

Tax Arrears Write-Off Strategy in the Czech Republic

A Challenge: Write-off Policy Paving the Way for Effective Tax Collection

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As mentioned in the title, one of the strategies to increase the efficiency of tax debt collection is to employ an effective write-off policy.

It's a challenge – yes, it is! A wise person once said: “*Today's challenge, tomorrow's achievement*”. And that's what happened in the Czech Republic. At the end of the year 2016 we changed our tax arrears write-off strategy, and the most critical new aim was to have a realistic amount of tax debt (i.e. ensure debts on hand are collectible debts). This aim was supported by the Czech legislation, which requires continual clearing of uncollectible arrears as one of the priorities.

Seven years later we have a tested and functional write-off strategy and this is much more beneficial for the state budget and the Tax Department. We have higher total payments (particularly voluntary) of taxes. Total collection of taxes in the Czech Republic is steadily growing, tax arrears have been at the same level since 2019 with growing level of collectability, and the total tax gap is decreasing, which is important. However, *we are not standing still*.

Our current aim is to push forward by supporting voluntary compliance, especially in terms of nudges and assistance before any due date. In this rapidly changing world, it's almost impossible to reach a 100 per cent tax payment rate. Even the leading tax administrations can't reach it, but our aim is to get as close as possible.

Background

The role of functional tax arrears write-off procedure in all our process is crucial, as previously mentioned. Based on our domestic legislation, **uncollectible arrears shall be written-off** for these reasons:

- a) unsuccessful enforcement action in relation to the taxpayer and any other parties that can be subject to enforcement action for the debt (e. g. the guarantor, representative); or
- b) enforcement would clearly be unsuccessful; or
- c) the cost of enforcement would likely exceed any amounts recovered; or
- d) there are special or disproportionate difficulties with the enforcement.

If one or more of the requirements are met (sometimes two or more of the requirements are met in a single case), the write-off of the tax arrears is legally required. The most commonly met requirement is the first one (point a). In these cases the taxpayer's assets have been seized and realised (sold or converted into money), no other assets have been found and the tax arrears have not been fully collected. So, any remaining tax arrears are written-off as uncollectible.

In the case of the Czech Republic, arrears continue to be due until the period for paying the tax has expired. This is usually 6 years from the due date, but the period can be extended up to 30 years under specific parts of our legislation (ongoing enforcement procedure, ongoing lien and/or ongoing instalment payments).

The Threshold

Up to 2016 our tax arrears write-off strategy was not comprehensive or applied consistently. Some local tax offices were active, meanwhile some were quite inactive. The introduction of a new strategy was the turning point, as a key element was a unified and united national procedure for all write-offs.

During the following year (2017) an analysis of the tax arrears write-off development was carried out. The results of the study were significant and focused on several surprising points.

Two key ones were:

- Changes in the levels of tax arrears over time are exponential, as you can see below in the graphical snapshot,
- The long-term prediction of **the Threshold** expecting the high of the tax arrears at the level of 0,8 billion €.

Figure 1
Tax Arrears and the Threshold

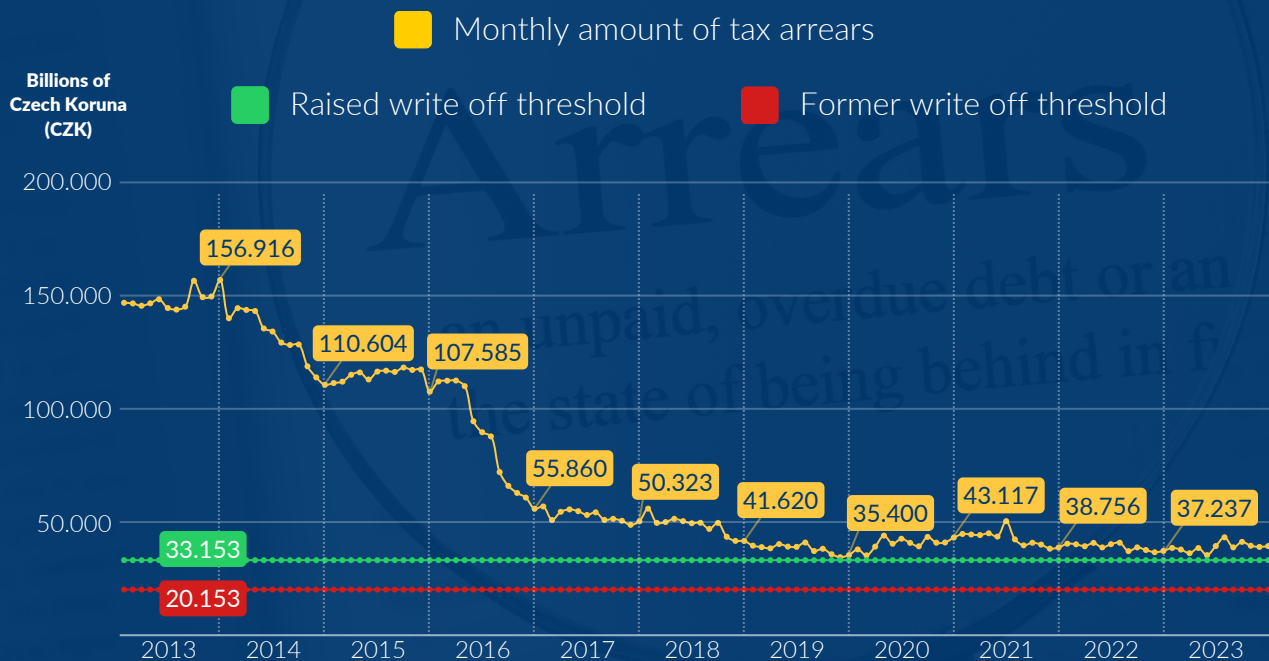


Figure 1 provides a graphical snapshot of the tax arrears and the Threshold covering the period between January 2013 and November 2023, a period of more than 10 years. This period is sufficiently long to identify trends that were mentioned in the study. The amount of current tax arrears is shown for every month of the period. It can clearly be seen that the 2016 increase in the write-off threshold corresponds with a rapid drop in the level of monthly tax arrears, and that level has consistently remained at a lower level ever since.

Since 2017 there has been one extraordinary fluctuation, in June 2021. This fluctuation happened as a result real estate tax due date occurring in that month and the payment of that tax being able to be deferred by several months, by law, as a COVID-19 easement. As the increase in arrears demonstrates, taxpayers took full advantage of this easement.

During 2020 the Threshold were moved upwards as a result of several unexpected causes: ongoing covid-19, followed by the Russian invasion of Ukraine and the high level of inflation across Europe. The Threshold have been moved up from 0,8 billion € to 1,3 billion € (see the stable green dotted line instead of the red dotted line showing the former write off threshold).

Thanks to this new tax arrears write-off strategy, the study and thanks to the Threshold project we have had a clear awareness of tax arrears development in a long-term period. That awareness helped us to understand the overall development of the tax arrears in the Czech Republic. We can allocate the workforce much more effectively, in the way that is currently required, so the whole process is flexible and can respond to current risks.

General Process & Aim on Collectible Arrears

Our aim is to focus directly on collectible arrears. The diagram below (see Figure 2) shows the general process of tax debt management in the Czech Republic. The real process is a little bit more complex, but for the purposes of this article the diagram is sufficiently detailed.

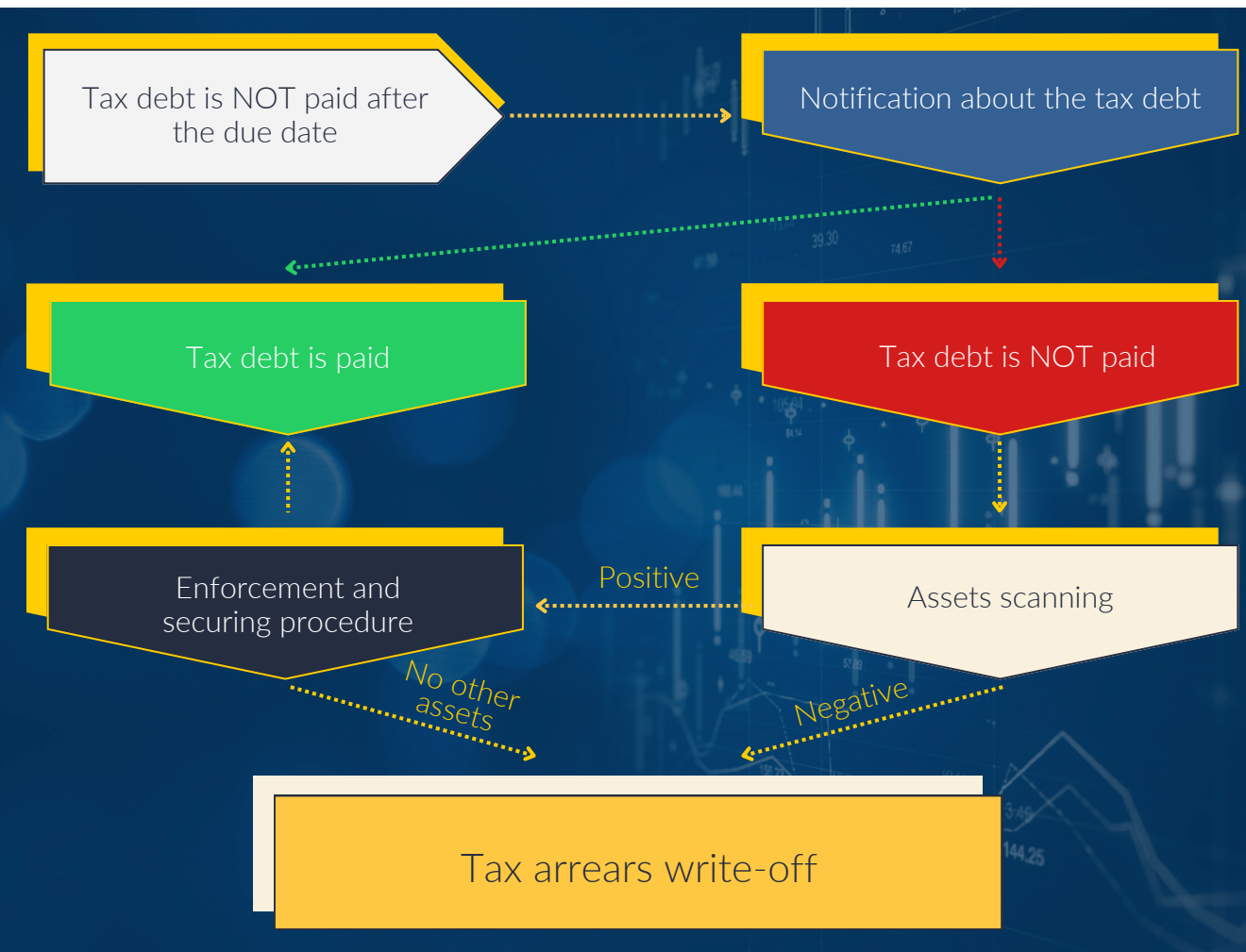
All the taxpayers in the Czech Republic can create an account on the website of Tax Administration of Czech Republic, called “My Taxes” which contains basic information about the taxpayer and their taxes. One of the functions of the platform is automatic notification that a due date is approaching. The diagram shows the process after the due date.

The bedrocks of the process are:

- **Notification** about the tax debt, which is paid or not,
- Automatic **assets scanning**,
- **Enforcement** and **Securing** procedure and/or tax debt write-off.

Figure 2

General process of the tax debt management in the Czech Republic



Thanks to the functional tax arrears write-off procedure we can focus on collectible arrears, which means we can concentrate on using our workforce effectively on recovering such arrears.

Data Mining

Since 1st of August 2022 an **internal application** called **APEX** (APEX is Czech acronym for Application Supporting Tax Payment) has been officially used by the Tax Administration of the Czech Republic. APEX draws on a range of key data concerning tax debtors (e.g., basic information, payment activity of the debtor, structure of the debt, assets, and activity of tax office).

One of the main functions of APEX is **assets scanning**. It automatically detects the assets of debtors, such as bank accounts, real estate, business partners, income (from sources such as rent, employer, financial capital, abroad etc.) cars, ship, airplanes, tax overpayments, accounting balance etc.

Write Off Process

If there are no detected assets, APEX helps with tax arrears write-off by creating and completing a standardised form. The only thing that must be added manually by tax officer is the specific reason why tax arrears are uncollectible.

Currently we have two types of write-offs:

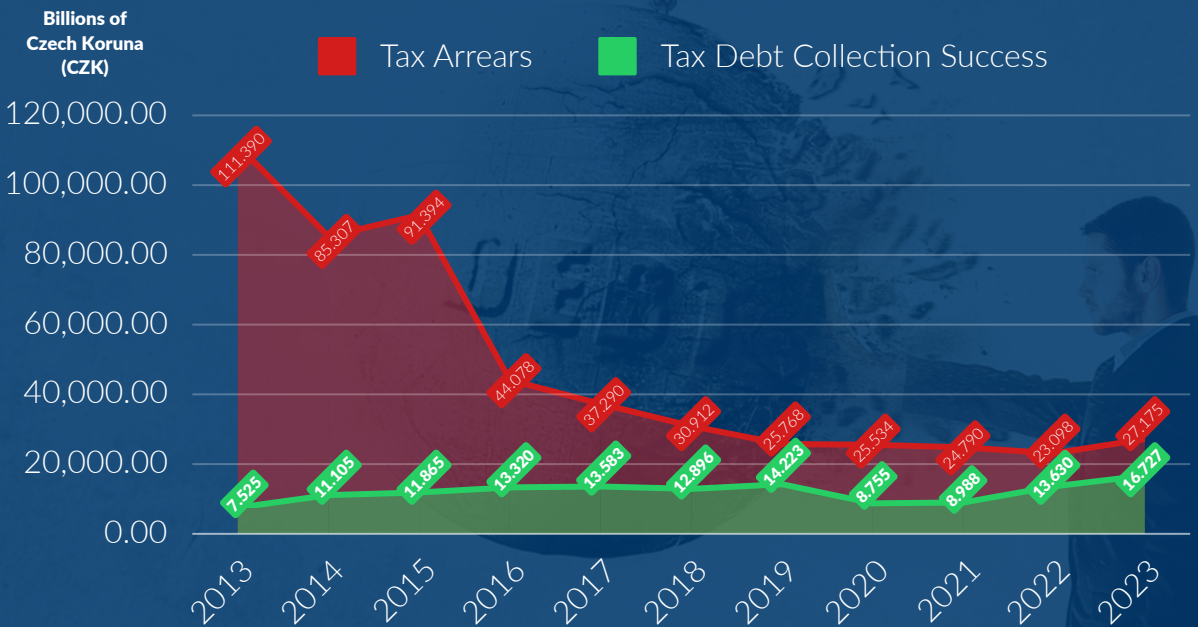
- “**common**” write-off; and
- “**speed**” write-off. This is especially for situations like:
 - legal persons with businesses that have shut down,
 - deceased natural persons without any heir apparent,
 - taxpayers after the successful settlement of debt.

APEX also helps with continual assets scanning during the tax arrears write-off process and if it finds new assets it immediately sends notification to the tax officer to start new enforcement and securing procedures.

Conclusion

As stated at the beginning, one of the strategies to increase the efficiency of tax debt collection is to employ an effective write-off policy. It's a challenge – yes, it is! However, we have clear data and evidence it works because **the tax arrears are constantly decreasing in exponential way while the success in collecting tax debts is constantly increasing**. Obviously the covid years (2020-2021) bucked that trend, as tax debt enforcement was partially or fully stopped or postponed. This is evident in the graphical snapshot in Figure 3, below.

Figure 3
Tax Arrears and Tax Debt Collection Success



In conclusion let's consider the changes, or maybe it's better to call them **pillars**, underlying the whole process that started in 2017. As you have seen, the introduction of these pillars took some time, was done step by step, and adjustments were made over time too. We analysed shortcomings and positive impacts, and we introduced our new internal application (APEX). Unexpected circumstances slowed down and impacted the process (especially COVID-19, the Russian invasion of Ukraine, and the high level of inflation). Despite all these problems there was a strong will to continue.

And now, in 2024, we feel we have achieved our goal from 2017, because all the changes (pillars) have come together and support each other. Each aspect needs to operate effectively to produce an effective tax debt management approach.

In the preface we started with a quote from a wise person about challenge. It is also worth remembering what another wise person once said: *"It's always the small pieces that make the big picture"*. An effective tax debt management strategy is like a jigsaw puzzle – you must put all pieces together to get the right picture.



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