

## The Bulgarian Flat Tax is No Longer What It Was

**Brussarski Rumen\***

Department of Finance, University of National and World Economy, Sofia, Bulgaria

---

### Info Articles

### Abstract

---

History Article:  
Submitted 23 January 2021  
Revised 4 March 2021  
Accepted 17 April 2021

---

Keywords:  
personal income tax, flat tax

---

The idea of a flat tax dates to the middle of the last century. At the end of the 20<sup>th</sup> and the beginning of the 21<sup>st</sup> century it finds practical realization in many countries of Central and Eastern Europe (including Bulgaria). However, our tax is unique because it is proportional. The flat personal income tax in other countries is progressive. This article is dedicated to the application of this specific tax technique in Europe and in our country. The article is structured in three parts. Part one presents the pioneering theoretical ideas for flattening the multi-rate structures of the personal income tax and the practice of so-called flat tax in Central and Eastern Europe (mainly in the Member States of the European Union) in recent decades. Part two examines the specific model of flat personal income tax in Bulgaria – proportional taxation of personal income from 01.01.2008. Part three examines the effect of the introduction of a de facto tax-free threshold for families with minor children in Bulgaria in 2021.

---

\*Address Correspondence:  
E-mail : [rbrusarski@unwe.bg](mailto:rbrusarski@unwe.bg)

## INTRODUCTION

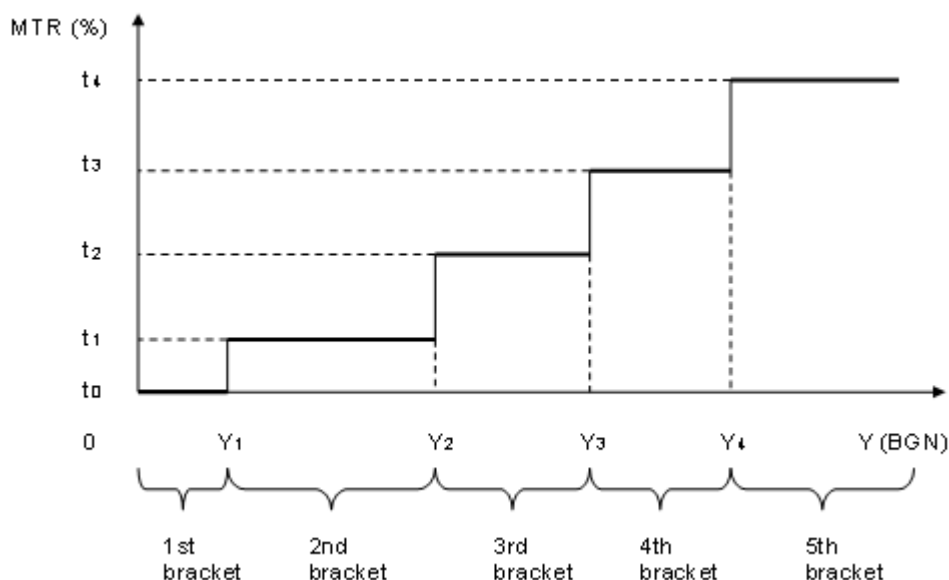
Personal income tax is a key fiscal instrument and a powerful tool for socio-economic regulation in the developed world. The true history of the tax began in Britain in 1798. To finance the Napoleonic wars, as a temporary measure, Prime Minister William Pitt Jr. introduced a progressive personal income tax which was put in force in 1799. In 1802 the temporary tax was abolished, however a year later it was reintroduced. In 1816 the tax was abolished for the second time. Finally, in 1842 Prime Minister Sir Robert Peel introduced the personal income tax in the United Kingdom for the third and final time. The British experiment was swiftly exported abroad and within a century the personal income tax "conquered" many developed countries – Prussia in 1891, USA in 1913, France in 1914 and others. In Bulgaria, the personal income tax was introduced by the Total Income Tax Act, adopted by the 19<sup>th</sup> Ordinary National Assembly on 30.06.1920 (Promulgated, SG, No. 88 of 22.07.1920). These events gave rise to Johannes Popitz (1884-1945), professor of tax law and finance minister of Prussia (1933-1944), to "crown" this tax as *the queen of taxes*.

The genesis and development of the personal income tax has deep abstract theoretical roots. As early as the middle of the 18<sup>th</sup> century, the father of modern microeconomics, Adam Smith, defined the classic, pertinent to this day, principle of tax equity: "The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state."<sup>1</sup>

Today, almost all countries in the world have an income tax in one form or another.

### 1. Genesis and development of the flat tax

Traditionally, the personal income tax is *progressive* – with the increase of the tax base the average tax rate<sup>2</sup> increases.<sup>3</sup>



**Figure 1.** Hypothetical structure of marginal tax rates (MTR)

The classic technique for progressive personal income taxation is the so-called *multi-rate income tax*

<sup>1</sup> Smith, A., *An Inquire into the Nature and Causes of the Wealth of Nations*, Methuen & Co, London, 1904, Vol. II, Book V, Ch. II, Part II, p. 310.

<sup>2</sup> The average tax rate measures the share (quota) of the tax in the tax base:

$$ATR = \frac{T}{B} * 100$$

Definitions:

*ATR* is the average tax rate;

*T* – the tax;

*B* – the tax base.

<sup>3</sup> In the event the average tax rate does not change when the tax base increases, i.e. it remains constant, the taxation is *proportional*. If the average tax rate decreases with the increase of the tax base, the taxation is *regressive*.

*progression*. Wherein the tax base is divided into several tax brackets and a different marginal tax rate<sup>4</sup> is applied to each bracket. Generally, the income in each subsequent tax bracket is taxed at a higher marginal rate than in the previous one. Figure 1 presents a hypothetical multi-rate progression of five tax brackets (from 0 to  $Y_1$ , from /over/  $Y_1$  to  $Y_2$ , from /over/  $Y_2$  to  $Y_3$ , etc.) and the five marginal tax rates related to them (from  $t_0$ ,  $t_1$ , etc. to  $t_4$ ).

In the 20<sup>th</sup> century, multi-rate structures with dozens of tax brackets and corresponding (rising) marginal tax rates became popular in the developed world. In the United States of America (USA), for instance, in 1953 the personal income tax rate for taxpayers and spouses who declared their income separately included 24 tax brackets<sup>5</sup> with marginal tax rates of 22,2% (for the lowest, first tax bracket) up to 92% (for the highest, last tax bracket) – displayed on Table 1.

**Table 1.** Marginal income tax rates in the USA for single taxpayers and married couples, filing separately for 1953

Tax brackets (USD)		Marginal tax rate (%)
Over	But Not Over	
0	2 000	22,2
2 000	4 000	24,6
4 000	6 000	29,0
6 000	8 000	34,0
8 000	10 000	38,0
10 000	12 000	42,0
12 000	14 000	48,0
14 000	16 000	53,0
16 000	18 000	56,0
18 000	20 000	59,0
20 000	22 000	62,0
22 000	26 000	66,0
26 000	32 000	67,0
32 000	38 000	68,0
38 000	44 000	72,0
44 000	50 000	75,0
50 000	60 000	77,0
60 000	70 000	80,0
70 000	80 000	83,0
80 000	90 000	85,0
90 000	100 000	88,0
100 000	150 000	90,0
150 000	200 000	91,0
200 000		92,0

Source: [https://files.taxfoundation.org/legacy/docs/fed\\_individual\\_rate\\_history\\_nominal.pdf](https://files.taxfoundation.org/legacy/docs/fed_individual_rate_history_nominal.pdf)

The United States is no exception. In the mid-1960s, the famous British musician George Harrison wrote the song "Taxman", included in the album "Revolver" (1966) of the legendary band the Beatles.<sup>6</sup> The first verse of this song reads:

*„Let me tell you how it will be*

<sup>4</sup> The marginal tax rate measures the share (quota) of the tax in the last (marginal) unit of the tax base:

$$MTR = \frac{\Delta T}{\Delta B} * 100$$

Definitions:

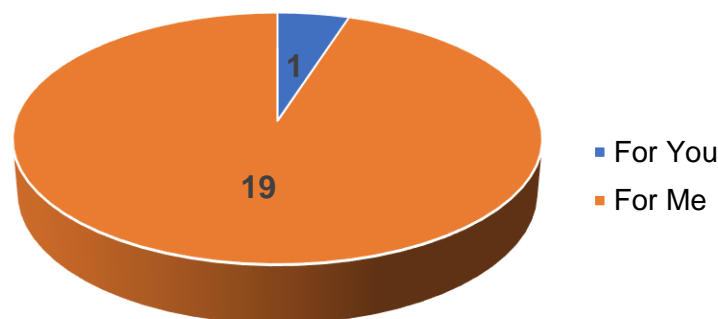
$MTR$  is the marginal tax rate;  
 $\Delta T$  – the change of the tax;  
 $\Delta B$  – the change in the tax base.

<sup>5</sup> Excluding the tax-free threshold (the so called zero tax bracket).

<sup>6</sup> The idea for the song came to Harrison when he learned that under the current tax system in Britain, a large part of the proceeds goes to pay taxes.

*There's one for you, nineteen for me  
'Cause I'm the taxman  
Yeah, I'm the taxman"*

Until 1971, one British pound sterling was divided into 20 shillings (and one shilling – into 12 pence). Hence, (at the highest tax bracket with a marginal rate of 95% at the time) 20 shillings \* 0,95 = 19 shillings tax and one shilling after-tax income, respectively – see Figure 2.



**Figure 2.** One for you, nineteen for me in the UK

In this environment, the Nobel laureates in economics Friedrich von Hayek<sup>7</sup> and Milton Friedman<sup>8</sup> developed the idea of flattening (leveling, rolling) the multi-step structure of marginal tax rates increasing with income. Their ideas are put to practice two to three decades later and the number of tax brackets and the maximum marginal tax rates are fall sharply.<sup>9</sup> In the 1980s, American economists Robert Hall and Alvin Rabushka developed a concept for an "integrated flat tax" to replace personal income tax and corporate tax in the United States.<sup>10</sup> The flat tax of Hall and Rabushka is a system of two taxes – payroll tax and business tax. Personal income from salaries and other sources above a certain non-taxable minimum is taxed at a single (flat) rate – 19%. The income of the companies is reduced by the investment costs and is taxed with business tax of 19%.<sup>11</sup> Thus, in essence, the integrated flat tax proposed by Hall and Rabushka is a consumption tax, not an income tax. In macroeconomic terms, when investments (savings) are deducted from income, consumption (income that is consumed) remains. This is in effect the basis of the well-known and widely used value added tax (VAT).<sup>12</sup> The original idea of Robert Hall and Alvin Rabushka failed to make its way into practice.

At the end of the 20<sup>th</sup> and the beginning of the 21<sup>st</sup> century, the theoretical concepts of a flat tax found practical application in Central and Eastern Europe – first in Estonia (1994) and then in many other former socialist countries. In eight years, eight (current) European Union (EU) member states have introduced a flat personal income tax (see Table 2). The Baltic states (Estonia, Lithuania and Latvia) and Romania did so before joining the EU, Slovakia in the first year of its membership in the union, and the remaining three countries (Bulgaria, the Czech Republic and Hungary) after that.<sup>13</sup>

<sup>7</sup> Hayek, F. A., Progressive Taxation Reconsidered, In: Mary Sennholz (ed.) On Freedom and Free Enterprise – Essays in Honor of Ludwig von Mises, 1956, pp. 265 – 284.

<sup>8</sup> Friedman, M., Capitalism and Freedom, Per. with English, New Publishing House, Moscow, 2006, pp. 187 – 204.

<sup>9</sup> At present (2021) the number of tax brackets in the United States is 7 and the maximum marginal tax rate is 37%.

<sup>10</sup> Hall, R. and A. Rabushka, The Flat Tax, Hoover Institution Press, 1985. (The monograph is preceded by two articles in the Wall Street Journal, as follows: Rabushka, A., "The Attractions of a Flat-Rate Tax System", 25.03.1981 and Hall, R. and A. Rabushka, "A Proposal to Simplify Our Tax System", 10.12.1981).

<sup>11</sup> The cover of the second edition of Hall and Rabushka's book is decorated with a collage of a scary roller that crumples regulations and guides for personal income taxation.

<sup>12</sup> There is no value added tax in the United States.

<sup>13</sup> Russia (2001), Serbia (2003), Bosnia and Herzegovina (2004), Ukraine (2004), Georgia (2005), Albania (2007), Macedonia (2007), Montenegro (2007) and other countries also introduced a flat tax.

**Table 2.** Introduction of the Flat Tax in the EU

Country	Year of introduction
Estonia	1994
Lithuania	1994
Latvia	1995
Slovakia	2004
Romania	2005
Bulgaria	2008
The Czech Republic	2008
Hungary	2011

Source: Author's own research.

There are various fiscal instruments behind the "flat tax" label. The tax function has the following general form:

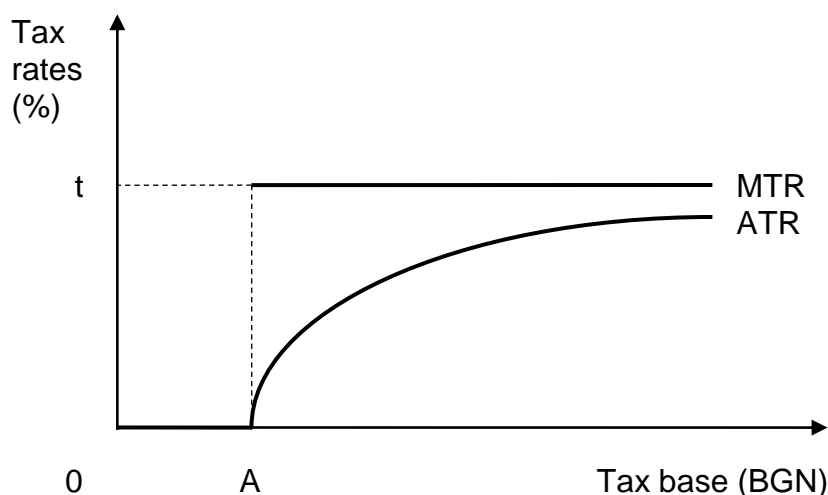
$$T(Y) = \max[t * (Y - A), 0] \quad (1)$$

Definitions:

- $T(Y)$  is the tax;
- $t$  – the flat marginal tax rate ( $t > 0$ );
- $Y$  – the tax base;
- $A$  – the tax-free threshold ( $A \geq 0$ ).

Seven of the aforementioned eight EU member states (all but Bulgaria) flattened the structure of positive marginal tax rates to a single rate and kept, in one form or another, the tax-free threshold, i.e. replaced *multi-rate* tax progression (two or more tax brackets, linked to positive marginal rates) with *single-rate* progression (flat tax rate on income above the respective tax-free threshold).

When  $A > 0$  and  $Y \leq A$ , the tax  $T(Y)$  is BGN 0, and for  $A > 0$  and  $Y > A$  the tax  $T(Y)$  is a product of the tax rate ( $t$ ) and the excess of the tax base over the tax-free threshold ( $Y - A$ ) – see Equation (1). The result is *progressive* personal income taxation – with the increase of the tax base (above the tax-free threshold) the average tax rate increases. Figure 3 presents the functions of the marginal tax rate (MTR) and the average tax rate (ATR) of this personal income tax technique.



**Figure 3.** Marginal and average tax rates

In Estonia, for instance, for incomes up to 1 200 euro/mo. the tax-free threshold in 2018 is 500 euro/mo. (the minimum monthly salary in the country). For incomes between 1 200 euro/mo. and 2 100 euro/mo. the tax-free threshold is calculated according to a formula, and for incomes of 2 100 euro/mo. and more there is no tax-free threshold ( $A = 0$ ). The marginal tax rate is 20%. Thus (in practice) the

Estonian flat tax is progressively proportional – between the monthly tax-free threshold and 4,2 times the minimum monthly salary the tax is progressive (ATR increases)<sup>14</sup>, and then – proportional (A = 0 and ATR = t = 20% = const.).

In 2018, the individual tax-free threshold in Romania is a function of taxable income (tax base) and the number of family (household) members supported by the taxpayer. For incomes over 3 600 lei/mo.<sup>15</sup> A = 0. The marginal tax rate is 10%. The flat tax in Romania is also progressively proportional – between the respective monthly tax-free threshold and slightly below 1,9 times the minimum monthly salary, the tax is progressive (ATR increases)<sup>16</sup> and then – proportional (A = 0 and ATR = t = 10% = const.).

In Hungary, the tax-free threshold in 2018 is the product of the number of children in the household entitled to a tax relief for children<sup>17</sup> and certain fixed amounts for 1, 2, 3 or more children. For taxpayers without children entitled to a tax relief A = 0. The marginal tax rate is 15%. Therefore, the flat tax in Hungary is progressive for taxpayers with at least one child entitled to a tax relief (ATR increases)<sup>18</sup> and proportional for taxpayers without children entitled to a tax relief (A = 0 and ATR = t = 15% = const.).

After initial enthusiasm, the appeal of the flat income tax in some EU Member States is weakening. Seemingly dissatisfied with the results of this fiscal experiment, the Czech Republic (2013), Slovakia (2013), Latvia (2018) and Lithuania (2019) abandoned the flat tax technique and returned to the tried and tested *multi-rate progression*. Out of eight "flat" EU Member States, there are four left – Estonia, Romania, Bulgaria and Hungary.

## 2. The Bulgarian model

In 2007<sup>19</sup>, personal income tax in Bulgaria is *progressive* – the result of the implementation of the four-rate tax structure (including the tax-free threshold), presented in Table 3.

**Table 3.** Marginal tax rates in Bulgaria (2007)

Total annual tax base (BGN)	Tax (BGN)
Up to 2 400	0
Over 2 400 But not over 3 000	20% for the excess over 2 400
Over 3 000 But not over 7 200	120 + 22% for the excess over 3 000
Over 7 200	1 044 + 24% for the excess over 7 200

Source: Law for the taxes on incomes of natural persons<sup>20</sup> (Promulgated, SG, No. 95 of 24.11.2006, effective 01.01.2007).

The monthly tax-free threshold (BGN 200 = BGN 2 400 / 12 months) is 11% higher than the minimum monthly salary in the country for 2007 (BGN 180)<sup>21</sup> and nearly 32% above the poverty line (BGN 152/mo.)<sup>22</sup>. The positive marginal tax rates increase in increments of 2 percentage points (20%, 22% and 24%) – see Table 3.

With a change in the Law for the taxes on incomes of natural persons in December 2007 (as of 01.01.2008) the Bulgarian state<sup>23</sup> introduces a flat personal income tax of 10%, without *tax-free threshold*<sup>24</sup>

<sup>14</sup> 0% < ATR < 20%.

<sup>15</sup> The minimum monthly salary in the country for 2018 is 1 900 lei.

<sup>16</sup> 0% < ATR < 10%.

<sup>17</sup> The right to a tax relief for children is available:

- after the 91st day of pregnancy;
- when starting an adoption procedure;
- for preschool children;
- for students under the age of 20 (undergraduate students, full-time education are not entitled to a tax relief, but are counted for children in the family /household/ for tax purposes).

<sup>18</sup> 0% < ATR < 15%.

<sup>19</sup> This is the first year of our country's membership in the EU.

<sup>20</sup> The Bulgarian Personal Income Tax Act.

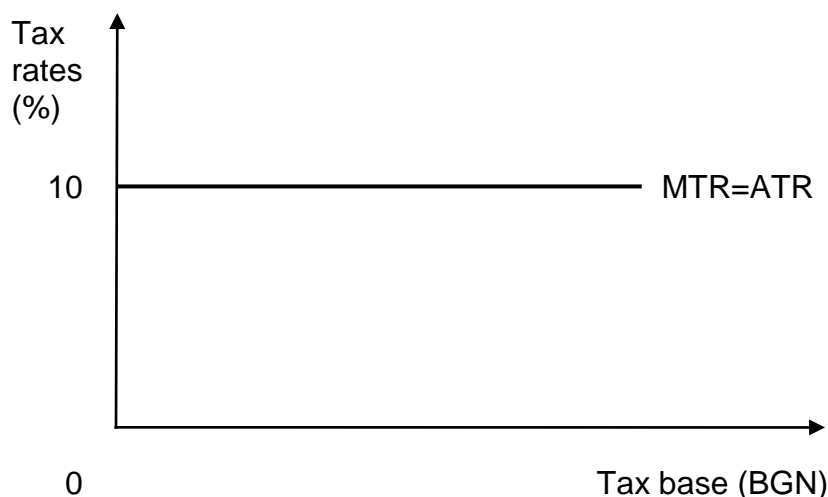
<sup>21</sup> DCM №324 / 06.12.2006.

<sup>22</sup> DCM №345 / 18.12.2006.

<sup>23</sup> With a government dominated by the Bulgarian Socialist Party.

<sup>24</sup> § 35 of the Law for amendment and supplement of the Law for the taxes on incomes of natural persons (Promulgated, SG, No. 113 of 28.12.2007).

(the four-rate tax structure is replaced by single-rate structure, but without zero tax bracket!). The era of proportional taxation of personal income in Bulgaria begins ( $A = 0$  and  $ATR = MTR = 10\% = \text{const.}$  for all levels of the tax base) – see Figure 4.



**Figure 4.** Marginal and average tax rates in Bulgaria from 01.01.2008<sup>25</sup>

The tax-free threshold, known as the zero tax bracket, is a key element in the personal income tax system. Both theoretically and in practice, it is determined by the *subsistence minimum*<sup>26</sup> in the respective economy. The theory assumes that "for a level of income lower than the amount of existence, the marginal utility (of income – R.B.) tends to infinity."<sup>27</sup> Therefore, "the recipient of an income sufficient only for sustenance has a tax capacity (ability-to-pay taxes – R.B.) equal to zero; and any encroachment on his income will cost him his life."<sup>28</sup> In other words, the tax-free threshold is a kind of zero level of the tax capacity of the individual.

This is the most popular understanding of the tax-free threshold, and its principled logic is not usually questioned. Moreover, it is an essential component of the conceptual foundation of modern tax policy.

Figure 5 presents the functions of the average rate for 8 selected levels of the total annual tax base of the progressive personal income tax in Bulgaria in 2007 and of the proportional personal income tax, effective from 01.01.2008.

The result of the introduction of a flat proportional personal income tax in Bulgaria is obvious – people with a total annual tax base of up to BGN 4 500 *lose*, and those with a total annual tax base of over BGN 4 500 *win* (see Figure 5). For example, in 2007 the tax of a person with a total annual tax base of BGN 2 400 was BGN 0 (average tax rate 0%), and in 2008 – BGN 240<sup>29</sup> (average tax rate 10%) . Respectively, in 2007 a taxpayer with a total annual tax base of BGN 10 000 paid BGN 1 716 (average tax rate 17,16%), and in 2008 – a mere BGN 1 000<sup>30</sup> (average tax rate 10%).

<sup>25</sup> Compare with Figure 3.

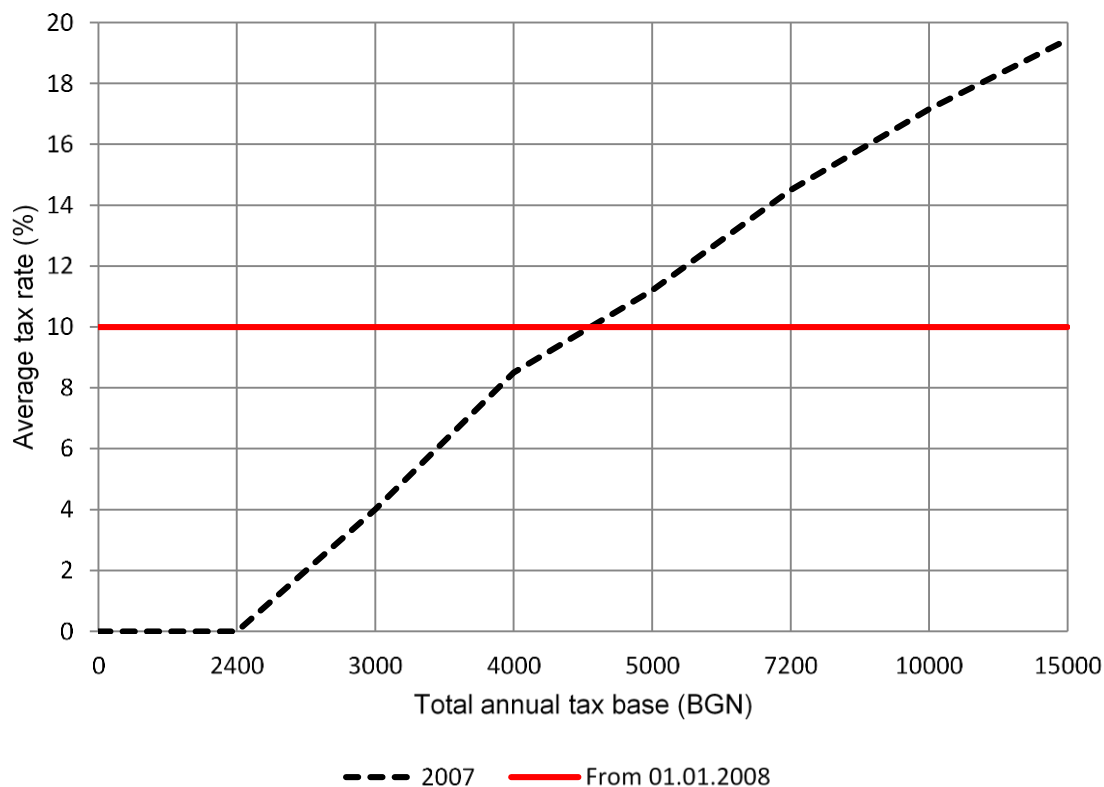
<sup>26</sup> According to §1, item 1 of the Additional Provisions of the Social Assistance Act (Promulgated, SG, No. 56 of 19.05.1998) "Basic necessities of life" are sufficient food, clothing and housing, in accordance with the socio-economic development of the country."

<sup>27</sup> Fagan, E. D., Recent and Contemporary Theories of Progressive Taxation, Journal of Political Economy, vol. 46, 1938, p.459.

<sup>28</sup> Fagan, E. D., Recent and Contemporary Theories of Progressive Taxation, Journal of Political Economy, vol. 46, 1938, p. 460.

<sup>29</sup> In 2008, the minimum monthly salary for the country was BGN 220 (DCM №1 / 11.01.2008), i.e. BGN 2 640 / year (= BGN 220 \* 12 months).

<sup>30</sup> According to NSI data, in 2008 the average monthly salary in the country was BGN 545, i.e. BGN 6 540 / year (= BGN 545 \* 12 months).



**Figure 5.** Average tax rates in Bulgaria in 2007 and from 01.01.2008

Moreover, in relative terms, the poorest lose the most, and the richest gain the most. The average rate of people with a total annual tax base of BGN 4 500 in 2008 is *exactly equal* to their average tax rate for 2007 (= 10%) – see Table 4. With a total annual tax base below BGN 4 500, the difference between the average tax rate in 2008 and the average rate for 2007 is a *positive value*<sup>31</sup>, which increases with the decrease of the total annual tax base and reaches its maximum with a total annual tax base  $\leq$  BGN 2 400 (10 percentage points = 10% – 0%) – see the last column of Table 4. Accordingly, for a total annual tax base above BGN 4 500, the difference between the average rate in 2008 and the average tax rate for 2007 is a *negative value*<sup>32</sup>, the *absolute value* of which increases with the increase of the total annual tax base (see the last column of Table 4) and tends to 14 percentage points.<sup>33</sup> For a total annual tax base of BGN 15 000, for instance, this difference is –9,44 percentage points.

**Table 4.** Change in average tax rates

Total annual tax base (BGN)	Average tax rates (%)		Change (p.p.)
	2007	2008	
(1)	(2)	(3)	(4) = (3) – (2)
2 000	0,00	10,00	+10,00
2 400	0,00	10,00	+10,00
3 000	4,00	10,00	+6,00
4 000	8,50	10,00	+1,50
4 500	10,00	10,00	0,00
5 000	11,20	10,00	–1,20
7 200	14,50	10,00	–4,50
10 000	17,16	10,00	–7,16
15 000	19,44	10,00	–9,44

Source: Author's own calculations.

<sup>31</sup> The average tax rate in 2008 is *higher* than the average tax rate in 2007.

<sup>32</sup> The average tax rate in 2008 is *lower* than the average tax rate in 2007.

<sup>33</sup> At very high levels of the total annual tax base, the average tax rate approaches the maximum marginal tax rate (in this case 24% for 2007).

In brief, replacing the progressive personal income tax with a proportional one makes the poor even poorer and the rich even richer!?

### 3. Renaissance of the tax-free threshold in our country

In December 2020, under the conditions of the COVID-19 pandemic, the Bulgarian state worked up courage and after 13 years encroached on the proportional flat personal income tax. The tax relief for children under the Law for the taxes on incomes of natural persons has been drastically increased and is becoming an *effective tax-free threshold* for all families with minor children.<sup>34</sup> In 2021<sup>35</sup>, individuals in Bulgaria will deduct from their total annual tax base as follows:

- BGN 4 500 for one minor child;
- BGN 9 000 for two minor children;
- BGN 13 500 for three or more minor children.<sup>36</sup>

The tax relief is used by one of the parents up to the amount of his total annual tax base. When the amount of the relief is higher than the total annual tax base of this parent, the difference can be used by the other parent.<sup>37</sup>

Table 5 presents the main results of taxation at 12 selected levels of the sum of the total annual tax bases of parents for different numbers of minors.

**Table 5.** Taxation at 12 selected levels of the sum of the total annual tax bases of parents with different number of minor children in 2021

Sum of the total annual tax bases of parents (BGN)	Sum of the total annual tax bases of parents, reduced by the tax relief for children <sup>38</sup> (BGN)			Total tax of parents under the Personal Income Tax Act (BGN)			Average tax rate (%)		
	With 1 child	With 2 children	With 3 or more children	With 1 child	With 2 children	With 3 or more children	With 1 child	With 2 children	With 3 or more children
(1)	(2) = (1) - 4 500 lv.	(3) = (1) - 9 000 lv.	(4) = (1) - 13 500 lv.	(5) = (2) * 10%	(6) = (3) * 10%	(7) = (4) * 10%	(8) = (5) / (1)	(9) = (6) / (1)	(10) = (7) / (1)
3 000	0	0	0	0	0	0	0,00	0,00	0,00
4 500	0	0	0	0	0	0	0,00	0,00	0,00
9 000	4 500	0	0	450	0	0	5,00	0,00	0,00
13 500	9 000	4 500	0	900	450	0	6,67	3,33	0,00
20 000	15 500	11 000	6 500	1 550	1 100	650	7,75	5,50	3,25
30 000	25 500	21 000	16 500	2 550	2 100	1 650	8,50	7,00	5,50
50 000	45 500	41 000	36 500	4 550	4 100	3 650	9,10	8,20	7,30
100 000	95 500	91 000	86 500	9 550	9 100	8 650	9,55	9,10	8,65
150 000	145 500	141 000	136 500	14 550	14 100	13 650	9,70	9,40	9,10
240 000	235 500	231 000	226 500	23 550	23 100	22 650	9,81	9,63	9,44
350 000	345 500	341 000	336 500	34 550	34 100	33 650	9,87	9,74	9,61
500 000	495 500	491 000	486 500	49 550	49 100	48 650	9,91	9,82	9,73

Source: Author's own calculations.

In 2021, families with a total annual tax base of up to BGN 4 500 will not pay any tax (regardless of the number of children) – see Table 5. For 2020, families with a total annual tax base of BGN 4 500 pay:

- BGN 430 for one child ( $= /4 500 - 200 / * 10\%$ );
- BGN 410 for two children ( $= /4 500 - 400 / * 10\%$ );
- BGN 390 for three or more children ( $= /4 500 - 600 / * 10\%$ ).

Provide both parents receive a minimum wage, for instance, the sum of the total annual tax bases

<sup>34</sup> See: § 9 of the Transitional and Final Provisions of the Law for the State Budget of the Republic of Bulgaria for 2021 (Promulgated, SG, No. 104 of 08.12.2020).

<sup>35</sup> The increase in tax relief for children is valid only for 2021.

<sup>36</sup> For 2020, these reliefs are BGN 200, BGN 400 and BGN 600, respectively!?

<sup>37</sup> This is essentially the Hungarian model of a flat personal income tax (see part 1 of the article).

<sup>38</sup> The tax relief is used up to the amount of the total annual tax bases of the persons.

is approximately BGN 13 500. In 2021, such a family will pay (see Table 5):

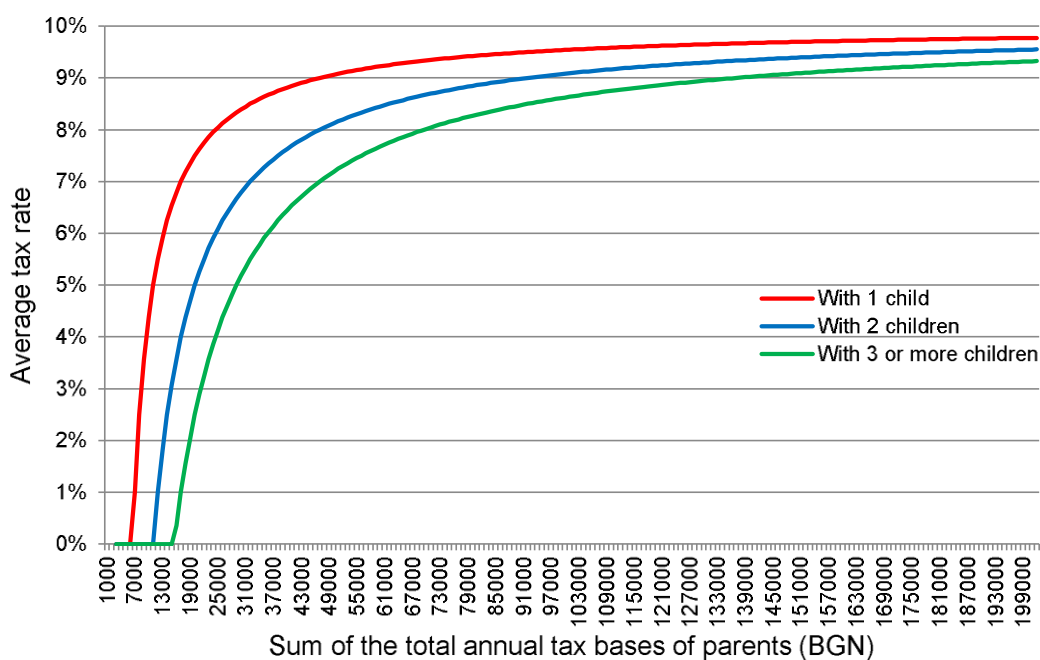
- BGN 900 for one child (for BGN 13 500 in 2020 the tax is BGN 1 330);
- BGN 450 for two children (for BGN 13 500 in 2020 the tax is BGN 1 310);
- BGN 0 for three or more children (for BGN 13 500 in 2020 the tax is BGN 1 290).

When the sum of the total annual tax bases is BGN 30 000 (the income of each parent is around the level of the average salary for the country) the family will pay (see Table 5):

- BGN 2 550 for one child (for BGN 30 000 in 2020 the tax is BGN 2 980);
- BGN 2 100 for two children (for BGN 30 000 in 2020 the tax is BGN 2 960);
- BGN 1 650 for three or more children (for BGN 30 000 in 2020 the tax is BGN 2 940).

By design, parents of minor children with relatively low incomes will be significantly relieved. As income increases, the effect of new tax reliefs for children weakens. With a total annual tax base over BGN 45 000 for families with 1 child, BGN 90 000 for families with 2 children and BGN 135 000 for families with 3 or more children, the average tax rate enters the bracket between 9% and 10%. The relative tax burden on parents of minor children with high incomes is approaching the level of the proportional flat tax of 10% for 2020.

In summary, Figure 6 shows the functions of the average tax rate of families with different number of minor children (and the sum of the total annual tax bases up to BGN 200 000) for 2021.



**Figure 6.** Average tax rates of families with minor children in 2021

The introduction of a tax-free threshold for parents of minor children will affect many people (over 2,5 million citizens). According to the National Statistical Institute (NSI), the total number of families in Bulgaria is 2 123 224, including 1 309 229 families with children (62%). Of these, 755 946 are families with minor children (58%), including:

- 478 550 families with 1 child (63%);
- 239 880 families with 2 children (32%);
- 37 516 families with 3 or more children (5%).<sup>39</sup>

A final point, the latest change in the Law for the taxes on incomes of natural persons (Promulgated, SG, No. 104 of 08.12.2020, effective from 01.01.2021) is *significant*. The introduction of a de facto tax-free threshold for parents of minors puts an end to the hegemony of proportional personal income taxation in Bulgaria over the last 13 years. The income of families with minor children in 2021 will be taxed *progressively* (see Figure 6). For other taxpayers, personal income tax remains *proportional* – an average rate of 10% (equal to the marginal rate) for all levels of the total annual tax base.

<sup>39</sup> National Statistical Institute, Census of Population and Housing in the Republic of Bulgaria 2011.

## CONCLUSION

Based on theoretical ideas from the recent past, at the end of the 20<sup>th</sup> and the beginning of the 21<sup>st</sup> century, many countries in Central and Eastern Europe introduced a flat progressive personal income tax (a combination of a tax-free threshold and a flat marginal tax rate). Out of a total of eight EU Member States that have used this technique, four have already given up and resumed multi-rate progression.

Bulgaria chooses something else – a flat proportional income tax of 10% (effective from 01.01.2008). The relative tax burden of low-income people is rising and that of high-income people is declining. For thirteen years, proportional taxation in our country has harmed the poor and benefited the rich.

In 2021, the Bulgarian state will restore the tax-free threshold for some of the taxpayers (parents of minor children) by drastically increasing the tax relief for children under the Law for the taxes on incomes of natural persons. The relative tax burden of all families with minor children is decreasing. Low-income parents benefit the most. As income increases, the effect of new tax reliefs for children weakens. Proportional taxation of the income of parents of minor children is replaced by progressive taxation. This change in the Law for the taxes on incomes of natural persons, at present, is valid only for 2021. In our opinion, however, the twilight of the proportional personal income tax is near. This is very good news for tax equity in Bulgaria!

## REFERENCES

- Fagan, E. D., Recent and Contemporary Theories of Progressive Taxation, *Journal of Political Economy*, vol. 46, 1938.
- Friedman, M., *Capitalism and Freedom*, Per. with English., New publishing house, M., 2006.
- Hall, R. and A. Rabushka, A Proposal to Simplify Our Tax System, *The Wall Street Journal*, 10.12.1981.
- Hall, R. and A. Rabushka, *The Flat Tax*, Hoover Institution Press, 1985.
- Hayek, F. A., Progressive Taxation Reconsidered, In: Mary Sennholz (ed.), *On Freedom and Free Enterprise – Essays in Honor of Ludwig von Mises*, 1956.
- Rabushka, A., The Attractions of a Flat-Rate Tax System, *The Wall Street Journal*, 25.03.1981.
- Smith, A., *An Inquire into the Nature and Causes of the Wealth of Nations*, Methuen & Co, London, 1904.
- Decree of the Council of Ministers №324 / 06.12.2006.
- Decree of the Council of Ministers №345 / 18.12.2006.
- Decree of the Council of Ministers №1 / 11.01.2008.
- Law for amendment and supplement of the Law for the taxes on incomes of natural persons (Promulgated, SG, No. 113 of 28.12.2007).
- Law for the State Budget of the Republic of Bulgaria for 2021 (Promulgated, SG, No. 104 of 08.12.2020).
- Law for the taxes on incomes of natural persons (Promulgated, SG, No. 95 of 24.11.2006, effective 01.01.2007).
- National Statistical Institute, *Census of Population and Housing in the Republic of Bulgaria 2011*.
- Social Assistance Act (Promulgated, SG, No. 56 of 19 May 1998).
- [https://files.taxfoundation.org/legacy/docs/fed\\_individual\\_rate\\_history\\_nominal.pdf](https://files.taxfoundation.org/legacy/docs/fed_individual_rate_history_nominal.pdf)