

Dear clients and business partners,

In the October edition Tax News, we will present some news concerning coming electronic records of sales and we will take a look at Act on Substantiation of Assets Origin.

With best regards

LERIKA Team

ELECTRONIC RECORDS OF SALES

We have already covered the topic of electronic records of sales several times in our regular tax news. In this issue, we would like to use the opportunity to remind you of the basic features of the new law and focus specifically on those entrepreneurs who will be subject to the requirements in the first phase from 1 December 2016.

SUMMARY

Main changes:

- Obligation to record sales based on the definition in the new Act on Records of Sales,
- Reduction of VAT rate from the current 21 % to 15 % for catering services and provision of non-alcoholic beverages,
- One-off personal income tax credit of CZK 5,000 during the year when the sales are recorded for the first time.

For whom and since when:

- Any entrepreneur who accepts, during the course of business, payments in cash (including through credit cards, checks, promissory notes, vouchers etc.) or through a payment gateway (PayPal, PayU, PaySec, Google Checkout, Click2Pay). This is rolled out in several phases based on the type of business.



In this issue

- Electronic Records of Sales
 - Summary
 - Catering and accommodation services
 - Other and miscellaneous activities
 - First steps, simplified regime, fair
 - Receipt lottery
- Act on Substantiation of Assets Origin

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Should you not wish to receive our Tax News, please contact Kateřina Navrátilová via e-mail: katerina.navratilova@lerika.eu or phone: +420 222 362 678.

For further information please contact the respective LERIKA's specialist.

How to file:

- Digitally with the tax administration using a device that is capable of communicating via internet and serve receipts.

CATERING AND ACCOMMODATION SERVICES

The live start of the electronic records of sales since 1 December 2016 for restaurants and hotels is an immutable fact. There has been an update in the definition of what constitutes catering services. In the first phase, the electronic record keeping will only concern those catering services defined as such in the VAT law i.e. provision of meals and beverages for immediate consumption at the point of sale including relating services (WC, tables). This represents the services that are now subject to the standard 21% VAT rate and for which the VAT rate will be reduced.

In contrast, the record keeping will not apply to sales or supplies of goods within the meaning of the VAT Act in cases where the product is delivered excluding consumption. This type of sale, mainly via stalls (or also as take-away service in restaurants or cafés) will only be subject to record keeping in phase three i.e. since 1 March 2018. It should be noted that the division between a service and supply of goods only concerns those activities that are defined as a catering service through NACE 56 code. Supplies of goods which are considered as retail (e.g. packaged biscuits or soda) will be subject to the record keeping in phase two i.e. since 1 March 2017.



However, an entrepreneur can voluntarily decide to start keeping records of those sales subject to the record keeping in future phases as of 1 December 2016 already.

In terms of obligations, entrepreneurs should not forget to inform the customer about the fact that the sales are subject to the record keeping and under which regime. The text of the notification is prescribed by the law and, as long as practicable, should be visible and legible. In case of retail shops, this means placing the text in the proximity of the cash desk or anywhere else in the premises. In case of e-shops, this should be stated on the website. The notification should read as follows:

- „In accordance with the Act on Records of Sales, the seller is obliged to issue a receipt to the buyer. The seller is further obliged to digitally record the sale with the Tax authorities immediately or, in case of a technical issue, within 48 hours at the latest“. This applies to cases when the taxpayer records the sale at the point of sale under the standard regime
- “In accordance with the Act on Records of Sales, the seller is obliged to issue a receipt to the buyer. The seller is further obliged to digitally record the sale with the Tax authorities under the simplified regime i.e. within 5 days at the latest. This applies to cases when the taxpayer records the sale at the point of sale under the simplified regime.

Since 1 November 2016, there will be a testing period during which the entrepreneurs will be able to test their devices in terms of functionality and suitability. The testing will be possible within the standard course of business while the entrepreneur will have a chance to review at the tax administration portal whether the record keeping is in line with the stated parameters and whether all sales have been properly recorded.

As regards the catering and accommodation services, it is worth mentioning the interpretation of the General Financial Directorate regarding tips. Based on the applicable methodology, the obligation to record sales depends on the fact whether the employer customarily shares the tips with staff or keeps it. In case the tips are shared with employees, the amount is not subject to record keeping regardless of the fact whether the tips were obtained by the employees directly or whether the employer distributed the tips subsequently (while keeping no part of it). From the operational perspective, if it proves difficult to separate the amount of tips, the full amount can be recorded as sale. In contrast, if the tip is income of the employer i.e. income from business activities, the full amount of the tip should be subject to record keeping regardless of the fact whether it was provided separately or included in the full amount.

OTHER AND MISCELLANEOUS ACTIVITIES

In other areas of business, the Electronic Records of Sales will be implemented as follows:

- **1 March 2017:** wholesale and retail
- **1 March 2018:** others excluding business activities in phase 4 such as taxi services, railway intercity passenger transport, road freight, self-employed manufacturers (bakers, confectioners, small-scale farmers), professionals (doctors, lawyers, accountants, auditors, tax advisors etc.), catering – supply of goods within the meaning of VAT (sale of hotdog or ice-cream at a stall etc.)

- **1 June 2018:** manufacturing: textiles, garments, soaps, perfumes, rubber and plastics products, furniture, metal constructions, repairs and assemblies: machines and equipment, computers and household products. This also includes manufacturers of games and toys, sport equipment, specialized construction activities such as electricians, painters, roofers and providers of other personal services such as hairdressers, masseurs and others.

In cases where the entrepreneur carries on several business activities and some of them can be considered marginal, the sales are only subject to the obligation to keep records from the date that applies to the main business activity. Marginal activities are defined as those the proceeds from which do not exceed 49 % for one establishment and at the same time do not exceed CZK 175 thousand in total. Marginal activities cannot be carried on in a separate establishment. A typical example is the sale of shampoo at the hairdresser saloon. The proceeds from the sale of shampoo (upon fulfilling the above conditions) will be subject to the record keeping starting 1 June 2018 as from this date the hairdresser will also be keeping records of sales from her hairdressing services (if she only sold shampoo which represents a retail activity, she would have an obligation to record sales from 1 March 2017).

For completeness, we would like to draw your attention to the fact that the stated classification of activities into marginal and main ones does not follow from the wording of the law but from the Decree of the Tax administration that can be found here: http://www.etrzby.cz/assets/cs/prilohy/Metodika-k-evidenci-trzeb_v1.0.pdf.

FIRST STEPS, SIMPLIFIED REGIME, FAIR ORGANIZED BY THE MINISTRY OF FINANCE

Some sections of the new law have already come into force as of 1 September 2016. Let us consider which steps can already be taken now by the taxpayers (regardless of the date as of which the obligation starts applying):

✓ Authentication details

Authentication involves the assignment of a login and a password that the taxpayer uses to log in the tax administration portal in order to administer the details regarding establishments and certificates. The request for authentication details can be filed digitally through a tax portal, the details are then received via data box. The second alternative is a personal application filed with any tax office, where the authentication details are issued immediately. The representatives of the taxpayers should remember to include in their powers of attorney not only the authorization to request the authentication details but also to receive them. Once an establishment is registered, it will receive a unique identification number that the taxpayer is obliged to state on a receipt.

✓ Certificates

The certificate serves to authenticate data sent via data messages through applicable devices (cash desk – PC, tablet, smartphone, cash desk etc.) on which it is installed. The taxpayer can have one certificate for all the establishments or cash desks or to differentiate establishments or devices through a unique certificate issued for each. The certificate is issued after logging in the EET application (using the authentication details above). The certificate is valid for 3 years and is issued free of charge.



✓ Binding assessment

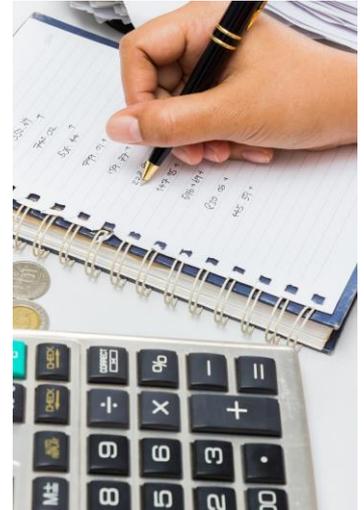
If a taxpayer is in doubt whether the transaction carried on within the ordinary course of business fulfills the definition of a sale defined in the Law on Electronic Records of Sales, he or she can submit a request for a binding assessment. The request shall state the identification details, sales that are subject to the assessment and their detailed description including the description of the business activities that generate them. The request should also include the proposed wording of the statement on the binding assessment (i.e. whether the sales qualify for record keeping or not). The request for the binding assessment can also include a specification whether the sale should be recorded under the simplified regime (see below). The stamp duty for the request is CZK 1,000 and the term for the tax administrator to issue a decision is 3 months.

✓ Request for simplified electronic records

The simplified record keeping differs from the regular one insofar that the records are not kept online, but offline. However, the entrepreneur is obliged to send the details regarding the offline sales within 5 days after making them at the latest. The sales subject to the simplified regime include those defined in the law itself (sales of goods and services carried on board of means of passenger transport), via a governmental decree or sales that were allowed to be kept under a simplified regime by the tax inspector. The main criterion for assessment by the tax administrator will be the preservation of smooth and continuous business operations. If the regular regime was to render business impossible or difficult (such as in case of missing internet connectivity in a specific location), the tax administration should grant the request.

On the other hand, cases of sudden interruption of internet connectivity that will prevent the entrepreneur from keeping record of sale and from issuing the appropriate fiscal code will not trigger the simplified regime. In such cases, the entrepreneur shall issue a receipt without the code and will be obliged to provide the information about the recorded sale to Tax authorities immediately when internet connectivity is restored but within 48 hours of making the sale at the latest. If the entrepreneur is unable to record sale due to a technical issue with the device, he or she will still be required to issue e.g. hand-written receipts. After restoring service to the affected device it will be possible to add the individual amounts on receipts and submit the entire sum as one record.

An analysis of the entrepreneur's specific needs and a timely selection of the appropriate device that will enable the record keeping is highly recommended. In this connection, we would like to inform you about a fair where the cash desk systems enabling the record keeping will be presented:



Ministry of Finance, the Czech Tax administration and the Czech association of small and medium size enterprises and self-employed individuals organizes an event on electronic records of sales. This will take place on 25 October 2016 at 9am in the Prague Congress Center (entrance 5). Apart from a conference, there will be a fair where companies specialized in providing cash desk systems and devices for recording sales will present their solutions. The fair will also include a practical demonstration of electronic record keeping. The Ministry of Finance and the Tax administration will also provide an information point where experts on electronic records of sales will be available to answer questions. Entry to the fair and conference is free of charge.

For more information, please visit the following website: www.e-trzby.cz.

RECEIPT LOTTERY

The tax administration has also provided a statement with respect to the planned receipt lottery. The purpose of the lottery is to support the practice of electronic record keeping and proper levying of taxes in general by enabling the customer to enter a unique number printed on each receipt in a state-wide lottery for cash and other rewards. Based on the statement of the Ministry of Finance, there is currently an effort underway in terms of "setting of parameters and definitions of the game strategy". The lottery should start midway through 2017 at the latest.

We will be happy to support you should you have any questions to any of the information contained in the above article.

katerina.navratilova@lerika.eu

ACT ON SUBSTANTIATION OF ASSET ORIGIN

A new amendment of the Income Taxes Act and the Criminal Act, also known as Act on Substantiation of Asset Origin, was published 3 October 2016 in the Collection of Laws. The new law provides the Tax authorities with a very powerful instrument to test whether the taxpayer's income and the increase in value of his or her assets was obtained legally or not. The law has stirred a lot of controversy within the general public, among communities of professionals as well as during the review process at the highest court authorities.

Let us consider the contents of the new law and its potential consequences for regular taxpayers:

- The law newly empowers the tax inspector to request a taxpayer to substantiate an increase in value of his or her net worth at any point, if the tax inspector has justified doubt about the fact that the increase in net worth is not proportional to income declared in a tax return and the difference is at least CZK 5 million (the original proposal of the Ministry of Finance stated CZK 10 million).
- It is obvious that in many case the tax inspector's justified doubt is going to result from anonymous denunciations motivated by conflicts among neighbors or competition in business. The enactment of the law lays the groundwork for such denunciations to multiply.
- Based on a request from the Tax authorities, the taxpayer is going to be required to present evidence that will credibly substantiate the increase in his or her net worth. This does no concern cases when the taxpayer substantiates the the income relates to periods which are no longer open for tax audits – i.e. generally more than 3 years since the last tax return filing deadline. In such cases the taxpayer should merely state this fact to the Tax authorities. Cases of potential tax avoidance should then be looked into by criminal investigation authorities.
- If the taxpayer does not substantiate the required facts, the Tax authorities will assess tax arbitrarily. In this connection, the law provides for a new regime i.e. special tax assessment using the tax inspector's own instruments. This procedure shall apply in case of a tax assessment higher than CZK 2 million and is more stringent than the current assessment using instruments as known from the Tax Code.
- When assessing tax using own instruments under the new special regime, the Tax authorities will request the taxpayer to file an asset declaration which should disclose all the taxpayer's assets as well as debt. This obligation shall not apply to assets or debt of less than CZK 100 thousand.
- The Tax authorities will determine the taxpayer's taxable income based on an estimate of income commensurate with the increase of net worth while taking into account the expenditures and other outlays. This will result in tax, penalties and late payment interest.
- Upon the assessment under the special regime using the tax inspector's own instruments, the penalties shall amount to:
 - 50 % of tax assessed or
 - 100 % of tax assessed if the taxpayer did not cooperate during the tax assessment.

In case of using instruments based on the Tax Code (i.e. the less stringent scenario), the penalties amount to 20 %.

On top of that, the tax assessment will be subject to late payment interest amounting to the Czech National Bank Repo rate increased with 14 %.

Example:

In October 2017, the Tax authorities request a taxpayer to substantiate a discrepancy between the increase in net worth, expenditures and other outlays for the period 1 January 2014 – 31 December 2016 which, based on an anonymous denunciation by a neighbor, exceeds by CZK 20 million the total income declared in tax returns to the Tax authorities. The taxpayer is unable to substantiate this difference and the Tax authorities make an initial assumption that the increase in net worth exceeds the total income declared in tax returns by the same amount of CZK 20 million. The Tax authorities proceed to assess tax using own instruments based on the special regime i.e. they request the taxpayer to file an asset declaration and, based on all available information, they estimate the income for the period 1 January 2014 – 31 December 2016. The determined income can be higher than the original CZK 20 million as the Tax authorities have to take into account the taxpayer's expenditures in the given period. Let's assume for the purpose of this example that the Tax authorities assess the undeclared income at CZK 23 million. If the taxpayer is unable to prove the origin of this income and the period when it was received, the undeclared income of CZK 23 million will be considered taxable in the year 2016 and will thus be subject to personal income tax rate of 15 % applicable for the given year i.e. CZK 3,450,000. At the same time, penalties of CZK 1,725,000 will be assessed if the taxpayer cooperated during the assessment. Late payment interest will also be assessed for the period from 1 April 2017 (date for filing the tax return).

As the above example makes clear, the Law on Asset Origin provides a very aggressive instrument to the tax administration which will create a great administrative burden for any taxpayer that will be subjected to this procedure even if he or she eventually successfully substantiates all the facts requested by the Tax authorities.

The controversial aspect of the law includes the fact that it forces taxpayers to retroactively substantiate origin of assets while no obligation to archive or store the relating evidence existed in the past. The new law can thus have adverse consequences even for

taxpayers who obtained assets in a perfectly legal way e.g. through inheritance, gifts within a family or through a capital gain on sale of shares. Compounding the controversy are practical issues such as how to prove personal expenses and other expenditures, how to assess the increase in worth of assets etc.

The law comes into force on 1 December 2016.

ivana.ottova@lerika.eu

Contacts:

Corporate taxation

Ivana Ottová
+420 277 277 085
ivana.ottova@lerika.eu

Alena Kučerová
+420 277 277 084
alena.kucerova@lerika.eu

VAT and customs

Eva Vrábelová
+420 277 277 086
eva.vrabelova@lerika.eu

Personal taxation

Martin Pecka
+420 277 277 087
martin.pecka@lerika.eu

Accounting

Monika Borkovcová
+420 277 277 089
monika.borkovcova@lerika.eu

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