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Diploma Thesis Abstract

**Comparison of Selected Direct Taxes
in the Czech Republic and Ireland**

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Summary

The main aim of the diploma thesis is to conduct a comparison study of tax systems of the Czech Republic and Republic of Ireland. The comparison mainly addresses direct taxation, primarily personal income tax.

The thesis consist of three main sections, a theoretical section, a practical section and a proposal section. The theoretical section describes legal tax frameworks in analyzed countries and underlines fundamental dissimilarities in tax systems. Majority of the emphasis is given to a taxpayer's entitlement to tax reliefs and tax credits, since these deductible items strongly influence tax base of the taxpayer, consequently his total tax burden. The practical section of the thesis is divided into two subchapters. The first subchapter is devoted to the comparison of macroeconomic prospective of the taxation system. The second subchapter focuses on the tax burden imposed on four hypothetical households in the Czech Republic and Republic of Ireland. The outcome of the practical section highlights our main drawbacks in the Czech tax system and present proposals for improvement of the tax system.

Souhrn

Hlavním cílem diplomové práce je provést srovnání daňových systémů České republiky a Irska. Srovnání je provedeno v oblasti přímých daní a zejména daně z příjmů fyzických osob.

Diplomová práce se skládá ze tří částí - teoretické části, praktické části a návrhové části. Teoretická část práce popisuje právní daňový rámec v analyzovaných zemích a poukazuje na zásadní odlišnosti v daňových systémech. Největší důraz je kladen na nárok poplatníka na daňové úlevy a slevy na dani, neboť tyto odečitatelné položky silně ovlivňují základ daně poplatníka a jeho celkové daňové zatížení. Praktická část diplomové práce je rozdělena do dvou podkapitol. První podkapitola je věnována makroekonomickému pohledu zdanění v obou zemích. Druhá podkapitola se zaměřuje na daňovou zátěž čtyř hypotetických domácností v České republice a Irsku. Výsledek praktické části poukazuje na nedostatky v českém daňovém systému a jsou zde předloženy návrhy na zlepšení daňového systému.

Keywords:

Czech taxation, Irish taxation, Direct tax, Income taxes, Personal income tax, Corporate income tax, tax base, tax rate, tax credits, tax relief, payroll

Klíčová slova:

Česká daňová soustava, Irská daňová soustava, přímé daně, daň z příjmů fyzických osob, daň z příjmů právnických osob, základ daně, daňová sazba, sleva na dani, odčitatelné položky od základu daně, mzdy

Introduction

“In this world nothing can be said to be certain, except death and taxes” Benjamin Franklin

The topic of this diploma thesis is the comparison study of tax systems both in the Czech Republic and Ireland. The topic I have chosen was inspired by my participation in my study abroad at University College Cork in Ireland. This was an exceptional opportunity for one to observe and analyze the functional mechanism of different types of tax systems. Subsequently, these taxation findings significantly contributed to the comparison of a traditional member of Anglo-Saxon country in contrast to the tax system in the Czech Republic.

Taxes are an important fiscal instrument for every government. Moreover, taxes generate income for the Treasury. Apart from the state level, municipal and regional budgets are heavily reliant on collected taxes. It is the same with the Czech Republic and Ireland, where taxes are crucial revenues for financing public goods and services. The Czech Republic and Ireland are members of European Union (henceforth referred as EU). The EU representatives place a great emphasis on tax harmonization across European countries in order to create a functional single market without any discriminatory barriers. Remarkable results has been achieved in terms of indirect tax harmonization (for instance harmonization of VAT tax rates – a basic rate set at minimum 15 % and a reduced rate at minimum 5 % or VIES system providing tax identification number). However, the direct tax harmonization is very limited due to reluctant EU members surrendering their tax and fiscal sovereignty. For this reason the thesis focuses on the comparison of direct taxes, primarily for personal income tax. It is assumed that much more dissimilarities can be found in direct taxes than in indirect ones.

Since the tax system influences daily lives of all members of society, the government strives to improve the economic situation of its citizens. The thesis provides an insight into the different tax systems and can challenge or support the general perception of the Czech taxpayers in regards to excessive tax burden on their earnings.

Objectives and methodology

Objective

The aim of this diploma thesis titled Comparison of selected direct taxes in the Czech Republic and Ireland is to characterise and compare two different tax systems in European Union. The comparison study is carried out both at a macroeconomic level and at a household level. Since taxation is a broad topic, the thesis is therefore mainly focused on comparison of direct taxes, primarily on personal income tax.

Objective of the practical part (case study) is:

Firstly, based on the literature from theoretical part of the thesis to analyse the tax quota, the tax mix, the implicit tax rate and other macroeconomics indicators which are utilised for tax comparison of two countries. Secondly, phenomenon known as tax burden levied on personal income tax of a taxpayer under different circumstances is compared. The outcome of the comparison can make proposal for future fiscal policies and set the direction of the Czech taxation system.

Methodology

Methodology in the theoretical part of the thesis is based on data collection from up-to-date and relevant legislation of both analysed countries, specialised publications and surveys undertaken by reputable organisations in tax environments such as the Organisation for Economic Co-operation and Development (henceforth referred to as OECD) or European Commission. Descriptive method is utilized in the theoretical part.

The practical part of the thesis compares tax burden of an Irish and Czech taxpayer through four assumptions which represent various types of households, such as single person without dependent children, single parent with one dependent child, one-earner married couple with two dependent children and two-earner married couple with three children. The effective tax rate indicator is used for tax burden comparison. The comparison analysis has been performed from relevant tax legislation valid until the December 31st 2014.

Conclusion

The main aim of the thesis was to conduct the comparative study about the structure and mechanism of functioning of tax systems in the Czech Republic and the Republic of Ireland. The comparison is primarily focus on direct taxes. Both tax systems has common attributes which are derived from tax harmonization of the European Union. On the other hand many differences exist in the systems due to vastly different historical, political and economic developments in both countries. Results from the comparison and suggestions for the Czech tax system are summarized in this section.

The structure of tax revenues classified according to the OECD revealed that the tax mix in the Czech Republic is an unusual and over reliant on finance sources from social security contribution represented of 44 % of the total tax mix. This is a characteristic feature of the Czech tax system. The dominant financial source is income tax represented 42 % of the total tax revenues in the Republic of Ireland. It was suggested by author to shift excessive burden on direct taxes to indirect ones. Especially property income tax which is highly ineffective and associated with a high administrative burden in the Czech Republic. Hence, it was recommended to adopt a market value assessment of property to the Czech tax system.

The tax quota and the tax implicit rate were used in order to compare the “Macro’ aspect of taxation systems. Firstly, these were used to find out on the base of an aggregate quota indicator that the Czech Republic has a much higher tax burden levied on national economy compare to the Republic of Ireland. The difference stands for nearly 6 % with respect to GDP. Nevertheless, both countries hover below the average of European Union. Another indicator was used in order to evaluate tax impact on different economic functions (labor, consumption, capital). The biggest difference was observed in implicit tax rate on labor. The Czech Republic reached figure of 38.8 %, whereas the Republic of Ireland stand for 28.7 % (The EU average was recorded for 36.2 %) The result demonstrates a huge proportion difference on social insurance contribution in relation to total labor cost between both countries.

Effectivity of tax compliance was highlighted in the last section of the first part of practical part. The SME segment in the Czech Republic is pose to higher administrative burden than in the Republic of Ireland. Business entities need 413 hours to prepare, file and pay tax compared

to only 80 hours required for the same process. This forgone time make the tax system a very expensive for business entities operating in the Czech market. Numerous amount of steps such as, methodological support in form of guided videos, helpdesk with tax specialist, user-friendly tax platform and other steps have been proposed by the author in order to mitigate administrative burden. Additionally, the idea of one single collection point should be implemented into the Czech tax system after years of discussions.

Second section of the practical part was devoted to computation of total tax burden on four different types of households upon assumption of three income intervals: **50, 100 and 150** percent of average earnings. The limitation of the study is that tax reliefs are not included in the computation. Apart from contrasting approaches towards to personal income tax, linear taxation is employed in the Czech tax system, whereas progressive approach is utilized in the Republic of Ireland. The biggest difference was in tax base determination itself. In the case of the Republic of Ireland, the base was computed directly from gross wage, however gross wage is inflated by mandatory contribution paid by the employer which is expressed by coefficient 1.34 (so called Super Gross Wage) in the Czech Republic. Findings from tax liability computation of different types of families backs up previous results. Higher tax burden was levied on most of hypothetical Czech households compared to the Irish households. One-earner married couple with two dependent children from case study 3 was the only family with lower effective tax rate across all income intervals. This was caused by non-earner spouse tax credit. The author made the improvement proposal in the form of the complete abolition of Super Gross Wage. Firstly, this step would ease employer's tax burden. Secondly, it would lead to the reduction of the incentive for bogus self-employment agreements. However, we must bear in mind that this shortfall for the state budget needs to be compensated by other resources. The increase of income tax rate might be one of many options. Subsequently, disparity between dependent employees and the self-employed in terms of contribution to the tax system and was pointed out in recommendation part of the thesis. The author is open to discussion about cutback of lump sum expenses which the self-employed are entitled to.

Distinguishing the better tax system is not straight forward process due to fact that there is differentiation in an economic situation in each country. Hence, it is not possible to mark a tax system as optimal. Additionally, each state has different welfare redistribution approach and size of cash transfers However, The Republic of Ireland could be in many ways an inspiration for the Czech Tax system.

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