

Dear Clients and Business Partners,

The summer issue of Tax News brings you new measures in the area of VAT that are being prepared by the government of Bohuslav Sobotka. We will also take a look at the amendment of the law regulating cash payments, decision of the Constitutional Court on limitation of default tax credit for working pensioners and, last but not least, we will cover the equally important simplification in communication of taxpayers with tax administration.

With best regards,

LERIKA Team

## VAT NEWS

Following the signature of the Coalition Agreement by KDU-ČSL, ANO and ČSSD parties on 13 January 2014, the incumbent government has prepared the following important VAT - related changes.

- Among the most important changes in VAT is undoubtedly the proposal to introduce the second reduced VAT rate of 10% that shall be applied to books, medicine and essential infant nutrition. The original reduced 15% rate as well as the current basic rate of 21% shall be preserved. This proposal was discussed by the Parliament on 17 July 2014 whereas the ratification process itself is planned for this September. The previous plan to unify both VAT rates at 17.5% as of 1 January 2016 has therefore been shelved.
- Another planned measure that should eliminate tax frauds is introduction of obligation to file VAT records as of 1 January 2016. The purpose of the VAT records is to keep track of specific tax-related information in order to improve efficiency of tax collection. A similar model has been in place since 1 January 2014 in Slovakia and it has been widely praised by the local tax administrators as it allows them to better identify cases of tax evasion.
- On 23 July 2014, the Parliament approved a VAT amendment reflecting EU Directive 2008/8/ES from 12 February 2008 which has amended EU Directive 2006/112/ES on common VAT system. This amendment concerns place of supply for certain services. When providing e.g. telecommunication, radio or TV transmission services or when digitally providing services to a non-VAT payer, the place of supply is currently determined in the state where the taxpayer is seated. The service is subsequently subject to taxation in that state. Starting 1 January 2015, the above rule will change and newly the place of supply shall be the place where the service recipient is seated. Based on the current law, the service provider would have to register as VAT payer in the target state and pay VAT there which would represent an additional administrative burden. Therefore, starting 1 January 2015, service providers seated within EU will be entitled to use a special regime on the basis of which the service provider will be allowed to pay foreign VAT without having to register in the relevant foreign state. This regime will be implemented through a digital platform administrated by the Czech tax administration that will be connected to similar systems of other EU tax administrations.

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- Another planned change is the shelving of the plan to reduce registration threshold for new payers from the turnover of CZK 1 million down to CZK 750 thousand. This change was originally planned in connection with (since then aborted) introduction of the unified tax payment point as of 1 January 2015. The previous registration threshold of CZK 1 million shall therefore further remain in effect.

## AMENDMENT OF LAW REGULATING CASH PAYMENTS

Another important piece of news to consider is the change of conditions governing cash payments. This change impacts the VAT law by affecting concepts such as the guarantee for unpaid VAT. Amendment No. 254/2004 Coll., on regulation of cash payments, which was approved by the Parliament on 9 April 2014, reduces the limit over which a payment has to be made through a cashless transfer from the current CZK 350 thousand down to CZK 270 thousand. Related to this change is the obligation of a taxable supply recipient to guarantee unpaid VAT in cases when the payment is provided fully or partly through a cashless transfer to the taxable supply provider's bank account that is different from the one published by the tax administration.

If the payment for taxable supply exceeds twice the maximum threshold stipulated in the law regulating cash payments and at the same time the payment is paid to an unpublished or a foreign bank account, the supply recipient becomes the VAT payment guarantor. Due to the above change, the threshold is therefore reduced from CZK 700 thousand down to CZK 540 thousand.

The amendment of the law regulating cash payments also contains other equally important changes such as a change in the definition of what constitutes payment. Newly a payment is construed as the act of handing over or transferring cash. This change makes good the inaccuracy of the current wording of the law which considered as payment only settlement of an existing payable. As a result, until now, the law had not covered those payments that only arose during the act of handing over cash such as a gift or a loan. The changes also affect conditions for payments receipts. The payment recipient is obliged not to accept a payment the amount of which exceeds the maximum limit for cash transfers, unless the payment was made through a cashless transfer.

## REPEAL OF LIMITATION OF DEFAULT TAX CREDIT FOR WORKING PENSIONERS

On 1 January 2013, anti-deficit package of laws collected in Act No. 500/2012 Coll., came into effect. Among other measures, the Act stipulated that working pensioners who are entitled to receive pension from domestic or foreign sources cannot reduce their tax through the basic (default) tax credit. Ever since coming into effect, this controversial step of lawgivers has stirred heated discussions not only among pensioners who were affected by the change the most, but also among the wide public. As a result, 12 June 2013, a group of senators filed a proposal with the Constitutional Court to repeal the limitation of default tax credit for working pensioners. The senators filing the proposal were mainly opposed to the fact that through this measure, working pensioners were being discriminated against compared to non-pensioners. The resolution of the dispute has only come on 30 July 2014 when the Constitutional Court published its decision in which it sided with the proposal of the group of senators and repealed the original measure limiting default tax credit of working pensioners.

In order to better understand the arguments of the group of senators as well as the constitutional judges, let us consider the explanatory report to the Act No. 500/2012 Coll. which introduced limitations of default tax credit for working pensioners. The main underlying idea is that a certain minimum living standard is afforded to working pensioners through the tax exempt pension. The group of senators cast doubt on the admissibility of this line of argument and reasoned that there is no connection between receipt of pension and gainful economic activities. By limiting the default tax credit, working pensioners were denied a part of income from their gainful activity which is; however, wholly unrelated to the fact that they were also pension recipients because they fulfilled all the relevant criteria for the pension payment. The group of senators therefore assumed that the scope of the measure they were challenging was disproportionate. Another important factor strengthening the views on unconstitutionality of the measure was the issue of time. The tax credit was awarded based on the taxpayer's status as of 1 January of the given calendar year. If the pensioner were only employed in January, he or she would thus lose the possibility to apply the entire default tax credit. In this aspect, the default tax credit is different from other tax credits stipulated in Article 35ba, Section 3 of the Income Taxes Act which can be applied for individual months in which

the gainful activities were performed. This fact further strengthened the disproportionate effects of the legislation that was being challenged. Due to the fact that there is currently no law prohibiting concurrence of gainful activities and pension, the fact of reaching the pension age does not cause the person to terminate the gainful activity in any way which is why there is no rational reason to put working pensioners into a worse position from the tax perspective compared to other tax payers. The law limiting default tax credits to working pensioners also appeared to be unsystematic from the perspective of Article 34 Section 4 of Act No. 155/1995 Coll., on pension. Not only does the Article not negatively sanction the concurrence of gainful activities and pension in any way, in contrary, it rewards it. Upon fulfilling specific conditions, the Act increases the amount from which pension is calculated by 0.4% for every 360 calendar days that the concurrence was in effect. This presents us with a situation when the Income Taxes Act sanctioned against the concurrence of gainful activities and pension whereas the Act on Pension rewarded it. Among other arguments that the group of senators put forth was the one that the law so defined leads to tax inefficiency due to the fact that the only chance for working pensioners to avoid higher rate of taxation is to terminate gainful activities. Only by so doing so could the working pensioners preserve their entitlement to the default tax credit. However, this would cause the state to lose not only income tax but also social security and health insurance receipts from the gainful activities.

In their decision, the constitutional judges also criticized the four-day period that the affected group of taxpayers had to read the new law and adjust their economic activities accordingly before the law came into effect. The constitutional judges ruled that such a period is too short for a legal change of such importance and therefore found it unconstitutional. Thanks to this decision, all the working pensioners will newly be allowed to use the default tax credit regardless of the fact whether they were receiving pension as of 1 January 2014 or not.

## SIMPLIFICATION OF DIGITAL COMMUNICATION WITH TAX ADMINISTRATION

Starting July 2014, the Czech tax administration has launched a new application on its web page that simplifies digital communication for taxpayers. Validation of taxpayer's identity is performed as part of logging into a data box (which is set up free of charge by the Ministry of Interior). Any digital message is thus validated through this simple procedure. As a result, the tax administrator can easily verify the identity of the submitting taxpayer on-line through the taxpayer register. The web application for digital forms is available through the Tax Portal of the tax administration at [www.daneelektronicky.cz](http://www.daneelektronicky.cz). Before submitting the relevant form, it is sufficient to check the relevant box („*validate identity through logging into the tax box*“).

Thanks to this measure, a certified digital signature will no longer be necessary. This is something that the taxpayers will likely appreciate because the process of setting up digital signature represents a relatively complicated process for a standard user. First, it is necessary to go through various administrative steps related to the submission of an application and subsequently, it is necessary to install the certificate on a specific computer. The Tax Portal also makes it possible to view tax information boxes which, unlike regular data boxes, enable users to view digital files kept by the tax administration. To enable access to a tax information box, it is necessary to first file an application which can; however, be newly submitted directly from the Tax Portal by validating identity through logging into a data box.

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