



## Tax&Legal Highlights

### Czech Republic

#### Planned Income Tax Changes for 2020

The Chamber of Deputies of the Czech Republic is currently debating two amendments to the Income Taxes Act (Act No. 586/1992 Coll., the Income Taxes Act, as amended), which may come into force in 2020. These amendments, parliamentary press nos. 572 and 509, bring the following proposals for changes.

#### **Change in taxation of interest income arising from bonds issued before 1 January 2013**

- The tax base for interest income arising from bonds issued before 1 January 2013 was rounded down to a whole Czech crown (so-called one-crown bonds). Subsequently, this treatment was changed when the tax on total income from one issuer started to be rounded. However, according to the transitional provisions, this adjustment did not affect interest income on bonds issued before 1 January 2013 (so-called one-crown bonds).
- Currently, a special transitional provision is proposed, removing this exemption for bonds issued before 1 January 2013 so that all interest income is rounded down on the level of the tax on total income from one issuer, regardless of the issue date of the bond. In practice, it

means that if the amendment is approved, the new rounding procedure will be applied to all bonds.

**Change in the method of creation and tax deductibility of technical provisions in insurance**

- According to the proposed amendment, insurance and reinsurance companies will newly take into account as tax-deductible expenses the creation of provisions pursuant to the Insurance Act, which is based on the Solvency II Directive and not technical provisions created according to the accounting legal regulations. Thus, technical provisions created according to the accounting legal regulations will no longer be considered as tax-deductible expenses. Another change in approach is that, as technical provisions created pursuant to the Insurance Act are not accounted for, the provisions in insurance will be reflected in the tax base in the form of non-accounting adjustments to profit or loss.
- The transition to the new system is expected to lead to a relatively large impact on the tax liability of insurance and reinsurance companies; therefore, transitional provisions are proposed to split this one-off tax liability into two taxation periods.

**Restrictions on the exemption of gambling winnings for natural persons**

- Newly, gambling winnings should be exempted from income tax only up to CZK 100,000 (for example Sazka, Sportka, including receipt lottery). Thus, a domestic operator that pays out a prize greater than CZK 100,000 will be obliged to withhold or collect tax on this income. In case of a prize from a similar foreign competition, this income is not reduced by tax-deductible expenses and the natural person has to state it in the tax return.

**Modifications following ATAD implementation**

- Avoid duplicating the inclusion of so-called capitalised interest in the calculation of the limit for the eligibility of borrowing costs (according to the proposal, it will be possible to apply it for taxation periods from 1 April 2019).
- Addressing the restriction on the deductibility of borrowing costs for partners in partnership companies – e.g. k.s. and v.o.s. (according to the proposal, it will be possible to apply it for the taxation periods from 1 April 2019).
- Setting the taxation treatment for the transfer of assets without change of ownership from another EU Member State to the Czech Republic for securities valued at fair value.
- New rules for taxation of a foreign controlled company in case such a company is held indirectly through a basic investment fund (according to the proposal, it will be possible to apply it for taxation periods from 1 April 2019).

**Other changes**

- In addition to municipalities and voluntary unions of municipalities, other public corporations such as regions and the state, or better the Czech Republic, are proposed to be considered as parent companies.

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- Definition and unification of terminology relating to international treaties (including double taxation law in relation to Taiwan).
- Clarification of the legislation when a taxable entity can claim the tax paid abroad as a tax-deductible expense.

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## Expansion of electronic sales records approaching

**On Friday 13 September, the Chamber of Deputies overrode the proposal of the Senate and approved the amendment to the Act on Electronic Sales Records. After more than one year in the Chamber of Deputies, the amendment is headed for the President's signature. The expansion of electronic sales records to include the remaining taxpayers can be expected no sooner than 1 April 2020.**

### **The amendment contains the following items:**

- The obligation to keep records will generally apply to all the remaining taxpayers from the third and fourth waves (sale of own products, provision of services).
- It introduces relief from the obligation to record sales for taxpayers performing activities in the area of social services, visually impaired entrepreneurs and sellers of fresh-water fish (only in the period from 18 December to 24 December). For technical reasons, the sales of prepaid telephone cards, commercial air transport and sales from gambling have been excluded from the records completely.
- Given the impossibility of review by supervisory bodies, taxpayers will no longer be required to record sales generated outside of the territory of the Czech Republic.
- The amendment brings back the obligation to include the tax ID on receipts. In line with the ruling of the Constitutional Court, this obligation applies only to situations where the taxpayer's tax ID does not include his or her personal ID number.
- Taxpayers with annual sales of less than CZK 600,000 will be allowed a special regime of sales records. This consists in the possibility of picking up a block of paper receipts at the local Tax Office, giving paper receipts to customers and submitting a quarterly report to the tax authority on the sales recorded under the special regime.

All companies that do not currently record sales and whose activities are not part of the above exceptions should think about how the amendment will affect them. The first step is to carefully analyse all transactions and find out whether they accept cash/bills of exchange/payments using various vouchers (even just exceptionally). If they do, it is necessary to get ready for the obligation to record sales. We will be happy to advise you on this

matter and help you find a practical solution for meeting the requirements of the amendment to the Act on Electronic Sales Records in your company.

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### Amendment to the Tax Code in the Legislative Process

**The amendment to the Tax Code, which was approved by the Government of the Czech Republic at the end of August 2019, promises changes in favour of taxable persons and modernisation of the tax administration. The amendment is presented by legislators under the name of MOJE daně, but in addition to the promised online banking in taxes, the amendment to the Tax Code also contains other process changes. Despite the fact that the amendment to the Tax Code proposed by the Ministry of Finance of the Czech Republic has now been approved by the Government of the Czech Republic, it still has the entire legislative process ahead. Taking into account possible complications, it can be assumed that the amendment may be effective in mid-2020.**

At the moment, we have to wait to see how the proposal will change during its legislative way and how long it will take to come into effect. The time and practice of taxable persons will show whether this is a step in the right direction and whether the launch of the technical solution is not rushed.

#### **So what makes the planned change so revolutionary?**

##### **Tax authority online**

The promised digitalisation of financial administration is a step towards modernising the system used by taxable persons. The vision of financial administration is clear: to make it easier for taxable persons to communicate with the tax administrator while reducing administrative burdens and making many other improvements. In practice, it means the introduction of a portal called MOJE daně, which is to extend the already available tax information box service. The current system allows the taxable entity to obtain selected but very limited information collected in the file and on the taxable entity's personal tax account using the internet. The Ministry highlights the importance of the meaning of the designation MOJE daně which is composed of the words modern (MOderní) and simple (JEdnoduché) and that is what the change should be like.

In addition to information, the new portal should also offer the possibility of active and passive communication with the tax administrator, for example, the possibility to submit tax returns via online forms, which will allow a certain amount of pre-filled data of taxable persons. However, communication should also work in the opposite direction from the tax administrator to the taxable entity in terms of delivery of documents. The Ministry of Finance estimates the launch of the portal in the last quarter of 2020.

### **Lower sanctions**

The amendment to the Tax Code contains a positive significant change for taxable persons, namely the revision of interest related to their new categorisation and its notable decrease. The Ministry of Finance expects the default interest to be reduced by 6% (from the current 14% p.a. plus the Czech National Bank's repo rate to 8% p.a. plus the Czech National Bank's repo rate). This change is also linked to a halving of the interest on the deferred payment.

### **Prepayments for VAT deduction**

The change concerning excessive VAT deductions for value added tax, for which the possibility of prepayments will be newly introduced, should also be helpful. The aim of this amendment is to prevent the phenomenon of retaining the entire excess VAT deduction, even if only a small part of it is examined and disputed by the tax administrator. The amendment includes the obligation to pay the amount of the excess deduction that is not disputed, ex officio. Thus, it will not be necessary to ask the tax administrator for a prepayment for tax deduction. However, following the introduction of prepayments for tax deductions, the amendment plans to extend the deadline for refunding VAT deduction to 45 days, which may have a significant negative cash flow impact. This is an extension of 15 days compared to the current situation to help the tax administrator assess which part of the deduction is disputed.

### **Changes in deadlines due to electronic submission and abolition of the 5-day "tolerance" limit for filing tax returns**

As part of the incentive to use the new system, the financial administration comes with an extension of the deadline for filing income tax returns by one month, in the case of filing the tax return electronically. However, a negative change for taxable persons is the interference with the established deadlines, which represents the abolition of the tolerance limit for filing the tax return, i.e. the current possibility of filing the tax return or paying the tax liability with a certain delay. Under the current rules, although the tax return is filed later (five working days are allowed for tax returns) or the tax is paid later (four working days are allowed for tax returns), the taxable person does not pay any financial penalty. Taxable persons use this tolerance limit either for subjective or objective reasons, when they were not able to file a tax return or pay their tax liability within the statutory period.

### **Other changes**

In addition to the changes outlined above, the amendment to the Tax Code contains other amendments to the relevant provisions. For example the following new rules were introduced:

- Change in the tax audit to allow the tax administrator to switch at any time from elimination of doubts to the tax audit. In the current legislation, this transition is only possible if longer evidence-taking is anticipated.
- To commence a tax audit, it will now be sufficient to deliver a notification on the commencement of a tax audit; a tax audit is currently commenced at a personal meeting.

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- A substantial change for state compensation in the event of unauthorised seizure of tax arrears should be a reduction of 20 percentage points.
- In the case of fines for late filing of a tax report, the limit of the amount to be incurred should be increased. This represents an increase from CZK 200 to CZK 500.
- Introducing the possibility of applying for a personal identifier in the field of tax identification numbers for natural persons is also being proposed, which should replace the currently used birth certificate number.
- It will be possible to combine the statement on the outcome of the audit findings with the completion of the tax audit. Thus, according to the Ministry of Finance, if no additional charges are assessed, the tax audit should be completed more quickly.
- The relation of interest paid by the tax administrator to the compensation of detriment will also be explicitly regulated. The law will only allow for compensation of detriment or reasonable satisfaction for non-material detriment caused to a taxable entity by the tax administrator's behaviour to the extent that no interest paid by the tax administrator arises. The law also explicitly stipulates that the interest paid by the tax administrator is the interest on a refundable excess payment, interest on incorrect taxation and interest on tax deduction.
- The scope of the tax audit will be expanded or narrowed during the course of the audit by the delivery of a notification on the change of scope of the tax audit. The notification received in connection with the tax audit will not contain a statement of reasons and no legal remedy may be lodged against it.

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## **DAC 6: New Obligation to Report Certain Transactions to Taxation Authorities in Advance**

**The Chamber of Deputies is currently discussing the governmental draft bill implementing the directive on administrative cooperation in the field of taxation ("DAC 6"). This directive regulates the obligation of businesses to report selected cross-border transactions and other arrangements affecting corporate income tax to taxation authorities in advance. The objective of this EU regulation is to gain better insight into the use of tax regulations and prevent aggressive tax planning.**

### **Cross-border arrangements**

According to the Czech draft bill, the reporting obligation will concern only cross-border arrangements, i.e. transactions, corporate measures and other transactions concerning more than one European Union member states or a EU member state and third countries if at least one of the participants of this arrangement:

- Is a tax resident in a different state or jurisdiction than another participant;
- Is a tax resident in at least two states or jurisdictions;
- Does business in another state or jurisdiction via a permanent establishment and this business takes place based on this arrangement; and
- Performs activities in a state or jurisdiction where it is not resident and where it does not have a permanent establishment

### **Hallmarks**

The obligation to report planned transactions to taxation authorities will affect all businesses. Nevertheless, only transactions meeting at least one of the hallmarks will have to be reported. They are legally defined indicators of potential risk of evasion of tax liabilities. An example of a hallmark is the purposive take-over of losses or a situation where the recipient is a resident in a jurisdiction with zero or near-zero taxation.

Certain hallmarks apply only if the main benefit or one of the main benefits involves obtaining a tax advantage.

### **Obligated person**

The reporting obligation will apply directly to businesses or to their advisors setting up the arrangement. If the advisor is, for example, a lawyer or a tax advisor, they are bound by the obligation of confidentiality. In such a case, they cannot under any circumstances report anything to the taxation authorities on your behalf. However, they should inform you that the reporting obligation applies to you. Failure to comply with the reporting obligation may carry a fine of up to CZK 500,000 imposed by the taxation authority to the obliged person.

The reported information will be subsequently shared with financial administration bodies in other EU member states.

Another round of discussion about this governmental proposal can be expected in the Chamber of Deputies. The final form of the act can therefore keep changing. However, it is necessary to keep track of these

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changes, because the notification obligation may apply to transactions realised as early as after 25 June 2018.

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