



Amendment to the Income Taxes Act, the Real Estate Tax Act and the Inheritance Tax, Gift Tax and Real Estate Transfer Tax Act

INCOME TAXES

On 19 December 2008, the President of the Czech Republic signed the Amendment to the Income Taxes Act, among other Acts. This Amendment had been under preparation for a long time, and after long negotiation (the Amendment had already been submitted to the House of Parliament by the government on 24 July 2008) was finally approved on 10 December 2008. The Amendment became effective on 1 January 2009 when it was published in the Collection of Acts of the Czech Republic under No. 2/2009 Coll.

Legal force

The amended provisions shall generally be used for the first time for the taxable period starting in 2009. Certain provisions (see below) shall be obligatorily applied also for the taxable period started in 2008 and certain provisions (see below - e.g. thin capitalization rules) offer the taxpayer the possibility to apply these in the amended wording also to the taxable period started in 2008.

THE MOST IMPORTANT CHANGES

Apart from the most important and long awaited change in the tax deductibility of financial costs related to credit and loans from related/non-related entities ("thin capitalization rules"), the Amendment also introduces changes in other aspects of corporate income tax, international taxation, investment incentives, personal income tax, tax rates and to the Reserves Act and the Social Security Act. The most important changes are listed below.

Thin capitalization rules moderated

This Amendment moderates the strict conditions that were added to the Income Taxes Act by the Act on Stabilization of Public Budgets and these were to be applied for the first time for the taxable period started in 2008. This change is one of the changes that may be voluntarily applied already to the taxable period started in 2008 and concerns credit and loans and annexes thereof concluded after 31 December 2007. Credit and loans and annexes thereof concluded before and on 31 December 2007 shall be subject to the wording of the act in force until 31 December 2007. The new wording shall apply to all financial costs from all contracts including annexes thereof from the taxable period starting in 2010 onwards.

Review of new rules on tax deductibility of financial costs:

I. Thin capitalization

Assessment of tax deductibility of financial costs based on thin capitalization rules for non-related entities shall be abolished.

The ratio of capital adequacy shall be set to 3:1 for banks and 2:1 for all other entities.



Assessment of tax deductibility of all financial costs related to the provided credit and loan (i.e. not only interest) shall remain in force.

Assessed credit and loans shall not include:

Interest-free credit and loans;

Credit and loans where the interest is included in the acquisition price of the asset;

Credit and loans where the financial costs are not tax deductible for other reasons (subordinated credit and loans and loans dependent on the debtor's profit).

II. Other financial costs

Assessment of tax deductibility of financial costs based on a single interest rate shall be abolished.

The rule of tax non-deductibility of financial costs from subordinated credit and loans and those credit and loans where the payment of financial costs depends on the profit achieved by the debtor shall remain in force.

Assessed credit and loans shall not include interest-free credit and loans and the credit and loans where the interests are included in the acquisition price of the asset.

Gifts, including gifts to foreign countries

In order to ensure compliance with community law, it is also possible to apply as a tax deductible item a gift provided to another EU member state as well as to Norway and Iceland under the condition of compliance with all rules regarding the objective of the gift or its beneficiary valid in the given state. If no such rule exists in the given state, it is necessary to comply with the conditions set by Czech legal regulations.

Abolishing the limit for financial leasing

Costs of financial leasing shall again be tax deductible without limit (formerly 1 % from the sum of the leasing payment if 1 % exceeds CZK 1 million).

Employee training as performance of work

The Amendment reflects the previously published approach (on the website of the Ministry of Finance) to assessment of costs disbursed by the employer for the training of employees. The test applied for assessing the tax deductibility of these costs is to determine whether the studies, education or training of employees are considered by the employer as performance of work in compliance with the Labour Code. It is also necessary to comply with the condition of the training being related to the object of activities of the employer. Costs disbursed by the employer shall not be tax deductible unless both conditions are met. At the same time, this amount shall represent a taxable income for the employee, unless it is non-monetary performance which may be exempt from tax in line with S. 6 (9) (d) of the Income Taxes Act.

Induced Investment and its sale

The Amendment provides taxpayers with the possibility to decide whether the costs of the induced investment shall be included in the acquisition price of such assets as a construction, building, house, apartment and non-residential areas or not. This generally applies to the situation where the so-called induced investment is being sold, in most cases for a price lower than the



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expended costs. According to the Amendment, it is possible to consider as tax deductible that part of the induced investment value which is not included in the acquisition price of the asset, to the maximum level of revenues from the sale.

Motivation insurance becomes tax non-deductible

The Czech Ministry of Finance considers it necessary to introduce a tax regulation for the employer contribution to life insurance schemes of employees containing both the risk part of life insurance (e.g. in case of death) and the premium for survival of a given term (the amount of this part often being significantly higher). This type of insurance is provided mainly to managers and the period of insurance is often rather short. This in fact represents some kind of a deferred benefit that is taxed by the employee later than it is disbursed by the employer. Therefore, the costs related to the survival part of the insurance shall be excluded as tax non-deductible.

Reserves only to the limit of deposit in a bank account

The Amendment introduces stricter rules for creating reserves for repairs of tangible assets. For newly created reserves for repairs of tangible assets, only those reserve increases that are covered by a corresponding financial amount deposited in a separate bank account shall be considered as tax deductible costs. The amount shall be deposited by the deadline for submission of the tax return at the latest (i.e. usually by the end of the third / sixth month after the end of the taxable period). This account shall be maintained solely in CZK or EUR and shall be intended only for the depositing of funds of reserves created for repairs of tangible assets. The bank shall have its seat in the territory of an EU member state. Several reserves created for repairs of tangible assets may be deposited in one account; the account reconciliation must, however, correspond to the balance of all reserves for repairs of tangible assets. Withdrawing funds is possible only for purposes for which the reserve was created. Should the funds not be deposited by the defined deadline in the amount corresponding to the reserve increase accounted for, the taxpayer shall be obliged to cancel the whole reserve in the following taxable period, i.e. in the period when the deadline for depositing the funds expired. This provision shall be applied to reserves newly created from the taxable period starting in 2009.

Rates and deductions

The Amendment changes the tax rates for personal income tax and withholding tax, which were to decrease to 12.5 % from 1 January 2009, back to 15 %. According to the explanatory report to the act, this change is made up for by retaining tax deductions for taxpayer, wife and child in the original amount and by reducing social security contributions from 8 % to 6.5 %. This means that employees will no longer pay sickness insurance contributions and state employment policy contributions. The contributions paid for the employee by the employer for sickness insurance and pension insurance, and the state employment policy contribution shall, however, remain unchanged.



Super-gross wage and foreign labour force

Further changes concern the calculation of the super-gross wage, affecting particularly the foreign labour force. The Amendment introduces the concept of mandatory insurance which covers social security contributions and the state employment policy contribution and general health insurance contributions which, according to the Czech legal regulations, is paid by the employer. The tax base for employees where the employer has not the obligation to pay the mandatory insurance is the income from paid employment increased by the Czech mandatory insurance.

International taxation

In compliance with the obligations of the Czech Republic regarding international law, exemption of dividends and interest from withholding tax becomes broader. The exemption applies also to dividends and interest paid to entities resident for tax purposes in Norway and Iceland (till now only payments to Switzerland have been exempted) and from 2011 the exemption applies also to all licence fees. To claim the exemption it is necessary to fulfil other statutory requirements for exemption.

Similarly, the exemption for income from transfers of shares in Czech subsidiaries is extended also for incomes of parent companies having their tax residence in another EU member state.

Further, the Amendment extends the scope of income from resources within the territory of the Czech Republic by contractual fines (withholding tax rate 15 %) and transfers of shares in companies with a seat in the territory of the Czech Republic between Czech non-residents (heretofore income from a resource within the territory of the Czech Republic was only income from the sale of shares in a company with its seat in the territory of the Czech Republic paid by a Czech tax resident).

Extended exemption of securities

For the sake of simplicity, income from the sale of all securities is exempted from personal income tax if the time between the acquisition and sale exceeds six months. Only the vendor's direct share in the registered capital or in the voting rights, in the maximum amount of 5 % during 24 months preceding the sale shall be tested. Therefore exceeding the limit in one or both of these categories is what is decisive. This provision shall be used for the first time already for the taxable period started in 2008.

Investment incentives

The Amendment specifies the wording of conditions for the application of a deduction in the regime of investment incentives, and reduces penalties in case of breach of conditions from double the tax to only the tax rate multiplied by that part of the tax base change caused by breaching the stipulated conditions.

Electronic statement of personal income tax from paid employment

With effect from 2010, employers shall submit only electronically the statement of personal income tax from paid employment including annexes through a data report. The deadline for submitting the statement electronically shall be extended to 20 March. This duty shall not apply to employers, natural persons and companies with no more than 10 employees.



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REAL ESTATE TAX

With effect from 2009, the fifteen-year exemption from real estate tax for new constructions of residential houses and apartments in new constructions shall be abolished. Constructions and apartments where the fifteen-year exemption is still pending shall be exempted for the last time in 2009.

Further, with effect from 2009, the five-year exemption from real estate tax for constructions which have been externally insulated shall be abolished. The last exemption shall be provided in 2012.

With effect from 2009, the tax for arable land plots, hop-fields, vineyards, gardens, orchards and permanent grasslands shall not be increased by the multiple of the local coefficient.

INHERITANCE TAX, GIFT TAX AND REAL ESTATE TRANSFER TAX

The subject matter of the amendment to the Inheritance Tax, Gift Tax and Real Estate Transfer Tax Act, published under No. 476/2008 Coll., is in particular the harmonisation with the community law so that the conditions for exemption depending on the permanent residence of a natural person or the seat of a legal entity are made equal for entities from every EU member state, as well as Norway and Iceland.

The Amendment further specifies some provisions of the act regarding the transfer of real estate in case of a debt secured by proprietary rights to real estate and regarding the assessment of the tax base in case of transfer of real estate into the ownership of municipal authorities.

The Amendment extends the exemption from real estate transfer tax also to contributions to companies and cooperatives established in compliance with legal regulations of other European states.

The Amendment becomes effective from 1 January 2009.

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