The Czech tax mix at a crossroads

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Abstract

The Czech tax system has the typical characteristics of post-communist systems of taxation and social security: social security contributions are the dominant tax channel and in addition the public health insurance premiums are collected by seven public health insurance companies and redistributed between them. The most significant change since the 1993 tax reform has been the reduction of the corporate income tax rate from 45% to 19%. A Czech peculiarity involves the transition to the taxation of the super-gross wage from 2008; the last three Czech governments have included the departure from this type of taxation in their programs, but for all that it is apparent that there is still no concept which could replace the existing system with its numerous neoliberal elements.

This paper analyses the linkage of the social insurance premiums to the respective social security branches in the interest of defining the area for the rational share of these contributions in the tax mix. We define four social taxation models in contemporary western countries to solve this problem: the liberal, Christian-democratic, social-democratic and neo-liberal models. Afterwards we define the space for personal and corporate income taxation. The Czech value added tax has a slightly above-average basic rate, so it would not be expedient to raise it as the OECD has advised us to do in response to the very high social security contributions. At the same time, it is also not desirable to reduce the taxation of wages and overall capital incomes.

Keywords: corporation tax; personal income tax; social insurance; social security contributions; tax mix

JEL Classification: H20; H24; H25; H55; I13

1 Introduction

The transformation to a market economy in the post-communist countries has essentially led to a change in the tax mix: a dual-channel system of levies on enterprises into the state budget (levies from profits, sales tax) dominated the previous system, while social security contributions followed by value added tax occupy first place in the new market-oriented post-communist economy. The personal income tax (PIT), significant in the advanced market economies, “was pared down”; in Czechia this happened by the mechanical division of the former wage tax into the labour income tax and social security contributions from 1993. The fundamental influence of neoliberal tax theory, which prefers the taxation of consumption (for example, in the form of value added tax) and also makes do with the taxation of personal incomes with the deduction of capital incomes, savings or investments, was also apparent in a number of other post-communist countries. The influence of neoliberalism and international tax competition has also manifested itself in an international fall in the role of the corporate income tax; in our country this tax rate has fallen from 45% in 1993 to the current 19%. These tendencies have resulted in the existing Czech post-communist tax mix which prioritises the role of the social security contributions (42% of public revenues); the value added tax takes the second place (34%, along with selective consumption taxes) and the taxation of personal and corporate incomes (23% of public revenue) come in the third place – see Figure 1.

The average tax mix of the OECD countries has three key components: consumption taxation (a 33% share), social security contributions (26%) and personal income taxation (24%). The corporate income taxation keeps some distance (a 9% share) followed by the property taxation (6%) [4]. This “large” (unweighted) average for the OECD countries includes both liberal tax mixes (with negligible social security contributions, for example New Zealand), and Christian-democratic mixes (with social security contributions accounting for the greatest share, for example Germany: 38% of public revenue). To keep order, I add that social insurance premiums are not considered to constitute taxation in Germany and that our taxation experts at the beginning of the 1990s knew the German taxation and insurance system very well, so they did not have any problem with the distinctive role of social and health insurance from the beginning of 1993. The Czech tax reform of that time essentially preceded (potential) social reforms, while the reform of the financing of healthcare was further advanced at that time: as such it can be of no surprise that health insurance premiums became a revenue for the individual, newly established health insurance companies.

One of the goals of this paper is to point to the connection between the tax mix and the social model or models used in individual countries and subsequently to compare the existing Czech tax mix with the essential features of Czech social security and with any prepared or recommended social reforms. A further goal is to analyse the...
OECD and EU recommendations for the reform of the Czech tax mix. The third goal is to analyse the
government and other proposals for the tax reform with a significant impact on the tax mix. Finally, we will then
summarise the acquired knowledge into a proposal for the reform of the tax mix.

**Figure 1 – The Czech Tax Mix in 2018. Source: [8]**

### 2 Social tax models

If we disregard the periods when liberals were rejecting even to look into the incomes of citizens as a rule (and therefore in practice an entire system of yield taxation supplemented with excises was implemented), it is possible to associate liberalism with the dominance of income tax in the tax mix. As the queen of the classic liberal tax system, the income tax should be proportionate and not change the income relations which have been created in the market (the Edinburgh Rule). A new significant tax channel was established after the First World War and not only in our country – the turnover tax, as a general consumption tax, which was implemented “as a manifestation of the exceptional need of the public finances, especially in the post-war period; from the point of view of the personal or material tax sustainability it cannot stand up to criticism” [5]. The star of value added tax has risen in the last half century, this tax has stood the test of criticism from the point of view of the material tax sustainability because it does not lead to the taxation “snowballing” in associated production and distribution levels. If contemporary liberals now accept the existence of value added tax (or a single-phase sales tax – in the USA) as a fact, they can therefore “approve” the existence of a progressive income tax without any greater problems – as a counterweight to the regressive value added tax.

A good example of the modern liberal tax mix is the tax system of New Zealand, preferably prior to the last tax reform. In 2009, the personal income tax (with a sliding progression of rates ranging from 12.5% to 38%) brought in 53% of all public revenues, while value added tax (GST) accounted for 21% and the share of corporate income tax was 17% (the remaining 9% consisted of selective consumption taxes, custom duties and some fees). There are practically no social security contributions (only a contribution to the compulsory insurance of employee non-work injuries). The state provides all residents with a relatively high, flat-rate old age pension. The tax reform from and after 2014 substantially strengthened the role of the universal value added tax: its flat rate was increased to 15%. The tax rates on personal income were reduced to a range from 10.5% to 33% (without a zero starting rate or basic tax credit), while the corporate income tax rate fell from 30% to 28%. The taxation of personal and corporation income accounted for 52.4% of the New Zealand tax mix in 2017, while the taxation of consumption amounted to 38.4% and property tax amounted to 6% [2]. The liberal model of taxing labour is therefore very simple: it consists of only the progressive personal income tax.

The modern Christian-democratic tax mix differs from the modern liberal mix “only” in the existence of considerable social insurance premiums. At the same time, we must overlook the frequent existence of state provision for public employees, which is financed from the public purse. In the Christian-democratic social model, social insurance stands outside the state budget and the insurance premiums are at most a parafiscal levy
which in essence most certainly does not involve a tax. In the interests of our subsequent comparison, we must, however, consider these insurance premiums to constitute part of the overall labour costs. At the same time, the basic structural parameters of the social insurance premiums, which belong to 3-5 branches of social insurance with the insurance contributions being paid into autonomous social insurance funds (for example, 6 branch funds and 6 local sickness funds operated in the basic Austrian “employee” insurance /and health/ insurance scheme. This year, they merge into a single Austrian health fund. Health/sickness insurance premiums account for 7.65% of wages!

Earnings ceilings are applied substantially in the individual social insurance branches of the Christian-democratic model and the same ceilings are also used to calculate the pecuniary benefits. In general, the ceilings amount to about 150-200% of the national average earnings of employees. Earnings ceilings (usually somewhat higher) also exist for the compulsory participation in the individual branches of social security; an insured individual may leave the system, if his or her earnings exceed this limit. A typical characteristic of the Christian-democratic model is the “halving” of the insurance premium between the employee and the employer, which is (has been) explained as an expression of the harmonisation of the opportunities and interests of both social partners in the social market economy. An exception is the social accident insurance, where the employer pays the entire insurance premium because this involves a work risk. This also usually involves the smallest entry in the overall insurance premiums, so we can disregard the non-halving of the premium for social accident insurance. The theory is also able to explain some state subsidies to a social insurance branch; for example, the state may or should finance the childcare credits in social pension insurance which constitute “state procurement” and not an insurance benefit. Employee social insurance premiums are deducted from the employee wage tax base (it is an employee cost from the point of view of the system).

Germany is an example of the Christian-democratic tax mix. The social insurance premiums are not locally recorded as part of the tax system. However, the situation is different in the OECD statistics [9] and the data from 2017 show that these premiums constitute 38% of total taxation and insurance revenues and that they are therefore the main German tax channel. The second largest tax channel is the income taxation in all forms (32%). The wage tax in Germany is progressive thanks to the progression of the tax rates (the upper marginal rate is 47.5%), moreover the earnings of up to 9,168 € per year (2019) are tax exempt. The third tax channel is the taxation of consumption (27%) which includes the value added tax. As such, the overall labour taxation in Germany as per the OECD concept is significantly more dominant than the taxation of consumption and the insurance premiums exceed the personal income taxation (38:23) within the framework of the labour taxation. The Christian-democratic model of payroll taxation therefore mainly consists of social insurance premiums and only secondarily of the progressive wage tax.

The social-democratic tax mix also “works” with social insurance contributions, but these insurance contributions are paid exclusively by the employer and are not used to finance the healthcare of the employee (and his or her family) unlike, for example, the situations in Germany and Austria. Here, the social insurance contributions are used (relatively more) in the interests of the entire economic and social policy, for example to support the employment of young and older individuals. This policy is or can be associated with the non-existence of an earnings ceiling for the payment of insurance contributions, whereby earnings ceilings are applied in relation to employees when calculating insurance benefits, for example when designating the amount of the contribution towards pension savings/insurance of the NDC type (the ceiling is around 120% of the national average earnings).

Sweden is an example of a social-democratic tax mix. The taxes on personal and corporate incomes account for 36% of the overall tax revenues. The share of income tax alone is about 27%. Social security contributions account for about 34%, while it is estimated that about 60% of these contributions have the character of a tax and only 40% can be standard social insurance contributions [13]. The employees pay contributions to NDC pension insurance at a rate of 7% (16% is credited to their personal account in the NDC system), but these contributions are deducted from the personal income tax. Employers pay contributions at a rate of 31.42% of the wages without any earnings ceiling. The taxation of consumption account for approximately 29% of the total tax revenue according to the OECD definition. The overall labour taxation amounts to about 60% of all tax revenue, while the contributions towards social security account for 36% of the total labour taxation; the remainder is the personal income taxation [4]. The small role of the state personal income tax (two rates: 20% and 25%, and a non-taxable minimum which is higher than the average annual wage) is also not without interest. The regional personal income taxes have flat rates ranging from 29.2 to 34.7% with substantially lower non-taxable minimums; regional tax revenues represent about 90% of all personal income tax revenues. The regions finance the healthcare, amongst other things. The social-democratic model of the labour taxation (in its Swedish version) therefore comprises approximately 55% of social security contributions in the shape of a proportional income tax and 45% of flat-rate municipal taxes and dual-rate state tax, the progressivity of which is given by the non-
taxable minimums. The deduction of employee contributions to pension insurance from the income tax base plays a non-systemic role here which clearly reduces the progressivity of the personal income tax.

The neo-liberal tax mix “knows” no social insurance contributions because all social security has been systematically privatised. The ideal neo-liberal tax would be a general tax on expenditure with a tax return which would apply a sufficiently high non-taxable minimum. This kind of consumption taxation is, however, very rarely practical and neo-liberals therefore now mainly do not recommend “leaving” income tax as the basic tax, but incorporating deductions of all income which is not directly aimed at consumption (this includes all capital incomes amongst other things) will be fundamentally modified. It is also necessary to deduct any certified private insurance and savings contributions, i.e. mainly contributions towards compulsory and voluntary pension savings or insurance, healthcare savings or insurance etc. The economy is also assisted from this point of view by the tax deductions of interest from mortgages and other loans. The neo-liberal tax model does not include the corporate income tax because it does not represent the taxation of the final consumption. The fundamental components of the neo-liberal tax mix therefore include substantially modified personal income tax which is supplemented in practice with a value added tax or a sales tax so that the tax burden is divided into two channels with lower tax rates. In the marginal neo-liberal variant of personal income taxation, this tax has a single rate and a tax credit (or a tax-free minimum), which replaces all social benefits.

Chile became famous for its neo-liberal pension reform from 1981. In 2017, Chile had the highest share of consumption taxation in its public revenues of all the OECD countries [1]: 55%. This share was even as high as 63% in 1990! Corporate tax occupies second place in the Chilean tax mix: 21% in 2017 and 12% in 1990. The personal income taxation was in third place in 2017 with a 10% share, while social insurance contributions (7%) were in fourth place, they include social health insurance which has escaped compulsory privatisation.

The compulsory contributions to private social security logically are not part of public revenues. Nevertheless, this fact does render the tax mixes of the affected countries significantly less comparable. This is substantial, for example, in the US where the insurance premiums for compulsory private health insurance are significantly high. Nobody has probably ever presented a proposal to extend the tax mix to include compulsory private insurance. However, the same does not apply in the case of the tax wedge (between the net wage and the labour costs for the employer); the tax wedge has been expanded to include non-tax compulsory payments in the compulsory payment wedge. Recently, Bruenig [2] calculated that health insurance provided via an employer in the US represents approximately 26.4 points of the overall American compulsory payment wedge of 43.2 points for a family with two children. This has catapulted the US into the 2nd place with regard to the amount (of this variant) of the compulsory payment wedge within the framework of the OECD countries (behind the Netherlands).

The post-communist tax mix developed under specific conditions in many post-communist countries, under the significant influence of neo-liberalism. The neo-liberal social security reforms in these countries have mostly been unsuccessful; either completely or partially. These countries have taken up the historical Christian-democratic model of social insurance, including social health insurance, which is manifested in the essential role of social security contributions in the tax mix. According to the OECD, the share of these contributions in 2017 was 44% in Slovakia, 43% in our country and over 41% in Latvia. On the other hand, the personal income taxation is relatively low: it accounts for 10-13% of public revenues in the stated countries. The taxation of capital incomes is also low, which “logically” follows on from the low taxation of wages. Estonia is considered to be a European pioneer in the flat taxation of income: in 1994, it introduced a flat tax rate of 26% on personal income and a corporate income tax with the same rate. The rate for these taxes was subsequently reduced to 20%; the value added tax also has the same rate. The corporate income tax concept is also quite unique: it taxes the distributed profits of companies; the dividends are not subject to tax at the personal level. The absolute majority of post-communist countries has followed in Estonia’s footsteps.

Slovakia introduced a uniform flat rate of 19% for all three taxes in 2004 like Estonia: the personal income tax, corporate income tax and value added tax. The Slovak tax reform also significantly influenced the experts from the Ministry of Finance of the Czech Republic: “Perhaps the most consistent and best-developed tax reform which concerns the flat tax, and which therefore deserves the closest attention, is the Slovak version with its unitary rate of 19% for individuals and corporate entities, as well as for VAT (true flat tax). This is, in fact, the rate recommended by Hall and Rabushka” [7].

The Hall-Rabushka modified neo-liberal tax concept replaces the generally recommended universal tax on consumption with two taxes with the same rate, namely an individual wage tax and a business tax, for practical reasons, whereby each of them only taxes a specific part of the value added. An advantage of this proposal (was and is) that these two “partial” taxes gel with the existing American personal income tax and corporate income tax; the proposal was presented as a substantial simplification of these two taxes [6]. At the same time, both existing taxes were suitably “modified” in the spirit of neo-liberalism. The new personal income tax was intended to tax wages only and therefore not any interest, dividends or other capital incomes. At the same time,
Hall and Rabushka “kept” the tax exemptions for the payer and his or her family from the existing personal income tax, so that this resulted in a progressive tax. Interest was not deducted from their business tax base, but investments were fully and immediately deducted (instead of write-offs). Both taxes were intended to have the same flat tax rate, i.e. 19%. The flat rate connects these two taxes: “Our flat tax adheres to the principle of a consumption tax: people are taxed on what they take out of the economy, not on what they put in” [6]. The Hall-Rabushka proposal has served as the blueprint for several proposals to reform the US federal tax system, but it has never been realised: it was simply too radical, amongst other things because American personal income tax has a large number of tax deductions which are strongly supported by lobbyists. However, the Hall-Rabushka concept has been relatively successful in post-communist countries. The irony of fate, however, is that it did not replace (and indeed could not have replaced) the already existing (and compulsory in the EU) value added tax. Value added tax was “additionally” packed in with the taxation of personal and corporate income with the same flat rate without this making any sense.

The concept of a single flat rate for the stated three taxes subsequently fell apart in a number of post-communist countries. For example, Slovakia introduced a second personal income tax rate (25%) in 2013, the basic value-added rate rose to 20% and a reduced rate of 10% was introduced for this tax, while the corporate income tax rate was increased to 22%.

The introduction of the taxation of the super-gross wage from 2008 was a small Czech contribution to the realisation of the neo-liberal tax policy. It was preceded by an unrealistic election promise by the ODS party to introduce a flat personal income tax rate of 15%. To realise it, the base for this tax had to be increased by the insurance contributions paid by the employers and, in addition to this, the deduction of the insurance contributions paid by the employees from the tax base was cancelled. We therefore became the only state in the world where the social security contributions paid by the employer are included in the personal income tax base. The tax base for single employees was thus increased by 54% [14]. The model anticipated the privatisation of social security, including an increase in the level of gross wages to the level of the total labour costs (the super-gross wage). If we ignore the unsuccessful attempt at the partial privatisation of public pensions, all that essentially “remained” from the concept of taxing the super-gross wage is the low taxation of capital incomes thanks to the 15% rate. Currently, the third consecutive Czech government has included the abolishment of the taxation of the super-gross wage as part of its program.

The individual social taxation models have their own internal logic which has developed from the given social philosophy or public policy. They can or could constitute the basis for or the objective of the tax policy of the appropriate political parties. If we proceed from the existence of value added tax and selective consumption taxes in the EU and in other countries, it becomes clear that the individual social taxation models differ mainly in their approach to social security contributions and to the role and structure of the personal income tax, followed by the corporate income and capital income taxation.

3 Social security contributions

According to the OECD the Czech “structure of government revenues is unbalanced, with a heavy reliance on social security contributions. While government tax revenues were almost 35% of GDP in 2016, social security contributions were 14% of GDP... In terms of collected social security contributions, the Czech Republic ranks among the highest across the OECD. At the same time, personal income tax revenues are low... VAT revenues are above the OECD average... Imbalances in the structure of government revenues contribute to a relatively high cost of labour. The tax wedge is the 6th highest across the OECD and the average rate of employers’ social contributions is the second highest” [10], see Figure 2. The OECD recommends us to „rebalance tax revenues by reducing social security contributions and raising indirect taxes (VAT compliance and environmental taxes).” The OECD specifically offers us 4 scenarios for increasing the VAT rate which should enable a reduction in the social security contributions by 1% of GDP (the 1st scenario: increasing the basic rate to 25%, the 4th scenario: cancelling the reduced VAT rates) [10].

The OECD’s argumentation in favour of reducing the overall rate of Czech social security contributions is more than problematic. One weakness lies in the very use of the tax wedge: its imperfect depiction of the wedges between net wages and the labour costs in a number of OECD countries (but not in Czechia). We have already shown above that the low wedge in the US has been essentially influenced by the non-inclusion of compulsory health insurance premiums and this is just one of the extreme examples. The rectification of the OECD tax wedges will substantially raise the average OECD wedge and Czechia will be counted as below-average. The OECD’s recommendation of increasing the value added tax rate or rates is also more than problematic in that the OECD has already confirmed that this taxation is above average in our country.

An analysis of the social security contributions not only in our country should constitute part of a social security analysis, which should clearly show the role of insurance in financing the individual branches of social security.
Social security contributions should definitely not substitute the general taxation of income or consumption. The ideal basic general tax may only involve the income or consumption taxation. According to English and most taxation theoreticians, such a tax should be a general income tax, according to the neo-liberals it should be a general consumption tax. Model social insurance premiums are not a tax, because the pecuniary benefits are earnings-related. Not everything in the world which is designated as social insurance is completely or at least predominantly real social insurance. That is why the term social security contribution exists, as it is essentially wider than the term social insurance premium. When analysing Czech contributions to social security, we must also pose the question as to whether and to what extent these contributions are insurance premiums at all.

**Figure 2** - Average rate of employer social security contributions. Source: [10]

![Average rate of employer social security contributions](image)

The Czech “general health insurance premium” is fully, without any doubt a tax and not a social insurance premium from an economic point of view. The amount of the premiums (with a rate of 13.5% of the gross wage!) is not in any way projected into the provision of public healthcare. There are also no rules for adjusting the rate of the contribution to the amount of the expenditures for this care in total or at the (seven) individual health insurance companies. Czech health insurance premium is therefore close to the income taxation, but it is of course a bad income tax, mainly because it does not apply to capital incomes (the OECD has, however, recommended that we extend the tax base to include these incomes). On the other hand, however, a lump-sum contribution is paid by “persons without taxable incomes” (currently 1,803 CZK per month). A gross imbalance lies in the taxation of employees and self-employed and a special problem involves the insurance contributions paid by the state on behalf of “state insureds” (currently 1,018 CZK per month) which constitutes a de facto state subsidy to the health insurance system which has been separated from the state budget (unlike the remainder of the social security system). The health insurance system is a de facto trust fund which is administered by the General Health Insurance Company of the Czech Republic. The fund is designated as “a special public health insurance account” and it is used for the realisation of the “100% redistribution of the insurance premiums” between the 7 health insurance companies and for the collection of the insurance contributions for “state insureds” which are paid by the state. This “redistribution of the premiums” results in the provision of risk insurance premiums for the clients of the individual health insurance companies according to the same or comparable principles (formulae), similarly to the way in which the central public healthcare fund functions, for example, in Germany or the Netherlands. The essential difference in comparison with these countries lies in the fact that the health insurance companies collect the insurance contributions themselves in our country. Czech health insurance contributions therefore constitute a special-purpose income tax, the yields of which are designated exclusively for the financing of healthcare. “Though tax hypothecation might have an expedient role to play in getting a specific project or part of a programme undertaken, it is not a solution to the large-scale and very difficult problems that governments face in making decisions on taxes and public spending” [16].

Czech employers pay premiums for the sickness insurance and the contribution to the state employment policy at a total of 3.3% of gross wages. From our point of view, the most significant fact is that these two social security sub-systems predominantly have the character of social insurance. The Czech old-age “pension insurance” scheme is approximated by 70% a liberal flat-rate pension and only by 30% a social insurance premium. In accordance with the modern pension theory and policy, it is necessary to divide this “pension insurance” into a solidary pension pillar (financed from general taxes) and a social old-age insurance (financed by premiums). The social security contributions, except for the aforementioned “health insurance premiums”, constitute regular revenues of the state budget and the corresponding social security benefits are mandatory expenses for the state budget. In essence, no direct link exists between these revenues and expenses within the state budget, these links are typical for classic social insurance systems. It therefore generally applies that these Czech “social insurance
premiums” are approximately one third real social insurance premiums and two thirds are an unjust income tax, because it is degressive. In this, we are essentially different from all our neighbouring countries.

The completely predominant non-insurance essence of the Czech social security contributions has created a significant room for the rationalisation of these contributions, for the substantial reduction of the rates of these contributions, for the tax reform.

4 Personal and corporate income taxes

Figure 3 confirms that Czech personal income tax revenues are low. Despite this, we have witnessed repeated attempts to reduce the tax rate on personal income in parallel with proposals for the cancellation of the concept of the super-gross wage. The program declaration of the existing Czech government states: “We will cancel the super-gross wage for the personal income tax, and we will propose a new reduced rate of 19% on the gross wage. We will preserve the existing solidarity tax increase by introducing a 23% rate on the gross wage. We will allow entrepreneurs to deduct three quarters of their insurance contributions. The changes in the system must bring a reduction in the tax burden on employees by one percentage point” [15]. The first proposal by the Minister of Finance to cancel the super-gross wage in 2018 was in compliance with the government declaration in that “the cancellation of the super-gross wage and the associated simplification and increased transparency of the tax system was one of the promises of previous government which had not been realised on reasonable grounds. The cancellation of the super-gross wage without a change in the rates for any other parameters is merely an administrative measure which would not bring about any real change to the tax burden. It was therefore responsible to wait to cancel the super-gross wage until such time when the improved collection of taxes would enable the reduction of employees’ real tax rate from 20.1 to 19%.”[12]

Figure 3 – The Czech fiscal burden on individual incomes. Source: [10]

The Minister is correct: the departure from the taxation of the super-gross wage alone would have been self-serving and pointless. However, it is not only necessary to “monitor” the impact on the self-employed, but also on tax deductions whenever a change is made to the structure, because an increase in the nominal tax rate also leads to an increase in tax expenditures, for example on state support for financial products. As such, the concept and extent of any such tax expenditures should be duly considered. Consideration should also be given to the liquidation of the principle of the flat nominal tax rate. Is it truly necessary to (“definitively”) implement a second tax rate (increased by only 4%) instead of the current solidarity tax increase with a 7% rate on gross wages which exceed the average national earnings by 400%? And alternative options for reducing the tax burden should, of course, also be considered. Why was a reduction in the rates for social security contributions not proposed? Is there to be an increase in the rate of withholding tax on dividends and other capital gains? The absence of an expert approach by the Ministry of Finance is clear. The aforementioned proposal was rejected by the Prime Minister (despite the fact that it was in compliance with the government’s declared program) with the justification that the proposal did not have political support from other parties without the entire proposal ever having been published (meaning that it could not gain any wider political support). They were keeping something essential from us…

Coincidentally, the realisation of the basic manoeuvre in the Minister’s proposal, i.e. the introduction of a 19% personal income tax rate, would have led to the realisation of the Hall-Rabushka plan for the introduction of two income taxes with one 19% tax rate: corporate income tax in our country currently also has a flat 19% rate. The completion of the Hall-Rabushka neoliberal concept would require the cancellation of the taxation of capital incomes (interest and dividends). The Prime Minister would not be against this, but he could fear a “hailstorm”
from his coalition partner or the opposition, because it would be apparent that any such tax reform is mainly beneficial to the oligarchy. Any additional joy at the application of the Hall-Rabushka plan would be slightly spoilt by the fact that there is no need for us to force ourselves into the (“definitive”) introduction of a 2nd personal income tax rate without a corresponding analysis of the completely different Czech conditions.

A remarkable proposal for the reform of personal income tax was leaked from the inter-resort expert meetings of the Ministry of Finance and the Ministry of Health at the end of February 2019. The Minister of Finance proposed raising the rate of health insurance contributions paid by employees from 4.5% to 8.2% of the gross wage (i.e. by 3.7 percentage points), while at the same time cancelling the insurance contributions paid by the state on behalf of “state insured”. (From our point of view, this insurance contribution is a remnant of the efforts to implement a neo-liberal healthcare reform.) The personal income tax rate (15%) would have remained unchanged, but the tax base would have changed from the super-gross wage to the gross wage. This would have led to a de facto reduction in this tax rate by 5.1% of gross wage, so employees would have gained 1.4% of their wage due to this reform [11]. This proposal was opposed by “healthcare experts”, including lobbyists, who consider the periodic increases in the state’s low payments to the “special public health insurance account” to be a more suitable method of implementing growth in the expenditure on healthcare than the increases in the insurance contribution rate. Subsequently, the proposal of the Minister of Finance was also opposed by the Prime Minister. Thus, the plan for “a large tax reform including smaller taxes, but higher health insurance” finished. The government, or rather its marketing experts, do not (yet) have any other plan.

If the politicians or the oligarchs do not insist on the preservation of the illogical post-communist tax model, there is a simple reform of Czech personal income tax available which involves the inclusion of the employees social security contributions into the tax on employment income or in the overall personal income tax. The reason is simple: under the given model of financing of the public healthcare expenditure, the insurance contributions for general health insurance are completely unnecessary. Approximately 70% of the insurance contributions for pension insurance are also unnecessary and we can therefore reduce them by 19-20 percentage points. So, we have the option of cancelling insurance contributions at around 33% of the gross wage which we can (should) transform to other taxation. To begin with, we can settle for 11% of the gross wage which the employee pays and by which we will increase the tax rate on employment income to the resulting 31.1% of the gross wage. Given that we are not beholden to the post-communist tax model which unilaterally favours the taxation of capital incomes (by means of the extremely high labour taxation), we can use this 31.1% rate in all personal income taxation, i.e. also when taxing all personal capital incomes.

Health insurance contributions should not be left out of any reform of income tax, as they include several irrational and easily removed structural elements, such as the isolated collection of the insurance contributions by the individual health insurance companies, the payment of the insurance contributions for “state insured” from the state budget and the payment of insurance contributions by individuals “without any taxable income”. All of this may be cancelled in a single stroke. The cancellation of the insurance contributions from individuals without any income (from what are they supposed to pay it?) will cost the system 1% of its revenue. Approximately, the same applies to the isolated collection of the insurance contributions, so the total effect will be negligible. We replace the payment of the insurance contributions for state insureds by increasing the personal income tax rate, the remainder up to 11% of the wage reduces the rate of the health insurance contributions. All pension insurance contributions will now be paid by the employer within the framework of the existing social insurance rate of 34% or 33.8% (from July 2019). A small health insurance contribution thus remains within the framework of employer insurance contributions and we can include it in the sickness insurance contribution.

There is no reason to reduce the personal income tax rate with the exception, of course, of populist marketing. Quite the contrary, this income tax has a clearly low rate which can, from an expert point of view, be simply raised by including the insurance contributions paid by the employee into the employment income tax. The overall income taxation of natural persons needs to be further adapted to this. International comparisons have shown that a personal income tax rate at the level of 31.1% is at the lower edge of comparable personal income taxation in western countries. The progressive system of personal income tax in our country involves a basic tax credit per payer of 2,070 CZK per month, which has not been adjusted for inflation since 2008. It is advisable to adjust this tax credit for inflation so that the progressiveness of the tax, including the insurance contributions paid by employees, reaches the average international level, which for that matter was the case in 2008. The corresponding rate of the tax credit is 8.9% of the national average wage. This would therefore amount to 2,910 CZK per month in 2019. This proposal to increase the basic tax credit by 840 CZK per month need not be seen as a marketing gift to voters, because Czechia needs to rid itself of its extremely high fiscal costs arising from supplementary pension savings (370 CZK per month per participant) and the state contribution to the building savings (up to 167 CZK per month). The degree of taxation on the average wage would thus newly be 22.2%. Figure 4 compares this proposal with the Minister’s original proposal. Our proposal eliminates the insufficient progressivity of the taxation, including the burden on very low incomes due to the flat insurance rate of 11%.
The progressivity of the income taxation might be further increased by cancelling the basic tax credit for high income groups (while maintaining the flat tax rate).

**Figure 4** – Personal income tax proposals: Minister of Finance (MF) and author. Source: Author

The personal capital income taxation is very low in our country: the “flat” income tax rate of 15% is applied. Deloitte has stated that the European average for capital income taxation in 2017 was 26.78% on interest and 26.47% on dividends [3]. In general, the same degree of taxation should be applied when taxing these incomes and employment incomes. The withholding tax is often used abroad in this case, including as an option. Either way, this taxation should rise significantly in our country. There is no reason to continue to apply the post-communist model of the low taxation of capital and the high tax burden on labour.

The classic corporate income taxation theory and policy was based on the so-called material payment ability of joint-stock companies or on their large market strength which manifests itself in their profits. This was also used to explain the necessity of using profitability surcharges [5]. Corporate tax rates were relatively high after the 2nd World War, but these rates began to fall significantly from 2004, while this was balanced out to a significant extent by the expansion of the tax base. In recent years, there has been regular talk of the ongoing drop in rates, especially in the EU, as a “race to the bottom”. The Czech corporate tax rate of 19% could have been considered to be slightly below average two years ago, which generally corresponded to the rates in other smaller countries. However, the race to the bottom has continued and it is possible to expect that we will have to respond to it within the next 2 years.

In the case of corporate tax the connection to personal income tax is also important. If the aforementioned classic concept of corporate tax essentially “falls”, the (neo-liberal) theory which rejects the double taxation of dividends and at the same time expediently unifies the taxation of dividends and interest (from corporate bonds), which can be encapsulated in the concept of the “comprehensive business income tax” (CBIT) which was proposed by the US Treasury in 1992, should be implemented. In the case of the CBIT, interest is not a deductible item from the corporate tax base. The CBIT rate was proposed at the highest upper limit rate for the personal income tax, which would correspond to 31.1% under Czech conditions after the proposed reform of the employment income taxation. In total, the double taxation of dividends in our country currently amounts to 31.15% given the full allocation of profits to the dividends. The taxation of capital incomes and corporate incomes according to the CBIT should therefore not fall below 31.1% in Czechia. The advantage of the CBIT for our country lies in the fact that any profits created in this country would be fully taxed here.

**5 Conclusion**

Czech social security contributions are extremely high, and they unilaterally increase the labour costs. It is certainly not rational to increase the health insurance contribution rate at the expense of the personal income tax. Indeed, the opposite should apply: health insurance contributions constitute the unjust income taxation and it is possible to essentially cancel them under the existing Czech conditions or to include them in the taxation of employment income. The reduction in public revenues because of the cancellation of these contributions paid by individuals without any taxable earnings will be recouped by the cancellation of the collection of the insurance contributions by the (seven) health insurance companies. The revenues of the health insurance trust fund will be replaced with a share of the personal income tax within the framework of the budgetary allocation of taxes. The remainder of the health insurance contributions (2.5% of the gross wage) will be levied to the state budget as (increased) sickness insurance contributions.

The reduction of the flat personal income tax rate to 19% of the gross wage is not rational, because we need to eliminate the unjust health insurance contributions which are only collected from labour earnings. The reform of the tax mix by replacing 81% (11% / 13.5%) of health insurance contributions with the flat employment income taxation will also lead to the extension of this flat 31.1% tax rate to capital incomes. At the same time, we
anticipate a substantial increase in the basic tax credit per payer in the interests of increasing the progressivity of the personal income tax to the average international level which corresponds to the degree of progressivity of Czech personal income tax achieved after the reform of 2008. This substantial increase in the basic credit will enable the government to keep its promise to reduce the income taxation and at the same time to reform the extremely high state support for pension and building savings.

The international “race to the bottom” in corporate income tax rates is forcing Czechia to make a further reduction in this rate. At the same time, it is not feasible to reduce the existing overall taxation of capital incomes (in the form of a tax on corporate income and a withholding tax on dividends) to 31.15%. We have reached a conclusion that it is useful to apply the comprehensive business income tax concept, which taxes corporate incomes without the deduction of interest costs, while dividends will no longer be taxed (in Czechia). This would lead to the strengthening of the role of corporate income tax in the Czech tax mix and to the systemic incorporation of corporate tax into general income tax. This should be accepted by both liberals and neo-liberals.

References


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