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## DIGITALIZATION OF CZECH REPUBLIC ADMINISTRATION AND ITS EFFECTS NOT ONLY ON TAX ADMINISTRATION<sup>1</sup>

### Abstract

Recently, digitalization has been a frequently used word in various economic fields. We have been able to realize this lately mainly due to the problematic situation brought by the COVID-19 pandemic. People could not personally visit public authorities, banks, the post offices or other institutions and in many cases, it was possible for them to manage their necessary matters. It is quite clear, that Czech public authorities are not 100 % ready to be able to function fully online. However, the Czech Republic is not lax about this and it is preparing further steps to achieve online functioning. The selected current steps of the Czech Republic will be presented in this article. The hypothesis set in the article is that the current status of digitalization of administration in Czech Republic is currently insufficient.

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The authors focus on the area of financial law, specifically the digitalization of tax administration. In addition to the current digitalization of tax administration, a new concept of the so-called SONIA project, which will bring the Bank's identity digitally, will be presented.

**Key words:** MY TAXES, project SONIA, banking identity, digitalization, state administration.

**JEL Classification:** K34, G21

## 1. Introduction

The topic of digitalization is increasingly inflected by both political leaders and the media and is currently also being reflected in legislative acts. In today's globalized society, it is necessary that the processes taking place in the state administration, both internally and externally, be as efficient and flexible as possible. In many ways, at least in the field of taxation, the forthcoming amendment to the Tax Code can help. Future changes, which need to be addressed now, will be addressed through the MY TAXES<sup>2</sup> project, but also in the possibilities of remote actions and legal filings during tax audits. Another very interesting project in the field of digitalization of (not only) state administration is the banking identity – the SONIA project. The SONIA project brings digital verification of a person's identity, which can work as a "universal key" for the state, which would make the services of private companies and the state accessible to many people.

Authors will use methods of description, deduction and the prediction to find out whether hypothesis will be confirmed or not. In this article, the authors will present the steps to digitize the state administration in the Czech Republic and will focus specifically on those brought about by the proposed amendments to the Tax Code and the Banking Act. The authors of the article also point out the strengths and pitfalls of mentioned amendments.

## 2. Theoretical Background

Once the article dealing with the term state it is based on the concept of Weber formal definition of state [Raadschelders 2015: 75]. It is therefore control over territory, with relatively centralized administration, differentiate from other social associations with assurance of administration of justice.

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<sup>2</sup> The Ministry of Finance states that the meaning of the designation MY TAXES is hidden in the first syllables of the words "MODERN" and "SIMPLE", and such should be the final solution.

Průcha defines state administration as: *“public administration performed by the state, with in each companies organized in the state form the state administration an irreplaceable part of public administration. In this sense, state administration is also the basis, the core of public administration. It is derived from itself the nature, position and mission of the state, from the nature and methods of exercising state power. By its nature of the state administration is a special type of social management carried out by the state”* [Průcha 2012: 60] State administration is performed by the state through a set of institutions, either directly or indirectly (by territorial self-government) [Provazníková 2009: 11].

Digitalization is one of the technologies of document reformatting (ie transfer of document content to another medium). During digitalization, analog documents (images, text, audio, video) are converted to the digital form [Vrbenská 2014]. In the case of this article, it is necessary to perceive digitalization primarily as a transition from an analogous form of communication with the state administration to the digital form of communication.

When further understanding the extent of digitalization, it is necessary to perceive it as part of both the private sector and part of the public sector. According to Veber: *“Digital transformation in the Czech Republic, as in many other countries, is taking place on two levels. The first is the private sector, which implements various, but in most cases partial, applications. The second are government organizations, which on the one hand implement part of the activities related to the digitalization of public administration, and on the other hand develop a number of programs to support the development of digitalization in the Czech Republic”* [Veber 2018: 50].

### **3. Digitalization of State Administration**

The fact that digitalization is a topic of today needs no further introduction. The following facts, which result from the summary report on the digitalization of public administration in the Czech Republic issued by the Supreme Audit Office ("summary report") [ Summary report on the digitalization of public administration in the Czech Republic], will answer how abstract or specific this topic is. Over the past seven years, massive investments have been made in the state's information infrastructure, which is doing very well in terms of technical sophistication. Expenditures of organizational units of the state and state funds on information and communication technologies (hereinafter referred to as "ICT") amounted to CZK 75 billion from 2012 to 2018, and approximately two tens of billions amounted to expenditures reimbursed from EU funds for the development of digitalization

of public administration") [Summary report on the digitalization of public administration in the Czech Republic].

However, there is a catch, because despite the amount of investment, it is not yet functional enough for citizens to be able to solve common situations primarily from the comfort of the office, home, or from anywhere through mobile phone. After all, the citizens of many states have noticed this very hard even in the current period, due to the COVID-19 pandemic, when the state administration reduced its contact activities towards the citizens to a minimum.

Naturally, there is also the possibility that citizens are not so interested in digitalization. According to the summary report, in 2018, 26% of natural persons used the online service to communicate with the authorities. Statistics on data boxes show that only 2% of non-business individuals have set it up voluntarily. Let us add that in 2018, 97 million transactions took place via data boxes, but only 0.65% of them were performed by non-business natural persons.

There are several reasons for inefficient or insufficient settings, but also for the use of digital public administration services. It is the lack of legislative readiness for further digitalization, obsolescence of ICT systems, individual components of public administration, poorly set conditions for cooperation with external suppliers, decentralized system performance financial management and last but not least, lack of personnel capacities (employers responsible for ICT systems who makes them keep running and who take care about their modernization).

However, many of the above issues are already targeted. The Ministry of the Interior can be considered as the main body coordinating information and communication technologies. The problematic area of the shortage of ICT service workers in public administration generally corresponds to a very low unemployment rate, which in the Czech Republic is around 2%<sup>3</sup>. Although there are generally more employees in IT services, they usually choose to work in the private sector [ICT Sector. Office].

The Czech Republic lags behind in digitalization compared to other European countries. There are definitely positive developments in this area, which the authors will demonstrate below, but in comparison to the other Member States of European Union, the Czech Republic in 2018 was ranked 22nd out of 28 Member States [Digital Economy and Society Index]. However, a significant number of factors is entering into the digitalization of public

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<sup>3</sup> The data available before Covid-19 pandemic. Nowadays the percentage of unemployed people will be greater. On the other hand, the fluctuation of employees in IT services is low.

administration (from political priorities to constraints related to the level and extent of connectivity) that make the process itself highly variable and unique in each country [The digital Czech Republic in digital Europe]. In addition, the Czech Republic was ranked 27th out of 28 EU countries in usage of e-services offered by public administration [Digital Economy and Society Index].

As for the legislative basis for the possible further development of the digitalization of public administration, a relative novelty, and at the same time the key law is the so-called Digital constitution [Act on the Right to Digital Services]. It regulates the right of natural and legal persons to digital services of public authorities, in the exercise of their powers, the right of natural and legal persons to perform digital acts, the obligation of public authorities to provide digital services and accept digital acts and certain other rights and obligations related to digital services<sup>4</sup>.

In this article, the authors focus primarily on the digitalization of tax and financial administration with an overlap into the private sphere. The concept of MY TAXES and the concept of banking identity – the SONIA project – will be presented below.

Through the COVID-19 pandemic, people have realized how important it is for authorities to function digitally. Authorities and ministries have now experienced what it is like to be without digitalization. After this experience, they found out that how much easier is to make and evaluate applications when they come directly to the system instead of on paper. The COVID-19 pandemic helped a lot in the pressure to accelerate digitalization. In an interview with E15 magazine, the government representative of the Czech Republic for IT and digitalization Vladimír Dzurilla have said, that banking identity might have helped very much in these COVID-19 times [We don't want people to complain on Facebook].

#### **4. Current Tax Information Box solutions and the MY TAXES platform**

In order for any state to function properly, i.e. to fulfil its functions, it needs financial resources to cover its mandatory and other expenditures. These are funds created by the transformation from individual goods to collective goods. The funds that make up the revenue side of the state budget come from many sources. The most important financial source of the states (applicable also to the Czech Republic) is tax revenues [Samuelson, 1991:748] [The report on the activities of the financial and customs administration]. Taxes can only be levied on the basis of law, as set out in the Charter of Fundamental Rights and

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<sup>4</sup> The law is relatively new; it was promulgated on 17 January 2020 in the Collection of Laws in Volume 5 under number 12/2020.

Freedoms. This provision is the starting point for any tax legislation and prevents abuse of power by the authorities [Charter of Fundamental Rights and Freedoms, Article 11, paragraph 5].

On the one hand, we have tax laws that stipulate the tax system of the Czech Republic, but on the other hand, there is a need to collect all of the taxes in tax system correctly. For example, the Czech Tax Code directly states in Section 1 paragraph 2 that the aim of the tax administration is the correct identification and determination of taxes and securing their payment [Tax Code, article 155, paragraph 6]. Already this provision is a kind of foundation for the proper and efficient tax administration.

The fact that digitalization of tax administration is necessary is without doubt. Already leading personalities of the Czech tax administration, such as Mgr. Tomas Rozehnal, Ph.D. the Director of the Appellate Financial Directorate, address this issue in his articles [Digitalization of tax administration in the context of current case law of administrative courts].

The digitalization of tax administration could be according the authors divided into two main categories. The digitalization of the form of filings towards tax administrator is one of them. In this category already exist some guidelines of General tax directorate<sup>5</sup> and many judicial rulings. The second category covers the communication with tax administrator, not only during the filings, but also during the tax audits and other necessary proceedings.

It is obvious that Czech tax payers and also Czech tax administrators need platform, which will combine both above mentioned categories. It is questionable whether it should be implemented quickly, or rather slowly and properly. According to authors the current system is unsatisfactory for a long time. On the other hand, rapid change could face insufficient staff training and poor cyber security.

Not only Czech tax administrator or tax administrators in other EU member states are dealing with application of modern digital technologies. According to Nazarov the achievement of Russian tax administrators is already visible [Nazarov, 2020].

Before listing the complex digitalization-related projects themselves, it must be noted that the Czech Republic has already successfully implemented some tools for better and faster data exchange between taxpayers and the tax administrator in the case of specific taxes. Among these are, for example, the sharing of VAT records or sales records. It should be

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<sup>5</sup> For example, the Guideline GŘ-D-24 determining the format and structure of the data message.

noted that although these tools work relatively well, they are very unpopular for sanctions imposed in the event of late or imperfect filing through them<sup>6</sup>.

Currently, the tax administration in Czech Republic offers only limited opportunities for citizens to communicate and perform actions through remote access. One of them is the Tax Information Box<sup>7</sup> (hereinafter referred to as "DIS"). DIS provides information on the status of the personal tax account broken down by individual types of taxes, an overview of documents between the tax subject and the tax administrator and a tax calendar with an overview of tax obligations [Tax information box]. Access to the DIS is possible if the tax subject has access to the data box or its own Qualified Certificate. Subsequently, it is necessary to submit an electronic "*Application for the establishment of a Tax Information Box.*"

DIS is a suitable tool for everyone who wants to have their tax affairs under the control. Historically, there have been some major problems with the implementation of DIS. For example, the implementation date was postponed by a quarter of a year in 2014 because IT systems were not properly prepared. Another problem soon appeared when the data displayed in DIS could not be relied on and how many times it was wrong [Tax information boxes]. Although the development of DIS has shifted since then, the authors still recommend that the list offered be indicative.

Although DIS is still imperfect and has only limited functions, thanks to it, it is possible to monitor mainly possible underpayments on individual taxes and possible sanctions resulting from them.

The importance of a clear and accessible display of the status of individual tax accounts of a tax subject can be shown not only on the example of sanctions for arrears, but also on the example of registered overpayment. Specifically, the Czech Tax Code stipulates that if the tax entity does not request a refund of the refundable overpayment within 6 years from the end of the year in which the overpayment arose, the overpayment expires and becomes budget revenue from which the tax administrator who registered it is paid [Tax Code, Section 155]. It is therefore always necessary to be interested in what is the balance the tax administrator records and, if necessary, to request the records. It is possible that a refundable overpayment will arise without being noted by the average taxable person.

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<sup>6</sup> For example, sanction for imperfect VAT control statement may be imposed in amount up to 50 thousand Czech crowns. It could be imposed repeatedly for several VAT control statements. The chance of waiving this sanctions are very limited.

<sup>7</sup> In Czech language: „*Daňová informační schránka*“.

The way to modernization and digitalization of the tax administration leads through the amendment to the Tax Code, the final wording of which has now been signed by the President of the Republic. The promised electronization of financial administration is an important step towards the modernization of the entire system used by taxable entities [My Taxes].

The vision of the changes was clear, namely, to make it easier for citizens to communicate with the tax administrator and to reduce the administrative complexity of this communication. In practice, this involves the introduction of a portal called MY TAXES, which is intended to be an extension of the already available Tax Information Box service. The current system allows the taxable person to obtain selected but very limited information collected in the file and on the taxpayer's personal tax account via internet.

In addition to information for taxpayers, the new portal should also offer the possibility of active and passive communication with the tax administrator, for example, the possibility to file tax returns via online forms, which will allow a certain degree of pre-filling the data of taxable persons.

However, communication should also work in the opposite direction, i.e. from the tax administrator to the tax subject, in the sense of delivering documents. The Ministry of Finance estimates that the portal will be launched in the last quarter of 2020.

It can therefore be expected that in the future we will communicate with the tax administration on a basis similar to electronic banking, through which we will not only be able to pay our tax obligations, but also handle all documents and communication with the tax administrator. This would mean a great simplification and a step towards clarity of tax processes and management in the Czech Republic. As always before the implementation of a new platform with such extended functionalities compared to the original DIS, it is especially important how the authors of the new system will do and how much they will manage to bring all functionalities to life to really make work easier. Another question is the time horizon in which this platform will be accessible to people.

## **5. Banking Identity – SONIA**

As mentioned above, the Czech Republic has only limited options for digital communication with the government and commercial service providers<sup>8</sup>. At the end of

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<sup>8</sup> For the purposes of this article, commercial service providers or third party service providers mean private individuals who use Bank ID to identify their customers (such as e-shops, real estate agencies, payment institutions etc.).



2019, with effect from 1 January 2021, the Chamber of Deputies of the Czech Republic has unanimously approved the so-called "SONIA project" – a private law base for identification and authentication. The initiator and tutor of the whole project was the Czech Banking Association [The way to use bank identity of the Czech Republic is open].

The aim of the SONIA project (banking identity or the Bank ID) is to simplify the form and access to the e-government services and online services in both, the private and public sectors. Bank ID is currently a commonly used solution in many foreign countries. The most advanced countries in the use of Bank ID are the Baltic and Nordic countries, especially Norway, Denmark or Sweden.

Banks use private identification tools that allow clients to access their internet banking. We normally access internet banking via client identification number, password and SMS. Banks must use the two-step verification for clients to access their bank accounts via internet. According to the RTS regulation [Commission Delegated Regulation (EU) 2018/389], the essence of two-phase verification is to verify the client using two or more elements from the categories of knowledge (PIN, password), possession (phone, card verified by reader, physical token) and inherence (biometric data, touch / face ID, voice recognition).

However, under the current Electronic Identification Act, these identification tools could not exist as commercial means of electronic identification, as they do not allow conditions for access to the Czech National Identification and Authentication Point (NIA)<sup>9</sup>. Only accredited providers of identification means are connected to the NIA. These means of identification include especially an ID card with a chip or logging in with a user NIA account.

As a part of the amendment to the Electronic Identification Act (in connection with the SONIA project), service providers will be divided into the public service providers, who will be able to use everyone's identification in the NIA (including private providers), and private service providers, who will be able to use state's tools (electronic ID cards).

The problem with the NIA was the small percentage of citizens who used the option of activating their ID card for electronic identification. Another shortcoming was the fact, that this solution was not available to the commercial sphere. The SONIA project should not compete with the state solution. The aim of the project is to combine means for electronic identification of banks in addition to the state system [About banking identity].

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<sup>9</sup> The national point serves as a tool for verifying the identity of the user of the online public administration service.

The main idea of the project SONIA is to be able to use the same banking data as we use for access to internet banking to access all the other online services. This aims to save time and money not only to clients but also to public and private service providers. Banks will be able to officially offer, provide or mediate identification services, which has not been possible before. This solution should simplify the existing AML processes [Regulation (EU) No 910/2014], which for many entities result from the regulation of money laundering and terrorist financing.

The current Czech legislation is restrained in this area. The AML Act allows identification in the physical presence of the client, remote identification through the first payment from an account held in a bank, identification through public administration contact point - Czech Point or identification based on electronic signature according to eIDAS [Regulation (EU) No 910/2014]. In practice, thanks to the Bank ID, clients will not have to visit branches or contact points to go through the identification process in person [Explanatory Memorandum to Act No. 49/2020 Coll].

However, even the amendment to the AML Act (in connection with the SONIA project) will not bring other possibilities for online identification. Authors still see a shortcoming in the Czech AML regulation in its impossibility of conducting online identification in the form of a video call or "selfie" photo. This method is possible in many legal systems of the surrounding countries, including the Slovak, German or Austrian one. On the other hand, we consider it as a contentious issue. We believe that people with Bank IDs would not prefer to use video call identification over the Bank ID identification. A possible target group could be people without internet banking (or bank account). However, we believe that a group of people without internet banking and bank accounts would also not be in favour of online identification via videocall or online identification in general. This group of people the most likely would include older people without trust in the digital world.

The aim of the legislation change is for banks to always provide third party service providers with the most up-to-date information about their clients. For this reason, the amendment to the Banking Act stipulates the possibility for banks to use data in the public administration information system, including data kept in the basic register. In practice, this will mean that the bank will receive information, for example, in the event of a change in the client's name or domicile.

## 6. Usage of Bank ID

Bank ID can be used in practice in many ways that cannot be exhaustively defined. The current public debate focuses on some of the main uses described below. As the amendment to the Banking Act will not take effect until 2021, it is more than obvious that these "use cases" will expand and change over time.

Probably the main use case of the Bank ID will be as a "universal key." The bank identity may be used not only as digital identification but also for signing transactions and documents [FAQ]. The bank identity meets the official binding requirements for an electronic signature. The client will be able to sign documents using the Bank ID.

The information that would be available within the Bank ID could be used, for example, also for age verification. If the client accesses websites that have limited content only for persons who have reached a certain age, the client would be verified through the Bank ID without confirming the declaration of reaching the required age.

Banking identity could be used also in the area of AML. As banks perform a thorough identification and control of their clients, they have all the relevant information about clients required by the AML regulations. Banks have robust AML systems that help them not only monitor client identification data, but also help determine the origin of their clients' funds. Banking identity data could assist a wide range of liable persons under the AML Act in providing their services. The client can be identified through the Bank ID when buying real estate or arranging a life insurance.

From 2021, it could be a reality that the Bank ID could be used, for example, at check-in at the hotel. Client could be able to check in and pay before the actual arrival to the hotel. Another example might be when renting a car from a car rental company. When renting a car, it is necessary to provide rental company with ID and driver's license. With Bank ID, its identity would be verified digitally. Bank identity can also be used in e-shops, when buying a car or when arranging a loan. Bank ID could be basically used in every situation, when client's identity needs to be verified.

In the future, according to the opinion of the authors, there is a lot of space for connection of banking identity and new payment services under the PSD2 [Directive (EU) 2015/2366]. As part of these services, the e-shop could access client data, such as the amount of the bank account balance. There is space for great potential of linking highly personalized services to clients along with verifying their identity. So far, financial institutions have already mentioned problems in identifying their clients. In such a case, commercial service providers could use the available client data via PSD2, on the basis of which a personalized credit product could be provided to the client. However, it is necessary to realize that

these third service providers must first obtain authorization (license) from the Czech National Bank to provide these services. Obtaining such license is not easy and the licensing procedure in such cases can last up to months. So far, there are only a minimum of non-banking entities on the Czech market that have the license for services under the PSD2<sup>10</sup>.

Bank ID will be for clients free of charge. Banks will be paid by third parties, i.e. commercial service providers. Decision to provide electronic identification services is up to the bank. Each bank will have equal conditions for the provision of these services.

## **7. Possible shortcomings of Bank ID**

Banking identity is a big step in digitalization. On the other hand, Bank ID brings also many legal and factual problematic issues. According to the authors, data protection is one of them. Banks and third parties will have to make great financial and technical efforts to prevent the chaining of bank identities and thus the misuse of personal data of bank clients.

The client's data should be passed to the third parties only with the consent given to the bank by the client. The client must always agree with the extend of the data. Without the client's instruction, the bank cannot confirm the client's identity to a third party and cannot pass on any other data. The use of a Bank ID is always only upon the request of the client and is completely voluntary. The client should always be able to check which information the bank provides to service providers and, if necessary, revoke the consent.

The transfer of the client's data should be based on the principle of minimization in order to protect personal data of the clients. In practice, this means that a third party providing, for example, the possibility to purchase alcoholic beverages online, will only need to verify whether the person has reached the age limit. In this case, the bank should only pass on a negative or positive response to the given e-shop. The bank should not pass on any other the specific data, including the exact age of the client.

Another problematic area is liability relations. The legal regulation will be effective in 2021 and it is not yet clear who and to what extent will be liable for damage in the event of misuse of client's data.

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<sup>10</sup> As of 31. 8. 2020 there are three non-banking entities authorized to provide account information service and payment initiation service.

## 8. Conclusion

The future lies in the use of technology and the question is how the relatively rigid processes of public administration will adapt to it. The so-called The Digital Constitution, while still a framework for further digitalization, must be seen as a major step forward and a promise for the future. It is obvious that with the growing digitalization of public administration, the importance of concepts such as cyber security and personal data protection will also increase. These and many other challenges await every single ICT system that will be newly introduced.

If the digitalization of public administration and services is to be successful, it must be targeted both to the end user (natural and legal person) and to the provider (state, authorities and official apparatus). Digitalization of the public sector can, according to the European Union reduce the administrative costs of communication between the state and the citizens up to 15% to 20%. Better access to data makes more efficient tax collection, the fight against financial fraud or better allocation of social assistance and benefits. However, this potential is not always successfully materialized. Often even large and expensive digitalization projects are unable to provide almost any added value or greater efficiency of official procedures. Similarly, newly created digitalization processes have often not been able to replace those original administrative procedures, leading to the existence of two analogous ones and parallel running systems. A prerequisite for the success of the digitalization of public administration is to prioritize the target user. The interface for users must be intuitive, easy to navigate and fully integrated across government institutions [The digital Czech Republic in digital Europe].

Not only the digitalization of the tax administration, but also the above-mentioned concept of banking identity should be understood as a big step forward. Both areas are now very topical and can be said to receive even more attention in the coming year. The MY TAXES project will become more important after the effectiveness of the tax code in the Czech Republic. The banking identity can potentially bring up to 5.5 million users who use their internet banking to the state as well as to the private sector. This can in many ways affect the functioning of digital services in the Czech Republic. Instead of the fact that only a few thousand citizens of the Czech Republic communicate with the authorities through the so-called Citizen's Portal using data boxes or electronic identity cards, millions of citizens would have access to e-government services.

However, when implementing digital services, we should be sufficiently critical and perceive the risks that digitalization entails. Digital service providers should focus on the

consistent protection of their clients' personal data, which will be crucial in this case. When using electronic identification services, the principle of minimizing the provided data should be observed so that the personal data of clients is not used in an unsolicited manner.

The hypothesis was confirmed based on the findings of this article, but there is no doubt that the digitalization of services is moving the state administration forward, at least in terms of speed and efficiency. It remains to be seen, however, the implementation of individual concepts presented above and the technical. It is necessary to deal with both the content and the necessity of digitalization, as well as cyber security. Therefore, particular attention should be paid to the consistent and thoughtful implementation of these digital tools.

According to the opinion of the authors, digitalization is for law very important issue, which should be a topic in academic circles as well. The implications of Bank ID and MY TAXES may raise many further legal questions and ambiguities. In the future, digitalization may fundamentally affect communication with state authorities in various areas, such as communication with the tax administrator, with municipal authorities, or when looking at court files. Many other issues also remain to be addressed in this area, such as the usefulness of digitalization in enforcing tax authorities and collecting tax underpayments. The issue is very interesting and up to date, but so far there is almost no foreign case law, literature or other articles in general. Authors believe that digitalization not only in financial law will find itself a place also among academics. The authors suggest that both the academic public and the body in charge of implementation of these projects should pay more attention to the topic of cyber security in the context of public administration digitalization

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