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CZECH TAX STRUCTURE AND ITS OPTIMIZATION

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Abstract

Social security contributions dominate in the Czech tax structure, at the expense of the personal income taxation. An optimum role of the social security contributions is the financing of the social insurance only; these contributions should not substitute personal income tax. The main aim of this article is the evaluation of the EU first-generation value-added tax (VAT) and its potential reforms, comparing it with other systems. An up-date of the EU and Czech value-added tax is possible and very efficient. A major reform would replace it with a wage tax and a business tax. A small, Czech VAT reform would introduce the missing financial sector taxation and mean a partial transition to the New Zealand second-generation value-added tax, in conformity with the EU VAT directive. The introduction of the (government-promised) single collection point might bring a partial optimization of the Czech tax structure, too.

Keywords

Tax Structure, Value-added Tax, Wage Tax, Business Tax, Social Security Contributions, Single Collection Point

I. Introduction

Relative to the OECD average, the Czech tax structure is characterized by substantially higher revenues from social security contributions, substantially lower revenues from taxes on personal income, profits and gains and lower proportion of revenues from property taxes – see Figure 1. These differences influence the development of the Czech economy and society. All taxes should be well-founded.

Social security contributions are justifiable to the extent that they are used to finance social security. This is most true or should apply to social insurance, where there is a strong interconnection between insurance premiums and insurance benefits, underlined by the existence of a social insurance fund, administered in the classic case by elected representatives of employers and employees. Even in countries with strong social insurance systems, these systems are now subsidized from the state budget. As a result, for example, the local social pension insurance rate is lower than in Czechia (28%). At the same time, the Czech "pension insurance" has the character of social insurance (equivalence between the amount of pension and wages) by only about 30% of the remaining 70% it is in fact an equal pension (Vostatek, 2024). An even more significant disproportion in this respect exists in the case of the Czech "general health insurance", the expenditure of which is essentially determined by the reimbursement decree of the Ministry of Health, while it is covered by high health insurance premiums paid by employers and employees from wages to a parafiscal account administered by the General Health Insurance Company, to which the state budget also contributes.

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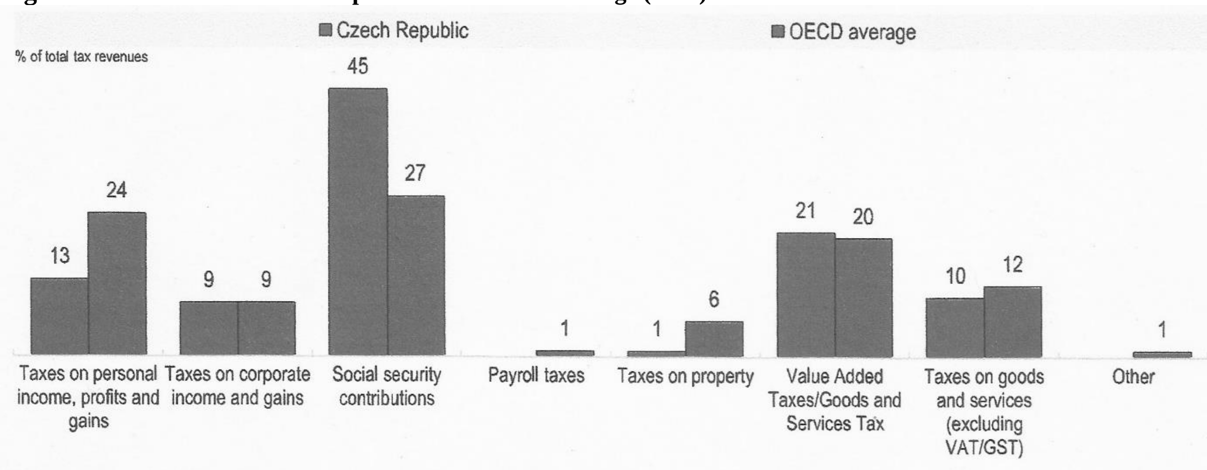
Figure 1 **Czech tax structure compared to the OECD average (2020)**



Source: OECD (2022)

A major reform of social security contributions, substantially reducing their role in the Czech tax mix, is possible and desirable, but it also requires an analysis of the overall system of taxes and redistribution. The Czech government should be at least partially prepared in this respect, as it has pledged to introduce a single collection point in its policy statement.

Shifting a significant tax burden from social security contributions to income tax is relatively easy and highly effective, as all employee contributions can be included in the employment income tax or personal income tax, leaving only social security contributions paid by employers and the self-employed. Even after this tax reform, the tax nature of contributions will prevail over the insurance elements, which facilitates a fundamental rationalization of the existing social security premiums and contributions to the state employment policy, general health insurance premiums and statutory employer liability insurance premiums for damage in the event of an accident at work and occupational disease, all within the first (and actually basic) stage of the implementation of the single collection point. The result of this reform will be a single employer contribution to social security at the rate of 34.1% of wages, collected by the Czech Social Security Administration into the state budget.

While a basically technical reform of the social security contributions is relatively simple and backed my government advisors, the value-added tax (VAT) is a much bigger political and economic problem. That is why we concentrate on this tax in the next chapters. We remember its history and particularities, including the role of the lobbying and its economic implications, using the abundant literature.

II. Value-Added Tax

After the First World War, a "provisional" turnover tax was introduced in European countries; in Czechoslovakia since 1924, the law (originally) expired in 1926. The weaknesses of the general turnover tax were obvious: "From the point of view of personal and material bearability, the turnover tax does not stand up to criticism and cannot have a place in the normal tax system. It is a manifestation of the extraordinary shortage of public finances, especially in the post-war period. Its financial advantage is its enormous yield, because the entire proceeds of national labour are carried out by it, and in part more than once, so that even with a small percentage of taxation its yield is great. With the amount of tax, of course, all its defects increase, and especially also the tendency to embezzlement" (Engliš, 1929). The turnover tax survived the Second World War and was only transformed into a value added tax in Western Europe after some time.

In 1967, the European Economic Community issued a directive for its 6 member countries to introduce VAT instead of turnover tax from 1970 at the latest. In 1993, the EU internal market was created, with the intention of creating a definitive VAT system by the end of 1996, using the country-of-destination principle. In this system, exports have a zero VAT rate, imports are taxed.

In the EU, the „credit invoice method“ is used in the construction of VAT: the tax is understood as an indirect tax on goods and services: a company burdens its sales with VAT and reduces the payment of VAT to the state budget by the VAT paid on the price of the goods and services purchased. Strictly speaking, it is not a value added tax, but a turnover tax with a deduction of the same input tax. On the other hand, a strictly conceived value-added tax ("income-type") taxes 2 components of value added (labour costs + profit including interest); In the literature, this construct is referred to as the subtraction method. Under a subtraction-method VAT … businesses pay tax on the difference between the value of their sales and the value of their purchases from other businesses. Table 1 compares these 2 VAT calculation methods with the US retail sales tax and the system without sales tax. In practice, the subtraction method was used in Japan until recently; however, from October 2023, they switched to a "qualified invoice system", which is similar to VAT in the EU. From a model point of view, the resulting tax burden of all these 3 types of tax is the same.

Table 1 Prices with different types of 10 percent sales taxes (taxes paid in parentheses)

Production stage	No tax	Retail sales tax	Credit-invoice VAT	Substraction method VAT
Farmer	$300	$300 ($0)	$330 ($30)	$330 ($30)
Miler	$700	$700 ($0)	$770 ($70-$30)	$770 ($40)
Baker	$1,000	$1,100 ($100)	$1,100 ($100-$70)	$1,100 ($30)
Total tax	**$0**	**$100**	**$100**	**$100**

Source: Toder and Rosenberg (2010)

„European countries … have largely used the VAT to reduce or eliminate other sales taxes… Cnossen, a leading VAT expert from Maastricht University in the Netherlands, called its spread “the most important event in the evolution of tax structure in the last half of the 20th century” (Tax Policy Center, 2020).

A typical feature of the EU first-generation VAT is the variety of VAT rates. “The EU countries with the highest standard VAT rates are Hungary (27 percent), Croatia, Denmark, and Sweden (all at 25 percent). Luxembourg levies the lowest standard VAT rate at 17 percent, followed by Malta (18 percent), Cyprus, Germany, and Romania (all at 19 percent). The EU’s average standard VAT rate is 21.6 percent, more than six percentage points higher than the minimum standard VAT rate required by EU regulation. Among the five European OECD countries that are not part of the European Union …only Switzerland levies a standard VAT rate below the EU minimum at a rate of 8.1 percent. In comparison, in the United States, combined state and local sales tax rates averaged only 6.6 percent in 2023” (Mengden, 2024).

“Generally, consumption taxes are an economically efficient way of raising tax revenue. To minimize economic distortions, there is ideally only one standard rate that is levied on all final consumption, with as few exemptions as possible. However, EU countries levy reduced rates and exempt certain goods and services from the VAT. One of the main reasons for reduced VAT rates and VAT-exempted goods/services is the promotion of equity, as lower-income households tend to spend a larger share of their incomes on goods and services such as food and public transportation. Other reasons include encouraging the consumption of “merit goods” (e.g., books), promoting local services (e.g., tourism), and correcting externalities (e.g., clean power). However, evidence shows that reduced VAT rates and VAT exemptions are not necessarily effective in achieving these policy goals and can even be regressive in some instances. Such reduced rates and exemptions can lead to higher administrative and compliance costs and can create economic distortions. A recent study shows that scrapping VAT-reduced rates in EU countries will allow standard rates to drop under 15 percent. To address equity concerns, the OECD instead recommends measures that directly increase poorer households’ real incomes” (Mengden, 2024).

"The harmonized European value-added tax (VAT) is anything but a modern consumption tax that taxes all goods and services at a uniform rate. As exemplified by an analysis of the Dutch version, some 60% of the base is exempted, that is, not taxed on output but on inputs. This has serious consequences. The VAT exemptions distort input choices, stimulate uneconomical self-supply, and complicate administration and compliance. The welfare costs of the exemptions can be estimated at one half of one percent of gross domestic product (GDP). Research shows that under an equal yield assumption, the elimination of the exemptions and the introduction of a single rate in conjunction with a reduction in the standard rate should foster economic growth. The Member States of the European Union (EU) should be allowed to replace their defective VATs with a modern version. This would strengthen competitive conditions" (Cnossen, 2020). This is a fundamental advice that we recommend applying also in Czechia, as a political priority.

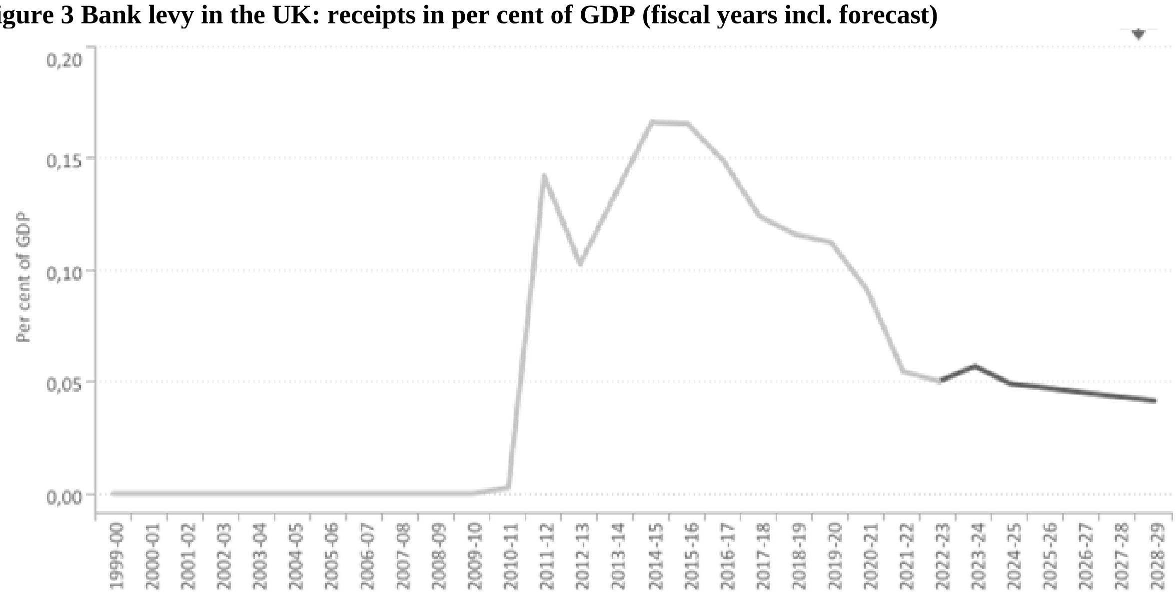
Figure 2 VAT revenue ratio (2018)

Source: Bunn et al. (2021)

The New Zealand Goods and Services Tax (GST) is a modified version of the European VAT. "While the New Zealand GST uses the same invoice-credit mechanism as the European VAT, it had two key innovations when it was designed in the mid-1980s. First, it had a uniform rate of tax, not multiple rates. Secondly, its tax base was comprehensive, without exemptions other than those necessary to define the base. In New Zealand, the GST tax instrument was designed to be efficient in practice and collect revenue at least cost, leaving distributional and other social and economic objectives to be achieved by other instruments: the income tax, the social welfare system (especially for working families and children), government expenditure and regulation. For 35 years, these two, and other, innovative features of the New Zealand GST have received favourable comments from international commentators, with some characterising it as a 'second-generation' VAT" (White, 2020).

The OECD measures the efficiency of VAT using the VAT Revenue Ratio (VRR). "VRR assesses the loss in VAT revenue because of exemptions and reduced rates, fraud, evasion, and tax planning… VRR measures the difference between the VAT revenue actually collected and what would be raised if the standard VAT rate were applied to the entire tax base. Therefore, VRR is the ratio of the actual tax revenue to the maximum possible tax revenue" (Bunn et al., 2021). Figure 2 signals higher VAT efficiency in leading non-EU countries: first and foremost, in New Zealand.

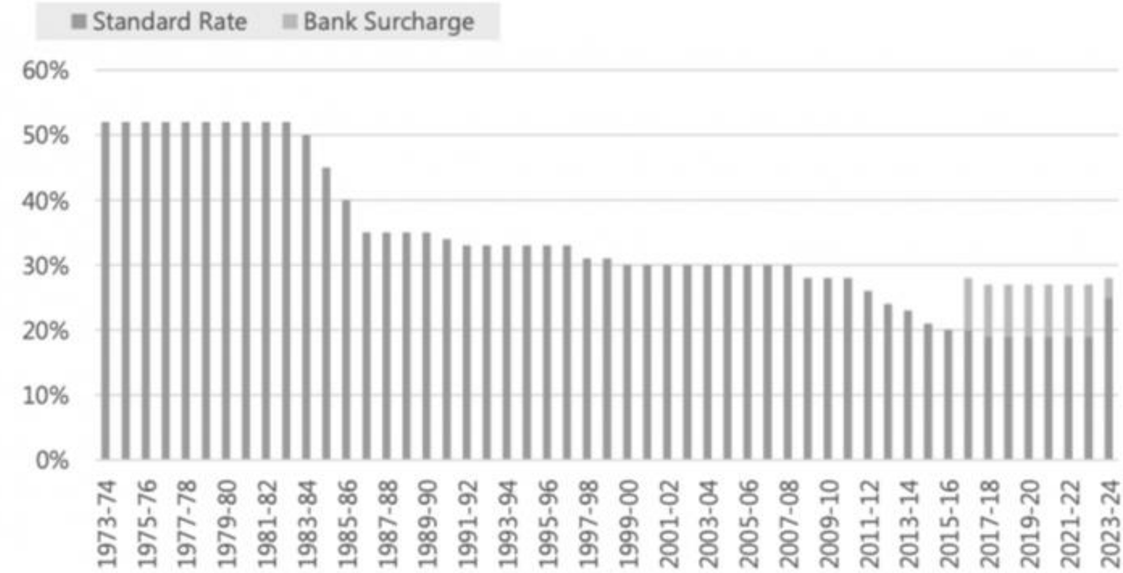
Figure 3 Bank levy in the UK: receipts in per cent of GDP (fiscal years incl. forecast)



Source: OBR (2024)

The British government's Mirrlees Tax Commission has made the following key recommendations on VAT: "Remove nearly all the current zero and reduced rates and, where possible, exemptions from VAT. Introduce a comprehensive package compensating the less well-off on average whilst maintaining work incentives. Retain a destination basis for VAT while ending the zero-rating of exports. Introduce a tax equivalent to VAT on financial services" (Mirrlees et al., 2011). Bank levy in the UK was introduced in 2011. "It is an annual charge on certain balance sheet liabilities and equity of banks and building societies, such as any outstanding loans or interest payments owed. All banks and building societies operating in the UK are liable to pay the levy, with some global groups also liable if they own UK-based subsidiaries or branches. There are two main rates – one for short-term chargeable liabilities with maturities of a year or less and one for long-term chargeable liabilities and equity. Progressive cuts to the bank levy rate from 2018 were announced at Summer Budget 2015, alongside the introduction of an 8 per cent corporation tax surcharge for banks. From 2021 onwards the short-term rate is 0.10 per cent and the long-term rate is 0.05 per cent. In addition, from January 2021 onwards the scope of the bank levy has changed, such that UK-based global banks are no longer taxed on their global equities and liabilities" (OBR, 2024); see Figure 3. From 1 April 2023, the banking surcharge rate was reduced from 8 to 3 percent, "to mitigate the impact for banks of the increase in the UK headline corporation tax rate from 19 to 25 percent, ensuring that the sector remains internationally competitive" (KPMG, 2022). Figure 4 presents the history of the UK corporation tax rates.

Figure 4 UK corporation tax rates (standard rate and bank surcharge)



Source: Rahman (2023)

In Germany, the banks pay a corporate income tax rate of 15%, plus a 5.5% surcharge and a 16.1% trade tax rate (for Frankfurt). “Companies that provide VAT-exempt services may be liable to pay special payroll tax (in Danish ‘lønsumsafgift’) in Denmark, which is calculated on the total payroll, including any type of wages and bonuses that the employee has received. There are four different calculation methods, which method should be applied depends of the activity and organisational structure. The method and percentage applied to calculate the special payroll tax depend on the ratio between VAT-able and VAT-exempt services supplied. In case the VAT-exempt financial revenue is more than 50% of the total revenue, the company will be qualified as a financial services provider and the special payroll tax is then 15.3% (2021 rate) of the payroll used for the VAT-exempt activities. This tax is deductible for income tax purposes” (Naess-Schmidt et al., 2021).

In most European countries, there is a tax on insurance premiums, which is considered a substitute for VAT in the insurance sector. There is a relatively large differentiation of rates, most of which do not apply to life insurance. E. g. in the UK, the insurance premium tax is a tax on general insurance premiums; there are 2 rates: a standard rate charged on most insurance premiums and a higher rate for travel insurance, mechanical or electrical appliances insurance and some vehicle insurance.

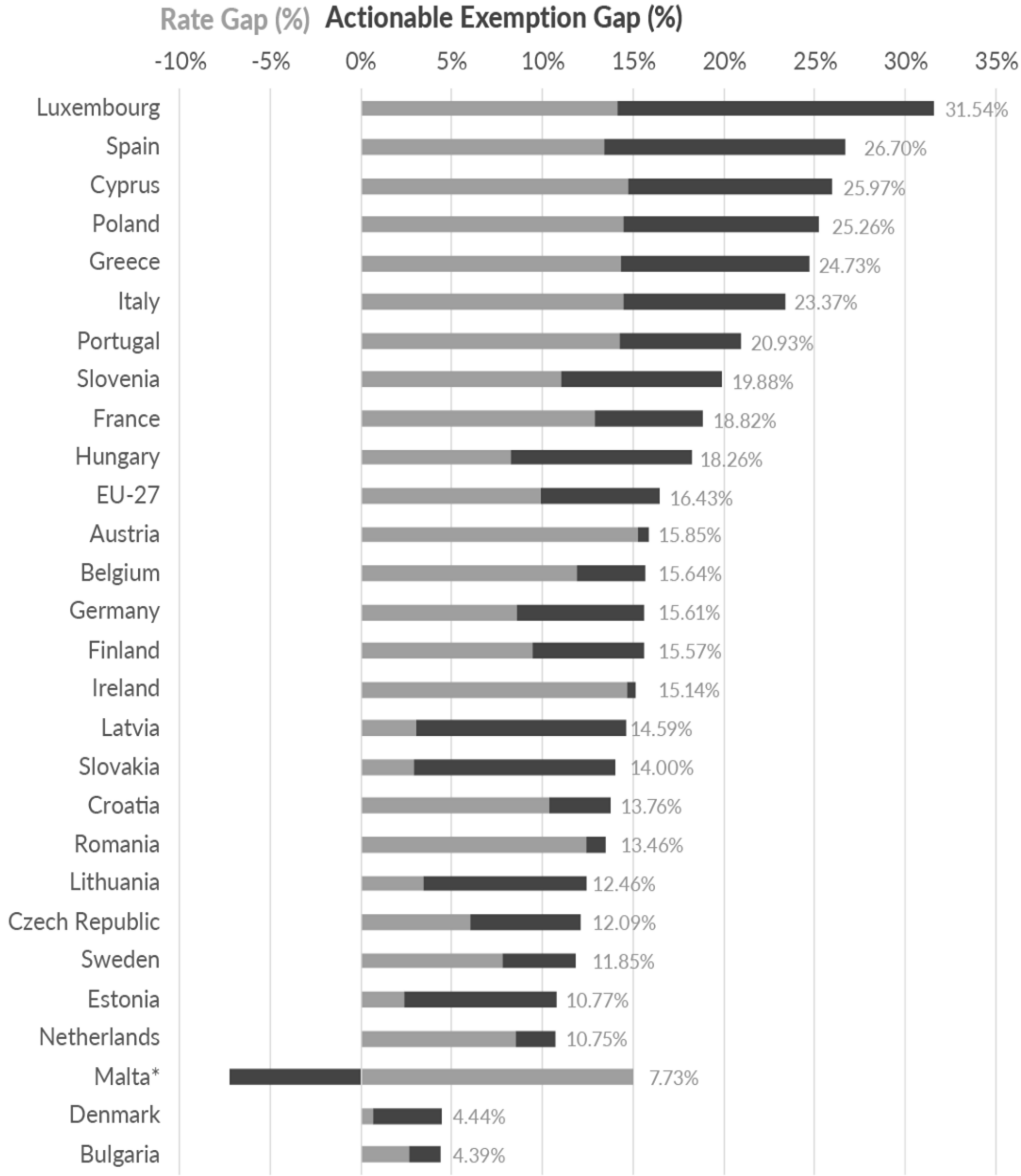
The exemption of financial services “creates several economic distortions in our economies. Firstly, VAT registered businesses pay too much when they are buying financial services, while consumers pay too little. Financial institutions pay VAT on their purchases, and the VAT costs are passed on to business customers who cannot deduct them in their own VAT bill (“hidden VAT”). By contrast, consumers gain an advantage as no VAT is applied to the real services that banks provide. This is a classic example of a distorted allocation of resources. Secondly, the exemption creates an incentive to insource production processes where they could have been outsourced. The reason is that VAT on the purchased inputs would be an additional expense compared to an insourcing scenario where the same value would be produced in-house. As a result, net of VAT production costs in the banking sector are likely to be higher as the incentive to save on taxes may outweigh the benefit from buying from lower cost external suppliers. The best solution to this problem is to go for something like a full VAT model for financial services” (Naess-Schmidt et al., 2021).

“The ideal VAT system has a broad base comprising all final consumption and a single rate of tax… This means consumers have no incentive to shift consumption to more lightly taxed goods and services that would be less enjoyable to them. The only distortion is between goods and services purchased on the formal market and informal home-produced goods and services. Yet there is little that redesign of VAT can do to mitigate this. Objectives other than raising revenue are ill-served by VAT concessions. For example, seeking to support poor households by exempting food from VAT can cost significant revenue. After all, the rich also purchase food - and often much more of it. The poor could be supported more efficiently by a combination of progressive income taxes and cash transfers. Similarly, regulating behaviour such as drinking, smoking, and polluting is not well achieved by differentiating VAT rates; it is better to use dedicated excises applied to alcohol, tobacco, and emissions. Most VATs are far from the textbook design. Countries often employ a variety of reduced rates, exemptions, and special programs. Some are intended to make it simpler to administer the tax. For example, many countries use a minimum registration threshold based on turnover to exempt micro businesses from VAT and its associated cost of compliance and administration. Most exemptions and reduced rates are adopted to improve the distributional impact of VAT, but they undermine the core objective of raising revenue, both directly and indirectly, by increasing the cost of collection and often facilitating fraud. Reforms to eliminate these VAT concessions have often met with fierce resistance from powerful lobby groups with vested interests" (Mooij, Swistak, 2022).

The Policy Gap is an indicator of the additional VAT revenue that could theoretically be generated if a uniform VAT rate is applied to the final domestic use of all goods and services. The Policy Gap has two components: the Rate Gap and the Exemption Gap. The Rate Gap represents the loss in VAT revenue due to reduced VAT rates, and the Exemption Gap is connected to the implementation of exemptions. The Czech Policy Cap was 6% + 6% = 12% in 2020 – see Figure 5. By subtracting this gap from the basic VAT rate in Czechia (21%), we get a rate of 9%, which also means that today's Czech VAT could be transformed into direct taxation of value added (wages and profit) at a rate of 9%.

The transition from turnover tax to value-added tax has eliminated the fundamental design flaw of turnover tax: its cascading. However, the first generation of value-added tax in the EU is very far from a universal, flat consumption tax. "Value-added taxes … are ripe for reform to avoid distorting consumption patterns and raise revenue in a stable manner" (Bunn et al., 2021). In this respect, the EU is essentially content to work on the 'definitive tax regime' for intra-EU business transactions. "The second key structural issue is the VAT treatment of trade between EU member states. We argue that while the goal of a systematic destination principle VAT treatment of internationally traded goods and services remains desirable, the current mechanisms by which this is achieved need reconsideration. Zero-rating of exported goods exposes the VAT system to significant risks of fraud and evasion – exploited by recent high-profile instances of 'carousel fraud', as well as by more mundane evasion. We argue that while the extent of these problems should not be over-stated, a reform of the VAT treatment of intra-EU trade, in which goods would be exported bearing VAT, would reduce the vulnerability of the VAT system to frauds and evasion surrounding international transactions" (Mirrlees et al., 2010).

Figure 5 Rate Gap and Actionable Exemption VAT Gap in EU Countries (2020)



Source: Enache (2023)

The transition to the "second-generation" VAT would be an important improvement of the EU VAT system. But it does not seem to that somebody would request such a reform. There would be a great opposition to such an improvement from the lobbyists. There are two other VAT reconstructions according to the Table 1: the "subtraction method VAT" and the retail sales tax. The (US) retail sales tax is a clear and simple solution … and should be considered in the EU discussions. The subtraction method VAT is de facto the only tax on value added produced in the business sector. The credit-invoice "value added tax" is a misleading entrepreneurial-sounding moniker for a tax ultimately paid by the consumer. In effect, it is a general consumption tax on goods and services, calculated by adding all of the costs involved in making and distributing goods or services, minus the amount that businesses can claim back during the production process for their "inputs": the raw materials, goods and services acquired in making the finished product. The EU VAT had to be called e.g. Goods and Services Tax (GST). /Germany has a law on turnover tax (Umsatzsteuer)./

III. Flat Tax

"While any tax system with flat rates could be called a flat tax, the name is usually reserved for a system developed by Robert Hall and Alvin Rabushka in 1985. Their flat tax is really a two-part

VAT: All value added except wages is taxed at the business level and wages are taxed at the individual level at the same flat rate… All taxable wages and all business non-wage value added would face the same flat rate. In Hall and Rabushka's original proposal … that rate would be 19 percent… Firms would be responsible for paying taxes (at a flat rate) on sales after they have deducted wages, pensions, material costs, and capital investments. Individuals would be responsible for paying taxes (again, at a flat rate) on the wages that firms have deducted, but only on wages in excess of an exemption level" (Tax Policy Center, 2024). "the flat tax was intended to simplify the federal tax system by replacing the progressive federal income tax system with a low and simple flat tax. They believed that the flat tax is the fairest and most efficient, simple, and workable tax plan… The flat-tax proposal gained steam in the 1980s and inspired President Reagan's Tax Reform Act of 1986. Two rates of 15% and 28% replaced the prior system's multiple tax brackets. In 1990, Congress added a third rate of 31% on higher incomes, reducing the simplicity of the tax structure. Just a few years later, under President Clinton, additional brackets effectively gutted what had been a relatively flat tax system… While the flat tax has lost steam as the basis for tax reform in the United States today, it's currently in use in 24 countries around the world" (Hoover, 2019).

Hall and Rabushka's concept of tax reform was relatively successful in the post-communist countries, but ironically it did not (and could not) replace the already existing (and in the EU) mandatory value-added tax; Value Added Tax was "in addition" added to the taxation of personal and corporate income, at the same, flat rate – without making any sense. The somewhat "Bata-like" rate (19%) seems to have a special, marketing appeal.

In 2004, Slovakia introduced a single flat rate of 19% for the same three taxes as Estonia did in 1994: personal income tax, corporate income tax and value-added tax. "Probably the most consistent, elaborate and thus the most attention-deserving tax reform towards a flat tax is the Slovak version with a uniform rate of 19% for personal income tax, corporate income taxation and VAT (true flat tax), i.e. the rate recommended by Hall and Rabushka. It was accompanied in a coordinated manner by social and pension reforms and health system reforms. In addition, in order to eliminate tax duplications, certain fiscally insignificant property taxes as well as the dividend tax have been abolished. Also, capital gains are taxed only at the level of the company's profits" (MF, 2008).

In many post-communist countries, the concept of a single flat rate for the three taxes was eroded in the following period. For example, in Slovakia, a second personal income tax rate (25%) was introduced in 2013, the basic value-added tax rate was increased to 20% and a reduced VAT rate of 10% was introduced; The corporate income tax rate was increased to 22%. From 2023, a new reduced VAT rate of 5% has been introduced for buildings (including land) that meet the conditions for state-supported rental housing. This shows, among other things, that uniformly designed taxes and tax systems are in practice under intense and one-sided lobbying and political pressures. But academics should not step down from them; they should (and usually do) prefer simple conceptual solutions.

From the point of view of modern tax theory and policy, the "two-part" value-added tax, e.g. as presented by Hall and Rabushka, appears to be a very effective substitute for the non-existent value-added tax (in the US). Even if it is "just" a product of the local federal, state and local tax system. Even the European Union's tax "system" does not have it easy – if it can be called a system at all. However, if we limit ourselves to a factual analysis, it is clear that the "two-part" value-added tax is significantly better and more effective than all the previously analysed value added tax systems. Our conclusion is that we could do without value-added tax (not only in the EU). However, it is necessary to elaborate on this and also to "fight" it with the neoliberals, who demand a different social tax model, based on the taxation of (final) consumption. Ideologically, this is "justified", but these academics and politicians should not assume the automatic existence of parallel income taxation. The progressivity of personal income taxation is achievable not only by progressive tax rates, but also by a basic tax credit per taxpayer (possibly considering the size of the family, as in the case of Hall and Rabushka). The general technical advantage of the taxpayer relief, which is also applied in Czechia, is its simpler indexation, eliminating inflation.

Thus, the current value-added tax in the EU can be replaced by a payroll tax (in one form or another) and a tax on corporate income of all kinds.

IV. Czech taxation of profits and wages incl. social insurance premiums

The VAT gap in Czechia is about 12%; if we subtract this rate from the basic rate of this tax (21%), we get 9%. Today's Czech VAT can therefore be replaced by (additional) taxation of value added (wages and broadly conceived profit) at a rate of 9%. The same approach can be taken in other EU countries. The introduction of the "definitive" value-added tax system (now planned for 2027) can thus be definitively laid aside. Should some EU countries conclude that they cannot do without (reformed) value-added taxation, there is still the possibility of switching (to a limited extent) to the retail sales tax that exists in the US. One way or another, we have concluded that (not only the first-generation) value-added taxes do not stand up to criticism ... and has no place in a rational tax system.

With the abolition of value-added tax, the zero tax rate for exports outside the EU, especially to the USA, will also be eliminated, and the full tax burden for imports. This issue has not yet received due attention in the world (potential retaliatory measures!).

The Czech tax mix is unbalanced: mainly because we have very high social security contributions (including health insurance) at the expense of personal income tax. Shifting a significant tax burden from social security contributions to income tax is relatively easy and highly effective, as all employee contributions can be included in the employee income tax or personal income tax, leaving only social security contributions paid by employers and the self-employed. Even after this tax reform, the tax nature of contributions will prevail over the insurance elements, which facilitates a fundamental rationalization of the existing social security contributions to the state employment policy, general health insurance premiums and statutory employer liability insurance premiums for damage in the event of an accident at work and/or occupational disease, all within the first (and actually basic) stage of the implementation of the single collection point. The merger of all these premiums/contributions will create a single employer social security contribution, which will also significantly reduce the (internationally monitored) administrative burden on (medium-sized) enterprises or employers in general.

The greatest fiscal rationalization will take place in the current sector of Czech public health insurance, which is an unnecessary complication in the conditions of unified state management of the financing of the sector based on the so-called reimbursement decree of the Ministry of Health. Health insurance premiums will thus become, as well as the other premiums and contributions mentioned above, an integral part of the collection of the new personal income tax and the new social contribution paid by employers and the self-employed. With this integration of health insurance, the existing payments of the state for the „state insureds“ and unfair health insurance premiums paid by persons without taxable income will also be eliminated.

The total amount of employee social security contributions currently amounts to 11.6% of wage, and after its integration into the payroll tax, the total taxation of employee wages will rise to 26.6%. Today's aggregate employer social security contributions are 34.1% of wages; If the value-added tax were abolished, it would increase by 9% to 43.1% of wages. If we would like to transfer part of the employer social security contribution to the payroll tax, we would have to make a corresponding one-off increase in gross wages.

V. Conclusions

Engliš concluded that the turnover tax cannot have a place in the normal tax system. Its advantage was its enormous yield, which came in handy after the World War. In the Czech Republic, it was introduced in 1924, with (original) validity until 1926, with two rates. However, with the extension of its service life and the increase in rates, all its defects increased, resulting mainly in large tax evasion. The sales tax survived the Second World War and was only transformed into a value-added tax in Western Europe after some time.

Value-added tax (VAT) is considered to be the most successful fiscal innovation of the last 60 years. The first generation of VAT was born in EU countries; Today, it is considered the weakest kind of this tax. There has been no transformation to a second-generation VAT which in its ideal variant would have been a general tax applicable to all sectors, with a uniform (and significantly lower) tax rate.

Value added is not subject of the VAT. VAT effectively taxes the sale of goods, with the tax liability being reduced by "input" VAT. To tax the value added actually would mean to tax profits and labour costs directly; until recently, they practiced it in Japan. But this is unnecessary: profits and wages are taxed anyway, with a few exceptions. So, we can actually do without a value-added tax.

Each tax is associated with various interests and lobbying, which often leads to tax distortions. At the same time, I respect several welfare regimes. The liberal model includes equal income taxation, while the neoliberal model includes consumption taxation – theoretically preferably in the form of proportional (annual) taxation of consumption expenditures, in practice in the form of a universal value-added tax, with a single rate. The Christian Democratic model is based on personal and corporate income taxation and disaggregated social insurance systems. The social-democratic tax model, on the other hand, is simpler: it applies dual income taxation and employer social security contributions. These last two models would be free of value added tax. Lobbyists in the EU have pushed for the financial sector to be exempted from VAT: it is not possible for conceptual reasons. If this were true, then of course there should be substitute taxation for this sector, e.g. in the form of taxation of wages or insurance products; this is the case (in various forms) in several countries.

In the U.S., attempts have been made to replace the non-existent VAT with two taxes: an individual payroll tax and a business tax, with a single rate. In Eastern Europe, Hall and Rabushka's proposal for a "flat tax" consisting of the two taxes mentioned above, with a uniform rate of 19%, became widely known. Dividends and interest income are not subject to these taxes, and interest expense and depreciation are not deducted from business tax (entire investments are "depreciated" for tax purposes). In the case of payroll tax, Hall and Rabushka proposed a deduction from the tax base based on the number of family members. Tax reform in Slovakia, for example, since 2004 has introduced 2 flat taxes (in principle) according to this model (with explicit reference to Hall and Rabushka), plus ... the same rate (19%) for value- added tax.

VAT can be replaced by value-added taxation: payroll and business tax, with appropriate integration with existing personal and corporate income taxation. In the reserve, the EU member states still may use the American sales tax, if some of them could not do without it.

The "transition period" leading to the elimination of value-added tax in the EU may even take quite a long time, as we will come up against various interests. However, we should immediately launch a campaign in Czechia to introduce substitute taxes for the value-added tax, following the example of other European countries. A small, Czech VAT reform might introduce the missing financial sector taxation and mean a partial transition to the NZ “second-generation” value-added tax (single-rate, 15%), in conformity with the EU VAT directive.

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