

# From Violation of the Budgetary Discipline to the Principle of Proportionality within the Assessment of the Levy for this Violation

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## Abstract

This contribution deals with the problem of violation of the budgetary discipline and with the associated necessity of application of the principle of proportionality within the assessment of the levy for this violation. The main aim of this contribution is to confirm or disprove the hypothesis whether the correct approach of the application of the principle of proportionality has been chosen in the Czech legal order when assessing the amount of the levy for a violation of budgetary discipline, taking into account the situation regarding the reporting of irregularities in the violation of the subsidy conditions.

## Keywords

jurisprudence; violation of the budgetary discipline; levy

## 1 Introduction

In the beginning, it is good to define the concept of subsidy, which forms the basis of this paper. The subsidy within the meaning of Art. 3 letter a) of Act No. 218/2000 Coll. on Budgetary Rules and on Amendments to Certain Related Acts (Budgetary Rules), as amended (hereinafter: the Budgetary Rules), means “finances provided from the state

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budget, state financial assets or the National Fund to artificial legal persons or natural persons for a specific intended purpose” (Grossová, 2008: 14). But the professional legal public looks at subsidy as a general one, without intended purpose (Bakeš et al., 2012: 113).

In addition to subsidies, the Budgetary Rules speak in Art. 3 letter b) of an institute of similar designation – repayable financial assistance. This means finances of the state budget, state financial assets or the National Fund provided, except as otherwise, by the special law interest-free to artificial legal persons or natural persons for the intended purpose and their recipient is obliged to return these finances to the state budget, state financial assets or the National Fund.<sup>2</sup>

Havlan grasps the fundamental difference in the variability of the ownership of these public finances (Havlan, 2016: 39).

The view of the support in the form of subsidy (state subsidy) differs according to the way of thinking. Consumers perceive them as a factor of decreasing or increasing of prices, economists regard them in the traditional sense as a state intervention of Keynesian character (Jurečka, 2010: 53), lawyers as in the conduct of a state that can be allowed or illegal (Art. 174 et seq. or Arts. 107 to 109 of the Treaty on the Functioning of the European Union), etc. This paper focuses on the legal view, which is very well depicted economically by the collective of authors around Jurčík: “The basic principle of the functioning of the single market is the assessment of any state support by the state as distorting competition and the competitive environment and, in principle, the granting of public support is forbidden. Only public support conducive to the realization of certain objectives of the Community is considered to be compatible if its positive effects outweigh the negative impact on the market environment” (Jurčík, 2001: 88).

One of the principal obligations of a recipient of the subsidy is to use it under the terms of the decision to grant a subsidy or refundable financial assistance and in accordance with the purpose for which it was granted. The Budgetary Rules regulate in Art. 3 letter e) that unauthorised use of finances of the state budget, other state finances, granted from state budget, state financial assets, state fund or National Fund, means their spending by whose performance was violated the obligation stipulated by legal regulation, decision or by an agreement to provide such finances or a violation of the conditions under which the finances have been provided, a violation of the purpose or the conditions under which finances have been classified in the state budget or moved

<sup>2</sup> The National Fund is further defined in Art. 37 of the Budgetary Rules, as the sum of: a) finances, which entrusts the European Union to the Czech Republic for the realisation of programs or projects co-financed from the EU budget through the Structural Funds, the Cohesion Fund and the European Fisheries Fund; b) Transition Facility finances; and c) the finances of the financial mechanisms that are entrusted to the Czech Republic under international treaties, including the interest thereon. Memorandum on the establishment of the National Fund was the National Fund established on 31 December 1998 at the Ministry of Finance of the Czech Republic as the central government for the transfer of finances from the European Union intended for the Czech Republic to finance programs and projects in accordance with the relevant Financing Memorandum. For more information about the powers of the National Fund and their performance, see National Fund of the Ministry of Finance, 2015.

by budgetary measures and are in violation of the intended purpose or conditions; it is also understood if it is not possible to prove how these finances were used. The above-mentioned is one of two basic points for defining the barriers of the violation of budgetary discipline itself.

## **2 Violation of the Budgetary Discipline**

The violation of budgetary discipline is defined in Art. 44 of the Budgetary Rules. This is a variation of situations, including, in particular, the unauthorised use or detention of public finances or violations of the obligations laid down when dealing with them (also contractual obligations). In the context of a violation of budgetary discipline, it is necessary to distinguish the pecuniary means to which it relates, as evidenced by the first two substantive facts – the unauthorised use of the finances of the state budget and other state finances and the unauthorised use or withholding of finances provided from the state budget, State Fund, National Fund or State Financial Assets by their recipient (the provisions of Art. 44 par. 1 letter a)–b) of the Budgetary Rules). The following provisions of Art. 44 par. 2 of the Budgetary Rules then divide the finances and the granted finances more closely, according to the source of their acquirement by the recipient of the subsidy (e.g. state budget finances, finances granted from the state budget and finances obtained in various ways from the National Fund).

### **2.1 Consequences of violation of the conditions for drawing the subsidy**

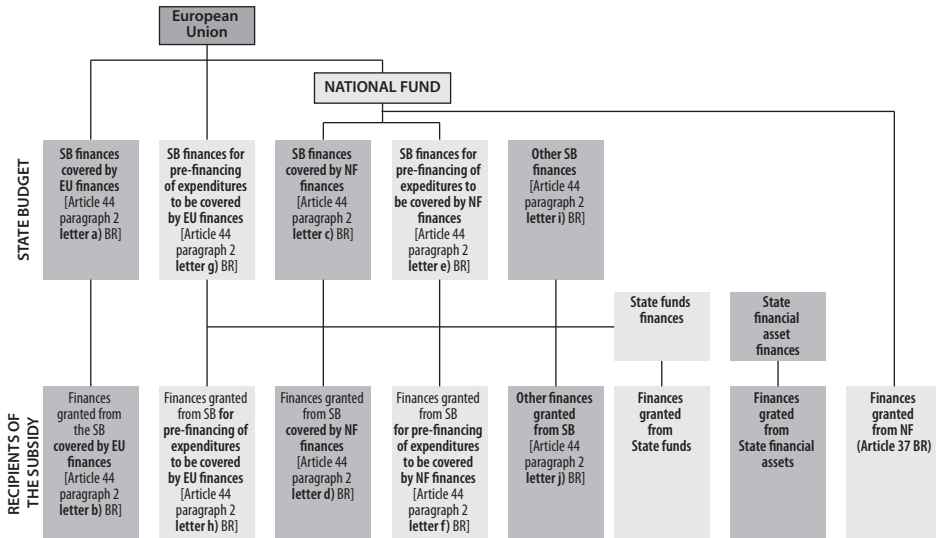
In theory, it is possible to divide the three consequences of the finding of misconduct – non-payment of the subsidy, withdrawal of subsidy and violation of budgetary discipline, including penalty. In terms of time, the consequences of the violation of subsidy rules can be divided to ex-ante and ex-post consequences of the payment of the subsidy.

The above-mentioned is of considerable significance for the state budget of the Czech Republic, as the finding of an irregularity<sup>3</sup> in the subsidy paid out (granted) from the European funds will retrospectively lead to the termination of the process and the co-financing or subsidisation of a specific European money case will not occur. This exerts pressure on the financial administration to investigate the impetus received from the subsidy provider and, in the event of their verification, to remedy to the state budget affected by the irregularity primarily through the assessment of the levy for violation of budgetary discipline, respectively penalty for delay with its payment, on the beneficiary of the subsidy.

<sup>3</sup> See National Fund of the Ministry of Finance, 2015.

## 2.2 Distribution of European finances in the Czech Republic

European finances have already been mentioned several times, so these are European Union finances that go to the Member States through the National Fund and are used to co-finance subsidy projects. These finances are provided through a rather complicated system with a number of control elements. The Budgetary Rules specify in Art. 44 par. 2 the different types of finances with respect to their source and use, as follows:



Source: Compiled by the author.

## 2.3 Irregularities

In a situation when the finances are provided to recipients of the subsidy from the European Union funds, they must be prepared for a number of control activities. A lot of authorities are eligible to control whether the recipient of subsidy complies with all its obligations (e.g. the purpose of the subsidy, deadlines, etc.) and the laws (in most cases, in particular, the rules for public procurement). If the audit authority, which is the Ministry of Finance of the Czech Republic, finds during its control activity a certain error, it must, simply said, report this as a so-called irregularity. The control of irregularities, therefore, occurs within the above-mentioned systems and, moreover, at all stages of the granting of the subsidy, i.e. from the European Commission through the payment and certification bodies to the governing bodies or the organisational units of the state up to the recipient of the subsidy, or even through the intermediaries.

In this multi-level system with dozens of controlling institutions or bodies, irregularities can easily arise. However, it is not the legal power of the decision that

will result in financing of the subsidy to the state budget, but a preliminary notice of irregularity, which may be purely formal, only sufficient to limit the supply of finances to the state budget from the European Union funds.

Thus, the state budget will always lose “money from the European Union” when the irregularity is reported, after which the financial administration, respectively later the court, decides whether the recipient of the subsidy has committed a violation of budgetary discipline and whether it is thus obliged to pay the levy for the violation, that would result in a partial compensation of reported irregularity.

## 2.4 Violation of budgetary discipline and the principle of proportionality

However, in the exercise of its powers to administer levies for violation of budgetary discipline,<sup>4</sup> the financial administration, in addition to the difficulties with reported irregularities, also has to deal with another problem area, taking into account the principle of proportionality. In the relatively recent period, the idea that in the event of a violation of budgetary discipline, the levy will be assessed in the amount in which the budget discipline has been violated, has been hold. In their first decisions at the turn of the years 2013 and 2014, the administrative courts have begun to promote the idea of taking into account the principle of proportionality in relation to the nature and seriousness of the violation of the budgetary discipline. This principle has been further developed and incorporated into the decision-making process of the administrative courts (and consequently the financial administration) over time, which resulted in the considerable fragmentation of this decision-making process, and in some cases even the Supreme Administrative Court has assessed the tensions between the proper management of public property and violation of the budgetary discipline in favour of good governance, unfortunately, in the author’s opinion, not according to the law<sup>5</sup> (see judgment No. 2 Afs 142/2016 – 32 of 30 March 2017 or judgment No. 2 Afs 208/2016 – 52 of 14 July 2017).

In the next part of the thesis, the author will focus on this case law area, namely the principle of proportionality and the necessity of its application by the financial administration when deciding on the assessment of levy for violation of the budgetary discipline. As the Supreme Administrative Court summarised in its resolution No. 1 Afs 291/2017 – 24 of 29 November 2017 in the case of the City of Krnov (hereinafter: the Resolution), which brought the case to the Extended Senate of

<sup>4</sup> The administration of the levies for violation of the budgetary discipline and penalties are executed according to Art. 44a par. 1 of the Budgetary Rules by the tax administration, and so procedurally in accordance with Act No. 280/2009 Coll., Tax Code, as amended.

<sup>5</sup> The author considers that even a formal misconduct is a violation of budgetary discipline, with only the amount of the levy for that violation being a manifestation of proportionality taking into account all the facts of the case and its implications.

the Supreme Administrative Court, this area has undergone considerable changes in recent years, mainly due to the case law of the administrative courts, and the Supreme Administrative Court itself is not united in its decision-making in the area where several approaches to the principle of proportionality can be found in its judgments.

## 2.5 The judicial concept of proportionality and related issues

In the case solving of the Resolution, the recipient of the subsidy violated the condition (submission of the application for the grant of the approval), which the parties agreed in the decision to grant the subsidy as a serious mistake, if not fulfilled. However, it is clear from the case law of the Supreme Administrative Court that the violation of the conditions must be assessed in the light of compliance with the purpose of granting the subsidy, which was not affected in this case according to the opinion of the Regional Court in Ostrava, and therefore, the decision of the defendant was cancelled and the case was returned to the proceeding to the defendant, Appellate Financial Directorate. The defendant lodged a cassation complaint against the judgment and the First Chamber, in its hearing, found that the existing case law relating to the subject matter was somewhat inconsistent and several opinion streams could be traced.

The first stream of opinion totally rejects the possibility of the proportionality of assessing the amount of the levy in relation to the nature and seriousness of the violation of subsidy conditions, except in cases where the violation relates only to a certain amount of the granted finances, not to the entire amount of the subsidy (particularly, the primary case law on the issue of levy for violation of the budgetary discipline, especially judgment No. 7 Afs 91/2013 – 28 of 30 May 2014 from the recent case law). In addition, there are two other streams of opinion that the assessment of the violation of budgetary discipline must be guided by the principle of proportionality. Proportionality can then be taken into account either at the stage of qualifying the process of the recipient of subsidy process under the concept of “unauthorised use of finances”, or “violation of budgetary discipline” (e.g. judgment of the Supreme Administrative Court No. 4 As 117/2014 – 39 of 10 October 2014, or No. 9 As 122/2014 – 34 of 12 March 2015), or at the stage of assessment the amount of the levy (e.g. judgments of the Supreme Administrative Court No. 2 As 106/2014 – 46 of 26 September 2014 or No. 4 As 215/2014 – 40 of 5 December 2014). The first of these approaches (and the second overall) highlights the need to take into account whether the purpose of the granted subsidy was kept when using finances. Marginal errors that do not affect the purpose of granted subsidy cannot be considered as unauthorised use of finances and no levy can be imposed for violation of the budgetary discipline. In the second case, the third stream of opinion in total, the Supreme Administrative Court as violation of the budgetary discipline also identified such violations that do not affect the purpose of the granted subsidy itself. However, the lower intensity of the violation of the subsidy conditions must be taken into account when assessing the amount of the levy for the violation of budgetary discipline.

It can also be considered as undesirable the fact that many of the newer decisions of the Supreme Administrative Court disparage the abovementioned discrepancies between individual streams of opinion and mark the case law on the question of levy for the violation of budgetary discipline as totally constant. For this purpose, they usually conceal the case law that does not correspond to the opinion of the deciding senate, and without any further argumentation they indicate conclusions from that judgment as unsuited or they misinterpret them directly. However, ignoring the persisting judiciary contradictions only strengthens the uncertainty of recipients of the subsidy and subsidy providers, for whom decision-making in this area is difficult to predict. Administrative authorities endowed with scrutiny powers in the area of budgetary discipline do not have clear guidance on how they should address the identified shortcomings, which also prolongs the length of proceedings, as participants are forced to turn to administrative courts in an increasing number of cases.

In the present case, the first senate considers that the violation of the obligation arising from the decision to grant a subsidy, is also a violation which does not affect the purpose of the granted subsidy, and constitutes a violation of the budgetary discipline and justifies the assessment of a levy for its violation, but not in the full amount of the subsidy granted, but only in such amount as is proportionate to the seriousness and consequences of the particular violation.

With regard to the persisting and rather deepening contradictions between the various streams of opinion, the First Senate submitted the matter to the Extended Senate of the Supreme Administrative Court, with the following two questions:

1. Does any violation of subsidy conditions, which are not defined as less serious in the decision to grant a subsidy, constitute a violation of budgetary discipline?
2. Is any violation of the budgetary discipline within the meaning of Art. 44a par. 4 letter c), respectively letter b) of the Budgetary Rules, which relates to the entire amount of the granted subsidy, connected with the levy for the violation of budgetary discipline in the amount of the whole granted subsidy, or is the administrative authority obliged to assess the amount of the levy proportionally in the light of the seriousness of the violation found?

In the author's opinion, it is necessary to answer the first question positively, namely that any violation of subsidy conditions constitutes a violation of budgetary discipline, especially with regard to the current wording of the Budgetary Rules and its Art. 3 letter e). As regards the answer to the second question, it is also in the light of the case law that it is necessary to state that the financial authorities are required to assess the amount of the levy for a violation of budgetary discipline proportionally, taking into account the seriousness of the violation found. However, it is a question of how the Extended Senate of the Supreme Administrative Court will address the issue, but we will have to wait for this answer for a while. Even now, however, the application of the principle of proportionality brings some difficulties with regard to the above-discussed reporting irregularities.



## 2.6 The European dimension of the problem

In the beginning, let us compare two different forms of certain “support” to tax subjects from the state. It is a well-known fact that the assessment of violation of the statutory conditions for granting deductible items to research and development within the meaning of Art. 34 of Act No. 586/1992 Coll. on Income Tax, as amended (hereinafter: the Income Tax Act), is very strict on the part of the court, as an assessment of other tax advantages. Even less formal misconduct ends with the impossibility of exercising this tax advantage (Snopková, 2016). There is no entitlement to a tax advantage, just like the subsidy granting. With regard to the deductible item for research and development, the courts usually confirm the decision of the tax administrator to withdraw the right to this tax advantage, but in the case of the levy for violation of the budgetary discipline this starts to be the opposite, because the courts confirm the assessment of the levy in full amount of the violation of budget discipline only in particularly justifiable cases, as described above. The fundamental difference between these two “supports” is also the extent of statutory regulation. The deductible item to research and development is governed by a few provisions of the Income Tax Act, while the violation of budgetary discipline and all contexts of subsidy granting are contained in tens of thousands of binding legal texts at both national and European levels.

The failure to provide finances from the European Union, without waiting for a final or at least a preliminary solution by the financial authorities, unfortunately only seeks to impose a proportionate amount of levy by the court,<sup>6</sup> but the financial administration will still be driven by an attempt to “punish” the recipient of the subsidy for the loss of the state budget by the levy equal to 100% of the amount of granted subsidy. In the other case, although the goal to be met by the deductible item to support research and development is achieved, the budget from which the finances are going to be withdrawn, without depending on the nature of the misconduct, is the budget of the taxpayer.<sup>7</sup> For this reason, according to the author’s opinion, the violation of budgetary discipline should be treated in the same way as assessing the justification of the deductible item to research and development from the tax base. The court therefore seeks to protect the recipient of the subsidy against transferring direct consequences of the reporting of irregularities from the state, respectively state budget, to this recipient, because in many cases there are marginal misconducts, which are inappropriate with the consequences of non-granting of subsidies to which the recipients are often dependent.

<sup>6</sup> See the Resolution.

<sup>7</sup> The case law of the Supreme Administrative Court is nonetheless a little less formal than the European Commission’s procedure when it finds an irregularity. Nevertheless, see judgment of the Supreme Administrative Court No. 7 Afs 39 / 2014 – 48 of 25 September 2014, (subsequently confirmed by the judgment of the Constitutional Court file No. I. ÚS 3566/2014 of 11 August 2015).



### 3 Conclusion

The solution to the problem is not in the power of the court or financial administration. The problem can only be solved at European level. As part of the process of identifying unconfirmed irregularities, it is necessary either to confirm or disprove these presumptions (irregularities), and only later to take concrete steps towards national budgets. Therefore, the author suggests that the subsidy should be paid out ex-post in the future, thus avoiding pre-financing of these projects. The resulting proposal will not lead to a 100% result – levies will continue to be assessed, but the risk of finding formal irregularities related to the start of the subsidy, which may also be caused by the inexperience of individual recipients of the subsidy, granting will be reduced. The problem with non-granting finances from the European Union to the state budget will not be solved by this, because it would really be necessary to change the European legislation in the sense outlined in this contribution, i.e. to wait with the final verdict of the (non)payment for the final decision of the tax administrator about the question whether the recipient of the subsidy violates the budgetary discipline or not.

The above question is related to the other issue in this contribution, namely the principle of proportionality. The author commends the decision-making practice of the administrative courts, which insist on assessing the levy for violation of the budgetary discipline in accordance with this principle, taking into account the nature and seriousness of the violation. It is inconceivable that the recipient of the subsidy should pay a levy in the amount of the granted subsidy just for a marginal violation. However, even in this case, the author believes that, according to the Budgetary Rules, this is also a violation of budgetary discipline. It is only a matter of time for the Extended Senate of the Supreme Administrative Court to decide on the matter, and hopefully, by this decision, it will help resolve at least one of the above-mentioned crucial administrative issues connected with the area of violation of the budgetary discipline.

So the hypothesis set at the beginning has been disproved from the point of view of the state budget, but on the other hand from the point of view of the recipients of the subsidy, who should not be “punished” for incorrect legislation, it has been approved.

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