

Dear Clients and Business Partners,

In the October issue of Tax News, we will focus on several interesting topics. First of all, we will take a look at selected news in the area of income and value-added tax, then follow with new features of the Tax Code and the last topic to cover will be the current situation regarding applicability of tax credit for working pensioners.

With best regards

LERIKA Team

INCOME TAX ACT AMENDMENT

24 September 2009, the Parliament approved the Income Taxes Act amendment containing 290 points that are scheduled to come into force on 1 January 2015. The following is the list of the most important changes with significant effect.

PERSONAL INCOME TAX

Limits on lump-sum deductions (Article 7 Section 7 Subsection a of ITA)

An important new feature of the Czech tax law relates to the establishment of caps on highly popular lump-sum deductions that offset income from agricultural activities, forest and water management as well as from crafts and other trades. Until now the lump-sum deductions have been uncapped regardless of the amount of income received. For income from crafts, agricultural production, forest and water management, the cap of CZK 1,600,000 shall apply. The lump-sum rate remains the same at 80%. For income from other trades, the cap of CZK 1,200,000 applies whereas the lump-sum rate also remains at 60%.

Notification on income exempt from personal income tax (Article 38v, 38w ITA)

If a taxpayer receives income that is exempt from personal income tax and that income exceeds CZK 5 million, he or she shall be obliged to file a special tax return for the relevant period within the same deadline as the regular tax return. This measure does not apply to income that a tax administrator can ascertain through public records and evidence. In case of non-compliance with the said obligation even within an alternative deadline, the tax administrator shall assess a fine of 15% of the undisclosed income.

Tax credits and allowances (Article 35c Section 1 ITA)

In line with its official program, the government has also approved the introduction of brackets for children-related tax allowances depending on the number of children under care sharing the same household with the taxpayer. The tax credit for the second child shall increase by CZK 2,400 to CZK 15,804 a year (CZK 1,317 a month) and by CZK 3,600 for the third child to CZK 17,004 a year (CZK 1,417 a month). If several children are subject to care in the same household, they shall be considered inseparably for the purpose of applying the tax credit.

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Tax exemptions (Article 4a Section m), Article 19b Section d) ITA)

Free-of-charge benefits from loans and borrowings will newly be exempt from personal or corporate income tax only as long as the value of the benefits provided by one party does not exceed CZK 100 thousand per tax period.

CORPORATE INCOME TAX

Definition of standard investment fund (Article 17b ITA)

In order to counter tax avoidance that consisted in setting up of special purpose investment funds (enabling the investor – corporate entity – holding at least 10% participation in an investment fund for over 12 months and thus fulfilling the definition of a controlling entity, to achieve tax exempt status on dividends received while the fund itself was subject to low 5% tax rate), the amendment defines a new concept of “standard investment fund”. The main features of such a fund are as follows:

- it is an investment fund regulated by the relevant law whose shares are traded on a regulated European market, or
- open-ended mutual fund, or
- special purpose fund of a joint stock company which has a status of a collective investment fund, or
- investment fund regulated by the relevant law that invests more than 90% of its assets into financial instruments, or
- similar foreign fund domiciled in another EU member state.

Funds that do not fulfill conditions for a standard investment fund will be subject to the same taxation as regular corporate income tax payers i.e. not subject to the beneficial 5% tax rate.

VAT

We have already covered the VAT-related changes in the summer issue of our Tax News. Let us have a look at the subsequent legislative process.

- The amendment that introduces the second reduced VAT of 10% applying to books, medicine and essential infant formula was approved by the Parliament in the third reading on 24 September 2014 with one amendment that further extends the use of the rate also to medicine for veterinary purposes. The reason for the adoption of the said amendment was to counteract use of human medicine to animals that has been only reinforced by the deepening of differences in the respective VAT rates (10% vs. 21%). The first reduced VAT rate as well as the standard VAT rate will remain at 15% and 21% respectively.

The law amendment was delivered on 7 October 2014 to the Senate of the Czech Republic and has been put on agenda for the session of 22 October 2014.

- The new feature regarding the change of place of supply when providing telecommunication, radio and TV broadcasting services as well as services provided digitally to tax non-payers was enacted on 12 September 2014 in the Collection of Laws No. 196/2014. The new rule stipulates that the place of supply for these services shall be the place where the recipient of the service is seated (as opposed to the current rule based on which the place of supply is the place where the service provider is seated). We have already informed you that in connection with this change a special regime regarding registration to tax shall be provided for with the purpose of minimizing the resulting administrative burden. Czech companies providing services to customers from other EU member states can register starting 1 October 2014 through the Czech tax administration web page. If a taxpayer wishes to use the regime as of 1 January 2015, the registration needs to be done by 31 December 2014. The registration for the special regime is voluntary; however, whenever the service provider opts to use it, he or she has to use the special regime in all the member states in which the services are going to be provided.

This amendment has already been signed by the President and enacted through Collection of Laws No. 196/2014.

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TAX CODE AMENDMENT

In parallel with a major income tax amendment from 24 September 2014 that went through the third reading in the Parliament, a significant amendment of the Tax code was also approved. The latter amendment introduces a variety of new features in the area of tax administration. All the amendments have one common denominator which is fight against tax avoidance. Assuming that the above amendment passes through the Senate and is subsequently signed by the President Miloš Zeman, it shall come into force on 1 January 2015. Let us take a look briefly at some of the most important changes.

- A change in the tax code newly allows taxpayers to be compensated for economic damage under the assumption that the tax administrator unlawfully withheld tax refund during a tax procedure. The compensation shall amount to one percent above the annual rate of repo rate announced by the Czech National Bank and valid on the first day of each six month-period. However, if a procedure initiated in order to remove doubts results in a tax audit, the entitlement to compensation ceases fully.
- Another new feature is the manner in which statutory executives of legal entities are allowed to act. Starting 2015, any statutory executive shall be allowed to act on behalf of a legal entity regardless of the company statutes. The legal entity can thus be represented by any statutory executive even if the statutes of the company stipulate that the statutory executives shall act inseparably.
- Taxpayer with a data box shall newly be required to file all tax-related filings that relate to registration data in a digital form. In case that the taxpayer does not fulfill the obligation, he or she shall be assessed a fine of CZK 2,000. In case that such an act renders the process of tax administration extraordinarily difficult, the fine can amount to CZK 5,000.
- Another change of similar importance is the reintroduction of individual waivers of various types of tax penalties. Waivers will apply to penalties, late payment interest and interest from tax with deferred payment schedule as long as the tax was paid. The penalties can be waived up to 75%, late payment interest up to 100%. When determining the exact amount to be waived, the tax administrator shall take into account taxpayer's assistance during tax assessment. The waiver can only be applied to tax liabilities that arise after 1 January 2015.
- Fine for improper behavior assessed to those who render the process of tax administration difficult or try to prevent it by not complying with the tax administrator's requests has also been amended. Such acts are newly punishable with fines up to CZK 500,000. This represents a significant increase compared to the current limit of CZK 50,000. The same amount of fine can newly also be assessed in cases where an obligation of non-monetary nature is not complied with (e.g. registration or notification duties) which was not punishable at all until now. On top of that, tax administrator is allowed to assess the fine repeatedly.

In case of any questions to the above matters, please do not hesitate to contact us.

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USE OF DEFAULT TAX CREDIT FOR WORKING PENSIONERS

In the summer issue of Tax News, we also considered the limitation of default tax credit for working pensioners (Article 35ba Section 1 Subsection a) ITA). To sum up the previous events: the anti-deficit package of laws enacted as of 1 January 2013 prevented the working pensioners from reducing their tax liability through the default tax credit. Since the very beginning, this rule had been subject to heated discussions because it was detrimental to working pensioners compared to other taxpayers not receiving pension. Half a year later, these concerns crystallized. On 12 June 2013, a group of senators submitted a proposal to the Constitutional Court on abolishing the measure limiting the eligibility of working pensioners to the default tax credit. One year later, on 30 July 2014, the



Constitutional Court proved the senators right and abolished the measure. On the basis of this conclusion of the Constitutional Court, the working pensioners were thus granted the possibility to use the default tax credit again. However, the decision of the Constitutional Court only allowed the use of the default tax credit prospectively i.e. for 2014 tax year, not retroactively for 2013.

However, this still did not put an end to the whole issue. On 16 September 2014, the Constitutional Court issued another decision (I. US 2340/2013 published on 22 September 2014) relating to the above matter. The Tax administration submitted the decision to legal analysis and came to the conclusion that the measure disallowing the use of default tax credit to working pensioners shall not be applied for 2013. This conclusion must have pleased a lot of the working pensioners as it effectively caused their tax liability to be reduced by up to CZK 24,840 which is not an insignificant amount. As a matter of fact, this caused the previous legislative state valid prior to the enactment of the anti-deficit package of laws on 1 January 2013 to be reinstated. Taxpayers to whom the change applies will be allowed to use the tax credit in the following situations:

- At the level of an employer who made 2013 payroll settlement, assuming the employee signed the representation of a payroll tax payer, did not use the default tax credit and did not file a tax return.
- Through a regular tax return for 2013 in cases such return has not yet been filed.
- Through an amended tax return in cases that the taxpayer already filed a regular tax return for 2013.

If an employee only received income from an employer in 2013 that was subject to withholding tax at a special rate, the default tax credit can be applied neither at the level of the employer nor in a tax return. The tax credit can be applied within a period of three years and the tax refund can be claimed by pensioners through a refund application that is a part of the tax return form. An amended tax return can be filed by the taxpayer until the end of the month following the month in which he or she identified reasons that the tax liability should be lower compared to the previously known amount.

In case of any questions regarding the above matters, we will be pleased to provide you with our full support.

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Even though due care is paid to the preparation of the tax news, please be aware that their contents are only meant to be informative. Therefore, we recommend that any action envisaged on the basis of the tax news be discussed with your counsel prior to implementation.

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