



TAX FRESH

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 **TAX NEWS
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Dear Business Friends,

Although with the arrival of July, we have entered a period which for many of us is the time of holidays when it is not customary to deal with amendments to tax legislation, this year is a little bit special in this respect. The reason is that a law amending the tax legislation came into effect as of 1 July 2017. We are therefore presenting you with some of these changes in our summer issue.

And because it is now already the holidays, we would like to wish you a great summer and say goodbye with the following quote of Albert Einstein: *"The Hardest Thing in the World to Understand is Income Taxes"*.

Yours faithfully,

Šárka Adámková
Tax partner

Ladislav Dědeček
Tax partner

HLB PROXY
Audit & Tax Services

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Provision on interest on excess deduction amended again

The extensive amendment to the tax laws in 2017 does not avoid the Tax Code (TC). From the perspective of taxable entities, the most important point is the amendment to Section 254a of the TC, which regulates interest on excess deduction.

The current wording of Section 254a of the TC entitles the taxable entity to interest on excess deduction in situations where the procedure for the removal of doubt (relating to the tax return, from which it follows that a tax deduction should arise to the taxable entity) lasts longer than 5 months. The amount of interest is stipulated as a repo rate of the Czech National Bank (CNB) increased by 1 percentage point (i.e. 1.05% p.a. until 30 June 2017).

The Financial Administration has now amended this provision in response to the related judicial practice of the Court of Justice of the EU (CJEU). It grants the taxable entity more favourable conditions than those assigned to them by the current wording of the law.

Pursuant to the amendment, the taxable entity should be entitled to interest on the tax deduction established by the tax administrator from the day following the expiry of the period of 4 months elapsed from the last day of the period prescribed for the submission of the regular or additional tax return, but no later than until the expiry of the time limit for its refund. At the same time, the amount of the surcharge to the CNB's repo rate is increased to 2 percentage points (i.e. to 2.05% p.a. from 1 July 2017).

The above mentioned four month period ceases to run in specific situations (e.g. if the financial authority is waiting for a statement of the tax payer) and thus the period can sometimes be even longer in practise.

The Czech Republic signed the Multilateral Instrument against tax optimisation

On 7 June 2017, the Czech Republic, as well as another 67 states, signed the Multilateral Instrument (MLI), the objective of which is to implement the BEPS measures to prevent the abuse of treaties on avoidance of double taxation. It contains two types of provisions:

- (i) Minimum standards – these must be contained in all double taxation treaties; and
- (ii) Optional provisions – the application of which depends on the agreement of the contracting parties, and in case of their consensus they need not be introduced.

The Czech Republic has only adopted the minimum standards, i.e. the anti-abuse rule for bilateral treaties ("Principal Purpose Test – PPT") and a more efficient settlement of tax disputes by agreement ("Dispute Resolution").

However, the question remains whether the amendment proposed and approved by the legislators has actually brought about the state that the financial administration defined in the statement of reasons, i.e. "that the legislation is clear, predictable and comprehensible and does not give cause for legal disputes".

In our opinion, this is not the case. **The time and amount of interest that is awarded to the taxable entity are not, in our opinion, compatible with the CJEU's judicial practice** because:

- (i) according to it, the taxable entity should not suffer without compensation for even a single day (see decisions of the CJEU C 286/94 GarageMolenheide, paragraphs 63 and 64 and C 107/10 Enel Maritsa Iztok 3 AD, paragraph 51); and
- (ii) the amount of interest should be a sufficient (!) financial compensation for the fact that the taxable entity was not able to handle their funds for a certain period of time. However, at its current rate of 2.05% the interest cannot fulfil the function of economic compensation.

Last but not least, there is a significant discrepancy between the compensation granted to taxpayers by the Czech courts in the early beginnings of the concept of interest on tax deduction, when the Supreme Administrative Court then considered as fair compensation an interest rate of 14.05% p.a. (for proceedings before 1 January 2015).

Even the Chamber of Tax Advisers had objections within the legislative process to the above points, but they were not accepted by the financial administration. All that remains to do is to believe that in the context of the next amendment to the TC, the financial administration will be more willing to listen to these objections.

Thus we have taken a minimalist and generally a rather tepid attitude towards the MLI. From among other countries, e.g. Switzerland has a comparable approach.

In practice, only Articles 6 (= real estate income), 7 (= profits of businesses) and 16 (= artists and athletes) are to be updated in the relevant contracts.

The text of the instrument can be found on the OECD website.

In this connection, a press release was also issued by the Ministry of Finance.

Pay attention to the correct application of the tax benefit to the second, third and each additional child

Act No. 170/2017 was promulgated in the Collection of Laws on 16 June 2017. In this law it is mistakenly stated that it is effective from 1 April 2017, since the lawmakers forgot to change the effective date. According to the interpretation using the rule in Section 3 of Act No. 309/1999 Coll., on the Collection of Laws and the Collection of International Treaties, this law becomes effective on the 15th day after its publication in the Collection of Laws, i.e. **1 July 2017**. The Ministry of Finance has promised to publish this information.

For payroll accountants this means that when **calculating the wages for July 2017** they will be able to already apply the tax advantage according to the new conditions, namely:

CZK 19,404 per year / CZK 1,617 per month for the second child

CZK 24,204 per year / CZK 2,017 per month for the third and any additional child.

Tax deductibility of tax withheld abroad beyond the framework of the double taxation treaty

In practice it happens that when paying the remuneration for the benefit of a taxpayer (a Czech tax resident) the foreign taxpayer deducts the income tax in a higher amount than is allowed by the relevant double taxation treaty (DTT).

Apart from cases of failure to meet the conditions for the application of the benefits from the DTT, there are cases in practice where the income source country applies a refund system, i.e. applies a tax rate according to the national law, and returns the tax only upon a request submitted by the Czech taxpayer.

With regard to the administrative costs associated with the submission of the request for tax refund and/or with the proof of the conditions for the application of a lower tax rate according to the DTT that reach or exceed the amount of the expected tax refund, the refund of the tax withheld abroad beyond the framework of the DTT is often not applied for.

In practice, there were problems with the tax deductibility of the tax withheld abroad beyond the DTT, which the Czech taxpayer recorded as an accounting expense.

This issue was dealt with at a recent joint meeting of the General Financial Directorate and the Chamber of Tax Advisors of the Czech Republic (Coordination Committee No. 497/22.03.17), at which the representatives of the financial administration rejected the opinions that the expense in question is tax deductible.

The annual amount of the tax advantage can only be applied within the annual settlement or within the filing of the income tax return of natural persons.

In addition to all this information relating to payroll accountants, on 21 June 2017 the President of the Czech Republic signed an amendment to the Income Tax Act (senate print No.115/0, parliamentary print No. 854), which includes, inter alia, an increase in the tax benefit for the first child. This law will be effective from January 2018.

Starting from January 2018, a taxpayer who is entitled to a tax benefit for the first child will be entitled to a tax allowance of CZK 15,204 per year / CZK 1,267 per month (currently CZK 13,404 per year / CZK 1,117 per month).

One of the many arguments presented by the financial administration was the view that the taxable entity could otherwise abuse this option, i.e. claim the tax in the Czech Republic as a tax-deductible expense and then request a refund of the tax abroad.

If in accordance with the legislation of the source state, the taxable entity is subject to higher taxation than allowed by the DTT, the benefits arising from the relevant DTT can only be applied in the source country through a request for a tax refund rather than reducing the Czech income tax base.



Latest information from the financial administration

The General Financial Directorate (GFD) recently issued the following interpretative opinions and information, to which we would like to draw your attention:

Interpretative opinions

The GFD recently published two interesting opinions, the aim of which is to respond to the inconsistency between the intention of the legislator and the wording of the law. The first opinion concerns the impossibility of exempting from real estate transfer tax the transfer of housing units in other than new constructions of residential buildings (this particularly affects the transfers of units in new constructions of family houses); the other concerns the taxation of personal income from the operation of photovoltaic power plants (in all cases where electricity is supplied to the electricity grid, the GFD classifies the revenue from such a photovoltaic power plant as income from business). The essential fact is that in the past the financial administration has also applied a different approach than the one that arises from the interpretative opinions.

News – information

Information on the extension of the tax liability transfer mode

With regard to the effect of the amendment to the VAT Act from 1 July 2017, in the context of which the so-called “permanent” application of the tax liability transfer mode to selected taxable transactions occurs, the GFD published new information on the issue on its website.

In this respect, we point out that starting from 1 July 2017 the domestic Reverse Charge System for the supply of staff engaged in construction and assembling work applies. At the same time, we remind you that the domestic Reverse Charge System had already been applicable when construction and assembling works were provided.

The Czech Ministry of Labour and Social Affairs has confirmed that the term “supply of staff” can be interpreted as brokering of employment according to the Act on Employment.

UBER service

According to the information from the GFD, persons operating a taxi service using the UBER application are taxable persons from the perspective of VAT, regardless of whether they have a licence to operate a taxi service or not. The GFD's information also includes details on the application of the Income Tax Act (according to the interpretation of the financial administration, this activity shows signs of a business activity) and the Road Tax Act.



PROXY, a.s. / PROXY – AUDIT, s.r.o.

PRAGUE

Plzeňská 3217/16, CZ-150 00 Prague 5

Tel.: 00420/296 332 411

Fax: 00420/296 332 490

E-mail: office@proxy.cz



PROXY, a.s. / PROXY – AUDIT, s.r.o.

ČESKÉ BUDĚJOVICE

nám. Přemysla Otakara II. / 36, CZ-370 01
České Budějovice

Tel.: 00420/386 100 011

Fax: 00420/386 100 022

E-mail: office@proxycb.cz

www.proxy.cz www.hlb.com