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Technical University of Liberec

THE IMPACT OF CORPORATE INCOME TAX ON THE CZECH MACROECONOMIC ENVIRONMENT AND THE FINANCIAL MANAGEMENT OF COMPANIES

Summary: The aim of the paper is to discuss the importance of the government in the position of the stakeholder in the environment of the Czech Republic. The discussed topic is explored on two levels in the paper. In the macroeconomic view, The basic theses defining the government as a main stakeholder of the business are analysed. The government creates the institutional and legislative framework of business, and one of the important components of this framework is tax policy and the tax system. In the microeconomic environment, the influence of tax legislation of corporate tax in the Czech Republic on business management is analysed.

Keywords: stakeholder, tax policy, tax legislation, corporate tax, financial management of enterprises.

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1. Introduction

All business units move in a specific economic environment and are influenced by a range of external and internal factors. This makes up the business environment of a particular business. If the business entity wants to successfully profile on the market and withstand strong competitive pressures, the company management must be familiar with all the powers which affect the company. The analysis and the investigation of this phenomenon have resulted in the formulation of the stakeholder theory. Edward R. Freeman [Freeman 1994] defined specific groups that affect a company, and vice versa, are affected by a company. This stakeholder approach sees a company as a network of relations of the company to individual groups of subjects – stakeholders. Each stakeholder brings to the company a deposit associated with some expectations which are enforced with respect to the bargaining power of the stakeholders. This bargaining power depends primarily on the position in which the relevant stakeholder is in relation with the company [Freeman 2010].

As these forces are generally based on specific institutions or individuals, companies can identify such interest entities, monitor and diversify them according to their importance and reflect this gained knowledge in strategic plans and decisions [Windsdor 2010]. The state is considered a major stakeholder which creates the framework of the economic process of any business entity through its policies, priorities and legislation. The state should create such an economic environment in which the business would prosper, the labor market would be supported and macroeconomic variables would show a positive trend, or the gross domestic product or national income would increase.

The state uses a variety of administrative and legislative instruments to influence the economic environment. The most powerful tool that reflects the state's defined policy to economic reality is the tax system. The legislative provisions of sub-taxes fall in full not only in the management of enterprises, but also help the country implement its macroeconomic objectives [Brunoni 2011].

2. Effect of collected taxes on the economic environment of the Czech Republic

In the Czech Republic in 1992, a new tax system was created that corresponded with the taxation system in the developed European countries. In connection with the accession of the Czech Republic to the European Union in 2004, some laws have been significantly amended, however because of the harmonization processes in the area of indirect taxes, there were also new laws passed for value added tax and consumption tax.

The provisions of corporate income tax are the most significant in the context of the tax system for the implementation of state policy in the field of the labor market and the stimulation of economic growth processes. The state that is in a position of an external stakeholder of a company is interested not only in the collection of taxes which make up the revenue side of the budget, but also in the promotion of entrepreneurship and the creation of jobs. This solves the dilemma regarding what amount the corporate tax rate should be set at in order to meet both objectives. According to the Laffer Curve, which shows the elasticity of taxable income [Knowles 2010] it is clear that if the tax rate exceeds a certain point, the willingness of enterprises to make a profit and employ workers decreases. Consequently, employment declines, the economic result of enterprises reduces and thus government revenue decreases [Rahn 2013].

The historical development of the corporate tax rate in the Czech Republic can be traced back to 1993. With the process of transforming a planned economy to a market economy, a gradual reduction in the corporate tax rate continued from 45% in 1993 to the current 19% tax burden. Figure 1 shows the steady downward trend in the rate of corporate tax and then the stagnation in the last four years.

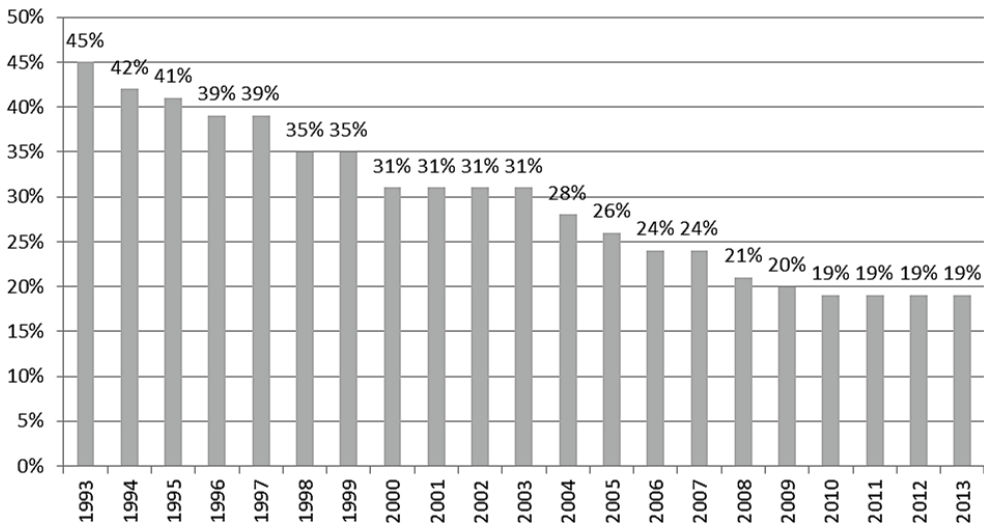


Figure 1. Development of corporate income tax in the Czech Republic

Source: author's own graph according to the data from the Ministry of Finance of the CR (Statistics of taxation 2013).

Corporate income tax in the Czech Republic has played an indispensable role in state budget revenue (it is the third largest state budget revenue for value added tax and consumption taxes). A continuously decreasing tax rate should promote economic recovery as well as growth in gross domestic product. Table 1 summarizes the development of corporate income tax, gross domestic product and the relationship between the two variables examined.

Table 1. Development of money collection, corporate tax and gross domestic product

bill. CZK	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Tax	52	55	58	76	91	97	107	137	129	156	174	111	115	109	120
GDP	2.062	2.149	2.270	2.449	2.568	2.688	2.929	3.116	3.353	3.663	3.848	3.759	3.800	3.841	3.843
Tax/GDP	0,03	0,03	0,03	0,03	0,04	0,04	0,04	0,04	0,04	0,04	0,05	0,03	0,03	0,03	0,03

Source: author's own table based on the data from the Ministry of Finance of the CR.

From the above data, it is clear that the decreasing tax rate itself does not affect tax collection to the state budget that much and it has no significant share of gross domestic product (the relationship of corporate income tax and gross domestic product is more or less constant).

The fact that although the rate of corporate income tax in recent years has continuously decreased, the apparent increase in the collection of this tax practically until 2008 is also noteworthy. Since 2009 other macroeconomic factors, particularly

the global financial crisis, have considerably influenced the choice of tax. The decline in exports, which the Czech Republic is heavily dependent on, is also related to this, together with the subsequent decline in production and an overall slowdown of the economic process.

The impact of the partial provisions of tax legislation of corporate income tax and especially the frequent amendments to the tax are crucial for the significance of the state as a corporate stakeholder. The calculation of corporate income tax in the Czech Republic is quite complex. There is a big difference between profit before tax and the actual tax base. This difference is mainly due to a number of items that tax law explicitly identifies as so-called non-deductible expenses [Marková 2013]. Subsequently, the tax base is extended by the following items against accounting profit. As a result of this legislative change, the result of the company's pre-tax economic activity does not indicate the potential tax liability and tax rate information does not have any information value without understanding a broader context. Table 2 shows selected data based on information collected from the tax returns of enterprises in the Czech Republic between 2005-2011.

Table 2. Selected data from tax returns of companies in the Czech Republic

Items	2005	2006	2007	2008	2009	2010	2011
Tax rate %	26	24	24	21	20	19	19
Profit – bill. CZK	485	480	658	593	534	225	253
Non-deductible expenses	466	486	484	518	548	665	650
Income tax – bill. CZK	125	143	166	147	119	117	115
Net profit after tax bill. CZK	360	337	492	446	415	108	138

Source: author's own table based on the statistics of the Ministry of Finance.

It is evident that although the tax rate during the analysis period decreased, the profit of the enterprise was not supported by this measure. This was obviously caused by the crisis that gradually engulfed the global economy; however, a significant contribution was also made by the group of the so-called non-deductible expenses, whose importance has increased over the years through amendments to the Act. The correlation of tax burden „T“ (expressed as a relationship of calculated tax/profit before tax) and the available resources „D“ that the company could use (net profit after tax/profit before tax) is expressed in Figure 2.

The above analysis shows that the ratio of after-tax profits and taxes paid has greatly changed over the years. While at the beginning of the period under review, profit after tax generated about 80% of pre-tax profits, in recent years this ratio has changed significantly. It can be said with a certain simplification that this proportion is practically in equilibrium (half of pre-tax profit is taxed and the other half is a source for enterprise development). This is mainly due to the increase of non-

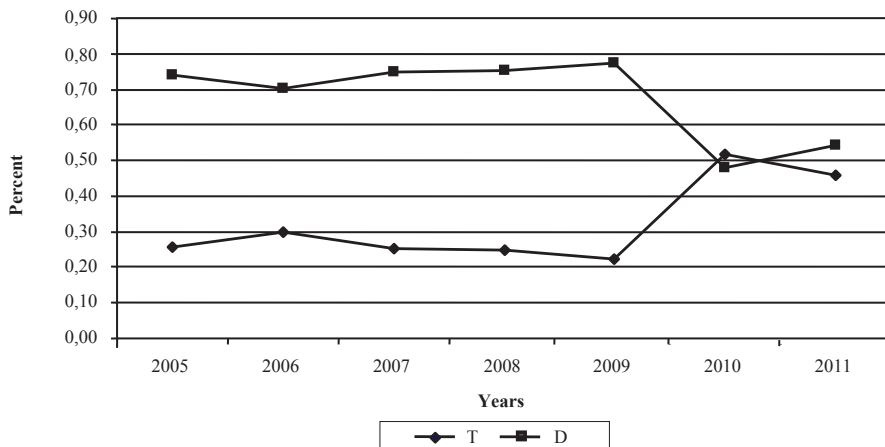


Figure 2. The development of the tax burden and available resources of companies in the Czech Republic in the period 2005-2011

Source: author's own graph based on the statistics of the Ministry of Finance.

deductible expenses, such as shortening the depreciation of fixed assets, the non-inclusion of all interest on loans as a tax-relevant expenditure and tightening the other conditions for the recognition of the company's costs for taxation purposes.

3. The impact of corporate income tax on the financial management

Successful financial management is related to the optimum settings of the ownership structure and in particular to the creation of an effective mix of the protection of corporate assets. In recent years, there have been postulated many scientific theories that addressed both the rules for determining the optimal structure of assets and capital resources, and also there were analyzed a number of factors that influence the process of determining the optimal structure of assets and liabilities. In the early days of research, the issue of the structure of capital resources was discussed without accepting the influence of taxes [Miller, Modigliani 1958]. Later, a revision of the basic theses was carried out and taxes were defined as one of the key factors affecting the formation of the capital structure of enterprises (in the literature there were subsequently investigated and discussed questions dealing with the impact of taxes on the property, in particular the capital structure of enterprises and the economic effect, and also the impact of the existing taxes on the decision-making of financial managers [Miller 1977].

Corporate income tax is a tax that significantly influences the decision-making of businesses in financial management, especially in dealing with the structure of capital equity and debt capital [Overesch, Voeller 2008]. The Income Tax Act in the

Czech tax system came into force in 1993, since then the law has been amended 133 times. The provisions of the Act are quite complex and confusing, especially for the financial management of enterprises in the Czech Republic. Frequent amendments make the situation even more complicated.

The partial provision of this tax is reflected not only in the decision-making about the capital structure of enterprises. The law on corporate income tax also significantly affects the amount of disposable income as a source for the successful operation of enterprises. An important factor in determining this profit is not only the income tax rate, but especially the way the tax base for the calculation of the tax liability of the company is assessed. In the Czech Republic, however, the financial profit from the tax base from which tax is then calculated differs significantly.

The most significant elements of the legislative provisions of corporate income tax that affect the performance of enterprises are evident both in the assets, the structure of the business assets, and in the field of liabilities, the sources of corporate assets [Massbaum, Sureth 2009].

In the area of assets, tax legislation particularly modifies the following areas:

- depreciation of fixed assets (only depreciation calculated under the rules of the act can be considered relevant in terms of income tax);
- management of problematic debts and adjusting items for them.

In the area of sources of financing assets (liabilities), the individual articles of corporate income tax affect in particular:

- the issue of taxation of dividends;
- profit after taxation of the company as a basic resource for potential business development (the defined method for calculating the tax liability and the corporate income tax rate);
- the conditions for the possibility of including interest on loans, which form an important source of corporate financing, into the costs accepted in terms of tax law;
- questions of the creation of statutory provisions, rules for their creation and use;
- employee income tax of individuals, including the issue of payment of social security and health insurance and their reflection in a tax-deductible expense [Vančurová 2012].

The impact of selected legal aspects of corporate income tax is quite large in the economic practice of enterprises in the Czech Republic. This is significantly reflected in the decision-making processes of the management of enterprises in the area of corporate finance and the creation of an optimal capital structure (with the necessary structure of capital equity and debt capital). The above specified provisions of the act fall on a broad group of stakeholders' enterprises. In the primary stakeholder group of companies, the provisions of corporate income tax affect a large group of business owners. Given that dividends or profit shares are taxed at the rate of corporation tax (currently 19%), followed by a special tax rate (15%), in rare cases there occurs the so-called double taxation of dividends (although according to EU rules the impact of the act on shareholders is mitigated). Tax legislation is also important for the group of employees of enterprises. The extent of their satisfaction with their work for the

company is closely related to the amount of wages, and hence their income tax rate. In the Czech Republic, the income tax rate for individuals is relatively low (accounting for only 15% of revenue). However, the tax base of employees does not constitute gross wages, but wages extended by social and health insurance, which the employer pays (currently 34% of the gross wages). For investors and creditors, there are important legislative provisions relating to options to reflect interest on loans as tax deductible expenses (the test of interest capitalization). The suppliers of fixed assets are faced with stricter conditions of leasing and the constant changes to legislation on the recognition of depreciation as a tax deductible expense.

4. Discussion

In various divisions of stakeholder enterprises, the state is considered to be the so-called secondary or external stakeholder. In this article, we highlight the tax policy of the state as an important element for examining the extent to which the Czech state fulfills the role of a stakeholder of businesses. From the above information, it can be said that the state significantly affects the economic environment, businesses and their financial management with its tax policy. Our analysis opens the debate as to whether the state performs the functions that are expected from a stakeholder. In research narrowed to tax issues, it can be stated that the state has primarily addressed the role of fiscal taxes and filling the state coffers. Although the state apparently liberalizes the economic environment (reduces the rate of income tax), companies do not have significantly higher resources available for their development (and this regulation is not likely to support the growth of macroeconomic indicators). The poor legislation of tax laws, particularly income tax, contributes to a great extent to this situation. The law is confusing, complex and changes frequently, usually toward stricter conditions for an enterprise. The significant expansion of the tax base of other items as required by law means that businesses operate with fewer resources than the economic results would indicate. Therefore the provisions of the act influence the sources of companies and the position of individual stakeholders.

5. Conclusion

Stakeholder theory is a phenomenon that emerged in the 1960s. There are many opponents and supporters of the idea that a company, in addition to profit maximization, performs other important tasks. It remains an open question whether a stakeholder-oriented company is actually capable of solving or changing a wide range of uncertainties of the contemporary world. The state, as one of the stakeholders, should ensure the prosperity of companies, and thus promote employment – and consequently - the growth of the entire economy. The tax system is just one of the tools that the state can take advantage of to reach these objectives. However, it is also one of the instruments, which may greatly complicate the position of a company.

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WPLYW PODATKU DOCHODOWEGO OD OSÓB PRAWNYCH NA OTOCZENIE MAKROEKONOMICZNE REPUBLICI CZESKIEJ I ZARZĄDZANIE FINANSAMI FIRM

Streszczenie: Celem artykułu jest omówienie znaczenia państwa będącego głównym interesariuszem w kwestiach otoczenia biznesu w Republice Czeskiej. Tematyka opracowania rozpatrywana jest na dwóch poziomach. Na poziomie makroekonomicznym postawiono podstawowe tezy analizujące pozycję państwa jako głównego twórcy zasad prowadzenia działalności gospodarczej. Rząd tworzy warunki prawne w zakresie prowadzenia działalności gospodarczej i znaczącym elementem tego procesu jest także kształtowanie ustawodawstwa podatkowego. W otoczeniu mikroekonomicznym zbadano wpływ przepisów prawa z zakresu podatku dochodowego osób prawnych na zarządzanie finansami firm w Republice Czeskiej.

Słowa kluczowe: interesariusz, polityka podatkowa, podatkowe przepisy prawa, podatek dochodowy od osób prawnych, zarządzanie finansami firm.