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Collection of Local Taxes in Insolvency Proceedings

ABSTRACT: *Local taxes take a very special place in the tax system of the Czech Republic. The process of administering local taxes is the same as for other taxes; however, their administration is not carried out by the tax authorities but by municipal authorities. They are the only part of municipal tax revenue that municipalities can directly influence the efficiency of collection. Today's economically challenging times have resulted in an increasing number of taxpayers being unable to pay their debts and ending up in insolvency. In the case of unpaid local taxes, municipalities become insolvent creditors, and the process of collecting local taxes enters the insolvency regime. This paper aims to identify the position of a municipality as a creditor in insolvency proceedings, which has tax debts against the debtor arising from unpaid local taxes, and find out whether municipalities actively use their right to enforce their claims in insolvency. The paper is based on the hypothesis that the municipality in the Czech Republic has a better position compared to other creditors because its tax debts have a public law character. First, the paper discusses the theoretical background, anchoring the position of the municipality in tax administration. Subsequently, the legal norms that regulate the issue of insolvency claims arising from unpaid taxes are analysed. The Czech approach is supplemented with case law conclusions to provide a comprehensive view of the issue. The results obtained from a questionnaire survey on whether municipalities use the examined tax collection option are presented. Based on the research, the hypothesis is refuted, and the findings are discussed and compared with continental and common law legislation.*

KEYWORDS: *local taxes, municipal authorities, tax claims, insolvency proceedings, order of satisfaction, creditor status*

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1. Introduction

Local taxes occupy a unique position in the Czech tax system. The fact that the Czech law calls them charges, not taxes, even though they are taxes by their very nature, is only one of many specifics. Municipal authorities play a crucial role in the field of local taxes. They act in delegated competence as a tax administrator and in independent competence as a legislator. Thus, they are in a very good position to influence both the setting of the system of local taxes that they introduce in their territory and the efficiency of their collection by carrying out all the tasks associated with their administration. Therefore, they have a direct impact on the tax revenue that is received in local budgets.

In today's difficult economic times, the number of insolvency proceedings in the Czech Republic is increasing. A taxpayer who is obliged to pay local taxes also becomes an insolvent debtor. The enforcement of unpaid local taxes then moves from the level of standard institutions to the insolvency area. In such a case, the municipality is in the position of an insolvency creditor. Since the efficiency of tax collection directly affects the revenues accruing to local budgets, it is necessary to consider the position of local authorities as creditors in insolvency proceedings in the administration of local taxes for fiscal reasons. This paper aims to determine the position of tax claims in insolvency proceedings in the Czech Republic. It is based on the hypothesis that tax claims have a better position in insolvency proceedings than other claims because of their public law character.

This paper is structured as follows: Section 1 discusses the theoretical background of the paper. Section 2 focuses on the position of municipal authorities in the Czech tax system and, using relevant literature, introduces the reader to the position of municipal authorities in relation to local taxes and what local taxes can be introduced in the Czech Republic. Section 3 highlights the importance of local taxes for municipal budget policy. Section 4 discusses insolvency issues. The position of tax claims in insolvency proceedings in the Czech Republic is identified by analysing the legislation and related case law. In Section 5, using the knowledge of taxes not only from a legal but also from a macroeconomic perspective, and using the synthesis method, the author explains why the tax claims of the municipal authority should have a different position in insolvency proceedings than the claims of other creditors. Section 6 concludes the paper by comparing the German legislation, which was a model for Czech insolvency law, and the UK legislation, which takes the opposite approach to the issue and demonstrates that such considerations are necessary. The whole insolvency issue is complemented at the outset by an analysis of data provided by municipalities, with the partial aim of determining whether municipalities are actively filing their tax claims in insolvency proceedings, which either confirms or refutes the relevance of the topic.

2. The Position of Municipal Authorities In the Czech Tax System

2.1. Municipal Authority as a Tax Administrator

The tax system in the Czech Republic is quite fragmented in terms of both legislation and tax administration. Although the priority position in tax administration is held by the tax and customs offices, the tax administrator can also be the courts, cadastral offices, or municipal authorities, which are the subject of this paper.

The law provides that the tax administrator is an administrative authority or other state authority to the extent that it is entrusted by or under the law with the competence in the field of tax administration. An administrative authority means an executive authority, a local authority, another authority, or a legal or natural person that exercises competence in the area of public administration. Municipal authorities act as local tax administrators based on Act no. 565/1990 Coll. on local charges¹ (hereinafter referred to as the “Act on local charges”). The Czech legislation uses the term “tax” extensively; therefore, local charges are also considered a tax and are administered as taxes. The theory in this respect is not entirely uniform, and it is often argued that, generally, charges cannot be equated with taxes, particularly with regard to their equivocability, since the payment of the charge involves some consideration. However, local charges are very different from administrative and judicial charges, since the taxpayer does not receive any direct service in return, but their revenue is used to fulfil public needs. Local charges are therefore based on the principle of non-equivalence and, despite their designation as “charges,” they are essentially tax revenue and can therefore be referred to as “local taxes.”²

The municipal authority thus acts as a tax administrator and conducts the entire process of administration of local taxes in its delegated competence, that is, their assessment, collection, control, and collection actions in the event that local taxes are not duly paid. The procedural rules governing the administration of local taxes are directly regulated by the Act on local charges, which acts as a special regulation in relation to the Tax Code.³ The Tax Code is then used in the subsidiary sense, that is, in areas not covered by the Act on local charges. One of these areas is the collection of arrears. The Tax Code broadens the tax administrator’s options in the area of collection, allowing tax debts to be enforced in four ways: by tax execution, recovery through a bailiff, bidding at a public auction, or in insolvency proceedings.

1 The term “fees” is also often used.

2 This term will be used in this paper.

3 Act. no. 280/2009 Coll., Tax Code.

Thus, the municipalities' filing of their claims arising from unpaid local taxes in insolvency is part of the tax administration process. The procedural capacity of the tax administrator to be a party to insolvency proceedings as a creditor is determined by the law, which provides that it may participate in civil court proceedings, but only in those proceedings that are related to tax administration. Insolvency proceedings are theoretically considered a branch of civil law proceedings.⁴

2.2. Municipal Authority as a Legislator

In tax administration, the municipal authority acts not only as an administrator but also as a legislator. Since the revenues from local taxes go directly to municipal budgets, the appropriateness of the local tax system and the efficiency of its collection are of considerable importance. While the administration of local taxes is carried out by the municipality in a delegated competence, law-making is carried out in an autonomous competence. On the basis of statutory authorisation, municipalities are entitled to issue general binding ordinances, through which they regulate the details of collection of a specific local tax; in particular, they set the rate of the tax, the reporting obligation for the creation or termination of the tax obligation, the due date, concessions or possible exemptions.

The power of a municipality to introduce one or more local taxes is one of the important manifestations of the economic autonomy of a municipality, which is based on, or guaranteed by, Art. 101(3) of the Constitution of the Czech Republic, according to which territorial self-governing units (including municipalities) may have their own property and manage according to their own budget. However, the economic autonomy of a municipality is not and cannot be limitless, as a municipality must also move within the boundaries of the legal system. In the context of the regulation of local taxes, this limitation is based on Art. 11(5) of the Charter of Fundamental Rights and Freedoms, according to which taxes and fees may be imposed only on the basis of law. Therefore, a municipality may only introduce a local tax that is regulated by the current version of the Act on local charges, while at the same time respecting all its current legal limits (e.g. the legal definition of taxpayers or payers, maximum rates). If a local tax is abolished by the Act on local charges or its parameters are changed, the municipality that introduced the local tax must respond accordingly. The Constitutional Court of the Czech Republic decided that the statutory regulation is mandatory and comprehensive; therefore, further rules or obligations imposed by the municipality when introducing local taxes are unlawful.⁵

⁴ Braun, 2019.

⁵ Constitutional Court of the Czech Republic, 2007.

Therefore, local taxes are optional, and it is up to the municipality to decide which statutory system of local taxes to introduce in its territory.⁶ The power of a municipality to levy local taxes generally varies in developed countries. As a rule, a system of local taxes is enacted, from which municipalities may levy specific taxes on their citizens and businesses. However, it is better to use a system of a small number of local (but profitable) taxes so that the collection and administration of taxes is as simple and inexpensive as possible, than a system of many local (but not profitable) taxes, when at the same time such a system is demanding for the administration and collection of these taxes, which absorb a substantial part of the tax revenue.⁷

In the Czech Republic, municipalities may introduce the following local taxes (the law calls them “charges,” as mentioned above) for individuals or legal entities: dog charge, charge for stay, charge for using public places, charge on entrance, charge on communal waste, charge for permission to enter selected places by motor vehicle, charge on evaluation of building land.⁸

3. Position of Local Taxes in Municipal Budgets

In the Czech Republic, municipal budgets represent the lowest level of public budgets in terms of the different levels of government. Their public status can be deduced from the status of local government units. According to the Constitution of the Czech Republic, municipalities and counties are public corporations that manage their own budgets, which are approved at public meetings of their councils. The principle of budgetary management of municipalities is established by Act no. 128/2000 Coll. on municipalities, and in the budget rules under Act no. 250/2000 Coll. on budgetary rules for territorial budgets. The specific features of the budgetary management of municipalities (and regions) reflect the fact that the municipality has its own property and the right to have its own money, which it collects both from the municipal budget and from a special-purpose monetary fund. The municipal budget, as the main financial instrument of the municipality’s management, must express all the financial relations that the municipality has with its economic environment. The municipality also has these relations with the state budget, the budgets of state funds, and other entities, including citizens.⁹ The budgets of municipalities (as local self-government units) are described as decentralised monetary funds, which concentrate both the revenues that the municipality or region receives as a result of their redistribution in the budget system and the revenues generated by their own activities. These are

6 Radvan, 2020, p. 79.

7 Peková, 1997, p. 137.

8 Section 1. Act on local charges.

9 Pařízková, 2008, p. 55.

distributed and used to finance public and mixed goods through the public sector of the local government or through the private sector.¹⁰

Similar to any budget, the municipal budget consists of revenue and expenditure. The revenues of municipalities are diverse and can be further divided broadly into three different groups, namely own budget revenue, state budget and state funds, and other or additional revenue.¹¹

From both the economic and legal point of view, it is important to distinguish between revenues that the local government unit can influence by its decision, its activities, and revenues that it cannot influence because they are decided by the state.¹²

In this paper, the core revenue is own revenue. This includes, apart from, for example, income from the sale of property owned by the municipality and income from its own management or from the management of entities it has established or set up, mainly income of a tax or charge nature, including revenue from local taxes. The main part of the tax revenues of municipalities is made up of so-called shared taxes; in other words, their revenue is distributed in various proportions determined by law between municipalities, regions, and the state (or other monetary fund). These taxes are not administered by municipalities; they are not able to directly influence the process of their lawmaking, and therefore, their actual revenue. A different position is then occupied by the real estate tax revenue, which is fully budgeted by the municipalities. Municipalities can partly influence their revenue based on partial corrective elements entrusted to them by the legislator, but to a very limited extent. They do not administer the tax themselves.

Therefore, in the context of other taxes, it is clear that the revenue from local charges, which, despite their name, represent another tax revenue, occupies a specific position in the field of municipal budgets. Unlike other tax revenues (shared taxes), local charges are fully within the autonomy of municipalities, both in the administration of charges and in the implementation of local charges. Their revenue falls 100 % within the municipal budget. The administration of these taxes is carried out directly by the municipality, or the municipal authority, and the actual lawmaking is its responsibility. Thus, it is an economic instrument that, although it does not represent a major part of the revenue side of the budget for municipalities (usually around 2 % of revenue¹³), but if the composition of the introduced local taxes is chosen appropriately, as well as their effective administration and collection, it complements the municipality's budget composition in a relatively stable way and supports its economic independence.

10 Provazníková, 2015, p. 51.

11 Marková, 2008, p. 49.

12 Mrkývka et al., 2020, p. 122.

13 Mrkývka et al., 2020, p. 127.

4. Municipality as a Creditor in Insolvency Proceedings

The municipal authority, as the administrator of local taxes, performs all acts related to their administration. One of these acts is the registration in insolvency proceedings of tax arrears that have not been paid by the taxpayer who has also become an insolvency debtor. Insolvency law¹⁴ in the Czech Republic distinguishes between three types of bankruptcy resolution – debt relief (for natural persons only), bankruptcy and reorganisation. The method of insolvency resolution plays a role in the actual actions of the municipality as a creditor in insolvency proceedings at certain stages of the proceedings, as it determines the person who has the power to dispose of the assets (the debtor or the insolvency administrator).

4.1. Claims Arising Since the Effective Date of the Bankruptcy Decision

Section 242(1) of the Tax Code provides that tax claims arising from tax obligations that arose between the effective date of the bankruptcy decision and the conclusion of the insolvency proceedings are claims against the estate (Section 168(2) Insolvency Act). The key to determining the nature, or ranking, of a tax claim in insolvency proceedings is when the tax obligation itself arises. The commentary literature¹⁵ on the Insolvency Act states that the decisive factor is not the issuance of payment orders or other decisions on tax assessment, but the creation of tax liability. The Tax Code provides that ‘a tax liability arises at the moment when the facts which are subject to tax under the law or the facts giving rise to such liability have occurred.’ The Supreme Administrative Court of the Czech Republic has also confirmed that the key point is the moment of the taxable fact, irrespective of the fact that the tax liability was decided after the bankruptcy.¹⁶

Claims against the estate shall be filed in written form against a person with dispositive rights, and the creditor shall always notify the insolvency administrator of the claim (Section 203 Insolvency Act). The person with dispositive rights shall satisfy such claims from the estate in full at any time after the decision on insolvency (Section 168(3) Insolvency Act). The claim against the estate is not dependent on whether the person asserting the claim is a registered creditor. Such claims may be asserted by any person who is entitled to assert the claims.

The satisfaction of these claims varies depending on the method of insolvency resolution. In the case of a reorganisation, claims against the estate must be paid

14 Act no. 182/2006 Coll. on Bankruptcy and its Resolution (Insolvency Act).

15 Hásová, 2014, p. 594.

16 Supreme Administrative Court of the Czech Republic, 2016.

before the reorganisation plan is approved or as soon as the reorganisation plan becomes effective, unless otherwise agreed. In the event of bankruptcy, claims against the estate should be paid without undue delay if there are funds in the estate. Otherwise, the creditor may seek payment of the claims through an action against the insolvency administrator, as the insolvency administrator has the right of disposal of the assets. Finally, in the case of debt relief, the debtor is obliged to behave in such a way as to avoid creating further debts. In this case, claims against the estate are asserted directly against the debtor, who is entitled to dispose of the estate and merely notifies the insolvency court and the insolvency administrator of this action. Failure to pay debts incurred during the insolvency proceedings may be grounds for the annulment of the debt relief or its conversion into bankruptcy.

4.2. Claims Arising Before the Effective Date of the Bankruptcy Decision

All creditors, including municipalities, file their claims arising from unpaid tax obligations with a competent insolvency court. This is always the regional court determined according to the debtor's registered office if it is a legal entity and the debtor's permanent residence if it is a natural person. All claims, including accessories that arose from tax obligations for the tax period that occurred no later than the day before the effective date of the bankruptcy decision are subject to registration in insolvency. In the context of the administration of local taxes, the law excludes the application of accessories; therefore, there is no need to address the special regulation of non-contractual penalties under the Insolvency Act, which excludes some of them from satisfaction in insolvency proceedings.

Creditors file applications for claims with the insolvency court from the commencement of insolvency proceedings until the expiry of the time limit set by the bankruptcy decision. The time limit starts to run from the publication of the bankruptcy decision in the insolvency register, and its missing cannot be waived (Section 83 Insolvency Act). Applications filed after the expiry of the deadline shall not be considered by the court, and the claims cannot be satisfied (Section 73(1) Insolvency Act). The application must comply with the general requirements pursuant to Section 42(4) of Act no. 99/1963 Coll., Code of Civil Procedure, and must also contain the legal basis for the claim, that is, the legal facts on which the claim is based (e.g. arrears incurred under the relevant legal regulation) and the amount of the claim being applied for. In the case of local taxes, the claim will often be an enforceable claim, where the enforcement title will be an enforceable payment order or collective prescription list or an enforceable statement of arrears. The advantage is that if such a claim (enforceable) is denied, the insolvency administrator is obliged to act. The possibility that a

claim arising from local taxes would be secured is generally not foreseeable, given the lower amounts involved.

If the application for a claim cannot be examined due to flaws or incompleteness, the insolvency administrator shall invite the creditor to correct or eliminate the flaws within a period that may not be shorter than 15 days. If the creditor fails to do so in time and properly, the insolvency administrator shall propose to the court to issue a decision that the application shall not be considered (Section 188(2) Insolvency Act). A registered creditor may withdraw its application in whole or in part (Section 184 Insolvency Act) at any time during the insolvency proceedings. The tax administrator will do so particularly in cases where the registered tax claim has been extinguished in the meantime (e.g. through payment by a guarantor).

With regard to the effects of the filing of the application from the perspective of the Tax Code, it should be noted that from the date of delivery of the application to the insolvency court, the prescription period for the collection and enforcement of properly registered arrears does not run throughout the insolvency proceedings. However, similar effects also arise in the case of private law claims.

Therefore, it can be concluded that the Czech legislation grants tax claims a certain above-standard status, however, only to those that have arisen since the date of the bankruptcy decision. Tax claims arising before that time have the same status as the claims of the remaining creditors.

4.2.1. Municipalities as Insolvency Creditors – Practice

According to the Freedom of Information Act,¹⁷ the municipal authorities administering local taxes were asked the following questions:

1. What percentage of tax obligations, i.e. local taxes administered by the municipal authority, were not paid by taxpayers in 2018, 2019, 2020, 2021, 2022?
2. Does the municipal authority register in the insolvency proceedings its claims arising from unpaid tax obligations, i.e. local taxes pursuant to Act no. 565/1990 Coll. on local charges, which it administers in accordance with Section 15 of this Act?
3. If yes, what was the total value of the claims so declared in each of the years 2018, 2019, 2020, 2021, 2022?
4. If no, does the municipal authority have technical security to monitor whether the tax debtor has been declared bankrupt?

¹⁷ Act no. 106/1999 Coll. on free access to information.

The city of **Adamov** (approx. 4,500 inhabitants), which administers the dog charge, charge for stay, charge for using public places and charge on communal waste, stated:

Ad 1) 2018–7 %; 2019–5 %; 2020–54 %; 2021–58 %; 2022–8 %

Ad 2) Yes, it does.

Ad 3) In 2018, the claims filed in insolvency totalled CZK 21 700

In 2019, the claims filed in insolvency totalled CZK 10 825

In 2020, the claims filed in insolvency totalled CZK 72 606

In 2021, the claims filed in insolvency totalled CZK 48 294

In 2022, the claims filed in insolvency totalled CZK 58 050

The city of **Brno** (approx. 396,000 inhabitants), which administers charge on communal waste (other charges are the responsibility of individual city districts), stated:

Ad 1) 2018–5,91 %; 2019–7,29 %; 2020–10,68 %; 2021–11,94 %; 2022–11,81 %

Ad 2) Yes, it does.

Ad 3) In 2018, the claims filed in insolvency totalled CZK 874 410,56

In 2019, the claims filed in insolvency totalled CZK 1 473 086,80

In 2020, the claims filed in insolvency totalled CZK 2 083 240,69

In 2021, the claims filed in insolvency totalled CZK 2 266 994,52

In 2022, the claims filed in insolvency totalled CZK 1 636 970,51

In both cases, question 4 was then irrelevant.

The city of **Lelekovice** (approx. 2,000 inhabitants), which administers charge on communal waste and the dog charge, stated:

Ad 1) In 2018–0,4 %; in 2019–0,5 %; in 2020–0,45 %; in 2021–0,49 %; in 2022–0,77 %

Ad 2) The municipality is not filing claims in insolvency proceedings.

Ad 3) Irrelevant in view of the above.

Ad 4) The municipality does not have this type of technical security.

4.2.2. Summary of the Questionnaire Results

The data provided shows that the COVID-19 pandemic played a role in the payment of local taxes in the case of the two larger cities among the three cities examined (the city of Brno and the city of Adamov). While in 2018 and 2019 the proportion of unpaid tax obligations for both municipalities was similar (5-7 %), the COVID-19 years brought significant fluctuation, which was especially enormous in the city of Adamov.

It is clear that the proportion of unpaid claims arising from unpaid local taxes is not insignificant for larger towns and therefore justifies the focus of this paper. The position of the municipality as a creditor in insolvency proceedings has a direct impact on the economic interests of the municipality. Positively, it is evident from the data provided that collection actions through registration in insolvency proceedings are usually actively undertaken by municipalities, even in the case of smaller cities. It is not possible to make any further conclusions from the absolute values of the data without the context of the other information; however, they demonstrate a clear economic interest for municipalities to actively participate in insolvency proceedings as creditors.

The smallest municipality, Lelekovice, is an exception among the three municipalities examined, mainly because of the share of unpaid local taxes, which is completely negligible. It is therefore justifiable that the municipality is not actively involved as a creditor in the insolvency proceedings, or even that it does not have the necessary technical equipment to detect such matters, since securing it would probably be at least as costly as any potential revenue from the insolvency proceedings.

4.3. Case Law of the Highest Courts in the Czech Republic

The Insolvency Act in Section 324(3) establishes a rule according to which, in the context of a bankruptcy resolution by reorganisation, the following applies:

From the moment of publication of the reorganisation plan in the insolvency register, no set-off of the debtor's and creditor's claims against each other is admissible, unless the insolvency court determines otherwise by way of an interim measure. This applies even if the statutory conditions for such set-off have been fulfilled before that time.

Furthermore, the Tax Code in Section 242(2) provides that:

For the purposes of insolvency proceedings, a refundable overpayment is considered to be the property of the tax entity, with the exception that the overpayment arising from tax obligations that arose no later than the day preceding the effective date of the bankruptcy decision shall be used only for the payment of outstanding tax claims that are not claims against the estate, at the latest until their examination at the review hearing.

Simply put, while the Tax Code allows set-off of claims where the conditions were met before the bankruptcy decision became effective, the Insolvency Act prohibits it

in the case of reorganisation, starting from the moment of publication of the proposal for authorisation of reorganisation. The Supreme Administrative Court has repeatedly considered¹⁸ whether the Tax Code or the Insolvency Act should be prioritised in this case and has concluded that the Insolvency Act has priority. The Supreme Administrative Court found that the Tax Code allows for an unreasonably broad application of set-off of tax claims beyond the rules on set-off provided for in the Insolvency Act. However, this concept, according to the Court, cannot be approved, as it leads to an impermissible advantage of the tax administrator as a creditor in insolvency proceedings, in which creditors should have the same position in principle. According to the court, the application of the rule contained in the Tax Code would result in an impermissible advantage for the tax administrator as a creditor in insolvency proceedings; therefore, the rule in the Insolvency Act must be considered special.

In this context, the Constitutional Court of the Czech Republic has repeatedly concluded¹⁹ that the arbitrary favouring of public law claims (typically tax claims) over private law claims is inadmissible because the state as an owner does not have a general right to be favoured over other owners. Similarly, the Constitutional Court rejected the favouring of the state as a creditor of a special nature, as this is contrary to the constitutional requirement of equal protection of property rights of all owners.

5. Tax as the Subject of an Insolvency Claim – Is the Tax Administrator Just Another “Ordinary” Creditor?

The above clearly shows that the highest courts of the Czech Republic fundamentally reject any favouring of the tax administrator over other creditors, based on one of the fundamental principles of insolvency law in general – the equal position of all creditors. However, the author believes that the case law fundamentally overlooks the different nature of claims arising from unpaid tax liabilities and therefore the fundamental objective of tax administration, which is to ensure their payment. Those principles must be measured and evaluated based on their consequences. Therefore, it is necessary, in the first place, to deal with the concept of tax itself and, above all, its function, since it determines the importance of its collection.

As has been repeatedly stated, taxes are a revenue of public budgets. This conceptual feature captures the essence of the fundamental function of taxes, which

¹⁸ Supreme Administrative Court of the Czech Republic, 2021.

¹⁹ Constitutional Court of the Czech Republic, 2008.

is to provide revenue for public budgets.²⁰ It is therefore a fiscal function. The funds raised through tax collection constitute the core source of revenue that finances public goods and services. The fiscal function of taxes is also sometimes referred to as the primary function because other functions attributed to taxes²¹ are derived from it. This is why the tax administrator cannot be seen in isolation as a state that would gain certain privileges due to its superior status. It is necessary to realise the economic importance of taxes themselves, which serve to provide funds to pay for public goods, that is, goods that serve all the citizens of the state. The state, represented by the tax authorities as a creditor, thus acts not for itself but for the needs and rights of taxpayers. The taxpayers are entitled to receive the proceeds of the taxes that have accrued by law. In effect, the insolvency creditor is not the tax administrator representing the state, but all citizens who directly and indirectly benefit from tax revenues.

The consequence of the above construction, which views the tax administrator as a representative of the needs and rights of citizens to obtain revenue from legally incurred tax obligations rather than as a representative of the state, has economic consequences. In recent years, the Czech Republic has been facing a severely strained budgetary situation, with the state budget deficit reaching unprecedented levels. Therefore, every step that is taken should also be measured against its fiscal consequences. Although the loss to public budgets cannot be reliably quantified, it is obvious that the strict prioritisation of the principle of equal treatment of creditors also leads to a loss of revenue to public budgets.

The tax, as the subject of the insolvency claim, implies further specifics in the position of the tax administrator as an insolvency creditor. A tax claim differs from a private law claim primarily in that it arises by law and not on the basis of a contractual relationship, whose creation is an expression of the will of the parties involved. The tax administrator is therefore not entitled to “choose” the person of its debtor in any way. A tax entity and a potential insolvency debtor refer to anyone who is subject to the tax liability that is provided for by law. In contrast, a private creditor can choose, through a completely targeted and conscious process, with whom it enters into an obligation relationship. In particular, bank and non-bank lenders often carry out a risk assessment of the customer, on the basis of which they consider the profitability and advantage of a particular commitment. The tax authority, as a creditor, does not have that option. It follows that tax authorities are in a worse position than other private creditors when it is not open to them to choose whether to enter into the commitment. The tax authority is, thus, a “forced creditor.” The impossibility of influencing one’s position as a creditor in the creation of tax debts is also reflected

²⁰ Walker, Long and Fullerton, 1994, p. 209.

²¹ Musgrave and Musgrave, 1994, p. 418.

abroad; however, the approaches chosen to deal with this differ. While the German legislation is strictly based on the equality of creditors, which does not entitle tax claims to priority,²² the Anglo-Saxon legislation represented by the UK gives a better status to tax claims.²³

5.1. Tax Insolvency Claims in the Continental Law System (Germany)

According to the Insolvency Code, Insolvency law is based on the principle of equal treatment of creditors. This means that the creditors participating in the procedure all receive the same proportion of the insolvency estate in relation to their registered claims. If a registered claim has been recognised in the procedure, it must be considered in a quota distribution. The available bankruptcy estate is then distributed to all creditors in equal proportions. This means that creditors with higher claims receive a higher amount than those with lower claims, so that everyone receives the same percentage. It follows that tax claims arising before the insolvency is opened are treated in Germany in the same way as in the Czech Republic and are satisfied on a proportional basis as for other creditors.

However, there are also debts incumbent on the assets, which have a different regime. These claims arise after the insolvency has been opened and must be satisfied in full. These are mainly the costs of the estate and the court costs of the insolvency proceedings, as well as the remuneration and expenses of the provisional insolvency administrator, the insolvency administrator, and the members of the creditors' committee (Section 54 Insolvency Code). Furthermore, these are the claims defined in Section 55 Insolvency Code, which include, among others, taxes, namely value added tax, other import and export duties, federal consumption taxes and pay personal income tax on employees. Unlike in the Czech Republic, not all tax debts arising after the beginning of the insolvency proceedings become debts incumbent on the assets, but only tax debts specified by tax law. Only when these priority claims have been paid in full will the remaining assets of the bankruptcy estate be paid to the bankruptcy creditors, in equal proportions.

It can be summarised that Germany significantly prioritises creditor equality over the economic importance of tax collection. Thus, the state is, in principle, in a similar position to that of other creditors. The exception is tax claims arising after the bankruptcy order, which must be satisfied in full, but even this applies only to certain taxes.

²² Roth, 2020, p. 76.

²³ Conway, 2020, p. 3.

5.2. Tax Insolvency Claims in the Common Law System (UK)

Since 1986, English insolvency law²⁴ has provided for the following order of priority for the payment of claims according to the person of the creditors:

- Secured creditors with a fixed charge
- Preferential creditors
- Secured creditors with a floating charge
- Unsecured creditors
- Shareholders.

The claims of creditors in a particular class are not paid until the claims of creditors in the previous class have been paid in full. There has been a fundamental change in the area of tax claims in recent years. Her Majesty's Revenue & Customs ("HMRC"), as the UK tax administrator, has been classified as an unsecured creditor since 2003 in all its claims. The abolition of preferred creditor status was introduced at the beginning of the millennium to promote business and make insolvency proceedings fairer for all creditors.²⁵ From 1 December 2020, the UK tax authority, HMRC, once again became the preferred creditor in insolvency proceedings in respect of certain taxes, which strengthened HMRC's position at the expense of other creditors. It is important to note that HMRC was given "secondary," not "ordinary," preferential status. The difference is that ordinary preferential creditors include employees who are entitled to arrears of wages, holiday pay, and other statutory payments up to a certain limit. This category also includes deposits that fall under the Financial Services Compensation Scheme (FSCS). Secondary preferential creditors, which are paid after the regular preferential creditors have been paid, currently include those parts of the deposit that do not fall within the protection of the FSCS.

This change will not affect all tax arrears, but only taxes held by a business (this includes individuals and corporations) on behalf of its customers and employees, which are value added tax (VAT) and debts that relate to pay as you earn (PAYE) income tax, employee national insurance contributions (NICs), students loan repayments and construction industry scheme deductions.²⁶

These debts are only preferential if the insolvent business entered a formal insolvency procedure on or after 1 December 2020. With other tax claims (e.g. income tax), HMRC remains in the unsecured creditor class.

The legislator considers the change to be a protection of taxes paid by employees and customers. If a corporation or individual becomes insolvent, the taxes paid by

²⁴ Insolvency Act 1986.

²⁵ Conway, 2020, p. 7.

²⁶ Government UK, 2020.

employees and customers, which were temporarily held by the insolvent corporation, are often not used to pay for public goods but go to pay debts owed to other creditors. In its 2018 budget briefing, the government estimates that this change could raise extra revenue, up to £185 million annually.²⁷ However, it should be added that there are also some concerns about this change. The logical consequence is a reduction in the returns to creditors in the lower categories. For this reason, there are views that the financial market will slow down as lenders will be even more concerned about the solvency of companies when lending (e.g. also about covering their tax liabilities) and there will be pressure to secure loans with fixed charges. This will reduce the willingness to provide finance to businesses that are in financial difficulty, even though the extra cash could help them and save the business.²⁸ There is also a fear of increased influence of HMRC on insolvency processes due to increased decision-making powers.²⁹ The impact of this may be indirectly related to the apathy of unsecured creditors. Even before this change, the amount they received in insolvency from their claim was around 4 %. The potential reduction of the return to zero may remove the interest of unsecured creditors to participate in insolvency processes at all.³⁰

In summary, the UK has made changes in recent years that reflect the economic importance of taxes to public budgets. It has prioritised the positive relevance of fiscal stability over creditor equality. However, the question is whether this disadvantages creditors. The step can also be seen as favouring citizens who benefit from tax revenues and enjoy public goods. The general benefit of higher tax revenues potentially affects everyone, including creditors.

6. Conclusions

Municipal authorities, as tax administrators, are usually active in insolvency proceedings and register their claims arising from unpaid tax obligations, which has been demonstrated by specific data obtained from Czech municipalities of various sizes. This fact has a positive impact on the budgetary situation and the municipality; therefore, it is appropriate to deal with the position of the municipality as a creditor in insolvency proceedings. Czech legislation basically distinguishes two regimes of municipal claims in connection with the administration of taxes. Classification under the relevant regime is based on when the claim arose, not on when it was formally determined by a payment order or other type of tax assessment decision. While claims arising before the date of the bankruptcy order arising from taxes are treated in the

²⁷ HM Treasury, 2018.

²⁸ Conway, 2020, p. 11.

²⁹ Stephenson and Stembridge, 2020, p. 2.

³⁰ Markham, 2019.

same way as other claims, claims arising from unpaid taxes after the bankruptcy decision, together with other statutory claims, are paid out of the estate as a priority. In general, however, the Czech legislation and the case law adhere strongly to the principle of equality of creditors and are inspired by German insolvency law. Thus, it can be concluded that the aim of the paper was fulfilled; however, the hypothesis was refuted.

Czech legislation does not formally provide that the principles of insolvency law are superior to tax law. However, case law has accepted this interpretation without explaining the broader circumstances, despite the indirect factual impact on all tax-payers. Tax can be viewed as a specific “public good,” since its revenues are ultimately the property of all the citizens of the state, or all benefit (in varying proportions at different times) from its revenues. The societal importance of taxes justifies the need to consider the consequences of any change or interpretation of tax law. According to the author, when interpreting the conflict of norms of tax and insolvency law, it should be taken into account that the tax administrator is not only a representative of the state, but above all of all its citizens. At the same time, a reduction in tax revenues is associated with a reduction in public funds to pay for public goods. Finally, the fact that the tax administrator does not have the autonomy of will to enter into an obligation must also be taken into account.

The author believes that all these aspects should be considered when conclusions affecting the position of the tax administrator as a creditor in insolvency proceedings are made.

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