TAX FRESH

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Dear Business Friends,

In the latest issue of this Newsletter, we would like to draw your attention to the news that was approved or decided before the end of the year. This include, for example, a registration in the Real Owner's Records, Country-by-Country Reporting or a new reporting requirement concerning income paid abroad but exempt from tax in the Czech Republic. On the contrary, the extension of a domestic reverse charge system (transfer of tax liability from supplier to customer) has not been approved yet.

Otherwise, we would like to thank all of you for the favour you are giving us, and we look forward to further cooperation in the new year.

Yours faithfully,

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Actual Owners Records – continuation

To follow up regarding the previous issue of our newsletter, we would like to add that records of actual owners will need to contain all details valid beginning from 1 January 2018 (including those which are no longer current as of today's date).

In the event of a subsequent change of the actual owner, it will be necessary to have this change made in the records without undue delay (in practice this is reflected within approximately 1 week from the date of the change).

We also hereby add that despite the fact that the current wording of the Anti-Money-Laundering Act does not include any sanctions for non-disclosure of the actual owner of an enterprise, we would like to draw your attention to the Act on Misdemeanours, according to which a corporation shall be considered to have committed a misdemeanour even if it fails to submit a request for registration, change or deletion of remarks recorded in other records. Such misdemeanour is punishable by a fine of up to CZK 100,000.

Therefore, in practice it cannot be ruled out that certain administrative bodies will proceed in accordance with the Act on Misdemeanours when failing to fulfil obligations relating to record keeping.

Country-by-Country Reporting

Based on the Act on International Cooperation in Tax Administration, a new obligation was implemented in 2017 requiring submission of a notification specifying the highest positioned parent company and the company submitting the country-by-country reporting for the entire group to its tax administrator. The respective notification would need to be submitted to the tax administrator by the end of October 2017.

The notification is submitted by the company to the Czech tax administrator only once. However, if there is a change to reported details (such as a change in the highest parent company or a change in its identification details), then it will be necessary to submit a new notification within 15 days from the date when the reported change has occurred.

If there has been a change to the highest parent company or if a company other than the parent company has already submitted a filing for the entire group for 2018, then we will be pleased to prepare a new notification for you.

Generalised reverse charge mechanism

Although the Economic and Financial affairs Council of EU states (ECOFIN) at its October session approved the option of time limited implementation of a domestic reverse charge system (transfer of VAT liability from supplier to customer) for all taxable supplies if for a single instance of taxable supplies the value of EUR 17,500 is exceeded, we hereby point out in relation to this that the implementation of this system in tax practice in the Czech Republic is not yet certain.

Individual EU member states may implement this system, but only by 30 June 2022, under very strict technical conditions. For example, they must prove that the share of carousel fraud amounts to more than 25% of the shortage of VAT revenue or that tax evasion cannot be combated using regular measures such as a control statement.

For this reason, it is not yet, despite media presentations of representatives of the Ministry of Finance, clear that the generalised implementation of a domestic reverse charge system will be implemented in the tax environment in the Czech Republic.

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Supreme Administrative Court's verdict - fulfilment for employees of third parties from the point of view of statutory insurance premiums.

The interesting current verdict of the Supreme Administrative Court is a verdict related to an assessment of **whether fulfilment (remuneration, benefits) from third parties who are not direct employers of employees are subject to health insurance and social security premiums.**

In the specific case, ČSOB agreed with the Czech Postal Service on a contract for providing of financial products which would be offered by Czech post office employees as part of their fulfilment of their work duties as postal service employees. No contractual arrangements existed between employees and ČSOB. For the purpose of raising motivation of Czech post office employees and with a permission of Czech Postal Service, ČSOB has provided various non-monetary prizes for Czech post office employees' sales achievements. From these benefits provided to foreign employees, ČSOB paid personal income tax on dependent activity but did not pay health insurance and social security premiums from this income, citing a differing definition of an employment in legislation governing insurance premiums. The tax office considered such approach improper.

The Supreme Administrative Court stated that fulfilment for legal employees of another entity in connection with their employment relationship under Section 6 (1) (d) of the Income Tax Act is subject to **personal income tax**, regardless of from whom they originate.

From the point of view of social security and health insurance premiums, the situation is different. According to Section 3 (1) of the Act on **Social Security Premiums**, premiums must be paid by employers who for the purposes of this Act shall be understood as corporations or individuals who employee at least one person. Employment shall be understood as activity of an employee for an employer, from which income from dependent activity stems or could stem**.**

The definition of the term Employer in the Act on Social Security Premiums in connection with the Act on Disability Insurance is based not only on the condition of the existence of taxable supplies stemming from the dependent activity but also on the condition that the income stems from employment, meaning from the employee's activity for the employer.

From the point of view of **health insurance**, except for the conditions of payment of income from the dependent activity as defined by the Income Tax Act, following to Section 3 (1) (b) of the Public Health Insurance Act, an employer is someone who employs employees. Also important in a tax matter is whether employees are engaged in any activity directly for a provider of income. In this particular case, this has not been sufficiently determined.

It can be stated in conclusion that if employees in connection with the dependent activities carried out for their employer receive monetary or non-monetary fulfilment from a third party without direct performance of activity for a third party, then such income is subject to income tax, but not to health insurance and social security premiums.

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Company Executive - VAT payer?

We would like to draw your attention to development in the area of taxation of Executives. The issue will need to be divided into two areas, the first of which relates to personal income tax and the second of which relates to VAT. At first glance, it is not clear that legislation regarding taxation of Executives could bring about significant complications in practice. Unfortunately, this is not so.

From the point of view of personal income tax, **remuneration for Executives** is taxed in the same manner as salaries and remuneration of employees, with citing of Section 6 (1) (c) of the Income Tax Act. For non-residents, this income is subject to withholding tax without a solidarity increase in taxation, regardless of from which country the Executive's activity is carried out (the approach is governed by the Article on Royalties in treaties on limitation of double taxation). Already the principle that an Executive is taxed in the Czech Republic as an employee - in a tax base for income from dependent activity - often prompts surprise among residents of other countries, because in other countries an Executive is often taxed as a self-employed person due to their independence and personal responsibility during performance of the position.

From a VAT point of view, however, complications arise in the Czech Republic depending on EU directives, jurisprudence of the EU Court of Justice and the Czech Supreme Administrative Court. There is uncertainty in the area of definition of economic activity for VAT purposes. **According to the current definition of the Czech VAT Act, economic activity is not activity of employees or activities of persons whose income is taxed as income from a dependent activity under the income tax act.** However, the Supreme Administrative Court, citing EU legislation and jurisprudence, summarised that if an Executive preform their activities on a fee, then it is necessary to view this activity as independent economic activity as defined by the directive and not to exclude it from the VAT system.

In practice, this means that if the Executive's remuneration would exceed CZK 1 million in no more than 12 consecutive month, the Executive would become a VAT payer under the VAT Act. **The draft legislative amendment for 2019 as a result of this jurisprudence has excluded from the definition of economic activities for the purposes of VAT the income from dependent activity under the Income Tax Act,** meaning that an Executive's remuneration would be subject to VAT if the limit of CZK 1 million is exceeded**.**

Other controversial areas are determination of the tax base from an Executive's remuneration (increasing by non-monetary benefits?), the technical approach in accounting, when an Executive's remuneration must "flow" through the system of wage processing, but also must enter into the VAT return and the control statement, along with several other corresponding problems. Following several discussions, submission of an amending proposal that could suspend the amendment in question has been pushed through successfully.

On the other hand, it is necessary to state that already now the definition of Czech VAT is at variance with the EU directive, and so Executives, who want to become VAT payers, have this option with the use of direct applicaiton of the directive.

New reporting requirement - Section 38da of the Income Tax Act

The amendment to the Income Tax Act for 2019 will enact a new notification requirement. This obligation applies to entities who pay income from the Czech Republic to a Czech tax non-resident (individual or corporation) and the income must be subject to withholding tax or it is the tax exempt income under the tax law or it is the income which, under an international treaty, is not subject to taxation in the Czech Republic. The new announcement replaces the current reporting regarding withholding tax applied on the income subject to taxation.

The scope of reported payments to the tax administrator is significantly expanded - **taxpayers will not report only a payment sent abroad from which the tax has been withheld, but also an income relieved from taxation.** The Czech Ministry of Finance explains the implementation of the new obligation by needing the data for mandatory cross-border exchange of information and also as a tool necessary for the control of unlawful tax optimisation.

The group of notified payments **may include dividends, licence fees, interest and also gratuitous income.** Untaxed payments would be subject to the notification, only if they exceed CZK 100,000 per month for one tax non-resident. According to the proposal, the effectiveness of a new notification obligation should arise directly after the amendment to the Income Tax Act takes effect. The notification will be issued electronically on a published form. In the notification, the payer is required to specify their identification details, the payment recipient's identification details and details regarding income, including the potential amount of withheld tax.

Tax base in the event of income from dependent activity, which is subject to foreign insurance premiums

On 6 December 2018, the President of the Czech Republic was asked to sign **an amendment to the Income Tax Act relating to the tax base in the event of income from dependent activity, which is subject to foreign insurance premiums.**

According to the current wording of Section 6 (12) of the Income Tax Act, the tax base in the event of income from dependent activity is **increased by an amount corresponding to the Czech amount of social security premiums** and contributions to state employment policy and premiums for public health insurance paid by the employer, even if the employee's income is subject to premiums paid under the legislation of another country. Income subject to foreign insurance premiums therefore are currently increased for taxation purposes by 34% (corresponding to would-be Czech insurance premiums).

After the President signs it, the amendment shall change the provisions of Section 6 (12) and income from dependent activity **subject to foreign insurance premiums** of the same type, which are governed by the legislation of another EU or EEA member state or Switzerland, **for the purposes of taxation of income resulting from dependent activity will be increased by foreign insurance premiums.** Such situation may result in a problem determining particular information in a specific country, so that taxation is implemented properly. Unfortunately, we are returning to the past, when such approach applied and brought major complications for taxpayers.

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