



TAX FRESH

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Dear Business Friends,

After a short summer holiday break – which we hope enabled you to recharge for the rest of the year – we are back with the most newsworthy information on taxes that may have an impact on your business.

This summer has been fruitful particularly in terms of tax innovations. We have prepared a complete overview of the changes to make sure none escapes your attention. We shall be happy to offer any further assistance.

Yours faithfully,

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VALUE ADDED TAX

Introduction

New Customs Act No. 242/2016 Coll. and related amendments to other acts (Act No 243/2016 Coll.) were published in the Collection of Laws on 29 July 2016 with the effective date on 1 September 2016.

Extended VAT Liability

When resident VAT payers receive goods locally from non-established persons, they will bear the VAT liability. For instance, if a foreign company with no registered seat or establishment in the Czech Republic supplies goods to a VAT registered tax resident, with the transaction taking place in the CR, the tax liability is transferred from the supplier to the tax resident / customer. This is limited to transactions between non-established suppliers (not registered for VAT in the CR) and tax resident customers duly registered for VAT.

In cases of supplies made by entities who are non-established in the Czech Republic to Czech VAT residents, the VAT registered customer is liable to record the tax on the day of the transaction or on the day of the payment, whichever comes first (e.g. in the case of advance payment).

Example: A Czech company A, duly registered for VAT in the Czech Republic, buys production machinery from a German company B, which is not registered for taxes in the CR. At the time of the transaction, the machinery is in the CR and the transaction does not include transportation. The German company B issues an invoice excl. VAT in the reverse-charge mode, and the Czech company A records VAT and claims the deduction. The date of taxable supply is the date of delivery.

Compared to the former procedure, company B no longer needs to register as VAT payer in the Czech Republic, and the invoice does not need to include Czech VAT.

In relation to this amendment, non-established persons can apply to terminate their VAT registration within 6 months from the date the amendment comes into force, i.e. by the end of February 2017.

To terminate their VAT registration, such persons must had registered as VAT payers under obligation before the date the amendment came into force, i.e. by the end of August 2016, and must only supply goods locally to a Czech VAT payer.

No need for customs documents on exports

Another important change relates to the tax document on goods exported to third countries. Exporters will only need a standard invoice issued to the name of a foreign customer.

The decision of the customs office on the export to a third country will be considered a proof of the good's exit from the EU territory, especially when applying for tax exemption.

Some payers to be administered by the Ostrava Tax Authority

In view of the limited capacity of the Prague Tax Authority, subjects with no registered seat or establishment in the Czech Republic will be administered at the Moravia-Silesia Regional Tax Authority, Ostrava. This measure will affect 3700 international VAT payers.

International tax payers will be transferred to the Ostrava Tax Authority gradually during the next 12 months, i.e. by the end of August 2017.

Longer time to respond to notice

The amendment of the VAT Act allows tax payers a longer time to respond to notices to remove doubt issued by tax authorities regarding a submitted VAT ledger statement. The payer must respond within five work days (formerly five calendar days). This will give tax payers more time to respond, especially in cases of public holidays or vacation.

Milder sanctions related to VAT ledger statements

Failure to submit a VAT ledger statement is subject to special fines. These are stipulated by law (*ex lege*), with a fixed amount:

- failure to submit a VAT ledger statement with subsequent spontaneous rectification – CZK 1 000;
- failure to submit a VAT ledger statement with subsequent rectification upon request – CZK 10 000;
- no response to request for rectification – CZK 30 000;
- failure to submit a VAT ledger statement upon request – CZK 50 000.

The CZK 1 000 fine will no longer apply to the first case of default in a calendar year. The payer is entitled to this exemption automatically, with no need to apply for remission. Moreover, all CZK 1 000 fines prescribed before 31 August 2016 were pardoned by the amendment and will not be requested again.

In the case of CZK 10 000; 30 000; and 50 000 fines, the payer will newly have the right to apply for remission. The tax payer can submit an application to the tax authority requesting partial or complete remission of the fine. The application fee shall be CZK 1 000.

When assessing the application, the tax authority is bound to follow the valid stipulations of the Tax Code, as well as the new directive issued by the General Financial Directorate. They will assess the frequency of tax management failures (i.e. not only the kind of failure to which the fine applies) and the reasons for not submitting the VAT ledger statements and/or not reacting to requests (e.g. health condition).

Tax payers who have seriously broken the tax or accounting rules within the last 3 years will not be eligible for the remission.

The application must be submitted within three months from the day the payment order requesting the fine has come into force.

Intrastat – change of exchange rate selection

In relation to the amendment to the Customs Act No. 242/2016 Coll., we would like you to note the new government decree No. 244/2016 Coll., on implementing some of the stipulations of the Customs Act, especially as relates to the Intrastat reports in the Czech Republic.

From August 2016, the Intrastat reports must calculate the foreign currency value using the VAT exchange rate. Up to July 2016, the reports used the customs exchange rate. The August report is the first to use the VAT exchange rate.

We recommend to modify your internal directives for foreign currency exchanges accordingly.



IMMOVABLE PROPERTY ACQUISITION TAX

Introduction

Act No. 254/2016 Coll. introduces a significant change in the immovable property acquisition tax liability from 1 November 2016. Until then, the tax can be paid either by the buyer or the seller. The new regulation explicitly specifies the purchaser as the liable person.

The new rules will only apply to transfers made after 1 November 2016.

Exemptions and guide values

The new act also limits the tax exemption on new flats and family houses only to completed buildings. Acquisitions of unfinished flats or family houses for a consideration will no longer be exempt from immovable property acquisition tax.

Guide values can newly be used to determine the price of land for which there is no right to build, even if there are weed trees (unwanted tree vegetation), hedges, fences or paved surfaces of up to 25 sq. m.

This will remove the need for an expert opinion in these cases.

Transfer of utilities

The tax shall newly apply only to (non-gratuitous) acquisition of buildings, or a share in such buildings, in the Czech Republic, which are connected to utilities.

The remaining parts of utilities, e.g. pipes or cables, shall not be subject to immovable property acquisition tax.

PERSONAL INCOME TAX

Taxation of old age pensioners

The plenary session of the Constitutional Court endorsed the proposal of 17 Senators to abolish the stipulations of the Income Tax Act which taxed the pensions for old age pensioners with gross annual income exceeding CZK 840 000.

In view of the need for legal certainty, the Constitutional Court deemed this stipulation inapplicable for the year 2016 as a whole.

We should therefore expect further discussion on the taxation of old age pensions in 2015, as the disputed stipulation was applied also in that year.

Remission of sanction for unreported income

In late June 2016, the General Financial Directorate issued an instruction specifying the criteria for judging applications for remission of sanctions for not reporting tax-exempt income. From 2015, persons with annual tax-exempt income exceeding CZK 5 million are obliged to report this income by the tax return due date.

The new regulation instructs tax authorities to remit a substantial part of the sanction in cases of delayed reporting, and some part also in cases of reporting upon notice. Should the failure to duly report the income be caused by health condition, the tax authorities are instructed to remit the sanction completely.

CASE LAW ON GRATUITOUS INCOME

Court rulings, especially from the Supreme Administrative Court, concerning tax laws represent a vital source of information on how to interpret the complex stipulations of tax laws and directives, especially in view of the fact that the understandings of tax payers and tax authorities frequently differ.

One of the rulings of this summer relates to a topic discussed in our last Tax Fresh – the tax consequences of gratuitous income.

In one of its last closed cases, No. 7 Afs 31/2016, the Supreme Administrative Court studied a situation in which a partner donated immovable property to his company based on a donation agreement. The relevant tax authority requalified the act as non-gratuitous transfer of immovable property, which is subject to immovable property acquisition tax.

The court backed the interpretation of the tax authority, especially for the following reasons:

- formal donation agreement cannot be decisive for the selection of tax mode (the principle of material truth)
- the transaction would be tax-exempt only if it was truly gratuitous; in this case, the transaction was considered non-gratuitous because by transferring the title to the immovable property to his company, the partner increased the value of his financial investment, which was deemed, by both the tax authority and the court, to represent consideration (remuneration).

The ruling included the following explanation:

If the plaintiff (PROXY note: the partner) later alienated his share in the joint-stock company (PROXY note: the recipient company), he acquired profit, including profit for the alienated immovable property, which he would not acquire by alienating his shares “

We believe this ruling considerably widens the scope of criteria that can be used to assess whether a legal act can or cannot be regarded as gratuitous income, with all related tax consequences, not only in the area of immovable property acquisitions.

This ruling puts all transfers from partners towards their companies on thin ice in terms of justified qualification as gratuitous income.



CASE LAW ON PROCEDURE TO REMOVE DOUBT

Frequently used especially in the field of VAT, the procedure to remove doubt (*postup k odstranění pochybností, POP*) was introduced in the Tax Code to replace the former tax review procedure (*vytýkací řízení*). Although it was intended to give tax authorities a quick and flexible tool for tax return review and prompt elimination of ambiguities which could hinder VAT refunds, the real experience shows many cases in which POP is used by tax authorities to withhold high VAT refunds for an unreasonably long time, which could have fatal consequences for the affected entrepreneurs.

Doubts expressed by the tax authorities within POP (unlike in standard tax inspection) must be specific and clearly formulated. POPs initiated by vague requests for elimination of ambiguity might be questioned for legitimacy.

One of the last rulings of the Supreme Administrative Court, No. 8 Afs 76/2015-58, addresses the level of specificity of tax authorities' requests, and specifies valuable examples of specific and vague (i.e. legally defective) requests.

The following requests are considered specific:

- The entrepreneur had no employees but reported output supplies of approximately CZK 1 mil. Who did the work?
- The amount of input and output taxable supplies was considerably higher than in recent taxable periods.
- Claim for refund on an invoice from an entity that has only a formal seat, does not communicate with the locally competent tax authority and does not file tax returns.
- Increase in economic activity of a tax payer with the seat at a shared address and with no registered business establishment for real economic activity.

Vague requests, i.e. legally questionable, include e.g.:

- General question about a high value of transactions indicated in a specific line of the tax return, or simply about a high refund value.
- Request for a complete VAT ledger kept under Article 100 of the VAT Act, or the complete accounting books of the tax payer.
- General request to prove legal grounds for the data included in the tax return, and/or to present complete records for the whole tax period, including all relevant documents considered in the calculation of the tax base (invoices, contracts, orders, receipts, Uniform Customs Declaration, bank account statements, etc.).

When launching any kind of tax procedure, it is advisable to consider both one's rights and duties, as the rights give you a powerful protection tool. The goal of any tax procedure is not to penalise, but to achieve a fair distribution of rights and duties between the tax authority and the taxpayer, ultimately leading to a correct determination of the taxes, which is beneficial (surprisingly for some) both for the tax authority and the tax payer.

Should you experience any problems in your dealings with the tax authority, do not hesitate to contact us.

TRANSFER PRICE INSPECTIONS

Statistics of the number of inspections and the value of additionally assessed taxes show that the Czech tax authorities currently focus predominantly on inspections of transfer prices. The Finance Minister officially announced an "Action Plan for Transfer Price Inspections".

Year	Number of inspections of arm's length prices	Additional income tax (CZK)
2013	282	71 759 104
2014	339	59 402 410
2015	800	446 183 957

Source: General Financial Directorate

The Appendix on Transactions with Related Entities, which has been a compulsory part of corporate income tax returns since 2014, provides tax authorities with a valuable tool for identification of subjects to inspect.

Tax authorities focus especially on the following conditions:

- companies that repeatedly record a loss;
- companies that have taken part in restructuring;
- companies that have been granted investment incentives;
- certain kinds of transactions with a related entities, e.g. managerial services, licence fees, interests;
- companies with high turnover and low profit.

In terms of preparation for the inspection, it is important to note the short periods granted for presenting means of proof to tax auditors.

It is most advisable to have all the means of proof ready for the possible inspection, instead of preparing them upon notice. The processes related to transfer prices are rather specific, which can make the preparation for the inspection of transfer prices very time consuming.

ADDITION TO PROXY CONSULTANCY TEAM

We are happy to announce that Ing. Vojtěch Souček joined our České Budějovice tax consultancy team in September.

Mr. Souček specialises in tax consultancy for business corporations, especially in corporate income tax. Vojtěch Souček graduated from the University of Economics, Prague, and has been a tax advisor since 2011. He speaks Czech and English. He likes sports and travelling, and takes interest in the Czechoslovak history of the 20th century.





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