TAXATION IN THE CZECH REPUBLIC

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This chapter is dedicated to the Czech fiscal system. It follows the established structure focusing on the levels of taxation in terms of the share of GDP for various taxes and contributions; taxation structure as described by the Implicit Tax Rates; administrative complexity of fiscal systems in terms of bureaucratic procedures and required human resources; and the level of fiscal decentralization.

The data come from international sources, namely Eurostat and the World Bank's Doing Business report, as well as some local sources.

Taxation: overview

Taxation system in the Czech Republic corresponds to that of many developed countries. Taxes can be classified in different ways. The most important taxes in terms of government revenue are consumption taxes; that is, the value added tax on goods and services and excise duties on selected goods as permitted by the EU legislation. Personal income is taxed in different ways depending on its source. There is general personal income tax; income from employment and self-employment is further subject to social security contributions and compulsory health insurance. Corporate profits are subject to corporate tax, dividends are also taxed at the shareholders' level as a personal income. Wealth in the form of real property – that is, land and buildings – is subject to property tax. Transfer of real property is also taxed. Corporations and entrepreneurs also pay road tax if they own and operate vehicles. The government has recently removed special taxes on donations and inheritance which are now incorporated in the income tax. Finally, there are several local taxes established by a general law which are administered by local authorities.

Levels of taxation

This section shows the evolution of taxation as a percentage of GDP in the recent years. It explores total taxation, including contributions, and receipts from specific taxes such as VAT or personal income taxes. Data are extracted from the Eurostat's "Main national accounts tax aggregates" database.

Figure 1 shows the tax receipts as percentage of GDP in the Czech Republic from 1995 to 2013 compared to the average EU-27 level, as reported by the Eurostat. The overall level of taxation is quite stable over the period. Fluctiations can be atributed to alternating right-wing and left-wing cabinets. The tax receipts of the Czech government are significantly lower than the EU average due to lower level of taxation as well as lower GDP per capita (which was between 70 and 80 per cent of the EU average over the period examined here).

Figure 2 shows VAT receipts in the Czech Republic and in the EU. The Czech Republic has been increasing VAT rates over the last decades and it is the largest tax in terms of government revenues. Since joining the EU in 2004, the share of VAT receipts on GDP is comparable to the EU average. The government relies on the VAT receipts not only because they are sizeble but also very stable over the business cycle.

Figure 3 shows total income taxes in the Czech Republic and in the EU, as well as personal income taxes (dashed) and corporate income taxes (dotted), all as a fraction of GDP. The level of income taxation is generally lower than the EU average. Personal and corporate income taxes have roughly equal share on the GDP. Comparative data on personal and corporate taxation in the EU are not available.

Figure 4 shows social contributions in the Czech Republic and the EU. Contributions have been quite stable in terms of GDP share over the last two decades and they are higher than the EU average. Employees' contributions are somewhat below the EU level; however, employers pay significantly more. Contributions of self-employed are slightly lower than the EU average, possibly due to benevolent policy in this area.

The comparison of tax receipts as a share on GDP suggests that the overall taxation in the Czech Republic is lower than the EU averages. Consumption is taxed in a similar way while income taxes are lower. On the other hand, the cost of labor is increased by the above-average social contributions paid by employers. Implicit tax rates examined in the next part should provide a more detailed analysis of particular modes of taxation.

Implicit tax rates

Implicit tax rates (ITR) present the fraction of consumption expenditures or incomes which go in taxes. The data used in this part are extracted from the Eurostat's "Implicit tax rates by economic function" database which provides ITRs for consumption, labor and capital.

Figures 5-7 show the implicit tax rates on consumption, labor, capital, business income, business income of corporations, and business income of households and self-employed. They present a different perspective on the levels of taxation.

Consumption ITR is quite substantive and growing over the recent years. Unlike in the previous analysis, the ITR shows that taxation of consumption is heavier in the Czech Republic in comparison with the EU average.

Labor ITR is also above the EU average, although, the trend is decreasing. The ITR confirms the intuition that relatively low personal income tax is offset by substantial social contributions. Tax reforms of 2008 have considerably improved the situation.

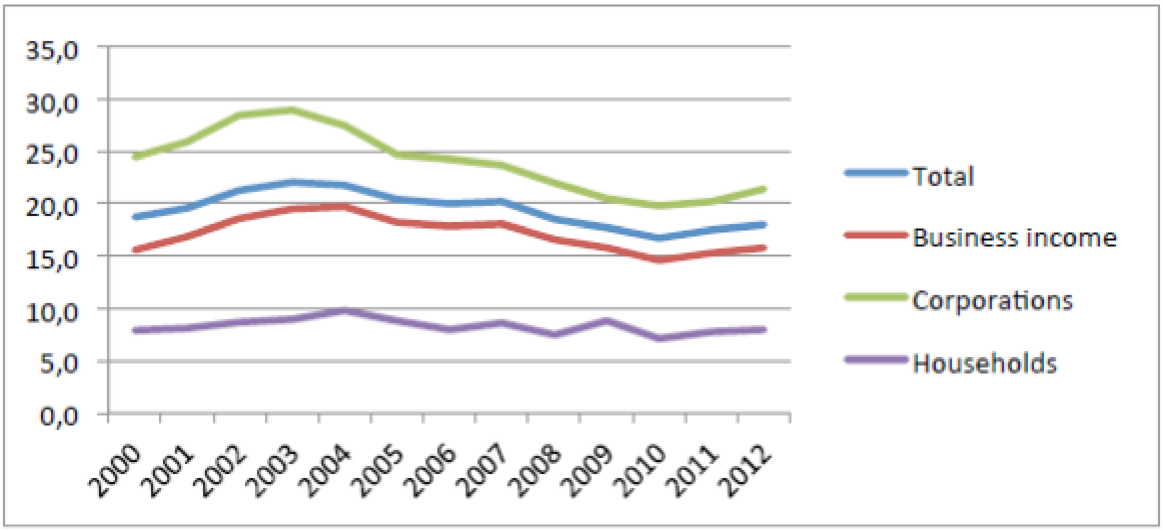

FIGURE 7 – Capital ITRs

Regarding the capital ITR, there are no data available on the EU average. Capital ITR is quite low in the Czech Republic. It is similar to neighboring countries such as Germany, Poland and Slovakia, but much lower than in Italy, France or the UK. Taxation levels have somewhat decreased over the past decade, especially for corporations.

The Eurostat data are available only up to 2012. In 2013, VAT increased in the Czech Republic. Certain changes in personal income taxation have also been adopted, although the effect on the ITRs is probably minor. Under the current Czech government, the levels of taxation may slightly increase, but no significant change is expected.

Administrative burden of fiscal procedures

The additional costs induced by taxation involve time, effort and other resources of tax-payers as well as of the public servants. They can only be measured using some proxy variables, typically number of administrative procedures, time spent in activities related to tax administration or financial resources used for the purpose, such as the cost of accounting services. The burden is unequal across different tax-payers and across different taxes.

Table I shows the World Bank's Doing Business data on the Czech Republic in the subfield called "Paying Taxes". The Doing Business index allows comparing economies across several dimensions including the administrative burden related to taxation.

Country	**Rank**	**Procedures**	**Time**	**Total Tax Rate**
Czech Republic	122^{th}	8	413	48,1
OECD High Income	-	12	175	41,3

TABLE I – The Czech Republic in the "Paying Taxes" field of the Doing Business 2014 report

The most burdensome is the taxation of labor, including social contributions, accounting for more than half of the estimated time burden. The rest is roughly equally divided between VAT and corporate income tax.

It is important to note that the indirect costs induced by taxation may be significant in comparison with the government's tax receipts. According to a local study (Vitek and Pavel, 2008), the private costs related to the income tax of self-employed is about 34,4 per cent of the receipts, for the road tax it is about 16,6 per cent, and for other taxes it is between 3 and 8 per cent.

Taxation and federalism

Public administration in the Czech Republic is divided in three levels: the central government, self-governing regions and municipalities (towns or districts in large cities). The revenue of local governments is mostly from taxes and grants or transfers from the central government. Most of the tax receipts are shares from nation-wide taxes. Local taxes are of limited importance.

Using the Eurostat data, it is not possible to distinguish between the individual levels of local government In the Czech Republic. Central, state and local governments and social security funds (labelled S1311, S1312, S1313 and S1314 respectively) are the four sectors of the general government distinguished in the Eurostat database. Since the Czech Republic is a unitary state, there are no state governments, a category intended for federations. An approximate index of fiscal autonomy of the local governments is computed as the ratio of the sum of capital and current transfers from the central to the local governments and the expenditures of the local governments.

Figure 8 shows the “fiscal autonomy index” for the Czech Republic in the recent years.

Over the last decade, the dependence of local governments in the Czech Republic on transfers form the central government has decreased significantly. The share of transfer receipts on local governments' expenditures is roughly equal to the Eurozone average (an average is not available for the whole EU). There have been several reforms of local government finance over the period; the most notable of them was implemented in the 2007. Starting with 2008, local governments have received a more generous share of general taxes (income and consumption) which allowed a decrease in the transfers from the central government. This creates more stable and predictable revenues and higher degree of autonomy to the local governments.

Conclusion

Taxation in the Czech Republic has undergone certain improvements over the past years. Generally, the government shifts the weight from direct taxes (both on labor and business income) to indirect taxation. This is motivated both by the need to secure stable and predictable revenues and the effort to create incentives for economic activity. Consumption is taxed at a level similar to other EU countries, while business income is taxed less.

One of the major problems is high taxation of labor income through the social contributions. This is a general problem of post-communist countries; they have to secure adequate living standards for the people out of labor force, especially the elderly, but their revenues are low due to relatively lower productivity. Considering the demographic situation, major reforms are needed in this respect. However, there is little consensus on how to reform the social security system in the Czech Republic.

Another major problem is the indirect cost of taxation due to complicated tax administration. Reforms in this respect have been proposed over the past years. Tax system has been somewhat simplified with the adoption of flat tax rate for income tax, there has also been a proposal for unification of VAT rates. As a major improvement, a concept of "integrated revenue administration" has been proposed. This would create a unified administration for all taxes and social contribution so that each economic entity would only deal with a single administrator. Implementation has been postponed several times and the future of the project is unclear.

Although there have been some improvements over the past decade, there are still certain problems to addressed. A major positive is the relatively generally lower taxation in the Czech Republic, compared to the EU average, and the fact that the government has not dramatically increased taxes in response to the economic crisis. Major problems to be addressed are high taxation of labor through the social contributions and complicated and burdensome tax administration.

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