TAX FRESH

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Dear Business Friends,

In this issue of our Bulletin we have prepared for you an overview of the most important changes that have occurred in the VAT Act and the Income Tax Act. We would also like to draw your attention to the amendment to the International Cooperation Act – Country by Country Reporting.

Our employees are still available to you at any time.

Yours faithfully,

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AMENDMENT TO TAX LAWS FROM 1 JULY 2017

The VAT Act – the most important changes effective from 1 July 2017

Place of performance when providing services related to real estate (Section 10)
The amendment redefines the term "service related to immovable property". It follows from the definition that such a service is a service that has "a sufficient direct connection with the immovable property" in the context of the Council Implementing Regulation (EU) No. 282/2011).

Right to deduct in the acquisition of goods with a specified place of performance according to the buyer's Tax ID (Section 11(2))
If in the acquisition of goods from another Member State, the Czech Republic is not the place of taxable transaction due to termination of transport, but due to the buyer's provided Czech Tax ID, the buyer shall not be entitled to claim the deduction in the Czech Republic.

This change is a response to the judgment of the European Court of Justice C 536/08 and C 539/08 (Facet – Facet Trading).

Obligation to make a tax return at the time of payment (Section 20a(2))
The amendment specifies that the obligation to make a tax return upon receipt of a payment before the taxable transaction takes place shall arise only if the goods or service concerned, the rate of tax and the place of performance are sufficiently known as at the date of receipt of the payment.

Carrying out taxable transaction (Section 21)
In the case of goods, the taxable transaction is deemed to be executed on the date of the change in economic ownership (i.e. "the date on which the transfer of the right to dispose of the goods as the owner takes place").

Date of taxable transaction (Section 21)
The amendment cancels the specific provision on the date of taxable transaction for repeated transactions and transfer of rights. For long-term transactions with the place of execution in the Czech Republic, which last longer than 12 months, the taxable transaction is carried out no later than the last day of the calendar year following the year in which the transaction commenced.

Correction of tax base (Section 42)
The amendment extends the time limit for the correction of the tax base and the amount of the tax for financial lease and for partial performance under a contract for work. The time limit is now 3 years from the transfer of ownership in the case of a lease / acceptance of work in the case of a contract for work.

VAT on shortfalls and damage (Sections 77 and 78e)
An explicit obligation arises to adjust additionally the VAT deduction for fixed assets – or as appropriate, to settle the deduction for current assets – in the case of their destruction, loss or theft, if this is not properly documented and confirmed. It is necessary to monitor the amount of settlement/adjustment separately for each type of business assets.

The taxpayer should also be able to assign the value of the initially applied deduction to any undocumented deficit or damage. The settlement/adjustment of the deduction should be made by the taxpayer on the date when they learned about these facts or when they should and could learn about them (i.e., the date of taxable transaction should be on the date of finding out the damage, but not later than on the date of inventory taking – evaluation of the results of inventory).

Reverse charge scheme (Section 92b – Section 92ea)
The amendment extended the reverse charge scheme to the following transactions:
- Provision of workers for construction and assembly work;
- Delivery of immovable property sold by the debtor in a public auction (as decided by the court);
- Delivery of goods provided as security when executing that security;
- Delivery of goods following the cession of the reservation of ownership to an assignee and the exercise of this right by the assignee (= delivery of the goods by the original buyer to a third party, which will use the right of reservation of ownership).

The reverse charge scheme shall be applied in these cases irrespective of the invoiced value.

Income Tax Act – changes effective from 1 July 2017

Financial lease
The amendment excluded from the possible subject of financial lease assets that are non-depreciated for tax purposes and intangible assets. The changes brought by the amendment will be applied to contracts, on the basis of which the subject of lease was rendered to the user after 1 July 2017.

Input price and cash gifts
A gift in cash provided for the acquisition of tangible assets or their technical improvement reduces the input price of the assets. Accordingly, this cash gift will be excluded from the tax base (= from taxable income).

Sale of share in a business corporation
According to the original version of the Act, exempting the income of a natural person in the sale of a share in a business corporation could not be applied in the case of sale of a share acquired as a result of the deposit of a partner in favour of equity capital made up to 5 years prior to the sale (an example of such a transaction may be the deposit of monetary capital in other capital funds). After the amendment, this restriction will only apply to deposits in non-monetary form.

Income Tax Act – changes effective from the tax period 2018, however, with relation to the year 2017

Maximum amount of flat-rate expenses for the self-employed
Natural persons – the self-employed may choose, when applying the flat-rate expenses for the tax period 2017, whether to apply the higher flat expense rate effective in 2016 without the possibility of applying a tax benefit on children and a discount on wife without own income, or whether to apply the flat rates effective from 1 January 2018 and apply the tax benefit including the discount.

The maximum amount of the new expense flat rates is:
- CZK 800,000 for income from agricultural production, forestry and water management and income from craft trade;
- CZK 600,000 for income from trade;
- CZK 400,000 for other income from independent activity;
- CZK 300,000 for income from the lease of property, even in the case of assets included in commercial property.

Extending the period of depreciation of intangible assets
The amendment gives the possibility of prolonging the period of depreciation of intangible assets, as the Act now stipulates the period of depreciation of intangible assets as a minimum period. The taxpayers will therefore be able to extend it at their discretion.

The provision can be applied to assets for which the depreciation commenced on 1 July 2017 or later.

Withholding tax
According to the amendment, each advance paid on income from which tax is withheld at a special rate, or supplementary payment from the statement of account of total performance, is regarded as a separate income. This principle should start to be applied to income that falls within the period 2018 or, as appropriate, already from 1 July 2017 or later, if the tax period is a business year.

The new approach should in principle be applied in the relation of the income to the taxpayer's tax period, not in relation to the moment when the obligation to withheld the tax arises.

Depreciation of technical improvement by a wider circle of taxpayers
Technical improvement ("TI") may now be depreciated also by the sub-lessee (in the words of the amendment, the taxpayer to whom the property was rendered for use). The conditions for the application of tax depreciation are similar to those of the lessee:
- TI was paid by a taxpayer who has the right to use the property on which the taxpayer carried out technical improvement;
- The taxpayer carried out the TI and applies the tax depreciation with the written consent of the owner;
- The owner of the tangible property did not increase its input price by the TI carried out;
- The depreciated TI is included in the same depreciation group as the appreciated property.

The above provision may be applied to tax depreciation of finished technical improvement after the item was fit for normal use starting from 1 July 2017.

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OTHER NEWS

The (im)possibility of partial tax assessment

The issue of partial tax assessment has been discussed in the past in particular in connection with the earlier refunding of the undisputed part VAT deduction. The taxpayers' hopes for a faster refund of their money from the State have now perished, because the Supreme Administrative Court (6 Afs 264/2016-44) rejected the possibility of partial assessment and partial refund of the undisputed part of excess deduction.

In October 2016, the Regional Court in Prague issued a judgment that allowed the possibility of a partial decision (i.e. the issue of a partial payment assessment) for the undisputed part VAT deduction. However, the financial administration did not agree with this view and pointed out the possible subsequent complications (e.g. the relation of the final and the "partial" decisions, application of ordinary and extraordinary remedies, or whether the partial decision can be issued by the tax administrator ex officio or on request only, and the passing of the time limits for determining and paying the taxes, etc.).

The whole issue was eventually brought before the Supreme Administrative Court ("SAC"), which agreed in this case with the financial administration. The SAC concluded the case so that the current tax procedure legislation does not allow partial tax assessment.

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Tax on the acquisition of real estate and VAT in the light of the Supreme Administrative Court's judgement

Recently, the Supreme Administrative Court ("SAC") ruled in a dispute, the subject of which was the question of whether the tax base from the acquisition of immovable property according to the agreed price should include the relevant VAT or not. The outcome of the whole case is favourable to taxpayers and, at the same time, a surprise for the professional public, as the SAC in it changed in relation to the disputed question the existing administrative practice.

In the disputed case, the taxpayer filed an amended tax return for the acquisition of immovable property where, as the basis for calculating the tax, the taxpayer stated the agreed price in the relevant amount without VAT, while the total purchase price in the relevant amount including VAT was stated in the purchase contract (on the basis of which the transfer took place). The taxpayer (in the position of the plaintiff) defended its procedure by claiming that the Senate's statutory measure[1] governing the tax on the acquisition of immovable property basically is not and in its meaning differ from the Triple Tax Act[2] which governed the real estate transfer tax prior to the effective date of the statutory measure. Therefore, it is in principle possible to apply the judicial practice that factually applies to the Triple Tax Act. According to this judicial practice, only the financial proceeds from the transfer of immovable property are subject to tax, and not the VAT paid to the State budget.

The tax office disagreed with this interpretation and argued that the Senate's statutory measure defined the subject of the tax in relation to the agreed price differently. It further argued that in the present dispute, it is not even relevant to apply the judicial practice relating to the Triple Tax Act.

The dispute between the two parties about the correct determination of the tax base has eventually come to the SAC, which took the taxpayer's side.

- The SAC insists on its existing judicial practice according to which **a change in legislation generally does not rule out the applicability of the judicial practice to previous legislation, especially if it is similar or maintains the same meaning and purpose.** Thus, in the present case, the judicial practice relating to the Triple Tax Act may be used;
- Following this conclusion, the SAC has used in deciding the disputed question its own judicial practice as well as the judicial practice of the Constitutional Court, according to which "***the intention of the legislator is to impose a burden on the value of the transferred real estate because what is taxed are the financial proceeds from the sale of the real estate achieved by the transfer or the achievable financial proceeds, if the agreed price is lower than the price ascertained***";
- In relation to this fact, the SAC stated that the core of the real estate transfer tax is the taxation of the value of the transferred property and the proceeds from its sale achieved by the transferor. However, the VAT, which was part of the purchase price of the transferred property, cannot be considered a part of the transferor's financial proceeds. Within a transaction subject to VAT, the taxpayer collects this tax as part of the purchase price and then transfers it to the State budget under the conditions set out in the VAT Act;
- In addition, if the plaintiff were obliged to include VAT in the tax base determined based on the agreed price, the plaintiff would be disadvantaged in relation to entities who need not pay this tax (i.e. sellers, who are not VAT payers). This would undoubtedly undermine the principle of tax neutrality.

[1] Statutory measure of the Senate No. 340/2013 Coll.
[2] Act No. 357/1992 Coll., on the inheritance, gift and real estate transfer taxes

Although in the next part, the SAC admitted the possibility of the interpretation advocated by the tax office (in particular on the basis of the explanatory memorandum, which foresees the inclusion of VAT in the tax base, but does not explain this procedure further), however, following the principle of *"in dubio pro libertate"*,[3] it concluded that **in the case under examination is not possible to include VAT in the agreed price, which formed the basis for the tax on the acquisition of immovable property.** [3]

This judgment could be used by companies that in the last three years have submitted tax returns for the acquisition of immovable property and as the tax base determined according to the agreed price reported an amount including VAT (i.e. they paid tax based on a higher tax base). If you need any professional assistance in this matter, please, do not hesitate to contact us.

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Amendment to Act No. 164/2013 on international cooperation – Country by Country Reporting

Based on the European law, the Czech Republic is obliged to introduce into its system a new type of report, which will give tax administrations a better overview of the functioning of the entire multinational enterprise group, the so-called Country by Country Reporting. Based on the information from these reports, the tax administrations will evaluate, on which entities in the group they will focus, e.g. when setting transfer prices.

These reports will annually provide information on the amount of revenue (broken down into transactions with related and unrelated entities), profit before tax, income tax paid and payable, number of employees, amount of registered capital, etc.

In addition, each entity should be identified within the group that carries out business activities. The regulation will apply only to those multinational enterprise groups in which there is at least one member entity, which is subject to taxation due to its seat or management address in the Czech Republic and for which the value of consolidated revenues for the immediately preceding accounting period exceeds EUR 750,000,000 (approx. CZK 20 billion).

In the case of exceeding the specified turnover, these reports will be submitted to the tax administrators by the parent companies. In the Czech Republic, therefore, this obligation will apply only to a very limited number of companies (15 companies are assumed).

The template of the county by country report and the instructions for its completion will be published in a separate decree. For Czech subsidiaries, the implemented directive will have an impact rather from the point of view of reporting this information to the foreign parent company.

What is the duty that may impact on most Czech corporations that are part of international groups?

It will be the so-called Notification:

In order for the tax administrators to have information about which state or jurisdiction the country by country reporting will be submitted in, the DAC IV directive requires that the member entities of the multinational enterprise groups submit to the tax administrator a **notification**, in which these data will be indicated.

This notification should be submitted by the end of the accounting period for which the country by country reporting will be compiled. Due to the late effective date of the Act, there is an exemption applicable for the accounting periods ending by 31 October 2017. In these cases, the notification must be submitted by **31 October 2017**.

The notification is submitted just once; only in the case of a change of the entity that will make the country by country reporting for the group, it is necessary to report this change to the tax administrator within 15 days.

Administration of the agenda

The country by country reports and notifications will be submitted to the specialised tax office on a prescribed form by means of data messages with a recognised electronic signature or the verified identity of the submitter in the manner that is used to log in to the data box. The submission will be carried out through the EPO application. The General Financial Directorate will then provide the international automatic exchange of these reports.

The Czech parent companies that fail to comply with their reporting obligations may be ordered to pay a disciplinary penalty of up to CZK 1,500,000, and the Czech member entities of multinational enterprise groups may be ordered in the case of non-compliance to pay a disciplinary penalty of up to CZK 600,000.

Although the DAC IV Directive was to be implemented by 4 June 2017, the amendment to the law was approved only on 16 August 2017. However, the amended or new provisions will be applied primarily to the parent companies for the accounting periods beginning on 1 January 2016.

[3] In translation "where there is doubt, liberty should prevail"

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