

## ASSESSMENT OF THE PROPOSED CHANGES TO INCREASE THE TAX-FREE AMOUNT TO PLN 60,000

Ewelina AUGUSTYNOWICZ

Kazimierz Wielki University, Faculty of Law and Economics; ewelina.augustynowicz@ukw.edu.pl,  
ORCID: 0000-0002-3692-4382

**Purpose:** The aim of the article is to determine the impact of changes in the tax-free amount on the tax wedge in Poland and to assess the proposed changes in the tax system.

**Design/methodology/approach:** In order to determine changes the development of the tax wedge, it was measured twice for 2024. The tax wedge analysis was performed for salaries in the range of PLN 4,242 - PLN 19,000 gross per month. The impact of the proposed changes on state budget revenues was adopted as a criterion for assessing changes in the tax system.

**Findings:** Increasing the tax-free amount to PLN 60,000 in 2024 would will reduce the tax wedge by between 1.3 and 4 percentage points and reduce state budget revenues by approximately PLN 48 billion. The current situation of local government units, in particular municipalities, is difficult and requires subsidization from the state budget, and the proposed changes in the tax system will further reduce their own income and pose a serious threat to their independence.

**Research limitations/implications:** The subject of further research may be the tax wedge taking into account the degressive tax-free amount and its impact on budget revenues.

**Originality/value:** The article was written in response to the work carried out by the Ministry of Finance on increasing the tax-free amount and is an attempt to assessment the proposed changes.

**Keywords:** Tax wedge, tax-free amount, budget revenues, local government units.

**Category of the paper:** Research paper.

### 1. Introduction

The election campaign period is always a time of numerous promises and announcements of changes that politicians or groups intend to implement. One of the promises made during the campaign preceding the 2023 parliamentary elections in Poland was to increase the tax-free amount. Such promises were included in the program of the Civic Coalition (2023), which assumed an increase in the tax-free allowance to PLN 60,000. The program of the Confederation of Freedom and Independence (2023) assumed that the free amount would

depend on the minimum wage - constituting 12 times its worth. After the elections ended and the opposition obtained a parliamentary majority, which includes, among others, Civic Coalition, the implementation of the announced changes in the tax-free amount has become realistic. Politicians' statements confirm that a bill in this regard will be submitted by the Civic Coalition, and the increased tax-free amount is planned to come into force in 2025 (Neneman, 2024; Jabłoński, 2023). Changes in the tax system have a number of effects on the country's economy. Undoubtedly, the increase in the tax-free amount will have an impact on the decrease in state budget revenues, which will also have a real impact on the situation of local government units (LGUs), for which income tax revenues are the main source of income (Radzikowski, 2021). For taxpayers, the increase in the tax-free amount means an increase in disposable income due to a decrease in the tax burden.

In this study, the effects of changes in the tax-free amount will be presented from the perspective of the burden on the remuneration of employees. Obtaining income from work involves taxation and contributions. With changes in tax and contribution systems, the burden on remuneration due to these taxes and contributions changes.

These changes can be measured and analyzed using the tax wedge which is the difference between the total cost of employment and net remuneration (Polarczyk, 2007). The total employment costs include the employee's gross remuneration and a mark-up on these remunerations in the form of contributions financed by the employer. Net remuneration is the amount an employee receives for the work performed, after mandatory deductions for taxes and contributions. The tax wedge is therefore the sum of taxes and contributions paid from remuneration by the employee and the employer. However, in comparative analysis, the tax wedge is presented as a percentage - presenting the share of the tax wedge expressed in PLN in the total cost of employment. This approach allows us to observe how the burden of taxes and contributions changes depending on the amount of remuneration earned.

The aim of the article is to determine the impact of changes in the tax-free amount on the tax wedge in Poland and to assess the proposed changes in the tax system. The adopted research goal required the use of the following research methods: critical analysis of legal acts and literature on the subject, comparative analysis. The impact of the proposed changes on state budget revenues was adopted as a criterion for assessing changes in the tax system. In order to determine the development of the tax wedge, it was measured twice for 2024:

- in accordance with the tax solutions applicable as of January 1, 2024,
- by modifying the tax solutions applicable as of January 1, 2024 by taking into account the tax-free amount of PLN 60,000.

The tax wedge was measured for 60 gross monthly salary variants ranging from PLN 4242 to PLN 19,000. The adopted range covers remuneration from the minimum values applicable from January 1, 2024 to the amount for which the taxpayer's annual income is approximately 150% of the first tax threshold. This salary range allows the survey to cover over 97% of taxpayers in Poland. According to data from the Ministry of Finance (MF) (2023) for 2022,

only 3.01% of taxpayers were in the second band of the tax scale. After measuring the tax wedge, a comparative analysis of tax wedge distributions was carried out in accordance with the assumptions. After measuring the tax wedge, a comparative analysis of tax wedge distributions was carried out in accordance with the assumptions. The article is divided into three parts. The first part of the study characterized the factors of the Polish tax and contribution system that constitute the tax wedge. The results of the comparative analysis of the tax wedge are presented in the second part. A discussion on the proposed changes to the tax system in the context of the simulation results constitutes the third part of the article. The synthesis of conclusions and the final conclusion are included in the summary.

Considerations on the proposed changes to the tax system are based on the assumptions included in the Civic Coalition's program and the confirmation by the Ministry of Finance at the beginning of January 2024 that work is underway to implement the election promise to increase the tax-free amount to PLN 60,000. The final direction of changes in the tax-free amount is not yet known and it is possible that in the first half of 2024 there will be specific proposals in the form of draft laws and possible modifications in this respect, given the indication by the Ministry of Finance that the changes will be preceded by numerous analysis and an audit of the state of public finances (Neneman, 2024).

## **2. Factors shaping the tax wedge**

The employee is entitled to remuneration for the work performed. The amount of this remuneration is the result of individual arrangements between the employer and the employee, and may also result from the regulations in force at the workplace. The Polish legal system includes the concept of minimum wage, i.e. a specific amount below which an employee's remuneration cannot fall. The minimum wage amounts change at least once a year; in certain situations, the minimum wage may be changed twice in a given calendar year.

From January 1, 2024, the minimum wage is PLN 4242, this value is valid in the first half of 2024, from July the amount of the minimum wage increases to PLN 4,300. The specified amount of remuneration constitutes gross remuneration. When employing an employee, an employer is not only obliged to pay remuneration for the work performed, but is also obliged to withhold tax and contributions from the gross remuneration. The remuneration after deductions, i.e. the net remuneration, is the amount paid to the employee. The employer also bears the cost of additional contributions, the financing of which is his responsibility. The amount of income tax withheld from the employee's salary as well as contributions borne by the employee and the employer constitute a tax wedge. The size of the tax wedge depends on the legal solutions applicable to taxation and contribution of wages.

The tax system is an important element of state budget policy. The purpose of the tax is to support the state budget, and thanks to the available funds it is possible to implement economic policy. Taxation of the income of natural persons is one of the main sources supplying the state budget (Lubaś, 2019). Shaping the tax system is the subject of numerous analysis and considerations, in particular in terms of its fairness (Radzikowski, 2021). It is assumed that income at a level sufficient to meet minimum needs should not be subject to taxation. In Poland, the subsistence minimum is achieved through a tax-free amount (Mariański, 2021). Additionally, according to the principle of ability to pay, taxation should depend on the taxpayer's individual ability to bear the tax burden. These possibilities should depend on the income, but also the taxpayer's family situation, thus also implementing a pro-family policy (Mariański, 2021).

Taxation in Poland is progressive - the tax rate depends on income, and as it increases above a certain amount, the tax rate increases (Wolański, 2009). Income for tax purposes is determined by reducing gross remuneration by contributions deducted from the employee's remuneration and by the costs of obtaining income<sup>1</sup>. If the taxpayer's income does not exceed PLN 120,000 in a given year, it is taxed at a rate of 12%. If this limit is exceeded, the surplus above this amount is taxed at a rate of 32% (Journal of Laws of 2022, item 2647). Additionally, the Polish tax system provides for tax exemption for a certain amount of income, the so-called tax-free amount, which in 2024 is PLN 30,000. This exemption is implemented through tax reducing amount by which the tax amount in the annual tax return is reduced. This reduction is made in the amount corresponding to the product of the tax-free amount and the tax rate applicable in the first bracket of the tax scale, in 2024 it is PLN 3600.

Mandatory contributions related to the employment of employees include the so-called social and health insurance and special purpose funds. The following contributions are paid under the social security system: pension, disability, sickness and accident contributions. These insurances finance subsequent benefits resulting from: reaching retirement age, permanent incapacity for work, illness and maternity, and accidents at work (Ciak, Kołosowska, Piotrowska-Marczak, 2019). In turn, the health insurance contribution finances access to health care under the National Health Fund (NFZ). Special funds include contributions to the labor fund, the solidarity fund and the guaranteed employee benefits fund, which finance tasks supporting unemployed people, people with disabilities and employees whose employer has become insolvent. Calculating the contributions and paying them to the Social Insurance Institution (ZUS) is the employer's responsibility. Some of the above-mentioned contributions are financed only by the employee, some only by the employer, and others are financed by both parties to the employment relationship. The dimensions of individual contributions financed by the employee and the employer are presented in Table 1.

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<sup>1</sup> Pursuant to Art. 22 of the Personal Income Tax Act, an employee's income-earning costs amount to PLN 250 or PLN 300 per month. The amount depends on the town where the employee lives and the town where the workplace is located. In special cases, the costs of obtaining income may amount to 50% of the income obtained or may be assumed in the amount of the actual costs incurred for the purchase of season tickets.

**Table 1.***Contribution amounts with indication of the financing party*

<b>Contribution type</b>	<b>Financed by the employee</b>	<b>Financed by the employer</b>
Pension contribution	9,76%	9,76%
Disability contribution	1,50%	6,50%
Sickness contribution	2,45%	-
Accident contribution	-	1,67% <sup>2</sup>
Health contribution	9,00%	-
Labor fund	-	1,00%
Solidarity fund	-	1,45%
Guaranteed employee benefits fund	-	0,10%

Source: own elaboration.

Social security contributions and special funds are calculated from the employee's gross remuneration. The basis for calculating the health insurance contribution is the gross salary, less social contributions financed by the employee (Journal of Laws of 2022, item 64).

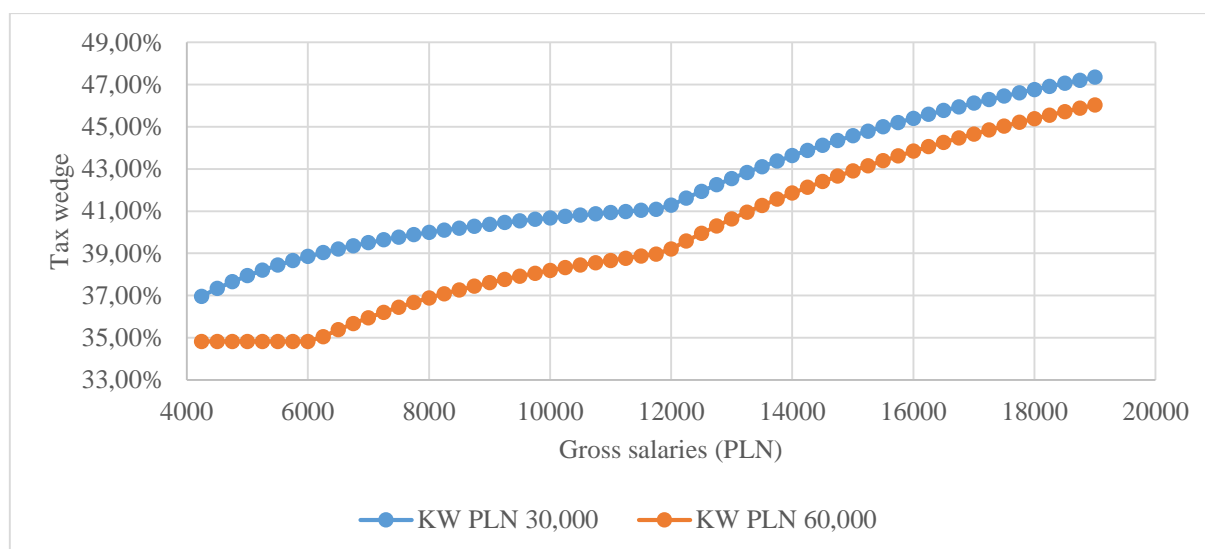
The tax wedge may also include contributions to Employee Capital Plans (PPK), an additional savings program for retirement. However, paying contributions to PPK is not obligatory, as is the case with contributions to ZUS and NFZ. If an employee decides to join the program, a contribution of 2% of his or her gross salary is deducted from his or her salary. In turn, the employer is obliged to pay 1.5% of contribution for each employee who decides to join PPK (Journal of Laws of 2023, item 46).

### 3. Results

The comparative analysis of the size of the tax wedge was carried out under the following assumptions: the remuneration in question concerns an employee employed under an employment contract, the basic costs of obtaining income apply (PLN 3000 per year), the remuneration from this employment relationship is the taxpayer's only source of income. The employee is not a member of PPK. The analysis omitted the application of any additional income tax reliefs and deductions. The measurements were made for gross monthly salaries in the range of PLN 4,242 - PLN 19,000. The analysis was carried out for two variants of the tax-free amount: PLN 30,000 and PLN 60,000.

Figure 1 shows the shape of tax wedges for 2024 in variant 1 - in accordance with the tax solutions current as of January 1, 2024 (KW symbol PLN 30,000 on the figure) and in variant 2, taking into account the tax-free amount of PLN 60,000 (KW symbol PLN 60,000 on the figure).

<sup>2</sup> The interest rate may range from 0.67% to 3.33%. In the case of entrepreneurs employing less than 10 employees, it is 1.67%. For employers with at least 10 employees, the contribution rate depends on the type of business.



**Figure 1.** Comparison of the tax wedge in 2024, depending on the tax-free amount.

Source: own elaboration.

The data presented in the chart shows that increasing the tax-free amount to PLN 60,000 will reduce the tax wedge by between 1.3 and 4 percentage points. The largest decline was observed for gross remuneration of PLN 6,000 - the tax wedge decreased by 4.03 percentage points. The differences in the tax wedge are most noticeable for taxpayers whose salaries are in the range between PLN 5000 and PLN 8250, the decrease being between 3 and 4 percentage points. For salaries above PLN 12,500, the impact of the change in the tax-free amount on the tax wedge is less than 2 percentage points and is gradually decreasing, due to the fact that the amount of PLN 3600 in the total amount of tax for this group of taxpayers no longer has such a significant impact on the tax wedge. This is mainly due to the fact that these salaries are already in the second bracket of the tax scale. Contrary to appearances, taxpayers earning the lowest salaries do not benefit most from the change - at the level of the lowest national salary and slightly above this amount. This is due to the fact that the income of these taxpayers does not exceed PLN 60,000, and therefore they do not fully use the higher tax reducing amount.

#### 4. Discussion

The latest legal changes affecting the tax wedge in Poland were introduced in 2022. The program known as the "Polish Order" was to be a response to growing expenses and decreasing budget revenues, and the changes were to result in an increase in the progressivity of the tax system and an increase in budget revenues (Justification, 2021).

The decline in budget revenues as a result of the COVID-19 pandemic has significantly reduced the own revenues of local government units, thus causing a decline in their financial independence and the need to subsidize them from the state budget (Stupałkowska, 2023).

The "Polish Order" was intended to remedy these problems, and the original version of this program included tax changes that would result in an increase in the tax wedge for most taxpayers, except for those earning up to approximately PLN 6000 gross per month. Ultimately, however, changes in the tax system after the amendment to the "Polish Order" turned out to be much more cautious. For taxpayers earning up to approximately PLN 15 000 gross per month, the tax changes not only did not result in an increase in the tax wedge, but this wedge decreased compared to the year preceding the introduction of the "Polish Order". The increase in the tax wedge was only felt by taxpayers whose salaries exceeded approximately PLN 15,000 gross per month, i.e. less than 3% of taxpayers (Augustynowicz, 2023). In reality, the distribution of the tax wedge has become more progressive, but the original goal in terms of budget revenues has not been achieved. The result of the "Polish Order" was a decline in tax revenues in accordance with the tax scale by over PLN 21 billion, from over PLN 86 billion of tax due resulting from taxpayers' returns in 2021 to PLN 64.5 billion in 2022 (MF, 2022, 2022).

According to analysis carried out by the Ministry of Finance, the effect of increasing the tax-free amount to PLN 60,000 would be a decrease in budget revenues by approximately PLN 48 billion. These data were prepared in the conditions of 2024 (Neneman, 2024). The estimated budget revenues from personal income tax for 2024 amount to PLN 109 billion (Journal of Laws of 2024, item 122). This means that fulfilling the election promise will mean for the state budget, but also local government units, a decrease in personal income tax revenues by approximately 44%.

## 5. Summary

Changes in the tax system should be well-thought-out and preceded by an analysis of their effects, both in relation to taxpayers and the state budget. The process of implementing the last major changes in the tax system as part of the "Polish Order" project was characterized by legislative chaos, numerous errors and had the character of a populist propaganda message (Radzikowski, 2022). Within local government units, it was the municipalities that lost the most, both in terms of income, but especially in terms of their financial independence (Łżykowski, 2023). The introduction of further changes to the tax system, which will result in a sharp decline in budget revenues from personal income tax and will deepen the difficult situation of local government units, may prove disastrous. Increasing the tax-free amount to PLN 60,000 is a costly solution for the budget, but at the same time it may be contrary to one of the main principles of the state's fiscal policy - the principle of ability to pay. According to this principle, the division of the tax burden among taxpayers should take into account their individual ability to pay, and the burden should increase with the increase in income (Mastalski, 2021). However, taxpayers earning e.g. PLN 15,000 gross per month will benefit more from

the proposed reform than those earning the minimum wage. The solution to this problem could be a return to the rules applicable until 2021 regarding the tax-free amount. The tax system in force from 2022 provides the same tax-free amount for all taxpayers, regardless of their income. In 2021, the tax-free amount was dependent on income, and for some taxpayers with income above a certain limit it was PLN 0. Perhaps making the tax-free amount dependent on earned income again would constitute a compromise between the implementation of the election promise and the financial capabilities of the state. The tax-free amount could again have a degressive character, but its minimum value (e.g. for taxpayers with income above the first tax threshold) could remain PLN 30,000. Of course, this solution is not ideal due to the complexity of the tax system. In the presented context, it turns out to be problematic to implement the principle of ability to pay in the event of increasing the tax-free amount without making it dependent on the taxpayer's income. The lack of additional modifications in the tax system, eliminating budget revenues reduced as a result of changes in taxation, may require a significant postponement of the proposed reforms or impose their modification. These issues may be the subject of further research on the Polish tax system.

It is worth adding that on February 7, 2024, a draft bill submitted by Confederation MPs was submitted to the Sejm, providing for an increase in the tax-free amount to PLN 60,000. Importantly, the project assumes that the changes will apply retroactively - from January 1, 2024 (Draft Act, form no. 194). It should be emphasized that such a solution has a number of negative consequences, which were visible, for example, in the case of the "Polish Order", the changes and amendments of which were also introduced during the tax year. The retroactive application of changes in the tax system may lead to chaos, in particular related to the need to quickly adapt accounting and HR systems to the changes, as well as the need for employees to update their declarations for the purposes of calculating tax advances. Changes during the year are problematic, especially from the perspective of enterprises. For sole proprietorships, the tax scale is only one of the three possible forms of taxation, and changes in the form of taxation for a given year can be made for most taxpayers by February 20 (Journal of Laws of 2022, item 2647). Changes in the tax system during the year will either deprive entrepreneurs of the opportunity to use the optimal form of taxation, which will change as a result of the reform, or force the legislator to introduce the possibility of retroactively changing the form of taxation, which will result in disorganization.



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