Tax expenditures estimation in the Czech Republic for 2023

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 rate[1]. 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 foregone revenue method is a static one which means that behavioral responses or the interaction with other tax bases is disregarded. However, entities may change their behavior following the new tax regime, which may lead to a different real impact on public budgets. At the same time, even if expected changes in behavior were not taken into consideration, abolition of any tax expenditure would not automatically result in the tax revenue increase. 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.

2 Tax expenditures estimation

In general, a lot of data is needed to estimate the amount of each tax expenditure. In many cases, obtaining necessary data would cause a disproportionate increase in the administrative burden for the entities concerned. Although the foregone revenue method is data-intensive, it is relatively simple compared to other methods and is therefore the most widely used method.

The quantification of all tax expenditures that the Czech tax system involves is not possible due to absence, unavailability or incompleteness of the data. It is also necessary to take into account the minimum limit of the tax expenditures from which they are calculated and the amount of the administrative burden required for obtaining them. 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.

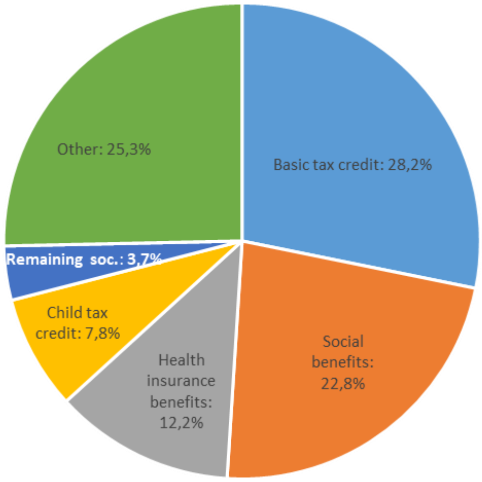
The data from Automated Tax Information System is mainly used to estimate the tax expenditures. Other data sources used, are publicly available or was requested by the Ministry of Finance (e.g. data from internal reports of various institutions).

2.1 Personal income tax

Total personal income tax (PIT) expenditures were estimated to CZK 560 billion in 2023. According to our analysis, CZK 340 billion is accounted for tax exemptions, nearly CZK 12 billion for items reducing the tax base and almost CZK 209 billion for items reducing the tax (Table 1). In total, 75% of the tax expenditures have a social aspect (Chart 1). The most significant is the basic tax credit (more than 28%), followed by the exemptions of social benefits from public insurance schemes, state social security benefits and material need (in total almost 23%), and child tax credit (nearly 8%). In the Czech Republic, benefits from public health care insurance system are also tax exempt (representing more than 12%).

[1] https://taxfoundation.org/taxedu/glossary/tax-expenditure/

Chart 1: Structure of personal income tax expenditures



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

Since 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 with effect 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. On the other hand, effective from January 1, 2024, a new tax-supported long-term investment product (pension investment scheme) was introduced as part of the Act No. 462/2023 Coll. Furthermore, with effect from January 1, 2026, based on Act No. 176/2025 Coll. the possibility of mortgage interest tax deduction will be extended to interest on loans drawn by a residential cooperative. The overall impact of the legislative changes will result in a reduction of tax expenditures for the year 2026 by an estimated amount of CZK 4,6 billion compared to the period before the change, which includes the year 2023 as well.

Table 1: Personal income tax expenditures for 2023 (CZK billion)

Category	Tax exemption	Income Tax Act	2023
Tax exemptions	Pension insurance benefits and services	§ 4	102,8
	Benefits from public health insurance	§ 4	68,5
	Winnings from lotteries nad raffles	§ 10	121,9
	State social security benefits	§ 4	9,1
	Meal vouchers provided by employer	§ 6	10,0
	Income obtained in the form of allowances and services from sickness insurance	§ 4	6,9
	Social support payments and payments received for close person care	§ 4	5,6
	Compensation from the insurance of persons	§ 4	1,9
	Benefits from the application of the State employment policy tools	§ 4	1,6
	Social benefits in material need	§ 4	1,9
	Pension insurance contributions provided by employer	§ 6	2,4
	Retirement allowance for security forces members	§ 4	1,8
	Benefits in kind from the cultural and social needs fund, social fund or profit after tax	§ 6	2,2
	Social services	§ 4	1,7
	Compensation received for donation of blood and blood components	§ 4	0,2
	Scholarships	§ 4	0,4
	Interest income from bonds issued after 1 January 2021 by the Czech government	§ 4	1,2
Tax deductions	Mortgage interest deduction	§ 15	7,9
	Contribution to private life insurance	§ 15	1,0
	Contribution to private pension insurance	§ 15	1,4
	Charitable donation	§ 15	1,4
Tax credits	Basic tax credit	§ 35ba	158,0
	Child tax credit	§ 35c	43,5
	Spouse tax credit	§ 35ba	4,2
	Placing a child in a preschool facility	§ 35ba	2,2
	Student tax credit	§ 35ba	0,4
	Disability tax credit	§ 35ba	0,4
Total			**560,5**

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

2.2 Corporate income tax

Corporate income tax (CIT) expenditures are estimated to CZK 33 billion in 2023 (Table 2). Exemptions amounted to more than CZK 13 billion, the tax deductions amounted to more than CZK 5 billion, tax credits amounted to CZK 4 billion, and the impact of reduced tax rates was estimated to CZK 11 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.

Table 2: Corporate income tax expenditures for 2023 (CZK billion)

Category	Tax exemption	Income Tax Act	2023
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	0,4
	Revenues from financial market operations with state treasury	§ 19	4,5
	Interest income from bonds issued after 1 January 2021 by the Czech Republic government	§ 19	7,9
	Earnings from reserves deposited on restricted account	§ 19	0,2
Tax deductions	R&D allowance	§ 34	2,8
	Charitable donation	§ 20	1,3
	Deduction for public benefit activities	§ 20	0,7
	Deduction to support professional training	§ 34/4; §§ 34f-34 h	0,4
Tax credits	Investment incentives	§§ 35a, 35b	1,7
	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	2,7
	Mutual funds	§ 21	3,4
	Pension funds	§ 21	4,9
Total			**33,2**

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

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 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.

In summary, it can be stated that the VAT exemptions exceeded CZK 200 billion in 2023, while the reduced tax rates of 10% and 15% decreased fiscal revenue by more than CZK 97 billion.

Table 3: Value added tax expenditures for 2023 (CZK billion)

Category	Tax exemption	VAT Act	2023
Tax exemptions	Immovable property renting	§§ 51, 56a	201,0
	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	97,3
Total			**298,4**

Source: Calculations of the Ministry of Finance of the Czech Republic.
Note: Sum differences are due to rounding.

3 Conclusion

Although individual tax expenditures influence each other and it is not methodologically correct to simply add up the amount of tax expenditures together, this analysis serves 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 2023 (CZK billion)

Category	PIT	CIT	VAT
Tax exemptions	340,1	13,4	201,0
Tax deductions	11,7	5,2	-
Tax credits	208,7	3,6	-
Reduced tax rates	-	11,0	97,3
Total	**560,5**	**33,2**	**298,4**
Total 2023		**892,1**	

Source: Calculations of the Ministry of Finance of the Czech Republic.
Note: Sum differences are due to rounding.