the taxpayer's legal successors or third parties liable for arrears of taxpayer's.[12] The basis for the application of the Art. 2a of the Tax Ordinance Act is the analogy of law.

Application of the principle *in dubio pro tributario* is not limited to tax proceedings, the tax authorities accept tax solutions. The provisions of the Tax

9 Art. 7 of the Tax Ordinance Act – A taxpayer is a natural person, a legal entity or an organizational entity without legal personality subject to tax liability by virtue of the tax acts.

10 Art. 8 of the Tax Ordinance Act – A tax remitter is a natural person, a legal entity or an organisational entity without legal personality obliged under the provisions of tax law to calculate and collect tax from the taxpayer and to pay it, by the appropriate deadlines, to the tax authority.

11 Art. 9 of the Tax Ordinance Act – A tax collector is a natural person, a legal entity or an organizational entity without legal personality obliged to collect tax from a taxpayer and to pay it, by the appropriate deadlines, to the tax authority.

12 In cases and to the extent provided for in this chapter, third parties shall also be liable with all their assets for the taxpayer's tax arrears jointly and severally with the taxpayer. The third parties shall be liable with all their assets jointly and severally with the taxpayer's legal successor for the tax arrears taken over by a legal successor. Closed list of entities that can carry such liability is regulated in the Tax Ordinance Act. About the tax liability of a third party decide to tax authorities. For example, in the case of the tax debt of the taxpayer his divorced spouse (third person) is liable with all its assets jointly and severally with the former spouse, but only up to the value attributable to its share in the joint property. See more in Chapter 15 of the Tax Ordinance Act.

Ordinance Act can also be applied by the tax authorities in the process of issuing written interpretations[13] (Morawski, 2016).

The main part of the content of the principle is the formulation concept "in favour of the taxpayer", which should be interpreted as an optimum (favourable) legal decision among those that have arisen in the course of the interpretation of the provisions of law. What solution is more optimal for the taxpayer, the taxpayer may indicate, for example, introducing the calculation in tax return or explaining the position in the tax process. The taxpayer's position may be challenged by the tax authorities, demonstrating that the provisions of law in this particular case is not in doubt or – if the situation raises some doubts – demonstrating that these doubts can be removed, and the result is correctly carried out by the interpretation of the provisions of the law, will be different from the taxpayer's position. It should be noted that the tax authority, making the interpretation of tax legislation must take into account also the jurisprudence of the Court of Justice of the European Union. It should be also added, that the wording of the concept of "in favour of the taxpayer" does not have an objective nature. The adoption of the interpretation in the context of optimal solution for the taxpayer in this case does not mean that all the tax authorities are obliged simply accept the wording / concept "in favour of the taxpayer" in respect of another taxpayer in another tax case.

The tax authority taking the decision cannot be limited only to the arguments presented in support of the issued decision. If the tax authority contends that the provisions of Art. 2a of the Tax Ordinance Act cannot in this case apply, the tax authority must demonstrate that the taxpayer is pushing other arguments and putting the thesis on the existence of doubts that can be eliminated, that the taxpayer was not right as for example his arguments were wrong, or arguments that were to confirm the existence of doubts, were so weak in comparison with the opposing arguments of the tax authority

13 The minister responsible for public finances shall endeavour to ensure the uniform application of tax law by the tax authorities and tax inspection authorities, especially by interpreting it and taking into account the jurisdiction and judicial decisions of the Constitutional Court and European Court of Justice (general interpretation). The minister responsible for public finances will issue a written interpretation of the provisions of tax law at the written application of a party concerned about an individual case (individual interpretation). Art. 14a of the Tax Ordinance Act.

It can be added that the Administrative Court, considering the legality of the actions of the tax authorities, will be able to cancel the tax authority's decision, for example, in a situation where the tax authority has not applied the principle of in dubio pro tributario, and in the opinion of the court, there are all conditions for the implementation of the principle "*in dubio pro tributario*".

3 Conclusion

There is no doubt that the tax law should be characterized by a particularly high level of legislation. Each taxpayer should make sure that paid tax is a legitimate mandatory payment. The introduction of the principle *in dubio pro tributario* (the principle of resolving doubts in favour of taxpayers) should be evaluated at this stage, that the postulate of legal doctrine and practice was implemented. Here is no need of course to overestimate the value of this principle, and to have hope that the tax laws of Poland immediately will become clearer and certain. Currently, we need some time to assess the significance and application of this principle in practice.

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Constitutional Court: K. 6/02

VAT IN THE POLISH COMMUNE

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Abstract

The main purpose of the article is an attempt to answer the question to what extent the imposition VAT on the commune occurs. Following this main objective will serve the specific objectives, so the answer to the questions: 1. Does the tax law clearly specify the activities carried out by a commune as a public authority, which are not taxed, and transactions, which are subject to VAT? 2. Do the communal budgetary units and communal budgetary establishments enjoy autonomy allowing for the taxation separate from the commune? 3. Has the case law of the Court of Justice of the European Union (CJEU) and the Supreme Administrative Court in Poland (SAC) led to legislative amendments in the taxation of the commune in Poland?

Based on the current analysis of the case law of the CJEU and the SAC and enactments the basic research thesis has been formulated: tax law in Poland allows for the taxation of the commune in a wide range. The following specific research thesis were adopted: 1. Tax law in Poland does not delimit precisely the taxation of activities carried out by the commune and the taxation of activities that fall beyond this scope. 2. The communal budgetary units and communal budgetary establishments do not enjoy autonomy allowing for taxation separate from the commune. 3. The CJEU and the SAC case law, because of the need to harmonize VAT, has led to legislative amendments in the taxation of the commune in Poland. In the article, the method of doctrinal analysis of legal sources was applied.

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The article presents a review and analysis of rulings by the Supreme Administrative Court in Poland and the Court of Justice of the European Union concerning the collection of value-added tax from communes. A review of the case-law leads to the clear conclusion that communal budgetary units and budgetary establishments are not payers of value-added tax. The commune is the taxpayer. In order to bring Polish law into compliance with the pro-EU interpretation accepted by CJEU and SAC, it is vital to make legislative changes allowing communes to refund past-due value-added tax, and facilitating ongoing settlement of tax liabilities.

Keywords: Commune; Value-added Tax; Harmonization of Tax Law; Right to Tax Deduction; Deduction Coefficient.

JEL Classification: K19, K34, K49, H20

1 Introduction

For years, scholars of tax law have advanced the postulate of clarity of tax regulations. This is particularly relevant to taxes which the taxpayer himself is obliged to calculate. Certainty as to uniform interpretation of tax law is a European and constitutional standard. Unfortunately, the practical application of regulations governing value-added tax encounters a range of difficulties when attempting to interpret them. A significant role in forming a proper understanding of the relevant laws is played by the case-law of the Supreme Administrative Court and the Court of Justice of the European Union, to which national courts turn with prejudicial questions.

Art. 113 of the Treaty on the Functioning of the European Union (hereinafter: TFEU) defines competences the EU to take actions concerning harmonization of laws regarding turnover tax, excise and other indirect taxes. Additionally, the EU can undertake appropriate measures only to the extent that such harmonization is necessary to ensure the establishment and functioning of the internal market and to avoid distortion of competition. The current Council Directive 2006/112 / EC of 28 November 2006 on the common system of value added tax is an example of the closest harmonization of tax at EU level. The common system of value added tax established under Directive 2006/112 / EC defines in detail all the elements associated with the system of calculating and collecting this tax, which have

been harmonized at EU level (Domik-Ogińska, 2011: XXI-4, XXI-10). The Member States are bound by objectives or effects of the Directive. They should be understood as the future effect – the state of affairs stated by the Directive provisions which Member States are obliged to provide. When the national law raises some doubts (ambiguities), the national court must interpret the law so as to adapt it to the requirements of the Directive. This is confirmed by the extensive case law of the CJEU, including von Colson and Kamann (C-14/83: I - 1891), where the CJEU expressed the view that the court in the application of domestic law, in particular the provisions adopted in order to comply with the Directive, is bound to interpret the Directive in the light of the wording and purpose of the Directive in order to ensure the achievement of a specific outcome stated in the current Art. 288 TFEU (Domik-Ogińska, 2011: XXI-34-35).

The issue of value-added taxation assessed on communes has provoked controversies for years in the practice of revenue authorities, as well as the case-law of the SAC and CJEU. The greatest difficulties in applying ambiguous regulations are experienced by communes themselves, which take decisions about specific situations on a daily basis concerning the scope of taxation. As a result, the tax law literature contains attempts at untying this Gordian knot (Lasiński-Sulecki, 2015: 193–205; Mudrecki, 2012: 417–425; Mudrecki, 2016: 227–236).

So far, in the literature there is no current analysis of the evolving case law of the CJEU and the SAC and the amended legal provisions in terms of the VAT treatment of the commune.

The main purpose of the article is an attempt to answer the question to what extent the imposition VAT on the commune occurs. Following this main objective will serve the specific objectives, so the answer to the questions:

1. Does the tax law clearly specify the activities carried out by a commune as a public authority, which are not taxed, and transactions which are subject to VAT?
2. Do the communal budgetary units and communal budgetary establishments enjoy autonomy allowing for the taxation separate from the commune?

3. Has the case law of the CJEU and the Supreme Administrative Court in Poland (SAC) led to legislative amendments in the taxation of the commune in Poland?

Based on the current analysis of the case law of the CJEU and the SAC and enactments the basic research thesis has been formulated: tax law in Poland allows for the taxation of the commune in a fairly wide range.

The following specific research thesis were adopted:

1. Tax law in Poland does not delimit precisely the taxation of activities carried out by the commune and the taxation of activities that fall beyond this scope;
2. The communal budgetary units and communal budgetary establishments do not enjoy autonomy allowing for taxation separate from the commune;
3. The CJEU and the SAC case law, because of the need to harmonize VAT, has led to legislative amendments in the taxation of the commune in Poland. In the article the method of doctrinal analysis of legal sources was applied.

In Polish conditions, the most significant issue is that of taxation of communes. The commune has been assigned a dual role in respect of VAT taxation. When it performs tasks within the scope of public administration it is not a VAT payer. However, other activity of local self-government units can lead to tax obligations being incurred. No less complicated an issue is determining whether communal budgetary units and entities should be taxed jointly or separately from their parent commune. An equally difficult question is that of the proper interpretation of regulations addressing the right to refund of tax assessed and the application of proportion in that respect. This is why analysis of case-law from the SAC and CJEU could prove useful for the proper functioning of local self-government units. Binding statements by the judiciary have led to the necessity of statutory changes in order to implement verdicts issued by the CJEU and SAC.

2 The Commune as a Public Authority Exempt from Value-Added Tax

Value-added tax is a state-levied, universal turnover and consumption tax, neutral for businesses, levied according to invoices, self-calculated and harmonized. Pursuant to the content of Art. 15/1 of the Tax on Goods and Service Act of 11 March 2004 (OJ L 2016, item 710, hereinafter: VAT Act), the rule in effect is that taxpayers of value-added tax are juridical persons, organizational entities without juridical personhood, and natural persons independently conducting commercial activity as referred to in Art. 2, without regard to the purpose or result of such activity. Exceptions to this rule are present. Public authorities and offices serving those authorities are not VAT payers to the extent they are performing duties assigned to them on the basis of other statutory provisions, and for the performance of which they have been constituted, excepting activities performed on the basis of concluded civil law contract (VAT Act, Art. 15/6).

The VAT Act contains no definition of the concepts "public authority" and "offices serving those authorities". In J. Zubrzycki's opinion, local self-government public authorities are entities of self-government, *id est* the commune, county, and province. As for "offices serving those authorities", he includes all entities engaged in the performance of those tasks. These include offices and departments of local self-government entities (Zubrzycki, 2011: 468–469).

Public authorities and offices are not considered as taxpayers within the scope of tasks performed and assigned on the basis of other legal regulations, and for which purpose they have been constituted. Thus, the performance of so-called official matters is essentially not subject to VAT, as these entities are not operating as taxpayers (Mudrecki, 2012: 418).

Clues facilitating the distinction of activities performed by the commune within the framework of its public tasks and those not included in that group can be generated by analysis of the Communal Self-Government Act of 8 March 1990 (OJ L 2016, item 446 with amendments). From the wording of Art. 6/1 of that Act it results that the scope of activities performed by a commune encompasses all public matters of local significance, which

are not reserved by statute for other entities. Paragraph 2, in turn, establishes a presumption as to the commune's authority. In turn, Art. 7/1 of the same Act provides a list of the commune's own tasks, but it must be kept in mind that this is not a complete enumeration. In particular, own tasks encompass matters concerning:

1. Spatial planning, management of property, environmental protection and water management;
2. Communal roads, streets, bridges, squares, and the organization of road traffic;
3. Waterworks and water supply, sewers, removal and cleansing of communal sewage, maintaining cleanliness and order as well as sanitary installations, landfills and neutralization of communal waste, provision of electric and heat power, as well as gas;

3a. Telecommunications activities;

4. Local mass transport;
5. Health protection;
6. Social aid, including care centres and facilities;

6a. Support for families and foster care;

7. Municipal housing stock construction;
8. Public education;
9. Culture, communal libraries and other institutions of culture, as well as protection of and care over landmarks;
10. Physical culture and tourism, including recreational areas and sporting facilities;
11. Markets;
12. Municipal greenery and woods;
13. Communal cemeteries;
14. Public order, safety of citizens, fire and flood protection, including equipping and maintaining communal flood prevention facilities;
15. Maintaining communal facilities of public utility and administrative facilities;
16. Pro-family policy, including providing pregnant women with social, medical and legal assistance;

17. Supporting and propagating the idea of self-government, including creating conditions for the activities and development of support entities, as well as implementation of programmes to stimulate civic engagement;
18. Promotion of the commune;
19. Cooperation and activity on behalf of non-governmental entities and entities listed in Art. 3/3 of the Act of 24 April 2003 on public benefit activities and volunteerism (OJ L 2016 item 239);
20. Cooperation with local and regional communities in other countries.

From the preceding definition it thus results that organs and offices of public administration act in the capacity of taxpayers when they:

1. Engage in activities other than those which are not encompassed by the framework set out for their tasks;
2. Engage in activities encompassed within the framework set out for their tasks, but do so on the basis of civil law contracts (Bartosiewicz, Kubacki, 2012).

This delineation of the borders for VAT taxation on communes can create significant difficulties in practice. For this reason, in order to guard against erroneous interpretation of legal provisions and to provide certainty of the law, taxpayers may take advantage of individual interpretations of tax law provisions. These have served as the backdrop for a number of casuistic rulings. The case-law of the Supreme Administrative Court has undergone evolution in conjunction with dynamically changing rules on commune own tasks, as well as with changing social and economic circumstances.

In its verdict in the case I FSK 1192/14 of 8 December 2015 (SIP LEX no. 1932086), the SAC examined the possibility of taxing the performance of public law tasks by communes, *id est* provision of the service of removing communal waste.[2] The SAC held that in light of the VAT Act and the Act on maintaining cleanliness and order in communes, by determining and collecting from property owners the fee charged for municipal waste management (including construction waste), the commune is acting from a superior position in relation to the entities participating in a given activ-

2 More on communal waste and its taxation in Radvan, 2016.

ity (property owners) and performing tasks within the scope of public authority as set forth in the provisions of the Communal Self-government Act. From the preceding it therefore results that the commune, in its performance of an "additional task" – *id est* "the performance of the service of collecting communal waste from property owners and management of waste in the form of placing and removing containers designated for construction waste", as was stated in the application for an individual interpretation – will be exempt from taxation, as it performs own tasks under public law regulation.

Another important issue coming up in the functioning of local self-government units was determining whether for-fee provision of access by communes to bus stops is subject to VAT taxation. In its verdict of 26 March 2015 in case I FSK 472/14 (SIP LEX no. 1659176), the SAC held that regulation of the rules of for the use of mass transit stops and rail stations constitutes the exercise of public authority which communes have been entrusted with in order to satisfy the needs of the community. The parties to those relations are: the commune, which acts in its capacity as an organ of public authority and an entity which legal regulations allow to make use of communal property within the framework of rules set out in provisions regulating the organization of public mass transport. Furthermore, the mode of determining the amount of the payment due indicated that what is under examination is a fee similar in nature to a public tribute, and not a price determined according to market realities. The legal relation linking the commune and entities using its communal property comes about to a large degree on grounds of administrative law regulations, which renders the civil law character of concluded contracts a secondary consideration. The parties to such relations do not enjoy total freedom in determining their terms, as they are restricted by generally applicable provisions of administrative law. Pursuant to Art. 15/6 VAT Act, organs of public authority are not considered as taxpayers, nor offices serving those organs in respect of tasks assigned to them on the basis of other statutory provisions, and for the performance of which they have been constituted, excepting activities performed on the basis of concluded civil law contracts. A literal interpretation of this provision thus makes the subjectivity of a public authority

in respect of VAT dependent on the nature of the legal relationship within which the performance of consideration is provided. Consideration within the framework of administrative (public) law regulations thereby remains outside the sphere of VAT taxation. Pursuant to the provisions of Art. 15/6 VAT Act, a commune collecting fees for the use of bus stops is not acting in the character of a taxpayer of VAT.

An analogous position, although couched in slightly different argumentation containing a pro-EU interpretation, was adopted by the SAC in its verdict of 2 July 2015, case I FSK 821/14 (SIP LEX no. 1767527). In this ruling it is pointed out that under Art. 13/1 of Directive 2006/112/EC on the common system of value added tax, activities performed by government authorities in such a role constitute a condition for excluding these entities from the scope of VAT taxpayers. A condition of the exemption contained in that provision is that the activity in question be performed by a public authority, and that it engages in the activity in its capacity as such. All other activities engaged in by a public authority are subject to the general definition of a taxpayer. The exemption contained in Art. 15/6 VAT Act is both subjective and objective in nature. An association of communes is a public authority, considering that it is established by communes with the purpose of assigning it public tasks. Both the rules for using bus stops and fees for such are determined by way of resolutions adopted by the appropriate unit of local self-government. Allocation of such fees is also not a discretionary matter, as the relevant legislation clearly states for what purposes it can be spent. The manner in which such fees are determined and in which the rules for allocating them are composed support the argument that the actions of an association of communes in this scope are a form of exercise of public authority, and not activity on the basis of civil law activities.

In its verdict of 12 August 2015, case I FSK 943/14 (Przegląd Orzecznictwa Podatkowego 2016/1/45–47), the SAC held that expenses associated with promotion of a municipality and maintenance of greenery are an own task of a commune. In this ruling it was found that expenditures incurred by a commune and related to promotional activities, as well as expenditures related to care of green spaces, cleanliness, maintenance and repair of pavements, and costs incurred in conjunction with the development and

maintenance of lighting infrastructure are expenses incurred within the framework of communal own tasks.

A commune which transfers vehicles free of charge for disassembly is also not a VAT taxpayer, as it is not conducting commercial activity in that scope (verdict of PAC in Wroclaw of 27 August 2014, case I SA/Wr 1581/14, SIP LEX no. 1506447).

A commune has also been held not to be a VAT taxpayer in conjunction with the construction of a public road. In its verdict of 19 November 2014 in case I FSK 1669/13 (SIP LEX no. 1540609) the SAC held that construction of a public road is part of the public sphere of a commune's activity. In this scope it does not act as a VAT payer and does not enjoy the right to write-offs. Construction of an access road to an industrial park which is a public road does not mean that the construction of that road is performed within the framework of commercial activity conducted by the commune. The commune, in building a road, is acting within the sphere of public law activities and is not engaged in the character of a VAT taxpayer; the expenses incurred in conjunction with the construction are not associated with the performance of activities subjected to taxation. By the same token it is not entitled to deduct tax assessed.

3 The Commune, Self-Government Budgetary Units and Communal Budgetary Establishments

One of the important practical issues faced by communes is determining who is a taxable subject of VAT. Is separate taxation of particular entities possible, or should a commune jointly tax itself as a VAT taxpayer?

In the first place it should be observed that a number of inconsistencies have occurred in practice in conjunction with the registration of a commune office as a VAT taxpayer (Mudrecki, Taxation: 419). In its verdict of 23 March 2010 in case I FSK 273/09 (SIP LEX no. 593864) the SAC explained that a commune as a juridical person is a VAT liable entity pursuant to the provisions of Art. 15/1, 6 VAT Act as a result of activities performed on the basis of civil law contracts. VAT filings should include the tax identification number of the juridical person who is the liable entity for VAT, in whose name the taxed activities are performed, *id est* the number

assigned to the commune. Issuing a municipal (communal) office a taxpayer identification number is associated primarily with the status of payer of personal income tax. A similar view has been expressed in the verdict of the SAC of 4 April 2008 in case I FSK 1148/07 (Wspólnota 2009/1/27), where it was held that the commune as a self-government entity is a VAT taxpayer, and not the communal office. The communal office is exclusively the apparatus employed by an organ of public authority, which is why it cannot be classified as a taxpayer.

The aforementioned inconsistencies were the result of the improper registration of the improper registration of a communal office as a VAT taxpayer in spite of the fact that the commune is such a taxpayer. However, until such time as the improper registration is not withdrawn by a tax authority, the submission of tax filings by communal offices and not by the commune itself cannot lead to negative legal consequences for the commune (Mudrecki, 2012).

Many disputes between communes and tax authorities have concerned the recognition of communal budgetary establishments as independent taxable entities. Tax authorities have ruled that such entities are separate taxpayers. In turn, uniform communes were more beneficial to well-organized communes. In its resolution of 24 June 2013 in case I FPS 1/13 (ONSA i WSA 2013, no. 6, item 96) the SAC held that in the light of Art. 15/1,2 of the VAT Act, communal budgetary establishments are not VAT liable taxpayers.

In the justification for the resolution it is emphasized that a communal budgetary establishment constitutes an organizational entity without juridical personhood, and is classified as a public finances sector entity. The status of such a budgetary entity results primarily from the provisions of Chapter 3 Section I of the Public Finances Act of 27 August 2009 (OJ L 157, item 1240 with amendments), in particularly Art. 11 and 12. A characteristic trait of the communal budgetary establishment is the absence of its own property, and that it disposes of and is responsible for only a distinct portion of the property of the commune, a separate juridical person. In conjunction with this, a communal budgetary establishment operates as a sort of *stadti municipi*. The authority responsible for constituting entities of local self-government, in this case the communal council, decides about the creation, fusion and liquidation

of a communal budgetary establishment. That authority gives the communal budgetary establishment its statute, which sets out the name, seat, and subject matter of its activity. Financial management of such an entity is characterized by the fact that the communal budgetary establishment covers its expenses directly from the budget of the local self-government unit, and its income is paid into the account of the commune (the so-called gross settlement rule). This means that the majority of expenses incurred by a communal budgetary establishment is completely unrelated to the amount of income generated by that entity. Furthermore, the communal budgetary establishment does not retain control of income it generates on its own. However, the organ responsible for performance of the budget – the commune – may dispose of the entire sum generated by communal budgetary establishments. In the subject literature attention is drawn to the fact that, since the level of expenses incurred by such an entity is independent of its income, there is no financial result, and there can be neither deficits (losses) nor profits. As a result, budgetary establishments perform to the fullest possible extent the redistributive function which is the primary function of public finances (Lipiec-Warzecha, 2011: remarks to Art. 11).

This position was confirmed by the Court of Justice of the European Union in its verdict of 29 September 2015 (C-276/14) in the case of Gmina Wroclaw *versus* the Minister of Finances (SIP LEX no. 1797948), in which it stated that Art. 9/1 of Directive 2006/112 on a common value added tax system should be interpreted in such a manner that public law entities, such as communal budgetary establishments, which are the subject of the main proceedings, cannot be considered as VAT liable entities for they do not fulfil the criteria of independence set out in that provision.

In its justification the CJEU emphasized that the use of wording which is not exactly the same in all language versions of Art. 9/1 of the VTA Directive does not undermine that statement. Indeed, both the words "independently" and "autonomously" indicate the necessity of assessing the conditions under which economic activity is conducted (thesis 36). From the reference invoked in this case it results that budgetary establishments which are the subject of the primary proceedings engage in economic activity on behalf of and to the benefit of the Municipality of Wroclaw, and they

are not liable for damage caused from that activity as this liability is born exclusively by the commune (thesis 37). It also results from the aforementioned provision that such entities do not incur economic risk associated with their activity, as they do not have their own assets, do not generate their own earnings, and do not incur costs associated with such activity as the income generated is assigned to the budget of the Municipality of Wrocław, while expenses are covered directly out of that budget (thesis 38).

The Supreme Administrative Court also employed this line of reasoning in its resolution of 26 October 2015 in case I FPS 4/15 (Przegląd Orzecznictwa Podatkowego 2015/6/577–584), where it held that it is the commune and not the self-government budgetary establishment that is the independent VAT taxpayer. In the text of the resolution it was held that in light of Art. 15/1 and Art. 86/1 of the VAT Act, the commune has the right to deduct tax assessed on purchase invoices in association with investments which are then assigned to a communal budgetary establishment performing tasks assigned to it by the commune, if those investments are used in sale subject to value-added tax.

In the justification of its verdict the SAC came to the conclusion that:

1. A self-government budgetary establishment does not have juridical personhood – it functions on behalf of and to the benefit of the entity which constituted it, and the director acts on the basis of authorization granted to him;
2. A self-government budgetary establishment performs only own tasks of the local self-government with the scope of communal management and related to public benefit activities;
3. The assignment of property to a self-government budgetary establishment is only an organizational measure. The property remains controlled directly by the self-government unit which establishes the rules for management of property assigned to the particular establishment;
4. Liability for obligations of a self-government budgetary establishment is born by the self-government unit that established it. The same unit also assumes the obligations of the establishment in the event of its liquidation.

Thus in light of the criteria for independence of the liable entity indicated in the judgement of the CJEU of 29 September 2015 concerning case C-276/14 Gmina Wrocław, it cannot be argued that a local self-government budgetary establishment engages in economic activity in its own name and on its own behalf, bearing liability and economic risk. The Court indicated clearly in its ruling that in assessing the independence of an entity as a VAT liable taxpayer, it must be found that the given entity performs commercial activity on its own behalf and to its own benefit for which it is directly liable, and it bears the economic risk associated with such activity. Although a self-government budgetary establishment has greater independence than a budgetary unit when applying the criteria set out by CJEU, because it does not fulfil the aforementioned criteria it cannot be held that it is a separate VAT liable entity from the local self-government unit which established it.

In summary, it can be said that the essence of a budgetary establishment is what attests to its deficit of independence in the context under consideration here. Indeed, it must be taken into consideration that a self-government budgetary establishment is appointed to perform own tasks of the local self-government unit in the sphere of communal management, acting in the name of that unit as a separate organizational unit, employing a portion of the assets of the commune assigned to it; this means that those assets remain the property of that unit, and they are used in the performance of its statutory tasks. It does so through the budgetary establishment strictly for pragmatic reasons.

By way of comparison we should mention the performance of self-government tasks by communal capital companies, in contrast to budgetary establishments. The separate personhood of communal capital companies gives them *inter alia* the possibility to incur their own debts when making capital investments. This is not possible for self-government budgetary establishments. The autonomy of communal capital companies, particularly financial and especially in respect of the capacity to assume debt for financing investments, distinguishes these entities from budgetary establishments precisely in the matter of their independence.

The rulings detailed above were very beneficial to well-organized communes, as they allowed for the recovery of tax assessed on purchases by communal

budgetary establishments and budgetary units. This, however, required amending tax filings taking into account all the units of a given commune (Mudrecki, 2015: 234).

In the light of the abovementioned findings the commune, which performs tasks of public authority, with the exception of civil law contracts, is not a VAT payer and therefore is not entitled to a VAT refund. In a situation, where the commune acts outside the scope of public authority or on the basis of civil law contracts, it is entitled to a VAT refund, however not in the full amount, but only proportionally to activities that are taxed and that are not taxed.

4 Legislative Changes Resulting from the Verdict of the Court of Justice of the European Union of 29 September 2015 (C-276/14) and Case-Law of the SAC

A consequence of the taxation of communes as a single subject was amendments to tax regulations. On 1 January 2016 a set of changes went into effect introduced by the Act of 9 April 2015 amending the Value Added Tax Act and the Public Procurement Act (OJ L 2015, item 605). Changes in particular affected the manner in which the VAT deduction coefficient is calculated. The informational brochure concerning the rules for deductions of VAT by taxpayers conducting activity of a mixed character issued on 17 February by the Ministry of Finances should be assessed positively. A deeper presentation of difficult issues associated with the entry into force of the aforementioned legislation was provided by J. Pęczak-Czerwińska (Pęczak-Czerwińska, 2016: 257).

However, this was not the last amendment to legal provisions in this area. On 1 October 2016 the Act of 5 September 2016 on particular rules for settlement of value-added tax and refund of public funds from the European Union budget or Member States of the European Free Trade Association by local self-government units (OJ L 2016, item 1454) went into force.

That Act sets out the rules for performing tax settlements of by units of local self-government beginning 1 January 2017 (Chapter 2). Chapter 3 details the rules for corrections to tax settlements by local self-government units for settlement periods expiring prior to the day on which they settled

the tax along with all organizational units. The issue of return of funds earmarked for carrying out projects in the event of a change in qualification of a tax as a result of a ruling by the European Court of Justice is also addressed in Chapter 4.

The legal regulations continued in the statute under analysis here are complicated, and in practice may give rise to significant controversy. Furthermore, they impose a range of burdens on organs of local self-government that smaller or poorly-organized communes may not be capable of handling. Here as well we should positively assess the Brochure of the Minister of Finances released on 24 November 2016 on centralization of VAT tax settlements for local self-government units. This document is written in a very accessible style and explains a large number of complex legal issues; however, this does not guarantee that the application of the adopted regulations will not lead to significant growth in court cases.

The new regulations resulted in the harmonization of domestic law with EU law, including the compatibility with the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax and also with the interpretation of the law presented in the case law of the CJEU. In particular, they allowed the commune to get the VAT return to a broader extent and also for earlier periods. However, the tax refund depends on making by a commune a correction of the tax declarations of all the communal budgetary units and the communal budgetary establishments. The commune is obliged to centralize the tax-related settlements. The newly enacted provisions describe rather in detail how to calculate the proportion of VAT refund. Due to the fact that the VAT is an especially complicated tax, in the situation when some activities of the commune are subject to tax and the other are not, the interpretation of the provisions faces inevitably difficulties in the application.

5 Conclusions

The imposition of VAT on communes leads to a significant range of difficulties resulting from the imprecise assignment of local self-government tasks performed within the framework of administrative authority or civil law contracts.

In the case-law of the Supreme Administrative Court and the Court of Justice of the European Union it has been accepted that communal budgetary units and communal budgetary establishments are not independent VAT liable entities – the commune itself is the taxpayer. The adopted interpretation of the relevant regulations has allowed communes to file amended tax returns in order to recover collected VAT.

The adopted legal solutions, a consequence of the case-law of the Court of Justice of European Union and the Supreme Administrative Court and which facilitate centralization of settlements by communes, allow for the filing of amended declarations and solve the problem of return of EU funds have ended the confusion of a previously disorderly situation. Nevertheless, there remains an absence of clear rules distinguishing activities performed by a commune as an organ of public authority and those subject to value-added tax.

Summing up, it can be assumed that the main thesis of the article stating that tax law in Poland allows for the taxation of the commune in a fairly wide range – has confirmed. The specific objectives of the research were also fully pursued. Tax law provisions do not delimit precisely the taxation of activities carried out by the commune and the taxation of activities that fall beyond this scope. Due to the lack of autonomy of the communal budgetary units and communal budgetary establishments they are not independent VAT liable entities – the taxpayer is the commune itself. The consequence of the CJEU and the SAC case-law was law amendment in terms of taxation of the commune in Poland – which has led to harmonization of VAT.

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DIRECTIONS OF CHANGES OF TAX PROCEDURES IN POLAND

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Abstract

The contribution deals with tax procedures in the new Tax Ordinance whose draft will be prepared by the General Taxation Law Codification Committee in the third quarter of 2017. The aim of the contribution it a presentation of basic directions of changes postulated by the Committee with regard to tax procedures. Moreover, the contribution presents proposals of regulations drafted by the Committee within the above scope. The analysis carried out herein depicts the following directions of tax procedures' evolution: the first one involves simplification of tax proceedings, the second direction of procedural aspects of the evolution deals with flexibility of forms of resolving tax matters, and the third direction of changes is connected with the introduction of new procedures.

Keywords: Tax Law; Tax Procedures; Tax Proceedings.

JEL Classification: K34

1 Introduction

In Poland, general tax laws are regulated in the Act of 29 August, 1997 – Tax Ordinance (Act no. 613/2015). This Act regulates institutions of both substantive and procedural law. On the one hand, we will find there regulations of a substantive nature including, among others, limitation, excess tax or principles of liability of third parties. On the other hand, this Act encompasses tax procedures such as tax proceedings, examinations and tax audit. After nearly twenty years since this Act came into force, a decision has been made

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to draft a new legal act within the above scope (Etel, Poplawski, 2016: 71). A reasonable assumption has been adopted thereon, i.e., that the Act passed in 1997 cannot be further amended, and it must be replaced with a modern act of general tax law. For this reason, Prime Minister appointed the State Committee by the Decree of the Council of Ministers of 21 October, 2014 on the establishment, organization and course of operation of the General Taxation Law Codification Committee (Act no. 1471/2014). Under this Act, within four months from the Committee's first meeting, general assumptions of a comprehensive statutory regulation of general tax law must be prepared. Moreover, within two years from the day of adopting the general assumptions, a draft bill containing comprehensive provisions on general tax law together with implementing acts must be prepared (Etel, 2015).

The purpose of the contribution is a presentation of basic directions of changes postulated by the Committee within the scope of tax procedures. Moreover, the contribution will present proposals of regulations drafted by the Committee within the above scope. Works on these proposals are still in progress and that is why their final form may differ significantly them those that will finally be presented by the Committee.

2 Simplification of Tax Proceedings

The need to simplify tax proceedings is justified by the general tendency to simplify administrative procedures (Kmieciak, 2014) as well as taxpayers' expectations (Etel, 2015). In the new Tax Ordinance, an essential element of such simplification will be the introduction of simplified tax proceedings. They will be based on the following components. First of all, cases simplified tax proceedings will apply to will be specified. A first instance tax authority should be able to settle a case in simplified tax proceedings in two situations. The first one will consider cases where the settlement will be issued on the basis of evidence submitted by a party, including a motion for the proceedings' initiation, well-known facts, facts ex officio known by a body conducting the proceedings. The second situation will concern cases where the determination or change of the amount of tax liability, excess tax, tax refund or loss issued in effect of the provided settlement will not exceed EUR 1,500.

Secondly, another component of simplified tax proceedings should be the lack of a decision on the initiation thereof, the lack of notice establishing

time-limit to make comment on the evidence collected in the case and providing reasons for the issued decision only upon the request of the party submitted already after it was served. Simplified tax proceedings may be also initiated ex officio or upon the request of a party, just as in any other case. If simplified tax proceedings are initiated ex officio, a tax authority should ask the party concerned for their consent to this type of proceeding by means of electronic communication or by telephone. The consent may also be given in writing or orally for the record. Requesting a consent of the party to simplified tax proceedings, a tax authority should inform the party about differences between simplified tax proceedings and the ones conducted according to general principles. A tax authority should record in a note (indication) the request made to the party for a consent to simplified proceedings as well as the party's decision. If the consent is given by telephone, a tax authority should make a note (indication) thereon. The party's consent to simplified proceedings cannot be alleged. The initiation of simplified proceedings upon the party's request requires a clear indication of the party's will to carry out simplified proceedings. If during the proceedings initiated upon the request, prerequisites to conduct simplified proceedings are revealed, the authority should inform the party about a possibility of applying for such proceedings upon their motion. The party should also be entitled to withdraw their consent to the application of simplified proceedings in any time, or withdraw a motion to start simplified proceedings unless the decision has been issued. If the consent is withdrawn by telephone, a note (indication) thereon is made.

Thirdly, the consequences of the situation when during simplified proceedings prerequisites to carry it out under this course do not apply should also be regulated. Then, a tax authority should contact a taxpayer disregarding provisions concerning simplified proceedings described above. Whereas activities undertaken in simplified proceedings so far should remain in force. However, after the disclosure of circumstances indicating the removal of not applicable prerequisites to carry out simplified proceedings, a tax authority should immediately inform the party about it by means of electronic communication or by telephone. The issue of submitting an appeal against a decision issued in simplified proceedings will also be regulated in a special way. Upon the request of the party submitted within 14 days from the day of serving a decision issued in simplified proceedings, a tax

authority should serve the reasons for the decision. If a motion for the issue of reasons for the decision issued in simplified proceedings is submitted, time-limit for lodging an appeal starts to run from the day of serving the reasons for the decision.

3 Flexible Forms of Resolving Tax Matters

The new Tax Ordinance will introduce a possibility of concluding an agreement between a tax authority and a party. It should essentially involve the acceptance of common arrangements in tax matters by the above-mentioned entities. A tax agreement, however, should not involve mutual concessions on the tax assessment. A possibility of concluding such an agreement should be granted, most of all, whenever doubts about the facts of the case arise, including the situation when their removal in the proceedings would appear impossible or would be connected with excessive difficulties or costs. Such a form could be used to establish the subject, character or value of a transaction, action or event, the subject of applied relief to pay tax, in particular a type of relief which should be applied and the manner of its application, and individual issues resulting from the course of tax proceedings. The conclusion of a tax agreement should be confirmed by the minutes whose copy should be served to the party. In principle, a tax authority should be bound by the arrangements resulting from the tax agreement. This rule, however, should not concern situations where the arrangements resulting from the tax agreement are concluded in breach of law, or when they fulfill prerequisites justifying reopening of the proceedings in a case finished with a final decision, or if invalidity of a final decision has been acknowledged.

The element favoring the conclusion of a tax agreement will be mediation. A tax authority will be able to refer a case to mediation upon the party's motion or consent. Nevertheless, mediation will always be voluntary for both a tax authority and a party. At the same time, this procedure should be open solely for a tax authority, a party and mediator. This rule will be supplemented by the principle according to which during tax and court proceedings, a tax authority and a party will not be able to adduce proposals of settlement, proposals of mutual concessions or other statements made during mediation. However, this restriction should not refer to the arrangements concluded in the tax agreement.

4 New Special Procedures

4.1 General Comments

In the new Act, special procedures will be regulated in Section VI titled "Special proceedings". This part will encompass the following proceedings: examinations, tax audit, interpretations of and information about tax law provisions, a consultation procedure, a cooperation agreement, agreements about establishing transaction prices, estimation of the tax base, security of tax liabilities' performance, the issue of certificates, estimation of the goods' value, participation of a prosecutor and Ombudsman, complaints and motions, and the procedure of files' reconstruction. Apart from this part of the new Tax Ordinance, the procedures will also be regulated in a separate part devoted to chargeability, performance and expiry of tax liabilities (Section II). It refers to such procedures as excess tax and tax refund as well as reliefs to pay tax liabilities. Moreover, the procedure concerning counteracting tax evasion will be regulated in Section VII titled "Counteracting tax evasion". Some of the above-mentioned procedures will be new, i.e. the issue of tax information, a consultation procedure, a cooperation agreement, estimation of the value of goods or property rights, participation of a prosecutor and Ombudsman, complaints and motions, and files' reconstruction.

4.2 Tax Information, a Consultation Procedure and Cooperation Agreement

The new Tax Ordinance proposes to introduce the regulation on the basis of which in case of a significant change or introduction of new tax law provisions, a minister competent in public finance will issue ex officio, without undue delay and before they come into force, information about the scope of their impact on taxpayers' rights and duties. Such information will be published in Public Information Bulletin on an official website of the office serving a minister competent in public finance. Upon a request of and in agreement with the interested party, a tax authority will issue a decision on the tax consequences of actions or events they are or will be a party or participant to within the scope of a given tax. The decision on tax effects may regard, inter alia, actions or events in result of which the ownership

of the elements of assets is transferred, or tangible and intangible goods are handed over, or loans (credits) are granted. This mechanism is assumed to be tax proceedings initiated upon a request of a taxpayer aiming at verification of regularity of tax settlements connected with specified actions of entrepreneurs or other entities. A fee will be charged for this procedure. The amount of the fee for a motion in this procedure is one per cent of the value of the transaction subject to the analysis. For transactions not connected with a business activity, this fee, however, will not be lower than PLN 500 and not higher than PLN 2000.

A tax authority and a taxpayer of significant economic or social importance will be able to conclude a cooperation agreement. This agreement will be concluded in writing upon a request or consent of a taxpayer for a fixed period from a year to five years. The objective of this agreement will be to assure that a taxpayer observes tax law in the conditions of mutual trust between a tax authority and taxpayer as well as transparency and understanding of the activity pursued by him/her. By concluding a cooperation agreement, a taxpayer will be obliged to follow appropriate procedures agreed upon with the tax authority of internal audit of the regularity of tax settlement and, without undue delay, reveal to the tax authority any tax significant information about his/her activity, report any essential tax issues that are potentially disputable between him/her and the tax authority, and inform about scheduled or implemented operations ensuing tax advantage obtained by him/her or other entities engaged in these operations, whereas the tax authority will be obliged to immediately provide counseling and express their opinion about the issues indicated by the taxpayer as well as adjust the form and frequency of the audit of the taxpayer's tax settlement to the level of its internal audit.

4.3 Other New Tax Procedures

The newly regulated procedure of the establishment of the value of goods or property rights in the Tax Ordinance is to be applied when tax law provisions entail the obligation of determination of the value of things or property rights by a taxpayer but he/she has failed to do so. Then, a tax authority will call upon the taxpayer to establish the value of things or property rights within 14 days from the day of serving the writ. A tax authority may also

request the taxpayer to increase or decrease the value of things or property rights within the above-mentioned time-limit if it finds the value of things or property rights indicated by the taxpayer considerably differs from the market value. In this writ, a tax authority indicates the value of things or property rights according to its own preliminary evaluation together with the prerequisites applied thereon, and requests the taxpayer to provide reasons justifying the indication of the value differing considerably from the one established by the tax authority. If despite this writ, the taxpayer has failed to determine or change this value, or provided the value not corresponding to the market value, the tax authority will establish the value of things or property rights.

The new Tax Ordinance is to regulate the issue of the participation of a prosecutor and Ombudsman. The prosecutor's right to participate in every phase of the proceedings is to assure the compliance of the proceedings and settlement of the case with the law. A tax authority will be obliged to inform a prosecutor about the initiation of the proceedings and pending proceedings each time they decide the prosecutor's participation in them is necessary. A prosecutor will also have the right to request an appropriate tax authority or fiscal audit body to initiate the proceedings in order to remove the state of affairs that is not consistent with the law. Moreover, a prosecutor will have the right to appeal against a final decision if Tax Ordinance provisions or special provisions envisage reopening of the proceedings, the acknowledgment of decision's invalidity, or its repeal or change. A prosecutor appeals to a body competent to reopen the proceedings, acknowledge decision's invalidity, or its repeal or change. Ombudsman is to be granted appropriately the same above mentioned rights referring to the prosecutor.

The new Tax Ordinance is to regulate the procedure of complaints and motions, i.e. Art. 221–256 of the Code of Administrative Proceedings will appropriately apply to lodging and accepting complaints and motions, participation of the press and social organizations, and supervision and audit of accepting and examining complaints and motions.

Moreover, the procedure of files' reconstruction, which is currently applied by administrative courts in the court procedure, is to be newly introduced to the Tax Ordinance. Files that have been lost or destroyed in the whole or part are to be reconstructed. A tax authority that was the last to conduct

the case will be competent to reconstruct the files of a pending case. If the competent body thereto is an appeal body, it will hand over the case to a first instance body unless only their files are to be reconstructed. A tax authority initiates proceedings ex officio or upon a request of the party. However, the tax authority will initiate proceedings solely upon the party's request if the files have been lost or destroyed due to force majeure. A motion for the reconstruction of the files of a pending case could be made within three years from the files' loss or damage whereas a motion for the reconstruction of the files of a finally settled case – within ten years from its closure.

5 Conclusions

A vital element connected with the works on the new Tax Ordinance are issues referring to tax procedures. The analysis presented herein entails three directions of changes. The first one involves simplification of tax proceedings. It is directly manifested in the introduction of simplified tax proceedings which are to embrace non-litigious cases as well as those where the subject of litigation is insignificant. The second direction of the evolution of procedural aspects involves flexibility of forms of settling tax cases. It is expressed in the introduction of tax agreements and mediation which is to favor their conclusion between a taxpayer and tax authority. The third direction of changes is connected with the introduction of new procedures. This element is to make currently very formalized legal frames under which tax authorities may operate more flexible. On the other hand, new procedures are to resolve issues which have not been embraced by the regulation so far.

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HOW TO GET TAXPAYERS TO PAY LOCAL CHARGES

Michal Radvan[1]

Abstract

Why taxpayers are not paying the taxes? Maybe some do not want to. Maybe some do not have money to pay. Maybe some are not apprehensive about sanctions. Moreover, some of them even do not know they are obliged to pay. This article deals with the last two issues: sanctions in local charges and promotion of local charges. As there is no classification of sanctions in tax in the Czech Republic, it is necessary to describe and analyze the law in this area and compare de lege lata regulation with the intended amendments. The second part of the article is focused on how local charges are promoted by State or local self-government units, or how local charges should be promoted, while using the analytical method. This is the aim of the paper. The hypothesis to be confirmed or disproved is that the promotion of local charges is not adequate to get taxpayers to pay local charges (on time, in correct amount, at all). Finally using the synthesis of gained knowledge the best tax promotion mix is presented.

Keywords: Tax; Tax Law; Local Charge; Sanction, Promotion; Advertising.

JEL Classification: K34, M37

1 Introduction

There are many articles, books and other research outputs dealing with local taxes, including mine. Mostly these texts are dealing with substantive and procedure law connected with local taxes. Imagine that the legal regulation is precise, there are no application problems, and law is clear and easy to understand. However, taxpayers are still not paying. Why? Maybe some

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do not want to. Maybe some do not have money to pay. Maybe some are not apprehensive about sanctions. Moreover, some of them even do not know they are obliged to pay.

This article will deal with the last two issues: sanctions in local charges and promotion of local charges. In case of taxes sensu stricto, there are several articles in the Czech Republic regarding the sanction issues, but concerning local charges, there is none. That is why it is necessary to clarify the law in this area. Talking about advertising of taxes, I was not able to find any publication output worldwide in any case. Well, there is a lot of advertisements how avoid paying taxes, how to lower taxes or how to optimize them, advertisements offering acting on behalf of taxpayer before tax authorities, etc. This is not the area of my interest; I would like to focus (and this is the aim of the article) on how local charges are promoted by State or local self-government units, or how local charges should be promoted. My hypothesis is that the promotion of local charges is not adequate to get taxpayers to pay local charges (on time, in correct amount, at all).

Firstly, it is necessary to define local charges. Secondly, I will describe and analyze the Czech tax law dealing with sanctions and I will offer the comparison with the intended amendments. Then I will, using the analytical method, introduce different forms of tax / charges advertisements and their pros and cons. Finally using the synthesis of gained knowledge I will present the best tax promotion mix.

2 Local Charges

Local charges together with immovable property tax create a group of local taxes. I have created and previously published my own definition, that the local tax would be a financial levy, determined to the municipal budget that can be influenced (talking about tax base, tax rates or one of the correction elements) by the municipality. It is not crucial whether the taxpayer obtains from the municipality any consideration or if it is a regular or a single levy – local taxes include both taxes sensu stricto and fees (charges) (Radvan, 2016 Article: 74; Radvan, 2016 Taxes: 515).

The Local Charges Act (Act no. 565/1990 Sb., on Local Charges, as amended) provides for the power of municipalities to assess local charges by means of issuing their ordinances (bylaws). Such ordinances must specify the conditions for levying, the charge rate, the charge maturity and possible exemptions, if any. The ordinances may not exceed the limits defined by the Local Charges Act (such as, for example, the absolute charge rate and the types of charges permitted). Presently, the municipalities in the Czech Republic have the opportunity to levy only the following local charges (the list is complete, i.e. municipalities are not allowed to levy any other charges):

1. Dog charge;
2. Charge for spa and recreation stay;
3. Charge for using public places;
4. Charge on entrance;
5. Charge for housing capacity;
6. Charge on communal waste;
7. Charge for permission to enter selected places by motor vehicle;
8. Charge on appreciation of building land (Radvan, 2016 Article: 75–76).

3 Sanctions in Czech Tax Law

One of the ways to get taxpayers to pay their tax duties is to threaten them with sanctions. The penalties (sanctions) for non-compliance with tax law may be classified as administrative tax penalties, default interest, and criminal penalties (Moravec, Radvan, 2016).[2]

3.1 Administrative Tax Penalties

Both administrative tax penalties and default interest are defined in the Act no. 280/2009 Sb., Tax Procedural Code, as amended (Tax Code) (Mrkývka, Šramková, Neckář, Pařízková, Kyncl, Radvan, 2008). There are five main categories of administrative tax penalties:

1. Failure to meet non-pecuniary legal obligation penalties
   - fine for breach of confidentiality;

[2] The following parts 3.1–3.3 were published in more detail in Moravec, Radvan, 2016.

- disciplinary fine that may be imposed on a person who seriously complicates negotiations with the tax authorities, or disturbs order, or does not obey an instruction of a tax officer, or behaves offensively to a tax officer or any other subject involved in tax administration;
- fine for failures to meet non-pecuniary obligations that may be imposed on persons who fail to comply with the registration, notification or other reporting obligations, or who fail to comply with the record-keeping obligations established by the tax law or the tax administration. This fine is imposed on any person whose filings are made in a way other than electronically and if such behavior (non-electronic filing) seriously complicates tax administration, a further, higher fine can be imposed;

2. General non-cooperation penalties
   - disciplinary fine can be imposed on a person who seriously impedes or obstructs the tax administration;
3. Late tax return submission penalties
   - fine for late tax return submission;
4. Late payment penalties
   - late payment interest. The taxpayer is entitled to ask the tax administration for the remission of late payment interest if the tax has been paid. The tax administration may wholly or partially waive these interests;
5. Incorrectly self-assessed tax penalties
   - penalty calculated from the amount of additionally assessed tax. The taxpayer is entitled to ask for the remission of penalties if the tax has been paid. The tax administration is not bound by the application and, on the basis of assessing the extent of the cooperation of taxpayer, may waive up to 75 % of the penalty.

3.2 Default Interest

The provisions on default interest represent surcharges in a broader sense, but they do not represent sanctions. Their purpose is rather to absorb possible liquidity benefits and secure timely payments as well as the real value of tax claims across different time periods. Interest can be paid by both taxpayers (interest on a deferred amount) and tax administrators (interest on a refunded overpayment, interest on the unauthorized conduct of the tax

administration and interest on tax deduction). The taxpayer can ask the tax administration for the remission of interest on the deferred amount if the tax has been paid. These interests may be waived wholly or partially.

At the request of the taxpayer or ex officio, the tax administration may permit postponement of the tax payment or payment distribution in instalments. During the period of deferment of tax or approval of instalments, the taxpayer has an obligation to pay interest on the deferred amount.

3.3 Criminal sanctions

There are two main factors to criminal tax acts to be covered by the Act No. 40/2009 Sb. of the Criminal Code, as amended. To reach the classification of fraud as the criminal tax act, two main conditions must be met:

a) Only intentional offences can be classified as tax criminal acts;
b) The damage must be higher than approximately EUR 2,000.

Nevertheless, the amount of damage identified as the result of the previous tax proceedings cannot simply be taken over as the amount of damage for determining the criminal penalties. The repressive function is weakened in practice, as an active repentance can be applied in advance and, in case of withholding taxes, even in the period before the judgment of the criminal court is declared.

3.4 Special Sanctions for Local Charges

In case of local charges, penalties, interest and fines regulated by the Tax Code cannot be applied, with the exception of disciplinary fines. If the charge is not paid, the tax administrator – municipal office may increase the local charge up to three times.

The most problematic issue is that only disciplinary fines and no other fines can be imposed in local charges administration. Especially, failures to meet non-pecuniary obligations (taxpayers fail to comply with the registration, notification or other reporting obligations, or fail to comply with the record-keeping obligations established by the tax law or the tax administration) are quite often and cause insolvable problems. For example, if the taxpayer does not notify facts relevant for charge assessment (for example his dog has died) and the tax administrator does not have any doubts

about the real situation (the dog was not old), the charge is assessed and the tax assessment is sent to the taxpayer. If the taxpayer does not appeal, the charge must be paid. If not, enforcement proceedings start. Usually in this moment, the taxpayer starts arguing that the dog has died and there was no object to be taxed. He is right, but the tax office has no legal possibility to cancel the tax assessment. In my opinion, fines for failures to meet non-pecuniary obligations are disciplinary fines, according to their characteristics, but I am the only one who thinks so. For the future, the situation should be solved by the act amending some acts in the area of taxes. At the moment, this act is discussed in the Parliament and should come into force at the beginning of April 2017. The new regulation should state that in case of local charges, penalties, interest and fines regulated by the Tax Code cannot be applied, with the exception of disciplinary fines and fines for failures to meet non-pecuniary obligations.

4 Forms of charges advertisements

Impending sanctions could be the reason for the proper tax and charge payments. But primarily, the taxpayers must know they are the taxpayers, that they are obliged to pay a certain amount on a specific date, etc.

Like the classic commercial advertising, which can promote both a company or a specific product or service, it is possible to promote the tax administration as a whole (brand promotion), or the payment of a single tax (product promotion). For this decision, it is necessary to follow intended target: shall the advertisement inform, persuade, or remind? (Wikipedia, 2016 Reklama)

Informative advertising is used while implementing a new category of products. In the Czech Republic, it could be the promotion of electronic revenue registry. Persuasive advertising is used to create a selective demand for the brand and to convince consumers that they can get the highest quality for their money. In practice, this could be the promotion of the tax administration as a whole, which would mean eg. the application of the principles of good governance while dealing with clients (taxpayers), the ways how to deliver money to the administrator, the possibility of using electronic applications when completing and filing tax returns, etc., or the promotion of the state how effectively it spends collected taxes. Advertising to remind

is very important for mature products (ie. "classic taxes"), because it reminds consumers (ie. taxpayers) not to forget to pay taxes. In the area of taxes, such a promotion could be a commemoration of tax obligations before the expiry of the statutory time limits, specifically eg. the deadline for filing tax returns and paying taxes or local charges, for example on the communal waste. Especially in case of local charges. it is extremely important, as there are no statutory deadlines; each municipality defines the time limits in the municipal generally binding ordinance.

What are the advertising media to be used for tax promotion? **Television** advertising is expensive. Globally, advertising to pay taxes in national televisions is rare.[3] At the local level, more television commercials are available, especially on local televisions. It is, therefore evident that the particular local taxes / charges will be advertised on local television; in the Czech Republic mainly charges on communal waste. Similar opportunities are offered by cinemas and radios.

The disadvantage of radio and television advertising based on the fact that the viewer or listener cannot replay it, can be supplemented with the promotion on the **Internet**. It is important to realize and take advantage of the fact that videos on the Internet begin to live their own life: youtube.com will offer similar videos, it is possible to share videos and other communications via social networks like Facebook, Instagram, twitter etc., or via email. In this case, we are talking about viral marketing, which is free. The Czech Tax Administration has created comics "From the life of Daněk Krátil" (in English translation the names is Tax Evasioner). It brings some of the real stories of financial authorities, which have a common denominator in the form of tax evasion. The aim is to convince the reader that it is fair that everybody pays taxes.

The **print** advertising takes many forms. The most common is the promotion in newspapers and magazines, both using direct advertising and PR articles. They seem to me more convenient. It is possible to help journalists to prepare article informing about the deadline for filing tax returns and

3 Sweeden: http://www.tvspots.tv/video/40830/swedish-tax-board—or-you-can-pay-tax. India: https://www.youtube.com/watch?v=Dsu88o8ISMw, https://www.youtube.com/watch?v=yGYJ5bFMf0c, https://www.youtube.com/watch?v=Bg1LE-9IlN4. Philippines: https://www.youtube.com/watch?v=-GS0leuEFTM.

paying the tax. Information on local charges (on communal waste, on dogs, etc.) could be included in regional annexes to national newspapers. For the promotion of local charges and tax on immovable property, municipalities can use posters, billboards and other urban accessories (eg. benches). It might be interesting to use trams and buses, too. Leaflets with information regarding the local charge on communal waste can be posted directly in the city transport facilities. Almost every municipality publishes its local magazine. Besides information about the local charges, there can be a promotion of the property tax, too. I have never read (in this way) the information what the revenue of this tax was and how it was used in the village. It is really easy to clearly summarize the expenses of the village for public lighting, building and maintenance of roads, the city police, the fire brigade, the functioning of kindergartens and schools, the construction and maintenance of playgrounds, subsidies to local traffic, etc. Such activities of the municipality not only make the living more comfortable, but also increases the value of the taxed property. It is more than certain that municipalities are spending more money for these activities than is the property tax revenue; the difference can serve as an argument for introducing one of the factors increasing the property tax (most likely by the local coefficient).

In the case of **non-media** advertisement, it is possible to use product placement in movies and TV series, promotional items (a dog owner who paid the charge gets plastic bags on the excrement with the logo of the municipality), telemarketing, etc. The list of possible promotions is endless.

5 Conclusion

In the text, I have clarified the regulation in the area of sanctions in tax law, especially local taxes. Later, I have focused on local charges promotion. It is obvious that to get taxpayers to pay local charges, it is necessary to have an adequate and effective list of sanctions, if charges are not paid on time or in the correct amount. The new regulation, currently discussed in the Parliament, stating that fines for failures to meet non-pecuniary obligations should be applied for local charges, represents the right way how to make the sanction system more effective.

On the other hand, a positive motivation to pay taxes is conditio sine qua non to get the expected revenue. It is called carrot and stick method. I have presented several examples of good practice how to promote taxes and I have offered many new approaches. Definitely, the existing promotion of local charges in the Czech Republic is not adequate to get taxpayers to pay local charges, and thy hypothesis stated at the beginning was refused.

To conclude, it is evident that the only form of tax promotion is not appropriate: it is always necessary to consider different combinations of advertising media. Taxes must be perceived positively or at least less negatively. To achieve this status, it is necessary to properly operate mainly expenditure side of public budgets, ie. tax revenue must be spent economically, efficiently and effectively. If the expenditure side of public budgets fails, it is very difficult for the taxpayers to perceive taxes as an honor, as a positive. The State must be aware of the self-application of taxes: each taxpayer must calculate and pay his taxes by himself, using only the law (and in case of local charges even the bylaw), without any assistance of tax administrator. The best advertisement for the tax payment is a proper use of tax revenues. Tax revenues must be used in the public interest and there should not be any illegal or unethical misuse of public funds.

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PART 4
INTERNATIONAL FINANCIAL LAW

POLITICALLY EXPOSED PERSONS APPROACH IN EU FINANCIAL INSTITUTIONS: LEGAL FRAMES AND BUSINESS PRACTICE DIVERGENCE (POLISH CASE)

Jolanta Ciak, Rafał Płókarz[1]

Abstract

This contribution deals with the enhanced due diligence processes in the context of anti-money laundering policies, concerning politically exposed persons (PEPs) in EU private financial institutions. The main aim of the contribution is to indicate the inconsistency and loopholes of regulations in place, from a business practitioner's point of view. An example of a Polish financial intermediary applying Polish regulations concerning PEPs in analysed in detail. The scientific methods as description, analysis, comparison, and synthesis are used to achieve the aims.

As a conclusion, at the end of this contribution one may find a proposal *de lege ferenda* of the amendment of one section of Polish Anti-money Laundering Act of 2000. In the author's view, the current definition of a PEP in Polish regulations should be modified in order to make the enhanced due diligence procedure more consistent and effective.

Keywords: Politically Exposed Persons; Money Laundering; Enhanced Due Diligence; Financial Institutions

JEL Classification: G28, K42

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1 Introduction

Anti-money laundering (AML) processes play a crucial role in tackling bribery and corruption. This is of pivotal importance for politically exposed persons (PEPs) who are one the most vulnerable social groups in the context of financial crime prevention. However, the international (FATF; EU Directives) and national regulations implemented are often inconsistent or their application in daily business practice remains costly but ineffective.

The new global and European regulations implemented in the last years, an increasing the role played by supranational bodies and national regulators, have become for economic actors a real challenge and a burden at the same time.

The main aim of the contribution is to indicate the inconsistency and loopholes of regulations in place, from a business practitioner's point of view. Two examples of private financial institutions coming from two distinct EU jurisdictions are analysed, basing on the author's business practice. One of them is a Luxembourg bank. Another one is a Polish financial intermediary applying Polish regulations concerning PEPs. The scientific methods as description, analysis, comparison, and synthesis are used to achieve the aims.

As a conclusion, at the end of this contribution one may find a proposal *de lege ferenda* of the amendment of one section of Polish Anti-money Laundering Act of 2000. In the author's view, the current definition of a PEP in Polish regulations should be modified in order to make the enhanced due diligence procedure more consistent and effective.

Contrary to the importance of the analysed question, there are not many printed sources on PEPs and related issues. The author reached for the FATF and World Bank sources. The analysis of the European and Polish regulations in place: AML directive and Polish Act on AML was crucial. The remarks of AML inspectors interviewed for this circumstance were also crucial.[2]

2 The authors are grateful to Mr. Jakub Strysik, F-Trust company in-house lawyer, for his remarks on Polish AML system effectiveness and weaknesses.

2 Politically Exposed Persons (Peps): Definitions and Different Approaches

A politically exposed person (PEP) is defined by the Financial Action Task Force on Money Laundering (FATF) as an individual who is or has been entrusted with a prominent public function. The non-exhaustive list includes:

- Heads of state or of government, senior government members (e.g. ministers), senior politicians, members of parliament, high-ranking officers of armed forces, senior executives of state-owned enterprises, ambassadors, high level judicial bodies members, members of boards of central banks or of courts of auditors, and international sports committee members (FIFA…);
- Immediate family members: PEP's parents, children, spouses or partners, siblings, uncles and aunts, and in-laws;
- Known close associates (beneficial owners, business relations).

High-ranking members of local governments (e.g. mayors) may also be in-scope, but international definitions vary. Other famous people, like show business celebrities (actresses…), even influential ones, are not considered PEPs, but 'simply' prominent individuals.

Due to their position and influence, it is recognized that many PEPs are in positions that potentially can be abused for the purpose of committing money laundering offences and related predicate offences, including corruption and bribery, as well as conducting activities related to terrorist financing. The potential risks associated with PEPs justify the application of additional anti-money laundering or counter-terrorist financing preventive measures with respect to business relationships with PEPs.

To address these risks, FATF so-called "Recommendation 12" requires countries to ensure that financial institutions implement measures to prevent the misuse of the financial system and non-financial businesses and professions by PEPs, and to detect such potential abuse if and when it occurs (FATF Guidance, 2013: 5).

According to the Recommendation 12, all financial institutions have to have appropriate risk management systems to determine whether customers

or beneficial owners are foreign PEPs, or related or connected to a foreign PEP. In such a case a financial institution has to decide whether to do business with such a customer or not. Additional measures beyond standard customer due diligence are to be applied.

In order to tackle money laundering, corruption and terrorist financing, since February 2012 FATF has expanded the mandatory screening requirements to domestic PEPs and PEPs of international organizations. However, in such cases, financial institutions must 'only' take reasonable measures to determine whether a customer or beneficial owner is a domestic or international organization PEP, and if so, they should assess the risk of the business relationship. The enhanced risk mitigation measures must be applied only in the case of a higher risk business relationship with the domestic PEP.

In many countries (e.g.: the UK, Germany, Italy, Luxembourg, Poland, Italy, Lithuania, Ukraine) an enhanced due diligence procedure is required only for foreign PEPs, and not for domestic ones. In other jurisdictions (e.g.: France, Spain, Russia, Switzerland, Monaco) enhanced due diligence procedures apply to both foreign and domestic PEPs.

The list of financial entities covered by national legislations requiring to apply enhanced due diligence in their business relationships includes not only banks and other credit institutions, but all kinds of financial institutions: investment firms, financial advisors and managers, dealers, auditors, lawyers, insurers, stock exchanges, brokers, pawnshops, money exchangers, etc. The list content varies from one country to another.

The difference between a foreign PEP and a domestic PEP is the country which has entrusted the individual with a prominent public function. Other factors, such as the country of domicile or nationality are not relevant in determining the type of PEP, but may be relevant in determining the level of risk of a specific domestic PEP. A foreign PEP is always high risk that is why some countries (e.g. Poland) have chosen to screen foreign PEPs only, while domestic PEPs remain outside enhanced due diligence procedure.

Large financial institutions (banks etc.) perform enhanced due diligence with the use of sophisticated global and electronic databases. Updated

commercial databases give instant access to the watch list of foreign PEPs, sanction list, negative news etc. They assist a subscriber in safeguarding from bribery, corruption, money laundering and avoiding heavy penalties, but also decrease reputational risk. For instance, Dow Jones Watchlist (Factiva) or Lexis Diligence database comprise lists of nearly 1 million PEPs each.

Smaller financial institutions (brokerage houses etc.) can hardly afford global database subscription fees and often use simpler manual tools, mainly public media: newspapers, web browsers etc.

As of December 2016, the FATF has identified 10 high-risk and non-cooperative jurisdictions, mainly in Asia: Afghanistan, Bosnia and Herzegovina, the North Korea, Iran, Iraq, Laos, Syria, Uganda, Vanuatu, the Yemen.

3 European Union Legislation on PEPs in Place and Amendments in Sight

EU legislation on politically exposed persons remains in line with up-to-date FATF recommendations, it transposes and reflects their spirit and records.

The PEP definition and rules on enhanced due diligence have been introduced into the *acquis communautaire* on 24 August 2006 with the entry into force of the EU Commission Directive 2006/70/EC of 1 August 2006 laying down implementing measures for Directive 2005/60/EC of the European Parliament and of the Council as regards the definition of 'politically exposed person' and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis (OJ L 214/29, 04. 11. 2006).

The Directive had to be transposed in the Member States until 15 December 2007 at the latest. Directive expires on the 26 June 2017, amended by the Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, the so-called AMLD IV (OJ L 141/73, 05. 06. 2015). The AMLD IV was subsequently supplemented in late 2016 by the regulations containing the up-dated list of countries with deficiencies (Commission Delegated Regulation 2016/1675, 14. 07. 2016).

According to the new AMLD IV directive 2015/849, "politically exposed person" means a natural person who is or who has been entrusted with prominent public functions and includes the following:

- Heads of State, heads of government, ministers and deputy or assistant ministers;
- Members of parliament or of similar legislative bodies;
- Members of the governing bodies of political parties;
- Members of supreme courts, of constitutional courts or of other high-level judicial bodies, the decisions of which are not subject to further appeal, except in exceptional circumstances;
- Members of courts of auditors or of the boards of central banks;
- Ambassadors, chargés d'affaires and high-ranking officers in the armed forces;
- Members of the administrative, management or supervisory bodies of State-owned enterprises
- Directors, deputy directors and members of the board or equivalent function of an international organization.

Also, family members of the above listed, as well as the "persons known to be close associates" are in-scope. "Family member" means:

- The spouse, or a person considered to be equivalent to a spouse, of a politically exposed person;
- The children and their spouses, or persons considered to be equivalent to a spouse, of a politically exposed person;
- The parents of a politically exposed person.

"Persons known to be close associates" means:

- Natural persons who are known to have joint beneficial ownership of legal entities or legal arrangements, or any other close business relations, with a politically exposed person;
- Natural persons who have sole beneficial ownership of a legal entity or legal arrangement which is known to have been set up for the de facto benefit of a politically exposed person.

According to the Art. 20 of the AMLD IV, Member States shall, in addition to the customer due diligence measures, require obliged entities to:

- Have in place appropriate risk management systems, including risk-based procedures, to determine whether the customer or the beneficial owner of the customer is a politically exposed person;
- Apply the following measures in cases of business relationships with politically exposed persons:
  - obtain senior management's (not necessary a board of directors') approval for establishing or continuing business relationships with such persons;
  - take adequate measures to establish the source of wealth and source of funds that are involved in business relationships or transactions with such persons;
  - conduct enhanced ongoing monitoring of those business relationships.

Special measures should be taken in case of insurance products subscribed by or in favour of a PEP. Financial institutions will have to determine whether the beneficiaries of a life or other investment-related insurance policy and/or the beneficial owner of the beneficiary are PEPs, at the time of the payout or at the time of the assignment of the insurance policy at the latest. If there is a higher risk identified, senior management of the financial institution should be informed before payout and the financial institution should scrutinise the entire business relationship with the policyholder (AMLD IV, Art. 21).

Art. 22 of the AMLD IV Directive stipulates that a PEP should be treated as a PEP by obliged entities for at least 12 months after he/she is no longer entrusted with a prominent public function by a Member State or a third country.

The requirements relating to PEPs are of a preventive and not criminal nature, and should not stigmatise them as being involved in criminal activity. A financial institution should not refuse a business relationship only because of a PEP status.

4 PEP Business Practice – Case Studies of Selected European Financial Institutions

Every EU-domiciled financial institution has to comply with the latest PEP regulations in place, and specifically in full compliance with the European legislation.

Two selected EU-domiciled financial institutions which were subject to an analysis over PEPs implemented rules can be found below. Although they differ substantially as to their scope of activity, and as to their country of domiciliation, they were chosen because of the close professional relationship binding both entities with the author. Thus, some insider's remarks and conclusions might be made.

4.1 A Case of a Luxembourg Private Bank (Rothschild Bank)

Luxembourg is known for its high quality and well developed financial sector. The country has avoided with success the label of a tax haven inside the EU for many years, while at the same time hundreds of financial institutions continued aggressive tax optimization operations on behalf of foreign investors. Luxembourg's vast activity as one of the main global financial centres in the midst of the European Union was tolerated, even despite many offshore connections and tax evasion practices. Its ex-Prime Minister and for almost 20 years the Minister of Finance, Jean-Claude Juncker, has become the President of European Commission in 2014. Surprisingly, his reputation suffered only slightly, even after the 'LuxLeaks" financial scandal outbreak in November 2014[3].

While still being a member of Financial Action Task Force's (FATF), Luxembourg's definition of a PEP was for many years (since the AML "Law of 2004", and then „Law of 2010") inconsistent with the FATF definition. Not all public functions and even certain direct family members were covered. Moreover, the enhanced due diligence obligation with respect to the

3 International journalists' investigation has revealed that Luxembourg was for many years a place where tax avoidance was commonly in use by 340 worldwide corporations, with consent of the Luxembourg tax authorities. Surprisingly, the only guilty and convicted persons (in June 2016) were two French whistleblowers responsible for leaking 30,000 pages of documents from PricewaterhouseCoopers consultancy company, which itself was involved in tax avoidance schemes implementation during years 2002–2010.

PEPs applied only to non-residents of Luxembourg. The measures were not applicable to beneficial owners who were the PEPs. There were no obligations to obtain a senior management approval to continue a business cooperation with a client who had been granted the PEP status (Luxembourg. Anti-Money Laundering and Combating the Financing of Terrorism, 2010*)*.

The situation will change soon, after the implementation of the 4th AMLD – Directive (EU) 2015/849 in 2017. The definition of a PEP in Luxembourg will become more restrictive, and expanded in line with the FATF regulations. Comparing with the previous rules, the new PEP definition extends the enhanced customer due diligence measures also to domestic PEPs.

Edmond de Rothschild (Europe) is a Luxembourg-based subsidiary of the Swiss-based Edmond de Rothschild Group, a famous bankers' family private bank, devoted to the high-end private banking and asset management services for wealthy private individuals and institutions[4]. The Group Head of Legal and Compliance is one of the 11 members of the Executive Committee of the whole group, chaired since 2015 by the Baroness Arianne de Rothschild.

This prestigious bank not only has to respect all AML regulations but it also has to carry about its reputation of top private banking services provider.

A PEP definition covers people with public mandate and/or publicly known:

- Policy makers (former and still active), from the local level and above;
- Central and local government officers;
- Other celebrities: show business people, top managers of large corporations;
- Relatives and collaborators of all above mentioned people.

The compliance, AML and 'Know your customer' (KYC) procedures play very important role in the Luxembourg bank daily business. While introducing a new prospect into the bank, the relationship manager (RM) submits the 'Profile of account operator' paper form, where all sensitive data concerning the prospect, his/her background and origins of his/her wealth have to be disclosed. Then, the relationship manager submits the 'Profile' for

4 The co-author, Rafal Plókarz, was the senior-vice president of the Banque Privée Edmond de Rothschild (Luxembourg) in the years 2007–2009, a Member of the Management Committee, and the CEO of its Polish Representative Office in Warsaw.

approval to the Compliance Committee, and in the case of PEPs – to the Management Board as well.

The relationship manager's duty is to check whether the prospect is present in the available PEPs dataset. Beside commercial datasets, government-issued PEP-lists, in-house databases, free and open datasets with several thousand of names of PEPs from almost every country, like: https://namescan.io or http://everypolitician.org are also available. If the prospect is not present in the dataset, and at the same time the relationship manager is aware the prospect is actually a PEP, the RM's duty is to notify the Compliance Committee and the Management Board of the bank about this fact.

All kinds of PEPs are seen as risky clients, and the bank, while still caring for its reputation, pays a special attention to such a group of customers. The bank may even deny suspicious or too risky client – from bank's point of view – to open an account, even without giving any justification. A PEP label means for the bank a higher level of corruption risk and money laundering risk incurred, and as a result – a higher level of reputation risk, due to the possible administration of justice implications and media unrequested attention. That may have a negative impact on the bank's daily business, which relays on discretion and secrecy. Money loves silence.

After the Compliance Committee and – when it is necessary – the Management Board approvals, an account may be open. However, the 'Profile' has to be updated on a regular basis by the introducing relationship manager even afterwards, e.i. during the customer's servicing time, especially when the customer's situation changes.

4.2 A Case of a Polish Financial Intermediary Company: F-Trust S.A.

Until the fall of 2009, and several years of Polish economic and political transformation, there was no specific regulation in Poland concerning PEPs. The issue was introduced into the Polish Anti-Money Laundering Act of 2000 (Act on AML, Art. 2/1/f). But the PEP section (Art. 2/1/f) was introduced later, finally by the amendment of the 25 June 2009 of the AML Act (Act on AML, Art. 1). The latter has been in force only since the 22 October 2009. So, the PEP specific regulations in the context of AML have been in force in Poland for only few years now.

The Polish definition of a PEP is in line with the EU directive of 2006 definition described above. The Polish definition namely contains: high-ranked policy makers, businessmen, diplomats etc., their family members and their close associates. However, the measures apply to persons having their domicile abroad only. So, any foreign PEP gets in scope. Even Polish ambassadors living abroad are treated as foreign PEPs and thus in scope of PEP regulations in place. Unfortunately, domestic PEPs stay out of scope from customer enhanced due diligence procedures as they remain subject to the 'standard' domestic AML treatment.

The case of a medium-sized financial company, F-Trust S.A is analysed below. It is a subsidiary of the Warsaw Stock-Exchange listed financial holding company, Caspar Asset Management brokerage house, one of the leading asset management companies in Poland[5]. F-Trust itself is a leading investment funds distribution company on the Polish market. Its product offer ranges over a thousand Polish and foreign investment funds, and other financial products, like unit-link insurance policies, asset management services, private pension funds etc. Company serves ca. 500 customers, mainly private, wealthy individuals.

According to its internal AML procedures, which are in line with the current legislation in place, F-Trust company with regard to the PEPs:

- Applies adequate measures to establish the sources of wealth that are involved in business relationships;
- Conducts enhanced ongoing monitoring of business transactions;
- Obtains Anti-Money Laundering (AML) Inspector's approval for the first subscription of investment funds by a PEP.

A PEP customer has to disclose sources of wealth invested with the company.

The company obtains written declarations of its foreign customers confirming their PEP's legal status. This is to be applied under criminal responsibility for any undisclosed or false information. Furthermore, the company verifies submitted declarations with other available and credible sources, e.g. public media.

5 Since 2013, the co-author, Rafal Plókarz, has been the Member of the Supervisory Board of the analysed company, as well as (since 2009) of its parent company, Caspar Asset Management brokerage house. He holds the position of the member of Compliance Committee of the latter as well.

The above obligation is binding only to PEPs domiciled outside the Republic of Poland. Domestic PEPs are out of scope of these obligations.

F-Trust is a medium sized financial intermediary. It does not use sophisticated global PEP databases to screen new prospects in scope. The company applies a less costly a manual approach and a case-by-case individual declaration system of verification. In practice, among a few hundred Polish customers, there have been only few foreign PEPs cases, as the company testifies.

5 Systemic Loopholes and Bridging the Gap: Example of the Polish Market

Implementing PEP regulations, and – in general – all AML rules is a process full of systemic loopholes. The Polish market example is in this context typical to some extent among other countries. This is analysed below.

The PEP screening hugely relies on the customer's declaration approach. As a result, the process is full of loopholes. A customer declares the origins of his/her wealth, and his/her business activity. A company AML inspector should verify all the information provided. However, an inspector's capability to conduct a deep inquiry remains very limited. Hence, the AML system stays leaky.

Two important issues arise:

- AML (and PEP) processes are very costly: large teams of high and well paid AML professionals need to be put in place. In large corporations entire AML departments have to be set-up and then maintained. Are these expenditures worthy spending? In reality, this is a simple burden shift: a public authority duty becomes a private sector one. The burden lies on the business side. This renders the daily business more difficult to be run. Regulatory constraints have become more and more tight in the last years, as FATCA and CRS[6] show;

6 FATCA – Foreign Account Tax Compliance Act, is a USA law, binding also outside USA. It requires all non-US financial institutions (e.g.: Polish banks – since the 1 December 2016), under penalty of high US withholding tax on US incomes, to provide US tax administration (IRS) with the data on accounts and assets held by wealthy US residents, with such a foreign financial institution. CRS – Common Reporting Standard, is a OECD global equivalent for FATCA.

- PEPs and other people willing to launder money (e.g. doctors), finally will succeed in doing so, while honest investors, making proper declaration, will suffer inconveniences.

The PEP regulations have been implemented in European Union, including Poland, due to higher risks associated with politicians. Namely, the corruption risk is higher within this social group because of its increased exposition to many interests and lobbies, not only legal ones. While they need to remain transparent and clear, the execution is often hard to achieve.

PEP's status consists of two criteria to be met:

- Subjective parameter;
- Domiciliation parameter.

5.1 Subjective parameter

According to the subjective (or personal) parameter, a PEP status is given to customers, but based on their (high) social position, public office run, and even family or social relations. However, practically, it is hard for an AML inspector to verify and to deny the customer's declaration credibility, especially when she/he comes from an exotic jurisdiction. The example of an investor from India, who is a judge, thus a PEP, and wants to invest in Poland, may pose such a problem.

Verification becomes even more complicated, because it should be performed before an investor's order gets executed. And on the financial markets time means money – any delay may be very costly, for the investor as well as for the broker.

Another problem for an AML inspector may arise while deciding how to verify whether an inspected person stays in close business or professional relationship with a PEP, or not. When does such a cooperation arise? Does renting a house or providing legal advice fulfill the definition? Institutions concerned (banks etc.) may investigate exhaustively and continuously the state of affairs, which could have an impact on the PEP's status. Moreover, an institution concerned will never be sure whether its obligations are fulfilled completely. Thus, it will be vulnerable to possible sanctions and penalties from the public authorities.

5.2 Domiciliation Parameter

In Poland, as in many other countries before the AML IV adoption, the PEP definition is limited to investors having their residency outside Poland. Other politicians, celebrities and their relatives, especially Polish citizens, are out-of-scope of PEP regulations in force in Poland. It is weakly justifiable, knowing that Poland is not a corruption-free country. Why, for instance, is a Scandinavian PEP, treated in a more restrictive way by Polish authorities and regulations than his counterpart living in a small Polish village? Is this discrimination compliant with the Polish Constitution? This distinction is not made for the citizenship or nationality, but for domiciliation! As a result, all Polish policy makers, government and self-government officials, judges, ambassadors etc. – remain out of scope, just because they are not PEPs in the sense of the Polish PEP definition. Unless, they live abroad…

That approach – from the legal, but also from logical point of view – seems to be doubtful, through its quite absurd distinction or even discrimination. To grant the PEP status to all Polish politicians, judges, government officials etc., regardless their place of residence would be much more reasonable and justifiable. Also foreign PEPs might be covered by the Polish PEP regulations, but – for screening effectiveness constraints – the latter solution could be limited, for instance – to those foreigners having "strong" connections with Poland, e.g.: residence; professional activity, family in Poland, etc. The Polish tax residence definition for non-residents also could apply.

Today's approach, where concerned financial institutions in Poland have to analyze, by definition – only superficially – the professional and political situation of foreign PEPs, while leaving behind unscreened all domestic PEPs, seems to be at least ineffective and unfair, not to use stronger words.

This narrow kind of approach has been criticized for many years also by supranational institutions, including World Bank, which recommends, among others: to apply enhanced due diligence to all PEPs, foreign and domestic, to require a declaration of beneficial ownership, and to review periodically PEP customers (Greenberg, 2010: XV-XVIII).

Consequently, for the better tackling money laundering among public officials in Poland (as in other countries), the authors would suggest a *de lege ferenda* proposal, to amend the section 2 1f) of the Polish Anti-money Laundering and Terrorism Financing Act of 16 November 2000. Namely, the final paragraph: "(…) *having residence outside the territory of the Republic of Poland*" should be removed or replaced by a phrase: "(…) *being Polish citizens, or having close business, professional, social or material relationships in Poland*". Also the notion of beneficial ownership should be clarified, in line with newest FATF definition.

The refining of the PEP definition could help Polish financial institutions to better screen their PEP-type clients and to insure more efficient AML process.

6 Conclusion

The main aim of the contribution was to indicate the inconsistency and loopholes of regulations on politically exposed persons (PEPs) in the context of anti-money laundering policy. The point of view of a EU business practitioner was applied.

As the analysed case of the Polish financial intermediary F-Trust has shown, the PEP regulations still need to be more consistent and more complete. The current approach is leaky and inefficient. At the same time the enhanced due diligence for PEP is costly and time consuming, for both large and smaller financial intermediaries. Thereby, it burdens business activity, and finally is harmful for consumers, investors, and the economy in general.

The new regulations to be implemented in Member States in the first half of 2017, namely the AMLD IV Directive, should improve the situation and boost the fight against money laundering, also among PEPs. Hopefully, the definition of a PEP, also in the Polish law, will change and the screening process will become more accurate.[7]

7 As of the beginning of the year 2017, no legislative initiative has been introduced yet by the Polish Parliament, in order to implement AMLD IV Directive into the Polish legal system. Otherwise, only two EU member states (France and Czech Republic) have started national transposition process.

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TAX LAW MANAGEMENT OF TAX RISK INCURRED BY INTERNATIONAL HOLDING COMPANIES

Dominik J. Gajewski[1]

Abstract

Nowadays appropriate risk management is assuming an increasingly profound significance within the framework of the strategies of development and operation of individual companies. Tax risk management has been particularly important. Tax risk management is of key importance for international holding companies that often have a complex organisational structure. The character of the presented factors shaping tax risk management systems is special owing to the nature of cross-border activity of holding structures. The tax risk faced by international holding companies is considerably influenced by the phenomenon of aggressive tax optimisation. The aim of the article is to analyse these issues.

Keywords: Management of Tax Risk; CIT; Holding; Corporate Tax.

JEL Classification: H34

1 Introduction

International holding companies have come to play a crucial role in the economic reality over the past decade. Insomuch that to a large extent the world economy is based on the real cross-border operation of international holding companies. One should bear in mind that in times of increasingly significant globalism, the role of cross-border settlements will continue to gain importance.

The fiscal policy is of key importance for the development strategy of each and every international holding company. Such a policy is long-term and of a strategic character. This results not only from the fact that tax burdens borne by international holding companies largely contribute to the total expense of the whole organizational structure but the amount of the

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expense also creates a direct impact on the competitive position. The fiscal policy of international holding companies is complicated and thus entails substantial risk.

The issue of tax risk involved in holding structures is of quite a specific significance. It is connected with the fact that a holding company includes many capital companies whose residence for tax purposes is located in various states. This means that assessment of risk will vary due to the fact that it will be performed through the prism of various tax legislations. There may even be various discrepancies within the holding structures operating on the territory of the European Union. The issue is further complicated when it comes to the assessment of tax risk incurred by international companies conducting cross-border activity outside the European Union (Lazonick, O'Sullivan, 2000: 978–992). The nature of international holding companies causes the tax risk involved in their business activity to be particularly substantial. Therefore, the issue and analysis of tax risk faced by international holding companies are quite specific and complex. It is very difficult to apply a single model of tax risk assessment with respect to holding companies conducting cross-border activity since the ownership structure of holding companies and the complexity of various tax residences of individual subsidiaries are of crucial importance. It is, therefore difficult to find two holding structures with an identical configuration and thus create a uniform model of tax risk assessment.

The scientific methods as description, analysis, comparison, and synthesis are used to achieve the aims of the contribution.

2 Management of Tax Risk versus International Holding Companies

Against the background of the complexity of the issue of tax risk incurred by international holding companies, the phenomenon of tax risk management in international holding companies is an interesting issue. First of all, the topic is considerably novel since analyses of tax risk management, which have been carried out so far, were only concerned with uniform entities operating within a single residence for tax purposes. Moreover, appropriate analysis of tax risk management by international holding companies

requires comprehensive knowledge on tax law applicable to international holding companies. It is particularly difficult due to the fact that in times of globalisation, tax policies of holding companies have been dominated by the phenomenon of tax optimisation (Adamska, 2009: 67–69). It is hard to continue to claim today that the policies of holding companies are based on classic – allowed within the boundaries of the law – tax optimisation as holding companies have started to adopt highly advanced tax engineering on a grand scale. In consequence, tax risk management becomes immensely complicated.

While undertaking analysis of tax risk management in holding companies conducting cross-border activity, it should be clearly stated that one is in fact dealing with international tax risk management. In order to discuss management of international tax risk, one must be aware that several or even over a dozen tax risks are managed: risks incurred by the parent company and the subsidiaries. The number of tax risks is dependent on the structure of a holding company (whether it is a pyramid or a flat structure) (Gajewski, 2012: 56–61; Stecki, 1999: 45–49). Only thorough analysis (identification and assessment) of tax risk faced by individual entities is management of the tax risk incurred by the whole structure possible.

3 Tax Risk Management in the Context of Tax Optimisation

International tax risk management in holding companies plays the key (strategic) role with regard to comprehensive management of tax risk incurred by holding companies. Especially considering the fact that tax optimisation of holding companies is not adjusted to economic and organizational activity of international holding companies but quite the opposite – it is the economic activity that gets "adjusted" to long-term international tax optimisation of holding companies. The reality of profit on international tax optimisation is that it may often be considerably higher than potential profit on business activities.

In times of aggressive international competition, no holding company may afford its tax strategy not to include optimisation mechanisms. Of course, the extent of tax optimisation may be very different – starting from aggressive (in principle prohibited by tax law) methods, through hybrid

constructions (which are evaluated in different ways from the perspective of legality – depending through the prism of which branch of the law the legality is evaluated), to the so called soft optimisation (referred to as legal optimisation). If one takes a look at the various methods of optimisation available to international holding companies, it is visible that tax risk may be considerably varied and thus management of such risk may turn out to be dramatically different. As a result, assessment of tax risk will be carried out on a very individual basis and with the use of various instruments; consequently, management of such risk may be based on tremendously varied parameters.

4 Factors Shaping Tax Risk Incurred by International Holding Companies

The theory of risk management states that its main pillar is peoples' knowledge, procedures, and appropriately implemented IT systems (Nadolska, 2012: 2–3). It is assessed that there are several most significant factors that cause tax risk and appropriate management of that risk to begin to play a strategic role in a comprehensive approach of the business world to economic risk. First of all – it is the imperfection of the human resources that a company possesses. The issue is of particular relevance for tax risk management. It must, however, be studied in two ways: from the perspective of qualifications of the employees of an international holding company as well as from the perspective of qualifications of the employees of fiscal authorities controlling holding companies. Evaluating the qualifications of employees of holding companies, the relationship between agreements concluded on a cross-border basis, which make use of numerous financial instruments, and the tax consequences that arise from these agreements should undergo analysis. Assuming that a holding company does not pursue an aggressive policy of tax optimisation and thus it is the company's priority to enter into an agreement giving rise to the most beneficial financial consequences (profit), lack of tax-related knowledge of people who negotiate and conclude agreements may be a threat. One should remember that it is not popular for holding companies to have the positions of directors/experts dealing with tax strategies and if they do have such positions, the people who hold them frequently do not take part in negotiations of contracts.

In consequence, they are often placed before an accomplished fact – they must tax the transaction in a manner that is adverse for the interests of the holding structure. It must thus be stated that lack of qualified staff (which does not participate in the decision-making process) results in the emergence of serious tax risk.

The qualifications held by the employees of tax authorities that exercise control over a holding company are of immense importance for tax risk management as well. Depending on how complicated a tax strategy an international holding company implements, the tax risk is diversified. Tax strategies designed by international holding companies are based on the application of manifold and complex financial instruments. These are often solutions that are absolutely novel in character and have not yet been taken into account in the currently applicable tax legislation and the employees conducting fiscal audit fail to "notice" them. Furthermore, such constructions are based on economic and accounting solutions, while the audit staff frequently has no economic background in terms of financial instruments.

The complexity of tax strategies followed by international holding companies is also a consequence of the fact that they are based on various tax jurisdictions. And so if a holding structure consists of several entities operating in different states – the domestic tax legislations of all the entities forming the structure are applicable. Frequently, holding structures conduct activities in more than a dozen states. What is more, a tax strategy of an international holding company is also based on European tax law which is, in particular, applicable to the structures operating on the territory of the European Union. Finally, strategies of international holding companies often make use of solutions derived from international tax law. The nature of international tax law originates from international agreements on avoidance of double taxation (Soloveva, 2015). Each state has entered into several dozens or hundreds of such agreements. Since international holding companies devise complicated tax strategies, they often take advantage of at least several dozens of international agreements and sometimes more. Taking into consideration the fact that a tax strategy of an international holding company is developed based on a cascade of various and comprehensive tax regulations – the issue should be considered immensely complicated and thus extensive and

specialist knowledge and experience is required to examine it (Gajewski, 2012: 118–120). It should also be noted that strategies which are complicated to such a great extent are often worked out by highly specialized teams of advisers from individual states forming the holding company.

Analysing such a nature of tax strategies followed by international holding companies, it should be acknowledged that they entail large tax risks arising from the level of the relevant knowledge of the fiscal audit staff. For it is hardly possible that the audit team (usually composed of two members) would be capable of digesting such voluminous material and handling its complexity. This poses serious risk of committing errors of assessment of the material under examination. One must be aware of the fact that essentially no body responsible for fiscal audit in the world is adequately prepared to assess so immensely specialised material. To make matters worse, the fact that tax procedures in individual states are limited in terms of the periods in which audit can be carried out is a serious aggravation. Finally, it is appropriate to note that documentation brought under control is very often drawn up in several languages due to the fact that a holding company is composed of entities having registered offices in various states. Translation definitely affects the time necessary to assess the material by the control authority as well as accuracy of assessment. In consequence, there is potential risk of making a mistake which would directly affect an international holding company – especially if tax a decision assessing the sanction, which is adverse for the holding company, is announced and thus the appeal process commences and next legal-administrative proceedings are instituted. All these factors influence the necessity to appropriately manage tax risk.

5 European Tax Regulations as One of the Key Factors Shaping Risk

Undoubtedly, another very important factor having impact on the necessity to appropriately manage tax risk is the high volatility of tax regulations, sanctions for breaching the provisions of substantive and procedural tax law as well as the phenomenon of fiscalization which is – currently – being endorsed by many states. This is of particular relevance and importance for international holding companies.

It may be clearly ascertained that the European Commission does not have a uniform and coherent idea for taxation of international holding structures. Such a claim may be supported by the fact that the CCCTB concept regarding a Common Consolidated Corporate Tax Base is highly unlikely to achieve the status of an applicable directive. Despite over a dozen years of expert work on the concept in the EC, it has developed into a solution that not only does not harmonize or facilitate (simplify) taxation of international holding companies in the European Union, but peculiarly it has also become the perfect solution for adoption of aggressive tax optimisation (Gajewski, 2012: 187–190). Consequently, many Member States have started to protest against this draft directive (including Poland).

Indubitably, the threats arising from the implementation of the CCCTB concept could have a major influence on tax risk faced by international holding companies. The most serious doubts concerning the CCCTB concept are as follows:

1. Further breaching of the principle of tax neutrality;

The existing means of tax avoidance and evasion would be sustained and new ones would be created as well;

2. The difficulties in comparing tax burdens imposed in individual Member States would not be eliminated and might even become more severe;
3. Tax barriers to cross-border business activity would not be eradicated completely or new barriers could emerge (e.g. the problems related to transfer pricing would not be fully eliminated and in addition new problems regarding the formulary apportionment would be introduced);
4. Numerous threats arising from apportionment in accordance with the formula would emerge (as the method is of a novel character) (Mintz, Martens-Weiner, 2003: 6);
5. Many negative phenomena and dangers would be brought about by the implementation of the CCCTB concept within the framework of enhanced cooperation.

6 Concepts Harmonizing Tax Law Applicable to Holding Companies as the Chance for Reducing Tax Risk

Other concepts aimed at harmonisation and simplification of tax law applicable to holding companies have not produced the expected effect either, i.e.:

- The European Union Corporate Income Tax (EUCIT) is a certain alternative to the national systems of taxation of holding structures. The EUCIT concept should be applicable exclusively to international entities. Within the framework of this concept, tax is imposed on the level of the EU on entities conducting cross-border business activity. This means that it would be revenue to the EU budget at least in some part, which would make it a European tax (Lang, Domes, 2007: 61–63);
- The concept of a Compulsory Harmonised Single Tax Base (CHSTB) consists in replacing the national systems of taxation of holding companies in the EU with the CHSTB concept. The national system in each Member State is superseded by a uniform tax mechanism, i.e. the CHSTB. Its personal scope of application encompasses all the previously included taxpayers of corporate income tax, both entities conducting cross-border activity and the ones running domestic businesses. The CHSTB concept is not an alternative for the national tax systems but it is – by definition – supposed to be a replacement. Owing to the CHSTB, tax authorities of all the Member States and their taxpayers would be using a single – the same – tax system dedicated to holding companies (Hellerstein, 2011: 105);
- The character of Home State Taxation (HST) is special as is assumes that both income generated by foreign subsidiaries and foreign establishments would be taxed in line with common rules consistent with the tax regulations applicable in the home state. A home state would be considered the country of residence of the parent company. A host state would be the country of residence for tax purposes of the subsidiary or the country where the permanent establishment is situated, as appropriate. An HST Group (Home State Group) would be composed of affiliated companies and their permanent establishments (Andersson, 2008: 14; Herzig, 2008: 551; Spengel, 2007: 6);

- Spontaneous harmonisation of Member States comes down to Member States making such changes in their tax systems on their own initiative that they become at least partially harmonised. Spontaneous harmonisation may be a consequence of tax competition among Member States that single-handedly take actions aimed at adjusting the tax law. Such adjusting measures serving to make the tax system more attractive are concerned with the tax areas that have not been subject to harmonisation. As a result of spontaneous harmonisation, changes are predominantly made to tax solutions that preserve inequalities in terms of taxation, which are the source of disturbances to the operation of the internal market. The phenomenon of spontaneous harmonisation of Member States intensified in the EU at the beginning of the nineties of the previous century and has been building up over the following years (Cerioni, 2006: 32);
- Harmonisation though the back door of the CJEU consists in responding to the decisions of the CJEU (Court of Justice of the European Union) by adopting similar solutions in national tax systems. However, the fact that Member States introduce certain changes to their tax systems in reaction to the decisions by the CJEU is not quite a spontaneous response but rather a sign of "reason". If they did not take such actions, they would have to take into account the possibility that an analogous decision concerning their tax regulations might be reached in the future. This is connected with the operations of the CJEU that in accordance with Art. 220 of the TEC is the guardian for interpreting and applying this Treaty (Grabowski, 2005: 4–5).

It should be clearly stated that all the proposed concepts were not faultless, which would certainly impinge upon tax risk incurred by international holding companies by making it higher. Undoubtedly, creation of harmonized tax law applicable to holding companies would allow to efficiently manage tax risk faced by international holding companies.

Currently, the European Commission has no consistent idea for standardisation of tax law applicable to holding companies, which is a serious problem affecting tax risk management by international holding companies. Due to the fact there are no comprehensive tax solutions designed for international holding companies, individual Member States are forced to regulate

taxation of such holding companies with their own domestic provisions of the law. It must be stated that each Member State adopts a completely different concept for taxation of holding companies, which is a serious problem for international structures and exerts a direct influence over tax risk management.

It must simultaneously be acknowledged that the majority of states (including European Union Member States) have not created tax law specifically designed for holding companies within their internal legislation, which would clearly regulate taxation of international holding companies. This would lead to holding companies devising tax strategies that could be based on stable legislation devoid of legal loopholes. It should also be stated that creation of modern tax law applicable to holding companies would lead to the lack of the necessity for numerous interpretations which contribute to the increase of tax risk.

7 Other Factors Influencing Tax Risk Management in International Holding Companies

Tax risk management is also affected by the global tendency to pursue aggressive tax optimisation. Due to the fact that a significant part of international holding companies makes active use of the instruments of aggressive tax optimisation, Member States have embarked on countering these illegal practices. This has been manifested with stricter control procedures with regard to all international holding companies. This has certainly led to a considerable increase in tax risk, which also influences its management. It should be clearly highlighted that a large part of holding companies running international activities but not adopting aggressive optimisation measures is severely affected by the consequences of such a policy pursued by fiscal authorities though it should not be directed at them.

An important pillar of any tax risk management system is also appropriate implementation of an IT system. The growing tendencies to seek innovative and more modern methods of operation on the market (and thus the necessity to adopt increasingly risky solutions or launch such business operations as part of building a competitive advantage) exert impact on the situation that international holding companies are faced with.

Operation within specialised IT systems by way of adopting more and more modern and simultaneously increasingly complicated IT systems (for accounting and taxation) also influences tax risk management exercised by international holding companies (Nadolska, 2012: 2–3).

An important factor posing tax risk is inappropriate implementation of an IT system. This factor is currently gaining in importance due to an increasing number and variety of transactions made by international holding companies as well as the requirements for documentation and record keeping imposed by domestic and international tax regulations.

Very frequently the existing irregularities in the IT system, concerning tax settlements, are manifested by, among other things: lack of simple access to tax databases, lack of application of optimal system features, or lack of appropriate preparation and training of employees in terms of operation of the IT system (Nadolska, 2012: 2–3; Wyszkowski, 2011: 38). Taking into consideration the nature and transnational dimension of holding companies, the shortages under examination mainly lead to the emergence of the necessity to make "manual" arrangements, which consequently prolongs the time of verification of data and makes it impossible to immediately detect possible errors.

8 Conclusions

It should be stated that effective implementation (understood as a continuous process) of tax risk management by international holding companies not only offers a chance to secure the tax position of the whole structure and identify the risks and potential areas for tax optimisation but should also be considered a business tool for conscious formulation of a long-term fiscal policy of the whole international holding company.

International holding companies are keenly aware of tax risks, however, management of these risks should undergo further modification and perfection. An insufficient number of tax risk management systems for international holding companies is still observable.

In conclusion, it should be acknowledged that each international holding company should strive to raise the standards of tax risk management. Awareness that a tax risk management system should be a priority for an international holding company should be fostered as well.

The state that shapes the legal and tax-related environment also exerts substantial influence over tax risk management. The tax-related nature of operation of international holding companies is immensely complicated and requires special skills and profound knowledge. Lack of harmonisation of tax law applicable to holding companies is particularly threatening and increases tax risk faced by international holding companies

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EU FINANCIAL MARKET LAW: FROM MINIMAL HARMONIZATION TO FEDERALIZATION

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Abstract

The development of European Union financial market law has been a journey towards federalization. This contribution discusses problems of harmonization and regulation of the European internal financial market. In the aftermath of the financial crisis, financial market regulation has been one of the fastest growing areas of EU law.

The main aim of the contribution is to present key phases in the evolution of EU financial market law. Following the financial crisis, the most significant change in the development of the law has been the trend towards federalization.

Keywords: Financial Market Law; Safety Net; Financial Crisis; Financial Supervision.

JEL Classification: F36, G18, G21

1 Introduction

Financial market regulation can only be understood on the background of the reactive nature of regulation. It develops in response to the crisis or scandal (Andenas, 2011:4).

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The global crisis has led to a general acknowledgement of the importance of financial stability and mitigating systemic risk as policy goals at EU level.[2] The financial stability and safety of financial market are currently acknowledged as the core aims of financial market regulation and supervision.[3]

Until the outbreak of the financial crisis of 2008, the EU regulations of the financial market had been based on the minimum harmonisation principle, meaning that only the most essential standards relating to the taking up and pursuit of the business of financial institutions were subject to harmonisation at EU level through directives.

Whilst earlier emphasis was placed mostly on deregulation, implementation of single market freedoms and creation of financial integration, the need to avoid systemic risk and safeguard market stability now feature more prominently in the objective of policy making. In the aftermath of the recent financial crisis systemic stability has become the most important aim of financial market law.[4] Post-crisis policy-making has adopted the regulatory objective of financial stability at EU level in order to inform legal reforms that would take a pan-European perspective and approach to managing financial stability under the conditions of market integration.

The process of europeanization of domestic market regulation has created problems to both national authorities and to institutions and markets that have an European dimension in their activities (Bache, Jordan, 2006: 30;

2 Generally, the term financial stability is used to denote a situation in which the financial system runs smoothly, its functions being performed without disruptions. Used in that meaning, financial stability is quite commonly defined "negatively" as the lack of a financial crisis, but also as a situation in which no systemic risk is present (i.e. a situation in which a crisis existing in one country or region directly triggers a financial system instability in other country or region, or even gains an international dimension). In Regulation (EU) No 1092/2010, systemic risk is defined as 'a risk of disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy, [whereby] all types of financial intermediaries, markets and infrastructure may be potentially systemically important to some degree'.

3 Many Authors use terms „regulation" and „supervision" interchangeably. However, they are conceptually different. Unlike regulation has to do with rule-making and its concrete outcome, supervision refers to the monitoring and enforcement of the rules resulting from the regulatory process.

4 The term 'financial market law' is used to refer to banking regulation, insurance, and capital market (securities) law.

Bulmer, 2007: 46–58).[5] The post-crisis legal framework of EU financial market increases regulatory agency power and changed the balance of powers between EU and national authorities. Moreover the Banking Union establishes a centralized framework for the supervision and resolution of credit institutions. It means a firm step towards the federalization of financial market law.

2 Harmonisation of Banking, Insurance and Securities Law: Legal integration of the EU Single Financial Market

The internal market has been at heart of the European integration project from the beginning. The objective of the 1957 Treaty of Rome was the transformation of highly segmented national markets into a single common market. The creation of the single market has been conducive to massive deregulation of the financial markets in all the EU countries and to very rapid growth in this area.

When the integration moved from the original common market model to single market it did take a step towards the home country model and away from the harmonized model. Financial market integration has resulted in increasing levels of cross-border financial activities, which could give rise to issues of supervisory efficiency and crisis management in case of cross-border spillover crisis effects (Schoenmaker, Oosterloo, 2005:1). The evolution of EU financial regulation is often described as having different phases, each with its own characteristics, agendas and specific circumstances (Tridimas, 2011: 783–804; Lastra 2015: 386–390).

The establishing of the single financial market has encountered problems of two kinds (Andenas, 2011: 12). The first is that market integration has not been very effective – the markets are still divided by national protective borders. The second is that the financial market integration renders national regulators less effective, so financial markets are becoming markets without state.

In the European Economic Community, financial market regulation has been dealt with since the 1970. The EEC issued a directive, as its main tool

5 In the literature Europeanization is understood as *the reorientation or reshaping of politics in the domestic arena in ways that reflect policies, practices or preferences advanced through the EU system of governance*. But this expression has also a wide and dynamic meaning: as a process of creating a common legal sphere in Europe and a common legal culture. Therefore the legal systems affected by the Europeanization are not only 'law - takers' but also 'law - givers'.

to accomplish the integration, requiring the Member States to transpose the EU law in to their national legal systems. Community legislation focused on harmonizing license requirements for the providing financial services. During the 1980 s, further progress was achieved in banking and insurance where a second generation of directives adopted the principle of mutual recognition and home country control according to which each Member States will accept the regulation and supervision enforced by other Member States on their domestic financial institution (credit institution, insurance firm) operating abroad. It helped to adopt the single license principle that financial institutions authorised in their home Member States should be allowed to perform throughout the European Union any or all of the activities referred to in the list of financial activities subject to mutual recognition by establishing branches or by providing services, provided that such activities are covered by the authorisation.

The 1992 Maastricht Treaty on European Union has confirmed the Single Market program. The main obstacle to the integration of the EU financial services sector was however the lack of a single currency, which was officially introduced in 1999. European financial (banking, insurance, securities) markets are not only affected by the creation of the single market, but also by the creation of the single currency.

In the end of the 1990 s financial services law become the top of the political agenda.

3 The Financial Services Action Plan, the Lamfalussy Framework and Post-FSAP Agenda on Financial Services Policy

Legal integration in financial regulation at EU level has proceeded at an accelerated pace since the Financial Services Action Plan (1999) and the establishment of the Lamfalussy framework (2002) to provide for fast-tracked single financial market legislation.

The Financial Services Action Plan (FSAP) was a blueprint of the issues that needed to be harmonized in order to complete the single market in financial services and ensure the full integration of banking and capital markets by the year 2005. It contained 42 legislation act designed to harmonise the member

states' rules on securities, banking, insurance, mortgages, pensions and all other forms of financial services within the European Union. By the end of 2004, almost all of these measures have been adopted (Schweigl, 2015).

The action plan for a single financial market marked a new era of strong EU presence in financial market law (Tridimas, 2011: 785). It put forward indicative priorities and a timetable for develop the legislative and non-legislative achieve four strategic objectives: a single EU wholesale market, open and secure retail banking and insurance markets, the development of prudential rules and supervision, and optimal wider conditions (essential fiscal rules) for an optimal single financial market.

The principles of mutual recognition and home country control formed the pivotal integration paradigm in financial market law area (Tridimas, 2011: 783). Nevertheless, the FSAP has been viewed more as *sui generis*, independent regulatory system than a – 'home Member State control' and mutual recognition based – integration device, which produces a regulatory framework only as a by-product of minimum harmonization (Moloney, 2003:812).

The FSAP was accompanied by the new model for the adoption of financial market rules which came from the proposals from the Lamfalussy Committee based on Final Report of the Committee of Wise Men on the Regulation of the European Securities Markets (Quaglia, 2007:269). The Lamfalussy process advanced a new regulatory model which has provided for a higher degree of harmonization and greater Community presence in the field of enforcement (Tridimas, 2011:783).

The Lamfalussy framework was designed to structure the coordination between the Member States and their connection to the legislative process on the EU level by introducing a four-level, comitology-based regulatory approach for financial services.[6] It was launched in response to the call for an integrated approach to supervision and regulation based on an evolutionary method.

6 Level one is referred to the adoption of directives and regulations to set the framework legislation. At level two the implementing measures for Community directives have been taken. Level three is focused on greater cooperation among national supervisors through establishment a network-based committees of local supervisors for banking, securities and insurance. Level four is devoted to enforcement of EU financial market law.

The Lamfalussy structure for law-making and supervisory co-ordination, was bringing a new dynamic to EU financial market regulation, supporting practical supervisory convergence and developing a soft-law rulebook. But the post-FSAP proposals issued in White Paper. Financial Services Policy 2005–2010 suggested a concern to minimize regulation and to engage in thorough impact assessment. A key objectives of it were dynamic consolidation, enhanced supervisory cooperation and convergence in the EU. The more important themes were also an accountability and need of better regulation.

The vital issue for development of the EU financial market law is the use of soft law regulations as a source of law (Duijkersloot, 2011: 176). They have not been attributed by legally binding force but nevertheless may have certain (indirect) legal effects, and are aimed at and may achieve practical effect. Soft law norm also can be "hardened" – given judicial recognition, or incorporated into national and European legal system.

4 Regulatory Responses to the Global Financial Crisis: from "Rules on the Books" to "Rules in Action"

The major failures in the financial sector and in financial regulation and supervision were fundamental causes of the global financial crisis of 2008. Before the crisis different jurisdictions had different arrangements in place for the regulation and supervision of the financial market. The pre-crisis construction of the EU financial market law essentially based on three pillars: harmonization of the regulations; national regulatory competence; and bilateral and multilateral cooperation. However, the EU has a long history of taking a centralized approach to the regulation of financial market activities, the supervisory structure has traditionally been decentralized based upon principle of home State control, combined with mutual recognition on the basis of prior regulatory harmonization, and subject to cooperation and coordination.

In April 2009, The G20 agreed at their London summit to strength financial supervision and regulation, in particular by establishing "the much greater consistency and systematic cooperation between countries, and the framework of internationally agreed high standards, that a global financial

system requires“ (The Global Plan for Recovery and Reform, paras. 13–15). Thereafter, many previously unregulated parts of the financial markets came under supervision for the first time. Most of the new legislation however, was concerned with the reform of regulation pre-existing the financial crisis (Hellgardt, 2014:157). In general view, the international regulatory response to the global financial crisis appears to support the idea of crisis as a game-changer (Ferran, 2012:1).

According to the phrase „Never let a good crisis go to waste", responding to the challenges of the global financial crisis, the European Union took steps aimed at reconstructing the regulatory and supervisory framework of the single financial market (Wymeersch, 2012:77,111). The crisis has forced institutional changes especially in the sphere of the EU financial market regulation and supervision supposed to better prevent such crises and manage them efficiently (Lastra, 2013:75). Europeanization of domestic regulatory policy also took place (Ferran, 2012:26).

Since 2008, the European has proposed 28 new legal schemes expected to enhance financial safety, provide better regulation of the financial market, and establish a more efficient supervision of the latter so that the taxpayers would not have to bear the costs of banking crises in the future (Dorn, 2015:91). Actions aimed at stabilising the financial market have also included measures supposed to better protect consumers in the financial services market. The new regulations have fundamentally changed the current regulatory and supervisory architecture of the EU single financial market. A set of new Commission proposal launched in 2009 on changes existing supervisory architecture took the process of federalization a step further (Financial supervision: New legislative proposals, 2009).[7]

After the global financial crisis the EU has adopted a new, more centralized, mode of regulation. Both the scope and the intensity of its activities have grown. The banking regulations created at the European level take the shape of "rules on the books" (law-making): establishing a uniform set

7 The creation of the European System of Financial Supervision came as a result of the 2009 de Larosière Report aimed at strengthening European supervisory arrangements in order to better protect citizens and rebuild trust in the financial system (Report of The High Level Group on Financial Supervision in the EU, 2009). The de Larosière Report supports "regulatory consistency" as being essential to the single market.

of provisions (the single rulebook for capital requirements, resolution and deposit insurance[8]), and for the first time in EU financial market regulation, through more radical "rules in action" (supervision and enforcement) (Moloney, 2010: 1317).

The financial crisis has reordered the location of regulatory and supervisory control over EU financial markets in favour of the EU (Moloney, 2013: 955–965.) It is relatively clear that significant new lines of tensions between the EU and its Member States have been exposed, including the integrity of the internal market and the location of direct supervisory powers.

The institutional architecture of financial supervision in the EU has undergone a considerable transformation due to the recent financial crisis. On 1 January 2011, EU financial regulation and supervision has entered into a new era, in which an increasing number of regulatory issues has been decided by the four newly created regulatory agencies (Wymeersch, 2012:232). These bodies are the European Systemic Risk Board responsible for oversight of systemic risk in the EU, and three European Supervisory Authorities (ESAs: the European Banking Authority, the European Securities and Markets Authority, and the European Insurance and Occupational Pensions Authority) responsible for the regulation and supervision of the banking, securities and insurance sector. These four institutions with the Joint Committee of the ESAs, and the national supervisory authorities of each Member State constitute the European System of Financial Supervision, a decentralised, multi-layered system of micro- and macro-prudential authorities established at the EU level in order to ensure consistent and coherent financial supervision in the whole EU.

The main task of the European Supervisory Authorities[9] is to contribute to the creation of the single rulebook in banking, insurance and securities whose objective is to provide a single set of harmonised prudential rules for financial institutions throughout the EU.

8 A single rulebook, advocated by the EU in the aftermath of the global financial crisis, means a set of fully harmonized EU rules on financial services applied consistently in all Member States.

9 The European Supervisory Authorities are vested in legal personality and while they do not exercise direct supervision of financial institutions, they may, in certain situations, make decisions that are binding on the national supervisory bodies.

The adopted rule of full harmonisation consists in the enactment of stringent sectoral directives concerning the banking, insurance, and capital market and in ensuring uniform regulatory standards for every Member State of the EU. There has occurred a shift from the rule of minimum to maximum harmonisation.

The directives implemented in all Member States provide for an extensive and detailed harmonisation of law at the national level. They are accompanied by EU regulations, directly applicable in the Member States. Thanks to the harmonisation of law at the Community level by means of the full harmonisation directives and directly applicable regulations, a transformation of the regulatory framework of the EU financial market is achieved.

A fundamental change in the architecture of financial regulation and supervision was the establishment of the European Banking Union. Within its framework, for the first time ever in the history of European integration, full supervision over the systemically most important banks was transferred to a common European institution – the European Central Bank in the Single Supervisory Mechanism.

The need for a banking union has emerged from the financial crisis of 2008 and the subsequent sovereign debt crisis. It became clear that, especially in a monetary union such as the euro area, problems caused by close links between public sector finances and the banking sector can easily spill over national borders and cause financial distress in other EU countries. Thus, the creation of the Banking Union is, therefore, part of a long-term vision of the economic and fiscal integration of the euro zone.

A distinct feature of Banking Union is its hybrid nature (Tridimas, 2016:154). It is daring both in terms of its objectives and in terms of its novelty as a legal construct.[10] The establishment of Single Supervisory Mechanism[11]

10 The hybrid nature of BU is prominently illustrated by the duality of its legal bases. The SSM Regulation grants the ECB more extensive supervisory powers than the reticent wording of Art. 127/2 TFEU appears to allow. The SRM Regulation uses Art. 114 TFEU to found a normative framework which applies to a selected group of Member States and is thus liable to fragment rather than unify the internal market.

11 The Single Supervisory Mechanism (SSM) is the first pillar of the Banking Union. It comprises the European Cental Bank and the national supervisory authorities of the participating countries. It was established as of 4 November 2014, when the ECB took over the exercise of the supervision of credit institutions in the euro zone. The ECB directly supervises the 126 significant banks of the participating countries.

with general transfer of direct supervisory powers to the European Central Bank (SSM Regulation), the creation of a Single Resolution Mechanism[12] as common resolution framework for credit institutions SRM Mechanism), and the project of gradual mutualisation of deposit guarantee insurance in the European Deposit Insurance Scheme[13] (EDIS Regulation), open a new chapter of EU law and take a firm step towards the federalization of financial market law.

Nevertheless, without the fully-fladged centralisation of all parts of the financial safety net, it will be difficult to achieve the relevant policy objectives (Binder, Gortsos, 2016:16)

The legal foundations of the Banking Union, however, are weak. They have required a generous interpretation of the Treaties, skilful legal acrobatics, and the expectation of a tolerant Court (Tridmas 2016:168). However, the legal foundations of this construction are to be found not in primary but in a rather complex array of instruments in secondary EU law.

Banking Union is the most intricate and far reaching of the law reforms undertaken following the recent financial crisis and euro zone sovereign crisis.[14] The regulations making up the foundation of the European Banking Union in their general dimension cover not only the Member States falling within the scope of the euro zone, but are also of relevance for the

12 The Single Resolution Mechanism complements the Single Supervisory Mechanism (second pillar of the Banking Union). It ensures that if a cresit institution – subject to the SSM – faces serious difficulties, its resolution can be managed efficiently with minimal costs to taxpayers and the real economy. The *Single Resolution Mechanism* became fully operational on 1 January 2016.

13 As a further step to a fully-fledged Banking Union, in November 2015, the Commission put forward a proposal for a European Deposit Insurance Scheme (EDIS), which would provide a stronger and more uniform degree of insurance cover for all retail depositors in the banking union. Thus the EDIS would be the third pillar. At the final stage of it set up as of 2024, the protection of deposits below EUR 100,000 of all banks in the euro area will be fully financed by EDIS, supported by a close cooperation between EDIS and national deposit guarantee schemes.

14 According to some authors, the euro zone sovereign crisis was the inevitable result of the asymmetric design of the EMU which provided for centralized decision-making in the field of monetary policy but left the management of economic and fiscal policies to the Member States. The imbalance arising from the strong 'M' but weak 'E' of EMU left the weaker economies of the euro zone exposed to systemic risks (The expression originates from Alexandre Lamfalussy in an interview given to the Guardian newspaper in August 2003, quoted by R.M Lastra, J-V Louis, 2013:57).

EU internal financial market as a whole. Therefore one of the key features of Banking Union is that it has accentuated the difference in treatment between euro zone and non-euro zone Member, so it takes a further step towards differentiated integration and, in doing so, challenges the position of the internal market as the predominant component of the integration model (Tridmas, 2016: 169). In this context one should remember also that in each of the components (pillars) of the Banking Union, directives, and partly also regulations adopted at the European level are applicable to all Member States, irrespective of their participation in the Banking Union. This means that staying out the Banking Union is, in the legal dimension, actually illusory, since it is within the law of the Banking Union that the rules for taking up and pursuit of business in the banking market, including prudential supervision standards, are laid down.

For the EU financial market law development, the European Banking Union indicates a post internal market model of regulation which recognizes strong EU presence not only in establishing the normative framework but also in institutional structures, regulation and supervision of the financial market.

The Banking Union Law has crucial impact on the European legislation concerning the single financial market and its operation, and is of great importance for the institutional architecture of the European Financial Safety Net.

5 Conclusion

We live in a complex and fast-changing world and the European Union faces a number of serious legal challenges at the present time: the ongoing fallout from the banking crisis, the creation of banking union, the Brexit, to name just a few. The single market itself is today part of a context, which has dramatically changed.

The financial markets have become much more international in recent decades, while their regulation and supervision still remain under the domestic jurisdictions. Thus, the issue of common responsibility for the financial market stability is still a basic challenge for the European Union especially after the experience of the recent global financial crisis. Financial stability cannot be achieved at a national level with the present level of market integration.

Moreover providing a system for preventing and managing of systemic crises cannot effectively be done at a local stage. The argument is that the division of powers between the EU and Member States is not achieving sufficient harmonisation to deepen an internal market. The obstacles to accomplish it presented by national regulatory and supervisory actors remain high, and the principles of minimum harmonisation and home country control have failed. Therefore, there is a need for broader based regulatory and supervisory legal framework for the EU single financial market.

The global financial crisis of 2008 highlighted very important flaws in the existing regulatory and supervisory architecture of the EU single financial market. Thus, the aim of systemic stability is now at the core of modern financial market regulation and supervision. The matters of the safety of the financial market and its participants are currently related to the new paradigm of the creation of legal regulations concerning the taking up and running of activities in the financial market, within a new branch of law – the law of the financial market. The financial markets are the subject of supervision and regulation by public and private law, hard law as well as soft law.

The global financial crisis of 2008 and, especially, the ensuing euro zone sovereign crisis have had an overwhelming influence on the development of EU financial market law. Legislative initiatives undertaken by the EU following the crisis have enhanced significantly the powers of the EU. Since the crisis has revealed the institutional and regulatory weaknesses of financial safety net, a fundamental change in policies relating to the creation of the EU financial market law took place.

The EU responded to the global financial crisis by changing the rules for the functioning of financial services and markets and by establishing new oversight bodies. The new financial regulations that have been adopted since the financial crisis have abandoned the principle of home country supervision and moved to a centralized approach with a single rulebook rather than a number of competing and mutually recognized national rules. The directives went from minimum to full harmonization. They no longer sought to establish just the minimum standards but attempted to regulate financial services comprehensively. In the area of supervision cooperation

and coordination evolved from the so-called Lamfalussy framework to the establishment of European System of Financial Supervision and Single Supervisory Mechanism in the Banking Union.

The Banking Union signifies a further transfer of sovereign powers from the national to the supranational level. Therefore, it can be perceived as the transition from a model based on substantive normative harmonization to a post-internal market model effecting the federalization of financial market regulation and supervision. The change does not concern merely institutional architecture, but also the legal framework for taking up and pursuing business in the EU financial market, especially in the area of prudential supervision and crisis management. It means that there is more EU competence, more institutional empowerment, and more executive power at EU level – based on a new regulatory and decision-making bodies, and fully harmonized EU legislation.

The new EU regulatory and supervisory agencies are undoubtedly strategic elements of the European Financial Safety Net.

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RE-LAUNCHED CCTB IN THE CZECH CONTEXT: A FEW INTRODUCTORY REMARKS

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Abstract

This contribution deals with Commission's 2016 Common Corporate Tax Base directive proposal from a Czech perspective. As a preparatory work on Income Tax Act reform is imminent in 2017, it provides the very first look into *de lege ferenda* considerations brought by the proposal. Therefore, the main aim of this contribution is to verify the hypothesis that the directive proposal will require a change of fundaments of the Czech Income Tax Act. The scientific methods used are description for introducing the most relevant proposal's aspects, comparison of *de lege lata* (the Act) and *ferenda* (the proposal) and finally, critical analysis to identify which fundaments should the new Act reflect.

Keywords: Tax; Tax Law; Harmonisation; CCTB.

JEL Classification: K34

1 Introduction

This contribution focuses on the first step of the Commission's key 2016 initiative – a new proposal for common consolidated corporate tax base. As an opposition against a Consolidation part is expected, first step is a Common Corporate Tax Base directive proposal (further CCTB) (Moscovici, 2016: 1). There are academic debates about a need to reform Czech Income Tax Act (further ITA) or rather draft a new one. That grants Czech academics and legislators a unique opportunity to draft an Act in accordance with future harmonisation requirements, namely CCTB. Considering the amount and frequency of ITA amendments, systematically future-proof Act is a desirable goal (Radvan et al., 2016: 11.1.3).

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Although the CCTB might remain pending in the Council for months, it should be reflected to avoid later redrafting of the Act's fundaments. Therefore, the main aim of this contribution is to verify the hypothesis that the CCTB will require a change of the fundaments of the Czech ITA.

The scientific methods used are description for introducing the most relevant aspects of CCTB, comparison of *de lege lata* (ITA) and *ferenda* (CCTB) and finally, critical analysis to identify what fundaments of *de lege lata* should be followed in the draft of new ITA.

Although CCTB follows the 2011 version, it differs in several relevant aspects. Therefore, most publications examining 2011 proposal can be only of a limited use. Moreover, CCTB was released only recently, scholarly writing did not manage to react. Also, to the author's knowledge, there are not any comprehensive publications comparing CCTB and the Czech ITA.

As the scope of this paper is limited, only a few selected fundaments of the CCTB are addressed. Following part is structured as follows: first, the CCTB provisions are described, then compared with the ITA and finally critically analysed regarding the implementation.

2 General Characteristic

Apart from already mentioned staged approach, there are another difference from 2011 proposal. It is a mandatory application of CCTB to groups over certain size. Further additions are Research and Development super deduction and Allowance for Growth and Investment (Explanatory Memorandum, 2016: 3).

There is another aspect to be addressed. Pursuant to its Art. 1/2, CCTB directive detaches its subjects from national substantive corporate law. CCTB seems to be founded upon maximum harmonization principle. Therefore, two distinct regimes, national and CCTB, would exist. If the further analysis proves that there are not any systematic differences, majority of provisions of new ITA could be used for both regimes. That would allow the Czech legislator to create more coherent act.

3 Scope

Pursuant to its Art. 2 and 3, the CCTB is to be used to companies incorporated in a listed form under the Member State's laws, subject to corporate tax, being either parent or a qualified subsidiary (parent has over 50 % of voting rights and over 75 % of the capital or profit rights) or having a permanent establishment (further PE) in the other Member State. Finally, its consolidated group revenue exceeds EUR 750 million. Comparing 2011 and 2016 proposals, CCTB is now mandatory for companies described in this paragraph. Under limit or standalone companies may opt-in.

CCTB annex lists forms that are the Czech equivalents of general partnership, limited partnership, private limited liability company, stock company and cooperative society. Scope of Art. 17 ITA that regulates a personal scope of the Czech corporate income tax (further CIT) is wider but not problematic. However, there are practical challenges connected with general and limited partnerships. General partnerships are formally subjects to CIT but due to specific accounting their tax bases and liabilities are zero (Vychopeň, 2014). Some expressed an opinion that general partnership and probably limited will fall out of scope 2011 CCCTB (Nerudová, 2014: 4. 5. 1.1). Same *ratio* might apply for 2016 CCTB.

4 Tax Base Calculation

CCTB defines a tax base as a revenue less exempt revenues, deductible expenses, and other deductibles. When computing the tax base, principles of realization, individuality, coherence, and accrual principle apply (CCTB, Art. 6–7). Pursuant to Art. 23 ITA, the tax base calculation is fundamentally the same. A starting position for the ITA tax base computation is a national accounting profit or loss that is subsequently adjusted. However, CCTB does rely solely on IFRS but also allows application of national accounting systems.

Under Art. 8 CCTB exempt revenues are subsidies linked to depreciated fixed assets, proceeds from disposal of pooled assets, proceeds from disposal of shares with an exception of trading shares (subject to 10 % capital or voting rights test and 12 months' time test). Under the same conditions are exempt received profit distributions. Also, received profit of a PE located

in taxpayer's residence Member State is exempt. Although ITA does not expressly exempt subsidies linked to fixed assets, they do not enter tax base calculation as revenues but decrease acquisition price of fixed assets (ITA, Art. 29/1; Morávek, 2010) analogically as in Art. 31/3 CCTB. As to disposal of shares and profit distribution, similar norm (but only capital test) applies under ITA, see Art. 19/1/ze and 19/3. Finally, an institute of pooled assets as is defined in Art. 37 CCTB does not exist under the Czech ITA. Thus, this presents quite important difference and challenge for implementation.

Pursuant to Art. 9 CCTB, general rule on deductible expenses is that the expense must be incurred in the direct business interest of the taxpayer. The similar norm applies under Art. 24/3 ITA.

New in comparison with 2011 proposal are Research and Development (further R & D) Super Deductions and Allowance for Growth and Investment (further AGI). Super deductions may reach another 50 % if the expenses are under EUR 20 million and 25 % on the exceeding amount. Medium and small enterprises with fewer than 50 employees, turnover/total assets under 10 million EUR, not market listed, not registered for more than 5 years, and not created by merger or associated are entitled to an extra 100 % up to EUR 20 million (CCTB, Art. 9/3). Institute of R & D is also used in the Czech Republic. Pursuant to Art. 34 ITA, subjects are entitled to an extra 100 % (110 %) super deduction subject to R & D conditions. However, this institute is debated by academics, interpreted by courts and from overall perspective understood as problematic (Radvan et al., 2016: 8).

AGI is the unknown concept in comparison with both 2011 proposal and the Czech ITA. It is rule against debt-bias as it combines a defined yield on AGI equity base and anti-avoidance measures the Commission may adopt as delegated acts. The defined deductible yield for using new equity would be ECB 10-year euro area government bond benchmark plus 2 % risk premium (CCTB, Art. 11). The Commission expects that AGI might have a positive impact on investment (3.4 %), employment (0.6 %) and overall growth (1.2 %). Compliance costs are expected to decrease by 2.5 % (SWD(2016) 342 final). To conclude, AGI presents an interesting option to reduce debt-bias, however, independent examination is required

to ascertain what economic impact it may have in the Czech context. From a legal perspective, it presents a challenge since drafting of such provision and subsequent anti-avoidance measures may prove difficult.

Art. 22 CCTB provides for non-deductible items, the list is drafted as exhaustive and includes profits distributions, repayments of equity and debts, 50 % of entertainment costs, corporate and similar taxes, illegal payments, fines and penalties, expenses linked with exempt income, gifts, donations (with exception), fixed assets improvement expenses and losses of PE in a third country. In comparison, ITA uses in its Art. 25 non-exhaustive list but all items mentioned by CCTB are generally non-deductible as well. The entertainment expenses present a sole deviation as they are completely notdeductible except for marketing items under CZK 500 limit (ITA, Art. 25/1/t). Therefore, CCTB non-deductibles would not be an implementation challenge as they are in line with ITA.

Depreciation of fixed assets is considered the most difference between CCTB and ITA (Krchnivá, 2015: 116). Fixed asset under CCTB is in substance one used for more than 12 months with costs exceeding EUR 1,000 (CCTB, Art. 4/19). Furthermore, CCTB recognizes only two categories of depreciated assets, individual and pooled. Individual assets are to be depreciated on a straight-line basis and pooled assets annually by 25 % of the depreciation tax base value (CCTB, Arts. 30–40). Under ITA there are several differences, a value limit of CZK 40,000, 6 depreciation categories, also an accelerated depreciation is allowed (ITA, Art. 26–30). Finally, it seems apparent that the Commission adopted IFRS concept of economical ownership regarding depreciation (Nerudová, 2014: 4. 5. 1.6). Altogether, CCTB regulation of depreciation differs fundamentally from ITA and its implementation will be challenging.

Deductibility of losses is granted pursuant to Art. 41 and 42 of CCTB in the subsequent tax years unless the taxpayer becomes a part of a new group or major change of activity occurs. As Consolidation directive is expected to be delayed, CCTB provides for proportionate loss relief and recapture of net losses of subsidiaries and permanent establishments. Comparing these provisions to ITA, it is apparent that there are two fundamental differences. First, intra-group tax base consolidation is not allowed and second,

losses can be carried forward only 5 years (ITA, Art. 34). Regarding the losses, caution can be expected from the drafters of new ITA as their relief and recapture might be a threat to overall tax base and subsequently a tax revenue.

5 Anti-Avoidance Measures

CCTB and Consolidations directives are supposed to solve most aggressive tax planning and abuse schemes of multinationals, eliminate mismatches and manipulations (Garbarino, 2016: 285–286). However, until these proposals are agreed upon, temporary, *de minimis*, solution in a form of ATAD was adopted (Dourado, 2016: 442). Although the anti-avoidance provisions in ATAD and CCTB are similar, latter lay down absolute rules rather than minimum standards (Explanatory Memorandum, 2016: 4).

CCTB contains a thin-capitalization rule in its Art. 13. This rule limits deductibility of the net borrowing costs to 30 % of EBITDA or a safe harbour of maximum EUR 3 million. Full deduction is granted to standalone companies, for already existing loans etc. ITA contains thin-cap rule for associated enterprises as well. However, its Art. 25/1/w denies deductibility to costs of credit instruments exceeding 4:1 debt/equity ratio. Consequentially, implementing CCTB the Czech Republic would have to introduce stricter, net costs/EBITDA ratio. Difference in thin-cap rules is a mismatch and those CCTB seeks to eliminate. (Cerioni, 2016: 464). One could also argue that net coasts/EBITDA ration better reflects economic reality. Thus, the Czech ITA should shift to net costs/EBITDA based thin-cap rule even for national regime.

Another anti-avoidance provision is Art. 29 CCTB containing exit taxes. This provision treats a transfer of assets as taxable event. Provision of CCTB differs from Art. 5 ATAD as it reflects tax base consolidation. Therefore, it does not have to contain CJEU rulings requirements but only treats a difference between market price and tax value of transferred assets as accrued revenue. Also, a switch-over clause contained in Art. 53 CCTB is new as it was left out of ATAD. It denies taxpayer an exemption of an income from an entity from a third country if the entity was subject to corporate tax statutory rate lower than half of rate in taxpayer's Member State. Another anti-avoidance

provision is a CFC rule in Art. 59, it mostly refers to Art. 7 ATAD. It effectively attributes an income of low taxed subsidiary to the parent company pursuant to certain conditions. Neither of these rules are in the Czech ITA (Radvan et al., 2016: 67–70) and the law maker should be careful when introducing yet unknown concepts. Nonetheless, as they protect taxation in the source country, much opposition is not expected.

Although the CCTB should eradicate most of the mismatches, it nonetheless contains hybrid mismatches provision in its Art. 61. This rule deals with a situation when different legal qualification results in double deduction or non-inclusion and resolves such situation with denial of deduction. The Czech ITA contains hybrid provision since May 2016 due to implementation of 2011/96/EU amendments (Pelc et al., 2016: 303). However, scope of Art. 19/2/c is narrower as it only denies exemption of received profit distribution if the subsidiary could deduct it. Thus, although the concept is not unknown, more general provision would have to be introduced.

Lastly, CCTB introduces in its Art. 58 general anti-abuse rule (Románová, 2015) based on three-pronged subjective, objective, non-genuineness tests. This rule obliges Member States to disregard arrangements whose essential purpose is a tax advantage that is in contrast with the object or purpose of CCTB and are non-genuine. This provision is in line with Art. 6 ATAD and is carefully drafted around CJEU requirements. There are two general anti-abuse rules in the Czech Republic. First, Art. 8/3 of Tax Procedural Code contains an obligation of tax administration to consider genuine content of the facts determining a tax liability. The scope of the provision was interpreted as applicable only to sham, i.e. dissimulation, transactions (Supreme Administrative Court: 1 Afs 73/2004–89). Second is an *abusus iuris* judicial doctrine that is inspired both by the Czech legal theory and CJEU rulings (Kohajda, 2015: 280–283). Thanks to CJEU inspirations, implementation of Art. 58 might not meet much opposition or problems.

6 Conclusion

The Czech government criticised the 2011 proposal regarding procedures and administration and discrepancies in accounting systems. Its overall position was that it was the least beneficial option bringing additional

administration expenses and lower tax revenue (Chamber of Deputies, 2011). Perhaps recent academic studies, disproving lower tax revenue argument, could persuade the current political representation. If the CCTB and Consolidation were agreed as mandatory and implemented by the Czech Republic, a tax revenue increase of 3,39 % can be expected likely due to the consolidation increasing respective tax bases (Nerudová, Solilová, 2016: 16). Contrarywise, if they were implemented under enhanced cooperation without the Czech Republic, the CIT revenue decrease by 0.2–1.73 % (Nerudová, Solilová, 2016: 297). Therefore, it is in the Czech Republic's economic interest to take part in common tax base project, either in the form of directive or enhanced cooperation.

From legal perspective, fundaments such as tax base calculation, exempt revenues, R & D Super Deductions, deductible and non-deductible expenses are mostly similar and thus could be drafted as general provision of new ITA and applied for both CCTB and national regime. On the other hand, AGI, depreciations, losses and some anti-avoidance provisions differ. They should be either adopted even for national regime or implemented as special provisions. The author is mildly in favour of the former. Therefore, the hypothesis was only partly confirmed as some fundaments are materially same and some differ. However, further research in this area is needed as this contribution contains only preliminary conclusions.

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LENDER OF LAST RESORT FOR EURO ZONE COUNTRIES

Przemysław Panfil[1]

Abstract

The aim of the article is to assess the actions that can be considered as a manifestation of the activity of lender of last resort for euro zone countries. In particular, it covered the assistance programs of such institutions as the ESM, IMF, ECB. This assessment was preceded by outlining the theoretical foundations of the lender of last resort and an indication of significant, from this point of view, characteristics of the debt crisis of the euro zone. This analysis allows for the verification of the hypothesis that only ECB could be the effective lender of last resort for big euro zone countries. The study utilizes legal and dogmatic analysis as basic research method.

Keywords: Debt Crisis; Euro Zone; Lender of Last Resort.

JEL Classification: G21, G23, G28

1 Introduction

At the outbreak of the debt crisis the euro zone was not institutionally prepared to solve it. In particular, there lacked the legal bases for the restructuring of the liabilities incurred in the internal market, and the financial support mechanisms for the countries covered by the phenomena of crisis. The answer to the first problem was the decision on the introduction of collective action clauses in issues of government debt securities of the euro area, which had already been taken in 2011. Financial assistance for individual members of the single currency area was initially granted on the basis of temporary solutions. Ultimately, however, it was institutionalized by the creation of the European Stability Mechanism (hereinafter referred to as: ESM). The creation of this institution does not finish the discussion on the target form of the lender of last resort for euro zone countries.

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It is particularly justified due to a number of actions the European Central Bank (hereinafter referred to as: ECB), which can be considered a form of indirect support of the members of the single currency area.

This article has two parallel goals. The first is to assess the actions that can be considered as a manifestation of the activity of lender of last resort for euro zone countries. This assessment was preceded by outlining the theoretical foundations of the functioning of this institution and an indication of significant, from this point of view, characteristics of the debt crisis of the euro zone. The second aim is to an attempt to verify the hypothesis that only ECB could be the effective lender of last resort for big euro zone countries. The basic research method used in the study is legal and dogmatic analysis.

2 Lender of Last Resort to the Banking Market

In the 19th century, the banking sector in countries such as Great Britain and the United States of America periodically struggled with successive financial crises (Redish, 2001: 1). At their source lay the loss of consumer confidence in individual institutions and the sudden withdrawal of deposits (a run on the bank). At the same time asymmetry of information resulted in the phenomenon of contagion, and even lead to bankruptcy of banks with stable financial standing (Willow, 2008: 65). The need to reduce the incidence and consequences of a banking panic has led to the development of the concept of the so-called lender of last resort. The first theoretical basis for the functioning of this institution was created by M. H. Thornton, in the book published in 1802 entitled *An Enquiry into the Nature and Effects of the Paper Credit of Great Britain* (Thorton, 1965). This thesis determined among other things, the basic functions of lender of last resort and they were entrusted to the Bank of England.

Research of M. H. Thorton has been developed by British journalist and editor of The Economist – W. Bagehot. The immediate impulse to take by this author the subject of lender of last resort was the financial crisis that began in 1866 after the collapse of Overend, Gurney and Company. Beliefs of W. Bagehot found its fullest expression in the book published in 1873 entitled *Lombard Street: A Description of the Money Market* (Bagehot, 1873)

and contributed to the change in the approach of the Bank of England to the issue of a banking panic. Their essence is comprised in a synthetic Bagehot Rule: lend freely at a high rate (Humphrey,1989: 12).

The appearance of the lender of last resort is considered by financial market participants in the category of extra insurance, which creates a moral hazard. This problem applies to both bank managers and shareholders, and creditors. The former are willing to take more risks, while others with less attention monitor the situation of institutions, which lend their money (Freixas, 1999: 159).

The risk of moral hazard has already been noticed by M. H. Thorton and W. Bagehot and it was important for the shape of the so-called classic lender of last resort. It was based on the following principles:

1. Protecting the aggregate Money Stock, not individual institutions;
2. Letting insolvent institutions fail;
3. Accommodating sound institutions only;
4. Charging penalty rates;
5. Requiring good collateral;
6. Preannouncing these conditions well in advance of any crisis so that the market would know exactly what to expect (Humphrey, 1989: 8).

With time the views on the principles of the lender of last resort were subject to certain modifications. In particular, attention was drawn to the specific situation that produced the financial crisis and the prevailing market panic. During this period, it is difficult to distinguish between financial institutions, which have only a liquidity problem from those that are also insolvent. The market does not take the rational decision on the allocation of funds flowing from the lender of last resort between the individual institutions. Thus, the recipient of assistance should not only be market conceived as a whole, but also specific institutions (Goodhart, Huang, 1999: 5), even if there are concerns regarding their solvency. The literature also presents the proposals of loosening the rules under which a lender of last resort provides support during the financial crisis. These included a reduction in requirements of securities serving as collateral for the loans (Meltzer, 1986: 83), or resignation from the application of penal interest rate (Gianni,

1999: 13). Experience has also demonstrated that the role of lender of last resort can effectively act as an entity other than a national central bank, for example Treasury or foreign monetary authorities (Bordo,1990: 27).

In the literature, there are also voices criticizing the principle consisting in ex-ante determination of the principles of granting aid by the lender of last resort. The concept of constructive ambiguity was put forward as an alternative. Its implementation would mean that banks could never be certain of liquidity support from the central bank. Accordingly, they would show a greater caution (Willow, 2008: 67). This concept, however, did not meet with the wider recognition. It was pointed out, among other things, that the likelihood of self-justifying crises would increase (Fisher, 1999: 92).

3 Debt Crisis in the Euro Zone

Paradoxically, the source of the debt crisis in the countries of southern Europe can be traced to the decline in interest rates that occurred in the peripheral countries of the euro zone at the stage of its creation. The reason for this was the reduction in inflation expectations and the risk premium demanded by investors purchasing government securities issued by those countries. Low interest rates have enabled cheap financing of the government borrowing needs and reduced debt servicing costs. As a result, determination of public authorities to take the necessary public finance reforms has decreased. At the same time countries of southern Europe characterized by low competitiveness of the market of production factors (Bagus, 2011: 42–49). These phenomena have created a very dangerous combination that became apparent during the economic disturbances caused by global financial crisis. A significant decrease in aggregate demand resulted in very high budget deficits and rapid accumulation of debt of Greece, Portugal, Cyprus, Spain and Italy. Slightly different are the sources of the debt crisis in Ireland. In case of this country they can be traced back in a huge financial assistance, which the Irish Government has given to the the banking sector (Bagus, 2011: 118).

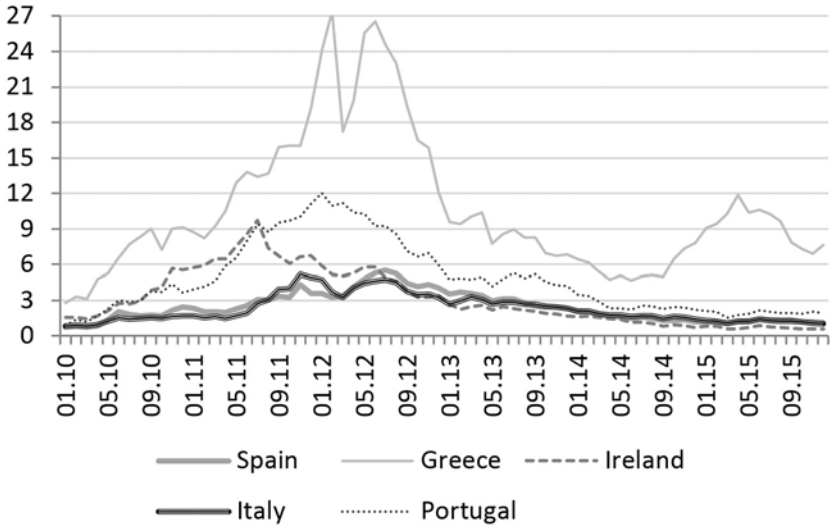
During the debt crisis in the euro zone has appeared the contagion effect, well-known in the banking sector. Interestingly it has been caused by the problems of a financial holding company Dubai World, which manages

a large portfolio of investments and projects of the government of Dubai. Therefore, investors assumed that its obligations are guaranteed by the emirate. On 30 November 2009, Abdulrahman al-Saleh, director general of Dubai's department of finance, clearly denied it (Reuters, 2009a). The most important lesson of this event was to raise awareness among the investors that any assumptions about hidden or informal guarantees of obligations could be misleading (Petru, 2015: 129). This awareness coincided with growing fiscal problems of Greece. At the end of 2009 it became clear that the country's deficit will reach almost 13 %. As a result, on 8 December 2009, Fitch downgraded the ratings of Greece to BBB+ with a negative outlook (Reuters, 2009b). On December 16, the same decision was made by S & P (Reuters, 2009c). The symbolic date of the beginning of the debt crisis can be 23 April 2010, when the Greek Prime Minister George Papandreou asked its European partners for financial assistance. The first rescue plan for the country was passed in May 2010 and two more in February 2012 and July 2015.

The deteriorating situation of Greece began to affect the profitability of treasury securities issued by other euro zone countries (Figure 1). First, the problems have affected Ireland and Portugal. At the request of those countries, they were covered by aid programs, passed in November 2010 and May 2011, respectively. The interest rate on bonds issued by Italy and Spain also began to rise dangerously. In this regard, two critical moments can be pointed out. The first took place in November 2011, when the profitability of Spanish bonds reached 6.2 %, while Italian 7.06 %. Negative trends in the debt market of these countries were temporarily stopped by two refinancing operations with a maturity of 36 months, which were conducted by the ECB on 22 December 2011 and 1 March 2012. As part of these operations, the banking sector received the amount of more than 1 trillion euro, which translated into an increase in demand for Treasury securities. These activities were found to have transient effects. Increasing the liquidity of the banking sector has not affected in any way the primary problem of the Treasury debt securities' market, which was the lack of confidence in some of the issuers of these instruments. Since April, the profitability of securities issued by Italy and Spain began to rise again. Meanwhile,

Cyprus has asked for financial assistance, which further worsened investor sentiment. Finally, in July 2012, Italian bond yields reached 6.0 %, while Spanish 6.79 %. The situation on the debt market of the two countries began to improve rapidly in the next month, when the ECB announced the implementation of the Outright Monetary Transaction (hereinafter referred to as: OMT). This program can be regarded as a form of guarantee granted to euro zone countries.

Figure 1. Spread between 10-year German bonds and instruments issued by selected euro zone countries in the period from January 2010 - December 2015 (in basis points)



Source: own study based on data from the ECB website: http://sdw.ecb.europa.eu

Analysis of the development of the debt crisis in the euro zone can identify common problems faced by banks and the states. Both groups of entities are dependent on a constant flow of repayable funds, which allow to refinance existing debt. In case of countries, the need to finance the repayment of previously incurred liabilities is usually the main element of borrowing needs. Moreover, such payments have a legally determined nature and do not depend on the decisions taken in the framework of the current fiscal policy. Therefore, a public-law association may go bankrupt

not only because of insolvency, but also due to the growing liquidity problems (Roubini, 2001: 11). Because of the "herd" behaviour of the holders of treasury securities, this type of processes can be characterized as very dynamic. In the short term, the ability to market financing of the borrowing needs at an acceptable cost, becomes a condition sine qua non for the fiscal stability of the state (Panfil, 2015: 80). To the loss of this ability may contribute the phenomena and processes taking place in the financial market. As a result, states become sensitive to the market situation, which is best evidenced by the situation, which took place in the past few years in the euro zone. The general increase in risk aversion caused investors' escape in the direction of financial instruments issued by entities with the highest credit ratings, which occured with the contagion effect. It shook the process of financing the borrowing needs of some euro zone countries. They faced a very unfavourable situation in which increased demand for repayable budgetary funds met with a decreased demand in debt securities issued by them and rising real interest rates. Incidentally, it should be emphasized that Treasury securities usually have high interest in the assets of banks and other financial institutions due to the low valuation of the risks involved (IMF, 2002: 22). Thus, these instruments are a potential channel of transfer of any financial problems of the public sector to the private sector.

4 Lender of Last Resort on the Debt Market

An extreme form of loss of fiscal stability for the country is its bankruptcy. It occurs when a country unilaterally cancelled all or part of its liabilities (repudiation) or forced revision of the terms of the contract (conversion), resulting in limiting the powers of the lender (Dalton, 1948: 234). Such an event always raises far-reaching implications, especially in the socio-economic area. In case of the euro zone, bankruptcy of one of its members raises additional consequences. It represents a threat to the primary objective of the ECB, which is to maintain price stability. The loss of fiscal stability by a member of the euro zone could lead to massive bankruptcies of financial institutions, and thus disrupt the transmission mechanism of monetary policy. Moreover, the bankruptcy of a country becomes a serious challenge to the process of European monetary integration, undermining the credibility

of the common currency. It is these circumstances that have led financial market participants to believe that there is an implicit fiscal solidarity of the euro zone countries. After the outbreak of the debt crisis, this solidarity has become a reality, despite the wording of Art. 125/1 of the Treaty on the Functioning of the European Union. Pursuant to this provision, neither the European Union nor its members are not responsible for the debts of other Member States.

Looking for optimal solutions for the lender of last resort for euro zone countries, it is necessary to refer to the scientific achievements described in Chapter 1. Of course, not all the rules developed for the banking sector are suitable for direct use. This observation relates primarily to solutions that aim to reduce the risk of moral hazard. Its source is the already mentioned belief in the fiscal solidarity of the euro zone countries. It may lead the public authorities of individual countries to conduct relaxed fiscal policy (Oręziak, 2002: 5). The way to minimize this risk does not seem to be the consent to the bankruptcy of excessively indebted member state, use of sanction interest rates or security requirement against it. This first solution would generate very high systemic risk to the continued functioning of the euro zone. While the second and third hinders the process of recovery of fiscal stability by the state facing the problems. Thus, the period during which it would require the support from the lender of last resort would be falling longer. This forces the creation of other solutions that would have restricted risky activities of public authorities and investors acquiring bonds issued by these authorities.

The way to minimize the risk of moral hazard on the side of public authorities are primarily well-designed and effective rules for fiscal policy that would prevent the emergence of debt crises. Their important element should be the automatically implemented system of sanctions for countries that would have violated applicable restrictions. In the case of the European Union this role plays primarily the Stability and Growth Pact, which in the age of the debt crisis has been significantly modified. The way to reduce the risk of moral hazard are also the conditions for receiving financial aid. These conditions should be precisely defined and differentiated depending on whether the country has only short-term liquidity problems, or lost

its solvency. In the latter case, the receipt of aid must be conditional on implementation of a wide-ranging reform of public finances. The related predictable socio-economic costs and their impact on the election outcome of the ruling party may be regarded as an element that reduces the tendency of public authorities from conducting excessively relaxed fiscal policy.

A separate issue is the risk of moral hazard on the side of investors. They can be minimized by establishing clear rules for the participation of the private sector in solving the debt crisis. This can be done even by the use of joint action clauses mandatoriy included in the issue contracts for treasury bonds of the euro zone countries. Another option is to also grant the lender of last resort the status of a privileged creditor.

The effectiveness of the lender of last instance is primarily dependent on the amount of funds that can be spent on assistance programs. The scale of needs is at the same time depends on the size and structure of the borrowing needs of the country and the nature of the problems it must deal. Basically, it is much easier to solve the crises that are associated with a temporary loss of liquidity, rather than crises, at the root of which lies the insolvency. In the latter case, the lender of last resort must be able to grant support in the long term. A particular challenge here is the occurrence of the phenomenon, which is called "structural deficit trap" (Petru, 2015: 154). This term describes the state of the economy in which the public authorities take action to correct the excessive deficit, at the same time increasing economic downturn. The associated decline in economic activity and the reduction of the tax base leads – through a feedback loop – to secondary increase of the deficit. In this case, the only solution may be ordered bankruptcy of such a state, even through the use of clauses of the joint action.

At this level it is worth paying attention to the lessons of the recent debt crisis. In case of Ireland, Portugal and Cyprus, the average period between the first tranche of aid and the moment of return to the financial market was 1.5 years. Nevertheless, these countries continue to benefit from the financial support mechanisms available, only partly financing its borrowing needs in the market. The total period of receiving loans ranged from 30 (Cyprus) to 36 months (Portugal). Quite different is the situation of Greece, which returned to the financial market after almost 4 years of receipt of the first

tranche of aid. These data lead to the conclusion that even in the most optimistic scenario of development of crises in the euro zone, the lender of last resort should have the ability to finance borrowing needs of individual countries for a period of 2–3 years. Because of the risk of contagion phenomenon, this capacity should include the possibility of support for several members of the euro zone at the same time. Considering the size of the borrowing needs of countries such as Spain or Italy, lender of last resort should have the funds at the level of EUR 1.5–2 trillion.

5 Assistance Programs for Euro Zone Countries

While analysing the debt crisis in the euro zone it is possible to identify many entities that carry out the functions of lender of last instance. At the initial stage of development of crisis phenomena, such role was played by members of the euro zone. Under the first aid package for Greece, they offered a pool of funds with a total value of EUR 80 billion, of which eventually 52.9 billion was paid[2]. Whereby, the loans were run under bilateral agreements. Direct financial assistance from other countries also included assistance program for Ireland. This time the role of lender of last resort served the United Kingdom, Denmark and Sweden. Together, these countries have granted Ireland loans in the amount of EUR 4.8 billion.

When assessing these measures, it should be noted that in an era of permanent budget deficits, even economically strongest states of the European Union do not have sufficient funds to finance the borrowing needs of other countries in the long term. Moreover, this type of aid granted on the basis of bilateral agreements, is difficult to negotiate. The government of the country acting as the lender of last resort must take into account the will of its electorate. Some argument for giving support to indebted countries is the desire to stop the development of crisis phenomena, which through a channel of Treasury securities can be transferred to the domestic banking market. Rising costs of intervention, however, can discourage the largest lenders to continue aid, considering the immediate rescue of their own financial institutions (Gross, 2011: 4).

2 The exception in this regard was Slovakia, whose parliament rejected the possibility of granting support to Greece at EUR 0.8 billion.

The development of the crisis and the need for synchronization of aid granted to the countries standing on the verge of bankruptcy forced comprising it within some institutional frameworks. Their essence was to create a large and liquid pool of financial assets that could be used to support the countries in need (Buiter, Rahbari, 2012: 14). Already at the Council meeting, which took place on 9–10 May 2010, a decision was passed to build a financial safety net (Kosterna, 2011: 21), comprising inter alia European Financial Stabilisation Mechanism (hereinafter referred to as: the EFSM) and European Financial Stability Facility (hereinafter referred to as: the EFSF). As the legal basis for the establishment of these mechanisms was indicated Art 122/2 of the Treaty on the Functioning of the European Union (OJ C 326, 26. 10. 2012, p. 47) (hereinafter referred to as: the Treaty).

EFSM was established on the basis of Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism (OJ L 118, 12. 5. 2010, p. 1). This instrument provides financial support to all members of the European Union, facing serious economic and financial difficulties. It disposes of an amount of EUR 60 billion. These funds are provided by the Commission, incurring financial obligations on behalf of the European Union. While the EFSF was created as a joint stock company with its registered office in Luxembourg. This instrument – from the beginning considered as a temporary solution – provided support to euro zone Member States. Also EFSF gained financial resources for the implementation of aid programs through the issuance of securities. It used therewith the guarantees granted by euro zone countries amounting to EUR 440 billion.

EFSF has been replaced by the ESM, which began operating on 8 October 2012. Creation of a permanent aid mechanism did not fall within the legal framework under Art. 122/2 of the Treaty. Therefore, the need to amend the Treaty solutions has emerged. Paragraph 3 was added to the contents of Art. 136 of the Treaty. Accordingly, Member States whose currency is the euro may establish a stability mechanism to be activated if it would be indispensable to safeguard the stability of the euro zone as a whole. Eventually, on 2 February 2012 these countries signed the intergovernmental Treaty establishing the ESM. This means that this institution was created outside the scope of EU legal order.

The objective of the EMN is to support Member States which are experiencing or are threatened with serious financial problems, as long as it is necessary to ensure the financial stability of the euro zone and its participants. The institution was at the same time equipped with the assistance programs for both countries with temporary liquidity problems and countries struggling with excessive debt. Prudential financial aid is addressed to the former, while to the second – loans subject to the adoption of macroeconomic adjustment program. ESM, supporting both groups of beneficiaries, may also purchase their debt instruments on the primary and secondary market. This enables the provision of multifaceted assistance to the euro zone countries (Panfil, 2015 b: 169).

The financial basis for the functioning of the ESM is stock capital, which closes with the amount of EUR 704.8 billion. All countries that have adopted the single currency participate in it. Share capital of the ESM was divided into two parts. The first is the so-called paid-up capital, which amounts to EUR 80.5 billion. It was brought in by the shareholders of ESM within the period 2012–2014. The investment portfolio was created based on the paid-up capital, the aim of which is to ensure the institution's high level of liquidity. The second part of the share capital creates the so-called call capital in the amount of 620 billion. Theoretically, it can be brought in by Member States in response to the call of capital. However, it is hard to expect that this solution will be used to finance aid programs.

The maximum amount of aid offered by the ESM is set at EUR 500 billion. Callable capital could therefore be considered as a form of guarantee that the members of the EMN granted to this institution. Simultaneously, the only available way of financing the assistance programs become repayable funds, in particular obtained on the debt instruments' market (Panfil, 2014: 68). From the point of view of financial liabilities incurred by ESM, creditworthiness of the institution dependent on the credit ratings of its key members is crucial.

So far, five countries have benefited from the financial assistance provided by the EFSM, EFSF and ESM: Greece, Portugal, Ireland, Cyprus and Spain (Table 1). In the latter case, however, it was about the recapitalization of Spanish financial institutions, and not the direct support of the state's finances.

Table 1. Countries benefiting from EU aid instruments (as of 01. 01. 2017)

State	Mechanism	Amount of aid (billion EUR)
Cyprus	ESM	6.3
Greece	EFSF, EFSM, ESM	130,9 + 7,2 + 31,7
Spain	ESM	41.3
Ireland	EFSF, EFSM	17,7 + 22,5
Portugal	EFSF, EFSM	26,0 + 24,3

Source: own study based on websites: European Union: http://ec.europa.eu, EFSF: http://www.efsf.europa.eu; ESM: http://www.esm.europa.eu

Assessing permanent aid mechanisms created in the European Union, the two basic problems that affect their effectiveness should be indicated. The first is the maximum lending capability, which, even in the event of ESM is closed with the amount of only 500 billion euro. It is too small to provide medium-term support to the largest economies of the euro zone. Moreover, none of the European aid mechanisms holds a pool of funds for the possible support of the countries in need. These funds are obtained through the issuance of debt instruments. This can primarily cause serious problems in the financing of major aid programs of the ESM. The increased issue activity of the of the institution with the increasing debt may lead to a reduced ability to acquire low-cost repayable funds. Also it should be noted that, paradoxically, these commitments are also guaranteed by beneficiaries of aid from the ESM. If there are some major euro zone countries, the situation would not remain indifferent to the creditworthiness of this institution. The big advantage of EU assistance mechanisms, however, are clear rules to assist Member States and the real "costs" that they may incur in the form of the need to reform public finances.

The newly created network of financial security of the European Union was strengthened by the International Monetary Fund (hereinafter referred to as: IMF), who supported assistance programs for euro zone countries totaling around SDR 72 billion, i.e. about EUR 100 billion (Table 2). These funds were made available primarily under the Extended Fund Facility (hereinafter referred to as: EFF). In addition, Greece has received support from the Stand-By Arrangements programme (SBA).

Table 2. Countries receiving assistance from the IMF (as of 30. 11. 2016)

State	Program	Amount of aid (SDR billion)
Cyprus	EFF	0.8
Greece	EFF + SBA	11,2 + 17,5
Ireland	EFF	19.5
Portugal	EFF	22.9

Source: own study based on websites: IMF: www.imf.org.

IMF for decades performs the function of an international lender of last resort, having gained a strong experience in this area. Clearly defined rules for granting aid and proven operating procedures are unquestionable advantages of this institution. Financial support for the countries with financial problems is mostly dependent on the need to implement relevant reforms, which can be considered as an attempt to reduce moral hazard. Unfortunately, the IMF is subject to the same restrictions as the ESM. In October 2016, its maximum lending capacity was SDR 691 billion,[3] which translated into an amount less than EUR 900 billion. It should be noted, however, that the area of activity of IMF is the whole world, which inevitably limits its involvement in solving problems of the euro zone. Moreover, this involvement is largely determined by the economic interests of the United States (Gross, 2011: 5), so it can change in the future.

Separate attention should be paid to three programs of the ECB, the object of which became the market of government securities. The first of these programs – Securities Markets Programme (hereinafter referred to as: SMP) – had a temporary character and has been adopted by Decision of the Governing Council of the ECB on 10 May 2010. Accordingly, the central banks of the Eurosystem could, among other things, acquire securities on the secondary market, issued by central governments or public entities of the euro zone. Under this program, debt securities for an amount exceeding EUR 200 billion have been purchased (Eser, Schwaab, 2013: 12).

SMP was completed on 6 September 2012 year, when the Governing Council of the ECB decided to implement the OMT. It was a program of outright

3 Https://www.imf.org/en/About/infographics/AM16-Bilateral-Borrowing-Infographic.

purchase of government bonds on the secondary market without specifying any amount limits. OMT, however, was restricted to securities with a maturity of one to three years, issued by countries receiving assistance under the EISF or ESM. This means that it concerned only the instruments of issuers by the countries with severe fiscal problems, which also started to implement the necessary macroeconomic, structural, fiscal and financial adjustments.

Full involvement of the ECB in the secondary market of debt securities can be dated March 2015, when the decision on the Public Sector Purchase Programme was passed (hereinafter referred to as: PSPP). On its basis has began buying of bonds issued by euro zone countries, qualified by international organizations (e.g. The European Union and ESM) and multinational investment banks (e.g. European Investment Bank). According to the announcement, initially it was supposed to last at least until September 2016 and close to the amount of over EUR 1.1 billion. Monthly value of the acquired assets was to amount to EUR 60 billion. However, in December 2015, the PSPP was extended for a further six months. In addition, the value of the assets to be bought per month was raised to EUR 80 billion. Indirectly, PAPP contributes to improve fiscal sustainability of the countries hereunder, increasing demand to the issued debt instruments and at the same time leading to a decrease in their profitability (Panfil, 2016: 31).

ECB programs proved to be the most effective measures in the fight against the phenomena of crisis in the euro zone. The mere introduction of OMT program stopped the increase in Spanish and Italian bond yields. The biggest advantage of the ECB as a potential lender of last resort is its unlimited financial resources. As a result, it is the only entity that could potentially finance the borrowing needs of the large euro zone countries in the long term[4]. As a drawback of the ECB programs can be recognized the fact that they were implemented ad hoc. So they were a specific response to the development of crisis phenomena, and not the target element of the new architecture of the financial market. In case of the activity of ECB, they bore the hallmarks of constructive ambiguity. In this sense, the possible solutions that would have reduced the risk of moral hazard for the Member

4 Another issue here is the question of the impact of such measures on inflation processes.

States were not likely to have significant importance. Although they may have originated only in case of the OMT program.

It is worth noting that the ECB programs could be more effective if the area of its activities was the primary market of government securities. This type of activities would be manifestly contrary to Art. 123/1 of the Treaty. It should be noted, however, that even the current actions violate the essence of the prohibition set forth in that provision. The described ECB programs were based on the purchase of government securities in unlimited and final manner, which de facto lead to the indirect financing of the borrowing needs of the euro zone (Panfil, 2017: 144). In this perspective, the lifting of the prohibition of Art. 123/1 of the Treaty may be postulated. At the same time, it should go hand in hand with the precise definition of the conditions under which the ECB would provide direct financial support to euro zone Member States. They should be at the same time sufficiently restrictive to minimize the risk of moral hazard. This solution undoubtedly would increase the stability of the whole financial sector of the euro zone. However, realization of this postulate in the current political situation seems unlikely.

6 Conclusion

The experience gained from the euro zone debt crisis clearly demonstrate the need for a lender of last resort for countries from this area. The entity filling this function should have the ability to lending at around EUR 1.5–2 trillion. Only this amount gives a chance to provide parallel support of several members of the euro zone, including the countries such as Italy and Spain. Thus, the aid programs provided by institutions such as EFSM, ESM, IMF may not be sufficient. At the same time, increase of their lending capacity seems unlikely. The role of lender of last resort for euro zone countries should therefore be fulfilled also by the ECB. To increase the effectiveness of its aid programs, however, it would be required to release the restrictions set forth in Art. 123/1 of the Treaty. At the same time, there should be strictly defined the rules, under which the ECB would support the members of the single currency area, in order to avoid inflationary financing of budget deficits. The analysis confirms the hypothesis that only this institution could be the effective lender of last resort for big euro zone countries.

The aid programs provided by all institutions acting as lender of last resort should be determined in advance, and their implementation depend on the adoption of the necessary reforms by the beneficiary. Such a solution would reduce both the risk of market panic, and limited moral hazard. In addition, these programs should be consistent with the EU's legal order and in particular the introductory provisions of the rules of fiscal policy, as well as collective action clauses.

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THE ISSUE OF MODERNIZATION OF THE TRADE DEFENCE INSTRUMENTS IN THE EUROPEAN UNION IN THE XXI CENTURY

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Abstract

This contribution deals with the issue of modernization of trade defense instruments, which has become particularly acute in recent years especially because of the use of subsidies on a massive scale by third countries, a number of government interventions and as a result of the creation of surplus production which then flooded the market of the European Union.

Trade defense instruments (TDI) include three types of measures: anti-dumping, anti-subsidy measures and safeguards. Anti-dumping and anti-subsidy measures serve to offset the losses caused to the economy of a country or organization (the European Union) by unfair trade practices.

The main aim of the contribution is to confirm or disprove the main hypothesis, that the trade defence instruments need urgent modernization in the changing world of the XXI century. This article aims to present the evolution of trade defense instruments in the European Union, the assessment of their development and proposals for change. Due to the fact that the current safeguard measures are used very rarely (only 3 proceedings in the recent years), the scope of this article covers only the anti-dumping and anti-subsidy measures. Research methods used are analysis and synthesis regarding recommendations.

Keywords: Law; Customs; Trade Defense Instruments; Anti-dumping; Anti-subsidy.

JEL Classification: F13, F19, G18, H27, K33, P45

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1 Introduction

Trade defense instruments (TDI) include three types of measures: anti-dumping, anti-subsidy measures and safeguards. These measures are of financial nature and they serve to offset the losses of the economy caused to a country or organization (the European Union) by unfair trade practices - imports of dumped or subsidized imports. The protective measures are applied for a strict predetermined period of time. This is a feature which distinguishes trade defense instruments from the duties included in the Customs Tariff (Drwiłło, 2003: 281–283).

The issue of modernization of trade defense instruments has become particularly acute in recent years especially because of the use of subsidies on a massive scale by third countries, a number of government interventions and as a result of the creation of surplus production which then flooded the market of the European Union. Industries that were especially vulnerable were iron and steel industry, as well as chemical, ceramic and mechanical engineering. Currently, as many as 39 anti-dumping and anti-subsidy duties used by the European Union apply to the steel industry and the main recipient of these duties is China. It was sharp steel imports from China, whose excess production capacity is almost double the annual production of the European Union, that contributed to the decline in prices of certain steel products by 40 %, resulting in 40,000 jobs loss since the beginning of the financial crisis (Communication from the Commission to the European Parliament, the European Council and the Council „Towards a robust trade policy for the EU in the interest of jobs and growth").

The trade defense instruments in the European Union are based on the provisions of the World Trade Organization (WTO). These rules allow member states to restore a fair playing field in the market by combating unfair commercial practices of other countries. Currently, issues related to anti-dumping and anti-subsidy are governed by European Parliament and Council Regulation (EU) 2016/1036 on protection against imports of dumped products from countries not members of the European Union (OJ 2016, L 176/21) and of the European Parliament as well as the Council (EU) Regulation 2016/1037 on the protection against subsidized imports from countries not members of the European Union (OJ 2016 L 176/55).

The main aim of the contribution is to confirm or disprove the main hypothesis, that the trade defence instruments need urgent modernization in the changing world of the XXI century. This article aims to present the evolution of trade defense instruments in the European Union, the assessment of their development and proposals for change. Due to the fact that the current safeguard measures are used very rarely (only 3 proceedings in recent years), the scope of this article covers only the anti-dumping and anti-subsidy measures. Research methods used are analysis and synthesis regarding recommendations.

2 The Evolution of Trade Defence Instruments in the European Union

The current shape of the anti-dumping and anti-subsidy legislation is the result of a long and gradual process, which began in the sixties of the twentieth century, when the first regulation governing the use of trade defense instruments was enacted to all six Member States of the European Union.[2] This act – Regulation 459/68 on protection against dumping or granting of bounties or subsidies by the countries which are not members of the European Economic Community (OJ 1968 L93/1) which was adopted on 5 April 1968, was based on the assumptions of the 1967 GATT Anti-dumping Code. It was amended several times. The most important changes took place in July 1979.3 They increased transparency by granting the parties access to the information submitted by the other parties. The changes in the determination of the normal value with respect to imports from non-market economy and in the case of constructing the export price were also introduced.

2 Earlier each of the Member States of the European Economic Area had a separate act concerning the use of trade defense instruments: in Belgium it was Law of 11 September 1962 on the import, export and transit of goods and associated technology (Moniteur Belge, 27 October 1962), in France Article 19 of Customs Law (Journal Officiel, 18 December 1966), in Germany paragraph 21 of Customs Law (Siebentes Gesetz zur Anderung des Zollgesetzes, 30 June 1966, BGB1 I 542), in Italy – Law no. 39 from 11 January 1963 (Gazetta Officiale No. 40, 12 lutego 1962, p. 761), in Luxemburg Law of import, export and transit of goods and associated technology from 5 August 1963 (Memorial Lux., 10 August 1963) and in the Netherlands Law of import and export of goods and associated technology from 5 July 1962 (Staatsblad No. 295/1962).

3 This act was Council Regulation (EEC) No 1681/79 of 1 August 1979 amending Regulation (EEC) No 459/68 on protection against dumping or the granting of bounties or subsidies by countries which are not members of the European Economic Community (OJ 1979 L196/1).

In December 1979, Regulation 459/68 was replaced by Regulation 3017/79 (OJ 1979 L339/1). It incorporated the provisions of the Agreement on Interpretation and Application of Articles VI, XVI and XXII (Subsidies and Countervailing Measures Code) adopted by the Tokyo Round negotiations. It introduced new rules regarding the determination of injury, in particular the requirement to prove that imports of dumped or subsidized imports have caused material injury, and not, as has been the case so far, only to prove that dumping or subsidies were the main cause of damage regardless of its type and size. Since that time, the imposition of protective measures was dependent from the occurrence of material injury to the domestic industry, and not from any damage (van Bael, Bellis, 2004: 23). Apart from that more detailed provisions on the confidentiality of the information were introduced. A result of the revision of Regulation 3017/79, which was introduced in 1982, was a requirement that reviews could be conducted only after passage of one year after the end of the proceeding[4].

Regulation 3017/79 was in force until July 1984, when it was replaced by Council Regulation (EEC) No 2176/84 of 23 July 1984 on protection against dumped or subsidized imports from countries not members of the European Economic Community (OJ 1984 L201/1). It introduced the so-called "sunset clause", a clause according to which the protective measures automatically expire after five years from their imposition. It also clarified the meaning of production costs in order to calculate the constructed value. In June 1987 the provision under which anti-dumping duties could also apply to products sold within the European Union by companies related to or associated with an exporter, to whose products anti-dumping duties were imposed was incorporated.[5]

Another regulation on the protection procedures was Council Regulation (EEC) No 2423/88 of 11 July 1988 on protection against dumped or subsidized imports from countries not members of the European Economic

4 This was done by Council Regulation (EEC) No 1580/82 of 14 June1982 amending Regulation (EEC) 3017 on protection against dumped or subsidized imports from countries not members of the European Economic Community (OJ 1982 L178/9).

5 This was done by Council Regulation (EEC) No 1761/87 of 22 June 1987 amending Regulation (EEC) No 2176/84 on protection against dumped or subsidized imports from countries not members of the European Economic Community (OJ 1987 L167/9).

Community (OJ 1988 L209/1). It introduced additional changes, which primarily included the ability of increasing the protective duty in the event of proving that the exporter can bore the cost of it (the anti-absorption duty).

In March 1994, Regulation 2423/88 has been changed.[6] The basic modification concerned the decision on the imposition of protective measures by the Council. It was decided that the Council will take decisions in this regard by a simple majority, rather than as it was so far – by a qualified majority. This change has been forced by the more protectionist countries, in particular by France, which made its acceptance of the Uruguay Round package conditional upon the adoption of this provision (van Bael, Bellis, 2004: 24).

In December 1994 a new act regarding trade defense instruments – Council Regulation (EC) 3283/94 of 22 December 1994 on protection against dumped imports from countries not members of the European Community (OJ 1994 L349/1) was adopted. It incorporated the provisions of the Uruguay Round Agreement. Its consolidated version incorporating the changes was published in March 1996 as Regulation 384/96 on protection against dumped imports from countries not members of the European Community (O.J. 1996, L 56/1). This regulation was for the first time devoted exclusively to the dumped imports, at the same time separating the anti-dumping legislation from anti-subsidy legislation. It applied to all products, except for products falling within the competences of the European Coal and Steel Community (ECSC), to which a separate Commission Decision was used. However, in July 2002 this decision – Commission Decision 2277/96, containing identical provisions to Regulation No 384/96 was repealed.[7] From that moment, Regulation 384/96 applied to all products. It should be noted, however, that services were excluded from its validity. This regulation was amended several times. The most particular change took place in 2004 and concerned the change of the method of counting the votes in the Council

6 Regulation 2423/88 has been changed by Council Regulation (EC) No 522/94 of 7 March 1994 on the streamlining of decision-making procedures for certain Community instruments of commercial defense and amending Regulations (EEC) No 2641/84 and No 2423/88 (OJ 1994 L66/10).

7 The temporary situation was regulated by Council Regulation (EC) 963/2002 of 3 June 2002, laying down transitional provisions concerning anti-dumping and anti-subsidy measures adopted pursuant to Commission Decision No 2277/96 / ECSC and No 1889/98 / ECSC as well as pending anti-dumping and anti-subsidy investigations, complaints and applications pursuant to those decisions (OJ 2002 L149 / 3).

during the voting on the adoption of definitive anti-dumping and anti-subsidy measures.

Subsidies have been regulated in Regulation 2026/97 of 6 October 1997 on protection against subsidized imports from countries not members of the European Community (O.J. 1997 L 288/1).

In December 2006 the European Commission published the so-called Green Paper on market protection instruments of the European Community. The aim of that Book was to encourage public debate on the future of anti-dumping and anti-subsidy legislation in the European Union.[8] Although the book was withdrawn by its originator Commissioner for Trade Peter Mandelson in January 2008,[9] it met with a significant response in the literature (Hindley: 2007; Vyboldnina: 2007; Vandenbussche, Zanardi: 2008).

In January 2007 a new institution has been appointed. The Hearing Officer is an independent mediator and his aim is to guarantee due process and the right of defense in anti-dumping and anti-subsidy proceedings. He/she is an independent official of the Directorate for Trade of the European Commission. The core duty is to give advice to the Director General of the Trade of the European Commission, but his opinions are not binding (McNellis, 2008: 77–80). Unfortunately his presence is not obligatory at all meetings organized by the Commission, he only participates at the meetings at the request of interested parties.

The introduction of the Hearing Officer pages has to be assessed positively. His/her participation in the proceedings ensures greater transparency of the proceedings. The parties gain an additional supporter of the European

8 The impetus for the publication of the book was the case of dumped imports of leather shoes from China and Vietnam in 2005. Anti-dumping duties have proved to be unfavorable for a large number of shoe manufacturers from the European Union. Many EU producers have moved their production to countries outside the European Union due to lower production costs. Paradoxically, the imports of footwear produced by them in these countries became the subject of anti-dumping and anti-dumping measures. See. GLOBAL EUROPE. Europe's trade defense instruments in a changing global economy. A Green Paper for public consultation, www.eur-lex.europa.eu Despite considerable differences of opinion between Member States it was decided to impose anti-dumping duties of 16.5 %, for a period of two years, which at the time was much shorter than usual.

9 The author suggested limiting the use of anti-dumping measures by the European Union, which was not met with a wider appreciation, especially within the Member States. Therefore, in January 2008, this proposal was withdrawn by him. See. eg. Polish responses to the questions in the Green Paper on TDI, www.mg.gov.pl

Commission, to which they can turn with their requests and complaints with regard to the proceeding. At the moment, however, the position of the Hearing Officer is quite passive as works at the request of interested parties, the Commission, the Member States, and only in exceptional cases, from ex officio.

Regulation 384/96 on protection against dumped import of goods from countries not members of the European Community was in force for 13 years, and then was amended by Council Regulation No 1225/2009 of 30 November 2009 on protection against dumped imports from countries not members of the European Community. On the other hand, Regulation 2026/97 of 6 October 1997 on protection against subsidized imports from countries not members of the European Community has been replaced by Regulation 597/2009 of 11 June 2009 on protection against subsidized imports from countries not members of the European Community.

Since 2012 the European Commission has been working on improving the functioning of the EU trade defense instruments. The importers, exporters, users have been asked to assess the functioning of market protection. They were also invited to suggest the direction of changes. An analysis prepared by independent experts was also helpful (Evaluation of the European Union's Trade Defense Instruments. Final Evaluation Study). The result of all these activities was to develop proposals for changes aimed at improving the functioning of market protection (Communication from the Commission to the Council and the European Parliament on Modernization of Trade Defense Instruments Adapting trade defense instruments to the current needs of the European economy). The Commission's proposal included six key areas: improving transparency and greater predictability of protective procedures, fight against the threats of retaliation, effectiveness and enforcement of protective measures, simplifying the refund procedures, the optimization of the review investigations and codification of certain assumptions (to align the European Union's legislation with current practice and in light of WTO jurisprudence). The aim of the proposals for changes in the functioning of the protective measures was to contribute to free and fair trade in accordance with Article 3 paragraph 5 of the Treaty of the European Union. It was stated that trade defense instruments should be improved in a pragmatic and balanced way for the benefit of all stakeholders.

3 Are The Changes Needed? – The Way Forward

The direction of changes proposed in the Communication of the Commission and above all the idea of undertaking the modernization of trade defense instruments should be assessed positively. The proposed changes largely meet the expectations of importers. They mainly intend to increase the transparency of anti-dumping and anti-subsidy procedures, especially by the introduction of the principle of prior, two weeks in advance, informing the interested parties of the intention of imposing the provisional measures, thus allowing to avoid the element of surprise. Such information should include a brief description of the proposed measures and the appropriate calculation of the dumping margin and damage for each cooperating exporter and the Union industry. The interested party has to be able to comment on the calculations within 3 days. This does not change the fact that the full disclosure should take place during the imposition of protective measures. The solution allows for possible correction of computational errors before the imposition of provisional measures and to avoid unnecessary delays in the legislative process.

The proposal to introduce the principle of informing the parties two weeks in advance before the expiry of the nine-month deadline for the imposition of provisional measures whether the introduction of definitive measures is planned or not deserves approval. The measures would have to be imposed within two weeks of delivering this information. To date, the parties have learned that the measures have not been imposed only after the expiry of this nine month period. The introduction of this rule would contribute to a greater transparency of procedures and allow for greater predictability and better planning by the entrepreneurs.

The proposal to simplify the information required by the Council in the course of proceedings, as well as the extension of deadlines to register as an interested party from 15 days to 29 and to respond to a questionnaire from 37 days to 51 is of particular note. This solution aims to improve cooperation between the authorities conducting the proceedings and the relevant stakeholders, who sometimes even resigned from cooperation precisely because of the short deadlines. It would with no doubt contribute to into even greater reliability of the findings on which the authorities of the European Union make the decisions.

So far, the retaliation usually taking the form of threats to production, as well as the creation of administrative barriers applied to producers from the European Union intending to submit an action for the initiation of anti-dumping or anti-subsidy proceeding was a big problem. Due to a fear of such adverse consequences the producers reluctantly filed the complaints and sometimes even withdrew from participation in the investigation. Although the current regulations provide for the possibility to initiate proceedings ex officio, this in practice has happened very rarely. Therefore, the proposal to clarify the provisions relating to initiation of the anti-dumping and anti-subsidy proceedings ex officio should definitely be assessed positively. The producers from the European Union fearing possible retaliation would have the possibility to contact the Commission in a confidential manner. The information required by the Commission would be published on the website of DG. Trade. The Commission, while deciding to initiate proceedings ex officio would be obliged to rely on the quality of the available evidence on dumping or subsidies, taking into account economic reasons – it would be necessary to check whether the imposition of anti-dumping or anti-subsidy measures, in the event of confirmed use of dumping or subsidies. It would have a positive economic effect for the entire European Union. The effectiveness of such proceedings initiated ex officio would be strengthened by the introduction of the obligation for the European Union's producers to cooperate, including in particular the duty to respond to the questionnaire transmitted at the beginning of the investigation. So far, the parties were not obliged to cooperate in anti-dumping and anti-subsidy proceedings, which obviously hampered those investigations. It should be emphasized that the data delivered by the producers to the Commission would have to remain confidential and would not be disclosed in non-confidential documentation.

A novelty is the proposal of a partial resignation from the application of the lesser duty rule[10] in anti-subsidy proceedings as well as in cases where there

10 Due to the principle of the lesser protective measures can only be imposed under the condition that dumping or subsidization has caused material injury or threat of material injury or the danger of delaying the development of the Union industry. In this case, anti-dumping or anti-subsidy measures are imposed at the level of the dumping margin or the subsidy margin, or at a level sufficient to remove the injury. In a situation where dumping or subsidy indeed occurred, but did not cause material injury, the measures are not imposed.

are structural distortions on the raw materials market. Such solution is justified by the fact that the application of the lesser duty rule by the European Union authorities may even encourage foreign governments to continue subsidizing their businesses and interference in the trade of raw materials (Communication from the Commission to the Council and the European Parliament on Modernization of Trade Defense Instruments Adapting trade defense instruments to the current needs of the European economy). The existing law does not yet contain provisions which would effectively discourage the entrepreneurs from third countries and the governments to refrain from such practices. Therefore, derogation from the lesser duty rule, according to which, the lesser duty rule does not apply to the whole country in the case of subsidization and for the entire country in the event of structural distortions in the commodity market should be approved.

The proposals of changes (included in the Communication from the Commission to the Council and the European Parliament on Modernization of Trade Defense Instruments) have not yet been included in Regulation of the European Parliament and of the Council (EU) 2016/1036 on protection against imports of dumped imports from countries not members of the European Union (OJ 2016, L 176/21) and Regulation of the European Parliament and of the Council (EU) 2016/1037 on the protection against subsidized imports from countries not members of the European Union(OJ 2016, L 176/55) both adopted on 8 June 2016, which consolidated amendments to previous regulations. The Commission's proposals of changes, have not yet been considered by the Council, mainly due to the inability to reach agreement on the modernization of the lesser duty rule.[11]

4 The Future of Trade Defense Instruments – Proposals

The European Union is a very moderate and careful user of trade defense instruments and currently only 0.21 % of the imports is subject to anti-dumping or anti-subsidy measures.[12] For comparison, the United States uses

11 This does not change the fact that changes to the current EU legislation concerning the protection of trade are urgently necessary because soon certain provisions concerning the calculation of dumping placed in the protocols of accession of China, Vietnam and Tajikistan to the World Trade Organization will lose the power.

12 The European Union ranks third globally in terms of the number of used protective measures, after India and the United States.

much more protective measures than the European Union and the applied measures are much higher. For example, European Union applied in 2015 an anti-dumping duty of 21.1 % on the cold rolled steel products from China, while the anti-dumping duty in force in the United States for the same product was 266 %. In turn, in 2012, the European Union applied the rate of 22.5 % anti-dumping duty for steel rebar imported from China, while the United States has imposed a duty of 133 % on this product.

The European Union observes high standards while using trade defense instruments. The provisions relating to the issues in question are much more liberal than those required by the World Trade Organization. Especially noteworthy is the use of so-called "WTO + elements", which include especially examining the interest of the European Union in the imposition of protective measures and the "lesser duty" rule. Those WTO + elements deliver significant savings in time and effort of carrying out anti-dumping and anti-subsidy investigations and ensure proportionality and balance in the application of trade defense measures. The above does not change the fact that, in certain specific situations, especially in cases where there are huge overcapacity in third countries or disturbances on the market of raw materials, limiting the application of the lesser duty is justified. In such situations, there is a risk of redirecting of the trade to the European Union, which further leads to the worsening of its economic situation.

When applying the trade defense instruments it is necessary to draw attention to the fact that the benefits should outweigh the costs of the implementation of the measures. The imposition of protective measures is not always the best way to repair the damage caused by unfair trade practices. It should be noted, however, that that criterion of the European Union's interest as a condition for the imposition of protective measures can sometimes be abused. The Commission ordinary states in most cases, that the imposition of protective measures is in the interest of the European Union. In virtually every case, the Commission ultimately favored the applicants against the interests of users, usually unwilling to admit to displace the domestic producers out of the market. It seems that the cause of identifying the European Union's interest with the interest of the applicants is the worse

organization and dispersion of the consumers, which weakens their influence on the actions taken. Therefore, it seems justified to demand more research on the impact of the protective measures on the situation of consumers.

In practice, protective measures are sometimes abused. This applies especially to anti-dumping measures, specifically to the method of determining the dumping margin, as well as the finding of damage caused by it. It seems that the actions taken by the Commission are too often discretionary. It should be considered whether, following the example of the American regulations, not to introduce the rules, that the anti-dumping investigation should be carried out by two institutions, independent from each other, with different competences. The task of one institution would be to detect the presence or absence of dumped imports and the second body would address the statement of damage.

Protective measures, both anti-dumping and anti-subsidy may in practice provide too little or too much protection to the economy, thus it is vital to find the appropriate balance between the interests of all stakeholders. Therefore, the extension of the competences of the Hearing Officer, whose task would be to find the right balance between strong reasons for and against the imposition of protective measures, should be considered. It seems reasonable to introduce the rule of the obligatory participation of the Hearing Officer in the anti-dumping and anti-subsidy proceedings. He/she should also be engaged in monitoring the impact of imposed protective measures, and in situations where their use is no longer necessary, initiate the review investigations ex officio.

Also, publishing price undertakings accepted by the exporters, of course subject to non-disclosure of confidential information, seems a good solution.

5 Conclusion

The system of trade defense instruments is still a subject of negotiations in the World Trade Organization. Thus, it would not seem reasonable to undertake unilateral commitments by the European Union, we should rather strive to promote more stringent than those under the provisions of the WTO European standards in other countries. The aim of anti-dumping and anti-subsidy regulations and protective measures imposed

as a result of the investigations should be sufficient to protect the European Union's market against imports of dumped and subsidized imports. These regulations should not, however, restrict the trade, but force its participants to play fair. The main aim of the trade defense instruments is in fact to restore the conditions of competition distorted by unfair trade practices.

The European Union's regulations of trade defense instruments in their current form are not perfect and changes are needed. The European Union's trade defense instruments should be effective in order to ensure fair competition in open markets. That is why proposals of modernization of the trade defense instruments should be adopted as a matter of urgency. It should thus be concluded that the main hypothesis of this contribution has been approved.

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SPECIAL ECONOMIC ZONES IN RUSSIA AND FOREIGN COUNTRIES: BUDGET RISKS AND TAX EXPENDITURES

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Abstract

The present study examines the legal aspects of the management and tax incentivization of special economic zones in the Russian Federation and foreign countries. The study proves that ineffectual management and ineffective tax incentives are one of the main reasons for the failure of special economic zones that lead to unwarranted budget risks and uncompensated tax expenditures as well. The study proposed legal measures for optimization of management system and tax incentives in SEZs, which could have an impact on reducing budget risks, tax expenditures and other budget losses.

The purpose of this study is to offer legal measures for optimization of management system and tax incentives used in SEZs that would have an impact on reducing budget risks, tax expenditures and other budget losses. The purpose of the study predetermined the choice of applied research methods, among which comparative method should be highlighted.

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1 Introduction

At present special economic zones (hereinafter SEZs) have been firmly involved into global business practices and have become an integral part of international economic relations. To date, more than 4,000 SEZs of various kinds have been established in the world. In comparison with other countries, establishing and functioning of SEZs in Russia do not have a long history. A few fragmented attempts of establishing of SEZs in Russia were made in the early 90th. Transition to implementing a unified state policy in the field of establishing, management and functioning of SEZs was implemented only in 2005 with the adoption of the Federal law "On Special Economic Zones in Russia".

Despite the attractiveness of SEZs as a mechanism of attracting investments, stimulating production, trade and innovation development, SEZs will inevitably create an imbalance in the domestic economy of the state. Establishment and functioning of SEZs, as a rule, requires spending on infrastructure and significant incentives (fiscal, administrative and other), entailing budget risks of incurring expenditures and not receiving incomes. In the case of achieving the objectives of establishing SEZs, these expenditures and losses are compensated by positive socio-economic changes (the growth of production and trade, creating new jobs, etc.).

If the objectives of establishing SEZs aren't achieved, state's expenditures aren't compensated. Among main reasons for the failure of SEZ, in our opinion, there are inefficient management of SEZs, as well as insufficient and (or) inefficient preferential mechanisms provided for SEZs residents. Namely these aspects of functioning of SEZs are subject of present article.

Thus, the purpose of this study is to offer legal measures for optimization of management system and tax incentives used in SEZs that would have an impact on reducing budget risks, tax expenditures and other budget losses.

If the objectives of establishing SEZs aren't achieved, state's expenditures aren't compensated. Present article analyzes management of SEZs and preferential mechanisms provided for SEZs residents to determine reasons for the failure of SEZ in the Russian Federation.

Another purpose of this study is to offer legal measures for optimization of management system and tax incentives used in SEZs that would have an impact on reducing budget risks, tax expenditures and other budget losses.

The study takes into account that the objectives of establishing SEZs vary considerably in developed countries and in countries in transition as well as in developing countries. For the first group of countries solution of economic problems is often not the main goal, whereas priority targets are innovative development, improving living standards of the population, stimulation of underdeveloped regions. For countries in transition and developing countries, on the contrary, the establishment of the SEZ is primarily subject for solution of economic goals. So, the Russian Federation, that is under the post-industrial stage of development, is interested in manufacturing and production industry. Therefore, the positive experience of SEZs' functioning in countries in transition and developing countries are more applicable to Russia.

The purpose of the study predetermined the choice of applied research methods, among which comparative method should be highlighted. This method has allowed comparing management of SEZs and tax incentives granted to special areas in different countries as well as identifying common regularities of their development. In addition, systematic approach has been used, as SEZ is a complex system where all elements are interrelated and interdependent. This study concentrated on the interaction of such elements of SEZ as budget risks connected with financing and incentivization of SEZs, system of management authorities of SEZs and tax incentives.

Problems of SEZs' functioning have been examined in many Russian and foreign scientific articles and studies. In our study we also relied on legislation on SEZs in force in different countries and empirical data accumulated in the working papers prepared of the International Monetary Fund, OECD, The World Bank.

2 Budget Risks as a Result of SEZs' Functioning

The Russian SEZs were set up to support stagnant regions, to develop high-tech activities and to create import-substituting industries.

In 2005 the Russian Parliament adopted the Federal Law on Special Economic Zones in the Russian Federation" (Act no. 116-FZ/2005). The current legislation provides for the creation in Russia of the four types of SEZs: industrial production; technical innovation (innovation); tourism and recreation; port (logistics).

In 2006 the Russian Federation established the Joint-stock company "Special Economic Zones" as a management SEZs company. The Ministry of Economic Development of the Russian Federation exercises the shareholder's rights on behalf of the Russian Federation. The JSC "Special Economic Zones" manages the existing and newly established SEZ in Russia.

Within 10 years from the Law on Special Economic Zone adoption 33 SEZs were established. By 2016 in the all SEZs there were registered 435 residents including 70 companies (16 % of the total number of investors) (Nikitina, 2016: 6).

A decision to create a SEZ is made by the Government of the Russian Federation. The Russian Government makes an agreement with reginal and local executive bodies on the establishment of a SEZ. The agreement establishes measures of SEZ development and an order of their funding (amount and timing of funding to create engineering, transport, social, innovation and other infrastructure of the SEZ at the expense of the federal, regional, local budget, and off-budget sources of financing).

A SEZ could be run by the JSC "SEZ" as well as a commercial organization established with the JSC "SEZ" or a commercial organization made an agreement with the Ministry of Economic Development on the management of the SEZ.

Budget legislation provided for some rules concerning financing of SEZ infrastructure facilities at the expense of the federal budget, the budgets of the Russian Federation and local budgets.

Analysis of Budget Code of the Russian Federation (Act no. 145-FZ/2008, as amended) and the Federal Law on SEZs shows that federal budget could finance the SEZ infrastructure facilities with help of capital contribution to JSC "SEZ" who finances the development of SEZ infrastructure. The federal budget could finance the SEZ infrastructure facilities with help of capital contribution to JSC "SEZ" who finances the development of SEZ infrastructure. The subjects of the Russian Federation and municipalities could finance the SEZ infrastructure development by making a contribution to the charter capital of the management company of the SEZ.

In fact, the federal government finances SEZs by budget grant (subsidy) to the JSC "SEZ" through the Ministry of Economic Development of the Russian Federation.

As a rule federal governmental acts prescribe the next purposes of the budget grant (subsidy):

1. For development of area planning design for the SEZ;
2. For designing and construction of SEZ infrastructure.

The total cost of SEZs infrastructure investments is estimated to be 334.2 billion rubles including 224.5 billion rubles subsidies from the federal budget and 109.7 billion rubles subsidies from regional budgets. At the same time from 2006 to 2015 the total amount of federal budget funds allocated for the SEZ creation and development were 121.9 billion rubles, regional budgets – 64 billion rubles (For 10 years the SEZ has never become an effective tool to support the economy).

However last time a number of publications and estimates calling attention to the fact that the ten-year SEZ experience shows that they has not become an effective tool to support the national economy.

The Russian President instructed the Government of the Russian Federation to analyze the efficiency of the investment expenditure carried out at the expense of federal budgetary allocations including the SEZ establishment and development, and submit proposals for optimization of costs (Presidential instructions following meeting on economic issues).

The Accounts Chamber of the Russian Federation noted that the process of SEZs creation and management is characterized by formalism,

irresponsibility and impunity, lack of operational discipline and demand for decisions and their consequences. The real economic benefit of the SEZs is not reached (For 10 years the SEZ has never become an effective tool to support the economy).

In addition, responsibility of the regions for the implementation of financial obligation agreements concerning the SEZs establishment are not provided. By January 1, 2016 the obligations of regional budgets have not fulfillment by approximately 41.7 % (i.e. more than 45 billion rubles).

As a result of inefficient management decisions budgetary funds allocated for the SEZ development are significantly higher than the real needs. By January 1, 2016 the amount of unused federal budget funds have been 24.8 billion rubles. As the audit showed the SEZs management companies allocated free funds in the period from 2006 to 2015. The total interest income amounted 29.3 billion rubles. At the same time financial transactions were high-risk. Thus by 2016 financial loses have been 2.6 billion rubles.

In 2016, the Russian Government adopted a decree introduced the Rules of SEZ efficiency evaluating (Act no. 643/2016). It introduced estimate indicators and formulas for their calculation. The Ministry of Economic Development of the Russian Federation should submit to the Russian Government reports on SEZs results as well proposals for SEZ termination in case of its efficiency.

The Rules of SEZ efficiency evaluating should increase the responsibility of the regions as well. The Ministry of Economic Development of the Russian Federation should prescribe a financial responsibility for regional budgets in the agreements concerning the transfer of SEZ management authority to subjects of the Russian Federation. The regional budgets should return to the federal budget some federal invested funds in case of SEZ ineffective functioning. The evaluation of the SEZ effectiveness should take place after the 3rd, 6th and 10th years of SEZ functioning.

Thus, the Russian Federation has chosen the path of region economic development with help of SEZs. However, the effectiveness of such a path was critically low. Some problems in SEZs legal regulation and lacks of proper control led to an inefficient use of significant budget funds. Until now there

is no long-term strategy of SEZ development in Russia. So the current legal acts try to adjust to the current situation in the SEZs.

In our opinion, mentioned circumstances indicate that previous regulation of SEZs in the Russian Federation was imperfect. There was no mechanism for control of SEZ effectiveness. Subjects of the Russian Federation and municipalities were not responsible for SEZ functioning results. Budget legislation did not provide for proper rules for targeted and effective use of budget subsidies. As a result now we have to establish necessary norms and acts to stimulate all participants of SEZ system for responsible and effective functioning.

3 Management of SEZs: Problems and Budget Losses

SEZs are run by a special system of bodies that have necessary powers for the general and direct management of the SEZs. The governing bodies of SEZs include all subjects authorized to take management decisions concerning SEZs not only the state authorities. Along with the state authorities the SEZs could be run by local authorities, public and private organizations as well as public bodies (councils, commissions, etc.) consisting of state and municipal representatives, investors and other stakeholders.

A SEZ management system is directly dependent on the territorial structure of the state and a territory where the SEZ located, on current system of state government, on purpose and on type of the SEZ. SEZ funding sources and benefits (advantages) providing for investors have impact on influence SEZ management system as well.

The table below shows the SEZ management dependence on the ownership of the land where the SEZ located and on types of investments to the SEZ infrastructure.

Table 1. SEZ management

	Ownership of the SEZ land	Investments to SEZ infrastructure	SEZ management
Model I	state	state	state
Model II	state	private	private / combined
Model III	private	private	private

Some states allow establishing of a SEZ upon an initiative of private subjects and on the basis of private capital. Such SEZs are run by private structures. And the administrative impact of the public authorities on the SEZ development and operation is minimal. Moreover, often the establishing of a SEZ by private subjects does not require a special permit from public authorities.[2]

The benefits of private SEZs are a stable business environment for investors; fewer administrative barriers resulting in reduce the cost of doing business, a significant degree of protection against political changes in the country. Also the establishment of SEZ on the basis of private capital demands lower government expenditure on infrastructure and SEZ development leading to lower budget risks. A special state control over the SEZs (including through participation in management) is required only in cases when the state provided some administrative and fiscal advantages for private SEZ investors.

In Russia the law allows to establish a SEZ on a land owned by private persons (organizations or individuals). However the law does not provide for a special mechanism of private SEZ establishment and management, for giving preferences for such SEZs. We consider that in Russia it's necessary to support commercial initiatives legally and to adopt simplified rules of creation and management of SEZ founded only or mainly on a private property.

In the world the most common SEZs are ones where state authorities play an active role in the management. The SEZ administration system could include federal public authorities, regional authorities (especially in the federal states) and the local administration. Regional authorities are involved in the SEZ management in federal state and in unitary states where regions

2 For example, the mentioned principles were applied in setting up of technology parks in the United States. Some of them were established spontaneously on the basis of private initiative ("Silicon Valley" (California), "Boston Road 128" (Massachusetts) and "Triangle Park" (North Carolina)). The other was set up under orders of the governments of states. Special economic zones based on private capital were established in Brazil, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Paraguay, Uruguay and in some other countries (Prikhodko, Volovik, 2007: 47–48).

have significant autonomy. Regional and local authorities could widely participate in the financing of the SEZ infrastructure; provide for benefits and advantages to the SEZ investors.[3]

There are two main approaches to SEZ management based on the current system of public government: centralized and decentralized management.

In case of centralized management all the main functions concerning overall management and SEZ development are concentrated in the central state authorities. Regional and local authorities could be involved in the management of some zones, but they could be delegated just minor powers. Centralized SEZ management system is not mobile and not conducive to fast solution development problems, does not provide the interest of the regions and municipalities in the SEZ effectiveness. In case of centralized management type specialized managing companies could participate in SEZ administration but mainly with significant state share. The state's share in the SEZ managing companies allows controlling financial flows and helps to observe state interests. International experience of SEZ functioning shows that centralized system of SEZ management is typical used in countries with transition economies that just only beginning to establish SEZs.

Centralize management of SEZs is typical for Russia. At the initial stage of SEZ establishment the management system was three-tier. It included the Ministry of Economic Development of Russia authorized to carry out general SEZ management and to adopt normative legal acts in this area; specially established public body realized the direct management of each SEZ; direct SEZ management could also be run by management companies. Regional and local authorities were not involved in the administration of SEZs. Moreover, regional authorities were obliged to delegate the power

[3] For example, in India governments of states play a key role in establishment of SEZs and their infrastructure. In Japan the development of "Technopolis" program aimed at accelerating of scientific and technical potential were relied on local authorities. In turn, the central government determined the basic criteria for technopolises establishment, provideв for technical assistance, granted tax benefits as well loans from the Bank of Japan. In 2014, under the «national strategic economic zones» program it was decided to give regulating powers to cities and regions along with fiscal and monetary stimulus (Tokyo's Special Economic Zones: http://www.seisakukikaku.metro.tokyo.jp/invest_tokyo/english/invest-tokyo/merit.html).

to manage and to dispose of land and other real property within the SEZ territory to the management bodies of the SEZ for the period of the SEZ lifetime.

In 2010, there was a transition to a two-tier management system. Powers of general management as well as part of the direct control functions have been retained by the Ministry of Economic Development of Russia; direct management partly have been transferred to management companies and regional authorities in accordance with agreements. So there appeared some features of decentralization in SEZ management system in Russia.

Decentralized management is characterized by the redistribution of powers concerning SEZ management between the central authorities and subfederal authorities. Decentralization of SEZ management the same as decentralization of state administration in general allows using the benefits of the regional authorities that close to their territorial communities and providing an impetus for regional development (territorial decentralization). However, the support of regional development has a downside. A connection between the center and regions is weakened, the dependence between the parts of the whole is lost and local autonomies are encouraged (Talapina, 2015).

As a part of the decentralization of SEZ management in Russia today there is a transfer of management authority from the central government to the regional (Act no. 643/2016). The regional authorities get functions concerning maintenance of SEZ investor registry; control over the implementation of the SEZ residents of rules within the zone; attract new residents; fulfillment state customer functions in preparation of the documentation necessary for the planning and development of SEZ infrastructure; providing expert examination of project documentation and expert examination of results of engineering surveys. To our opinion the delegation of real powers for SEZ management to regional authorities could increase SEZ effectiveness as well as responsibility of the regions for the socio-economic effects concerning the SEZs. The management reform of the SEZ taking place in Russia doesn't assume involvement of regional authorities to work with SEZs. In our opinion, creation of conditions for initiatives of local authorities in development of SEZs would increase local authorities' interest in functioning of SEZs and their responsibility.

Decentralization is also presented in the delegation of SEZ management authority to private management companies. This way SEZs take a form of public-private partnerships that characterized not rigid vertical administrative and enforcement influence of the state to business but cooperation between entrepreneurial initiatives and government support.

For the SEZ administration the Russian Federation established commercial organization as a joint stock company (a hundred percent of stocks owned by the state). Third-party management companies (non-state) run just three SEZs (while in Russia currently there are more than two dozen SEZs). Apparently in Russia private companies are not engaged for SEZ management in general.

At the same time in the world there are various models for encouraging private companies to manage SEZs. The SEZ could be controlled by: a) the dominant investor who also fulfills functions of the management company (primary user); b) the management company whose shareholders are the major investors of the SEZ (limited partnership); c) an independent management company whose shareholders are not investors of the SEZ (Dzhetpisova, Potapov, 2009: 84).

An interesting example for Russia is the experience of SEZ management in Lithuania. The non-state management company selected on a competitive basis includes one member from the Government of Lithuania and from municipal council of the territory where the SEZ located (Law on the Fundamentals of Free Economic Zones no. I-976/1995). Thus, on the one hand, it provides for professional management by a company who is interested in the SEZ effectiveness, and, on the other hand, it provides for internal control over the management company by the state and local authorities

4 Tax expenditures as a Result of SEZs' Functioning

Tax expenditures are generally described as a loss of budget revenues as a result of provision of tax incentives established by tax legislation to achieve socio-economic goals in which the state is interested in a particular period of its development. In world practice along with direct budget expenditures (subsidies, etc.), tax incentives are widely used as a stimulating mechanism of subjects of SEZs' activity and attraction of domestic and foreign investment.

The main direction of tax incentivization in the vast majority of states that have established SEZs is providing incentives for corporate income tax (hereinafter – CIT). Primarily there is full exemption from payment of CIT or taxation at reduced tax rates:

- In China, for SEZs participants there are provided a five-year "tax holidays", i.e., exemption from payment of CIT as well as reduction of tax rate to 15 % (standard tax rate of CIT is 25 %);
- In the Philippines full exemption from payment of CIT is provided for a period of 4 to 6 years, depending on the kind of SEZ and type of project/activities undertaken within a particular SEZ (Philippine Economic Zone Authorities: http://www.peza.gov.ph/index.php/eligible-activities-incentives/fiscal-incentives);
- In the Republic of Kazakhstan and Brazil participants of SEZs are exempt from payment of CIT up to 10 years (Code no. 99-IV/2008);
- Among the African countries Kenya, Mauritius, Ghana and Madagascar have been most successful in development of SEZs although SEZs have been established and function in considerable part of African countries (especially in Nigeria, Senegal, Tanzania, Lesotho and some other). Incentives on CIT are the main mechanism of tax stimulation for SEZs in African countries. Almost all countries (except Senegal) provide to participants of SEZs significantly long periods of full or partial exemption from CIT (standard rate of CIT in African countries is between 25 and 30 %). In some countries (e.g. in Ghana) after the expiry of full exemption from CIT it is guaranteed tax rates that do not exceed certain rate specified in legislation. (Zeng, 2015: 7–9, Farole, 2011: 136–147).

In the Russian Federation CIT is 20 % and is federal tax that is established by federal law. However, revenues from this tax are credited not only to the federal budget (2 %) but to the budgets of subject of the Federation (18 %) as well. Subjects of the Russian Federation are entitled to fix reduced rate of CIT payable to their budget. The vast majority of subjects of the Russian Federation where SEZs have been established, fixes reduced rate of CIT payable to their budgets if incomes are derived from activities carried out in SEZs. Such tax incentive is aimed at direct reducing of the amount of tax

payable to the budget of corresponding level of budget system. The size of reduced tax rates varies and depends on the type of economic activities carried out by taxpayers that are participants of SEZs or type of SEZ.

Reduced tax rates can be provided without limitation of the terms of their use as well as for a certain period of time. Moreover, in the last specified case a number of subjects of the Russian Federation, fixing low or minimum tax rate for a certain period of time, gradually increase it for all subsequent tax periods.

In addition to zero or low tax rates tax on CIT there are other tax incentives in the world practice that are also known to the Russian tax legislation:

- Accelerated depreciation (for example, Malaysia, Bangladesh, some African countries);
- Preferential costs' accounting of certain types of activities (e.g. R & D, material costs, etc.).

Apart from CIT tax incentives in the form of full or partial tax exemptions are provided for property taxes, primarily for real estate tax and taxes on property of companies (Radvan, Šramková, 2017; Radvan, 2012; Bogovac, 2015). Typically, property taxes are mostly local taxes unitary states and they are regional and local taxes in federal states. So, tax incentive on property taxes can be fixed by national legislation (e.g., France, Thailand), by legislative acts of subjects of federation (for example, state laws in India, laws of the provinces in China) or be national legislative acts and (or) acts of municipal authorities (particularly in the Philippines).

It should be noted that the percentage of revenues from property tax in budget revenues is relatively small in developed countries as well as in countries in transition and developing countries. Thus, in some African countries participants of SEZs are granted full exemption (permanent or temporary) from payment of all local taxes and fees. A number of Asian countries exempt participants of SEZs from payment of regional and local taxes or provide tax exemption for certain taxable items (machinery and equipment used for activities in SEZs, buildings and structures, etc.).

In the Russian Federation, subjects of the Federation are entitled tax incentives, grounds and procedure of their use for tax on property of organizations and transport tax that are regional taxes.

Property of organizations are exempted from tax on property of organizations within ten years from the month following the month of registration of such property on the balance sheet of organizations if the following conditions are met:

- Property is accounted on the balance sheet of organizations that is participant of SEZ;
- Property is produced or acquired for carrying out activity in SEZ;
- Property is used on the territory of SEZ in the framework of the agreement on the establishment of the SEZ.

As for the transport tax, incentives are provided in the form of:

- Full tax exemption, that is available for all vehicles, accounted on the balance sheet of organization that is participant of SEZ;
- Limited tax exemptions, that is available only for part of vehicles that meet certain legislation requirements.

Analysis of regional legislation shows that mentioned tax incentives are available to all residents of SEZs without taking into account economic indicators of their activities. If activities of resident of SEZs upon the expiry of set period of time do not lead to realization of planned socio-economic results, providing tax incentives to them leads to uncompensated expenditure budgets. Thus, it is advisable to develop indicators for differential providing of tax incentives primarily depending on the amount of investment and estimation of positive impact on the realization of SEZ purporses.

The main problem mainly of an economic nature is the question of efficiency of tax incentives stipulated by Russian tax legislation. Despite the fact that there are foreign studies of effectiveness of tax incentives in SEZs, in Russia there is no permanent complex analysis of effectiveness of these stimulating mechanisms. In some research and materials of control authorities ineffectiveness of different tax benefits are emphasized. As an example we can cite the report of the Accounts Chamber of the Russian Federation that pointed out the shortcomings of accelerated depreciation in calculating corporate income tax, as depreciation costs are often not spent on the

renewal of fixed assets of enterprises but are used only to reduce net profits (Report of the Accounts of Chambers of the Russian Federation, 2016: 156–158).

From the point of view of attracting investment and stimulating the activities of SEZs' participants, generally, the system of tax incentives in Russia is estimated as favourable by most researchers (we are talking namely about the system of tax incentives, and not about the conditions of their granting). It should be borne in mind that tax incentives do not usually top the list of investment factors in countries in transition and developing countries (Sinenko, 2016: 226–227). In fact, subjects of the Federation provide comparable tax incentives and, consequently, other conditions and incentives like preferential loans, public funding of infrastructure, administrative preferences, and other non-tax incentives become more and more important for taking investment decisions.

Focusing on best practices in the functioning of SEZs it is justified to make a conclusion about the need for the Russian Federation, at least, to shift the focus of tax incentivization to CIT and to increase the effectiveness of tax incentives through changes in terms of their provision.

At the same time providing tax incentives leads to the growth of tax expenditures of budgets of all levels of budget system of the Russian Federation. The fiscal interest of the budgets of different levels should be ensured through the achievement of settlement indicators of budgetary and social efficiency of tax incentives and their investment returns, that is, dependence of the volume of attracted investments from the volume of provided tax incentives.

5 Conclusions

Despite the fact that since the beginning of 90th a certain number of SEZs have been established and operated in Russia SEZs have not become effective institute of national economy's development and have been much less effective than SEZs in some other countries in transition.

In our opinion among main reasons for the failure of SEZ, in our opinion, there are inefficient management of SEZs, as well as insufficient and (or) inefficient preferential mechanisms provided for SEZs residents.

Analysis of SEZs' functioning in Russia and foreign countries has allowed identifying weak points of Russian SEZs' functioning and working out some recommendations concerning legal measures for optimization of management system and tax incentives for SEZs in Russia:

1. Until now there is no long-term strategy of SEZ development in Russia. It is advisable to set up a unified strategy of SEZ development in Russia. SEZ development policy should take into account that there is an urgent need for strict control measures over activity of SEZs. Such control should relate to use of budget funds for needs of SEZs to preclude unwarranted budget losses. Tax control should also be strengthened for the purpose of prevention of tax evasion with the use of special provisions of SEZs' taxation.
2. The SEZ administration systems could be very diverse. The organization of SEZ management has a significant impact on the efficiency of its functioning. The most effective areas including in relation to budget risks are ones where a state uses no administrative power mechanisms of SEZ administration, but redistribute authority and responsibility between the central government, regions and municipalities as well as business representatives (managers companies).

   In Russia the delegation of SEZ management authority to regions has been started recently, and in our opinion the process should be activated. It should also be noted that the municipalities do not still participate in SEZ management. The Russian Federation should provide for entrepreneurial initiative support by involving of private management companies to SEZ management. In addition, Russian legislation should prescribe special simplified rules for establishment and management of SEZs that are set up on basis of private capital.
3. The study has showed that most of the countries with economies in transition have primarily focused on reducing the tax burden of participants of SEZs for corporate income tax. Thus, from the perspective of tax incentivization, the main shortcoming of Russian SEZ regulation is significantly smaller amount of tax incentives than in other countries because the state redistributes a policy of tax incentives mainly on regional and local taxes. Determination of the balance between the amount of tax incentives and fiscal interests of budget is extremely important: insufficient tax incentives, in fact, minimizes

its incentive effect; the excess amount of tax benefits and (or) their inefficiency leads to harmful loss of budgets, especially for regional ones.

4. It is justified to use more comprehensive differentiating approach to selection of specific tax incentives and conditions of its application depending on the type of SEZ and type of economic activity of SEZ's participants. It is also advisable to develop indicators for differential providing of tax incentives primarily depending on the amount of investment and estimation of positive impact on the realization of SEZ purporses.

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PART 5
BANKING LAW

CONSUMERS PROTECTION IN THE AREA OF LOANS INDEXED TO FOREIGN CURRENCY

Damian Cyman[1]

Abstract

This contribution deals with mortgage loans denominated or indexed to foreign currency and its influence on consumer's financial stability. The main aim of the contribution is to confirm the hypothesis, that consumer's protection should be increased in the area of this kind of loans. It can be achieved by appropriate law regulations, however, the important role of Court of Justice of the European Union is presented.

Keywords: Mortgage Loan; Loan in Foreign Currency; Consumer Protection.

JEL Classification: K15, K22

1 Introduction

Prior to the global financial crisis, borrowing in foreign currencies (or lending indexed to foreign currencies)[2] by households and non-financial corporations was popular in Central and Eastern Europe. There are several factors driving foreign currency lending on the supply side, especially as a consequence of easy access to wholesale funding (facilitated by positive global liquidity conditions and financing from foreign parent entities).

On the demand side, the lower interest rates applicable to foreign currency loans compared to loans in the domestic currency seem to have played the major role (Rosenberg, Tirpak 2008: 8). Foreign currency loan agreements often offered more attractive reimbursement characteristic, such as delayed reimbursement schemes. Financial institutions selected a currency that entailed the lowest short-term interest rate (usually Swiss franc). It resulted

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2 There are a lot of differences between loan denominated and indexed to foreign currency, however in this article I do not make a distinction between those loans, because from a consumer's point of view they often seem to be the same and have similar effect.

in the smallest initial instalment for a given amount of loan, what made it suitable for lending to a very wide scope of households, including subprime ones. CHF-denominated or indexed lending started from Austria and was quickly introduced by other market players as well.

Loans were denominated in or indexed to foreign currency and the funding was in (or was transformed into) foreign currency, but borrowers received loans in local currency. Repayment of the loan was made in the local currency and then converted to foreign currency (usually Swiss franc). A significant depreciation of the local currency against Swiss francs caused an increase in the local currency value of outstanding debt. As a consequence, the debt-servicing capacity of borrowers deteriorates, leading to a significant weakening in their financial condition and putting the borrower into a financially disruptive situation. It reduced the borrower's ability to pay, because the value of the loan in some cases exceeded the value of collateral. They have been required to repay monthly instalments denominated in domestic currency that were much higher than they would have had to pay if the repayments had been calculated on the basis of the historical rate of exchange applicable when the loan was advanced.

In recent years these products have caused serious problems for customers in a number of Member States, including Hungary, Croatia and Poland. The Hungarian regulator reported a sharp rise in complaints about foreign currency loans as the forint weakened in 2008. According to the regulator's 2008 annual report 69 % of all household debt was held in a foreign currency, primarily the Swiss franc. In Croatia, the interest rate and outstanding value of mortgages tied to the Swiss franc increased substantially in 2010/11 as the Kuna depreciated relative to the franc. In Poland, depreciation of the Zloty from 2007 caused a significant rise household's foreign currency mortgage debt (EPRS, 2014: 49). Foreign currency housing loans constituted approximately 43 % of all outstanding housing loans and 26 % of all outstanding loans to households in May 2016 (CON/2016/39). The regulator identified a sharp increase in mortgages "under observation" (78.4 %) and "under threat" (33 %) (Polish Financial Supervision Authority, 2008).

On 15 January 2015, the Swiss central bank stopped maintaining an exchange rate threshold against the euro and let the revaluing power break loose in the market, resulting in deeper depreciation of local currencies against the CHF. It indicates, that household over-indebtedness mainly in foreign currency became a major social problem, which resulted in a strong deterioration of the confidence in the financial intermediary system.

The aim of this contribution is to confirm the hypothesis, that consumer's protection should be increased in the area of this kind of loans. In many cases this protection was inadequate and financial institution abused consumer's right, using its economical and information advantage. To achieve this aim, legal framework and most important judgments of Court of Justice of the European Union had been analysed.

2 Importance of Consumer Protection

Consumer credit has a number of economic, legal and social aspects and is one of the most significant financial services in modern economies (Mijatovic, Gongeta 2014: 410). Mortgage loans effect deeply on consumer's financial situation, usually for many years. The most affected debtors are those contracted mortgage loans indexed to foreign currency. Contractual clauses were often widespread and transferred on the consumers the full risks of crediting, allowing the credit institution unilaterally to amend the interest rate, other costs and charges and, above all, the risk of depreciation of local currency and exchange rates fluctuations. The most typical foreign currency mortgage loan product was Swiss franc-denominated, with variable interest rate, which the bank could change unilaterally based on the broad discretion power of the lender. For the majority of loans, credit institutions used a buying and a selling rate upon loan disbursement and repayment. The extent of the spread applied was left to the discretion of banks. These products have the potential to be seriously disruptive for consumers because fees and charges can cause sudden and potentially unexpected shortfalls in customers' finances, possibly leaving insufficient funds to cover other outgoings. For the majority of loans, financial institutions used a buying and a selling rate upon loan disbursement and repayment. The extent of the spread applied (deviation from the central rate) was left to the discretion of banks.

Consumers, predominantly households, were typically unaware of foreign currency lending risks. They were lured by lower nominal interest rates of foreign currency loans compared to loans in domestic currency. Consumers tended to downplay the risk of a depreciation of the domestic currency or fail to comprehend the impact of such depreciation on the debt servicing cost and the overall amount due. Very often they had poor financial education and skills to assess the medium and long- term consequences of the complex financial contracts. In the period when foreign currency household lending was expanding, practically no steps, neither from a prudential, nor from a consumer protection aspect, were taken. Concerns arising from excessive foreign currency lending in some Member States and its impact on consumer's financial stability have been debated in several fora in the last few years. Borrowers initiated lawsuits against banks, accusing them the use of unfair contract terms, some of the cases were presented to Court of Justice of the European Union.

Inadequate consumer protection may be a major contributor to the global financial crisis, as it happened in the United States mortgage market. In the European Union, mis-selling of financial products has also resulted in significant consumer harm. Considering the significant potential detriment that loans in foreign currency can cause to individual consumers, because over-indebtedness might cause a sharp contraction in the living conditions of the households concerned, it requires the adoption of appropriate legislative provisions in order to guarantee an effective protection of consumers. Those loans were taken without having adequate information about or understanding of the exchange rate risk involved. It was driven by market and regulatory failures as well as other factors such as the general economic climate and low levels of financial literacy.

Complexity of some financial products and their influence on financial situations both consumers and financial institution caused the change of approach to the protection. Member States regulators are turning to product-related techniques in the retail markets, in the form of product prohibition and product oversight techniques (Moloney 2012: 187).

3 Legal Framework

Although the area of consumer protection has been regulated in European Union since 1987 (EPRS 2015: 4), the global financial crisis has highlighted the importance of consumer protection and financial literacy for financial stability. It also confirmed, that educated and informed consumers are an important factor in stability of financial market. The need for increasing consumer protection arises mainly from an imbalance of power, information and resources between consumers and financial service providers, placing consumers at a disadvantage. They may find it difficult to obtain sufficient information on their financial purchases. Information may be too difficult and complex for the average consumer to understand and assess. In spite of the increasing concerns connected with mortgage loans, little harmonisation has been reached as far at the European level. The development of a common approach is hindered by the existence of national resistance on the basis of different sets of preferences and legislative provisions.

Directive 93/13/EEC on unfair terms in consumer contracts applies to all terms contained in contracts with consumers which have not been individually negotiated and introduces a requirement of fairness against which such terms are to be tested. The purpose of this Directive is to approximate the laws, regulations and administrative provisions of the Member States relating to unfair terms in contracts concluded between a seller or supplier and a consumer. Directive 93/13 carried out only a partial and minimum harmonisation of national legislation concerning unfair terms, while recognising that Member States have the option of affording consumers a higher level of protection than that for which the directive provides.

Directive is based on the idea that the consumer is in a weaker position then professional seller or supplier, as regards both his bargaining power and his level of knowledge. This situation leads to his agreeing to terms drawn up in advance by the seller or supplier without being able to influence the content of those terms. Directive requires Member States to provide for a mechanism ensuring that every contractual term not individually negotiated may be reviewed in order to determine whether it is unfair. At the same time, Directive precludes an assessment of the unfairness of non-negotiated provisions, which form the very 'core' of the contract. This significantly

reduces the scope of protection, therefore some Member States opted to extend the level of protection conferred by Directive by not reproducing the limitation under Art. 4/2 in their implementing legislation.

As a consequence of the financial and economic crises, increasing rates of indebtedness connected with loans have necessitated the development of new legal frameworks. In order to create increased consumer protection and greater transparency of consumer loans at the unique European market, the Directive 2008/48/EC on consumer credit contracts was adopted. It introduced the obligation to inform the consumers in the pre-contractual and contractual stages, with the purpose of achieving a greater degree of equalization of the parties and eliminating consumer's misconceptions regarding the advantages and disadvantages the individual creditor offers in his contractual provisions. It also stressed the obligation to assess the consumer's creditworthiness, consumer's right to cancel the loan agreement concluded for an indefinite period, and the right to terminate the loan agreement. However, because of a very specific nature of credit agreements covering the granting of credit secured by real estate, they were excluded from the scope of Directive 2008/48/EC as well as credit agreements the purpose of which is to finance the acquisition or retention of property rights in land or in an existing or projected building.

European Systemic Risk Boar recognized problems connected with loans in foreign currency. In its Recommendation (ESRB/2011/1) ESRB pointed out, that excessive foreign currency lending may produce significant systemic risks for those Member States and may create conditions for negative cross-border spillover effects. It recommended to provide borrowers with adequate information regarding the risks involved in foreign currency lending. Such information should at least encompass the impact on instalments of a severe depreciation of the legal tender of the Member State in which a borrower is domiciled and of an increase of the foreign interest rate. From a consumer protection viewpoint, the provision of comprehensive and transparent information, and uniform standards, is essential for well-informed decisions, because of asymmetric information between borrowers

and lenders. Financial institutions schould be encouraged to offer customers domestic currency loans for the same purposes as foreign currency loans as well as financial instruments to hedge against foreign exchange risk.

To improve consumer's protection, the Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property was adopted on 4 February 2014. It applies to both secured credit and home loans. Member States had to transpose its provisions into their national law by March 2016. Its aim is to develop a more transparent, efficient and competitive internal market, through consistent, flexible and fair credit agreements relating to immovable property, while promoting sustainable lending and borrowing and financial inclusion, and hence providing a high level of consumer protection. Main goals of this directive is to prevent the repetition of irresponsible lending and borrowing practices, create a more efficient and competitive single market for mortgages, foster consumer confidence and customer mobility and establish a level playing field and promote cross-border activity.

The main provisions include consumer information requirements, principle based rules and standards for the performance of services. Some most important information should be provided to the consumer ahead of a contract being concluded. Financial institutions should act fairly and professionally, and that their staff should have an appropriate level of knowledge and competence. Consumers creditworthiness should be tested, by looking at their income and expenditure, to determine whether they can afford the mortgage loan. When loans are in a foreign currency, lenders should put in place additional consumer safeguards, to protect the customer against exchange rate risk. Directive also contain assessment obligation, provisions on foreign currency loans, provisions on early repayment, provisions on tying practices, some high-level principles and a passport for credit intermediaries who meet the admission requirements in their home Member State. Advertising of products should be fair and not misleading, with certain standard information included where specific rates are being quoted. In case of difficulties in payment, lenders should exercise reasonable forbearance to customers before initiating repossession proceedings.

4 Selected Judgements of the Court of Justice of the European Union

Court of Justice of the European Union plays an important role in clarify the scope of the Consumer Protection. There were two request for a preliminary ruling, that concerns loans in foreign curriences.

Case C26/13 concerns a mortgage loan supplied by Hungarian bank to two Hungarian consumers. In order to diminish inflation risk, the loan was denominated in foreign currency. Agreement stated, that „the lender is to determine the amount in HUF of each of the monthly instalments due by reference to the selling rate of exchange for the foreign currency applied by the bank on the day before the due date. Lender did not make any foreign currency available to its clients, but only linked the monthly repayment instalments in Hungarian forints to the current rate for Swiss francs to ensure stability of repayment of the loan advanced in HUF". This clause was rather beneficial to the Bank, because consumers in fact were paying back a higher amount then they borrowed – not taking into account interest.

The borrowers brought an action against bank claiming that this clause was unfair, because it authorised the bank to calculate the monthly repayment instalment due on the basis of the selling rate for the currency applied by the bank, it conferred on the bank an unjustified, unilateral benefit.

The Court ruled that Art. 4 of Directive 93/13/EEC must be interpreted as meaning that the expression the 'main subject matter of a contract' covers a term, incorporated in a loan agreement denominated in foreign currency concluded between a seller or supplier and a consumer and not individually negotiated, such as that at issue in the main proceedings, pursuant to which the selling rate of exchange of that currency is applied for the purpose of calculating the repayment instalments for the loan, only in so far as it is found, which it is for the national court to ascertain having regard to the nature, general scheme and stipulations of the contract and its legal and factual context, that that term lays down an essential obligation of that agreement which, as such characterises it.

The Court answered the question whether the clause in standard term was sufficiently transparent to the consumer and made clear, that the

requirement that a contractual term must be drafted in plain intelligible language is to be understood as requiring not only that the relevant term should be grammatically intelligible to the consumer, but also that the contract should set out transparently the specific functioning of the mechanism of conversion for the foreign currency to which the relevant term refers and the relationship between that mechanism and that provided for by other contractual terms relating to the advance of the loan, so that that consumer is in a position to evaluate, on the basis of clear, intelligible criteria, the economic consequences for him which derive from it.

It this case the Court applied the average consumer benchmark in the context of determining whether terms of contract were sufficiently transparent to the consumer. It is important, that the mere insertion of the terms is not sufficient. Financial institution should not only provide information in formal meaning, but also ensure, that average consumer should be enabled to assess the financial consequences of the term. In this context, the judgement is consumer-friendly and could be seen as a signal of a trend to strengthen consumer protection (Duinenvoorde, 2015: 51).

Case C-312/14 concerns Hungarian, who entered into a foreign currency denominated consumer credit agreement with financial institution for the purpose of purchasing a motor vehicle. At the time the loan was granted, lender calculated the equivalent amount in foreign currency of the amount that it was to advance in Hungarian forints, in accordance with the exchange rate applicable on a date which had been previously determined. Next, the bank purchased from the client that currency, using the actual exchange rate for purchases of foreign currency that was applicable at the time of the advance of the loan and paid the equivalent amount in Hungarian forints to the client. In next step, the bank sold to the client the registered currency in exchange for forints, using the actual exchange rate for sales of foreign currency that was applicable at the time of the repayment of the loan, in order that the client could meet, in foreign currency, his repayment obligation, which was registered in foreign currency.

The question arose, whether the offer of an (exchange rate) transaction to a client which, under the legal form of a foreign currency denominated loan agreement, consists of a spot transaction at the time of the advance

of the loan and a forward transaction at the time of repayment, which is carried out by converting into forint a registered amount of foreign currency and which exposes the client's loan to the effects and risks (currency risk) of capital markets, constitutes a financial instrument, under the scope of Directive 2004/39/EC.

The Court cleared that Art. 4/1/2 of Directive 2004/39/EC must be interpreted as meaning that, subject to verification by the referring court, an investment service or activity within the meaning of that provision does not encompass certain foreign exchange transactions, effected by a credit institution under clauses of a foreign currency denominated loan agreement such as the one at issue in the main proceedings, consisting in fixing the amount of the loan on the basis of the purchase price of the currency applicable when the funds are advanced and in determining the amounts of the monthly instalments on the basis of the sale price of that currency applicable when each monthly instalment is calculated.

Since the borrower seeks only to secure funds with a view to purchasing goods or a service (not to manage a foreign exchange risk or to speculate on a currency's exchange rate), the transactions at issue do not have as their purpose the provision of an investment service. The borrower is not, consequently, subject to the rules of EU law relating to investor protection described in Directive 2004/39/EC. In that regard, the Court considers that those operations do not relate to a forward contract because they do not have as their purpose the sale of a financial asset at a price fixed at the time of conclusion of the agreement. Excluding loans based on mentioned mechanisms from the scope of Directive 2004/39/EC deprives the consumer protection resulting from this Directive, that is why the judgement met with criticism, especially from the borrower's side. It may be noted, that supreme courts in some Member States recognised multi-currency mortgage loan as a derivative financial instrument and therefore covered by this Directive regulations (Spanish Supreme Court 323/2015)

5 Conclusion

Protection of consumers in the sector of financial services falls within the broader aim of protecting their economic interests. The area of financial

services is very complex and involves serious risks for consumers, especially when they are unable to understand the complex financial products, or take out inappropriate loans based on uninformed choices.

Directives described above constitute the relevant body of legislation at the EU level. They aim to define a clear legal framework for the European credit institutions, decreasing the barriers for cross-border lending and improving the prevention of overindebtedness within the EU. They contain specific provisions on pre-contractual and contractual standardised information that has to be presented to the client as well as particular provisions on the advertisement of financial products.

The protection however focuses on the average consumers, imposing high expectations as to the average consumer behaviour. It emphases consumer's responsibility not to be affected by unfair terms or practices rather than financial institution's responsibility not to act unfairy. It also results in no protection for consumers, who ale sub-average, for example less educated, had poor financial education and skills to assess the medium and long-term consequences of the complex financial contracts. Court of Justice of the European Union in his judgements refers to a model of average consumers and clears, that if information are sufficient for such consumer, he deserves no protection. In most cases this way of interpretation is correct, but still some under-educated borrowers may be treated unfairly by credit institutions, especially in complex products that may connect many financial instruments.

Outside the scope of protection remains terms, which form the very 'core' of the contract even when they are obviously unfair. That makes protection sometimes insufficient. It has led to the adoption of a new suite of retail market regulatory tools related to product intervention. It increases the level of protection to all consumers, is independent of their financial skills. Increased protection is essential for such complex contracts as loans denominated or indexed to foreign currencies, due to potential effect for lender, financial institutions and whole financial market. Lack of consumer protections and its effect may be seen in many Member States, where the problem of overindebtness is a serious problem.

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THE ORGANIZED BOND MARKETS IN POLAND AND CZECH REPUBLIC – A COMPARATIVE ANALYSIS

Magdalena Mosionek-Schweda[1]

Abstract

This contribution deals with the bond markets organized by stock exchanges. The main aim of the contribution is the evaluation of the development of such markets as well as the analysis of their organization structure and operation rules. Two stock exchanges were concerned in the study i.e. the Warsaw Stock Exchange and the Prague Stock Exchange. They both started their operation at the beginning of 1990 s, however, their further development, the structure of organization as well as legal and formal requirements towards issuers are different. These differences, especially relating to the debt markets organization and operation, were the premise for selecting these stock exchanges.

The study is based on the regulations of the analyzed stock exchanges, relevant legislation and statistical data obtained from the websites of these stock markets, the World Federation of Exchanges and the Federation of European Securities.

Keywords: Bonds; Debt Instruments; Stock Exchange; Capital Market.

JEL Classification: G15, G18, G23, K22

1 Introduction

Among long-term securities related to capital markets, usually equities are indicated in the first place followed by bonds. The literature presents numerous benefits for both the issuers of these instruments, as well as for investors

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committing their financial resources. In practice, however, the exchanges responsible for organizing trading in financial instruments develop primarily equity markets. According to the World Federation of Exchanges, in November 2016, the stock markets listed shares of a total of 51,139 companies, and the value of trading in these instruments reached within 11 months of 2016: 103,582.5 billion USD. During this time, these values for bonds amounted to 150,770 series and 17,258.6 billion USD (WFE, 2016).

In this study, the analysis of the functioning of the organized bond market includes the markets managed by the Warsaw Stock Exchange (WSE) and the Prague Stock Exchange (PSE). The genesis of each of these exchanges may be traced back to as early as the nineteenth century, although in their present form, they have functioned since the early 1990 s. Despite a similar period of operation, their development determined by economic, political and social factors, proceeded far differently. The undisputed leader in terms of market capitalization, number of listed companies and the trading volume is the Warsaw Stock Exchange. The offer of the WSE also includes the largest number of available both equity and bond trading platforms in a regulated and unregulated market (alternative trading system, ATS). Despite the creation of a special market dedicated to debt instruments, the Warsaw Stock Exchange is still the market primarily for equities. The Prague Stock Exchange is in turn one of the smallest in Europe but its debt instrument markets generated turnover tremendously exceeding the values of equity markets.

The abovementioned issues were compelling for the selection of these two exchanges for the analysis in this article. The aim of the study is to assess the development of the selected bond markets and to analyse the adopted organizational solutions in terms of their functioning. The study was based on the analyzed stock exchanges regulations, relevant legislation and statistical data obtained from the websites of these stock markets, the World Federation of Exchanges and the Federation of European Securities.

2 Bond Markets Organized by the Warsaw Stock Exchange

The founding act of the Warsaw Stock Exchange was signed on 12 April 1991, and four days later (16 April) the first trading session was opened with

the participation of 7 brokerage houses and 5 companies listed at the time. The origins of the stock market in Poland, however, date back to 1817, when the first stock exchange in Poland was opened on 12 May, closed with the outbreak of World War II (Ziarko-Siwek, 2007: 347). In 1938, the Warsaw Stock Exchange listed 130 securities, including shares as well as bonds (government, banking, municipal). On the trading floor of the WSE reactivated after more than 50 years, first bonds appeared in the quotations of 16 June 1992 – these were one-year government bonds. By the end of 1992, 5 series of securities were listed (WSE, 1993: 2). In subsequent years, the stock exchange bond market was characterized by a gradual increase in the value of issuances and trading in the listed bonds. An important event for the Polish capital market, however, was the creation, in 2009, of the Catalyst market designed exclusively for debt instruments.

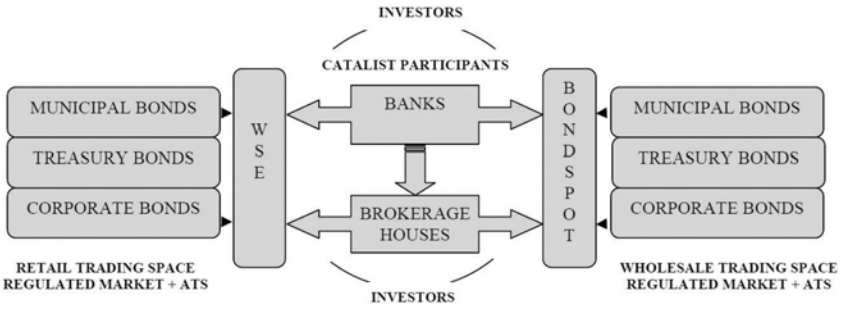
2.1 The Organizational Structure and Legal Basis of the Catalyst Market

Catalyst started functioning on 30 September 2009. It is run jointly by the Warsaw Stock Exchange and its subsidiary BondSpot S.A.[2]. The intention of the Catalyst organizers was to create an organized market for trading in debt financial instruments, providing flexible operating rules for all participants – issuers and investors (Mosionek-Schweda, 2015: 117–118). Catalyst was to supplement the structure of the capital market in Poland, which traded mainly equities. Therefore, on the Catalyst market there are listed Treasury bonds and non-Treasury debt instruments: corporate, cooperative, municipal and mortgage bonds. The aim of the Catalyst is also to provide capital for entities seeking financing alternatives to traditional forms (i.e. bank loans, issuance of shares). Such a goal resulted in quite a complex organizational structure of the Catalyst market, however, allowing access

2 BondSpot S.A. was founded in January 1996 by more than 20 major Polish banks and brokerage houses under the name of Centralna Tabela Ofert S.A. Since November 2000, it is included the capital group of the Warsaw Stock Exchange. In May 2004, it entered into a strategic alliance with the MTS group, adopting the name MTS-CeTO S.A. Starting from 18 September 2009, it operates under the name of BondSpot S.A. The company conducts a wholesale trading market for treasury bills and bonds, known as Treasury BondSpot Poland (formerly MTS Poland) and the regulated OTC market and alternative trading system for trading in debt financial instruments, which since 30 September 2009 are listed within the Catalyst market (BondSpot S.A., 2013: 2).

for a wide range of issuers having various expectations in terms of size and parameters of debt securities issuance. The result of these objectives was the creation of four submarkets within the framework of the Catalyst (see: figure 1): a regulated market and an alternative trading system operated by the Warsaw Stock Exchange (intended for retail investors), and the same markets operated by the BondSpot, but aimed at wholesale investors (individual transaction of not less than PLN 100 thousand) (WSE, 2010: Art. 4).

Figure 1. The structure of the Catalyst market



Source: own studies

Legal grounds of the functioning of the Catalyst are contained in the document "Catalyst Operating Rules", which is the framework regulation regarding, among other things: general operating rules for market operation, disclosure obligations of issuers, the principles of admitting debt instruments to trading on individual segments of the Catalyst and the rights and obligations of the participants in this market. The detailed arrangements for the operation of each of the four submarkets are contained in separate regulations adopted by the organizers. In addition, the regulations contained in Acts on the Polish capital market apply accordingly, especially the Act on Bonds and the Act on Public Offering (Mosionek-Schweda, Panfil, 2014: 156–157).

Table 1. Legal acts related to the Catalyst market

Catalyst Operating Rules (text according to legal condition as of 1 September 2014)	
Regulated markets	**Alternative Trading System**
The Warsaw Stock Exchange Rules adopted in Resolution No. 1/1110/2006 of the Exchange Supervisory Board dated 4 January 2006, as amended (text according to legal condition at 1 September 2016)	Alternative Trading System Rules adopted by the Exchange Supervisory Board by Resolution No. 147/2007 dated 1 March 2007, as amended (text consolidated at 1469October 2016)
Rules of Trading on the Regulated Market adopted by the Supervisory Board by Resolution No. 22/13 dated 9 May 2013, as amended (text consolidated at 1 January 2016)	Rules of Alternative Trading System organised by the BondSpot S.A. adopted by the Supervisory Board by Resolution No. 153/16 dated 28 July 2016
Act of 15 January 2015 on Bonds, Journal of Laws of 2015, item 238 Act of 29 July 2005 on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies, Journal of Laws of 2005, no. 184, item 1539 Act of 29 July 2005 on Trading in Financial Instruments, Journal of Laws of 2005, no. 183, item 1538	

Source: own studies

The complex organizational structure of the Catalyst and the related multitude of legal acts regulating the operation of the particular submarkets may determine the disincentives for issuers and investors to engage in this market. On the other hand, the adopted architecture of the Catalyst allows to raise capital through the issuance of bonds to entities for whom limited access to capital is often the primary barrier for development (e.g. small and medium-sized enterprises). The Catalyst structure in fact includes unregulated markets, acting in the formula of the alternative trading system, which is characterized by more flexible and liberal regulations for issuers. One of the fundamental differences between regulated and unregulated markets is the ability to market on the ATS the financial instruments offered

by private offering addressed to a maximum of 149 investors, implemented by simplified procedure, without the participation of the Polish Financial Supervision Authority, without the need to draw up a prospectus and application of the provisions of the Act on Public Offering, which significantly shortens the issuance time and lowers its costs. In turn, the choice of the regulated market requires the completion of all procedures involved in preparing and conducting a public offering of securities (including the prospectus, which is subject to approval by the Polish Financial Supervision Authority). The conditions for admission to trading on the regulated exchange market also set the nominal value of bonds, i.e. not less than PLN 4 million (WSE 2006: Art. 40).

The Catalyst allows, regarding in particular small and medium-sized enterprises, raising capital from the public market, which may be an excellent alternative to other sources of funding, i.e. bank loans, leasing, the European Union funds, while providing additional benefits – the status of a public company, which translates into an increase in the prestige of the entity, promotion and better perception of the issuer by contractors, customers and their environment, and therefore, often easier access to the necessary capital. The Catalyst market may also be an alternative for those companies that intend to take advantage of the opportunities offered by stock exchange listings, and at the same time prefer not to change their legal form to a joint stock company or prefer financing with debt capital rather than share capital (Mosionek-Schweda, Spychała-Krzesaj, 2015: 314). The organizational structure of the Catalyst also affords investors a chance to diversify investment portfolios by including debt financial instruments listed on an organized stock exchange and unregulated market, issued by a diverse group of entities, with widely differing issuance parameters.

2.2 Basic Statistics of the Catalyst Market

Despite the many benefits associated with the issuance of bonds on the organized market of debt instruments, resulting, on the one side, from the characteristics of these instruments and their advantages over other sources of funding (for issuers) and investment instruments (for investors), and, on the other side, the benefits of organized trading, the development of the Catalyst deviates

significantly from the assumptions and expectations of its organizers. After seven years of its functioning, at the end of November 2016 it listed (including Treasury bonds) 564 series issued by 178 issuers (see: table 2). The Catalyst, however, is dominated by government bonds, listed here since 2011 (initially, it was assumed that the Catalyst would be used exclusively for marketing non-Treasury debt instruments). Excluding the issue of Treasury bonds, the market value decreases from EUR 158 billion to the amount of just over 18 billion EUR, of which about EUR 17.4 billion represents corporate bonds (including corporate, cooperative and mortgage bonds), and only EUR 0.7 billion represents municipal bonds. Although about 90 % of the Catalyst value are bonds, they generate about 40 % of the Catalyst trading. The remaining part is generated by corporate bonds (WSE, 2016).

Table 2. Basic statistics of the Catalyst market in 2009–2015 (at the end of the year) and as of 30 November 2016

Parameter	2009	2010	2011	2012	2013	2014	2015	2016
Turnover value (EUR mil.)	41.35	189.66	274.73	409.32	664.38	540.10	508.17	501.04
Number of trades	318	4300	29978	42323	60101	64084	65835	61973
Number of series	35	97	246	361	442	517	532	564
Number of issuers	13	48	100	156	176	193	192	178
Number of new listings	35	69	146	173	196	191	147	149
Issue value (EUR mil.)	2591.07	5431.34	120268.67	139385.53	149192.44	126347.88	144607.30	158313.34
Non-Treasury issue value to GDP (%)	0.78	1.49	2.55	3.21	3.56	3.72	3.87	-

Source: own studies based on Catalyst Statistic Bulletins, http://www.gpwcatalyst.pl/dane_rynkowe_en

Among the 178 issuers present on the Catalyst at the end of November 2016, there were 159 issuers of corporate bonds. Excluding cooperative banks and mortgage banks, the group of issuers of corporate bonds consisted of 135 companies, among whom were both large, well-known companies, such as PGNiG S.A. or PKN Orlen S.A., as well as smaller companies with limited liability, mainly investment firms and companies operating on the real estate market. The issuance parameters also varied considerably. Trading included issues not exceeding PLN 1 million (including the lowest issuance by VENITI S.A. with the value of PLN 355 thousand – about EUR 80 thousand), as well as exceeding the value of PLN 1 billion (e.g. PKN Orlen S.A., Energa S.A.). The nominal price of instruments ranged from PLN 100 (about EUR 22–25) to PLN 500 thousand (about EUR 110–115 thousand), and the interest rate from approximately 0.56 % to 10 % (WSE, 2016).

3 Bond Markets Organized by the Prague Stock Exchange

The beginnings of the Prague Stock Exchange (PSE) date back to 1871, and it reopened, after closing in 1948, on 6 April 1993. The opening of the stock exchange and its initial operation were closely associated with the process of privatization. In practice, it turned out, however, that the implemented privatization did not produce the expected results and generated unforeseen costs, and the PSE operation was determined primarily by administrative decisions that ignored the traditional rules of organization and functioning of the stock market. This was reflected, inter alia, in the obligation to introduce all privatized companies to trading on the PSE, even if they did not meet the existing PSE conditions of admission. This meant that the decision to list the company on the stock exchange was taken neither by the company, nor by the authorities of the PSE, but by the state authorities responsible for privatization. After only two months since the launch of PSE in June 1993, the exchange listed 622 companies, and the highest number of security issues ever registered on the exchange (a total of 1,792) was achieved on May 2, 1996[3]. Starting from 1997, the exchange authorities, in order to improve its functioning, began the process of removing from

[3] At that time, the capitalization of the Prague Stock Exchange in relation to the country's GDP was 31.3 %, which was the highest value among the post-communist countries. For comparison, in Hungary this rate was 11.66 %, and in Poland 6.42 % (Fungáčová, Hanousek, 2011: 351).

listing the issuers who did not meet the criteria for public companies. Most entities were removed in 1997 – a total of 1,301 (Fungáčová, Hanousek, 2011: 350–353). The lack of IPOs and further removal of companies due to bankruptcies or issuers deciding to leave the listing caused the number of listed companies to decrease gradually in the coming years, and finally in November 2016 dropped to just 25 entities.

Since the beginning of PSE, it also listed bonds, however, they were subject to different organizational solutions for trading than on the Polish stock exchange.

3.1 Organization and Legal Basis of Debt Markets at the PSE

The PSE also includes regulated markets characterized by stringent requirements to IPOs and listed companies (Official Market and Regulated Market) and an unregulated market (Multilateral Trading Facility, MTF) allowing access to the stock market for entities unable to meet the conditions of the regulated market subject primarily to the PSE regulations. This market consists of two segments: Free Market and Start Market.

Figure 2. Debt markets in the structure of the Prague Stock Exchange

Source: own studies

Similarly to the Polish stock exchange, bonds on the PSE are traded in regulated and unregulated markets (see: figure 2), but in contrast to the Warsaw Stock Exchange, the Prague Stock Exchange has not created a separate bond market dedicated exclusively to those instruments. On the regulated markets bonds are traded next to the equities, structured products and collective investment securities. In case of non-regulated market, there are traded bonds, equities and structured products (PSE, 2015: 4).

Table 3. Basic legal acts regulated operation of the PSE debt markets

Regulated markets	Multilateral Trading Facility
EXCHANGE RULES, SECTION VIII. Conditions for Admission of Bonds to Trading on the Official Market of the Exchange	EXCHANGE RULES, SECTION XIII. Free Market Rules
EXCHANGE RULES, SECTION IX. Conditions for Admission of Debt Securities to Trading on the Regulated Market of the Exchange	EXCHANGE RULES, SECTION XVI. Start Market Rules
Act No. 190/2004 Sb., on Bonds, as amended Act No. 256/2004 Sb., Undertakings on the Capital Market, as amended	

Source: own studies

Basic principles of organization and operation of the regulated and unregulated market may be found in Act No. 256/2004 Sb., Undertakings on the Capital Market (Art. 37–68 and Art. 69–73 respectively). In addition, detailed rules concerning, inter alia, the conditions and procedures for admission of financial instruments to trading, disclosure obligations of issuers, the circumstances and procedures for suspension of trading or exclusion from trading of an issuer are located in the PSE regulations separate for each trading platform (see: table 3). The regulated markets require public issue of financial instruments related to, inter alia, the necessity of preparing the prospectus. In addition, the conditions for admission to trading on Offical Market also include the requirement to submit financial statements for the period of 3 years and a minimum nominal value of the listed bonds of at least EUR 1 million (for Regulated Market the value is at least EUR 200

thousand). In turn, the unregulated market allows private issuance of financial instruments that does not require a prospectus, there are no requirements for the minimum period of functioning of the issuer or the minimum nominal value of the instruments. Significant differences between the regulated markets and the MTF occur also in the disclosure obligations – issuers listed on both segments of the unregulated market are not obliged to publish, inter alia, semi-annual and quarterly financial reports and a calendar regarding the fulfilment of the disclosure duty.

To summarise, it is worth mentioning the Free Market, which is one of the segments of the unregulated market of the Prague Stock Exchange. This platform allows admission for trading of attractive foreign issues (including bonds) without active role of the issuer, so-called unsponsored listing.

3.2 Basic Statistics of the PSE Debt Markets

Since the beginning of the PSE, the bond market was the key segment of the Prague Stock Exchange, far ahead, in terms of trading volume, of the share market listing more than a thousand companies, the majority of which did not meet the conditions for admission and was thus ignored by investors. The recourse of the share market widened further as a result of the process of delisting which began in 1997. During this time, the bond market gradually increased the number of listed series and the volume of trading. The largest turnover in bonds in the history of the PSE was listed in 2001: 54,615.9 million EUR[4], representing 103 % growth compared to 2000. In 2002, this figure fell to EUR 51,870.6 million and has since seen a constant downward trend (PSE, 2010: 26), although in relative terms the share of trading in bonds in the total turnover on the Prague Stock Exchange until 2012 surpassed or was close to trading shares (see: table 4). The vast marginalization of the bond market on the PSE has occurred since 2013. It should also be noted that in the analyzed period, the number of listed series changed in a small range, reaching a maximum in 2007 – 132 series.

4 For comparison: the trading on the stock market reached EUR 3,780.7 million in 2001 (a decrease of 49 % compared to 2000) and EUR 6,413.8 million in 2002 (PSE, 2010: 26).

Table 4. Basic statistics of debt markets organized by the PSE in 2009–2015 (at the end of the year) and as of 30 November 2016

Parametr	2009	2010	2011	2012	2013	2014	2015	2016
Turnover value (EUR mil.)	22087.4	20938.9	25423.6	23598.5	74.2	298.4	186.4	127.4
Number of trades	6056	6523	6025	7265	1333	1903	1721	2602
Number of series	116	106	95	98	110	116	112	111
Number of new listings	11	15	9	23	20	21	15	17
Bond turnover to total turnover on the PSE (%)	44.69	48.62	55.43	66.36	0.65	1.28	1.17	2.16

Source: own studies based on the PSE Fact Books, https://www.pse.cz/en/market-data/statistics and the FESE's Factsheets, http://www.fese.eu/statistics-market-research

The PSE listed bonds issued by the Treasury, the local government units (Public Sector), enterprises (Corporate Sector) and financial institutions, including primarily banks (Financial Sector). Most series are issued by banks, but the largest turnover is made on the bonds included in the Public Sector. Analyzing the parameters of bond issuance (excluding Treasury bonds), as in the case of the Polish exchange, significant differences may be observed. In the analyzed period, the PSE traded issues of CZK 10 million (approximately EUR 370 thousand), as well as of CZK 5 billion and more (about EUR 185 million). The nominal price of instruments ranged from CZK 1 (about EUR 0.04) to CZK 10 million (approximately EUR 370 thousand), and the interest rate from 0.25 % to 0 %.

4 Conclusion

This contribution presents two different methods employed by stock exchanges in organizing bond markets. In the case of the Polish capital market in 2009, trading debt instruments was intended to be arranged by organizing the entire trading (regulated market, alternative trading system) in one market, dedicated exclusively to debt instruments, conducted jointly by financial institutions responsible for bond trading, i.e. the Warsaw Stock Exchange and BondSpot. The structure of the established Catalyst includes both regulated and unregulated markets, therefore, it is also available for those issuers who do not meet the conditions for admission to trading on a regulated market. The creation of the Catalyst was intended, inter alia, to promote bonds in the Polish capital market as a source of financing for companies and local governments and as an investment instrument. And although this market is slowly expanding, the objective of the organizers may not be considered accomplished. Entrepreneurs and local governments seeking capital continue to use primarily bank loans, and investors are trading mainly in shares on the stock market (trading in shares on the Warsaw Stock Exchange is about one hundred times greater than trading in bonds). On the Prague Stock Exchange, bonds may also be traded on more restrictive, regulated markets or unregulated markets characterized by lesser regulatory regime. Trading in debt instruments is still conducted on the same platforms as trading in shares and other financial instruments and a market dedicated exclusively to bonds does not exist. Despite this, until 2013, bonds listed on the PSE were not of marginal significance, generating in some years 85 % of the total stock exchange trading.

Undoubtedly, the decision to focus regulated and unregulated trading in bonds on a specifically created market facilitates trading in these instruments, increases the transparency of the market and contributes to increased interest of issuers and investors in the possibilities offered by bonds. However, it should be emphasized that the organization or the scope of existing regulations on the market are not the only determinants of its development. The development of capital markets is affected by many micro- and macroeconomic factors. An analysis of these factors is beyond the scope of this study.

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ABUSIVENESS OF CONVERSION CLAUSES IN FOREIGN CURRENCY MORTGAGE LOAN CONTRACTS (POLISH CASE)

Rafał Mroczkowski[1]

Abstract

The problem of foreign currency mortgage loans still awaiting a systemic solution, generates a growing threat, both to the financial position of the parties to those contracts, as well as to the financial stability. The attempts undertaken so far to overcome that problem through legislative and administrative means have not yielded satisfactory results. The further depreciation of the Polish zloty in relation to the main currencies in which the mortgage loans were denominated or indexed, expected by many currency analysts, could lead to the significant increase of the systemic risk in the banking sector. At the same time, the judicial resolution of disputes between borrowers and banks may turn out to be most expensive for the latter.

The objective of this article is an analysis of the typical conversion clauses used in contracts for foreign currency mortgage loans regarding their potential abusiveness, and also the assessment of the effects of recognizing such clauses as prohibited within the framework of judicial incidental control. Complementarily, this analysis will be extended to the attempt of assessment of the impact of the emergence of line of judicial decisions favourable for the borrowers on the financial stability in Poland. The implementation of the assumed objective will require the application of legal research methods, and in particular the following methods: general and theoretical and formal and dogmatic, and complementarily the statistical one.

Keywords: Financial Market Law; Banking Law; Mortgages; Conversion Clause; Foreign Currency.

JEL Classification: G21

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1 Introduction

The peak of popularity of foreign currency mortgages in Poland was in the years 2006–2008 and was connected to the boom on the real estate market. In that period the prices of houses, apartments and construction plots were growing, recording a double-digit pace annually, and despite a record number of real estate offers on the primary and secondary markets, the demand seemed to be insatiable. These were also the years of the peak of the business cycle translating into the growing rates of the level of employment and average remuneration. It was not the first time that people succumbed to the illusion that real estate market is a "money making machine" which allow for fast increase of the value of personal assets without the risk of investment. At that time those who had not yet bought real estate fell into fear that their income would not keep up with the increase of real estate prices. They accepted prohibitive offer prices, which were increasingly more detached from the economic realities, dictated by the sellers. This is how the speculative bubble, not the first one and surely not the last one, grew on the real estate market.

The real estate purchases were to large extent financed with a bank loan. Record turnover on the real estate market translated to the high demand for mortgage. Banks were unable to keep up with the analysis of loan applications. The most important barrier limiting the creditworthiness of the potential real estate buyers was the high interest rate of loans provided in the national currency, which inflated the interest rates. At the same time, the disparity between the market interest rates in Poland and in the Euro zone and Switzerland turned out to be an opportunity to overcome this difficulty. The growing popularity of foreign currency loans denominated or indexed in Euro or in Swiss franc coincided with the significant strengthening of the Polish zloty in relation to those currencies, which significantly increased the currency risk from the point of view of the borrowers. Banks, offering mortgages to clients, were encouraging them to take loans in foreign currency, ensuring not only the linking of the interest with the London Interbank Offered Rate for EUR or CHF, but also a lower margin. At the same time, those banks formally informing the future clients about the loan risk did not indicate its scale and potential effects in the scope of loan

servicing costs, taking advantage of the discrepancy between the sides when it comes to the access to financial information.

More than one million of foreign currency mortgages granted by banks have for decades had their adverse effect on the financial and housing situation of households in Poland. The strengthening of the currencies in which the currency loans were granted in relation to the Polish zloty in the period from the mid-2008 to the end of the 2016 of more than 100 % for the CHF/PLN pair and 35 % respectively for the EUR/PLN pair[2], resulted in a proportional increase of the mortgage debt expressed in foreign currency. This resulted not only in consequences of economic nature, which are discussed below, but also of social nature. More than one million Polish families, until the repayment of the mortgages taken out, were "trapped" in their own apartments or houses. Their sale in order to buy another property or change, in the absence of the possibility to transfer mortgage to the new property, would result in the necessity to repay the loan in full and the materialization of the effects of currency risk. In extreme cases, due to the drop of the transaction prices of real estate within the analysed period, this could mean that the price obtained from the sale of apartment or house, despite 8 years of a systematic servicing of the currency loan, would not suffice to repay its remaining part. As a consequence, many Polish families live in housing conditions maladjusted to the changing needs, and the term referring to such people as "ripped off on loan" has become a part of the everyday language.

The objective of this article is an analysis of the typical conversion clauses used in contracts for foreign currency mortgage loans regarding their potential abusiveness, and also the assessment of the effects of recognizing such clauses as prohibited within the framework of judicial incidental control. Complementarily, this analysis will be extended to the attempt of assessment of the impact of the emergence of line of judicial decisions favourable for the borrowers on the financial stability in Poland.

The implementation of the assumed objective will require the application of legal research methods, and in particular the following methods: general and theoretical and formal and dogmatic, and complementarily the statistical one.

2 On the basis of: Table A of average exchange rate of foreign currencies, http://www.nbp.pl/home.aspx?f=/statystyka/kursy.html (access: 31 December 2016).

2 Genesis, Essence and Classification of the Foreign Currency Mortgages

Foreign currency mortgage loan is a type of long-term bank loan, secured with a mortgage that is established for the benefit of the lending bank, granted for the financing of the purchase of real estate or conducting a construction project, the characteristic feature of which is its paying out and repaying or only settling in a currency other that the national one.

This type of loan is the result of the evolution of financial products dedicated to persons interested in external, debt financing of investments on the real estate market. Its genesis and development are connected to the disparity of interest rates on the national and foreign monetary markets. In the first decade of the last century a significant barrier to the popularization of the mortgage loans on the Polish banking market was their high interest rate resulting from the connection to the WIBOR rates. This translated to the level of interest instalments, reducing the availability of the loan to a significant group of potential borrowers.

The solution to this problem analysed by the banks could have been the granting of **currency loans (*sensu stricto*)**, the interest rate of which would be related to the LIBOR rates for CHF or EUR. The main advantage was the significantly lower interest rate than in the case of Polish zloty loans on the basis of WIBOR rates. An inherent feature and at the same time a disadvantage resulting from the essence of the currency loan is the currency risk its structure involves, which occurs for parties to the contract. However, the main disadvantage of that solution, which limits its application on a larger scale, was connected to the multiple and at the same time burdensome and costly for both parties currency exchange transactions. The bank obtaining funds from deposits made in the national currency, in order to pay out the borrower the amount of loan expressed in the foreign currency, would have to buy it on the currency market, and then perform a reverse operation after each repayment of loan instalment. In turn, the borrower obtaining funds in the foreign currency with the intention to finance projects on the national real estate market, would be forced to conduct currency exchange at the beginning of the loan and then each time before the repayment of each loan instalment. In total, both parties would conduct the currency exchange

four times, which would significantly influence the increase of costs related to the granting and servicing of the loan.

The solution to the outlined problem commonly accepted on the banking market has become the mortgage loan, in the structure of which the foreign currency plays exclusively the conversion function, and both the starting of the loan, as well as its repayment takes place in the national currency (**currency loan *sensu largo***). In banking practice, basically two types of currency loans based on this type of structure have developed and spread gradually, namely: loans denominated in the foreign currency and loans indexed in that currency. Their common feature is that the inherent currency risk associated with them entirely encumbers the borrower. Since this type of loans was introduced on the market, the term "foreign currency mortgage loan" is no longer a unified conceptual category.

The essence of the **loan denominated** in the foreign currency is connected to the granting of loan in a currency other than the national, with a simultaneous assumption that is initiated in Polish zloty according to the exchange rate, the determination method of which or the level of which is specified in the contract. The repayment of this loan takes place in Polish zlotys in the amount constituting the equivalent of the principal and interest instalment expressed in the schedule of repayment in the foreign currency.

At this point, a question surfaces whether the foreign currency loan, providing in its structure for the granting of loan in foreign currency and payment of means in national currency at a known exchange rate, whereas, the repayment at the future and unknown exchange rate, is in fact a financial instrument, to which the provisions of Directive 2004/39/EEC of the European Parliament and of the Council of 21 April 2004 on the markets in financial instruments amending the Directive 85/611/EEC and 93/6/EEC of the Council and the Directive 2000/12/EC of the European Parliament and of the Council and repealing the Directive 93/22/EEC of the Council[3], also known as the MIFID I Directive[4], should apply, which involves the necessity to apply the procedures specified in that directive when offering such a loan?

3 Official Journal of the European Union L 145 of 30 April 2004, as amended.

4 Currently, those issues are regulated with the provisions of the directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on the markets in financial instruments and amending the Directive 2002/92/EC and Directive 2011/61/EU (Official Journal of The European Union L of 12 June 2014, No. 173, p. 349), known as MIFID II.

This issue, as a result of the asking by the Hungarian court a preliminary ruling question regarding the *Banif Plus Bank Zrt. vs. Márton Lantos and Mártonné Lantos* case was subject to the assessment of the European Court of Justice. In the judgement regarding this issue made on 3 December 2015 (Court of Justice of the European Union: C-312/14) the Court of Justice concluded that the exchange transactions, which are of auxiliary nature compared to the activities of granting and repayment of the consumer loan denominated in the foreign currency, that is they are limited to the exchange, on the basis of the purchase or sale rate of a particular foreign currency, loan and instalment amounts expressed in that currency (**settlement currency**), to the national currency (**the currency of payment**) and do not constitute investment services nor investment activity in the understanding of MIFID I. The sole function of such transactions is the performance of relevant payment obligations under loan contract, that is providing capital by the lender and repayment of the principal amount with the related interest by the borrower. The aim of those transactions is not the implementation of investment, because the consumer intends only to gain funds for buying consumer goods or performance of service, and not for example manage the exchange rate risk or speculate with the foreign currency exchange rates (Court of Justice of the European Union: C-312/14).

An essential disadvantage of the denominated loan follows from the necessity to convert the settlement currency (EUR/CHF) to currency of payment (PLN) on the day the loan is initiated. In case of change of the exchange rate between the date of contract conclusion and the date of its pay-out, the amount made available to the borrower in the national currency may be different from the applied for. This problem is particularly evident in case of initiation of a loan in tranches, when the pay out of subsequent loan tranches takes place after a significant amount of time from the day of the contract conclusion. In case of rise of the loan currency exchange rate in relation to the Polish zloty, the amount made available to the borrower will be higher than the amount covered by the loan application, whereas, in case the currency goes in the opposite direction – the amount will be lower. The solution applied in practice for the first problem is a contractual stipulation that the amount actually paid to the borrower cannot be higher than the

amount specified in the contract in national currency. Another approach assumes that the sum of money constituting the difference between the amount applied for expressed in the national currency and the one actually paid out will be charged against the loan repayment. This second solution is particularly unfavourable for the client, who not only pays the commission on the amount applied for, but also looses due to the difference between the exchange rate of purchase and sale of the currency in a given bank, i.e. the so-called **currency spread**. However, none of the above contractual clauses protects the borrower against a reverse situation, i.e. a drop of the foreign currency in relation to the Polish zloty. Because in such a case, the amount of money paid out to the borrower in the national currency will be lower than the amount applied for, which will result in the necessity to increase the amount of own contribution, generating additional risk. Its materialization will make it necessary for the borrower to obtain an additional source of financing, and in case of failure – will prevent the investment project from implementation.

The solution to the problem described above has become the construct of the **currency loan indexed in foreign currency.** Its essence is that the loan amount is contractually determined in the national currency, in which the loan is also paid out, and only secondarily it is settled in the foreign currency. This means that the loan amount expressed in Polish zloty is converted to the foreign currency on the day of loan initiation. The amount expressed in the settlement currency constitutes the sum from which the lending rate is calculated with the application of interest rate applicable for the foreign currency. At the same time, it is assumed as the amount, which the borrower obliges themselves to repay, with principle and interest instalments in Polish zloty, which are converted into the foreign currency only for the settlement purposes. The structure of the loan indexed to foreign currency has therefore this advantage that because the loan amount is expressed *explicite* in the national currency and the repayment takes place in the same currency, the risk of noncompliance between the loan amount applied for and mobilised is gone.

As a result of the application of indexing clause, of which is said below, the loan, which at the moment of its granting was a loan expressed in Polish

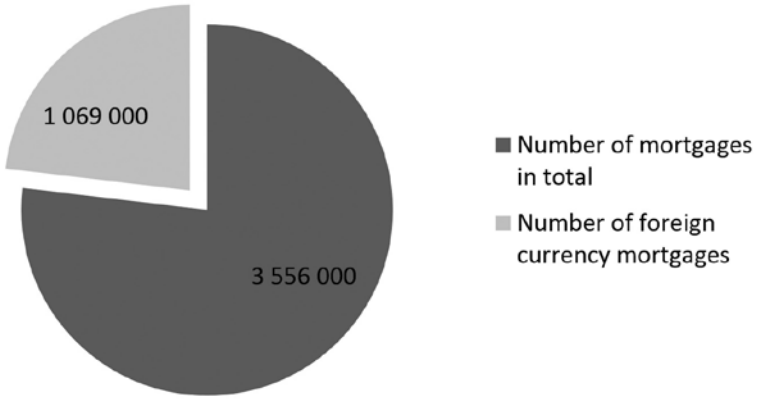
zloty is converted into a currency loan, which makes including it in the same group justified (The District Court in Warsaw: III C 1073/14).

3 Foreign Currency Mortgages as a Threat to the Financial Stability

When analysing the issues of foreign currency mortgage loans from the economic point of view and using statistical tools for that purpose, it must be noted that creating by the banks a financial instrument used for debt financing of transactions on the real estate market, which generates currency risk and encumbering client entirely with that risk, due to its widespread used, has turned against those banks. The foreign currency portfolio of mortgage loans began to threaten not only the solvency of individual banks, but what is worse also the stability of the entire banking sector. The analysis of both the stock exchange prices, as well as the OTC transactions on banks' shares with large exposure to the market of foreign currency mortgage loans shows that valuation of those banks is underestimated due to the currency portfolio they possess.

From the statistical data provided by BIK is follows that among the PLN 3.556 million of mortgage loans serviced currently, as much as PLN 1.069 million (i.e. 30.06 %) are currency loans (Quarterly Report of BIK: 2016: 23).

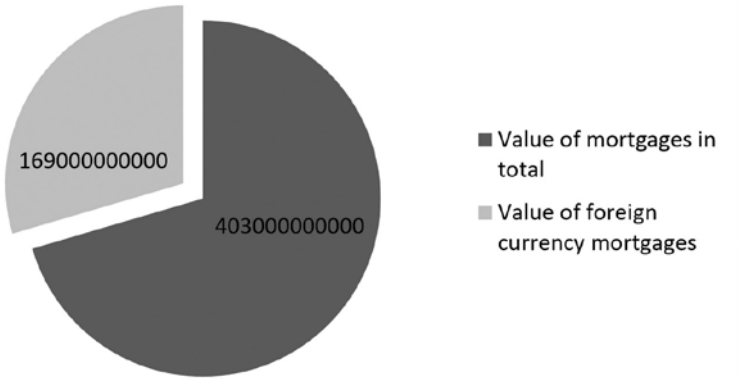
Graph 1. Quantitative share of foreign currency mortgages in mortgages in total as of 30 June 2016



Source: own study on the basis of: Quarterly Report of BIK: 2016: 23

The value studies indicate an even larger share of the currency portfolio in the total pool of active mortgage loans. For the amount of PLN 403 billion of total debt from mortgage loans, PLN 169 billion (41.93 %) is the currency portfolio (Quarterly Report of BIK: 2016: 23).

Graph 2. Value share of foreign currency mortgages in mortgages in total as of 30 June 2016



Source: own study on the basis of: Quarterly Report of BIK: 2016: 23

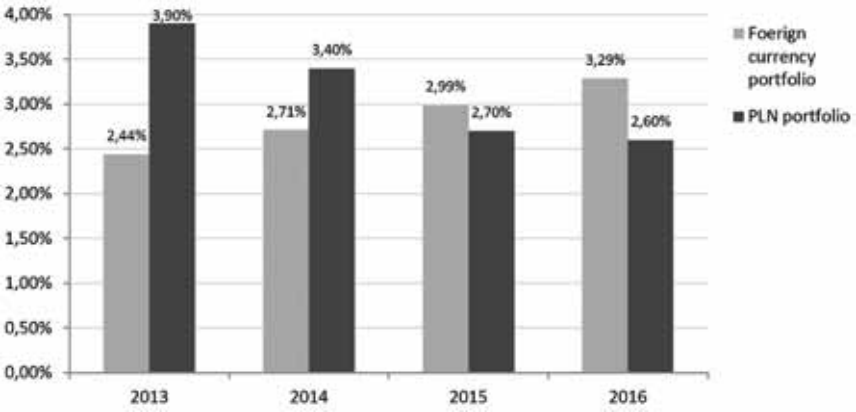
The above statistical data indicate a high share of the foreign currency mortgage loans in mortgages in total, which results in the fact that the quality of the currency portfolio has a significant impact on the condition of the entire portfolio of mortgage loans, and indirectly on the financial result of the banks which in the past granted mortgage loans denominated or indexed in the foreign currency.

In that context, the assessment of the quality of mortgage loans portfolio is significant taken into consideration the division into foreign currency and Polish zloty loans. When limiting the scope of analysis only to active loans[5] it must be noted that the value share of loans delayed of more than 90 days in the currency portfolio has grown systematically from the level of 2.44 % at the end of 2013 to 3.29 % as of 30 June 2016. At the same, in that same period, an opposite trend was taking place in the Polish zloty portfolio,

5 With the exception in the analysis of the accounts closed as a result of loan repayment or redemption.

in which that share dropped from the level of 3.90 % to 2.60 % (Quarterly Report of BIK: 2016: 28).

Graph 3. The value share of active loans delayed in service of more than 90 days in the Polish zloty and foreign currency portfolio as of the end of the year 2013, 2014, 2015 and June 2016



Source: own study on the basis of: Quarterly Report of BIK: 2016: 28

The main determinant differentiating the situation of both groups of borrowers are the costs of loan servicing: rising in the case of foreign currency loans and falling in the case of loans in Polish zloty. The first tendency was caused by the strengthening in the analysed period of the foreign currencies (EUR and CHF) in relation to Polish zloty, and second one by the drop of market interest rates indicated by WIBOR (Warsaw Interbank Offered Rate). Taking into consideration the threats expected by currency analysis of economic and political nature for the years 2017–2018, which can constitute the basis for the further appreciation of the foreign currencies rate of exchange to the Polish zloty, in particular in the currency pair CHF/PLN, we should consider the risk of further dynamic deterioration of the quality of currency portfolio, which is becoming a large threat to the financial position of individual banks, and due to the scale effect also to the financial stability. Such threat is already perceived by the Financial Stability Committee. This authority, responsible for the macroprudential supervision in Poland, assessing the stability of the financial system, in the content of the statement of 5

December 2016 *explicite* indicated that "as a result of this analysis the portfolio of currency loans was assessed as risk of systemic character"(Statement of the Financial Stability Committee of 5 December 2016). At the same time, it should be noted that this assessment was issued in the context of the current situation. In case of further materialization of the exchange rate risk, this threat will grow accordingly and can become the catalyst of the banking crisis in Poland on a scale previously unknown.

4 Abusiveness of the Conversion Clauses in Loans Denominated and Indexed in Foreign Currency in the Light of the Provisions of the Polish Law and Case Law

In contracts for foreign currency mortgage loans both denominated, as well as indexed in foreign currency, **conversion clauses** are used. Despite a different legal and economic structure of those two types of loans, the conversion clauses used in contracts have a common feature: their essence are the principles of conversing the loan amount into principle and interest instalment from the settlement currency into the currency of payment or the other way round, depending on the type of loan and the performed operation.

Moreover, the conversion clauses applied both in denominated, as well as indexed loans, introduce to the loan relationships and encumber the borrowers with currency risk, which is typical for loan contracts concluded in foreign currency. At the same time, this solution allows for the calculating the lending rate based on the interest rate applicable for that particular currency. For those reasons, conversion clauses should not be identified with the escalation clause, regulated with the provisions of Art. 358^1 of 23 April 1964 the Civil Code[6]. The analysis of the literature, as well as the case law leads to the conclusion that wrong terminology is sometimes used in the doctrine (Czabański, 2016: 1, 10) and in case law (The District Court in Toruń: I C 916/16). Meanwhile, in case of both types of clauses thee objectives of their use are entirely different. Because conversion clauses do not introduce a mechanism which is intended to ensure the preservation of the value of the benefit in time, and its objective is not the protection

6 I.e. Journal of Laws of 2016, item 380, as amended.

of the borrower against the reduction of the purchasing power of money (inflation). Instead, their aim is to encumber the borrower with currency risk, which constitutes a necessary condition for providing them with capital in return for a fee that constitutes the lending rate calculated on the basis of interest rate appropriate for the currency of settlement (The District Court in Warsaw: III C 1073/14).

Conversion clause with denominated loans is used for converting the amount of loan expressed in settlement currency (EUR, CHF) into the currency of payment (PLN), in which the loan is paid out. In the banking practice, the purchase rate of loan currency is most commonly used in this type of operations; the rate is determined in accordance with the table of exchange rates from the day of funds mobilisation applicable in that bank. The interest rate of the loan is calculated from the amount of loan in the settlement currency on the basis of the interest rate applicable for this currency. The repayment of the loan takes place also in the currency of payment, in principle instalments that constitute the equivalent of the loan amount expressed in the settlement currency. At the same time, to calculate the height of principle and interest instalments the exchange rate of a particular currency is used on the basis of the table of exchange rates from the day of repayment. The exchange rate table is determined unilaterally by the bank, and the client has no impact on the level of currency exchange rates adopted by the bank for settlement.

At the same time, despite the fact that conversion operations are of accounting nature only and are not connected to an actual exchange of currencies, banks use spreads, which constitute the difference between the purchase rate and sale rate of the loan settlement currency. The spread between the two exchange rates is usually a matter of few percents. This constitutes an additional and at the same time economically unjustified source of income for the bank.

The essence of the **indexing clause** is the determination of the principles of conversion of the loan amount expressed in the currency of payment (PLN), in which the loan is paid out, into the settlement currency (EUR, CHF), which is the basis for specifying the amount subject to repayment, as well as the bases of loan lending rate according to the rates applicable to that currency. For the purposes of conversion, banks, as a rule,

use the purchase rate of the settlement currency in accordance with the table of exchange rates applicable in a particular bank on the day of loan initiation. At the same time, the borrower is obliged to repay the loan in the currency of payment, whereas the principle and interest instalments for the purposes of settlement are converted into a foreign currency in compliance with the sale rate determined in accordance with the table of exchange rates applicable in a particular bank on the day of instalment repayment.

As is indicated in the case law "as a result of operation of the indexing clause, at the moment of pay out of the loan amount comes, therefore, to the existence the effect similar to the novation of the liability, as a result of which in place of the primary liability of repaying the amount indicated in the contract in Polish zloty a liability emerges to repay the equivalent of that amount in the currency of indexation. The loan, which at the moment of its granting was a loan expressed in Polish zloty is converted into a currency loan" (The District Court in Warsaw: III C 1073/14).

It should be considered whether the use of conversion clauses defined in that way in the content of mortgage loan contracts can violate the prohibition on the use in model contracts concluded with consumers of prohibited contractual provisions, of which is said in Art. 385/1 of the act – the Civil Code,[1] expressed in the content of Art. 23a of the act of 16 July 2007 on the competition and consumers protection[7] (**abusive clauses**),[8] and in consequence, whether they can be considered in the course of judicial review as prohibited provisions violating the interests of the consumers.

The analysis of the content of Art. 385[1] of the Civil Code indicates that this provision formulates the following premises for recognizing the contractual clause as abusive:

1. Its provisions were not agreed with the individual consumer;
2. They shape their rights and obligations in a way contrary to good practice, grossly violating their interest;
3. Its provisions do not specify the main benefits of the parties.

7 I.e. Journal of Laws of 2015, item 184, as amended

8 The Polish act uses the term "prohibited contractual provisions", not introducing to the legal language, the concept of "abusive clauses" used in other European countries and the doctrine - more on the topic in: M. Skory: 2007:12,13.

The provisions of mortgage loan contracts can be divided into two categories: agreed with the borrower individually (e.g. the loan amount, lending rate, schedule of pay outs of tranches, etc.) and not agreed with the borrower individually. In some cases, such a division of contractual provisions is expressed in the form of a contract consisting of two parts: individual and general. General terms and conditions are presented to the borrower by the bank at the signing of the contract, without providing the borrower with any possibility of influencing the content of both the individual clauses, as well as its entirety. Such terms and conditions, in particular the ones contained in the general part of the contract are not subject negotiations nor any agreements with the consumer. Their decision with regard to the general terms and conditions of the loan contract submitted to them by the bank, is limited to the signing of the contract in full without any changes or exclusions, or resigning from its conclusion. Therefore, it must be assumed that those provisions are unilaterally imposed by the bank, as a professional and a stronger party to the contract. At the same time, if such provisions are applied by the bank as a standard with other mortgage loan contracts concluded with the consumer, then this determines their qualification as a model contract, which was not agreed individually with the consumer. At the same time, if the bank claims that the general provisions were, however, agreed with the client individually, then on the bank lies the burden of proving that (Civil Code, Art. $385/4^1$).

In the light of the above conclusions it is without a doubt that the conversion clauses that constitute the basis for classification of the currency loan as denominated or indexed in the foreign currency, cannot be and in practice are not agreed with the consumer individually. Because their exclusion from the contract would deprive the concluded contract of the feature of denominated or indexed loan.

The conversion clauses described above, examined in individual cases both individually, as well as comprehensively in the context of the remaining contractual provisions, shape the rights and obligations of the Notifying Persons as consumers in a way that is contradictory with good practice and grossly violates their interests. The analysis of the content of typical

contracts for mortgage loan denominated or indexed to foreign currency in majority of cases[9] leads to the conclusion that:

1. They were not adjusted to the individual needs of the borrowers, known to the bank, who receive income in national currency and search for project financing in Polish zlotys;[10]
2. They were constructed in a way grossly unbalanced, protecting mainly the interests of the lender, due to:
   a) passing on of the currency risk entirely on the borrower;
   b) providing the lender with the possibility of unilateral determination of the levels of currency spreads, which allows them to obtain additional income at the expense of the consumer unjustified by any actual currency operations.

The crucial objection regarding the conversion clauses comes down to the unfair practice of banks which reserve themselves the possibility to obtain additional benefits at the expense of the consumers resulting from the application of conversion between the settlement currency and the currency of payment with the use of an exchange rate favourable to them. The abusiveness of this type of clauses manifests itself in granting the lender the right to unilaterally define the future exchange rate binding for the borrower. At the same time, the majority of contracts concluded before 26 August 2011[11] did not specify any criteria of the shaping of that exchange rate, nor the spread between the purchase rate, after which the loan was to be initiated, and the sale rate of the currency, used for calculating principle and interest instalments. As a consequence, the lenders secured themselves the right to specify freely, unilaterally and binding the borrower, the level of revenues from the exchange rate differences. Meanwhile, pursuant to the content of Art. 385^3 (8) of the Civil Code, in case of doubts it is considered that prohibited contractual provisions are those which in particular: make the performance of benefit reliant on the conditions dependant only on the will of the consumer's counterparty.

9 Such analysis as part of the incidental court control is only of individual character. This publication of the author is based on the analysis of particular cases known to the author from his own professional practice.

10 This does not concern persons who obtain income in the currency of the loan, at the same time, financing the investment in the same currency.

11 I.e. the day of entry into force of the act of 29 July 2011 on the amendment to the act - Banking Law and some other acts (Journal of Laws, No. 165, item 984).

Additionally, it should be noted that both denominated, as well as indexed loans are paid out the Polish zloty and are repaid in the same currency. Both at the loan initiation and loan repayment, no actual currency operations take place. The use of two different currency exchange rates by the lenders for the purposes of loan initiation and repayment has no economic justification. It is an artificial construct which is to constitute an additional source of income and unjustifiable benefits for the banks, which remain outside any possible control of the borrowers. What is more, lenders have their right secured to unilateral shaping of the currency exchange rate, influencing the cost of the loan servicing; the right which they execute during the contractual term i.e. due to the long-term nature of such contracts, usually for the period of several decades. In that aspect, this clause has the features of a prohibited contractual provision indicated in the content of Art. 385^3 (20) of the Civil Code, providing the consumer's counterparty with the right to determine or increase the price or remuneration after the conclusion of the contract without providing the consumer with the right to withdraw from the contract.

The contractual provisions indicated above which violate the interests of the consumer must be examined also in the context of good practice with reference to the industry, within the framework of which the entrepreneur who uses the model contract conducts their activity. In the analysed case, it is the bank which holds a special status of public trust institution. In relation to this type of entity, a heightened standard of care in shaping and observing good practice should be applied. Bank should shape its relations with the client in such a way as to ensure a high level or trust to the activity conducted by it. It is a *sine qua non* condition of the proper functioning of individual banks on the market of financial services, but also the stability of the entire sector. Meanwhile, in contracts for denominated or indexed mortgage loans there are conversion clauses, which not only fundamentally threaten the trust in the activity conducted by the banks, but also, in relation to the popularity of such practices, constitute a threat to the entire banking sector. Indicating the above, it must be noted that the financial stability is a public good, and its disturbance can lead to a financial crisis, and indirectly to an economic crisis.

When analysing the disputable clauses within the framework of the entirety of provisions of typical contracts, it must be concluded that banks by developing and applying model contracts for loans denominated or indexed to a foreign currency have created toxic financial instruments, which not only violate the interests of particular consumers, but also generate a significant risk to the entire financial system, which has been evidenced above. In the financial literature it is indicated that the toxic feature of the financial instruments is that on their own or jointly with other instruments they can cause turbulences in the correct functioning of the finance market leading to the emergence of a financial crisis (Pol, 2009: 9).

It must be indicated that conversion clauses used in the construct of indexed loans were entered to the register of prohibited clauses maintained by OCCP[12] under the following numbers: 3178,[13] 3179,[14] 5622,[15] 5743.[16]

The analysis of the notion of "contractual provisions determining the main obligations of the parties" should be made in the context of a legal definition of the bank loan contract and the case law.

In the bank loan contract, defined in Art. 69/1 of the act – Banking Law, the category of *essentialia negotii,* determining the main obligations of the parties, includes the provisions that specify: the objective, amount and lending rate of the loan, and also the height of commission and the method of loan repayment, including also the loan term. In view of the above – in the opinion of the author – it must be consequently assumed that conversion clauses do not determine the main obligations of the parties.

12 This register was supplemented with contractual provisions which were deemed prohibited with a final judgement of the Court of Competition and Consumer Protection (CCCP) before 17 April 2016. Currently, due to the change of the model of abstract control of provisions of model contract from judicial to administrative and judicial, implemented by the President of OCCP, the register is supplemented only of those cases in which the lawsuits were brought to CCCP before 17 April 2016. In new cases, the judgements on the use of prohibited provisions in model contracts follow from the decision of the President of OCCP and are published in the decisions base on the website of that office.

13 On the basis of the judgement of the District Court in Warsaw - Court of Competition and Consumer Protection: XVII AmC 426/09.

14 On the basis of the judgement indicated above.

15 On the basis of the judgement of the District Court in Warsaw - Court of Competition and Consumer Protection: XVII AmC 5344/11.

16 On the basis of the judgement of the District Court in Warsaw - Court of Competition and Consumer Protection: XVII AmC 1531/09.

Such approach is also used in the judicial decisions, in which it is underlined that the category of "provisions determining the main obligations of the parties" should include such provisions that define the constitutive elements for a given type of activity, allowing for their identification and distinguishing from similar contracts (The District Court in Warsaw: III C 1073/14). At the same time, such interpretation is also assumed in the case law of the European Court of Justice. In the case *Árpád Kásler and Hajnalka Káslerné Rába* on the loans settled in foreign currency, in the judgement of 30 April 2014 (Court of Justice of the European Union: C 26/13) the Court of Justice concluded that the contractual conditions which fall within the notion of "main subject matter of contract", should be considered to be those which determine the main obligations within the framework of a particular contract and which because of that characterise that contract. The Court of Justice has taken such a stance uniformly also in other judgements, additionally underlining that the assessment should be made taken into consideration moreover the following: general scheme and provisions of the contract, as well as its legal and actual factual context.

5 The Effects of Abusiveness of the Currency Clauses

The regulations of the Polishlaw that implement the provisions of the Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts[17] providing the consumer with a wide scope of protections against unfair practices of entrepreneurs, both of civil law nature, as well as the administrative and criminal law nature (Skory: 2007: 16).

The effects of the potential abusiveness of conversion clauses, as with all prohibited contractual provisions, are specified in Art. 385^1 § 2 of the Civil Code. This provisions determines that they are not binding for the consumer. At the same time, the disposition of this legal standard is applicable *ex tunc* i.e. from the moment of loan contract conclusion. This means that from the moment of the initiation of a legal relationship, the abusive clauses does not constitute the basis for the determination of the rights and obligations of the parties under that contract. Therefore, in principle the basic consequence of the application of a prohibited provision in the contract

17 OJ L 95, 21. 4. 1993, p. 29.

is a partial ineffectiveness of the contract in the scope limited to the abusive clause. At the same time, the consumer who is in the relationship with the entrepreneur can derive legal effects from it.

The provision corresponding to the content of Art. 6 /1 of the directive 93/13/EEC, in accordance with which the unfair conditions in contracts concluded by the sellers and the suppliers with the consumers shall not be binding for the client, and the contract in the remaining part will be still binding for the parties, if this is possible after the exclusion of unfair conditions, has not been directly transported to the Civil Code. Despite a direct implementation of that provision in the content of Art. 385^1 of the Civil Code, in the practice of OCCP[18], the Financial Spokesperson (The Report of the Financial Spokesperson: 2016: 27, 28) and the case law, an interpretation is used with the intention of preserving the validity of the contract to the broadest extent it is possible, after excluding abusive clauses from its content.

In accordance with the case law of the European Court of Law, a national court that recognizes the terms and conditions are of unfair nature, is obliged to:

- In the first place – draw all the consequences provided for the national law in order to ensure that those terms and conditions are not binding for the consumer (judgement of 6 October 2009 in case *Asturcom Telecomunicaciones*, Court of Justice of the European Union: C-40/08);
- Next – examine the possibilities of substituting the abusive clause with dispositive provisions (judgement of 30 April 2014 in case *Árpád Kásler* and *Hajnalka Káslerné Rábai,* Court of Justice of the European Union: C-26/13);

18 The opinion of the President of the Office of Competition and Consumer Protection containing an important view on the issue of 29 July 2016: DDK-644–505/16/MF "The opinion of the President of the Office of Competition and Consumer Protection containing an important view on the issue of 7 September 2016: DDK-644–504/16/AU, The opinion of the President of the Office of Competition and Consumer Protection containing an important view on the issue of 12 September 2016: DDK-644–506/16/MF, The opinion of the President of the Office of Competition and Consumer Protection containing an important view on the issue of 12 October 2016: DDK-644–522/16/PS, The opinion of the President of the Office of Competition and Consumer Protection containing an important view on the issue of 21 October 2016: RŁO-644–501(2)/16/AM, The opinion of the President of the Office of Competition and Consumer Protection containing an important view on the issue of 4 November 2016: DDK-644–510/16/AS.

- And only subsequently – perform an assessment whether the discusses contract can continue to be valid after the unfair provisions are excluded; at the same time, if theMember State has established, respecting the laws of the EU, national provisions allowing for the recognition of the annulment of the entirety of the contract, which was concluded between the entrepreneur and the consumer and contains one or more unfair terms and conditions, it is allowable to recognize the annulment of such an contract in its entirety, if such a solution ensures the consumer better protection (judgement of 15 March 2012, *Jana Pereničová and Vladislav Perenič vs. SOS financ.*, Court of Justice of the European Union: C-453/10).

With the above in mind, it must be assumed that in the light of the cited case law of the European Court of Justice, as well as the emerging line of judicial decisions of the common courts in Poland (The District Court in Warsaw: III C 1073/14), after it is recognized that a defective contract cannot be no longer valid, because it does not sufficiently determine the rights and obligations of the parties, it is allowable, within the framework of the judicial incidental control, to apply the sanction of invalidity with reference to the entire contract.

In the Polish law the legal basis for such a solution is provided for in Art. 58 of the Civil Code in relation to Art. 69/1 of the Act – Banking Law, if it turns out in a particular case that after the abusive clauses are excluded, when it is impossible to supplement them with dispositive provisions, it is impossible to determine the obligations of the parties, such as the loan amount to be repaid, basis for the lending rate, and also the height of principle and interest instalments or the method of their repayment. As a consequence, to mutual obligations fulfilled by the parties the provisions on the undue benefit (Civil Code, Art. 410 i n) should apply, with all relevant consequences, and in particular the obligation of the mutual reimbursement of profits obtained under the contract by the parties.

6 Conclusion

From the perspective of time, the practice implemented by the banks at the end of the first and beginning of the second decade of this century of offering mortgage loans to clients who do not obtain revenues in the currency of the

loan and who are at the same time looking for financing investments in real estate in the national currency must be unequivocally negatively assessed[19]. Thus led to the negative phenomena both in the social, as well as economic dimension and both from the point of view of the individual (for particular borrowers and banks), as well as the banking and economic systems. In consequence, a toxic tangle of legal and economic interests of consumers and banks emerged which resembles the Gordian knot.

All attempts to solve this problem undertaken so far in Poland by means of legislation have failed, mainly due to the fear of the entities who had the right to legislative initiative (the President, the Senate, the Council of Ministers, Members of Parliament) of the liability for damages of the State Treasury to banks, which as a result of regulation providing for a statutory conversion could record losses. Also the attempts to exert supervisory pressure on the banks by the Committee of the Financial Supervision, which within the framework of the possessed competences applies heightened supervision requirements towards banks which have a portfolio of foreign currency mortgage loans, turned out to be unsuccessful.

In that situation, the burden of solving that problem lies on the common courts within the framework of the judicial incidental control. It must be noted that emerging case law that in case of recognition of the abusiveness of conversion clauses, in face of the impossibility to substitute them with dispositive provisions and difficulties in determining the main obligations of the parties, permits for the possibility of acknowledgment of the invalidity of the entire currency loan contract, constitutes a threat not only to the solvency of the banks that have in their assets such liabilities, but also the financial stability of the entire banking sector.

19 The problem was solved only in 2013 when the Polish Financial Supervision Authority (PFSA) issued Recommendation S addressed to banks and related to good practices in the scope of managing credit exposures secured with mortgages (Recommendation S: 2013). This recommendation began to be binding for the banks in the scope of the majority of regulations on 1 January 2014. The S Recommendation introduced further limitations of crediting in foreign currencies - stating that currency loans indexed or denominated in foreign currencies should be a product offered only to clients with permanent income in the loan currency, ensuring a regular servicing and repayment of the loan; in case of clients (or households) that obtain income in various currencies, bank should ensure compliance of the loan currency with the currency in which the borrower (or household) obtains the highest income from the creditworthiness accepted for the calculation, and in case of other currencies, bank should predict their depreciation of 20 %.

In such circumstances, the passivity of the legislator caused by the pressure of the banks themselves can turn against them, because the judicial resolution of disputes with the clients will be connected to the higher costs not only financially, but also encompassing the reimbursement of costs of the court representation, but also the costs of the lost reputation and trust of clients, which constitute the foundation of the activity of financial institutions.

An opportunity for overcoming this stalemate is the work of the Working Group of the Committee of Financial Stability, which by the end of March 2017 is to analyse the possibility of applying supervisory and regulatory tools, the implementation of which would create incentives for the banks and the clients to make joint, voluntary decisions concerning the restructuring of the foreign currency mortgage loans. Based on the assumption that the maintaining of the status quo can turn out to the unfavourable for all parties, the development of a compromise solution within the framework of a social dialog, which would be strengthened by the economic incentives, seems to be an optimal solution. Only in case this initiative should turn out to be ineffective, a statutory solution can be reconsidered.

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BORROWERS' SUPPORT FUND IN POLAND

Zbigniew Ofiarski[1]

Abstract

Borrowers' Support Fund, created from the funds transferred by banks, grants transitional and repayable and free financial aid to the borrowers who have taken housing loans and have difficulties with current repayment of credit instalments. The aid may be granted to persons meeting the social criteria specified in the Act. The basis for financial aid is a contract concluded between the creditor and the borrower, while the funds are transferred to the creditor by Bank Gospodarstwa Krajowego that oversees the Borrowers' Support Fund. The period of providing aid may not be longer than 18 months, and monthly amount of aid cannot exceed PLN 1,500. After 2 years from completion of granting the financial aid, the borrower is obliged to return it repaying the interest-free monthly instalments within the next 8 years.

The purpose of the study is to analyse exceptional legal solutions, introduced in connection with significant deterioration of solvency condition (creditworthiness) for borrowers repaying the so-called housing loans. Introduction of such solutions is most often determined by the occurrence of crisis phenomena in the banking sector or even in the whole financial sector. Provision of aid to the borrowers by the state is often associated with involvement of public funds and treatment of a given social group in a preferential manner as compared to other groups which are in a similar market situation. The study applies the dogma-legal and supplemental comparison method. It also utilises the available statistical data illustrating the scale and scope of involvement of public funds in the borrowers support process.

Keywords: Housing Loans; Financial Aid; Fund; Borrower; Creditor.

JEL Classification: G21, K12

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1 Introduction

The purpose of the study is to analyse exceptional legal solutions, introduced in connection with significant deterioration of solvency condition (creditworthiness) for borrowers repaying the so-called housing loans. Introduction of such solutions is most often determined by the occurrence of crisis phenomena in the banking sector or even in the whole financial sector. Provision of aid to the borrowers by the state is often associated with involvement of public funds and treatment of a given social group in a preferential manner as compared to other groups which are in a similar market situation. The study applies the dogma-legal and supplemental comparison method. It also utilises the available statistical data illustrating the scale and scope of involvement of public funds in the borrowers support process.

The outcome of the financial crisis is occurrence of different kinds of risk in particular sectors of the financial market. This phenomenon is also typical of the banking sector, and one of most significant risks is the credit risk. The importance of this risk for bank operations results from the fact that credit activities normally includes ca. 55–60 % of assets of the bank and, at the same time, has an impact on 80 % of the financial result of the bank. The credit risk means a threat that the borrower fails to perform any obligations resulting from the credit agreement and thus will cause a financial loss in the assets of the creditor (Wiatr, 2013: 163).

Some types of credits are more risky than others, e.g. long-term investment credits (Dobosiewicz, 2011: 180). This category of credits includes also credits granted for housing purposes. Long-term credit period, mortgage security on the credited real estate and changes of prices on the residential real estate market are natural sources of credit risk. The borrowers also constitute a specific group due to their sources of income most often originating from employment relations. Loss of such source or significant change of its efficiency during credit repayment directly affects the limitation of their financial capacity to pay. Very often they do not have any larger saving resources which could help repayment of the subsequent credit instalments.

The Borrowers' Support Fund created in 2015[2] (BSF) refers, with regard to the general concept, to the aid for borrowers from the Labour Fund used since 2009.[3] On the basis of the Act from 2009 a temporary repayable aid of the state is granted to natural persons obliged to repay the housing loan, who have lost work after 1 July 2008. The aid is implemented through Bank Gospodarstwa Krajowego (BGK), and the source of its financing is the Labour Fund. The beneficiaries of this financial aid, should meet all the following social criteria:

- Loss of work (performed so far under contracts of employment or other paid work or work consisting in conducting business operations entered into the records of this activity without hiring employees);
- Registration as an unemployed person with the right to the unemployment benefit.

In the period of preparation of the draft of this Act it was estimated that implementation of such form of aid will result in increase of the Labour Fund's expenditures in 2009–2011 by PLN 108 million, PLN 225 million and PLN 106 million respectively and increase in revenues of the Labour Fund in the subsequent years by ca. PLN 40 -55 million per year. The total costs of implementation of these regulations in 2009–2020 (including the cost of money in time, the 3 % discount rate amounts to PLN 73.5 million, of which PLN 6.6 million solely as costs of BGK). Assuming the lack of possibilities of enforcement of the granted aid (for instance, as a result of regulations on the consumer bankruptcy) at the level of 10 %, the additional cost of this instrument would amount to ca. PLN 44 million, and thus the total cost of the solution amounts to PLN 117.5 million). The above calculations were made on the basis of the assumption, according to which 1 % of the value of the credits will not be repaid and is redeemed, while the redeemed amounts would be subject to taxation with the rate equal to 18 % (Sejm, 2009).

2 Motives of Establishing the Borrowers' Support Fund

Similar or even identical is the purpose of establishing the BSF. It was directly indicated that it is provision of financial support to persons who,

2 Act of 9 October 2015 on Support of Borrowers Being in a Difficult Financial Situation Who Have Taken Housing Loans (Journal of Laws of 2015, item 1925 with amended), hereinafter referred to as the Borrowers' Support Act.

3 Act of 19 June 2009 on the Aid of the State in Repayment of Some Housing Loans Granted to Persons Who Have Lost Work (consolidated text: Journal of Laws of 2016, item 734 as amended).

as a result of objective circumstances, are in a difficult financial situation and their obligation to housing loan instalments repayment has become a significant burden. As a result, many borrowers lost their capacity to timely settle their liabilities towards banks. This problem is particularly relevant for borrowers who are repaying credits denominated in or indexed to a foreign currency. In connection with strengthening of the French Franc towards Polish Zloty, monthly instalment or repaid credit (taken in 2005–2010) be the end of October 2014 increased on average by ca. 21 %, and maximally even by 30 % (Osiński, 2015: 36). In September 2015, the situation slightly improved mainly due to a low level of interest rates, decrease in unemployment and increase in average salary and income from work performed in one's own name (Osiński, 2016: 44).

Assessment of the situation in the area of housing loans conducted by the Polish Financial Supervision Authority (KNF) was also focused on the events which may threaten the stability of the banking sector. In particular, the emphasis was placed on the fact that strengthening of the Swiss Franc resulted in significant increase in the amount of the loan, which in many cases already exceeds the value of the real estate constituting the basic security of the loan. At the end of 2014, this problem concerned 236.4 thousand housing loans (12.8 % of the total number of all loans) with the value of PLN 84.1 billion (24.3 % of the total value of all loans). In addition, many persons repaying the housing loans in the Polish currency, as a result of loss of work or decrease in income, also untimely regulated their monthly obligations in that respect. During this period, ca. 38 thousand housing loans secured on the residential real estate had the status of the impaired loan (Kotowicz, 2015: 71–72).

At the end of 2015, in portfolios of banks, there were 1 948 963 housing loans granted to natural persons, of which 1 318 514 in the Polish currency and 630 449 denominated to or indexed in a foreign currency. The total value of the debt in this respect amounted to ca. PLN 371 billion. In the total number of credit contracts granted for housing purposes as much as 562,928 were concluded for a period from 10 to 20 years. Only slightly less contracts i.e. 525,135 were concluded for a period from 25 to 30 years, while 422,463 contracts were concluded for a period from 20 to 25 years. This means a long exposure of banks to the credit risk. During this period, 229 500 housing loans (11.8 % of the total number of all loans) with the value of PLN 88.3 billion

(23.8 % of the total value of all loans) had a higher current value than the value of the real estate constituting their basic protection. As compared to the condition by the end of 2014, the situation slightly improved. However, many of the impaired loans remained unchanged (35.6 thousand i.e. 1.8 % of the total number of all housing loans) similarly to the number of loans delayed in repayment by at least 30 days (34.3 thousand i.e. 1.8 % of the total number of all housing loans) (Kotowicz…2015, 2016: 98–101).

It was assumed that the threat related to the possibility of loss of the residential real estates constituting security of the impaired loans is an important argument justifying introduction of another mechanism of financial support for borrowers being in a difficult financial situation resulting from the market phenomena beyond the control of the borrowers. The support should be transitional and repayable and apply to the borrowers concluding both the credit contracts in the Polish currency and the credit contract denominated to or indexed in a foreign currency[4].

3 Principles of Creation and Service of the Borrowers' Support Fund

Art. 14 of the Borrowers' Support Act (BSA) established the BSF as a special-purpose fund, but not being state purpose fund as defined in the Act on Public Finance.[5] The calculated funding sources of the BSF are as follows:

1. Payments from creditors, namely from the Polish banks, branches of credit institutions, foreign bank branches[6] and credit unions[7] which granted a housing loan;

4 Justification of the bill of the Act on Support of Borrowers being in a difficult financial situation – form no. 3859 of the Sejm of the Republic of Poland 7th term of office.

5 Act of 27 August 2009 on Public Finance (consolidated text: Journal of Laws of 2016, item 1870 as amended).

6 Pursuant to Art. 4/1/1, 18 and 20 of the Act of 29 August 1997 – Banking Law (consolidated text: Journal of Laws of 2015, item 128 as amended) the national bank is the bank having their registered office on the territory of the Republic of Poland. The Branch of a credit institution is the place of conduction business constituting legally subsidiary of this institution and directly implementing all or some from among the transaction inherently associated with operations of the institution, without the status of a branch of a national bank of a foreing bank. Organizational unit of a foreign bank performing for and on its behalf all or some different operations resulting from the permit granted to this bank, is a branch of a foreign bank, given that all such organizational units of a given foreign bank corresponding to the above characteristics, established within the territory of the Republic of Poland, are regarded to be one branch.

7 Act of 5 November 2009 on Credit Unions (consolidated text: Journal of Laws of 2013, item 1450 as amended).

2. The repayments of the support granted from this fund are made according to the procedure as outlined in the quoted Act;
3. Revenues under the BSF investment funds (temporarily free funds of the Fund may be invested by the BGK with utmost diligence, only in: securities issued or guaranteed by the State Treasury; securities issued by the National Bank of Poland; securities issued by state governments or central banks of the states being members of the Organization for Economic Cooperation and Development (OECD); deposits in banks);
4. Other inflows.

The main source of financing of the BSF are payments by creditors made in proportion to the size of the owned portfolio for residential loans for households whose delay in repayment of the capital or interests exceeds 90 days. According to the Report of the Polish Financial Supervision Authority (KNF) on the situation of banks in 2015, the number of loans where the delay in repayment is from 90 to 180 days is decreasing improves for several years (in 2011 the problem concerned 4,477 loans; in 2012 – 4,383 loans; in 2013 – 3,566 loans; in 2014 – 3,342 loans; in 2015 – 3,008 of all loans). Less favourable is the situation regarding these loans where the delay in repayment is more than 180 days (in 2011 the problem concerned 17,452 loans; in 2012 – 22,051 loans; in 2013 – 23,731 loans; in 2014 – 22,815 loans; in 2015 – 20,286 loans) (Kotowicz…2015, 2016: 101). In the first half of 2016, there was observed a moderate increase of the impaired housing loans (by PLN 0.5 billion i.e. by 1.3 %), but as compared to the situation of 30 June 2015, the condition of the impaired housing loans decreased by PLN 1.4 billion i.e. by 11.2 % (Kotowicz…2016, 2016: 52). The amount of payment to the BSF, assigned to a given creditor is communicated by the BSF Board on the basis of information provided by the Chairman of the Polish Financial Supervision Authority (KNF) concerning the sizes of the owned portfolios for residential loans for households whose delay in repayment of the capital or interests exceeds 90 days, according to the situation at the end of the quarter preceding the payment determination date. Introduction of the system of the proportional payments is a justified solution because it mainly charges these creditors who are most involved on the housing loans market and at the same time their customers have the largest periodical difficulties associated with repayment of credits.

Another source of funding for the BSF are repayments of support made by their beneficiaries (borrowers):

- Beginning in the month following the one in which the 2 years period from payment of the last instalment of support elapsed (they are made for 8 subsequent years in equal interest free monthly instalments, payable up to 15 day of the month to the account of the BSF);
- In the event of sale of the object of crediting covered by support by the borrower (made within 30 days from the date of the sale);
- In the case of observing that the granted support was undue (the repayment includes the amount of the granted support increased by statutory interest charged from the day of transfer by the BGK of funds under the support).

When released, the funds of the BSF amount to PLN 600 million (the maximum amount of the BSF). The procedure of supplementation of the BSF funds was also introduced in the event the value of the funds is lower than PLN 100 million. In such a situation the BSF should be supplemented up to the amount of PLN 300 million. The creditors contribute to the BSF the supplementation in the amount proportional to the amount of the support given to their customers in the period from the day of establishing of this fund or its last supplementation. The mechanism of calculating the supplementary payments is intended to provide greater share in payments to the BSF of these entities which customers participate in the most in the aid granted from this fund. In particularly justified circumstances, at the request of the creditor, the Board of the BSF may divide the supplementation payment into instalments.

In connection with the need to provide stability of the financial sector the Minister of Finance, after seeking opinion of the Financial Stability Committee[8], may suspend, by way of a regulation, supplementing of the BSF. In such a situation the BSF Board suspends granting support as of exhaustion of the funds of this Fund and informs the creditors on such suspension. The BSF Board announces, in a daily of national range the information about suspension for granting support.

8 The scope and forms of the Financial Stability Committee are determined by the Act of 5 August 2015 on Macroprudential Supervision over Financial System and Crisis Management in Financial System (Journal of Laws of 2015, item 1513 as amended).

The BSF is located in the BGK, which prepares its separate balance sheet and profit and loss account, as well as transfers the quarterly information on using the funds of the BSF to the Minister of Finance. Under implementation of the tasks related to granting support, the BGK is entitled to commission remuneration, calculation principles and payment terms of which were defined by the Minister of Finance (Minister of Finance, 2016). It is a fixed quarterly commission remuneration in the amount of a product of 1/4 size of the BSF funds on the day of its activation (i.e. PLN 600 million) and the 0.5 % rate, so it amounts to PLN 75 thousand. Remuneration is paid from the BSF funds in quarterly periods, until the 10th day of the month following the quarter for which remuneration is payable.

In addition, the legislator created the BSF Board. It includes the representative of the Minister of Finance appointed thereby (as the Chairperson of the board) and the representative of the Chairperson of the Polish Financial Supervision Authority (KNF), the representative of the President of the BGK, the representative of the Financial Ombudsman; the representative of the creditors jointly appointed by 5 creditors paying the highest contribution or the highest last supplementation. The BSF Board adopts resolutions by ordinary majority of votes, in the presence of at least 3 members of the board. In the event of a tie, the vote of the BSF Chairperson will be the casting vote. The BSF Board is serviced by the BGK.

The Act does not directly determine the status of the BSF Board, but it may be performed by analysing the scope of competence of the board determined by the legislator. This includes:

- Informing the creditors about the amount of payments for the BSF;
- Determination of the date of making payments on a the BSF;
- Informing the creditors on dates of contribution and amount of supplementation for the BSF;
- Division, at the request of the creditor, the supplementation payment into instalments in particularly justified circumstances;
- Suspension of granting support (after prior issuance by the Minister of Finance of the Regulation suspending supplementation of the BSF in connection with the need to ensure stability of the financial sector) as of exhaustion of the funds of the BSF and informing the creditors

of this suspension, as well as announcement in a daily of national range the information about suspension for granting support;

- Postponement of deadlines for payment and division of the receivables under repayment of the BSF support into instalments;
- Remission of receivables, in whole or in part, upon a reasonable request of the borrower, under repayment of the BSF support.

4 Granting Support from the Borrowers' Support Fund

Repayable financial support is granted to natural persons obliged to repay the housing loan that fall into a difficult financial situation. From the quoted provision of the Act there can therefore be inferred the subjective-objective boundaries of the granted support. The beneficiaries of support are solely natural persons in difficult financial situation obliged to repay a particular type of credit, i.e. a housing loan, which is the credit granted in connection with satisfying residential needs of the borrower:

1. Construction of a detached house,
2. Acquisition:
   a) of ownership of a detached house or the right for separate property of a dwelling unit,
   b) of the cooperative ownership rights to a dwelling unit,
   c) of the right for separate property of a dwelling unit in housing cooperative

   – which repayment was secured with a mortgage established on the object of crediting.

A housing loan as defined by the quoted Act is also:

1. A credit granted for the repayment of the above mentioned housing loan, if it was secured by mortgage on the object of crediting;
2. A part of the credit granted for the repayment of various credit obligations, which is intended for repayment of the above mentioned housing loan, if it was secured by mortgage on the object of crediting.

Therefore, a legal definition of a housing loan states that it is a special type of the so-called mortgage loan in which the purpose of the credit and its object are integrally related with the form of a security (Dobosiewicz, 2006: 186; Główka, 2010: 186; Gąsowska, 2000: 12). In spite of the fact

the subject of such a credit is an investment purpose implementation of which aims at satisfying residential needs of the borrower, it also has the characteristics of a consumer credit, particularly serving financing of personal needs of the borrower (Flejterski, Świecka, 2006: 253).

A difficult privatization of the party obliged to repay the housing loan should be analysed with emphasis on the provisions of Art. 3 of the Borrowers' Support Act which also regulates the conditions for granting the support from the BSF. They are of social nature and refer directly to the financial situation of the borrower. The support may be granted, if:

- On the day of filing the request for support, the borrower is an unemployed person (is not possible to grant the support in the case when the loss of employment occurred as a result of termination of the employment contract by notice of termination by the borrower or for termination of employment without notice through the employee's fault[9]), or
- The borrower bears the monthly costs of a housing loan service in the amount exceeding 60 % of income per month earned by a household, or
- A monthly household income, reduced by the monthly costs of the housing loan service does not exceed the amount agreed in accordance with the relevant provisions of the Act on Social Aid.[10]

These are disjunctive conditions and fulfilment of any of them entitles the borrower to apply for support from the BSF. There are also determined the negative premises occurrence of which makes it impossible to grant the support from the BSF. It is unacceptable to grant the support:

- For the repayment of housing loan, if one of the borrowers from the same household gained support on the terms as provided in the Act,

9 Following the procedure outlined in Art. 52/1 of the Act of 26 June 1974 - Labour Code (consolidated text: Journal of Laws of 2016, item 1666 as amended), namely in the case of: material breach by the employee of basic employee obligations; committing by the employee, during the term of employment a crime which makes it impossible to further employ them on the occupied position, if the crime is obvious or was observed with a legally binding sentence; caused by the fault of the employee loss of the rights necessary to work on the position.

10 In 2016, pursuant to Art. 8/1/1, 2 of the Act of 12 March 2004 on Social Aid (consolidated text: Journal of Laws of 2016, item 930 as amended.) in case of the one-person household it is the amount of PLN 634, and with regard to the multiperson household is the product of the number of members of the household of the borrower and the amount of PLN 514.

unless the support is no longer granted and the period of the granted support did not exceed 17 months (in this case the total period of the support granted to the borrowers for the repayment of the housing loan, secured with mortgage established on the same object of crediting cannot exceed 18 months);

- In the case when the housing loan contract was terminated;
- For the period in which the borrower is entitled to a benefit for loss of work resulting from the concluded credit repayment insurance contract, guaranteeing payment of the benefit in case of a job loss;
- For the borrower, who, on the day of submission of the request for the support is the owner of another dwelling unit or a detached house; has other cooperative tenant right to a dwelling unit, co-operative right of ownership of a dwelling unit, the right to a detached house in housing cooperative or the right to a detached house or dwelling unit being built for the purpose of transferring their ownership onto the members; is a lessee of another dwelling unit or a detached house.

The amount of support from the BSF is limited in the quota-based and time aspect because it must not exceed the value of liabilities of the borrower under housing loan from the period of 18 months, i.e. the equivalent of the expected 18 monthly capital and interest instalments of the housing loan. If the amount of such monthly loan instalment is higher than PLN 1,500, determination of the amount of the support uses the amount of PLN 1,500. In order to obtain the support the borrower files a request with the creditor by 31 December 2018. After positive verification, of the request the support is transferred by BGK in monthly instalments, not higher than PLN 1,500, to the bank account indicated by the creditor intended for transferring of the support. The amount of support and the dates of its transferring are determined in the contract concluded between the borrower and the creditor, while in order to implement the provisions of the discussed Act the BGK concludes a contract with the creditor.

5 Conclusion

It is possible to positively assess system of the support granted from the BSF funds *de lege lata*, which is monitored both in the period before releasing the support (including verification of the request of the borrower and its

compliance with the conditions entitling for receipt of the support) as well as in the course of using the support by the borrower. Initial control is carried out by the creditor, while current control is exercised by the creditor and the BGK. To ensure effectiveness of the current control the information exchange procedure was introduced. The district labour office is obliged to promptly notify the BGK about loss of the unemployed status by the borrower. On the other hand, the creditor is obliged to promptly notify the BGK about: sales of the object of crediting, increase of monthly income or reduction of monthly loan instalment leading to failure to fulfil the premises of granting support, undertaking enforcement actions from the object of crediting, increase of monthly income or reduction of the number of members of the household of the borrower leading to failure to fulfil the premises of granting support, termination housing credit contract or repayment of it. The borrower should immediately provide the creditor with the information about occurrence of such events. In case of fulfilment of any of the above mentioned premises the BGK stops the payment of the support. The scope of obligations of the creditor includes enforcement of claims for returning the granted support, both after the end of payment of the support and in the case of request to return the undue support.

The solutions adopted in Act state that the program of the support granted to the borrowers from the BSF funds is limited in the time aspect. The request for the support may be submitted only until 31 December 2018, and thus the positively verified requests which will be submitted at the last acceptable time will be implemented for a period not longer than until the end of June 2020. The confirmation of this assessment can be found e.g. in the provisions of Art. 16/7 of the Borrowers' Support Act, according to which after 6 months from the final deadline for submission of the requests for the support the funds of the BSF which will be used or reserved for granting the support, will be returned to creditors, in six-month tranches, in proportion to the sum of made payments and supplements, reduced by the amount of the support granted to the borrowers, being clients of a given creditor.

In the period from February to July 2016, the BSF granted support in the overall amount of PLN 6.6, million only by entering into 293 contracts with borrowers. It is the result of both rigorous statutory conditions approving

granting support and a relatively low participation of the impaired housing loans in the total number of contracts for such credits (at the end of 2015, the impaired housing loans constituted only a 2.8 %). Low use of funds of the BSF may also be the effect of the borrowers lacking knowledge on functioning of this Fund and terms of granting financial aid from it. Originally it was estimated that the discussed aid would be used by ca. 38,000 borrowers who at the end of 2014 fell into a difficult financial situation affecting the timely repayment of housing loans. As a result of the aid granted to the borrowers 116 creditors would indirectly benefit from it (i.e. 37 national commercial banks, 29 branches of credit institutions and 50 credit unions) (Kotowicz, 2015: 72).

In general, it is possible to positively assess introduction of this system of aid for borrowers because it provides equal treatment for natural persons, who taken credits in the Polish currency and credits denominated in or indexed to a foreign currency. The aid is addressed to persons being in a difficult financial situation, is repayable but free-of-charge for borrowers and does not involve aid of public financial means, but the financial resources transferred from the banking sector. However, in connection with contribution of payments to the BSF by the creditors there will be a depletion of budgetary income under corporate income tax. It is estimated that the total loss in tax income from creditors, assuming the 19 % tax rate, payments to the BSF funds in the amount of PLN 600 million and a possible necessity of supplementation of the BSF with the amount of PLN 300 million, will amount to PLN 171 million. Financial aid granted from the BSF may result in restoration of the financial liquidity lost by the borrower, reduction of the risk of loss of its residential real estate being object of security of repayment of the credit and provision of regular repayment of credit in the years to come.

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MISSIONARY OPERATIONS OF BANK GOSPODARSTWA KRAJOWEGO AS A NATIONAL PROMOTIONAL BANK

Sebastian Skuza, Robert Lizak[1]

Abstract

One of the crucial institutional elements of the Plan is to create a Polish Development Fund – based on functioning institutions that support development, an integrated structure of development institutions under the Polish Development Fund Group supervised by the Minister of Development and Finance. The main aim of the contribution is to confirm a thesis that in the Bank Gospodarstwa Krajowego it could conduct to date promotional operations, both its own ones and also subcontracted ones without the need for taking essential action and/or changes that are systemic in nature, such as the need for notifying operations or separating part of operations. In summary the Authors try to provide *de lege ferenda* conclusions. As a science method the Authors use the legal analysis of the sources of the binding law and the other documents.

Keywords: National Promotional Bank; Bank Gospodarstwa Krajowego; State Aid; Financial Law.

JEL Classification: G20, G28, H41, K20

1 Introduction

The Responsible Development Plan adopted by the Resolution of the Council of Ministers No. 14/2016 of 16 February 2016 is a reply to challenges that can be described using the formula of five developmental traps (Council of Ministers, 2016: 3; Skuza, Propozycje… 2016: 112):

1. Average income trap;
2. No balance trap;

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3. Average product trap;
4. Demographic trap;
5. Institution weakness trap.

The Responsible Development Plan assumes that in view of depletion of to date factors for growth the Polish economy needs a new model for economic development, based on the five following pillars (Council of Ministers, 2016: 6):

1. Re-industrialisation;
2. Development of innovative firms;
3. Capital for development;
4. Foreign expansion;
5. Social and regional development.

Quantitative targets assumed in the aforementioned Plan for 2020 are as follows (Skuza, Propozycje… 2016: 113; Ministerstwo rozwoju, 2017):

1. Increase in numbers of large- and medium-sized firms > 22,000;
2. Increase in the share of r & d expenses in the gross domestic product from 0.8 % to 2 %;
3. Increase in loans for firms, increase in the share of investments in the gross domestic product >25 %;
4. Increase in the importance of export, polish direct foreign investment – increase by 70 %;
5. Decrease in the at-risk-of-relative-poverty rate (below 15.5 %);
6. Gross Domestic Product per capita – 79 % of the average of the European Union.

One of the crucial institutional elements of the Plan is to create a Polish Development Fund – based on functioning institutions that support development, e.g. Bank Gospodarstwa Krajowego ("BGK"), Korporacja Ubezpieczeń Kredytów Eksportowych S.A. ("KUKE"), Polska Agencja Informacji i Inwestycji Zagranicznych S.A. ("PAIZ"), Agencja Rozwoju Przemysłu S.A. ("ARP"), Polski Fundusz Rozwoju S.A. ("PFR"), Polska Agencja Rozwoju Przedsiębiorczości ("PARP"), an integrated structure of development institutions under the Polish Development Fund Group supervised by the Minister of Development and Finance.

In this publication the Authors are attempting to prove a thesis that in BGK it could conduct to date pro-development operations, both its own ones and also subcontracted ones without the need for taking essential action and/or changes that are systemic in nature, such as the need for notifying operations or separating part of operations. As a science method the Authors use the legal analysis of the sources of the binding law and the other documents.

2 Issues of Own Operations of the National Promotional Bank

Origins of formation of a state-owned bank (including BGK) are separating a specific part from the assets of the State Treasury and equipping a new legal person with these assets – for the purposes of conducting business operations. A public administration body exercises control over this form of operations. In state-owned enterprises, the role of public administration bodies is determined by the powers of the so-called founding body.

BGK as a National Promotional Bank has a role of a financial institution that supports the economic policy of the Council of Ministers. Operations of BGK are regulated by the Act of 29 August 1997 – Banking Law Act and as a rule are subject to prudential standards applying to national deposit and credit banks. At the same time the Act of 14 March 2003 on Bank Gospodarstwa Krajowego introduces solutions that are *lex specialis* in nature for example in respect of:

1. Determining a catalogue of statutory tasks of BGK, including in the area of handling governmental programmes and funds handed over to BGK as well as the rules for financing them;
2. Ensuring by the Minister of Finance own funds as well as liquidity of BGK at a level that allows BGK to meet prudential standards;
3. Taking over by the State Treasury the property and liabilities of BGK in the case of its liquidation.

In the course of works on the Treaty of Accession Poland negotiated putting BGK on the list of credit institutions to which the provisions of the then in force Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 concerning taking and conducting operations by credit institutions did not apply. The consequence of the above,

in accordance with Art. 2/5/18 of the Directive of the European Parliament and of the Council 2013/36/EU of 26 June 2013 ("CRDIV Directive"), is a subjective exclusion of BGK from applying the provisions of this Directive. By referring to the provisions of the aforementioned Directive, BGK is also excluded from the need for keeping to standards and regulations contained in the provisions of the Regulation of the European Parliament and of the Council (EU) No. 575/2013 of 26 June 2013 ("Regulation No. 575/2013") without the need for implementing to the national legal order (Skuza, Proposals… 2016: 443).

In view of the above and because of a special nature of BGK and their operations, separate solutions in respect of applying some prudential standards were accepted (e.g. increasing concentration limits towards groups of related parties, individual banks as well as investment funds) in the Act on Bank Gospodarstwa Krajowego, thus stressing the nature of BGK as a National Promotional Bank.

The provision of Art. 4 of the Act on Bank Gospodarstwa Krajowego indicates fundamental (pro-development and missionary) objectives of operations of BGK, i.e. supporting the economic policy of the Council of Ministers, supporting governmental social and economic programmes as well as supporting programmes of local autonomy and regional development. The regulations of the Act on Bank Gospodarstwa Krajowego by determining the above objectives do not introduce limitations as to opportunities of their implementation only through subcontracted missionary operations.

The fact of conducting operations of a National Promotional Bank on own account on market conditions does not, however, determine their commercial nature. Commercial operations and own missionary operations must not be understood as identical. Commercial operations conducted on a commercial basis are operations aimed only at the maximization of profits, irrespective of the scope of action carried out and concerning the general objective of conducting business operations. Development operations may be aid (then it needs to meet all of the four conditions for State aid) or market in nature, i.e. when a development bank operates in the area of an identified market gap. In this sense it must not be assumed that pro-development operations based on market conditions are commercial operations.

Analysis of to date decision-making practice of the European Commission indicates, however, that in the case of action implemented on market conditions, it can be considered to be either commercial operations (when a bank operates in conditions of full competition with private entities), or development/missionary operations, as long as it is demonstrated that there is a market gap in a given area/sector. In this context the Decision of the European Commission to Great Britain (casus Green Investment Bank) – Decision C(2012) 7133 final needs to be quoted where the European Commission clearly stressed that the investment policy of GIB needs to combine action on preferential conditions (containing public aid) and – wherever possible – action on market conditions, i.e. analogous to those offered by commercial entities. From the Decision C(2012) 7133 final, it results that: *(…) the GIB will be subject to a double bottom line constraint. Its investment policy should target at the same time two distinct objectives: first, maximizing its environmental effect, second, achieving an average overall nominal return target (which has been fixed at 3,5% p.a. after operating costs excluding set up costs but before tax). (…) According to the UK authorities, that double bottom line approach should result in the GIB investing whenever possible but not exclusively on so-called commercial terms to ensure both reaching the green objectives and sufficient profitability".*

Furthermore, it was ruled in the Decision that Green Investment Bank needs to operate based on the principle of subsidiarity the effect of which is to be organisation whenever possible of financing of undertakings with the participation of private investors (attracting private capital, and not driving it out). It is also important that merely operating in the area where commercial banks are present also does not yet determine that this is commercial operations. Because the fact of the existence of the market does not determine that there are no imperfections.

In recent years, cases can be indicated in which the European Commission indicated separation of missionary and commercial operations – in Great Britain and Latvia. However, in practice the separation of commercial operations to other entity included only the case of British Business Bank because the European Commission acknowledged that British Business Bank in their commercial part would operate in the area where also commercial banks are active, and therefore the existence of market gap was not found (commercial

financing of the sector of SMEs). On the other hand, "missionary/promotional" part of British Business Bank, the so-called Mandated Arm, may operate both through aid schemes (based on General Block Exemption Regulation and/or *de minimis*), and also on market conditions (and in newly introduced market schemes mechanisms need to be introduced protecting not driving the private sector out – this stipulation will, however, not apply to already applicable schemes). From the BBB Decision C(2014) 7366 final, it results that "*the remit of the Mandated Arm will also cover specific schemes providing financing to SMEs on market economic operator ("MEO") terms. To ensure the MEO financing addresses SME access to finance market failures, the Mandated Arm's MEO financing activities will target SMEs eligible under the GBER and will comply with all the conditions of the relevant article of the GBER, except the requirements relating to aid intensities or aid amounts. (…). All future funding of the Commercial Arm by the UK government or TopCo will also be performed on commercial terms. All additional equity funding provided in the future by TopCo to the Commercial Arm will be required to generate incremental returns consistent with the Commercial Arm's return targets set out in the business plan.*"

In the case of another British institution – Green Investment Bank the European Commission acknowledged that the entire operations of this institution were categorised as operations within the gap, without the need for any division (even in the area of internal regulations organisational in nature). On the other hand, in the Latvian case the identified problem was not about conducting development and commercial operations (mainly the issue of commercial mortgages was debatable, so operations fully commercial in nature, and not market missionary operations), but about no suitable separation of those areas (not determining the need for forming a new unit) of operations, i.e. within this institution, no sufficient organisational, financial or accounting division was found. In view of the above the European Commission accused Hipoteku Banka of unlawful use of financial means from recapitalisation by the State Treasury for commercial operations (mortgages), which in the opinion of the European Commission distorted competition on the market of the European Union. As a result, Hipoteku Banka (currently conducting their operations under the name Altum as the so-called Single Development Institution) had to sell isolated portfolios recognised as commercial.

According to the Communication from the Commission to the European Parliament and The Council: Working together for jobs and growth: The role of National Promotional Banks (NPBs) in supporting the Investment Plan for Europe (European Commission, 2015: 2/3), there is a statement that *"to avoid mutual subsidisation, commercial operations of national pro-development banks is after all separated from their promotional operations"*. Therefore, the above provision refers to the principle of ensuring suitable organisational, financial and accounting separation, it does not however indicate the need for separating to a separate legal entity); furthermore, the guidelines of the Communication refer only to formation of new development banks and have no direct application to already functioning institutions.

Theoretically, the issue of creation can be considered e.g. by separating a New Bank from BGK. However, it should be noticed that it would not be possible for the New Bank to make use of the subjective exemption from the obligation of applying the Regulation No. 575/2013, as it is the case now towards BGK (double concentration limits). It is likely that it would not either be possible for the New Bank to make use of the tax exemption from the bank levy or use on account of benefits for the Bank Guarantee Fund and would be an entity with a bankruptcy capacity. It would not be therefore possible to assign exposures towards the New Bank a risk weight at a level of the State Treasury, which would decrease their effectiveness of operations and would increase financing costs towards BGK which, in turn, would limit investment possibilities of the New Bank. In the case of implementation of a proposal to leave in BGK only subcontracted missionary operations (i.e. flow funds and handling EU programmes), the New Bank similarly as currently BGK would conduct missionary (own) operations on market conditions, which *de facto* – in relation to the object of operations – would make this institution be a development bank. In this variant, the New Bank's commercial operations would not be significant, therefore, in practice there would be formed a development bank conducting operations on general terms (Banking Law Act). Furthermore, it needs to be stressed that limits in the European Investment Bank for development banks are counted on their balance sheet total, therefore, reduction in the balance sheet total of BGK would reduce a potential "absorption level" of obtaining preferential financing.

3 Issues of Operations of the National Promotional Bank in the Context of State Aid

On the question of public aid attention should be paid to a differentiation of the so-called first and second level State aid. The first level aid is aid that may be given at a stage of formation of a public bank and/or their operations in the form of e.g. guarantee and/or recapitalisation (State aid – National Promotional Bank relationship). This aid will be acknowledged to be conforming to the common market, as long as this support does not impact distortion of competition, i.e. public banks will be operating in a gap, and their possible commercial operations will be properly separated and will not make use of this support. It should, however, be noticed that support for commercial operations is also possible and it will not be acknowledged to be the first level public aid in the case this aid is given on market conditions, i.e. based on the so-called private investor principle.

The second level State aid is aid contained in operations of National Promotional Banks, which may, but does not have to take place. According to the quoted Communication "*their* [National Promotional Banks'] *interventions are categorised as State aid, if all of the other criteria specified in Article 107(1) [of the TFEU] are met"* ((European Commission, 2015: 2/3). From the above, it therefore appears that development banks are allowed to conduct operations both on aid principles – based on acceptable systems (General Block Exemption Regulation, *de minimis*) and/or notified programmes, as long as all of the four conditions for the existence of public aid arising out of the TFEU (including distortion of competition on the market) are met, and also on market principles – based on the so-called market operator test. Examples of functioning development banks not providing support being public aid (e.g. Bpifrance) can even be indicated. Attention should also be paid to the fact that in the Communication there is a statement that *"NPBs prove to work best where they focus on economically viable projects and operate with sufficient profitability (albeit below private operators' cost of equity) to maintain financial soundness without continued capital injections by the government (profits mostly being retained to bolster future lending capacity). High standards of transparency and accountability are important for NPBs' reputation in the market, as well as professional management and the necessary degree of independence. Prudential supervision exercised*

independently by a separate entity further strengthens this reputation." ((European Commission, 2015: 2/2).

In the recent period, only processes of formation of new development banks have been notified (in Great Britain - Green Investment Bank, British Business Bank and in Portugal – Development Finance Institution), but also not in all cases (e.g. formation of Strategic Banking Corporation of Ireland was not notified). Also the Communication does not establish the notification obligation, and the principles described in it are only guidance (that is not legally binding in nature) one should be guided by when forming new development banks. Also towards new development banks there is no legal notification obligation, if aid is not given – *"Member States intending to set up a new NPB are invited to contact the Commission early on in their plans so as to facilitate the compliance with State aid rules in view of the standstill obligation laid down in Article 108 TFEU."* (European Commission, 2015: 2/3).

4 Conclusion

The Act of 10 June 2016 on an amendment to the Act on Export Insurance Guaranteed by the State Treasury and Some Other Acts introduced amendments in respect of principles of supervision over for example:

1. KUKE, ARP, PFR and PAIZ – transferring competence of the minister competent for public finance and/or competent for the State Treasury to the minister competent for economy;
2. BGK – taking the minister competent for economy into account in the procedure for appointing and recalling members of bodies of BGK.

In the Authors' opinion BGK under the implementation of the Plan towards Responsible Development in the economic context could conduct operations without the need for taking substantial action systemic in nature such as the need for notifying and separating part of operations. Therefore, taking into consideration the fact of changes in respect of supervision of entities from the PFR Group by one body, i.e. the Minister of Development and Finance, assumptions of the Plan towards Responsible Development may be implemented through an appropriate strategy (coherent and complementary for the PFR Group entities) as well as co-ordination of actions of individual entities.

Taking into consideration mitigation of some risks the Authors would suggest introducing some legislative changes in the provisions of the Act on Bank Gospodarstwa Krajowego in two areas, i.e. relating operations of BGK to EU regulations in respect of operations of a National Promotional Bank as well as clarifying their objectives by stressing the application of the principle of operation as the complementary good (i.e. supplementing, and not stuffing). In the first area, the issue seems to be essential enough that the European Commission suggested defining a public credit institution also in a draft amendment of the CRDIV Directive. According to the aforementioned suggestion, a public credit institution is defined as *a credit institution that meets all of the following conditions:*

1. *it has been established under public law by a Member State's central government, regional government or local authority;*
2. *its activity is limited to advancing specified objectives of financial, social or economic public policy in accordance with the laws and provisions governing that institution, on a non-competitive basis. For these purposes, public policy objectives may include the provision of financing for promotional or development purposes to specified economic sectors or geographical areas of the relevant Member State;*
3. *its goal is not to maximise profit or market share;*
4. *subject to state aid rules, the central government, regional government or local authority has an obligation to protect the credit institution's viability or directly or indirectly guarantees at least 90% of the credit institution's own funds requirements, funding requirements or exposures;*
5. *it is precluded from accepting covered deposits as defined in point (5) of Article 2(1) of Directive 2014/49/EU or in the national law of Member States implementing that Directive.*

Below, Authors' suggestion of statutory provisions:

> *In the Act of 14 March 2003 on Bank Gospodarstwa Krajowego (Journal of Law of 2016, item 1787, as amended), Article 4 reads as follows:*
>
> *Article 4. 1. BGK is a national promotional bank within the meaning of the Regulation (EU) 2015/1017 of the European Parliament and of the Council of 25 June 2015 on the European Fund for Strategic Investments, the European Investment Advisory Hub and the European Investment Project Portal and*

amending Regulations (EU) No 1291/2013 and (EU) No 1316/2013 - the European Fund for Strategic Investments (OJ EU L 169 of 1 July 2015, p. 1 as amended).

2. Fundamental objectives of operations of BGK include supporting the economic policy of the Council of Ministers, supporting governmental social and economic programmes as well as supporting programmes of local autonomy and regional development under conducted commercial operations, including banking operations.

3. The operations referred to in sec. 2 include in particular:

- *projects implemented with the use of financial means from funds of the European Union as well as from international financial institutions within the meaning of Article 4(1)(3) of the Act of 29 August 1997 - Banking Law,*
- *infrastructural projects,*
- *projects connected with the development of the sector of SMEs*

- including those implemented with the use of public financial means.

4. BGK conducts operations referred to in sec. 2 in a manner that ensures undistorted competition, under co-operation with public entities and/or private partners referred to in Article 2 points 1 and 2 of the Act of 19 December 2008 on public private partnership (Journal of Law of 2015, item 696, 1777), and/or by supplementing operations of such entities as well as partners.

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