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Unrealized Exchange Rate Differences

Last week the Supreme Administrative Court published a breakthrough decision, file No 5 Afs 45/2011-94, on the basis of which unrealized exchange rate gains are not taxable even if they are included in the income statement and are therefore included in the accounting profit.

Consequently, the judgment breaks through the present standard practice according to which exchange rate gains are subject to tax as any other recognized income. In the above-mentioned judgment the taxpayer accepted long-term foreign currency loans and entered in the books unrealized exchange rate gains arising from the conversion of foreign currency to Czech Crown between 2004 and 2006. The taxpayer then included these unrealized exchange rate gains in the income tax base within the regular income tax return. Subsequently, the taxpayer filed an appeal against his own tax return in which he excluded these exchange rate gains from the tax base.

The Supreme Administrative Court decided that no real income arises at the moment of the mere change of the exchange rate and its projection in the accounting where unrealized exchange rate gain is posted but only through its realization.

However, in this case the Court dealt neither with the issue of unrealized exchange rate losses which is, in our opinion, the other side of the coin, nor with the technique of taxation of exchange rate gains at the moment of their realization since each unrealized exchange rate gain will become a realized gain once and will be subject to tax.

The judgment also opens further questions and doubts in cases where unrealized differences in valuation are shown in the profit and loss statement, which the logic of this judgment might also be applied to.

The General Finance Directorate will publish its opinion on this matter in the foreseeable future, and a negative attitude to the above-mentioned judgment is to be expected. Nevertheless, this judgment has been passed; it is final and is to be taken into account since it may be changed only by the decision of the extended senate of the Supreme Administrative Court in the future.



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In case you are interested, we would be glad to be of service to you when solving your situation, in particular filing additional tax returns for tax periods not yet lapsed. However, it is to be expected that this way will place increased requirements on recording and consistency when using the Czech National Bank's exchange rates under applicable law. Finally, the possibility of pursuing your claims even by legal action must also be taken into account.

We will of course keep you informed of further developments. If interested, please do not hesitate to contact us.

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