



cutting through complexity

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TAX AND LEGAL UPDATE

09

2015

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Dear Students,

So, we've got through the first school day. The curriculum remains unchanged, although the sunny atmosphere of these first days is soon to be clouded over by upcoming changes. The Ministry of Financial Education has revealed its plans for 32 new subjects which students will have to master before graduation. Even at first glance, it is obvious that these will be tough for both students and teachers alike.

As has become customary, we will find out the exam questions only right before Christmas, which we then can spend revising for the new subject titled 'a Comprehensive Approach to Gratuitous Supplies' – finally we will tax our Christmas presents correctly! Over half term we will be supplying ledger statements, and starting with the summer holidays we may even report sales online.

And, not to forget: we will have to substantiate the origin of the contents of our schoolbags – as soon as the teachers tidy up theirs.

Have a good school year!

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Partner in charge of
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VAT ledger statement submission soon to be mandatory – be ready!

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All taxpayers effecting taxable supplies with the place of supply in the Czech Republic or claiming VAT deductions will have to file VAT ledger statements, monitoring in detail transactions reported in VAT returns. It is therefore high time to make all the necessary preparations!

The first period for which VAT ledger statements will have to be filed is January 2016. Legal entities will have to submit their first VAT ledger statements by 25 February 2016 (individuals have to meet deadlines according to respective taxable periods). VAT ledger statements should contain information from issued and received invoices and should be filed electronically in the required format. The vast majority of companies will have to adjust their accounting systems for this purpose. If companies manually adjust data generated by their systems (e.g. to file their VAT returns), they have to resolve how the system will work with the adjusted data to be filed in the VAT ledger statements.

Sanctions for the failure to file VAT ledger statements range from CZK 1 000 (for late submission of a VAT ledger statement) to CZK 550 000 (for serious encumbrances or obstructions of the tax administration). Simultaneously, companies may also be designated as unreliable payers. The entire process of preparing and filing VAT ledger statements is quite demanding and should therefore not be underestimated.

The General Financial Directorate (GFD) issued information about the XML structure required for preparing and filing VAT ledgers correctly. Please note that on 10 August 2015 the GFD issued an update to the previously published XML structure. The update involves minor changes to the number of characters relating to figures

(http://www.financnisprava.cz/assets/cs/prilohy/d-seznam-dani/struktura_DPH_KH1_082015.pdf).

The GFD may yet slightly amend the required documents. Nevertheless, we believe that since the setting of all systems seems to be a process requiring considerable time, companies should start dealing with the following issues as soon as possible:

- knowledge of legal requirements and the structure of VAT ledger statements;
- identification of accounting data necessary for completing VAT ledger statements;
- communication with accounting and IT departments regarding system settings needed to export XML structures;
- decision whether to prepare VAT ledger statements internally or externally;
- system implementation and training of relevant employees;
- trial testing of system settings.

We will be happy to meet with you personally, discuss with you all requirements associated with VAT ledger statements in detail and present to you how we can assist you in this respect.

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Taxes in the near future

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In early August the government let the professional public see the changes currently under preparation for income taxes. Below we summarise some that caught our interest.

In early August the government disclosed its plans to amend the tax legislation. The Ministry of Finance seems to be keeping its promise not to carry out any radical changes to income taxes either this or the following year. Some of the major changes to be proposed by the government in the near future and of interest for us are as follows:

- The government is planning a conceptual change in the taxation of gratuitous supplies currently causing considerable interpretation difficulties. More details about the extent of the planned changes are not yet available.
- An extensive change is being prepared with respect to Section 23(4)(e) of ITA allowing the re-classification of revenues from taxable to non-taxable if these relate to non-deductible expenses as a follow-up to the restriction relating to Section 24(2)(zc) already applicable from 2015.
- Without providing any details, the government intends to ensure that all payments made by companies from profit after tax be treated the same for tax purposes irrespective of their designation or the method of their accounting recognition. The government plans to find a conceptual solution to tax treatment of various payments made from equity (including controversial revaluation differences).
- The government abandons the necessity to distinguish between open-end and close-end mutual funds for the purpose of defining basic investment funds. Under the new regulations, a 5% rate of tax would without any further restrictions also apply to close-end mutual funds. This change is planned to be in effect already from 2015.
- 2017 is also likely to bring changes to finance leases. The government is planning to extend finance lease rules to the acquisition of intangibles.
- A change in the taxation of non-profit taxpayers, especially with respect to family foundations, is planned to become effective from 2017.
- From 2016, dividend recipients should not exempt dividends from tax where the paid-out amount is deductible for the entity paying the dividends. The government is also planning to clarify the taxation of advanced payments for dividends, especially in the case of subsequent transfers of business shares. In such cases, the tax treatment should follow the taxation of a particular business share.
- From 2016, pensions paid over a minimum of ten years should be exempt from tax within the government's plan to extend its support of "old age" insurance and pension products.
- The government is considering the possibility of cancelling a deduction for research and development as well as a deduction to support professional and vocational education from the income tax base on employment from 2017.
- In the area of personal income tax, another increase in the tax credit for dependent children is also being considered.

Unfortunately, a number of really interesting topics are now only in the form of general sentences pointing to the necessity to find conceptual solutions. We just have to believe that from the bills subdivided into particular sections we will soon learn of draft solutions suitable and reasonable for taxpayers.

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Harmonisation of Czech accounting with EU legislation harmonic in practice?

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An amendment to the Accounting Act implementing other EU rules is waiting for the president's signature. The new amendment divides accounting entities and consolidated groups into categories, which may either increase or lighten the administrative burden placed on companies or groups. 2016 will by all indications be the year of changes for accounting.

From 1 January 2016, accounting entities will be divided into four categories: micro, small, medium-size and large according to whether they exceed two of three criteria, which are the amount of assets, net turnover and the average number of employees as at the balance sheet date.

The category into which the accounting entity falls will be decisive for the scope of information that must be disclosed in the financial statements and annual report and for the duty to have the financial statements audited. The extent of financial statements will be defined for individual categories in amendments to implementing decrees, which are currently in preparation. The administrative burden imposed on micro and small accounting units will be reduced. Some small non-profit organisations will again have the chance to keep single-entry accounting books. Conversely, from 2016 large accounting entities operating in the mining industry will have the duty to prepare reports on payments made to EU member state governments or non-EU state governments as at the balance sheet date.

Consolidated groups will be divided into three categories such as small, medium-size and large. Small consolidated groups will not have to prepare consolidated financial statements. The amendment to the Accounting Act also introduces a new definition of public interest entities (PIEs), which were earlier defined in the Act on Auditors. The employment of more than four thousand employees will no longer be the sole factor defining companies or consolidated accounting entities as public interest companies.

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Payments to old age pension scheme to vary according to the number of children?

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The Ministry of Labour and Social Affairs is planning to increase the birth rate and, consequently, also the number of people contributing to the old age pension scheme by reducing the pension insurance rates of parents. Working parents with children in their care would be liable to lower rates than the childless.

The Ministry of Labour and Social Affairs has prepared a notice adjusting the insurance premium rates for the old age pension scheme according to the number of dependent children. The ministry's primary objective is to increase the birth rate and, consequently, to increase payments to the old age pension scheme in the long-term.

In accordance with the current draft notice, persons with dependent children would make payments to the old age pension scheme as follows:

	one dependent child 6.5% (the same as today)
	two dependent children 5%
	three dependent children 2.5%
	four and more dependent children 0%

Conversely, the childless would be liable to a 7.5% rate, which is higher by 1% than the current payment rate.

The draft notice discusses a number of options that differ in who specifically may make use of the reduced rates and when. Their common objective, however, is to reduce pension premiums paid by working parents taking care of children. The ministry appears to prefer the alternative allowing both parents to apply a reduced rate until their children complete their studies. Employees with an annual income of more than CZK 1.3 million would save up to CZK 83 thousand per year on pension insurance, or CZK 166 thousand if such an income is generated by both parents. Lower pension insurance premiums would not affect the amount of the parents' future pensions.

The differentiation of insurance premium rates should apply only to individuals liable to pay premiums and not to persons paying the insurance premiums on behalf of those individuals. Thus, the rate applied by employers to the portion of old-age pension contributions that is paid by employers would remain unchanged. Employers, i.e. their payroll accountants, would nevertheless have to do more paperwork as they would have to request necessary documentation from employees to apply these reduced rates to employees' part of the premium.

The intended subject-matter of the notice has been proposed by a pension reform technical committee. The ministry is yet to prepare a version subdivided into individual sections.

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In August, the government submitted to the Chamber of Deputies a bill amending laws regulating capital markets. The amendment will namely concern the central securities depository, issuers of listed securities, investment funds, and their depositories and managers.

The draft amendment to the Act on Pursuit of Entrepreneurial Activities in Capital Markets implements EU law and responds to requirements that have arisen in practice. The rights and duties of issuers of securities listed on the Czech capital market have been modified to comply with relevant EU directives. This means, for instance, that issuers of securities will no longer have to publish the interim reports of their statutory bodies; on the other hand, the scope of the obligatory annual report has been slightly extended. Special corporate rights will be awarded to qualified shareholders. To allow issuers to manage their businesses efficiently while maintaining these shareholders' rights, higher reporting requirements have been introduced for entities who exceed a stipulated share in the issuer's voting rights.

With Czech law adapting to the EU Regulation on securities settlement and Central Securities Depositories (CSDR), foreign depositories will be allowed to provide the same services in the Czech Republic as a local central securities depository. Issuers thus may choose a central depository from across the EU or from a third country. Attention should also be paid to amendments regarding security prospectuses: it will now be possible for the prospectus to be published and approved by the CNB in English.

A significant portion of the amendment is devoted to the regulation of investment funds in the Act on Investment Companies and Investment Funds. Firstly, it transposes the EU's UCITS V directive, which regulates the activities of depositories of collective investment funds and the principles of remuneration and imposition of sanction. Beyond the obligatory transposition of EU law, the government has proposed changes to the regulation of investment companies with variable capital (SICAV): for instance, SICAVs will have to clearly separate the assets generated from founder shares from those obtained from investors' shares and the assets of the sub-funds from other possible assets of the SICAV. The minimum obligatory amount of registered capital has been reduced to CZK 1 or EUR 1. Investment companies already in existence will have to comply with the amendment within 12 months from its effective date. The draft also includes an amendment to the Income Tax Act, making a more preferential tax rate accessible also to close-end mutual funds.

Note also that the CNB will now have the duty to publish all its final decisions (including rationale) on its website. This may be especially interesting in licencing and penalty proceedings. The amendment also revises the current regulation of administrative fees as per the Act on Investment Companies and Investment Funds, the Act on Pursuit of Entrepreneurial Activities in Capital Markets and legislation in the area of insurance and pension funds.

Finally, there is yet another amendment to the Act on Pursuit of Entrepreneurial Activities in Capital Markets and related laws, still going through the legislative process: it will implement into Czech law the MiFID II – EU Market in Financial Instruments Directive – and the relevant MiFIR regulation, which are the cornerstones of the European regulation of financial markets.

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“Kurzarbeit” in Czech law

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Starting October, a *Kurzarbeit* system will be introduced, whereby employers who find themselves in difficulties and unable to assign work to their employees in the standard weekly amount may apply for a state contribution of 20% of the employees' wages; the employees will thus receive 70% of their average wage.

The so-called *Kurzarbeit* system has been introduced into Czech law by Act No. 203/2015 Coll., amending the Employment Act, effective from 1 October 2015. Under the system, employers who are temporarily unable to assign work to an employee in the scope of at least 20% of their standard weekly working hours, may pay the employee 50% of their standard weekly wage, while through the Labour Office the state will supplement this with another 20%. The scheme will have to be agreed between the employer and the Labour Office, with prior consent by the government. The Labour Office's benefit may be paid for up to half a year, with the possibility of repeating the scheme once. In justified cases, the government may set an even longer benefit payment period. Detailed conditions for the provision of the benefit will be stipulated by a governmental regulation. The *Kurzarbeit* system, inspired by German law, is meant to help employers get through difficult times without having to let go of their employees who would otherwise have to receive state unemployment benefits.

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Tax reforms in many countries include steps aimed at increasing the efficiency of tax administration, e.g. the integration of the administration of direct and indirect taxes and of customs, the establishment of autonomous institutions for tax collection, the consolidation of work and reductions in staff numbers.

The Organisation for Economic Cooperation and Development (OECD) issued its annual comparative report on tax administration. The analysis of 56 countries of the world now also includes Costa Rica, Croatia, Morocco and Thailand.

The following trends were identified:

- **Significant organisational changes:** Tax reforms in many countries include steps aimed at increasing the efficiency of tax administration, e.g. the integration of the administration of direct and indirect taxes and of customs, the establishment of autonomous institutions for tax collection, the consolidation of work and reductions in staff numbers. Over 85% of tax administrators have adopted a structured 'co-operative compliance model' for managing large corporate taxpayers; one-third use similar arrangements to manage the tax affairs of high net worth individuals.
- **Strong investment in the digitalisation of tax administration:** Average IT expenditure as a percentage of the total budget remained constant at 9.5%. Notable exceptions were Austria, Finland, Singapore and Norway where approximately 25% of the total tax administration budget is spent on IT. Over 95% of all tax administrators offer the opportunity to file returns electronically, and the use of these services in OECD countries was over 75% for personal and corporate income tax and VAT in 2013.
- **Improvement in outstanding tax debt positions:** Total tax debt for OECD member countries rose marginally in 2011 to 2013, from around 22% to just over 24% of net annual revenue collections. However, this ratio is significantly impacted by two outliers - Italy and Greece; if these were removed, the results would show a mild decrease. This is also due to seven 'exceptional' countries: Estonia, Ireland, Japan, Korea, Norway, Sweden and Switzerland, who have a collection to debt ratio of less than 5%. Their success is primarily based on strong management information systems, well-developed analytics tools allowing enforcement, extensive use of tax withholding at source, wide use of electronic payment methods, and significant investment in information technology.
- **Improved tax gap measurements:** More than 43% of tax administrators report that they undertake or are researching estimates of the aggregate tax gap, i.e. tax not assessed as a result of tax fraud, the grey economy and other types of tax evasion.
- **Greater use of voluntary disclosure programmes (disclosing tax planning techniques or concealed tax liabilities):** Even though two-thirds of OECD member countries reported that their tax law permits voluntary disclosures, only 40% have a policy to encourage taxpayers to use them. Furthermore, only 11 member countries were able to report the results achieved from their voluntary disclosure programme. With the imminent implementation of the automatic exchange of financial information, however, it is expected that there will be greater interest in these programmes.
- **Electronic matching of VAT invoices continues to expand:** A growing number of countries are successfully using systems to process bulk VAT invoice data, with the aim of preventing or detecting tax fraud.

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SAC: When to pay VAT on technical improvements carried out by a tenant?

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According to the SAC, for VAT purposes, technical improvement carried out by a future tenant before the conclusion of a lease agreement should be considered at the time of the improvement's completion, not only upon the termination of the lease. From the viewpoint of VAT treatment, this differs from cases where technical improvements are carried out by tenants during the existence of leases.

The Supreme Administrative Court (SAC) in Judgement Ref. No. 7 Afs 137/2015 – 30 dealt with the application of VAT where a technical improvement to a property had been carried out by a tenant.

In this case, an extension had been added to the building and an occupancy permit obtained before the conclusion of a lease agreement. At the time of building the extension, the future tenant had an agreement on financing the extension and on a future lease agreement. According to the agreement, the future tenant was to carry out the extension at his own expenses, and subsequently depreciate it over the term of the lease; at the end of the lease, the total value of the rent was to be offset against the net book value of the extension. The SAC dealt with the issue at what time VAT should have been paid on the technical upgrade.

The SAC dealt with a similar case before (1 Afs 70/2010 – 57), then concluding that the tenant had provided a service consisting of providing the right to use another property value occurring at the time of lease termination, which is when the technical improvement passed into the unlimited disposal of the landlord. However, in this previous case, the technical improvement had only been carried out by the tenant at a time when the lease was already in existence. In the opinion of the SAC, this difference is crucial, and the two cases cannot be treated identically.

In the case now in question, no lease relationship existed at the time of building the extension, therefore the landlord had the extension at his disposal without any restriction immediately after it was built. According to the SAC, this means that VAT should have been paid at that time and not upon the termination of the lease.

We recommend paying increased attention to contractual regulations wherever technical improvements are carried out by tenants, especially where such modifications are completed before a lease agreement has been concluded.

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How to apply six-month period for corrections of VAT for insolvency receivables?

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The financial administration will not follow the Supreme Administrative Court's interpretation of a six month period for corrections of VAT for insolvency receivables. Tax authorities will continue to allow corrections of VAT only for receivables that are older than six months as at the date of the court's decision on insolvency.

High ambiguity arose in connection with the Supreme Administrative Court's Decision No. 9 Afs 170/2014 – 42 regarding the definition of a six-month period for corrections of VAT for insolvency receivables, already discussed in the February 2015 issue of Financial Update, and regarding the application of this time limit in practice. According to the SAC, corrections of VAT may be performed for receivables that are younger than six months as at the date of the court's decision on insolvency. However, according to generally accepted historical and some tax authorities' current interpretations that we lately have come across, VAT corrections may only be performed for receivables older than six months.

We believe that stronger arguments can be found for VAT corrections made to receivables older than six months. Our conclusion has also been informally approved by a representative of the General Financial Directorate who also confirmed that other subordinate financial administration bodies should be instructed to proceed accordingly.

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- The coalition committee confirmed the extension of the period between the force and effect of the Act on Electronic Reporting of Sales from three to seven months. The electronic reporting of sales should thus be in operation from July 2016.
- The government approved a draft notice increasing the minimum monthly wage by CZK 700 to CZK 9 900 and the minimum hourly wage from CZK 55 to CZK 58.70 from 1 January 2016. The minimum wage of persons with disabilities will increase by CZK 1 300 to CZK 9 300. In connection with this, the government will also adjust the lowest levels of guaranteed wages for employees whose wages have not been agreed through collective agreements and for employees working in public services and administration.
- An act amending the Labour Code effective from 1 October 2015 was published in the Collection of Laws under No. 205/2015 in August. The amendment repeals an act on employee accident insurance that had not yet been in effect, harmonises the cancellation of obligations arising as a result of agreements to perform work and agreements to complete jobs and moves the substantive-law regulation of damages paid for work injuries and occupational diseases, temporarily included in transitional provisions, back into Part 11 of the Labour Code, placing it among provisions regulating damages in labour-law relations.
- An amendment to Act No. 326/1999 Coll., on the Stay and Residence of Foreign Nationals, entered into effect on 17 August. According to the amendment, visas (residence permits) are considered valid until the date on which decisions regarding requests to extend visas enter into legal force, also including cases in which the validity of current residence permits expires before respective decisions are issued (i.e. fiction of a legal stay). While legislation in effect before 17 August did not cover employment, the new regulation does; therefore, if a request to extend a long-term stay is filed within the statutory deadline, the stay as well as the employment of a foreign national in the Czech Republic is considered legal regardless of whether the validity of the existing residence permit has elapsed.
- A bill on gambling prepared by the Ministry of Finance considers the possibility of using three tax rates compared to the one of 20% currently in application on lotteries and similar games. The bill proposes a rate of up to 35% on technical gaming facilities, 30% on lotteries, bingos and live games and 25% on fixed-odds betting, totalisator games, raffles and small-scope tournaments. The bill also intends to introduce a minimum tax on technical gaming that should replace the existing fixed part of payments from technical equipment. The new rules should be in effect from 1 January 2016.



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