

CZECH BUSINESS ENVIRONMENT: BURDEN OR PROSPERITY?

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Abstract

The free market economy in the Czech Republic currently reaches its twenties anniversary. During this period the entrepreneurial spirit has been developed as well as the legislative framework and administrative basis for business activities. Tax system and its culture as well as the labour issues have been closely connected, and all these factors are the key ones to consider when discussing the business environment and its impact on the competitiveness. The article is focused on the area of comparison of taxes, levies and tax administration, which often burden the businesses and lower their competitiveness not only within the EU single market but worldwide. The attention is paid also to labour issues with a special emphasis on the labour mobility. In the context of the described burdens of the Czech business environment in the article, the two decades of development do not seem to be sufficient in case of the labour market, professionalization of the tax collection and refinement in the management of public resources. Regular evolution in these areas, like most of other democratic processes, requires much more time and is apparent especially in critical situations.

Key words: levy burden, tax administration, e-government, labour mobility

JEL Code: H25, M21

Introduction

During the last two decades of market economy in the Czech Republic the entrepreneurial spirit has been developed as well as the legislative framework and administrative basis for business activities, entrepreneurial business environment and prosperity of the Czech Republic. An increased opportunity for labour migration has also become an important factor of competitiveness of both the Czech Republic and Czech businesses. The whole process was significantly marked by the accession of our country to the European Union in May 2004.

Although the fact that many definitions of the competitiveness voluntarily lack the factor of human capital and quality of business environment, they are the best defined in the article of Feurer and Chaharbaghi (1994). They have proposed a holistic definition of competitiveness, taking into account the sustainability: “Competitiveness is relative and not absolute. It depends on shareholder and customer values, financial strength which determines the ability to act and react within the competitive environment and the potential of people and technology in implementing the necessary strategic changes. Competitiveness can only be sustained if an appropriate balance is maintained between these factors which can be of a conflicting nature”.

This article is divided into two parts dealing with the current state of issues linked to the Czech business environment and its competitiveness, and the likely development or solutions to these issues, particularly with regard to the context of the overall environment of the European Union. The article is primarily conceived of the micro-perspective, therefore from the point of view of companies involved in the Czech business environment.

The first issue concerns taxes and levies, as well as administrative components of the system. The newly proposed system of the Common Consolidated Corporate Tax Base (CCCTB) is also included. The CCCTB concept was, despite many objective obstacles, also proposed to simplify current tax collection systems and to reduce their costs.

The second important issue with direct impact on the quality of business environment and hence the competitiveness of the country, is the labour force mobility. The labour force mobility concerns cross-border mobility (within the EU) and mobility within the Czech Republic, as it has its specifics compared with other economically advanced countries.

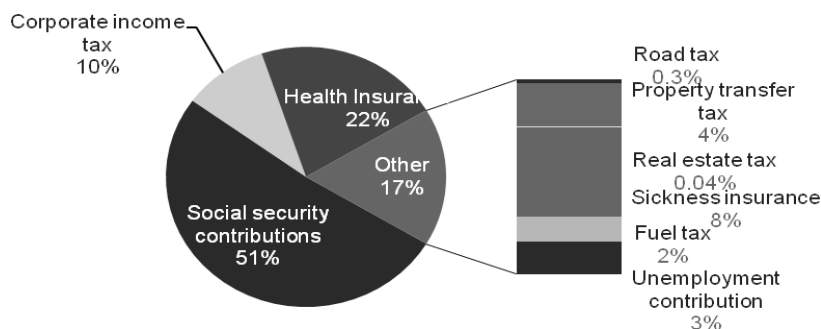
1 Taxes and levies burden, tax administration, CCCTB system

1.1 Corporate income tax and levy burden on companies – the impact on competitiveness

In general, the taxes can be understood as a tax for civilization. Regarding the input of the Czech State budget we can conclude that companies have, in the last two decades of the Czech market development, more or less voluntarily accepted this mechanism. The tax burden in the Czech Republic stands at the average level in comparison with developed European countries (Corporate Income Tax, CIT). Such satisfactory result, however, cannot be

attributed to tax levies applied to Czech companies and especially the tax and levies administration, which is in the Czech Republic one of the highest in the world.¹

Fig. 1: Composite tax rate in %



Source: PriceWaterhouseCoopers: How the taxes are paid in the Czech Republic, 11/2009

The public budget indiscipline and inefficient public finance management in hands of politicians and officials, as well as the total tax anonymity whose need increases in direct proportion to the perceived inefficiency of public spending, result in disappointments and negative perception by Czech companies and overall public.

The levies burden becomes increasingly important burden for companies in connection with labour costs and conditions of employment of workers (inflexible Labour Code (Act No. 262/2006 Coll.) based largely on the provisions of the former Labour Code No. 65 / 1965 Coll.), that are the factors with significant influence on the overall weakening of international competitiveness of Czech companies.

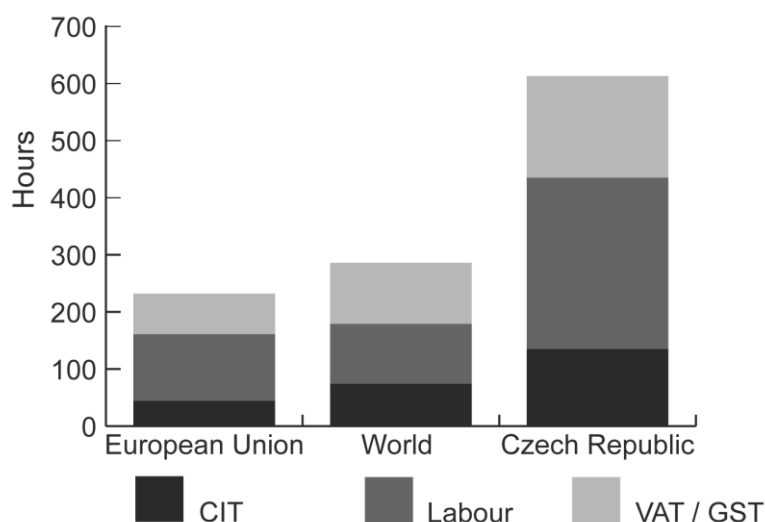
1.2 Tax administration and administrative burden

Similarly to the high burden of levies, one of the factors reducing the international competitiveness of Czech companies is also considerable administrative burden, which is costly for companies in terms of time and consequently money. At the same time, this item is also a significant expenditure of State budget as it costs the State and public administration approximately CZK 86 billion to process 2,206 various reports, statements, etc. By collecting

¹ PriceWaterhouseCoopers: How the taxes are paid in the Czech Republic, 11/2009

corporate income taxes the State budget gets CZK 82.78 bn (8.1% of total income of the State) and by collecting personal income taxes it gets CZK 90.96 billion (8.9%).

Fig. 2: Time needed to fulfil the tax duties depending on the type of tax – in comparison with the EU and World average



Source: PriceWaterhouseCoopers: How the taxes are paid in the Czech Republic, 11/2009

According to the Association of Small and Medium-sized Enterprises of the Czech Republic² survey 57% of companies surveyed³ consider that the communication with public authorities, covering business issues, causes unnecessary red tape. Between the most common objections of surveyed companies belong the duplicate provisions of data by multiple authorities, always conceived in a different form. Significant burden lies also in insufficient e-government, which should not be such a problem giving to information technologies available. The opposite is the reality.

„Digital technology, the big development of the past generation, thus appears to have some significant limit-breaking capacity in administration. But that does not mean the new information state is free of administrative limits altogether — only that the limits are different“ . (Hood, 2010).

² Result of the AMSP ČR survey n° 8: Business opinion on e-governement, 2/2011(See on-line www.amspace.cz).

³ Participation: 324 respondents from SMEs and crafts in sectors such as industry, construction, services and agriculture. Respondent were chosen in accordance with Czech Statistics Office methodology. The survey was conducted on the basis of CAWI method and phone calls.

The problem lies often in the specific user environment, the inability to export certain folders (the need to mechanically fill out electronic forms) and to receive certain document formats (e.g. doc / docx), and, on the other side, exclusive acceptance of formats that are not commonly used (e.g. XML, etc.) as well as requirement of electronic signature use, although the access to the system (e.g. data exchange) is already subject to a high degree of security.

The same survey shows that for instance electronic tax returns are used only by about one-fifth of companies and almost half of the companies have never used the e-return to declare their taxes. This is therefore a challenge for the government to make the electronic version of filing tax returns for businesses affordable and attractive as well as to remove unnecessary administrative burden and costs that are associated with. For filing tax returns electronically, the majority of respondents use firstly data boxes, smaller majority then the EPO application. The greater part of entrepreneurs (60%), however, does not intend to submit tax returns electronically. The most favourite way to submit tax returns is completing tax returns on the PC, printing them and bringing them to the financial office. The second most favourite way is a hand completion and its submission to the tax office. The current relatively low share of electronic forms of tax returns witnesses a considerable development delay in B2PA communication compared with current electronic communication in B2B relations.

Surveyed entrepreneurs also point out that some authorities still require delivery of original documents and reply to businesses with paper form. Roughly half of the respondents have their electronic signature. Others say that they have not needed the e-signature yet. The objections also include the costs associated with the use of electronic signatures, mainly when the entrepreneur has to have more than one electronic signature that must be regularly renewed and thus paid. These costs are not worthy for some businesses, especially if the amount of mails is quite low.

1.3 CCCTB – challenge or threat?

The works on European project on Common Consolidated Corporate Tax Base (CCCTB) begun in 2004. The project has the main objective: to simplify tax legislation and reduce administrative costs of tax compliance and tax administration. The CCCTB is a uniform set of rules that could be used by companies in the EU to calculate their taxable profits. When calculating taxable income, a company or group of companies would have to comply only with a single EU system and not with different rules applied in each Member State in which

they operate. Firms operating in more than one EU Member State would have to submit only one tax return.

The main advantages of the system should be administrative simplification and transparency of company taxation in Europe. The Commission estimates that the CCCTB will save for businesses across the EU nearly EUR 700 million a year due to lower costs to comply with regulations and other EUR 1.3 billion through consolidation. According to the Commission the CCCTB is primarily aimed at SMEs. As pointed out in their article Pirvu and Matei (2010), compliance costs are much higher for the companies with cross-border activity, and these costs are disproportionately high for the small and medium-sized enterprises, since they must meet the requirements of 27 different tax systems. Corporation tax rules in all Member States should be sufficiently comparable and allow companies to easily identify the differences between tax systems and procedures in different countries.

The initiative refers to a number of documents: the Europe2020 Strategy, the Single Market Act and also the Pact for Euro. Despite obvious advantages, the proposal has not a complete support from companies, neither the Member States. The position of the Czech Republic regarding the introduction of CCCTB is rather distant. The Czech government fears adverse budgetary implications as a result of losses and profit compensation of the group members.

Matei and Pirvu (2010) in their works go further when they point out that the problem of distortions caused by different taxation corporate income may be summarized as follows: if taxes are higher in a certain area, capital will migrate to areas with lower tax if other economic considerations do not keep better the original location. To solve these problems, at the EU level it is said frequently the need to partial harmonization (only the tax base) of corporate income taxation. Note that in order to prevent the “migration” of national tax bases, by moving corporate headquarters in countries with more favourable tax regimes, there have been proposals for total harmonization (both tax bases and tax rates) of corporate income taxation.

Harmonization of corporate income tax base has been supported by most members of the Association of European Chambers of Commerce and Industry EUROCHAMBRES, with the exception of Chambers of Commerce in Great Britain and Ireland who are not convinced that this model is the best suited to meet the needs of economic growth in the EU. Although Cyprus Chamber of Commerce expressed reservations about the model of “the common

consolidated corporate income tax”, it was willing to consider the impact of its introduction (Eurochambres, 2007).

The most significant differences between the CCCTB concept and the Czech corporate income tax system are the following:

- Depreciation
- Deductibility of provisions / reserves
- Write-off of receivables
- Non-tax costs (50% of representation expenses, bribes, fines and penalties paid by the state authorities for violation of law, donations to charity over allowed amount, cost and technical evaluation of depreciated property, etc.)
- Czech specifics (additional taxation arrears, penalty payments, etc.)

In the Czech Republic, the companies say that, under some circumstances, it would be possible to introduce the CCCTB, however, not the common rate. The base of voluntarism seems to be also one of the main factors playing significant role. Common consolidated tax base was even defined as a “Trojan horse of Europe” which, once adopted, will allow the Commission to put pressure on Member States to harmonize the tax rates (Gnaedinger, C., 2008).

2 Labour mobility and its impact on Czech business environment

Free movement of persons and workers is one of the fundamental freedoms of the European Union. Germany and Austria applied until the last moment (end of April 2011), the transitional period for free movement of workers from countries which joined the EU in 2004 (except Cyprus and Malta, the EU-8). The abolition occurs automatically, i.e. at the end of the third stage, not at the discretion of the above-mentioned States.

The original concerns of the old EU Member States (EU-15) of excessive influx of migrants from new Member States have not been confirmed. A number of Commission studies and reports stated that the opening of markets has had mainly positive impact on the EU-15 economies and had not a negative impact on their labour markets. There is only a small number of evidence that workers from new Member States caused dramatic reduction in wages in one of the EU-15 or that the local workers lost their jobs because of the migrants from EU-8 (MS who joined the EU in 2004 excluding Malta and Cyprus). .

The relatively low migration is due to the convergence of wages and conditions of labour markets in the EU-8 as well as relatively high living standards in these economies and unwillingness of workers from new Member States moving to work abroad (Břečková, P. and Vlačihová, A., 2011) .

The study "Job mobility within the EU in the context of enlargement and the functioning of the transitional period"⁴ from 2009 prepared by an international consortium for the European Commission, highlights, among other important points, the fact that migrants from the EU-8 often occupy jobs requiring less education than they actually have. The reason may be the reluctance to fill these places by local workforce, but also a lack of language skills of migrants reducing their professional qualifications (Břečková, P. and Vlačihová, A., 2011).

The Czech Republic belongs among countries with the lowest mobility (1%). The most mobile workers are in Poland (3.4%) and Lithuania (3.8%). In this case there was no need to worry about the influx of Czech workers to Germany and Austria after 1st May 2011. Those who were interested to work in the German labour market have been already working there. Czech university graduates can work in Germany already since January 2009, and electrical engineers and experts from the automotive industry even from autumn 2007. The Czech Republic is a net recipient of migrants with balance of 80 000 people annually. Number of active foreigners grows every year and moves to 5% of the economically active population. Although these are mainly workers from countries outside the European Union, an important share of this percentage represent also workers from the EU like Slovakia and Poland.

Main causes of the low mobility of the Czechs are especially the mentality and life habits. The labour migration in the Czech Republic has not a long tradition, even the mobility within the country. Another important factor is the relatively strong social network and a solid living standard which allow workers in many cases, not to be necessarily active in search of jobs in greater distance from the residence. Unlike other EU countries, commuting to work within a radius of more than 30-40 km is not usual in the Czech Republic. Willingness commuting decreases with qualification. Important burden on social system and imbalance of regional unemployment rate within the country have also considerable impact on the Czech economy. From the microeconomic perspective, the impact on the economy has also a regional lack of some qualifications and sometimes sourcing of manpower from abroad, which is again associated with a higher administrative burden on companies. From their point

⁴ Consortium IAB, CMR, fRDB, GEP, WIPO, Wiin, Norimberk, 2009.

of view, increased mobility of workers, at least within the country, is welcome as the continuation of the present development might negatively affect the sustainability of the welfare state and to further decrease the economy competitiveness.

On the other hand, interesting findings were brought by Zhang and col. (2009) in their paper on analyzing the possible influences from the spill over of human capital on the economic growth and educational investment in the Chinese environment. They found that the regional mobility of labour has made the developed areas gain the spill over benefits of human capital investment from the underdeveloped areas with their superiority of social and economic environment and restrained the incentives for public education investment in the underdeveloped areas, thus the different areas walk on a different growth path, with the expansion of the difference in the economic and education investment growth.

Conclusion

Due to the long interrupted tradition of democratic market development, Czech business environment is still under the process. Two decades of development are not sufficient in case of the labour market, professionalization of the tax collection and refinement in the management of public resources. Regular evolution in these areas, as well as in all democratic processes, requires much more time and is manifested especially in critical situations. Its deficiency therefore may not be immediately obvious, but in a more detailed view it is with very high impact on the microsphere which is the engine of the economy of any country. Increase in labour mobility and reduction in administrative burden and levies of companies are thus key factors for improving not only Czech business environment, but also for enhancing the competitiveness of the whole country.

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