



# TAX NEWS

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Dear clients and business partners,

It has already become a tradition that with the onset of a new year, we bring to you information on tax and accounting changes applicable in the upcoming year. However, you may have noticed that this year's changes have not come into effect as of 1 January 2017 but are still under review by the Parliament (currently pending the Senate's approval). The third reading of the tax package, which marks probably the last major intervention of the incumbent government in the current tax system, took place mid-January with expected effect as of 1 April 2017. However, some of the changes have retroactive effect for the whole tax period of 2017.

In addition to the above, we would like to inform you about the receipts lottery, the possibility of sending real estate tax payment details via e-mails and last but not least, we would like to draw your attention to the latest interpretation of the reverse charge VAT treatment when providing digital communication services.

We trust that the stated information will be interesting to you. In case of any questions, please do not hesitate to contact us at any time.

With best regards,

LERIKA Team

## INCOME TAX

The changes that come into force for the 2017 tax year include the increase of the income tax exemption limit for employer's contributions towards employees' supplementary pension insurance, supplementary pension savings, pension insurance and private life insurance from the current CZK 30,000 to CZK 50,000 a year. For the first time for 2017, taxpayer will also be able to claim a higher deduction for supplementary pension insurance, pension insurance and supplementary pension savings, increased from CZK 12,000 to CZK 24,000 a year and a higher deduction for paid contributions for private life insurance, increased from CZK 12,000 to CZK 24,000. As a result of the increase of the minimum wages to CZK 11,000, the maximum threshold for the tax credit for placing a child in pre-school child care will increase as well. This tax credit can be claimed by the taxpayer for the actual costs incurred when placing a child in the child care up to the amount of CZK 11,000 a year for every child. These changes were already approved before and are not part of the tax package that is currently under review.

### Tax package

Retroactively for the whole tax period of 2017, the income tax amendment that is a part of the tax package introduces an increase of the tax credit for the second, third and any other child. This increase will start being reflected when calculating payroll tax since the law's effective date (current assumption is 1 April 2017) and retroactively for the whole year when settling tax on a tax return.

However, based on the transitional provisions, most of the other changes will only become applicable for the tax periods starting after the law's effective date i.e. 2018 tax period for those taxpayers whose taxable period is the calendar year.

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### Tax | Accounting | Payroll

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One of these changes is the limitation on the maximum threshold for applying lump sum deductions by individuals to one half of the current level. It will thus be possible to apply the following lump sum deductions for the 2018 tax period:

- 80 % of income from agricultural production, forest and water management, with the cap of CZK 800,000;
- 60 % of income from self-employment, with the cap of CZK 600,000;
- 30 % of income from the lease of registered business assets, with the cap of CZK 300,000;
- 40 % of income from other types of self-employment, with the cap of CZK 400,000.

The Parliament also approved the lifting of the ban on applying a tax credit in respect of a spouse without income and in respect of tax bonus for a child by those taxpayers who applied lump sum deductions and whose income from business and lease exceeded 50% of the total taxable income (the current provisions of Article 35ca of the Income Taxes Act). Based on the transitional provisions, these self-employed individuals will be able to claim the above tax credit and tax bonus in the 2017 tax period already.

The tax law amendment will be reviewed by the Senate. The law is planned to take effect on 1 April 2017; however, as we have already covered above, some of the changes will apply as of 1 January 2017 already while others only as of 1 January 2018.

We will be happy to assist you in case of any questions to the above issues.



## VAT

The last significant change in the VAT law was the reduction of the VAT rate applying to catering services and to the provision of non-alcoholic beverages from 21 % to 15 % as of 1 December 2016. Mid-December, the Senate also approved the reclassification of provision of news to the 10% VAT rate. The planned effect of the amendment was on 1 January 2017; however, it was vetoed by Miloš Zeman, the President. However, the veto was overruled by the Parliament on 10 January 2017 and the amendment will become effective as of the date of its publication in the Collection of Laws.

The changes included in the tax package for the 2017 tax period with the planned effect as of 1 April 2017 are technical in nature. See below a summary of the following ones:

- Abolishment of the difference in VAT treatment for taxpayers conducting business activities through entities without legal status. The standard VAT rules will apply for these taxpayers.
- One-off adjustment to the VAT deduction (its clawback) for fixed assets that were destroyed, lost or stolen.
- Extension of the domestic reverse charge VAT treatment to the provision of labor for construction or assembly works to the taxpayer.

## RECEIPTS LOTTERY

The Ministry Finance has presented the concept of the receipts lottery under the name Účtenkovka (Czech diminutive for the word receipt). The receipts which the customers will be able to submit through a web service as well as a mobile app, will be subject to a draw on the 15th of every month. The winners will receive between 20 and 30 thousand tangible as well as cash prizes each month. The annual value of the prizes will be CZK 65m. The launch of the lottery is planned midway through this year.

# EET – NO CHANGE FOR E-SHOPS AND SMALL ENTREPRENEURS

The first wave of Electronic Sales Records (referred to as “EET” in Czech) was launched more than a month ago and all the way until its launch, it looked as if the law’s wording had already been final.

The disputed point of the law (or rather its methodological decree) is the obligation to keep electronic records of sales also in case of cashless payments via payment portals i.e. transactions that we encounter when making purchases via e-shops (the launch of the record keeping is as of 1 April 2017). As regards the e-shops, mid-November last year, the General Financial Directorate (“GFD”) issued guidance in which it confirmed that cashless transfers are subject to electronic record keeping whenever the transfer of cash is authorized by the payer through the recipient i.e. through the seller who is supposed to keep the relating record of the sale. As for payment portals, GFD stated in its guidance that the providers of payment services should know which services they provide and it is up to the payer to find this out. The provider of payment services should thus be able to inform the seller whether the cash transfer taking place is being authorized by the payer through the recipient, enabling the seller to assess whether the relating sale is subject to record keeping or not. In case of doubt, the payer can request the tax administrator to issue a binding ruling. In this guidance, GFD also confirmed that the transfers from one bank account to the other are not subject to record keeping, cash collection and cash deposits made to banks, savings companies or other financial institutions.

Less than a week later, the Minister of Finance, Andrej Babiš, decided that payments which are received by e-shops would be exempt from the law on record keeping. He tried to push this through via an amendment which he submitted after the second round of vote on the tax package. However, the Parliament rejected these changes in the third reading of the tax package.

The Parliament also rejected the other planned change of the law on record keeping which proved to be contentious i.e. obligation to keep records of sales for small entrepreneurs. In response to a public outcry, the Minister of Finance tried to exempt from record keeping small entrepreneurs who pay (or would start paying) lump sum tax and whose annual income in the last three tax periods did not exceed CZK 250,000.



It’s worthwhile pointing out that several other Members of Parliament took advantage of the possibility to introduce a change in the law on record keeping of sales and, as a result, the amendment included a few additional proposals such as annulment of the obligations to keep records of sales (i) when paying in a shop in a cashless way with a credit card, (ii) for individuals with annual income of up to CZK 414,000, (iii) for sales made at farmer markets and (iv) for individuals who only pursue own business as an auxiliary activity. However, none of these proposals was accepted by the Parliament and it seems unlikely that the Parliament would revisit these proposals until the implementation of the second wave of EET for wholesale and retail.

## REAL ESTATE TAX: SENDING PAYMENT DETAILS VIA E-MAILS

With the onset of the 2017 tax period, the Tax administration has introduced a new feature which includes the sending of real estate tax payment details via e-mail. The service is aimed at those taxpayers who currently get the information via a money order. Therefore, it is only aimed at legal entities with data box or for those payers who pay tax via the SIPO service.

The service consists in the annual provision of the complete payment details in the pdf format to a designated e-mail address. The e-mail address is provided by the taxpayer on a designated form which is filed with the locally competent tax office (if the taxpayer has several locally competent tax office, he or she must file the form with each one individually) until 15 March of the given tax period. If the form is filed later, the payment details will only be provided for the following tax period.

# TAX ALERT: ADDITIONAL INFORMATION TO THE REVERSE CHARGE VAT TREATMENT WHEN PROVIDING DIGITAL COMMUNICATION SERVICES

At the start of November last year, we informed you via a TAX ALERT about the extension of the reverse charge VAT treatment to digital communication services. A month later, GFD issued additional guidance to the original law which aimed at answering the numerous questions that had arisen. The additional guidance introduced several modifications.

The reverse charge VAT treatment for digital communication services (telephone, internet and similar services) will only apply in cases when the provider as well as the service recipient are VAT payers and, in addition, both parties are also designated as entrepreneurs in the digital communication business. Therefore, the qualifying condition is that both parties act as entrepreneurs when providing digital communication services and are required by the law to be listed in the Register of entrepreneurs providing digital communication services. In other words, when they purchase and sell digital communication services consistently with an aim to seek profit.

The above effectively means that all taxpayers who only recharge digital communication services without doing so in their own name as part of their business activities and without an aim to seek profit (i.e. they are mere intermediaries) are not required to apply the reverse charge VAT treatment. Consequently, the providers of digital communication services will continue to issue invoices with VAT and the recipient will be able to claim the corresponding input VAT deduction. Upon fulfilment of the above conditions, the reverse charge VAT treatment will not apply in the following cases:

- The service recipient is an end user,
- The service recipient enables the use of the service to another end user e.g. employee, subsidiary, lessee or another subject (e.g. free wifi),
- The service recipient recharges the service without any mark-up.



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## CZECH COURT RULES ON THE USE OF COST PLUS METHOD

In its recent decision, the Czech Supreme Administrative Court ("SAC") ruled on the acceptability of loss realized by a toll manufacturer.

The underlying situation concerned a Czech toller which provided services of manufacturing cables to its German principal. The toller used a CP Method for which it had corresponding Transfer Pricing Documentation. The toller's services were charged based on a budget, with no year-end true-up in place. Since the toller's capacity utilization was unexpectedly low in 2008 with the onset of the financial crisis, the toller could not absorb its fixed costs in the price of its services and realized a loss.

The Tax Authorities challenged the loss, performing their own benchmark to establish the arm's length range of Cost Plus Mark-ups and subsequently restating the taxpayer's taxable income to the minimum value in the range.

The taxpayer argued that the loss was a result of objective market conditions and as such should be regarded as arm's length. However, the taxpayer's appeal was ultimately struck down by SAC. First, SAC ruled that the use of the CP Method is justified for a low

risk toller. SAC then sided with the Tax Authorities in ruling that a toller whose functions only concern routine manufacturing should not bear the capacity utilization risk and this risk should be for the account of the principal. Therefore, implicitly, the only situation in which a toller could justifiably end up in a loss position would be in case extra costs resulted from its own manufacturing inefficiencies. SAC also upheld the benchmark performed by the Tax Authorities in commercial databases (including Amadeus).

In our view, the case showcases the quickly increasing sophistication of the Czech Tax Authorities as well as courts in transfer pricing matters. Our main takeaways are as follows:

- In case there is no reliable basis for the use of the CUP Method, the use of other (margin-based) methods is justified. SAC has repeatedly ruled in this manner, using basic economic principles without referencing OECD Transfer Pricing Guidelines;
- TP adjustment should afford the most favorable result to the taxpayer i.e. in case of an upward adjustment to the lowest point in the range. This is a very taxpayer-friendly approach that not many other countries would follow (the more common practice is to adjust to the median);
- Targeting margins based on budget without subsequent true-up is not acceptable in case the risks incurred by the tested party as a result of budget-to-actual variance are not commensurate with its functions;
- SAC consistently follows the substance-over-form principle, dwelling less on formal legal arrangements and putting emphasis on the underlying economic substance of the related party transactions.

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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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