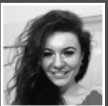


# Taxation on Consumption in the Czech Republic: Alcohol, Beer, and Wine



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ŠÁRKA  
PRÁT

The system of consumption taxation showcases a country's public finance system. It does not only show how much functional compromise is found in the country between "free-to-choose" economic freedom of the individual, and seeking resources to eliminate negative externalities resulting from the consumption of taxable substances. Taxing consumption also allows lowering the taxation of labor and capital.

The tax wedge in the Czech Republic in 2018 was 43.7. A tax wedge measures the difference between the cost of labor and the take-home pay of the worker, expressed as a percentage of the cost of labor. Put in simpler terms, it is the difference between wages before and after taxes. The formula for calculating a tax wedge is  $((PIT + \text{social security contributions of the employee and employer}) - \text{family benefits}) \div \text{total labor cost}$ . A tax wedge of 43.7 means that the average single Czech worker takes home just 56.3% of what their employer paid.

As the tax wedge increases, workers tend to have less incentive to seek legitimate, tax-paying work as they receive a decrease in the take-home pay. If PIT were to increase in the Czech Republic, in this case (as a result of the elimination of excise taxes) we can expect to see the tax wedge grow larger, which could lead to an increase in people seeking illegitimate (non-tax paying) work.

Currently, the Czech Republic does not have a separate capital gains tax for individuals or for corporations; capital gains are included in PIT and CIT. There are also a few cases in which capital gains are exempt, mainly pertaining to property. These exemptions for individuals are: three years of direct ownership of a joint stock company

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## THE CZECH REPUBLIC DOES NOT HAVE A SEPARATE CAPITAL GAINS TAX FOR INDIVIDUALS OR FOR CORPORATIONS

or of a fund (five years of ownership for other companies), two years of ownership for an individual's primary residence (five years of ownership for other real estate), and one year of ownership for cars, boats, and planes. It is likely that without a consumption tax some, if not all, of the capital gains in these currently exempt cases would become included with the other, non-exempt, capital gains in the 15% PIT rate in order to make up for the loss.

This phenomenon also shows how the tax administrator of a comprehensive system of set excise tax rates dealt with specific factors, such as the formal form of the tax system and its efficiency. Including (but not limited to) the structure of the economy, purchase power, location and size of the state, setting up the taxation system in neighboring countries, the size of the black market, among other aspects.

The efficiency of the consumption taxation system can be defined as a vector of several parameters: 1) stability, 2) simplicity

and comprehensibility, and 3) flexibility or shock absorption capacity caused by social changes.

In addition to the general description, some of the new challenges that are related to social and consumer behavior need to be identified. There are, however, certain challenges that can, and obviously will, in the coming years, put pressure on the negative development of the collection of consumer taxes. This is, of course, an undesirable phenomenon. In the public finance system with a high proportion of mandatory (legally determined) expenditure, any outage is undesirable. Revenues from excise duties are a stable anchor in the Czech Republic's public finance system, and so should stay as such.

### **STATE BUDGET REVENUE AND EXCISE TAX SHARE**

Excise duties are indirect and selective taxes, which are mainly introduced for the purpose of increasing state budget revenues and regulation of consumption on selected goods on the market. Regulation on consumption of selected goods is based on the assumption of their harmfulness for users, or society as a whole.

The introduction of excise taxation on selected goods achieves an increase in their value prices, which usually leads to a reduction in their consumption. Reducing the amount of such goods consumed limits the negative impact they have on individuals and society.

Excise taxes have been used in the Czech Republic since its establishment on January 1, 1993. Their subjects are selected products, which include mineral oils, alcohol, beer, wine, intermediate commodities, and tobacco products. It is not unusual that excise duty on such products is more than half of their final price. Excise duties reliably



IN THE PUBLIC FINANCE SYSTEM WITH A HIGH PROPORTION OF MANDATORY (LEGALLY DETERMINED) EXPENDITURE, ANY OUTAGE IS UNDESIRABLE

fulfill the function of increasing the revenue of the state budget [See: Table 1]

Throughout the monitored period between 2010 to 2018, excise tax revenue accounted for a significant part of the state budget revenue. The share of excise taxes in the state budget revenues has been gradually trending downwards from 13% to 11 %, but excise tax revenue is increasing in absolute terms. As the GDP rises, the amount of, for example, alcohol sold, does not necessarily increase at the same rate. This leads to a situation where excise tax revenue is increasing as an actual amount, but as a percentage of total budget revenue it is heading on a downward trend [See: Table 1]. At the same time, income tax revenue is trending upwards both as an absolute amount, and as a percentage of budget revenue. In 2018, excise tax revenue was CZK 153.7 bn (CZK 26.1 bn more than in 2010).

Table 1: State budget revenue and excise tax share

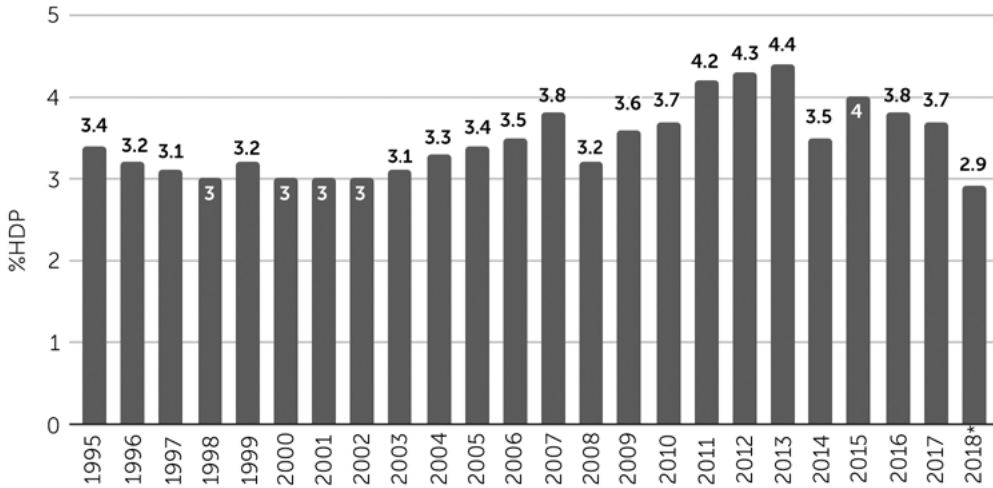
|                                                                                  |                         | 2010              | 2011          | 2012          | 2013             | 2014          | 2015          | 2016          | 2017              | 2018            |
|----------------------------------------------------------------------------------|-------------------------|-------------------|---------------|---------------|------------------|---------------|---------------|---------------|-------------------|-----------------|
| State revenue total budget                                                       | bn. CZK                 | 1000              | 1013          | 1051          | 1092             | 1134          | 1235          | 1282          | 1274              | 1401            |
|                                                                                  | Total                   | 100%              | 100%          | 100%          | 100%             | 100%          | 100%          | 100%          | 100%              | 100%            |
| Consumption taxes                                                                | bn. CZK                 | 127.6             | 130.1         | 130.1         | 127.6            | 129.2         | 138.2         | 145.4         | 149.4             | 153.7           |
|                                                                                  | % of total              | 12.76%            | 12.84%        | 12.38%        | 11.68%           | 11.39%        | 11.19%        | 11.34%        | 11.73%            | 10.97%          |
| Personal Income Taxes (rate of 15%)                                              | bn. CZK                 | 131.7             | 142.8         | 144.8         | 149.8            | 153.8         | 164.7         | 183.1         | 202.2             | 229.8           |
|                                                                                  | % of total              | 13.17%            | 14.10%        | 13.78%        | 13.68%           | 13.56%        | 13.33%        | 14.28%        | 15.87%            | 16.40%          |
| Corporate Income Taxes (rate of 19%)                                             | bn. CZK                 | 128.2             | 129.7         | 135.2         | 140.4            | 151.2         | 165.1         | 178.7         | 188.3             | 184.7           |
|                                                                                  | % of total              | 12.82%            | 12.80%        | 12.86%        | 12.86%           | 13.33%        | 13.34%        | 13.94%        | 14.78%            | 13.18%          |
| PIT + CIT                                                                        | bn. CZK                 | 259.9             | 272.5         | 280           | 290.2            | 305           | 329.8         | 361.8         | 390.5             | 414.5           |
|                                                                                  | % of total              | 25.99%            | 26.90%        | 26.64%        | 26.56%           | 26.90%        | 26.70%        | 28.22%        | 30.65%            | 29.58%          |
| % PIT and CIT would need to increase to keep revenue the same with no excise tax | Only PIT increases      | 14%               | 14%           | 13.5%         | 13%              | 13%           | 13%           | 12%           | 11%               | 11%             |
|                                                                                  | PIT rate after increase | 29%               | 29%           | 28.5%         | 28%              | 28%           | 28%           | 27%           | 26%               | 26%             |
|                                                                                  | Only CIT increases      | 19%               | 19%           | 18%           | 17%              | 16%           | 16%           | 15%           | 15%               | 16%             |
|                                                                                  | CIT rate after increase | 38%               | 38%           | 37%           | 36% <sup>3</sup> | 35%           | 35%           | 34%           | 34%               | 35%             |
| Increase of PIT and CIT if excise tax revenue is split evenly (new rate)         | PIT+ 7% (22%)           | PIT+ 7% (22%)     | PIT+ 7% (22%) | PIT+ 6% (21%) | PIT+ 6% (21%)    | PIT+ 6% (21%) | PIT+ 6% (21%) | PIT+ 6% (21%) | PIT+ 5.5% (20.5%) | PIT+ 5% (20.5%) |
|                                                                                  | CIT+ 9.5% (28.5%)       | CIT+ 9.5% (28.5%) | CIT+ 9% (28%) | CIT+ 9% (28%) | CIT+ 8% (27%)    | CIT+ 8% (27%) | CIT+ 8% (27%) | CIT+ 8% (27%) | CIT+ 7.5% (26.5%) | CIT+ 8% (27%)   |

Source: MFČR and OECD

In addition to Table 1, Figure 1 shows the stability of excise tax revenues, showing the evolution of excise tax revenues as a percentage of GDP. The figure shows that the

domestic excise system generates revenues between 2.9% and 4.5% of GDP throughout the reporting period, averaging at 3.47%. Since joining the EU in 2004, this average

Figure 1: Excise tax revenue in relation to GDP in the Czech Republic



Source: MFČR

Table 2: Excise tax revenue (ETR) in the Czech Republic for 2014 to 2018 (CZK bn /% of total)

| ETR in Czech Republic (bn CZK)    | 2014         |             | 2015         |             | 2016         |             | 2017         |             | 2018         |             |
|-----------------------------------|--------------|-------------|--------------|-------------|--------------|-------------|--------------|-------------|--------------|-------------|
| <b>ETR TOTAL</b>                  | <b>136.5</b> | <b>100%</b> | <b>145.7</b> | <b>100%</b> | <b>153.3</b> | <b>100%</b> | <b>157.4</b> | <b>100%</b> | <b>164.9</b> | <b>100%</b> |
| ETR mineral oils                  | 81.6         | 59.78%      | 84.5         | 58%         | 88.4         | 57.66%      | 91.7         | 58.26%      | 93           | 56.40%      |
| ETR tobacco products and stickers | 44.7         | 32.75%      | 50.9         | 34.93%      | 54.4         | 35.49%      | 56.2         | 35.71%      | 58.8         | 35.66%      |
| ETR alcohol and spirits           | 6.8          | 4.98%       | 7.1          | 4.87%       | 7.2          | 4.70%       | 7.3          | 4.64%       | 7.9          | 4.79%       |
| ETR wine and intermediates        | 0.3          | 0.22%       | 0.3          | 0.21%       | 0.4          | 0.26%       | 0.4          | 0.25%       | 0.4          | 0.24%       |
| ETR beer                          | 4.6          | 3.37%       | 4.7          | 3.23%       | 4.6          | 3.00%       | 4.6          | 2.92%       | 4.8          | 2.91%       |

Source: Customs Administration, Treasury Monitor

has increased by 3.68%. This phenomenon reinforces the fact that excise taxes consistently add a significant amount to the state budget.

The highest share of income to the state budget through excise taxation is the excise taxation of mineral oils – mainly fuels [See: Table 2]. In 2018, the share of mineral oils amounted to 56.4% of total excise tax revenues. Tobacco products reached 35.66%, alcohol and spirits 4.79%, wine and intermediate products only 0.24%, and beer 2.91% of the total collection of excise duties. In the period between 2014 to 2018, the share of excise duty on tobacco increased slightly, while the share of excise duty on mineral oils slightly decreased.

The importance of excise taxation for the Czech Republic is obvious. The following chapters analyze in detail, individual groups of selected products that are subject to excise taxation.

### ALCOHOL AND SPIRITS

Alcohol is another product that is subject to excise tax in the Czech Republic. There is a special excise duty for beer and wine [See: Table 3]. The basis for calculating the excise duty on alcohol is the amount of pure alcohol expressed in hectoliters



THE INTRODUCTION OF EXCISE TAXATION ON SELECTED GOODS ACHIEVES AN INCREASE IN THEIR VALUE PRICES, WHICH USUALLY LEADS TO A REDUCTION IN THEIR CONSUMPTION

multiplied by the rate of CZK 28,500 / hl. As with cigarettes, the tax burden includes VAT, which increases with the price of the spirits. The excise duty per liter of pure alcohol is, therefore, set at CZK 285.

Table 3: Taxation of a 0.5 liter bottle of hard alcohol (40% alk.)

|              | CZK 70 | CZK 90 | CZK 180 | CZK 400 |
|--------------|--------|--------|---------|---------|
| Excise duty  | CZK 57 | CZK 57 | CZK 57  | CZK 57  |
| VAT          | CZK 12 | CZK 16 | CZK 31  | CZK 69  |
| Taxation (%) | 99%    | 81%    | 49%     | 32%     |

Source: Own processing



EXCISE DUTIES  
RELIABLY FULFILL  
THE FUNCTION  
OF INCREASING  
THE REVENUE  
OF THE STATE  
BUDGET

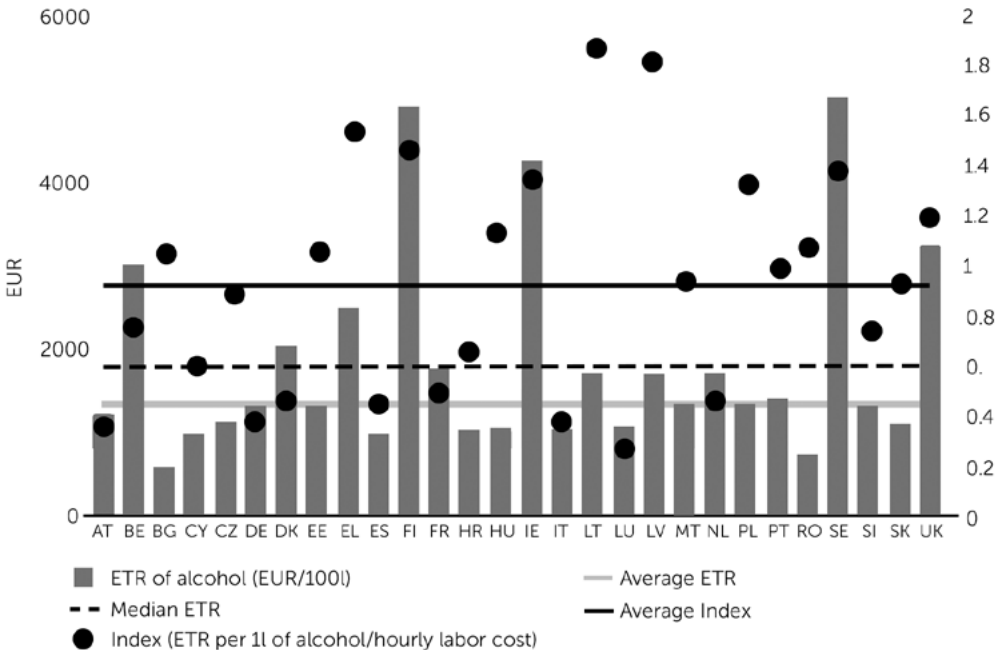
Percentage taxation decreases with increasing alcohol prices. By contrast, the total tax in absolute terms is rising. At a price

of CZK 70 per 0.5 liter, a bottle of 40% spirits is almost all its price tax. In this situation, production costs, transportation, margins, etc. are not covered. It is, undoubtedly, interesting that despite this fact, bottles are available at discount prices close to this threshold, sometimes even below it.

Figure 2 shows a comparison of alcohol excise systems in EU countries. The bars show the amount of taxation in EUR / 100 liters. Green dots show the proportion of hourly labor costs (wages + levies) of excise duty on 1 liter of alcohol. They simply present how many hours of work are required to pay excise duty on 1 liter of alcohol. The yellow line represents the average of this index.

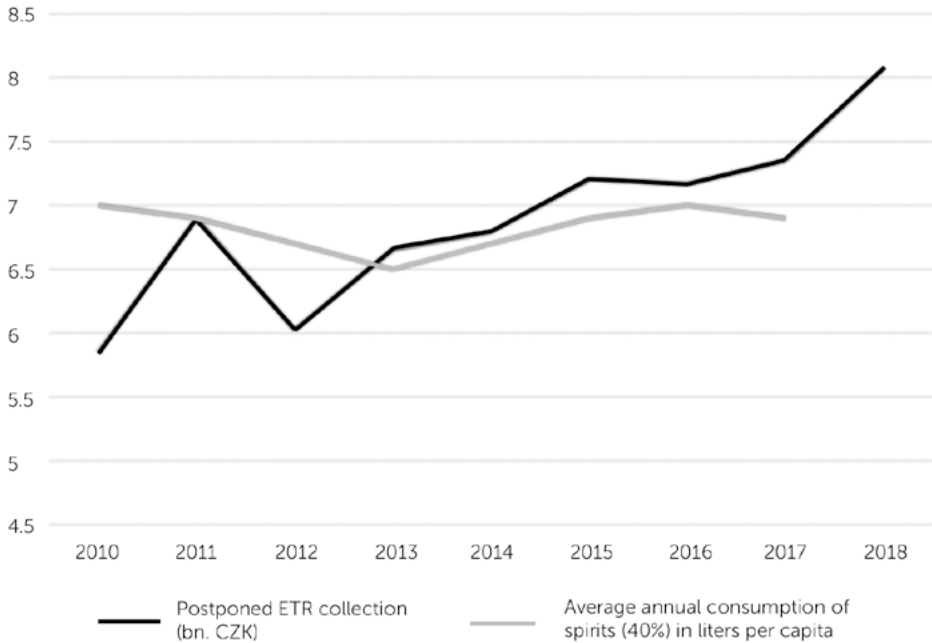
The Czech Republic, with the level of excise duty imposed on alcohol, is below the av-

Figure 2: Comparison of the alcohol excise system in the European Union



Source: Eurostat

Figure 3: Development of the collection of excise duty on spirits and consumption of spirits



Source: Eurostat

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THE HIGHEST  
SHARE OF INCOME  
TO THE STATE  
BUDGET THROUGH  
EXCISE TAXATION  
IS THE EXCISE  
TAXATION  
OF MINERAL OILS –  
MAINLY FUELS

erage and median of EU Member States. By contrast, the share of excise duty in wage costs in the country is almost identical to the EU average. Nordic countries traditionally pay the highest excise duty on alcohol. After including the purchasing power of the population over hourly labor costs, the excise taxation in the Czechia reaches almost the EU average. In the Czech Republic, the average cost of 0.88 hours of excise duty per liter of alcohol is equal. In Belgium, the excise tax rate is almost three times that of the Czechia. Due to high wages, however, the index is lower than in the Czech Republic. It takes only 45 mins to pay excise duty on 1 liter of alcohol in Belgium.

Figure 3 shows the development of the consumption of spirits and postponed collection of excise duties from 2010 to 2018. These figures are key. The purpose of excise tax is to regulate consumption and



increase revenues to the state budget. The annual consumption of 40% of spirits in the Czech Republic is relatively significant. The value oscillates around the average annual consumption of 7 liters per capita throughout the period under review. The average Czech drinks fourteen bottles (0.5 l) of hard alcohol a year.

The development of postponed direct debit confirms the importance of income from excise duty on alcohol for the state budget. In the last eight years, the income from this tax has increased by CZK 1.2 bn to the final CZK 8 bn in 2018. It represents less than 5% of the state budget revenue from excise taxation.

In addition to excise tax revenues, the social costs of alcohol consumption must also be mentioned. According to a study by iHETA, in cooperation with the Center of Economic and Market Analysis and the Office of the Government of the Czech Republic<sup>1</sup>, the costs of alcohol consumption are CZK 56.57 bn (or 1.15% of GDP). The biggest cost, at CZK 24.3 bn, is the cost of lost productivity in the workplace. Health costs of 26 major examined diagnoses related to alcohol consumption amount to CZK 12.9 bn. Moreover, the costs resulting from premature death were estimated at CZK 6.6 bn, those related to criminal activities at CZK 6.3 bn, whereas the costs of traffic accidents at CZK 4.4 bn. The social expenses are not only related to the consumption of spirits, but also wine, beer, and other alcoholic beverages.

The most visible scandal of this decade in relation to the harmfulness of alcohol was the so-called "methanol scandal". In the Czech Republic and Poland, in 2012, there

were a series of methanol poisonings, which was contained in alcohol bottles distributed from the gray market zone (tax evasion). Forty-seven Czech citizens died of poisoning and dozens of others were hospitalized. Many victims still suffer from visual impairment.

The regulator responded by introducing a temporary ban on the sale of alcoholic beverages with an alcohol content of over 20%, followed by a series of systematic measures to monitor the production and distribution chain. Control of alcohol production has improved in recent years through mandatory safety measures. These measures include the introduction of new protective bottles for alcohol and the mandatory introduction of a CCTV system at the stamping or bail-in point of manufacturers. This development has significantly reduced the size of alcohol from the black market.

However, a high excise duty on alcohol, of course, creates incentives for many groups and individuals to participate in the black market. The negative result is the necessity of a high investment in the CCTV system, in many cases exceeding CZK 100,000. This investment has become fatal, and led to liquidation of a number of small liquors producers and the market has consolidated



THE AVERAGE  
CZECH DRINKS  
FOURTEEN BOTTLES  
(0.5 L) OF HARD  
ALCOHOL A YEAR

<sup>1</sup> iHETA, CETA (2019). *Společenské náklady konzumace alkoholu v České republice*. Available [online]: [http://www.iheta.org/ext/publication/files/Report\\_merged\\_grant\\_alkohol\\_2019-04-10%20-%20final.pdf](http://www.iheta.org/ext/publication/files/Report_merged_grant_alkohol_2019-04-10%20-%20final.pdf) [in Czech]



## CONTROL OF ALCOHOL PRODUCTION HAS IMPROVED IN RECENT YEARS THROUGH MANDATORY SAFETY MEASURES

due to regulatory measures. Still, the measures have proven to be very effective in relation to the health risks of gray market products. Furthermore, as a result of the Romanian Presidency in the EU, the issue of the exemption for homemade alcohol from excise duty is now open. In the Czech Republic, such alcohol is not for sale, but is for personal use only, and is exempt from excise duty up to 30 liters of pure alcohol per person per year. Romania proposes to increase this limit to 175 liters. Unanimity of all EU states is required for a change in the tax area. From the point of view of maintaining the culture of alcohol burning as a preservation of rural tradition, this is a rational proposal, but not in terms of the purpose of excise taxation.

Alcohol consumption entails significant societal costs that dramatically exceed its consumption tax revenues. In terms of harmfulness, the size or location of the distillery does not matter. Similarly to tobacco, it makes no sense in terms of the purpose of excise taxation to grant a tax exemption to the equally harmful alternative, but not to the less harmful options. The fiscal implica-

tions of the proposal cannot be overlooked either. The consumption of untaxed alcohol entails the same costs as that of taxed alcohol. However, it does not bring funds to the state budget to mitigate the abovementioned negative impacts of its consumption.

### Recommendations for Regulator:

- *Close control of the black market:* Timely capture of shadow market trends (such as continued dialogue with legal producers) will increase the collection of alcohol excise duty, the safety of alcohol consumption, and reduce the negative impact associated with the consumption of substances not subject to quality control.
- *Comprehensive regulation:* The exceptions to their substitutes reduce the effectiveness of any fight against pathological dependence. Examples of hard alcohol are beer and wine. Regulation targeting only a narrow segment of a problem area has very limited efficiency.
- *Consistent prevention:* Prevention of overconsumption is one of the most effective tools to combat addiction, especially among people unaware of the consequences of their actions (persons under 18 years old). Effective programs in this area cannot do without the cooperation of government, manufacturers, retailers, and dependency experts.

### BEER

Beer is another product in the Czech Republic that is subject to excise duty. Here, excise duty also fulfills the main two tasks – increasing revenues to the state budget and reducing consumption.

The Czech Republic is the world's leader in per capita beer consumption. The average annual consumption of beer per capita is 147.3 liters. Since 2010, this rate has slightly



## AS A RESULT OF THE ROMANIAN PRESIDENCY IN THE EU, THE ISSUE OF THE EXEMPTION FOR HOMEMADE ALCOHOL FROM EXCISE DUTY IS NOW OPEN

increased. This is mainly due to the fact that beer is historically part of the national gastronomic culture, as in France or Italy with wine. It is not necessarily an indication of massive binge drinking, but this does not reduce the attention to be paid to any undesirable aspects of beer consumption.

The excise tax on beer is determined in CZK / hl for each full weight of the original wort extract. In 2010, the basic rate increased from CZK 24 / hl to CZK 32 / hl, as well as reduced rates [See: Table 4]. The reduced rate is intended for small independent breweries according to their production volume.

From the point of view of the purpose of excise tax, similarly to tobacco and spirits, the tax advantage certainly does not make sense for a group of producers – in this case, microbreweries. Excessive alcohol consumption generates risks irrespective of its origin or size. The tax advantage of small breweries is a good economic step in terms of promoting small businesses and the diversity of typical Czech beer culture.

From the point of view of the purpose of excise duty, this measure cannot be considered appropriate, especially if the tax advantage is indefinite. Moreover, the reduced excise tax rate creates space for opportunistic behavior, where instead of extending the existing prosperity of the small brewery, a new brewery will be established. This leads to shortfalls in excise tax revenues.

Table 4: Consumer taxation of beer in the Czech Republic

| Year      | Tax rate in CZK / hl for each weight percentage of the original |                                                                            |                            |                             |                              |                              |
|-----------|-----------------------------------------------------------------|----------------------------------------------------------------------------|----------------------------|-----------------------------|------------------------------|------------------------------|
|           | Basic rate                                                      | Reduced rates for small independent breweries by production volume (in hl) |                            |                             |                              |                              |
|           |                                                                 | (...- 10,000>                                                              | (10,000- 50,000 including> | (50,000- 100,000 including> | (100,000- 150,000 including> | (150,000- 200,000 including> |
| 2009      | 24                                                              | 12                                                                         | 14.4                       | 16.8                        | 19.2                         | 21.6                         |
| 2010–2019 | 32                                                              | 16                                                                         | 19.2                       | 22.4                        | 25.6                         | 28.8                         |

Source: Customs,, CZSO

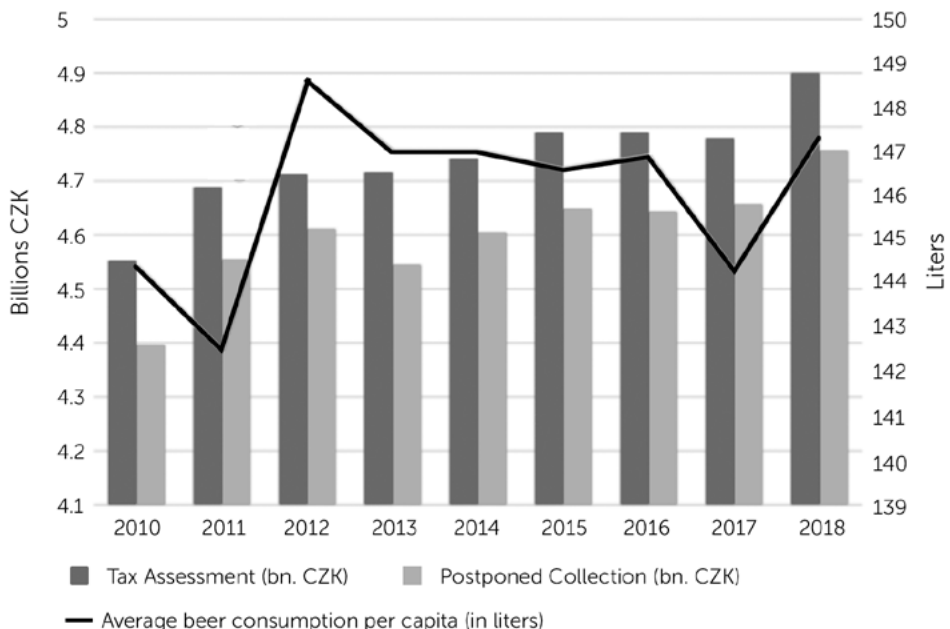
In Figure 4, we can observe the assessed excise tax on beer, its actual collection, and average annual consumption of beer per capita. Between 2010 and 2018, there was a systematic difference between the tax levied and the postponed collection. The amount of tax assessed speaks to the market, and the occurrence of tax liability. Tax collection represents the actual receipt of funds into the state budget. The difference between the assessed tax and direct debit is due to incomplete data and a deficit in the payment discipline of taxpayers.

In the Czech Republic, brewing has flourished in times of economic growth. Total exhibitions in 2018 increased by 4.7% to 21.3 mln hl. Despite the continuing trend of small breweries, enterprises with an exhibition of over 200,000 hl account for more than 90% of the collection of excise duty on beer.

In order to develop the collection of excise duty on beer, it is necessary to monitor trends in consumption behavior. Beer consumption per capita increased year-on-year in 2018 and reached the second highest value in the period under review. Another important trend is the transition to the substitutes of classic beer – especially ciders, flavored beers, and non-alcoholic beers.

The transformation of the market, and the transition to alternatives may have a negative impact on the collection of excise duties. In 2018, non-alcoholic beer consumption increased by 7.3% year-on-year, and so-called “beer mixes” increased by 42.5%. Once again, the proportion of beer consumed in restaurants decreased, as the proportion of total beer consumption dropped by two percentage points, to 36%. This also implies other fiscal impacts

Figure 4: Measured excise tax on beer, postponed collection, and average beer consumption per capita in the Czech Republic





## THE CZECH REPUBLIC IS THE WORLD'S LEADER IN PER CAPITA BEER CONSUMPTION

(limited economic activity, lower employment, lower additive sales in the hospitality industry, etc.). These changes must be reflected when setting the excise tax on beer.

### Recommendations for Regulator:

- *Tax advantage for microbreweries:* It is necessary to consider the need for a tax advantage for small breweries that do not make sense from the point of view of the excise duty, especially when it comes to a lasting advantage. The advantage goes against increasing revenues to the state budget and against regulating excessive consumption of the product. For example, small cigarette manufacturers could benefit from the same prism.
- *Effectiveness check:* When excise tax exemptions are granted, close scrutiny is necessary to prevent abuse. Take the situation of setting up several small breweries instead of extending the existing one due to the amount of excise duty.
- *Consumer Behavior Reflection:* The regulator needs to prepare for the consequences of market changes and changes

in consumer behavior, mainly due to the increasing popularity of classic beer substitutes (such as beer mixes). Continuation of this trend could have negative consequences on the collection of excise duties.

- *Economic Freedom vs. Economic Freedom over-consumption:* Programs aimed at eliminating negative aspects of alcohol consumption should focus on the area where the vast majority of negative aspects arise – not average consumption in general, but excessive alcohol consumption or consumption of people under 18 years of age.

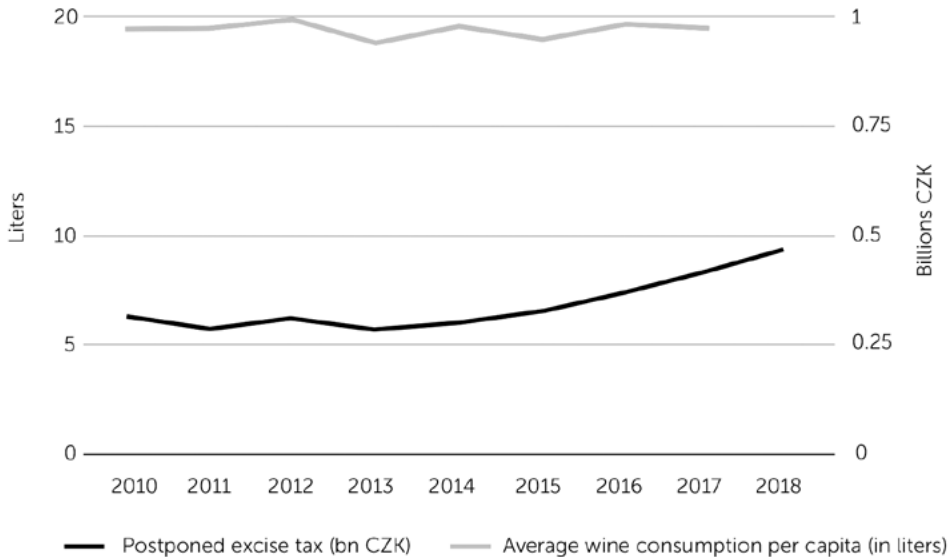
### WINE

Wine is another product that is subject to excise duty in the Czech Republic. Wine, intermediate products, and fermented beverages are defined as the object of the tax as containing at least 1.2% to 22% alcohol by volume.

The taxation system in the EU, and thus in the Czech Republic, is significantly influenced by a strong interest group of wine producers. A natural person who produces exclusively still wine in the tax territory of the Czech Republic shall not be subject to the tax on wine and intermediate products, provided that the total quantity of still wine produced per calendar year does not exceed 2,000 liters. However, although the subject is a wine taxpayer, still wine is a formal designation [See: Figure 5]. In addition, excise wines and intermediate products intended for the production of selected ingredients and products such as vinegar, chocolate, and pharmaceuticals are exempt.

The rates in CZK / hl are set for the calculation of the excise tax. For sparkling wines, it is set at CZK 2,340 / hl. The same rate applies to intermediates. For still wines, the excise tax is set (according to EU legislation)

Figure 5: Postponed collection of excise tax on wine and average wine consumption per capita in the Czech Republic



Source: Customs, CZSO

at the lowest possible amount of CZK 0 / hl. EU legislation setting minimum allowable excise rates for any other category does not allow for a zero excise duty (the minimum for beer is EUR 0.748 / hl and alcohol for EUR 550 / hl of pure alcohol).

Figure 5 shows the average wine consumption and collection of excise duty on wines. The collection of excise duty on wine is clearly the lowest of all product groups on which excise duty is levied. In 2018, the share of this product group in the total collection of excise duty was only 0.24%.

The low collection can be partly explained by relatively low wine consumption compared to beer, when the annual wine consumption per capita does not exceed 20 liters. The zero excise duty rate on still wine is a more significant factor. In fact, excise tax revenue on wine is thus drawn only on sparkling wine and on intermediate products.

The vast majority of the market in the Czech Republic belongs to still wines. The total volume of wine and intermediates put into free tax circulation in the Czech Republic in 2018 was 2,360,876 hl. Still wine of this volume accounts for 2,181,281 hl, or 92,39% of the total. Sparkling wines comprise 166,572

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EXCESSIVE ALCOHOL  
CONSUMPTION  
GENERATES RISKS  
IRRESPECTIVE  
OF ITS ORIGIN  
OR SIZE



## THE TAXATION SYSTEM IN THE EU, AND THUS IN THE CZECH REPUBLIC, IS SIGNIFICANTLY INFLUENCED BY A STRONG INTEREST GROUP OF WINE PRODUCERS

hl and intermediate products of negligible 13,023 hl. In terms of volume, almost 93% of wine does not contribute to the collection of excise tax in the country. Using the static model, where still wine is subject to excise duty as well as sparkling wine, i.e. at the rate of CZK 2,340 / hl, the potential for state budget revenue can be quantified at CZK 5.1 bn in excise duty.

Figures 6 and 7 illustrate the situation of excise duty on still and sparkling wine in the EU countries. A zero threshold is set for both types of wine in the EU. As can be seen from the figures, the Czech Republic is far from the only country that has set a minimum of CZK 0 / hl for still wines. There are fifteen countries in total. Ireland levies the highest excise duty on still wine above EUR 600 / hl. Relatively high taxation of still wine can also be observed in Finland, Sweden, and the United Kingdom.

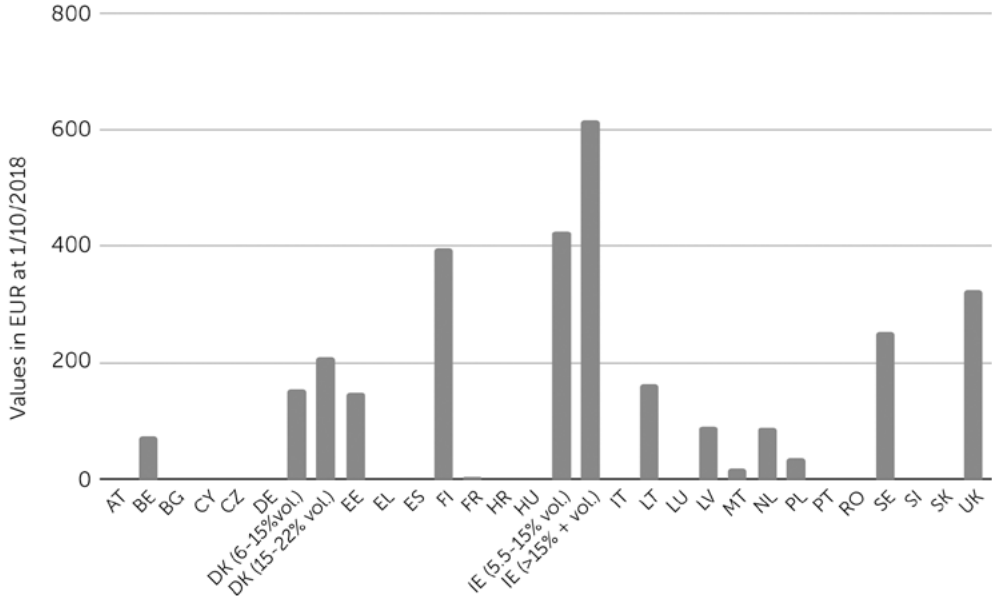
The situation regarding the excise duty on sparkling wine in EU countries can be seen in Figure 7. Nine Member States are still using the zero minimum, including Belgium, Croatia, Portugal, and Italy. There are fewer countries using zero rate for sparkling wine. In addition to the Czech Republic, Slovakia, Romania, Hungary, Germany, and Austria also constitute countries with zero rates for still wines and non-zero rates for sparkling wines.

From the point of view of the purpose of excise taxation, exception, or zero rate, makes no sense. The purpose of the excise tax, as has been already mentioned, is primarily to regulate consumption and increase revenues to the state budget. Zero rate for still wine goes against the whole logic of excise taxation. Fiscal outage due to zero rate on still wine reaches up to CZK 5.1 bn for excise duty alone, i.e. about CZK 0.3 bn more than the total collection of beer excise tax.

Alcohol contained in wine carries the same health risks and causes the same harm to society as alcohol contained in other alcoholic beverages. Moreover, the absence of excise duty causes a situation where wine is the cheapest alcohol after conversion to volume units. Box wines with an alcohol content of 11% and a volume of 1 liter can be purchased for less than CZK 20, except for special offers. Deciliter of pure alcohol in this package costs less than 2 CZK. Some 1-liter bottles containing 37.5% alcohol are also discounted at CZK 160. A deciliter of pure alcohol in this package costs more than CZK 4. Thus, in the cheap brand of spirits, alcohol is twice as expensive as in the cheap brand of wine.

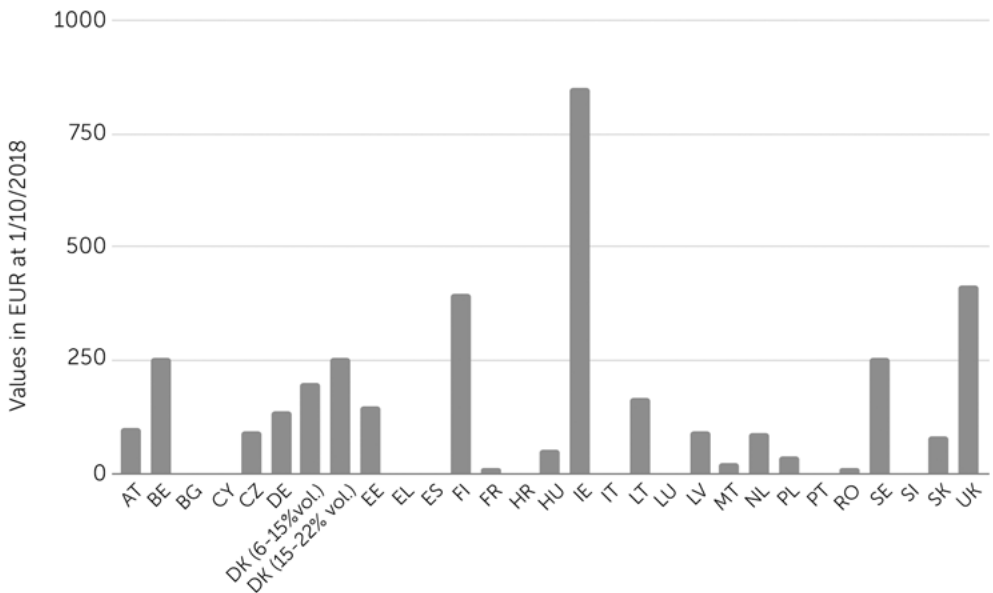
Exceptions to their substitutes reduce the effectiveness of any fight against pathological addictions, not only alcohol dependence. Regulation targeting only a particular

Figure 6: Excise taxation of still wine in EU countries



Source: European Commission

Figure 7: Consumer taxation of sparkling wine in EU countries



Source: European Commission



segment of a problem area has very limited efficiency. The example of zero excise duty for still wines is a textbook example of such a practice. This dramatically increases the difficulty of combating pathological addictions.

Proponents of zero excise duty on still wines correctly point to the excise tax settings of wines in other EU countries [See: Figure 7]. From the point of view of tax competition, however, the reasoning does not make much sense, because the obligation to pay tax arises in the territory of a given country, so that every liter of wine released for tax circulation in the Czech Republic is burdened by the same rate regardless of its origin. It can be assumed that some importers of wines from countries with a zero rate of excise duty could cross-subsidize lower sales prices in the Czech Republic from margins in other countries. However, given the end prices of products, such a situation might already exist today.

It is true that collecting a relatively small amount of taxes from a somewhat large number of entities can be quite administratively demanding. Nevertheless, a system where producers register, but do not actually pay tax, is probably the least effective option in terms of cost to state administration. The market distortion in the current system is indisputable: it is a competitive advantage over wine substitute producers. These are mainly producers of beer and other alcoholic beverages.

#### **Recommendations for Regulator:**

- *Excise duty on still wine:* The regulator should consider the advantages and disadvantages of a zero burden on excise duty for still wine in the context of potential state budget revenues, as well as the elimination of negative externalities associated with excessive alcohol consumption.



THE PROBLEMATIC NATURE OF EXCISE DUTIES REPRESENTS A VERY IMPORTANT AND MUCH-DISCUSSED ISSUE FOR EVERY DEMOCRATIC COUNTRY. THE CZECH REPUBLIC IS NO DIFFERENT

- *Comprehensive fight against addictions:* The non-systematic nature of the zero rate of excise duty on still wine dramatically increases the difficulty of combating all kinds of pathological addictions.

- *Exception for small winemakers:* The exemption for small winemakers can be equaled by the same exception for large winemakers for the first 2,000 liters produced in a calendar year in case the still wine is taxed on excise duty.

#### **CONCLUSIONS**

The problematic nature of excise duties represents a very important and much-discussed issue for every democratic country. The Czech Republic is no different.

In general, excise duty revenues are considered to be a stable pillow profit for public finances. This is because of the characteristics of the taxed goods. Excise duty represents about one-fifth of all the tax yields of the Czech Republic, and nearly one-tenth of all Czech public budget revenues. If we compare tax liability to GDP, excise duty truly constitutes stable outcomes every year.

In all present-day modern democracies, excise duty is used as a fiscal-political instrument that aims to generate tax yields for the state budget and regulates the overall consumption at the same time. This concept is called “the Ramsey Rule taxation”. It is the difficulty of finding a suitable substitute for the taxed goods that makes excise duty a hallmark of stable state budget revenue.

In the Czech Republic, excise duty focuses on five types of goods: mineral oils (propellant fuels), tobacco, hard alcohol, beer, and wine. It is administrated by the Ministry of Finance (MF) and the Customs Service (CS). This study shows aggregated excise duty yields for hard alcohol, wine, and beer in the Czech Republic and their decomposition on the individual taxed groups of goods.

An excise tax is considered an indirect tax, and its economic effect is twofold: fiscal (taxing yield) and regulative (limitation of consumption of goods or services related to negative impact, e.g. health). Excise duty directly impacts the final price of taxed goods or services; thus, it influences the composition of consumption and disposable household income.

Non-integrated (or different) approaches to taxation of goods that are relatively close substitutes (e.g. alcohol, beer, or wine) can generate unintended, negative impacts on society – either in non-accomplishment

of the fiscal potential or in addiction policies. Therefore, when taxing consumption, we must not regard the placing of the system and its functioning separately. In order to accomplish both excise duty goals (fiscal and regulatory), it is necessary to use a more detailed analysis reflecting the market situation and empiricism of the subjects involved, while reacting elastically to changes of relevant factors influencing the excise duties system.



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