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Tax systems in the Czech Republic and the Slovak Republic: comparison with an emphasis on income tax

Abstract. The purpose of this article is to compare the methods of income taxation in the two neighbouring states - the Czech Republic and the Slovak Republic after more than a quarter century since the disintegration of their previous unified state. The article also focuses on the question of which of the two tax systems is more socially just and whether there is a realistic assumption that there will be reintegration of the principles of income taxation of both states within the European Union in the future. Several research methods were applied, dominated by the method of analysis and the comparative method. The selection of income taxes was not arbitrary. The method and rate of taxation plays a vital role in the social status of citizens of a particular state. Income taxes, on which both global and European coordination and harmonization processes have had very little impact, have become more important. Due to this fact, and also because of the free movement of labour, the applied way of income taxation within various territories may become an essential factor in tax competition between countries. Based on the analysis and comparison of individual tax practices related to the taxation of income, it can be stated that the income taxation between the two states does not differ fundamentally even after a quarter century of their independence.

We assume that the Slovak Republic is committed to looking for ways to develop more efficient methods of taxation of income even at the cost of some of the measures which have not been justified in practice yet. The Czech Republic is more conservative in this direction. It does not make radical changes and plays a waiting game to carry out the relevant measures later. Based on our analysis of the income tax systems both in the Czech Republic and the Slovak Republic, we conclude that the income tax system in the Slovak Republic is more effective, less costly and more socially just than the income tax system of the Czech Republic.

Keywords: Business Tax; Comparison of Tax Systems; Personal Income Tax; Tax Harmonization; Slovak Republic; Czech Republic

JEL Classification: H20; K34

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Порівняння податкових систем Чеської та Словацької Республік з акцентом на податок на прибуток

Анотація. Метою цієї статті є порівняння способів оподаткування доходів у двох сусідніх країнах: Чеській та Словацькій Республіках за чверть століття після розпаду їхньої єдиної в минулому держави. Визначено, система оподаткування котрої з країн є соціально більш справедливою, та чи резонним буде припущення, що в майбутньому відбудеться реінтеграція принципів оподаткування доходів в обох країнах в рамках ЄС. Вибір податку на прибуток не був довільним. Метод і ставка оподаткування відіграють важливу роль у визначенні соціального статусу громадян окремо взятої країни. Податок на прибуток, на який глобальні та європейські процеси координації та гармонізації мають незначний вплив, набув особливої значимості. У зв'язку з цим, а також беручи до уваги вільне переміщення робочої сили, спосіб оподаткування доходів у різних країнах стає істотним чинником міжнародної податкової конкуренції. На основі аналізу та порівняння оподаткування доходів можемо стверджувати, що оподаткування доходів у Чеській і Словацькій Республіках суттєво не відрізняється. При цьому в Словаччині спостерігається тенденція до пошуку й розробки більш ефективних методів оподаткування доходів. Чехія є більш консервативною. Вона не вдається до раптових радикальних змін й очікує слушної нагоди, щоб вжити відповідні заходи. На основі аналізу систем оподаткування доходів як у Чеській, так і в Словацькій Республіках робимо висновок, що система оподаткування доходів у Словаччині є більш ефективною, соціально справедливою та водночас менш затратною, ніж у Чеській Республіці.

Ключові слова: податок на підприємницьку діяльність; порівняння податкових систем; податок на доходи фізичних осіб; гармонізація оподаткування; Словацька Республіка; Чеська Республіка.

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Сравнение налоговых систем Чешской и Словацкой Республик с акцентом на налог на прибыль

Аннотация. Целью данной статьи является сравнение способов налогообложения в двух сопредельных странах, а именно: Чешской Республике и Словацкой Республике спустя четверть века после распада их единого в прошлом государства. Также внимание уделено определению того, система налогообложения которой из названных стран является социально более справедливой и будет ли резонным полагать, что в будущем произойдет реинтеграция принципов налогообложения доходов в обеих странах в рамках Европейского Союза. При проведении исследования были использованы несколько методов, основными из которых были метод анализа и метод сравнения.

Выбор налога на прибыль не был произвольным. Метод и ставка налогообложения играют важную роль в определении социального статуса граждан отдельно взятой страны. Налог на прибыль, на который глобальные и европейские процессы координации и гармонизации имеют незначительное влияние, приобрел особую значимость. В связи с этим, а также принимая во внимание свободное перемещение рабочей силы, способ налогообложения доходов в разных странах становится существенным фактором международной налоговой конкуренции.

На основании анализа и сравнения налогообложения доходов двух вышеупомянутых стран можем утверждать, что налогообложение доходов в Чешской Республике и Словацкой Республике существенно не отличается даже спустя четверть века после того, как эти страны стали независимыми. При этом можно предположить, что в Словацкой Республике наблюдается тенденция к поиску и разработке более эффективных методов налогообложения доходов, в том числе и за счет мероприятий, целесообразность которых еще не была доказана на практике. В этом отношении Чешская Республика является более консервативной. Эта страна не прибегает к внезапным радикальным изменениям и ожидает удобного случая для того, чтобы принять соответствующие меры. На основе систем налогообложения доходов как в Чешской, так и в Словацкой Республиках делаем вывод, что система налогообложения доходов в Словацкой Республике является более эффективной, социально справедливой и в то же время менее затратной, чем в Чешской Республике.

Ключевые слова: налог на предпринимательскую деятельность; сравнение налоговых систем; налог на доходы физических лиц; гармонизация налогообложения; Словацкая Республика; Чешская Республика.

1. Introduction

The issue of taxation does not lose its relevance because it affects almost every citizen. Nowadays, however, this area has undergone considerable changes, mainly due to the globalisation of the world economy. Thanks to this phenomenon, we observe not only movement of capital, but also migration of labour force between different parts of the world. National governments are compelled to respond adequately to these new conditions to avoid disruption of basic state functions. Among the key elements of the state stability, we include the methods of taxation, because tax revenues are a crucial part of the state budget. Mainly an effort to balance the state budget leads heads of states to seek ways how to, on one hand, secure enough revenues for the state budget and, on the other hand, to keep the basic principles of taxation.

Although outwardly it seems that every sovereign state seeks the ways on its own, it must be admitted that, especially at this time, this decision is not entirely independent. No state nowadays stays in total isolation from the outside world. In the age of modern technologies, political and economic decisions may represent both a major competitive opportunity and a major competitive threat to neighbouring and distant economies. Within Europe, this question seems even more acute, because the European Union ensures free movement of persons, goods, services and capital. Therefore, each member state of the European Union tries to make its own tax system attractive and appealing to subjects to taxation of the entire European Union. Otherwise, the outflow of capital may begin, which would have a negative impact not only on the economic but also on the political situation in a particular state. Competing risks escalate geographically, culturally and linguistically. Czech Republic and the Slovak Republic appear to be a typical example of this competitive relationship.

The focus of this article is therefore the tax systems in the Czech Republic and the Slovak Republic. We focus on how the tax systems of these two countries, which for more than seventy years had a common tax policy, differ, compete with each other or adapt, and which tax system is more socially just. The starting point was the tax system in force in both

countries on the date of the establishment of two independent states on 1 January 1993. The date was not chosen arbitrarily. On that date, a new tax system of the Czech and Slovak Federative Republic was supposed to enter into force. As a result of political changes occurring prior to the above date, there was a collapse of the unified state. Consequently, the two successor states took the tax laws enacted in the previous period into their national laws.

In a global context, income taxes are traditionally considered a stable source of income for the state budget, although it must be admitted that their importance has been diminishing in recent decades, and the attention has been shifted primarily to consumption taxes which currently constitute an essential source of tax revenue for state budgets. This trend is accentuated particularly by heavy administrative burdens, long periodicity and volatility of the amount of income tax receipts. On the other hand, it must be noted that income taxes continue to be a powerful instrument of national governments, both as a means of motivating behaviour and decisions of individual taxpayers and as a means of promoting social justice.

2. Methodology

To ensure that the purpose of the article is achieved, we have used certain methods of scientific work. The method of description and the method of synthesis applied in the breakdown of literature sources dealing with taxation are the methods used in this article. However, the most important methods used in this article are the method of analysis and the method of comparison. The method of analysis is applied in the analysis of individual income taxes in both states and in the analysis of bottlenecks in legislative adjustments to the income taxes in both states. The method of comparison follows the method of analysis, which is a logical outcome of the detailed analysis of the researched phenomena. The analysed provisions of tax laws were subsequently compared and the identified differences were recorded.

General conclusions with the use of the induction method were drawn from the analysis and comparison of various provisions of the tax laws in both states. When comparing the impacts of various provisions of the tax laws on different social groups, we used the method of deduction.

3. Brief Literature Review

Issues of taxation are frequently mentioned in the literature, but in the context of a particular state. In terms of legal liability, we must first mention the laws which have been approved by both states and become a springboard for writing this article. We must also take into account the fact that if both states sign international treaties and agreements, which are contrary to the provisions of the national laws, then international agreements possess greater legal force. The same applies to the EU decisions which are legally binding for all the EU member states, regardless of whether they have been transposed into the national legislation. Also, we must not forget about those EU directives, which member states are obliged to incorporate into their national laws. Nevertheless there is a time lag between the moment of approval of such directives in the EU and the time of their actual approval to become a law in each of the member states.

Outside the legal framework, we find a wealth of Czech and Slovak literature dealing with the issue of taxation. From our perspective, individual sources may be synthesised into the following groups:

Macroeconomic perspective - monographs, textbooks and university textbooks dealing with the tax system as a whole. Individual macroeconomic indicators are tracked, especially in relation to gross domestic product. This group may also include the literature on public finances with the forefront of the revenue side of the state or local budgets by Kubatova (1994, 2003, 2005, 2010), Široký (2003, 2008, 2010, 2012), Lénartova (2004), Medved' (2009), Medved' and Nemeč. (2007) Vančurova and Lachova (2008, 2010, 2014) who focus primarily on taxation issues.

Microeconomic perspective - monographs and professional publications of several authors, based on the position of taxpayers. Attention is focused on the analysis of individual tax mechanisms needed for the correct taxation in accordance with tax optimisation. A special subgroup in this area consists of scientific publications dealing with the accounting management. Although accounting in both countries constitutes a relatively independent circuit, because of the financial statements as part of closing operations, this circuit connects to the tax area. The authors of this type of literature are primarily tax advisors.

Legal view - taxes are understood here in their broad sense, including taxes, duties and other compulsory payments. Tax laws are viewed as primary legal acts which are subsequently followed by secondary acts. Under this perspective, attention is also focused on legal support necessary for the avoidance of double taxation. The authors dealing with this issue include Bakes (2006), Babčák (2008, 2012), Pauličkova and Bakes (2007) and others.

International comparison perspective - the tax system is compared with tax systems of other states. Comparisons usually include states of particular economic grouping. Great attention is paid to the agreements on avoidance of double taxation, harmonisation and cooperation in the field of taxation. On the other hand, this literature frequently discusses topics dealing with tax competition and harmful effects of tax havens. The authors publishing in this area include Nerudova (2011, 2014), Široký (2003, 2008, 2010, 2012), and Lénartova (2004).

In terms of the topic presented in the article, we have found only one college textbook by Pauličkova and Bakes (2007). A closer analysis, however, proved that the book consists of two separate parts which deal in isolation with the analysis of the tax systems of both states without critical elements of the comparison of tax systems between them.

From the European Union point of view, the literature on the income taxation and tax reforms include several publications. Botman and Daninger (2007) analysed tax reform and

debt sustainability in Germany using the International Monetary Fund's Global Fiscal Model. During the 1990s, Germany was considered to be a high tax country; therefore Germany introduced a tax reform in 2000 with corporate and personal income tax rates being reduced in 2001. Schreiber (2000) analyses this tax reform, as well as the effects of this tax reform for foreign investment, from an international perspective. Fossen and Steiner (2006) further discuss the impact of the tax cuts of 2000 on transitions and the rate of self-employment.

A relatively recent income tax reform was presented by the Austrian government in March 2015. Bruckbauer and Pudschedl (2015) assume that the tax reform will result in significant tax reductions and provide important tax relief to all taxpayers with particular benefit to small wage earners. A summary of the income tax in France during the last century (1914-2014) was provided by André and Guillot (2014).

4. Purpose

The purpose of this article is to compare the methods of income taxation in the two neighbouring states - the Czech Republic and the Slovak Republic after more than a quarter century since the disintegration of their previous unified state. The article also focuses on the question of which of the two tax systems is more socially just, and whether there is a realistic assumption that there will be reintegration of the principles of income taxation of both states within the European Union in the future.

5. Results

Based on the survey it can be stated that Act No. 586/1992 on income taxes in the Czech Republic still retains the same structure as it was before the disintegration of the common state. Although the Law has been amended many times and undergone many changes, it has not been replaced by any other law.

In the Slovak Republic, the Law on income taxes is also subject to frequent amendments, but unlike in the Czech Republic, there have already been three changes since 1993. First, there was an adoption of Act No. 286/1992 which was replaced by Act No. 366/1999 in 2000. The last major change to the legislation relevant to the income tax was in 2003 when Act No. 595/2003 as of 1 January 2004 was adopted.

In both countries, the institutions responsible for tax collection and processing are the Financial Administration (*Finančná správa*) operating under the Ministry of Finance.

In the Czech Republic, the legislation devotes part of the Act to personal income tax, while another separate part addresses business tax followed by common provisions. Also, all previously adopted laws on income taxes in the Slovak Republic have the fourth part dealing with tax collection and payment. This part consists of three sections, which contain separate as well as common provisions for individuals and legal entities, which does not always contribute to the clarity of the Law. On the other hand, the structure of common provisions in the Czech legislation does not add to the clarity of the Law either, because the common provisions and the provisions dealing with only one tax are mixed together.

With regard to the tax collection in the Czech Republic and the Slovak Republic, Table 1 and Figure 1 show the collection of personal income tax and corporate tax in both countries.

Tab. 1: Taxes on individual or household income and on the income or profits of corporations, in million EUR

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 ^e
	Personal income tax									
Czech Republic	5616.8	5646.9	5126.5	5191.4	5804.7	5 731,0	5797.3	5849.4	6031.9	5526.2
Slovakia	1623.1	2 019,0	1793.7	1789.6	1999.9	2 122,8	2 175,0	2275.1	2464.4	2379.4
	Corporate tax									
Czech Republic	6165.1	6491.9	5005.8	5038.9	5247.3	5 069,0	5102.3	5224.8	5751.6	5785.5
Slovakia	1637.2	2011.6	1 577,0	1659.2	1699.2	1714.8	2117.8	2504.4	2945.3	3187.4

Note: e - estimates based on data from the Financial Administration of the Czech Republic and the Financial Administration of the Slovak Republic.

Source: Compiled by the authors based on data from EUROSTAT (2007-2015), Financial Administration of the Czech Republic (2016), Financial Administration of the Slovak Republic (2016) [28]

It is obvious from Figure 1 that the collection of both taxes has risen in Slovakia from EUR 1.62 billion (personal income) and EUR 1.64 billion (corporate income) in 2007 to EUR 2.46 billion and EUR 2.95 billion in 2015, respectively.

A different situation occurs in the Czech Republic, where the collection of personal income tax increased from EUR 5.62 billion in 2007 to EUR 6.03 billion in 2015; however, the corporate tax collection decreased from EUR 6.17 billion in 2006 to EUR 5.75 billion in 2015.

From a relative point of view, there was a growth in tax collection by 52% for personal income tax and by 80% for corporate tax in the Slovak Republic between 2007 and 2015. In the Czech Republic, an increase in the collection of personal income tax in the same observed period was only by 7.5% for personal income tax with a decline in the collection of corporate tax by -6.7%.

Preliminary estimates available from the Financial Administrations of both countries for the fiscal year of 2016, suggest some changes especially for personal income tax. In both countries, the estimates are in favour of a decrease in personal income tax between 2015 and 2016 by 7.8% in the Czech Republic and by 3.5% in the Slovak Republic respectively. On the other hand, preliminary data suggest an increase in the corporate tax in both countries with a higher increase in the Slovak Republic (8.2%) compared to the Czech Republic (0.6%) in future.

Based on the analysis and comparison of individual tax practises in the taxation of income, it can be stated that the income taxation does not differ fundamentally in the two states even after a quarter century of their independence. This hypothesis was valid until 2003, when the overall arrangement of the laws and most fiscal institutes were nearly identical.

The biggest breakthrough came after the adoption of Act No. 595/2003 on income tax in the Slovak Republic. This Law disrupted the established order in both states, not only by an effort to simplify the taxation system, but mainly due to a flat tax rate. It seemed that the tax legislation of the two countries would continue to develop independently.

In 2006, the Czech Republic left the system oriented towards the deductible item from the tax base and strengthened the focus on the minimal tax base and tax credits. In contrast, the Slovak Republic focused mainly on the social impact of

tax allowances. The success of the Slovak tax reform and the political situation in the Czech Republic made it a competitive advantage of the Slovak Republic.

The Czech Republic reacted in 2008, when it also adopted a system of income taxation based on the linear tax rate. The reform in the Slovak Republic also included tax advantages for children called tax bonus. The Slovak Republic gradually continued in its progressive activity in an attempt to discover the mechanism that would help to find a fair and socially appropriate way of income taxation. For this reason, on the one hand, a novelty called the employee bonus was introduced and on the other hand, a certain tax share paid to the distinctive purposes was applied.

As regarding business taxation system, it remained basically the same. Minor differences occurred only partially in the content of individual elements. Nevertheless, the amendment to Act No. 595/2003 shows that attention of the law makers is slowly shifting to efforts to streamline tax collection from business income tax, for example by introducing a minimum tax liability.

In the Czech Republic, the efforts focused primarily on the precise definition of the various institutes to prevent tax evasion. It follows that, although the basic structural elements of the taxes remained largely the same, neither of the tax systems was rigid. It was a living, evolving process, as evidenced from tens of amendments to the Acts.

This dynamic attitude is eventually forced in both states indirectly due to the global crisis and the state of their public finances. We may claim that there still remain many common regulations and taxation procedures in both tax systems, however there are also many distinct and independently evolving institutes in both states. It must be admitted that the initiator of these innovative methods of taxation is primarily the Slovak Republic.

Several months after the establishment of the independent Slovak Republic, the state acceded to the amendment of certain laws on taxation. However, those changes affected only the level of rates and marginally some specific institutes. The overall tax burden in the Slovak Republic was higher than in the Czech Republic primarily due to higher tax rates. However, an entirely different situation occurred after the tax reform in 2004. The introduction of the flat tax significantly simplified the tax system. Most of the exemptions from tax and special tax rates (there were 21 different exemptions and special rates until 2003) were abolished. There was a significant decrease in income tax rates, both with regard to high-income groups of individuals and partly legal entities, which opened the inflow of foreign investors.

The new Law promoted a more attractive business environment for enterprises, inter alia, that raised more favourable rules for assets write-offs, deduction of tax losses and the recognition of tax expenses. The introduction of the tax bonus instead of deductible items from the tax base, in turn, contributed to the financial stability and support for families with children due to the possibilities of negative tax. Transfer taxes were abolished in the Slovak Republic. On the one hand, their revenues did not match the costs involved and, on the other hand, there was a trend towards the avoidance of double taxation, with which the abolition of taxation of dividends and other profit shares (which had been subject to 19% income tax) is closely related. Thanks to all these efforts, in 2008 the total taxation in the Slovak Republic was the third lowest across the EU, while the Czech Republic was down to the eleventh place in the framework of the EU member states in terms of the level of taxation. This successful step that brought the Slovak Republic a competitive advantage has been followed by the Czech Republic and other post-communist countries since 2008.

The tax reform of the year 2004 had an impact on the entire tax system applied in the Slovak Republic. The major portion of taxes shared between the national and local governments was shifted in favour of local taxes. Such a system is more efficient and less costly than the system operating in the Czech Republic; however, it conceals the danger of confusion.

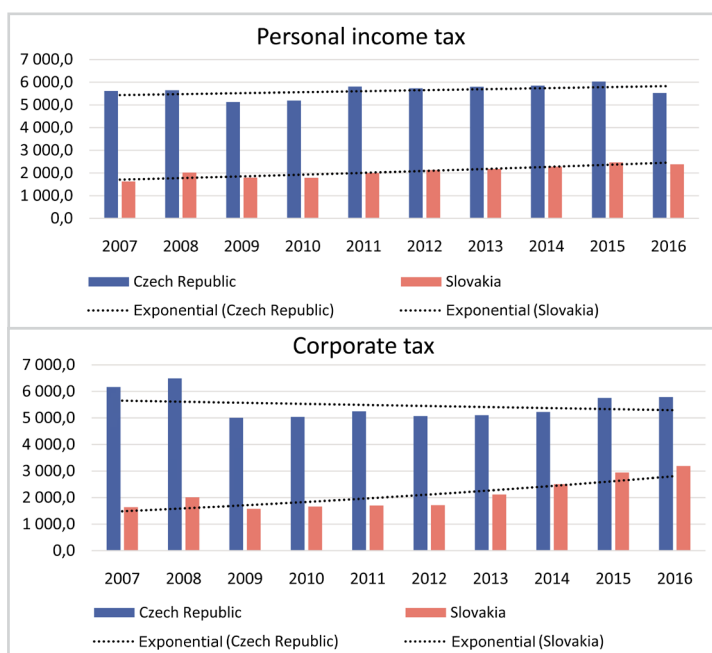


Fig. 1: Taxes on individual or household income and on income or profits of corporations, in million EUR
 Source: Compiled by the authors based on data from EUROSTAT (2007-2015), Financial Administration of the Czech Republic (2016), Financial Administration of the Slovak Republic (2016)

From the foregoing we can assume that the Slovak Republic is committed to looking for ways to more efficient methods of taxation of income even at the cost of some of the measures which have not been justified in practice yet. The Czech Republic is more conservative in this direction. It does not make radical changes and plays a waiting game to carry out the relevant measures later.

From the progressivity of the tax reform in the Slovak Republic in 2004, it is shown that the Czech Republic took over many of the tax institutes applied in the Slovak Republic, mainly due to tax changes advocated since 2008 by the *Občanská demokratická strana* (Civic Democratic Party), the ruling political party at that time. Partial deviation from the chosen direction occurred in the years 2010-2013, when the Czech Republic was rather impacted by the German tax system, the result of which was, for example, the introduction of the solidarity tax increase in the country. In 2014, Slovak-born Andrej Babiš became Minister of Finance. His Slovak origin, together with academic education, indicates that the treatments of the methods of taxation in the Czech Republic are approaching the elements of the tax techniques applied in the Slovak Republic. An assumption that the development of the tax system in the Czech Republic is developing similarly to the development of the tax system in the Slovak Republic can therefore be partially regarded as valid.

The original system of a progressively rising tax rate on personal income has an inbuilt principle of solidarity, when incomes of high-income groups were taxed at a higher tax rate. With the introduction of the flat tax in 2004, the Slovak Republic gained a huge competitive advantage, which also included hidden downsides. The neutrality of taxation was a major disadvantage. This led to a paradoxical situation when taxpayers with low-income paid higher taxes after the tax reform compared to the taxes they paid before the reform and vice versa taxpayers with higher income paid less than before the tax reform. In an effort to reduce the negative impact on low-income population, the Slovak Republic began to set the amount of tax allowances for the taxpayer, including his/her wife, based on the subsistence level together with disposable income of the taxpayer. With increasing incomes, tax allowance continues to diminish until it finally reaches zero. The subsistence minimum is also related to other institutes mitigating the impact of taxes imposed on the low-income population.

The Czech Republic introduced a linear income tax rate four years later. Standard tax allowances for the taxpayer, however, were repealed and replaced by a system of tax credits, which however represent a fixed amount, the taxpayers

may claim in general, irrespective of their social status. On the contrary, if the amount of tax is not sufficient for the tax credit, the discount will not be applied. It is possible to reach a negative amount of tax in both states, however only through the tax benefit or the tax bonus on children. After the abolition of progressively rising tax rates, the Czech Republic does not have a system in place which is able through income tax to distinguish between taxpayers with low incomes and taxpayers living on subsistence level, which is below the low-income group of taxpayers.

On the contrary, the Slovak system virtually assures hidden progressivity of income taxation. From the above findings, we conclude that the taxation of individuals in the Czech Republic is less socially equitable than it is in the Slovak Republic. Thus, the hypothesis that the tax system of the Slovak Republic is socially just is confirmed.

The answer to the assumption that there will be a unification of the rules for taxation of income between the two states within the European Union is not yet clear, although harmonization efforts have also been made with regard to direct taxes since the establishment of the European Union. Concerning the income taxes, this process is constantly slowing down, and it is even stagnating in some areas.

The Slovak Republic is positively inclined to make all reform and harmonization efforts within the framework of the EU. On the contrary, the Czech Republic within the EU acts as a state that often dissociates itself from the proposed changes. Although current developments do not indicate the possibility of harmonizing rules on the taxation of income, we may see slow gradual unification of the rules for income taxation through EU directives. In the future, it can be assumed that by retaining this economic grouping, there will be a consensus of the EU member states in the area of income taxation.

6. Conclusions

The purpose of this article was to compare how much the tax systems of the Czech Republic and the Slovak Republic differ one from another after more than 22 years of separate existence. Given the scale of the observed problem, we focused on the comparison of income taxes and not on the comparison of the whole tax systems in these two states. Income taxes were chosen because they, like consumption taxes, are traditional and stable sources of public budgets.

Based on our analysis of the income tax systems in both the Czech Republic and the Slovak Republic, we have concluded that the income tax system in the Slovak Republic is more effective, less costly and more socially just than the income tax system of the Czech Republic.

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