

Tax expenditures estimation in the Czech Republic for 2022

1 Methodology

The American Tax Foundation defines tax expenditures as a departure from the “normal” tax code that lower the tax burden of individuals or businesses, through an exemption, deduction, credit, or preferential rate¹. Tax expenditures can lead to significant losses of public revenue and make subsidy or transfer schemes unclear. In terms of impact, the recipient of the tax expenditure is the taxpayer, and the purpose of the tax expenditure follows directly from its definition.

Although the methodology for estimating tax expenditures is not harmonized, the European Commission defines certain recommendations which are reflected in the following text. For the estimation of tax expenditures in the Czech Republic, the **foregone revenue method** has been chosen. It quantifies a decrease of fiscal revenue caused by using a tax expenditure by a taxpayer. The revenue forgone method is a static one which means that behavioral responses or the interaction with other tax bases is disregarded. If a tax expenditure is abolished, entities may change their behavior, which may lead to a different impact on public budgets.

At the same time, if any tax expenditure is abolished, this would not automatically mean that the tax revenue would increase by the estimated amount. Indeed, the estimation of the tax expenditures do not take into account, given the unavailability of individual data, any possible interactions between different tax expenditures. Taxpayers may take advantage of other tax expenditures, may shift their activity to a different area or may be completely discouraged from any activity.

Furthermore, particularly in the case of tax exemptions, the actual amount of tax due would also be affected by the construction of the tax base (e.g. if any expenses can be claimed, reduce tax base and therefore the tax due). Thus, the overall fiscal impact of the tax expenditures abolition may actually be lower.

In general, a lot of data is needed to estimate the amount of each tax expenditure. In many cases, obtaining necessary data would cause disproportionate administrative burden. Although the revenue foregone method is not data-intensive and is relatively simple compared to other methods, it is the most widely used.

2 Tax expenditures estimation

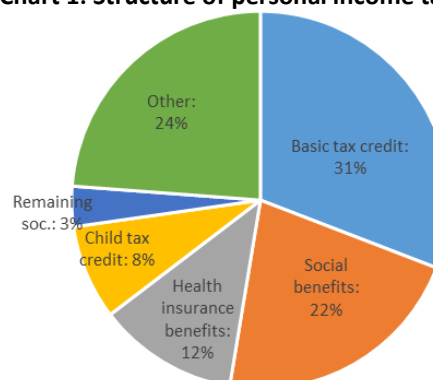
It is not possible to quantify all tax expenditures included in the Czech tax system. The main reason is due to absence, unavailability or incompleteness of the data and high administrative burden required for obtaining it. Given the data issue, only those tax expenditures for which data is available can be quantified. At the same time, only those tax expenditures whose potential impact on public budgets exceeds CZK 100 million are analyzed.

The data from Automated Tax Information System, whose aggregated version is available to the Ministry of Finance, is mainly used to estimate the tax expenditures. Other data sources used, are publicly available or was requested by the Ministry of Finance (e.g. data from internal reports of various institutions).

2.1 Personal income tax

Total personal income tax (PIT) expenditures were estimated to CZK 519.8 billion in 2022. According to our analysis, CZK 299.5 billion is accounted for tax exemptions, CZK 10.7 billion for items reducing the tax base and CZK 209.6 billion for items reducing the tax (Table 1). It is important to mention that 80% of the tax expenditures have a social aspect (Chart 1). The most significant is the basic tax credit (almost 31%), followed by the exemptions of social benefits from public insurance schemes, state social security benefits and material need (in total almost 22%), and child tax credit (more than 8%). In the Czech Republic benefits from public health care insurance benefits are also tax exemptions (12%).

Chart 1: Structure of personal income tax expenditures



Source: Calculations of the Ministry of Finance of the Czech Republic.

¹ <https://taxfoundation.org/taxedu/glossary/tax-expenditure/>

Table 1: Personal income tax expenditures for 2022 (CZK billion)

Category	Tax exemption	Income Tax Act	2022
Tax exemptions	Pension insurance benefits and services	§ 4	88,3
	Public health-care insurance payments	§ 4	62,5
	Winnings from lotteries nad raffles	§ 10	105,6
	State social security benefits nad payments	§ 4	8,5
	Meal vouchers provided by employer	§ 6	7,7
	Sickness insurance payments	§ 4	7,2
	Social support payments and payments received for close person care	§ 4	5,5
	Insurance payments except of one-time payments	§ 4	2,5
	State employment policy payments	§ 4	1,5
	Social benefits in material need	§ 4	2,2
	Pension insurance contributions provided by employer	§ 6	2,2
	Retirement and housing allowance for security forces members	§ 4	1,6
	Payments and benefits received from cultural and social needs funds (FKSP)	§ 6	1,9
	Social services	§ 4	1,5
	Compensation received for donation of blood and blood components	§ 4	0,1
	Scholarships	§ 4	0,4
Interest income from bonds issued after 1 January 2021 by the Czech government	§ 4	0,3	
Tax deductions	Mortgage interest deduction	§ 15	6,7
	Contribution to private life insurance	§ 15	1,1
	Contribution to private pension insurance	§ 15	1,4
	Charitable donation	§ 15	1,5
Tax credits	Basic tax credit	§ 35ba	160,3
	Child tax credit	§ 35c	42,1
	Spouse tax credit	§ 35ba	4,4
	Placing a child in a preschool facility	§ 35ba	2,0
	Student tax credit	§ 35ba	0,4
	Disability tax credit	§ 35ba	0,4
Total			519,8

Source: Calculations of the Ministry of Finance of the Czech Republic.

Note: Sum differences are due to rounding.

In a context of the adoption of Act No. 349/2023 Coll., which amends certain laws in relation to the consolidation of public budgets (the so-called consolidation package), and other legislative changes, some tax expenditures have been abolished or limited effective from January 1, 2024. This primarily include the parametric adjustment of the tax credit for a spouse, the abolition of the tax credit for placing a child

in a preschool facility, the abolition of the student tax credit, and the reduction of the exemption limit of income from raffles and gambling. The impact of the legislative changes will result in a reduction of tax expenditures for the year 2025 by an estimated amount of CZK 5.3 billion compared to the period before the change, which includes the year 2022 as well.

2.2 Corporate income tax

Corporate income tax (CIT) expenditures are estimated to CZK 25 billion in 2022 (Table 2). Exemptions amounted to CZK 10.7 billion, items reducing the tax base amounted to CZK 5.7 billion, items reducing tax amounted to CZK 4.1 billion, and the impact of reduced tax rates was estimated to CZK 4.8 billion.

Our estimations do not cover the exemption of income from profit distribution between the subsidiary and the parent company due to the data unavailability.

However, the inclusion of this item in the tax expenditure estimation is questionable as the profit distributed have already been taxed. The amount of this item can be estimated at tens of billion CZK, which is higher than the list of other corporate tax expenditures presented here.

After year 2022 there were no legislative changes which would have a direct impact on the estimations of corporate income tax expenditures.

Table 2: Corporate income tax expenditures for 2022 (CZK billion)

Category	Tax exemption	Income Tax Act	2022
Tax exemptions	Income of State Institute of Drug Control and Institute for State Control of Veterinary Biologicals and Medicines	§ 19	0,2
	Contributions to the fund of the Czech Insurance Office	§ 19	0,2
	Revenues of Insurance funds	§ 19	0,7
	Revenues from financial market operations with state treasury	§ 19	4,3
	Interest income from bonds issued after 1 January 2021 by the Czech Republic government	§ 19	5,2
	Earnings from reserves deposited on restricted account	§ 19	0,1
Tax deductions	R&D allowance	§ 34	3,1
	Charitable donation	§ 20	1,6
	Deduction for public benefit activities	§ 20	0,7
	Deduction to support professional training	§ 34/4; §§ 34f-34 h	0,3
Tax credits	Investment incentives	§§ 35a, 35b	2,2
	Tax credit for employing disability people	§ 35	1,4
	Tax credit for employing severe disability people	§ 35	0,5
Reduced tax rates	Investment funds	§ 21	1,8
	Pension funds	§ 21	1,7
	Mutual funds	§ 21	1,3
Total			25,3

Source: Calculations of the Ministry of Finance of the Czech Republic.

Note: Sum differences are due to rounding.

2.3 Value added tax

In order to estimate the amount of value added tax (VAT) expenditures, it is necessary to know whether the supply provided by the taxpayer is intended for a VAT payer or a non-taxpayer.

However, such detailed information is not available and we can only rely on the data about supplies received

by non-taxpayers contained in Supply, Use and Input-Output Tables published by the Czech Statistical Office.

Non-taxpayers include households, public sector and exempt sectors according to Value Added Tax Act which is not a complete list of non-VAT payers. This leads to inaccuracies in the estimation of tax expenditures.

Table 3: Value added tax expenditures for 2022 (CZK billion)

Category	Tax exemption	VAT Act	2022
Tax exemptions	Immovable property renting	§§ 51, 56a	189,3
	Financial services	§§ 51, 54	
	Insurance services	§§ 51, 55	
	Lotteries	§§ 51, 60	
	Postal services and stamps delivery	§§ 51, 52	
Reduced tax rates	Reduced VAT rates	§§ 47 - 49	89,1
Total			278,4

Source: Calculations of the Ministry of Finance of the Czech Republic.

3 Conclusion

The aggregate amount of tax expenditures in the Czech Republic is difficult to estimate. Individual tax expenditures influence each other and it is not methodologically correct to simply add up the amount of tax expenditures together. On the other hand, this analysis can serve to outline the overall distortions caused by the current tax system.

Given the foregone revenue method and the static approach used, the **individual amounts of tax expenditures estimated do not represent an estimate of the increase in tax revenue that could be achieved**

if they were abolished. In fact, it is likely that in the case of several changes in tax expenditures at the same time, the behavior of the tax subjects will change, which, combined with the interdependence of some expenditures, will lead to a different impact on public budgets. Thus, the overall impact of the abolition of exemptions is likely to be lower than the isolated static impact.

In the following table, a simple sum of the quantified tax expenditures is made to obtain a rough estimate of the total distortions caused by the current tax system.

Table 4: Aggregate amount of estimated tax expenditures for 2022 (CZK billion)

Category	PIT	CIT	VAT
Tax exemptions	299,5	10,7	189,3
Tax deductions	10,7	5,7	-
Tax credits	209,6	4,1	-
Reduced tax rates	-	4,8	89,1
Total	519,8	25,3	278,4
Total for the year	823,6		

Source: Calculations of the Ministry of Finance of the Czech Republic.