Tax&Legal Highlights

Czech Republic

Changes in the Implementation of Double Tax Treaties Applicable From 2019 Onwards

On 1 January 2019, the new Treaty for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital that the Czech Republic signed in 2016 with Turkmenistan will start to be implemented.

The principal concepts of the treaty include:

•A time limit for forming a permanent establishment of 12 months for construction projects and 6 months for services;

•Withholding tax on passive income of 10 % at maximum (exceptions apply to interest); and

•Application of the credit method in respect of double taxation.

Furthermore, from the New Year onwards, the most-favoured-nation clause treatment will be applied in relation to the Treaty for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital between the Czech Republic and Chile (specifically

Section 11 (7) of the Treaty which makes it possible to apply more favourable terms based on the treaty signed at a later date between Chile and Japan). As a result, from 1 January 2019 onwards, provided all the stipulated conditions are met, the rate of 10% of gross interest will be applied between the Czech Republic and the Republic of Chile for the purposes of Section 11 (2) (b) of the above stated tax treaty.

In this context, the Ministry of Finance has also updated the Summary of Valid Treaties, which is available on its website.

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Public Consultation on Virtual Currencies

We would like to draw your attention to an initiative of the Ministry of Finance (MF) which has raised the topic of cryptocurrencies, or virtual assets, and the blockchain technology.

We have received a document from the MF of approximately 30 pages summarising the MF's findings and views concerning blockchain and related topics. The document aims to solicit the opinions of experts as regards opportunities for the legal regulation of virtual assets and the use of blockchain technology for the record-keeping of book-entry securities. The document comprises a technical part, a summary of applicable legislation in the Czech Republic and abroad and an overview of the MF's further course of action. Each part summarises the MF's attitude, or expertise, including a question as to whether any objections have been raised by experts.

If you are interested in this topic or would like to comment on it, the respective document is available here. Comments on the MF's document may be lodged until 14 January 2019.

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TaxAlert: Complications in calculating the super-gross salary from January 2019

The President of the Czech Republic signed the amendment to the Income Taxes Act on 11 December under which employers will have to distinguish a country in which an employee participates in a system of compulsory insurance (social security and health insurance) in calculating prepayments for employment income tax starting from 1 January 2019. The same procedure will apply to tax returns from the 2019 taxation period.

Nothing will change for those participating in the compulsory insurance system in the Czech Republic or a non-European country: the super-gross salary will be calculated as equal to the gross taxable income increased by the Czech compulsory insurance contributions paid by employers, or hypothetical Czech insurance contributions. If your employee is insured in another EU Member State, an EEA state or in Switzerland you will have to adjust the calculation: the super-gross salary will include the compulsory foreign insurance contribution paid by employers.

As Member States have different structures of insurance systems (often consisting of multiple sub-systems) it will be complicated to find out what amount of insurance contribution to include. Insurance rates and calculation methods are different as well. Therefore, the change in salary calculation will require much attention and effort.

This amendment is a draft proposed by deputies for which financial administration has not been prepared at all. Some of you may remember a similar situation, which occurred ten years ago; however, at that time, the method of calculation was so difficult to administer that the Ministry of Finance quickly unified determination of the super-gross salary into a form prevailing to date. Again, financial administration may have serious difficulties in reviewing accuracy of prepayments for employment income tax of employees insured abroad but employers should not rely on weaknesses on both sides. We recommend that you undertake all reasonable efforts to set up your tax prepayment calculations correctly.

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Current information on the debate on the tax package

The tax package will not be approved by the end of the year, the tax changes will therefore not be effective from the New Year.

On Tuesday 4 December, the proposed amendments to the original proposal of the tax package (Press of the Chamber of Deputies no. 206) were presented during the second reading in the Chamber of Deputies. 35 amendments were filed in the end and they should be voted on together with the overall vote on the tax package either before the Christmas holidays or next year, further discussion is possible from 21 December.

The amendments do not address technical changes in most cases, but instead they are based on the programme declarations of the parties (e.g. increase in taxpayer relief, child tax credit, cancellation of super-gross salary and solidarity surcharge, decrease in VAT rates – both in general and for specific commodities, such as heat or organic food) etc.

Other important (government) amendments, which partially react to current discussions and practical problems related to the postponement of the effective date of the tax package, are part of the resolution of the Budget Committee.

They include for example:

•New treatment of deductions of research and development expenses

•New definition of the limit for participation in insurance for dependent activities

•Change of the definition of economic activity for VAT purposes related to the issues of statutory executives, more information available here, and

•Postponement of the effective date of the individual provisions of the tax package (in certain cases taxpayers will be able to choose whether they want to follow the old rules next year, or the amended ones).

We monitor the development carefully and after the third reading we will bring you detailed information – what changes were approved by the Chamber of Deputies for the various taxes and when these changes should come into force.

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VAT Act Amendment

On 4 December 2018, the Chamber of Deputies debated an amendment to the VAT Act. A series of motions to amend the Act were presented (which are likely to be subsequently voted on during the course of January) and we specifically draw attention to the proposal to retain the current VAT treatment of payments made to statutory executives and members of statutory bodies and the proposal to temporarily retain the current definition of a finance lease of goods (through the end of 2019).

In addition, the proposed changes include the postponement of the change affecting the public television station and the public radio broadcaster and special rules for determining the tax point in respect of the services of insolvency trustees as well as various alternatives for revisiting VAT rates or reclassifying certain supplies into a lower VAT rate (eg in respect of the delivery of organic food) have been proposed. In view of the date on which the amendment and related motions are to be voted on, it is realistic for the amended Act to become effective as of 1 April 2019.

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GFD's New Guidance Note on the Binding Assessment of Transfer Pricing and the Method of Determining the Tax Base for Permanent Establishments

On 9 November 2018, a new guidance note, D - 32, of the General Financial Directorate ("GFD") was published in the Financial Bulletin of the Ministry of Finance on the binding assessment of the pricing method between related parties and the method of determining a tax non-resident's tax base on activities performed through a permanent establishment (hereinafter jointly as the "binding assessments").

The new guidance note replaces Guidance Note D – 333 and, besides changes relating to the binding assessment of pricing between related parties under Section 38nc of the Income Taxes Act, it also newly incorporates information on how to proceed during a binding assessment in assessing the determination of a tax non-resident's tax base on activities performed through a permanent establishment under Section 39nd of the Income Taxes Act, which was introduced as early as 1 January 2018, yet in respect of which no accompanying methodology has been issued so far.

Although the guidance note is not legally binding, it serves as a clue for tax payers as to how the tax administration will address the issue of transfer pricing between related parties and the determination of the tax base/tax loss in respect of permanent establishments.

Shortening the Deadline for Filing an Application

A major change introduced by Guidance Note D – 32 in respect of binding assessments is the clarification of the deadline for filing the binding assessment application. In line with the previously applicable guidance note, it was possible to file the binding assessment application both during the taxation period for which it was being filed as well as subsequent to its expiry until the deadline for filing the tax return for the period. The new guidance note clarifies the interpretation of the deadline for filing the binding assessment application in that, with effect from 1 January 2018, binding assessment applications may only be filed for the taxation period during which the application is filed and for the subsequent taxation periods.

The change may have a significant impact on applications filed subsequent to 1 January 2018 in compliance with the rules stipulated by the replaced Guidance Note D – 333. However, it still applies that in situations where the payer used the same transfer pricing method or method of attributing profits to a permanent establishment in the preceding periods under corresponding terms, it may be assumed that if an affirmative ruling is issued, the tax administrator will, despite the invalidity of the ruling for prior periods, proceed similarly during tax audits as if the binding assessment had been issued.

Who are the Applications to be Submitted to and who Issues the Binding Assessment Ruling?

The new guidance note also specifies that taxable entities must submit binding assessment applications to the locally competent tax administrator. The application will be examined either by the locally competent tax administrator or the General Financial Directorate depending on the number of domestic entities to which the binding assessment relates. If the application exclusively relates to payers falling within the competence of a single locally competent tax administrator, the ruling will be issued by the respective tax administrator. If the payers in respect of whom the ruling is issued fall within the local competence of multiple tax administrators, the application will be examined by the General Financial Directorate. The same procedure will apply to bilateral or multilateral advanced pricing agreements.

Uncertainty about the Issuing of Rulings Persists

However, the new guidance note fails to eliminate tax payers' uncertainty regarding the deadline for issuing binding assessment rulings as the tax administrator's deadline for binding assessments has not been clarified or determined in any way.

The Administrative Fee Depends on the Number of Transactions or Permanent Establishments

The administrative fee for accepting applications is not newly fixed at CZK 10,000 per application: its amount will depend either on the number of transactions or permanent establishments assessed.

Assessing a Set of Unrelated Transactions

In respect of the binding assessment of transfer pricing between related parties under Section 38nc of the Income Taxes Act, major changes include

the approach to assessing a set of closely unrelated transactions with related parties. Pursuant to the previously applicable guidance note, if the tax administrator had issued a negative ruling, the rejection of the application only related to the application itself, ie to all assessed transactions contained therein. Newly, the tax administrator will assess each transaction from among the set separately, independent of the others, with rulings issued on each transaction. These may be affirmative or negative regardless of the ruling on other transactions. The change in determining the administrative fee is also related to this update.

Assessing the Determination of the Tax Base in Respect of Permanent Establishments

With effect from 1 January 2018, Section 38nd of the Income Taxes Act also introduced a "binding assessment of the method of determining a tax non-resident's tax base on activities performed through a permanent establishment". Therefore, Guidance Note D – 32 specifies the methods for this type of binding assessment. In assessing the tax base for permanent establishments, the methods are similar to those in assessing transfer pricing. The primary basis are the tax non-resident's accounting books (tax records), with the tax base customary for tax residents in a similar situation taken into consideration. In determining the tax base, Section 23 (11) of the Income Taxes Act and Article 7 of the respective Double Taxation Treaty are applied, as are the general principles stipulated by the 2010 OECD Report on the Attribution of Profits to Permanent Establishments.

The assessment application must always be filed by the tax non-resident that has formed or will form a permanent establishment in the Czech Republic. If the tax non-resident generates profit in the Czech Republic through multiple permanent establishments whose activities are unrelated, each of them is separately assessed. However, if the activities of permanent establishments are inextricably linked, only one application may be filed and the permanent establishments will be jointly assessed. However, the administrative fee is again charged in a corresponding amount.

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