



LEGAL TAX AUDIT

A black and white photograph of a person standing on a large, flat, rocky outcrop that extends over a deep valley. The person is wearing a light-colored long-sleeved shirt and dark pants, and has their arms raised. The valley below is filled with trees and a winding road. In the background, there are more mountains and a body of water.

COMPREHENSIVE LEGAL, TAX, ACCOUNTING AND AUDIT SERVICES

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NEWSLETTER
October 2017

AMENDMENTS TO THE INCOME TAX ACT

The long-awaited amendment to several tax acts published in the collection of laws under no. 170/2017 Sb. finally took effect on 1 July 2017. Besides this amendment, several other amendments to the Income Tax Act have been adopted and are now effective with some changes being applicable already in the tax period of 2017, while others only in the tax period of 2018. Below, we have selected the most important legislative changes introduced by these amendments:

Flat rates

From the tax period of 2018, the maximum flat rates which sole traders (OSVČ) and lessors may deduct from their taxable income will be reduced as follows:

- ▶ craftsmen and farmers will continue to be able to deduct expenses in the flat rate of 80 % of their income, but only up to the limit of CZK 800,000
- ▶ other sole traders (sole traders which are subject to the Trade Licensing Act) will

continue to be able to deduct expenses in the flat rate of 60 % of their income, but only up to the limit of CZK 600,000

- ▶ other sole traders (sole traders which are not subject to the Trade Licensing Act) will continue to be able to deduct expenses in the flat rate of 40 % of their income, but only up to the limit of CZK 400,000
- ▶ taxpayers with income from lease will continue to be able to deduct expenses in the flat rate of 30 % of their income, but only up to the limit of CZK 300,000

On the other hand, the amendments extend the possibility to claim spouse tax credit and child tax bonus to tax payers using flat rate deductions, which was not possible before. If it is beneficial for the tax payer, the new rules may be applied already to taxes payable in 2017.

Child tax bonus

The amendment has introduced the long-expected rise in child tax bonuses applicable

to second, third and further children. For employees, this change was first applied in the calculation of net pay for July 2017. The tax bonus for January - July 2017 may be claimed in the annual tax reconciliation or in the annual tax return. With the effect from 1 January 2018, the tax bonus for first supported child will be increased by CZK 150 a month, which is the result of act no. 200/2017 Sb. The outlook regarding tax bonuses in the upcoming years is summarized in the following table:

Tax Bonus	2016	2017	2018
1. child	13.404	13.404	15.204
2. child	17.004	19.404	19.404
3. and further children	20.604	24.204	24.204

From 2018, the conditions of availability for tax bonuses will be tightened. While currently, tax payers may reach the required amount of sixfold the minimum pay by including the income from lease or from equity in to their total income, in the future, only income from dependent work or from sole trader entrepreneurship may be included.

AMENDMENTS TO THE INCOME TAX ACT

Donation deduction

Amendment to the Income Tax Act no. 254/2017 Sb., which is applicable to the tax period of 2017, raised the amount which blood donors may deduct from their tax base from the original CZK 2,000 per donation to the current CZK 3,000 per donation. It is now also possible to deduct CZK 20,000 per each donation of blood-making cells.

Small scale employment

A withholding tax has been introduced to tax income received from „small-scale“ employment. Income from small scale employment is understood as income not exceeding CZK 2,500 received from an employer with whom the employee did not sign the tax declaration (prohlášení o dani).

Books as employment benefits

The amendment extends the range of benefits

exempted from taxation and social security and health insurance levies to cover printed books, including picture books for children in which commercial content does not exceed 50 %. Employer's expenses are not recognized as tax-deductible.

Depreciation of the costs of technical enhancement by sub-lessors

According to earlier opinions and instructions published by the tax administration, sub-lessors were not entitled to depreciate the costs of technical enhancement of subleased property.

Thanks to the amendment, the costs of technical enhancement which was completed and ready to be used after 1 July 2017 may now be depreciated even if the property is intended for use of a third party (i.e. a sub-lessor) under the same conditions under which a lessor may depreciate the costs of technical enhancement of the property.

Tax amortisation of the costs of intangible property

Under earlier regulation, taxpayers were entitled to amortise the costs of intangible property only for a period of time prescribed by the law. This period now merely serves as a statutory minimum, and the costs of tangible property may therefore be amortised over a longer period of time. However, for property for which amortisation of costs started already before 1 July 2017, the earlier regulation will continue to apply.

Destruction of old property due to new construction

If old property is torn down or destroyed due to the development of a new construction or due to its technical enhancement, the tax entry price of the new construction will include the actual amortized price of the property being destroyed, instead of the book amortized costs, which used to be the norm in the past years.

AMENDMENT TO VALUE ADDED TAX ACT

A vast majority of the 134 changes brought by this amendment to the Value Added Tax is of a rather technical nature. There are however some material changes which we would like to inform you about below:

Special regulation applicable to associations repealed

The amendment repeals all provisions regarding VAT applicable to partners in an association, e.g. joint monitoring of turnover, registration obligation, rules for claiming tax deductions etc. The General Financial Directorate has issued an instruction regarding the application of tax deductions in an association which we believe to be in contradiction with decisions of the European Court of Justice.

Each member of an association will now be considered individually and transactions between members will be considered taxable transactions. Members of an association may decide to continue to follow the old regulation until 31 December 2018.

Specification of obligation to pay VAT on advances

Following decisions of the European Court of Justice, the circumstances under which it is necessary to pay VAT on a payment received before the taxable transaction itself (an advance payment) are now specified in more detail. The obligation to pay VAT applies only if the goods to be delivered or the service to be provided and the tax rate and the place of delivery are known in sufficient detail. Despite the information published by the General Financial Directorate trying to explain these broad legal terms in several case studies, a number of questions remains unresolved.



AMENDMENT TO VALUE ADDED TAX ACT

Changes in determining the date of taxable transaction

The amendment repeals the rule concerning determination of the date of the taxable transaction for repeated transactions, and introduces another rule which states that transactions which are continuously performed for at least 12 months are to be considered completed at the latest on the last day of each calendar year following the calendar year in which the transactions started.

Deduction of deficits

According to earlier court decisions, a taxable subject who during a physical stock inventory identified a deficit in inventory, which was not claimed from the employees, did not occur due to theft, destruction or demonstrable confusion

or did exceed the limit for natural loss, had the obligation to pay input tax. From now on, in compliance with the European Directive on VAT, the input tax deduction will be settled instead. Even though this change is rather of a technical nature, it may have a financial impact, e.g. in case of a change in VAT rate.

Extension of the reverse charge mechanism

From 1 July 2017, the reverse charge mechanism will be extended to a number of additional transactions:

- ▷ provision of workers for construction or installation works
- ▷ provision of real estate sold by debtor due to a court order on forced sale
- ▷ delivery of goods provided as a guarantee during realization of such a guarantee

- ▷ delivery of goods after assignment of reservation of title to the transferee and realization of this right by the transferee
- ▷ provision of broker services consisting in provision of investment gold, if such service is taxed.

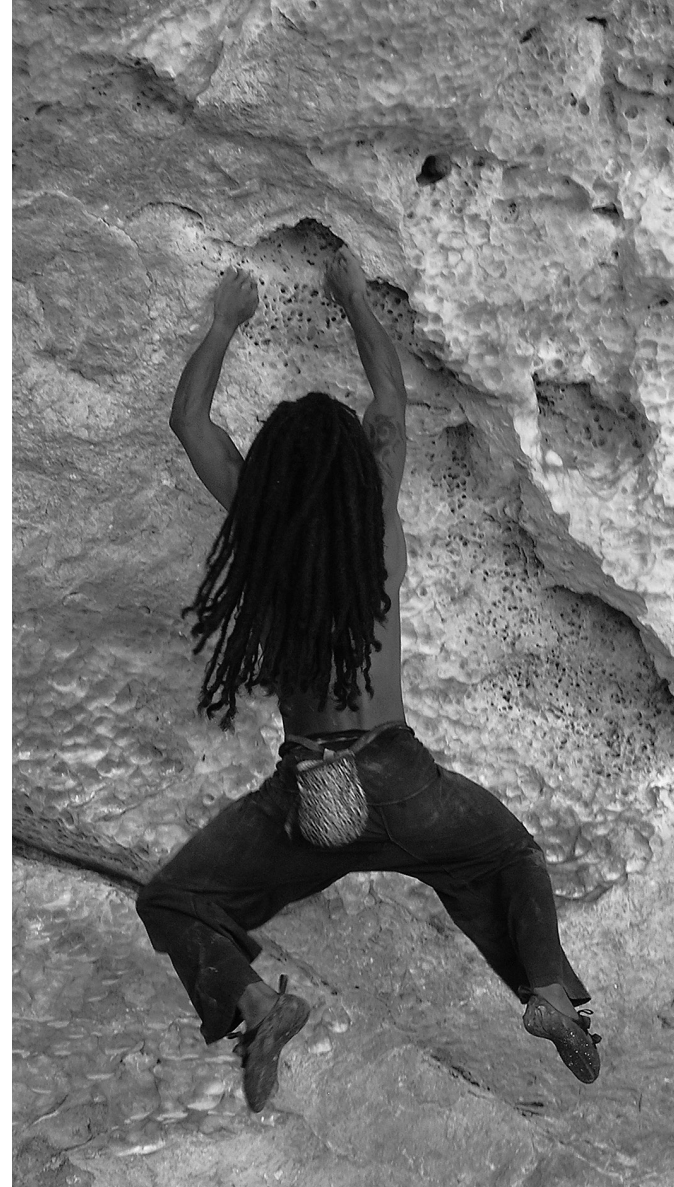
Introduction of the institution of unreliable tax subject

In order to prevent certain tax subjects from their efforts to get rid of the designation of unreliable tax payer by cancelling their VAT registration and subsequently renewing it, the institution of an unreliable tax subject has been introduced. Any subject which materially breaches its tax obligations may be designated as an unreliable tax subject.

AMENDMENT TO TAX PROCEDURE CODE

The amendment to Tax Procedure Code introduces an increase in the interest on tax deduction payable to a VAT payer, if the tax administration blocks an “excess” for an extended period of time. While before 30 June 2017, the interest on deduction equalled the repo rate set by the Czech National Bank increased by 1 percentage point, from now on, the repo rate is increased by 2 percentage points. The period after the end of which the taxable person is no longer entitled to the interest on deduction is also subject to a change and changes from the original 5 months from the initiation

of the proceedings to 4 months from the last day on which the tax return could have been filed. The amendment also introduces the possibility to stay this period in certain situations.



REAL ESTATE TRANSFER TAX

The Supreme Administrative Court has ruled in a dispute between a municipality and the tax administration regarding determination of tax base for calculation of real estate transfer tax, that VAT shall not be included in the agreed price if the transfer was subject to VAT payment.

The Supreme Administrative Court based its decision on an analogy between the legislative measure of the Senate on real estate transfer tax from 31 October 2016, under which both the transferor and the transferee could have been subject to the real estate transfer tax, and on the no longer effective act on inheritance tax, donation tax and real estate transfer tax and earlier case law concerning transfers of real estate.

The argument used by the tax administration supported by the explanatory memorandum to the legislative measure on the real estate transfer tax was not accepted, as the court applied the principle that if there are two equal interpretations of a legal regulation, the interpretation which least restricts the rights of tax subjects should be given preference.

The tax administration subsequently confirmed that it would accept the purchase price excluding VAT in situations in which, between 1 January 2014 and 31 October 2016, the real estate transfer tax was paid by the transferor. This interpretation may be used in pending proceedings or by filing and additional tax return form.

Therefore, if you sold real estate which was subject to VAT and paid the tax on transfer of real estate within the above period, it is possible to have a part of the tax returned. We will be happy to assist you with any steps in this direction.

For the cases in which the tax payer was the transferee, especially after 1 November 2016, the decision of the Supreme Administrative Court does not, in our opinion, provide a conclusive guideline, and the tax administration is of the same opinion and is still to analyse the consequences of the decision for such transfers.

SERVICES CONNECTED TO THE EXPORT AND IMPORT OF THE GOODS

The European Court of Justice dealt in its case no. C-288/16 with the definition of services concerning export and import which may be exempted from value added tax. According to the European Directive on the common system of value added tax, services, including carrier services and other pertaining services are exempted from VAT if such services are directly tied to export or import of goods.

This exemption from VAT should, in the opinion of the ECJ, be interpreted restrictively, and therefore, the services exempted shall not only contribute to the actual export or import, but have to be provided directly to the exporter, to the importer or to the recipient of the goods. Tax exemption may therefore be claimed only by the contracting parties themselves and not by their subcontractors.

Before this judgment, the interpretation of the relevant provisions of the VAT Act has been less restrictive, as the Act does not precisely define the recipient of the exempted services. The tax administration should therefore, in the near future, issue an instruction on how VAT payers should deal with this new situation.



Fraud occurring in lease of workforce

Tax administration published an announcement on its website, that taxable transactions consisting in provision of workforce under any kind or form of contractual relationship may be subject to VAT frauds. As possible VAT deductions on the part of the recipient of the service may be challenged by the tax authority, it is necessary to pay extra attention to the selection of your suppliers of these services. According to the information published by the tax administration, possible indicators of a VAT fraud may include the supplier not having the necessary licence from the unemployment office, the supplier providing foreign workers without the necessary employment permit, money being transferred to foreign accounts or in cash etc.

Increase in minimum pay

From 1 January 2018, the minimum monthly pay will be increased from the current CZK 11,000 to CZK 12,200 and minimum hourly wages will be increased from the current CZK 66 to CZK 73,20. This change will among other things influence the size of tax credit available for a child in day care (“školkovné”), the limit for exemption of pensions from taxation and the limit for being entitled to payment of a tax bonus. Along with the increase of absolute minimum pay, the rates of minimum pay set for different professions will also be increased.



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