

THE EVALUATION OF THE TAX WEDGE ON MINIMUM WAGE IN TERMS OF THE PRINCIPLES OF JUSTICE IN TAXATION

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Abstract

The subject of this study is to determine the tax wedge on the minimum wage and evaluate it in terms of the principles of taxation. In the study, the tax wedge ratio on the minimum wage was calculated and it was assessed in terms of the principles of taxation by considering the tax wedge ratio on the wage of some employees working in the public sector and having a level of income above the minimum wage. The study is important in terms of eliminating the tax burden on the minimum wage and hence reducing the rate of tax wedge and making recommendations to improve the wage rights of minimum wage earners. The results of the study show that the tax wedge rate on the minimum wage is higher than the tax wedge rate on wages of other public employees. In the taxation of minimum wage workers, an inconsistency was determined in the principles of justice in terms of the factors such as tax wedge rates, in other words, tax burdens, the power to pay and devotion.

Keywords: Tax Wedge, Minimum Wage, Tax Burden, Principle of Justice.

JEL Codes: H24, H55, J31, K34.

1. Introduction

Labour compensation of employees in the workforce is calculated according to several tariffs. The subsistence level tariff is called minimum wage in Turkey. Millions of employees, who participate in the productive activities of private economic groups, are entitled to minimum wage. Moreover, some of the employees who work in the productive activities of the private sector are paid less than minimum wage while some are paid more. On the other hand, the wage scale of public officers, who perform public services, changes depending on different legal arrangements. All in all, employees who perform different productive activities are subjected to different wage scale. Therefore, the tax burden regarding the wage differs.

The tax burden on wages has been attempted to be defined through diverse ratios in finance. One of these ratios is the tax wedge ratio. Tax wedge refers to the ratio between the total tax paid over an employees' wage and the labor cost for an employer. This study aims to examine the tax wedge on the wages of minimum wage workers and public officers who rank among middle and higher income groups according to the wage scales in 2019. Further, the current study evaluates these ratios in terms of the principles of justice in taxation. The results of the study, which has touched upon one of the most highly debated issues, have found support for the public opinion which asserts that tax burden on minimum wage must be alleviated. In this respect, the results of the study are particularly important. The study deals with minimum wage workers and public officers from four different income levels. Further, the wages of these groups are evaluated. In terms of methodology, the study has adopted a qualitative perspective through a systematic literature review.

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2. The Tax Wedge and Rate Within The Concept of Tax Burden

Tax is a kind of public revenue which is collected in order to finance the public services under compulsion on a complimentary basis from the ones who earn income. The terms in the description reflecting the characteristics of tax being collected “*under compulsion*” and “*on a complimentary basis*” lead to the impression of the fact that it is considered as a burden by the relevant individuals. This burden refers to the rational relationship between the income being earned in a particular period (this period can be defined as settlement period) and the payments rendered to the state and other public corporations (Kılıçaslan & Yavan; 2017: 35). Indeed, the tax burden is defined as the total amount of the taxes paid in a country which includes direct and indirect taxes (Nar, 2015: 688). The tax burden concept to be handled in this study refers to the personal tax burden. Personal tax burden reflects the relationship between the total amount of taxes paid by the individual and the total income of the individual (See: Pehlivan, 2013: 160-161). All these statements indicate that the tax wedge is considered as a factor in the calculation of the ratio of the tax burden, particularly of wage income.

Tax wedge is a concept that measures the tax burden on social insurance contributions and wages (Radu et. al., 2018: 688). It is clear that the tax wedge can be expressed either as a fixed price or it can be expressed through proportion (See: Tuncer, 2012: 69). Therefore, the difference between the gross wage (or the total amount paid by an employer to an employee) and net wage is considered as tax wedge (Festa, 2015: 140; Tuncer, 2012: 69). Indeed, the tax wedge specified above indicates the tax burden on the wage. In the literature, the tax wedge is also defined as a ratio (See: Nar, 2015: 689-691; Buyrukluoğlu & Kutbay, 2016: 262; Gülşen & Öztürk, 2016: 21). According to the definition accepted by Organization for Economic Cooperation and Development (OECD), tax wedge is determined as the ratio of the difference between the total cost of an employee to the workplace and the net wage of the employee on the total cost of an employee to the workplace (Tansöker, 2017: 317; Gabrilo, 2016: 233).

3. The Scope of the Tax Wedge Rate

Besides income tax imposed on employees, stamp duty and employees’ share of social insurance contribution are included in the scope of the tax burden on income within Turkish tax and social security law. Further, unemployment insurance deduction is also in this scope. On the other hand, social insurance contribution paid by employers and unemployment insurance deduction are the main values in the assessment of tax burden on wage.

4. The Tax Wedge In Varied Wage Practices in 2019

In order to evaluate the tax wedge on wage according to principles of justice in taxation, a total of five different wage tariffs considering the wages in January 2019 will be discussed under this title. In order to secure an evaluation that reflects the Turkish social structure, a non-exempt employee, who is presumed to be married to an unemployed spouse and has two children, is handled. Table 1 below displays the tax wedge rates according to income levels of employees and other statistics.

Table 1. Tax Wedge Rates of Employees According to Income Levels and Other Statistics

| Employee | Gross Wage / The total cost of the employee for workplace (TL) | Net Wage (TL) | Income tax paid in January (TL) | The tax burden on the wage (TL) | Tax wedge rate (exclusively for January) (TL) |
|---------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------|------------------|------------------------------------------|------------------------------------------|--------------------------------------------------------|
| Minimum wage worker | 2.558.40 | 2.116.85 | 38.38 | 889.27 | 29.5 % |
| Ordinary public officer | 6.119.48 | 4.606.22 | 6.75 | 1.489.68 | 24.3 % |
| A qualified officer who is employed according to the law no. 5434 (middle income) | 8.348.18 | 6.380.31 | 10.83 | 1.761.60 | 21.1 % |
| A qualified public officer who is employed according to the law no. 5510 (middle income) | 7.219.67 | 5.823.15 | 10.83 | 1.249.14 | 17.3 % |
| A qualified public officer (high income) | 14.788.10 | 11.748.47 | 94.68 | 2.853.62 | 19.2 % |

According to Table 1, the tax wedge rate on minimum wage is calculated as $(889.27/3.006.12 =)$ 29.5 % for January exclusively. Under the light of the data displayed in Table 1, the tax wedge rate on the wages of ordinary public officers is 24.3 %. The tax wedge on the wages of the employees who are employed according to the law no. 5510 among other public officers who are called qualified public officers and fall into the middle-income group is 17.3 %. The tax wedge rate on the wages of the public officers who are employed according to the law no. 5434 is 21.1 %. Further, the tax wedge rate on the wages of the qualified officers who rank among the high-income group is 19.2 %. Despite all these calculations, OECD data regarding tax wedge varies. OECD data reported the mean tax wedge rate as 38.65 %, based on the wages paid in Turkey in 2017. The mean of OECD countries for 2017 was approximately 36 %.

5. The Evaluation of The Tax Wedge on Subsistence Wage in Terms of Taxation Principles

5.1. The Evaluation of The Tax Wedge on Subsistence Wage In Terms Of The Principle of Justices in Taxation

The justice principle in taxation refers to the release of taxation according to financial power besides the fair and well-balanced distribution of tax burden. In other words, according to this principle, taxpayers' personal and financial conditions are needed to be taken into consideration in taxation.

On a non-discriminatory basis, the ones who are dependent on minimum wage and the public officers exercise their subsistence reduction rights under the same conditions. For example, a person who is dependent on minimum wage with two children and an unemployed-spouse and a public officer receive 287.82 TL discount for the year of 2019. This is not a matter of hesitation.

However, the fact that the employees who receive minimum wage in return for their service and the employees who rank among high-income group have the same subsistence discount is an important issue which needs to be considered in terms of the principle of equality. These two groups of employees have a different level of income, therefore, they are needed to be subjected to different taxation conditions. In this sense, in the calculation of the subsistence discount for the employees with minimum wage, it is important that there need to be different practices in the main parameters. On the other hand, it is clear that there will be no hesitation in applying “graduated tariff” to the employees with minimum wage and the employees who rank among the high-income group or paying attention to “principle of segregation”. Further, graduated tariff leads to taxation of the employees who rank among the high-income group at higher rates in the upcoming months of the year which is an important instrument that reflects the power of solvency. Nevertheless, as it is clear from the examples handled in the current study, the employees with minimum wage and other public officers finalize the year as being taxed according to 20% ratio specified in the second part of the tariff in ITL article 103, almost in the same period of the calendar year. At this point, there appears a situation that is against the principle of solvency.

The “fair and well-balanced distribution of tax burden” which is the other extension of the principle of justice is handled in the second paragraph of article 73 in the Constitution of the Republic of Turkey. In this sense, the sovereign authority is expected to set a fair and well-balanced taxation system. Therefore, it is reasonable to propose that unbalanced taxation and the tax burden which does not consider taxpayers’ solvency is against the constitution. The tax wage of the salary of a minimum wage worker, who is paid 2.116,85 TL as net pay, with two children and an unemployed spouse, is about 30%, whereas the tax wage of the salary of public officers is around 17-25%. The main reason of this situation is that besides base pay, the public officers receive other payments from their employers (university allowance, education allowance, educational indemnity etc.) which are free of tax and tax assessment. For this reason, the tax assessment of a minimum wage worker is above the tax assessment of some public officers. This contradicts with the principles of fairness, equality, and solvency in taxation. Because, when the tax burden of the salary of a minimum wage worker who is paid 2.116,85 TL net pay is compared to the tax burden of the salary of a public officer (ranges from 4.500 to 11.700 TL), it is clear that the solvency of a minimum wage worker is ignored. On the other hand, this is against the rationale of justice of income distribution and collecting duty “more from the ones who earn more, less from the ones who earn less” which serves the goal of social justice and equality. The personal income tax of a minimum wage worker in January is 38.38 TL. on the other hand, the personal income tax of a public officer who receives more than 4.000 TL salary is 6.75 TL. Besides, the personal income tax of a public officer who ranks among the high-income group and receives more than 11.500TL salary is about 1000TL. Beyond any doubt, the effect of the personal income tax of a minimum wage worker on the total tax burden is easy to be overlooked. However, while the effect of the social security contribution is not the same, it needs to be ruled out through several practices. The principle of equality which is the other extension of the principle of justice refers to the consideration of all factors in the determination of solvency. It is apparent that the conditions for minimum wage workers and public officers who rank among the middle and high-income group are different. Nevertheless, according to the aforementioned data, these workers who are dependent on different conditions seem not to be taxed differently. In that case, it is safe to state that the principle of equality is ignored.

From a different viewpoint, the tax burden of minimum wage workers, which is the result of the taxation based on the principle of “proportional equal sacrifice”, is against the principle of justice. Because, the marginal benefit which is provided by when the amount of tax burden on the salary of minimum wage workers is turned into the disposable income is not the same with the marginal benefit which is provided by when the amount of tax burden on the salary of public officers from the middle or high-income group is turned into disposable income.

5.2. The Evaluation of The Tax Wedge on Minimum Wage in Terms of The Principle of Generality in Taxation

Whereas the principle of generality in taxation refers to the fact that everyone pays tax in order to cover the public expenses, because of economic, social, political or cultural reasons, some of the individuals who have solvency being treated as free of tax through tax immunity or exception is considered a contradiction to this principle (Pehlivan, 2018: 23). One of the situations that contradict with the principle of generality is the tax exemption of the taxpayer because of economic reasons. When the tax wedge rate on the salary of minimum wage workers is compared to the tax wedge on the salary of public officers, it is essential to remit the tax burden on the salary of minimum wage workers considering the current economic conditions despite it is a deviation from the principle of generality.

5. Result

Despite it is under the mean rate of OECD, the tax wedge/burden on minimum wage, exclusively depending on the current economic conditions, is rather high. When compared to the middle and high-income group, minimum wage workers are disadvantaged considering the income tax and tax wedge rates on the wage. This contradicts to the principles of justice in taxation. Some precautions need to be taken on this issue which has been being widely discussed in public opinion. Hence, minimum wedge discount of minimum wage workers should be treated differently. The tax wedge on the salary of minimum wage workers (especially employee’s share of social security contribution) should be removed through either governmental incentive or subsidy or tax concession. In this way, on one hand, minimum wage worker’s 2.116,85 TL salary can catch up the desired levels (through turning the social security contribution into disposable income), on the other hand, the minimum wage can be caught up with the rate of tax wedge on the wages of public officers. Surely, it is important to take precautions against the abuse of the governmental incentive, subsidy or tax concession.

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