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INCOME TAX AS A FISCAL INSTRUMENT AND ITS IMPACT ON THE SOCIAL ENVIRONMENT

Abstract: *Income tax is one of the important sources of the formation of the country's budget revenues. In Georgia, the most significant part of the state budget revenues (approximately 28%) is mobilized through this tax. In addition, it creates approximately 85% of the budget revenues of the autonomous republic. The fiscal forecast in relation to income tax is always fulfilled, therefore, it is a stable source of revenue for the country's budget.*

Income tax is an important fiscal instrument in Georgia, however, in the context of the Association Agreement signed with the European Union, it is also important to study its impact on the social environment, since in most of the European Union countries, income tax is progressive, there is a tax-free minimum and the tax burden is different for high and low income employed persons. Therefore, in this regard, the following circumstances should be taken into account using the example of Georgia:

- The proportional income tax rate places highincome and lowincome taxpayers under an unequal tax burden;

- In order to avoid the high tax burden, lowincome taxpayers resort to employment without registering as taxpayers and contribute to the growth of the shadow economy;

- Funds mobilized in the form of income tax participate in the financing of important state programs in the areas of education, healthcare and social protection, thereby having a positive impact on the social situation of the population.

Thus, the current income tax mechanism in Georgia increases social inequality, stimulates low-income groups of the population to hide their income and, accordingly, avoid paying taxes, which somewhat limits the possibility of increasing the positive impact of this tax on the social environment.

It is important to develop an effective tax policy in order to ensure the positive impact of income tax on the social environment.

Keywords: *income tax, fiscal instrument, social environment.*

JEL classification: *H2, H3, K34, E62.*

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საშემოსავლო გადასახადი, როგორც ფისკალური ინსტრუმენტი და მისი გავლენა სოციალურ გარემოზე

აბსტრაქტი. საშემოსავლო გადასახადი ქვეყნის საბიუჯეტო შემოსავლების ფორმირების ერთ-ერთი მნიშვნელოვანი წყაროა. საქართველოში აღნიშნული გადასახადის მეშვეობით ხორციელდება სახელმწიფო ბიუჯეტის შემოსავლების უმნიშვნელოვანესი ნაწილის (დაახლოებით 28%) მობილიზება. ამასთან, იგი ქმნის აჭარის ავტონომიური რესპუბლიკის ბიუჯეტის შემოსავლების დაახლოებით 85%-ს. ფისკალური პროგნოზი საშემოსავლო გადასახადთან მიმართებაში ყოველთვის სრულდება, ამდენად, იგი ქვეყნის ბიუჯეტის შემოსავლების სტაბილურ წყაროს წარმოადგენს.

საშემოსავლო გადასახადი საქართველოში მნიშვნელოვანი ფისკალური ინსტრუმენტია, თუმცა, ევროკავშირთან გაფორმებული ასოცირების შეთანხმების ფონზე, ასევე, მნიშვნელოვანია მისი გავლენის შესწავლა სოციალური გარემოზე, ვინაიდან ევროკავშირის ქვეყნების უმეტეს ნაწილში საშემოსავლო გადასახადი პროგრესულია, არსებობს დაუბეგრავი მინიმუმი და საგადასახადო ტვირთი განსხვავებულია მაღალი და დაბალშემოსავლიანი დასაქმებული პირებისათვის. ამიტომ ამ მიმართულებით საქართველოს მაგალითზე გასათვალისწინებელია შემდეგი გარემოებები: საშემოსავლო გადასახადის პროპორციული განაკვეთი, არათანაბარი საგადასახადო ტვირთის პირობებში აყენებს მაღალშემოსავლიან და დაბალშემოსავლიან გადასახადის გადამხდელებს; დაბალშემოსავლიანი გადასახადის გადამხდელები მაღალი საგადასახადო ტვირთის თავიდან ასაცილებლად მიმართავენ გადასახადის გადამხდელად რეგისტრაციის გარეშე დასაქმების გზებს და ხელს უწყობენ ჩრდილოვანი ეკონომიკის მასშტაბების ზრდას; საშემოსავლო გადასახადის სახით მობილიზებული თანხები მონაწილეობს განათლების, ჯანდაცვის, სოციალური დაცვის მიმართულებით მნიშვნელოვანი სახელმწიფო პროგრამების დაფინანსებაში, რითაც ის დადებით გავლენას ახდენს მოსახლეობის სოციალურ მდგომარეობაზე.

ამრიგად, საშემოსავლო გადასახადის მოქმედი მექანიზმი საქართველოში, ზრდის სოციალურ უთანასწორობას, ასტიმულირებს მოსახლეობის დაბალშემოსავლიან ჯგუფებს დამალონ შემოსავლები და შესაბამისად, თავი აარიდონ გადასახადების გადახდას, რითაც გარკვეულწილად

იზღუდება აღნიშნული გადასახადის დადებითი გავლენის ზრდის შესაძლებლობა სოციალურ გარემოზე.

მნიშვნელოვანია ეფექტიანი საგადასახადო პოლიტიკის შემუშავება, საშემოსავლო გადასახადის პოზიტიური გავლენის უზრუნველყოფის მიზნით სოციალურ გარემოზე.

საკვანძო სიტყვები: საშემოსავლო გადასახადი, ფისკალური ინსტრუმენტი, სოციალური გარემო.

JEL კლასიფიკაცია: H2, H3, K34, E62

Introduction and literature review

Income tax plays an important role in the fiscal policy of most European countries. It creates a significant source of budget revenues. In addition, by regulating income tax rates and benefits, it is possible to redistribute income in such a way as to achieve social justice and social well-being. Therefore, this tax has a significant impact on the formation of the social environment in the country.

Inequality is one of the main current economic problems, affecting not just developing countries, but also major developed economies. Although inequality is generated by differences in market income, the public sector plays a key role in reducing it through the redistributive effect of the tax-benefit system.

European countries have a developed welfare state, but use different policies to reduce inequality, distinguishing five different models: Nordic, Mediterranean, Continental, Anglo-Saxon and Eastern countries. Some models place more emphasis on income replacement benefits (derived from work) and others on income guarantee benefits (derived from the welfare system) (Granel et al., 2024).

Tax policy related to income tax has a significant impact on the social environment, which is reflected in the degree of income equalization, the level of poverty and social well-being, as well as trust in state institutions.

Mutual trust favors cooperation between businesses and authorities while creating a synergistic climate. On the one hand, if entrepreneurs believe that authorities support citizens' wellbeing and economic development, they give back to societies by fully complying with tax laws (Batrancea et al., 2022).

Some studies show that, at least in Europe, direct taxes (personal income tax, profit tax) are more effective in reducing inequality than indirect taxes (Beljić et al., 2025).

Since direct taxes (such as personal income taxes) are more effective in reducing inequality than indirect taxes, tax policymakers should ensure that tax rates are progressive, gaps are minimized, and high incomes are taxed fairly (Barrios et al., 2016).

Studies show that in a country like Belgium, the tax and social security system significantly reduces inequality, although this is not the case in Germany or the Netherlands (Dianov et al., 2022).

To ensure the principle of fairness in taxation, countries choose a progressive method of income tax taxation, which also ensures the fulfillment of the income redistribution function. The fiscal policy of progressive income tax is reflected in a higher growth in budget revenues than in a proportional one, in performing the function of a built-in stabilizer, which alleviates the tax burden during periods of economic instability and in the redistribution of income between high and low income earners.

Progressive tax systems seek to reduce social inequality by redistributing income throughout the economy.

Developed economies ought to adopt policies aimed at raising CIT (Corporate Income Tax) to reduce inequality, while emerging economies should concentrate more on raising PIT (Personal Income Tax) to improve equity.

Maintaining and strengthening progressive direct tax systems to achieve long-run reductions in income inequality across the EU, while also recognizing the short-run redistributive potential of VAT when accompanied by well-targeted social transfers and exemptions on essential goods (as it was implemented in Lithuania, Finland, Germany, Greece, and Sweden).

The structure of a country's tax system plays a crucial role in both shaping economic growth and income distribution. In economics, shifting to less growth-distortive taxes, like indirect taxation, often reduces equality. This trade-off is notable in European OECD economies, where moving from direct to indirect taxes has increased income disparities (Beljić et al., 2025).

High progressive income tax rates, on the other hand, may have a negative impact on the labour supply or encourage tax evasion, which contributes to a strong income gap. The social environment is also damaged. High-income earners may move to another country, which reduces the domestic tax base;

Research by the Joint Research Centre (JRC) has shown that under-declaration of self-employed income in European countries can account for 10–43% of the income of employed people, resulting in a loss of up to 1.6% of GDP. It also has consequences for income distribution, as high-income groups may be more likely to evade taxes.

Methodology

The research process used the methods of studying and reviewing various studies, studying tax practices in different countries, analyzing and evaluating normative documents, reports published by various agencies, and statistical information. Statistical information reflected in budget execution reports was analyzed and relevant conclusions were drawn.

Research Results

Governments in European countries consider income tax (a system of taxes and benefits) as part of social policy, to redistribute income, provide social protection, and support equal opportunities.

A study on Italy conducted by the JRC (Joint Research Centre) analyzed the transition from personal income taxation (PIT) to consumption taxation and found that lower PIT rates can lead to efficiency gains, but carry the risk of regressiveness (D'Andria et al., 2021).

In light of this reform, the Article 1 of the Decree has provided for a reduction to no. 3 IRPEF rates (instead of the former no. 4) as of January 1st, 2024, with each rate corresponding to the specific annual income bracket according to the following scheme:

Table 1. Income tax rates in Italy

Till to December 31st, 2023	From January 1st, 2024, till to December 31st, 2024
(1) up to €15,000,00 – 23%	(1) up to €28,000 – 23%
(2) from €15,001.00 and up to €28,000.00 – 25%	(2) from €28,001 and up to a €50,000 – 35%
(3) from €28,001 and up to €50,000 – 35%	(3) from €50,001 – 43%
(4) from €50,001 – 43%	–

Source: <https://blog.pwc-tls.it/en/2024/01/04/revising-of-personal-income-tax-rates-irpef-issued-the-first-decree-on-the-general-tax-systems-reform/>

It is reflected in the above amendments that the former first two income brackets are merged into a single bracket to which the 23% rate will be applied in 2024.

In Italy, For 2024, the basic employee tax credit for taxpayers with a taxable income up to EUR 15,000 is increased from EUR 1 880 to EUR 1 955 therefore, the de facto no-tax area is extended from EUR

8 174 up to EUR 8 500 (source: https://www.oecd.org/en/publications/taxing-wages-2025_b3a95829-en/full-report/italy_14a52901.html?utm).

In France individuals, whether French or foreign nationals, who have their tax domicile in France are generally subject to PIT on worldwide income unless excluded by a tax treaty. Rates are progressive from 0% to 45%, plus a surtax of 3% on the portion of income that exceeds 250,000 euros (EUR) for a single person and EUR 500,000 for a couple subject to joint taxation and of 4% for income that exceeds EUR 500,000 for a single person and EUR 1 million for a couple subject to joint taxation (source: <https://taxsummaries.pwc.com/france/individual/taxes-on-personal-income>).

Germany has progressive tax rates ranging as follows (2025 tax year):

Table 2. Income tax rates in Italy Germany

Taxable income range for single taxpayers (EUR)		Taxable income range for married taxpayers (EUR)		Tax rate (%)
Over	Not over	Over	Not over	
0	12,096	0	24,192	0
12,096	68,429	24,192	136,858	14 to 42*
68,430	277,825	136,860	555,650	42
277,826	and above	555,652	and above	45

* Geometrically progressive rates start at 14% and rise to 42%.

Source: <https://taxsummaries.pwc.com/germany/individual/taxes-on-personal-income>

In addition, Germany has a tax-free minimum, information about which is presented in the following table:

Table 3. Tax-free minimum in Germany

Year	Basic allowance (single)	Effective zero-rate band (joint, via splitting)	Notes
2024	€ 11,784	€ 23,568	Retroactive increase approved in late 2024
2025	€ 12,096	€ 24,192	An increase of €312 vs 2024
2026	€ 12,348	€ 24,696	Legislated step for 2026

Source: https://taxrep.us/tax_guide/german-income-tax-guide/german-income-tax-the-basic-personal-allowance-grundfreibetrag/

The United States levies tax on its citizens and residents on their worldwide income. Non-resident aliens are taxed on their US-source income and income effectively connected with US trade or business (with certain exceptions).

Table 4. Income tax rates in USA for single taxpayers

Taxable income (USD)	Tax rate (%)
0 to 11,925	10
11,926 to 48,475	12
48,476 to 103,350	22
103,351 to 197,300	24
197,301 to 250,525	32
250,526 to 626,350	35

626,351+

37

Source: <https://taxsummaries.pwc.com/united-states/individual/taxes-on-personal-income>

Scotland also has progressive rates, as shown in the following table:

Table 5. Income tax rates in Scotland

Category	Taxable income	tax rate (%)
Personal Allowance	Up to £12,570	0
Starter rate	£12,571 to £15,397	19
Basic rate	£15,398 to £27,491	20
Intermediate rate	£27,492 to £43,662	21
Higher rate	£43,663 to £75,000	42
Advanced rate	£75,001 to £125,140	45
Top rate	over £125,140	48

Source: <https://www.gov.uk/scottish-income-tax/how-it-works>

Among European OECD countries, the average statutory top personal income tax rate lies at 42.8 percent in 2025. Denmark (55.9 percent), France (55.4 percent), and Austria (55 percent) have the highest top rates. Hungary (15 percent), Estonia (22 percent), and the Czech Republic (23 percent) have the lowest top rates (<https://taxfoundation.org/data/all/eu/top-personal-income-tax-rates-europe/>).

Despite the differences between individual European countries, European income tax systems share common features, including:

- Progressive personal income taxes in many EU countries, with multiple tax rates and higher marginal rates for the highest earners;
- In many European countries, employees pay both personal income taxes and social security contributions;
- The tax systems of European countries include benefits (for dependents, for education, for mortgage interest, etc.);
- Income tax systems in European countries operate in conjunction with social transfers, which means that disposable income and social transfers must be assessed together;

According to the European Commission's Annual Taxation Report (2025), in the 27 EU countries, the tax-to-GDP ratio has slightly decreased and the tax structure has changed (the share of taxes on labor is decreasing, while the share of taxes on capital is increasing).

In Georgia, income tax is an important and stable source of budget revenues. It constitutes 28% of state budget revenues (second only to VAT) and 85% of autonomous republic budget revenues. The funds mobilized by this tax are themselves used in state-funded social security, healthcare, and education programs.

It is important to note that the largest share of state budget expenditures falls on social security, which includes pension provision, social benefits, universal healthcare, co-financing of the accumulative pension scheme, provision of public healthcare and medical services to the population, and financing of employment promotion in public works. Information on taxes mobilized in the form of income tax and social security expenditures is presented in the following table:

Table 6. State Budget Indicators of Georgia

Years	Share of income tax in state budget revenues	Share of social security financing in state budget expenditures
2020	29.36%	42.60%

2021	27.38%	42.80%
2022	28.23%	39.40%
2023	29.78%	40.20%
2024	30.33%	38.80%

The table was compiled by the authors based on data from the Georgian State Budget Execution Reports.

Unlike many European countries, Georgia has a proportional income tax rate (20%). This method of taxation places the same tax burden on high-income and low-income taxpayers, which hinders the redistribution of income. Although in absolute terms, high-income earners pay more in taxes than low-income earners, the financial burden for the latter is greater. Therefore, the proportional rate reduces the effect of reducing social inequality.

Although income tax benefits include social benefits, they are mainly for a small category of taxpayers (mainly people living in mountainous settlements), which in conditions of high urbanization reduces the scale of the positive impact on the social environment.

The research also examined the structure of funds mobilized in the consolidated budget of Georgia in the form of income tax, which shows that the main source is income tax withheld by employers. Income tax paid by individual entrepreneurs accounts for a negligible share. This information is presented in the following table:

Table 7. Georgian Consolidated Budget Indicators

Years	Income tax withheld by the employer to the consolidated budget		Income tax on income received from the activities of entrepreneurial individuals	
	Amount	Share in revenue	Amount	Share in revenue
2020	2,951,076,358.50	22.38%	54,206,048.67	0.41%
2021	3,353,034,333.30	21.01%	54,944,234.65	0.34%
2022	4,406,228,871.05	21.48%	70,048,107.07	0.34%
2023	5,276,593,384.50	22.45%	80,078,585.73	0.34%
2024	6,102,720,676.94	22.24%	78,268,421.07	0.29%

The table was compiled by the authors based on data on revenues of the consolidated budget of Georgia.

Therefore, under the conditions of the proportional income tax rate in Georgia, the effect of reducing social inequality is reduced, which negatively affects the social environment. As a result, the scale of employment without registration as a taxpayer increases, which, in turn, also leads to a loss of budget revenues.

Conclusions

- In accordance with the European Commission recommendation, income tax legislation should be designed to automatically respond to economic shocks, as evidence shows that direct taxes absorb a significant portion of economic shocks.

- In Georgia, the implementation of a progressive income tax system would ensure the implementation of the principle of fair taxation. Progressive taxation of high incomes and their redistribution could reduce the Gini coefficient and other indicators of inequality;

- By providing revenues for social programs supporting vulnerable groups, the risk of poverty could be indirectly reduced and social integration could be promoted;

- By investing income tax revenues in education, healthcare and infrastructure, equal opportunities could be created and long-term social outcomes could be ensured;
- Including medical insurance, treatment, education and other necessary expenses in income tax benefits for low-income taxpayers will increase the positive impact of this tax on the social environment;
- Under conditions of a fairly perceived tax system (when high-income earners pay more), trust in state institutions may be strengthened, and conversely, tax evasion or tax fraud harms the social environment.
- Under conditions of effective tax administration, the scale of employment without registration due to the high tax burden will decrease and revenues brought to the budget in the form of income tax will increase.

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