



Dear ladies and gentlemen, the main topic of this newsletter is determined by its date of issue. In December 2013, it is simply not possible to avoid the new Civil Code. It is probably not worth repeating yet again that it represents the biggest recodification of the civil law in dozens of years. Nor does it make sense to speculate whether so fundamental changes were even necessary. The new Civil Code is simply meant to come into force in a couple of weeks and will affect a number of areas in tax, accounting and relating commercial issues.

Much has been said about the fact that at this moment we cannot really assess all the consequences and impacts of the new law. This is actually the case – not only because of the fact that settled interpretations and relating case law will take years to be formed. However, at this point, it is possible to say which specific tax consequences can be expected and which

new obligations (as well as simplifications) the awaited change brings. And that is something that our team of professionals at LERIKA is prepared for. Our professionals made sure that they stayed ahead of the new law by studying it in advance.

Some of the important information can be found on the following pages. You will find there an article summarizing the main tax changes coming into effect in the new year. You will also find there interpretations specifically focusing on the impact of the legal measures that the Senate approved after the law amendment had been rejected. And, last but not least, you can find there a more detailed article about trusts which are completely new in the local environment and thus require special attention.

I wish you pleasant reading and a fresh start in 2014. And, above all, I wish you Christmas holidays undisturbed by the usual concerns of daily life and dedicated to things that are much more important in life than laws, accounting or taxes.

Ivana Ottová

INTRODUCTION INTO TRUSTS

What will be the purpose of trusts – a concept until now not known in the local environment? What to understand under the terms "beneficiary" or "trustee"? What are the tax impacts of forming a trust? In the absence of practical experience so far, the least we can for our readers is to make a summary of what the law says.

The new Civil Code (in Czech widely abbreviated as "NOZ") applicable since 1 January 2014 brings many new legislative changes and novelties. Some of them, such as "*pacht*" (type of lease with usufruct) or "*výprosa*" (borrowing an item without specifying the term upfront) used to exist in the past and have thus been merely re-introduced and updated. Other changes are completely new in the local legal system and only time will show us whether their introduction was the right thing to do and whether they can even exist reliably within the local legal system and the overall environment.



Inspired by Canadian regional law

One of the completely new concepts is

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the introduction of trusts. Trusts are specified in Articles 1448-1474 of NOZ and the respective provisions are almost entirely taken over from *Code civil du Québec* from 1994. This means that the well known Anglo-Saxon concept of trust, as stipulated in Quebec's local law, is being integrated into the local traditional continental law.

What is a trust? First of all, it does not represent a legal entity. It is a collection of assets that their owner (trust settlor) excludes from his property and transfers to the trustee. Through this act, the settlor effectively loses all ownership rights over the assets and can no longer claim them as his or her. In practice, this can be achieved either by signing a contract (during the settlor's life) or through a will or inheritance contract that sets up the trust after the settlor's death. The documents must also define the assets and the purpose of the trust.

In accordance with Article 1452 of NOZ, trust must be founded on the basis of a trust deed. The trust deed is issued by the settlor and must be drawn up as public document and duly notarized. The trust deed is the founding document of a trust and must contain the designation of the trust and of the assets forming the trust at inception. It must also define the trust's purpose, conditions for disbursements from the trust, its duration and its

beneficiaries or how they shall be determined. Despite the fact that the trust deed must be made as public document, there will be no supervision in place governed by public law as there will be no public register containing the full list of trusts. It is too early to tell whether this is a good or bad thing. To the better or (as I fear more) worse, Czechs are an inventive bunch and are likely to use this feature to their full advantage.

...the settlor can determine that the purpose of the trust is to pay out a certain amount to his child or grandchild e.g. after finishing studies at university.

Key person: trustee

Trust as such comes into existence at the point when the trustee agrees to manage it (at this point, it is worth stating that the trustee is appointed by the settlor or, alternatively, on the basis of the relevant provisions in the trust deed). An exception to the rule is trust that comes into existence after the settlor's death.

Trustee has a very important role to play. Who can be the trustee? Any person that is eligible to act legally on their own. However, if the trustee and the settlor/beneficiary are one person, the trust must have one more trustee and both trustees must act inseparably. Trustee is not the owner of assets under his or her management despite the fact that s/he is formally designated in a public register or any other public record (e.g. real estate cadaster) as the owner of the assets (together with information that s/he is a trustee). The trustee only exercises the ownership title formally and is bound to act with due care of a manager and in line with the trust deed.

When is the time to set up a trust

We defined above what trust is, how it is created and managed. What is going to be the actual purpose of trust and to what ends can it serve? The purposes of the trust can be manifold, from someone's private benefit to public welfare, investment

or profit-seeking. It can serve to prevent frivolous spending of money obtained through inheritance e.g. enabling the settlor to arrange payments of sums to a child or grandchild once he or she completes studies at university. The purpose of the trust can also be charitable (in the sense of public welfare) or investment, shielding the settlor from potential creditor claims or ensuring anonymity. In fact, the only limitation in terms of trust's purpose is that it shall be dissolved when its objectives as stated in the trust deed can no longer be achieved.

What are the benefits of trust? Why to consider it? These are questions that you may be asking now already or could sometime in the future. The answers may include the following: avoidance of inheritance proceedings and prevention of frivolous spending of money obtained through inheritance, providing material comfort to oneself or significant others,

Overall, it is fair to say that in the Czech Republic, trust is not a suitable instrument for tax optimization, at least for the time being.

assuring that family business continues to operate after the settlor's death, arranging for charitable works, reducing investment risks, ensuring anonymity to the settlor and, last but not least, tax optimization...at least that's the case in most jurisdictions where trusts already have some history.



Tax optimization tool? Not for the time being

In the Czech Republic, trust shall be a corporate income tax payer (despite the fact that it is not a legal entity) and its profit will thus be subject to the general corporate income tax rate (currently at 19%). The act of contribution of assets into the trust will be tax neutral; however, subsequent disbursements from the trust may not always be so. For taxation purposes, any disbursements from trusts will first be



made from profit and only then from the remaining trust property. Share of trust profit distributed to an individual shall represent a capital gain within the meaning of Article 8 of Income Taxes Act and as such subject to 15% withholding tax. Income

of trustee shall represent business income within the meaning of Article 7-1-c of Income Taxes Act. One of the few positive features of the trust is that any disbursements of trust's assets contributed into it for the event of the settlor's death shall be tax exempt, the same as beneficiary's income from assets contributed to the trust by a relative. However, the overall conclusion is that trust does not currently represent a suitable instrument for tax optimization, at least not for the time being.

The above text contains an outline of basic information relating to trusts, their legal treatment, functions, purposes and goals though without reference to any practical experience (that no one currently has in the local legal and tax environment). Only the passage of time will show us how trusts will be used in the future and whether we will be able to confirm that they represent suitable tools for tax optimization. We may even be in for a surprise.

Martin Pecka

TAX NEWS IN 2014

It has become standard practice that on 1 January, a number of legislative changes are being introduced that are going to affect tax amounts and relating administration. Some of them result from the much discussed legal measures approved by the Senate (see the dedicated article in this Newsletter); however, many others that are on their way as well. Therefore, we list below a summary of the most important changes.

- **Solidarity tax increase.** Already applicable for 2013. In 2014, the tax increase will apply to taxable income exceeding CZK 1,245,216 in a year (or, in case of employment, to income exceeding CZK 103,768 in one month);
- **Changes in minimum insurance advances.** Minimum pension and health insurance advance will newly increase to CZK 1,894 and CZK 1,752 respectively;
- **Loss from sale of land** will newly be

through the increase of the multiplier of square meters for an apartment from the current 1.2 to 1.22;

- **Universal tax exemption for inherited property.** Assets obtained by an individual through an act of will always be exempt from tax regardless of the type of relationship of the individual to the decedent (i.e. not just among wider family members). The exemption will equally apply to corporations inheriting assets;
- **Abolition of inheritance and gift tax.** Assets obtained through an act of inheritance or gift will newly be within scope of income tax. Gifts will generally have the same tax treatment i.e. tax exemption will only apply to gifts among direct or indirect relatives.



*All the filings
to the Tax authorities
(tax returns,
EC Sales Lists,
registration
applications etc.)
will have to be made
in a digital form.*

- **Increase of maximum assessment base for pension insurance.** The cap is still calculated as 48 times the average national salary which is newly CZK 1,245,216. Health insurance is uncapped. Insurance is levied equally from employment and business income;
- **Donation of body organ as a deductible item.** As of 2014, donation of an organ such as kidney can claim CZK 20 thousand against taxable income as a deductible item;
- **Individuals receiving pension income from the state will newly tax only portion exceeding CZK 306 thousand** (up from CZK 288 thousand this year). This is the result of the increase of minimum wages to CZK 8,500 enacted since 1 August 2013. The amount is calculated as 36 times the minimum wages as of 1 January of the given year, the assuming being that the current minimum wages will not increase as of 1 January 2014;
- **VAT guarantee.** VAT unpaid by the supply provider will newly be guaranteed by the supply recipient who settled money for the supply to an unpublished bank account but only if the payment is CZK 700 thousand or more (i.e. twice the limit of the maximum allowable payment in cash).
- **Mandatory VAT-related filings in digital form.** All filings towards Tax authorities (tax returns, EC Sales Lists, registration applications etc.) will be required in digital form. Only individuals with annual turnover not exceeding CZK 6 million will be allowed to elect between communication in paper or digital form;
- **Change in taxation of land.** Land which is attributable to a unit (i.e. apartment) and land co-owned by all the apartment owners in a building used inseparably by the apartments will newly not be subject to tax. The goal of taxation will be achieved

The above summary of changes for 2014 is not full. There are various other changes coming into effect in relation with the new Civil Code and the Law on Corporations. If you are unsure as to how the individual changes may affect you, we would be happy to discuss your specific situation and impact on your business. This also covers changes not discussed in this article.

A bargain

"The day before yesterday, you came three hours late because a wheel on your car came off. Yesterday, you did not make it by two hours because of the broken gearbox. Today, you've come at twelve o'clock instead of at seven because your battery died," fumes the employer. "Can you add something to that?" "Yes, I've come to the inevitable conclusion that the risks of buying a used car outweigh the benefits," says the accountant glibly.

IMPACTS OF THE SENATE'S LEGAL MEASURES ON TAXPAYERS

From transfers of real estate, through inheritance, VAT guarantee for payment made to unpublished accounts to creation of provisions for tax purposes – this is the breadth of issues dealt with by the legal measures passed by the Senate after dissolution of the Parliament. Since the measures will come into effect in less than four weeks, we would like to inform our readers about the key points and principles.

On 12 September 2013, the Senate rejected an Income Taxes Act amendment that followed the recodification of the Civil Code as of 1 January 2014. Since then, the taxpayers, specialists as well as the wide public have been asking questions as to what type of changes the turn of the years 2013/2014 actually brings.

The lawmakers dealt with the issue ingeniously – through the use of the so-called legal measures, which were proposed by the government, approved by the Senate, signed by the President and endorsed by the Parliament during its first session. We will not analyze the reasons for the Senate's rejection of the law amendment or constitutionality of the use of legal measures in this specific case. The legal measures have been approved, that's a fact, so let us take a look at some of the important changes that 2014 is going to bring.

Taxation of real estate transfers

Legal measure on tax from property acquisition which replaces the current real estate transfer tax keeps the current principle that the seller is the taxpayer and the purchaser the tax guarantor. However, the parties can contractually agree that the taxpayer shall be the purchaser. In such case, the seller shall not guarantee the tax payment.

Exemption for new buildings that have not been used so far will not have universal effect. It will only concern e.g. new apartments or land with new housing. Contributions into share capital will no longer be exempt.

The new law also introduces some simplifications e.g. tax will be declared only by one spouse or in usual transactions an expert valuation report will no longer be required.

Inheritance, gifts, loans and land

The legal measure amending the tax and relating regulations follows the new Civil Code and the Law on Corporations. However, it also contains additional changes

some of which are related to the codification partly, some of them not at all. However, extraordinary tax depreciation of assets proposed by the government was not included in the end. This measure was rejected by the Senate and thus it will not apply in 2013.

A positive change brought about by the integration of the inheritance and gift tax into the scope of the income tax is the new tax treatment of interest-free loans. Interest-free loan shall not be subject to taxation at the level of the recipient, not even in case of loans provided by employers to employees. As part of the integration process, the current tax exemptions

... for example, assets obtained by an individual through an act of inheritance will always be exempt from tax regardless of the type of relationship of the individual to the decedent.

have been extended e.g. to assets obtained by individuals during the course of inheritance which shall always be exempt, regardless of the relationship of the individual to the decedent.

Real estate tax has been completely recast. Newly, all buildings will be subject to the building tax regardless of the fact whether they are part of the underlying land or not.

VAT

The legal measure also updates the VAT Act. As of 1 January 2014, a building shall newly be considered part of land (several exceptions apply). In accordance with Article 56 of the VAT Act (No. 234/2004 Coll.), sale of land with building on it shall be exempt from VAT upon satisfaction of a five-year period between the building's final approval and its sale. As a result, the current dual treatment consisting in the sale of land with building on it being

exempt and the sale of building being taxable will no longer be possible.

As of 1 November 2013, the legal measure also implements VAT guarantee for payments made to bank accounts not published in the VAT payer register. Newly, the VAT guarantee will only apply to payments for supplies of CZK 700 000 or more.

Taxation of short-term contracts, sales of securities and other changes

The legal measure brings many individual changes that are not necessarily related to the process of codification but are equally important to keep in mind.

- Income from short-term contracts ("dohoda o provedení práce" in Czech) up to CZK 10 thousand will be newly subject to withholding tax (assuming the taxpayer does not sign the relevant income tax declaration),
- It will be possible to include income subject to withholding tax into a tax return. The withholding tax will thus be creditable against the overall tax bill;
- As of 1 January 2014, the test for tax exemption of income from sales of securities (period between purchase and sale) will newly be extended from 6 months to 3 years;
- The process of creation of tax provisions to receivables in accordance with Article 8a of the Act on Reserves will be simplified – the condition that a receivable must be claimed through a court or similar process will newly only apply to those receivables obtained through assignment and exceeding CZK 200 thousand in face value. However, this will only apply to receivables arising after 1 January 2014.

As already stated in the beginning, using legal measures to enact new (tax or other) laws or amending existing ones is definitely not standard practice. However, at least the measures were approved in November and not early 2014.

Alena Kučerová



TWENTY TWO YEARS OVER PAYROLLS

It took Vladimíra Brožíková only three days back after joining LERIKA firm in the summer of this year to fully take over the payroll agenda from her predecessor for around 200 employees of several companies. "I have been handling payroll for around 22 years. All I needed was to find my way around the system of hand-over, processing and saving of documents from the client in the payroll software," she says. She is also happy about the clients that were assigned to her. "I am lucky that the contact persons are generally helpful and communicative and it's a pleasure to work with them so that any issues are solved easily and to everyone's satisfaction."

Vladka Brožíková started handling payroll when she joined a Prague subsidiary of an Israeli firm during her studies. During a couple of months, she learnt more than during many years spent in classrooms and soon found out that she wanted to handle payroll on a long-term basis. She still likes it. "It is definitely not monotonous work. Every year, there are many changes – in tax laws, Labor Code and Civil Code. In addition, outsourcing is very interesting insofar that you get to work with various clients and every client is somehow specific."



As regards LERIKA firm, Vladka Brožíková liked from the very beginning that the owners are two women with children. "Women (mothers) basically deal with the same issues and understand certain things better and are more accommodating to one another. In the previous employment, it was unthinkable to leave the office before half past five even though kindergartens are generally only open until 5 pm. At LERIKA, it is important that one can do their job thoroughly, on time and to

the client's full satisfaction" she says. She likes the relationships at workplace and the longer she is with the firm, the better she feels there.

If you are among LERIKA's clients in terms of payroll services, the fact that you receive the right amount of your salary and on time is thanks to the diligence of this elegant accountant. And thanks to her experience with payroll obtained for the period of 22 years.

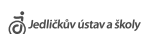
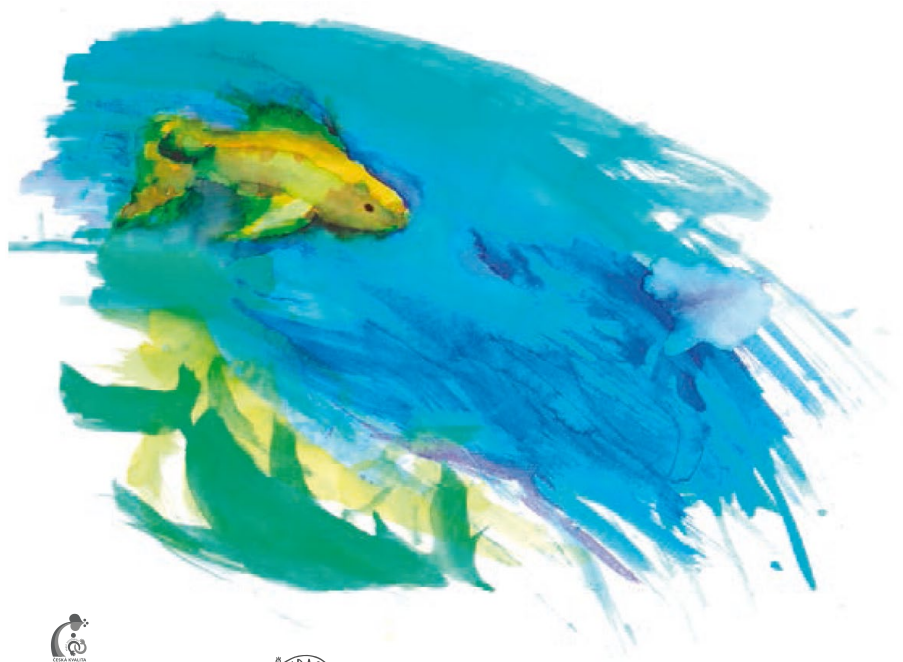
Fall from a window

An old accountant tells a colleague: "You know that I live on a sixth floor. Well, yesterday, when I leant from a window, I got dizzy and sort of fell." "Can't be. You would have been dead!" "Why? I fell back into the room!"

Madness

How to utterly infuriate an accountant? "Tie him to a chair and, stand right in front of him, then fold a paper map slowly in the wrong order".

ACCOUNTING JOKES



By purchasing products with pictures created by pupils and students at the Jedlička Institute and Schools you are supporting the development of the social firm Maturus and the training vacancies for young people with handicap – thus increasing their chance of finding a position on the open labour market. Thank you!

The founder of the social firm Maturus is the Jedlička Institute Foundation.

Merry Christmas

Good luck

and many achievements

in the New Year

Wish you your team

at LERIKA



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