LEGAL TAX AUDIT

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LEGAL, TAX, ACCOUNTING AND AUDIT SERVICES

NEWSLETTER

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The ruling coalition has introduced an „Economic Recovery Package“ which is expected to have a positive impact on the national budget in 2024 and 2025. The government aims to introduce a wide range of changes to existing tax legislation, which will affect most tax subjects. Most of these changes are expected to be effective from 2024. The most important ones are summarized below.

Corporate Income Tax

- Corporate income tax will be increased from 19% to 21%.

The government explains the increase by the fact that the current corporate income tax is one of the lowest in the EU. Increasing the tax will therefore bring it closer to the European average.

- Purchase of corporate passenger cars will be deductible only up to CZK 2 million.

Businesses will be able to deduct the costs of purchase of a passenger car only up to CZK 2 million, which amount will thereby become the tax depreciation limit. No information has been published yet on whether said limit will also apply to VAT deduction.

- Purchase of still wine up to CZK 500 for promotional or marketing purposes will no longer be tax-deductible.

Personal Income Tax

- Change in the limit for application of increased tax rate.

Although the tax rates of 15% and 23% are to remain unchanged, the threshold at which the higher of the two tax rates applies is to be reduced - namely from the current 48 times the average salary to 36 times the average salary. Even though the average salary increases every year, this measure will increase the number of taxpayers who will pay the 23% income tax.

- Tax exemption for non-monetary benefits stopped.

The government plans to cancel tax exemption for non-monetary employee benefits such as stays in recreational facilities, sports events and cultural events, health-care equipment, pre-school childcare facilities, etc.

- Restrictions on tax credit for spouses with annual income below CZK 68,000.

The tax credit should now apply only to spouses who take care of a child under 3 years of age.

- Tax credit for placement of children in pre-school facility stopped.

The main reason for stopping this tax credit is the fact that it is used mainly by taxpayers in the middle- and upper-income brackets.

- Tax credit for students stopped.

- Restrictions on tax exemptions which apply to sale of securities or equity shares.

The tax exemption will apply only to proceeds of sale of securities or equity shares up to CZK 40,000,000 per taxpayer and provided that 3 years, or 5 years, have passed since their acquisition.

- Meal vouchers or meals provided at the workplace will be subject to the same tax rules as the existing meal allowances paid to employees in cash.

- The existing threshold for exemption of raffle and gambling winnings from tax will be reduced from the current CZK 1 million to CZK 50,000.

- Union dues will no longer be tax-deductible.

- Costs of exams verifying the results of continuing education will no longer be tax-deductible.

Value Added Tax

An amendment to the Value Added Tax Act should bring changes to VAT rates with effect from 1 January 2024, abolish the reduced 10% VAT rate and reintroduce only one reduced VAT rate of 12%. The standard VAT rate of 21% will remain unchanged.

At the same time, the government proposes to reclassify certain goods and services to be subject to the reduced VAT rate instead of the standard VAT rate and vice versa:

- For beverages, only tap water and certain liquid dairy products will be eligible for the reduced 12% VAT rate. Other alcoholic and non-alcoholic beverages will be included in the standard 21% VAT rate.
- As for beverages sold in the hospitality sector, only tap water will be provided at a reduced rate. The serving of any other drinks, including draught or bottled beer, will be reclassified and will be subject to the standard VAT rate.
- Certain goods and services, such as foodstuff, with the exception of beverages (see above), certain pharmaceutical products and medical devices, construction works, child car seats and funeral services, etc., which are currently subject to 15% VAT rate, will be reclassified to be subject to the new reduced 12% VAT rate.
- Hairdressing and barbering services, services of authors and artists, freelance models and models, collection, transportation and dumping of municipal waste, repair of clothing, footwear, leather goods and bicycles, cleaning services, firewood, cut flowers and decorative foliage, import of works of art, collectibles and antiques will be moved to the standard VAT rate.
- Other items classified in one of the current two reduced VAT rates will remain subject to the unified reduced rate of 12%.
- In contrast, occasional land passenger transport (e.g., bus transportation to excursions) will be moved from the standard VAT rate to the reduced VAT rate.

Books, both in paper form and electronic books on tangible carriers such as CDs or DVDs, as well as electronic books, including audiobooks, will be exempt from VAT with the right to deduct tax. It will also be possible to request a binding opinion from the tax administration when claiming VAT exemption on a supply of books.

Assessment base for self-employed persons increased

The proposal is to increase the minimum assessment base for social security insurance payments for self-employed persons from 25% to 40% of average salary. The increase should be implemented gradually, and the base should grow by 5 percentage points per year. At the same time, the government coalition proposes that self-employed persons should pay social security payments on at least 55% of the tax base instead of the current 50%.

Other taxes and payments

- Increase in the price of toll vignettes from CZK 1,500 to CZK 2,300 and regular indexation in the following years.
- Reintroduction of employee sickness insurance at a reduced rate of 0.6%.
- Increase in real estate tax rates up to a double of their current rate and automatic indexation.
- Return of excise duty on diesel back to its original level (1.5 CZK/l).
- Cancellation of tax exemption for aviation fuel.
- “Green diesel” rebates according to standards.
- Abolition of energy tax exemptions.

- Increase in tax on tobacco products and heated tobacco and introduction of tax on alternative products.
- Increase in the second tax rate on gambling from 23% to 30%.
- Capping tax relief for work performance agreements.
- Increase in excise duty on alcohol by 10% in 2024 and by 5% for each of the following years 2025, 2026 and 2027.

The government will approve the bill introducing the recovery tax package during June and the first reading in the Chamber of Deputies will take place before the summer parliamentary recess, so that the new legislation will apply from 1 January 2024. However, the proposal is not final yet and a major debate is expected on certain parts of the bill. We will keep you informed as soon as we have any new information on the matter.

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A major change in the area of real estate taxation is that the effective date of the amendment to the Building Act, which was to bring terminological changes to the VAT Act from 1 July 2023 relating to construction, sale and lease of real estate, is postponed to 1 January 2024. The amendment includes a number of interpretative ambiguities, e.g., whether or not the registration in the Land Registry will be the key criterion for assessing whether a building is a family home or an apartment building. This assessment affects not only the VAT rate applicable but also the possibility to voluntarily apply VAT on the lease of the property. These ambiguities should be resolved in a notice which is being prepared by the General Financial Directorate (GFD) and expected to be published during the summer.

The GFD is also expected to soon publish a detailed notice on the application of VAT on real estate (hereinafter the „Notice“), which should replace the existing GFD notice on real estate and the conclusions of the coordination committees consisting of representatives of the Czech Association of Tax Advisors and the Tax Administration („Coordination Committee“). Given the scope of the draft Notice (70 pages) and the fact that the Notice may still be subject to changes, we will only highlight the most important changes below.

The draft also addresses the question whether registration in the Land Registry or the actual use of the building is essential for its classification as an apartment building or a family home or residential space under the current legislation.

The draft incorporates the conclusions of Coordination Committee No. 568/09.09.20 - Application of VAT on the sale of property by a VAT payer, which addresses the conditions under which the sale of real property by a VAT payer is regarded as a sale within the VAT payer's economic activities even if the VAT payer acquired it as a private person (e.g., by inheritance, etc.). Please note that according to the GFD, the assessment of the sale as a taxable transaction subject to registration may also be based on the fact that the seller took certain steps during the sale of the property, which may include advertising and similar activities, as well as improvement of the property prior to the sale, e.g., construction of utility networks on the land or renovation of the property prior to the sale.

The Notice should also incorporate case law regarding the definition of building lots. For example, a land lot should be considered a building lot subject to VAT even if there are buildings on the land that meet the exemption defined under Section 56(3) of the VAT Act which are however intended for demolition. If, for example, the land lot is subject to a planning permission for the construction of a building other than the ones located on the land and the existing buildings are not being used, these buildings should not be regarded as the actual reason for the sale at the time of the transaction and their existence cannot result in exemption from VAT and such a transaction would in fact be a sale of a building lot, which is subject to VAT.

Following the judgment of the CJEU C-308/16 in Kozuba Premium Selection, the Notice should significantly reduce the ratio determining what constitutes a substantial alteration of real estate which causes the restarting of the five-year period needed for VAT exemption under Section 56 of the VAT Act from 50% to 30% of the price of the property before the construction change occurred. It should be noted that the VAT Act itself does not explicitly set out this threshold and it is therefore being debated whether it should be included directly in the VAT Act.

For the sake of legal certainty, the Notice proposes that the 30% ratio should only apply to substantial changes to the building, unit or underground utility which resulted in a building permit or occupancy permit issued by the building authority after 1 July 2023. If the occupancy permit or consent issued after a substantial change to the building,

unit or underground utility were issued before 1 July 2023, the existing 50% ratio should apply.

The Notice will also provide a more precise guidance on calculation of floor area of family homes, apartment buildings and apartments. The Notice also addresses in detail, reflecting the existing case law on the matter, the question of functional units, the existence of which has an impact on the VAT rate for buildings ancillary to family homes or apartment buildings and on tax exemption for plots of land. The Notice also addresses tax questions pertaining to the right to build and the question of removing real estate from property used for an economic undertaking's business activities.

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CASE LAW: TAX DEDUCTIBILITY OF INTEREST ON ACQUISITION LOANS

The Regional Court in Prague (the "Court") dealt with the question of tax deductibility of interest accrued on an acquisition loan (ref. no. 55 Ab 4/2020). The facts of the case were as follows: A new investor acquired an existing group of companies, which included a Czech-based company. The acquisition was made at the level of foreign-based senior companies and was financed by a bank consortium (i.e., externally from the original or the new owner's group of companies). Subsequently, in order to implement the acquisition of the Czech part of the group (Teleplan Prague s.r.o.), the usual post-acquisition steps were taken: In the first step, a shell limited liability company based in the Czech Republic was involved, which bought the shares in Teleplan Prague s.r.o. The purchase was financed by transferring part of the total acquisition loan to this shell corporation. In the second step, the two Czech entities merged. The result was that the loan needed to finance the acquisition of the company was compressed to the level of the operating company. Or, in other words, the result of the transaction was that there was the same structure as at the beginning, with the (only) difference that the Czech operating company was now burdened with a loan taken for the purchase of the same company.

The tax administration assessed the entire situation as an artificially created transaction and abuse of rights and excluded the interest accrued on the acquisition loan from tax deductible expenses. For the sake of completeness, let us add that the dispute concerned events occurring in 2013 and 2014.

The Regional Court in Prague (the „Court“) initially agreed with the tax administration that the objective condition for the application of the abuse of rights doctrine was indeed met (i.e., that the conduct was not compliant with Section 24 of the Income Tax Act).

However, as for the subjective requirement for application of the abuse of rights doctrine (i.e., that the conduct in question had no rational justification and that the transactions were artificially created solely for the purpose of obtaining an unjustified tax advantage), the Court's opinion differed from the arguments used by the tax administration. In assessing whether this requirement was met or not, the Court considered it central that the reasons for carrying out the transaction the way it was were based on the conditions of financing provided by an external bank, which had to be met in order to get the financing. The Court considered these conditions, which, according to the tax subject's explanation, were intended to ensure maximum efficiency in repayment of the loan by pushing it down to the lower-ranking operating entities which actually generate profit, to be economically rational. If the tax subject carried out the transaction in order to meet these conditions, the Court does not see it as self-serving conduct which could be interpreted as abuse of rights.

As the tax administration failed to prove that the subjective requirement for application of abuse of rights was met (i.e., that obtaining the advantage of tax deductibility of interest was the main objective of the transaction), the Court annulled the decision of the tax administration. An appeal against the Court's decision is currently pending before the Supreme Administrative Court.

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WHISTLEBLOWER PROTECTION

Whistleblower protection is an important element to keep organizations and, more broadly, the society fair, transparent and accountable. Whistleblowers are individuals who draw attention to unfair, illegal or unethical practices, most often within legal entities (typically corporations) and other institutions. Without adequate protection, whistleblowers may be subject to retaliation, such as dismissal from the workplace, intimidation, or other form of discrimination.

The Whistleblower Protection Bill, Parliamentary Document No. 352, is a legislative step to provide such protection to whistleblowers in the Czech Republic implementing Directive (EU) 2019/1937 of the European Parliament and of the Council of 23 October 2019 on the protection of persons who report breaches of Union law.

This bill introduces a series of rules which ensure that whistleblowers can report breaches without fear of retaliation, most often from their employers. The bill is now in the Senate and a debate on the bill was scheduled for 31 May 2023.

The law defines what is considered an unlawful act of which the whistleblower became aware in connection with their work or similar activity. A whistleblower may not be penalised in any way for reporting such a breach. Importantly, the law does not grant protection to anonymous notifications, which means that until the identity of the whistleblower is revealed, the procedures set out in the law do not apply and the whistleblower cannot (logically) be afforded the protection otherwise granted by the law.

Not only criminal offences may be reported. The law also grants protection to the reporting of administrative offences for which the law sets a fine of at least CZK 100,000.

According to the law, certain employers are obliged to introduce an internal reporting system and appoint a competent person to receive and follow up on reports. The competent person should be impartial as it will review reports made by whistleblowers and communicate with the employer to ensure that reported breaches are remedied and unfounded reports are discarded. The competent person may be an external entity, such as a law firm or other specialised body, or an employee.

The law sets out a procedure for reporting suspected breaches which includes creation of trustworthy reporting channels. This includes internal whistleblowing systems within companies as well as creation of an external whistleblowing system run by the Ministry of Justice, to which whistleblowers will always be able to turn.

The effective date of the obligation to implement an internal reporting system and to appoint a competent person will vary according to the size of the employer:

- employers with 250 or more employees (as of 1 January of the given calendar year) will be obliged to implement a reporting system immediately upon the law becoming effective, which is expected to be the first day of the 2nd calendar month after the promulgation of the law,
- employers with 50 to 249 employees will only be obliged to do so from 15 December 2023; these employers may also share internal reporting systems with each other.

Smaller employers are not obliged to implement any internal reporting system.

Further, the law provides that employers may not take any retaliatory actions against whistleblowers or persons close to whistleblowers. The first part of this rule is already part of the Czech legal system, namely employment law and the rules of civil service, but it should now be extended to apply to other areas of human activities.

WHISTLEBLOWER PROTECTION

The Whistleblower Protection Act will bring a certain administrative burden to employers, regardless of whether its exact provisions are changed in the legislative process or not. Therefore, employers who are subject to the legislation should already start preparing for meeting their duties thereunder.

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CASE LAW: APPEAL FILED IN CIVIL PROCEEDINGS CANNOT AGGRAVATE APPELLANT'S POSITION

At the beginning of this year, the Supreme Court of the Czech Republic (hereinafter the "Supreme Court") in its case ref. no. 22 Cdo 2258/2021 dealt with a rather important question, namely whether an appellant's position in civil proceedings can be aggravated if the other party to the proceedings has not filed an appeal.

This rule (the so-called prohibition of "reformatio in peius" principle) is expressly enshrined in the Criminal Procedure Code and applies in criminal proceedings. Therefore, if a defendant appeals a sentence and the prosecutor does not, the defendant's position cannot become worse as a result of the appellate court's decision (i.e., a more severe sentence cannot be imposed). Neither the Code of Civil Procedure nor any other legislation governing civil process contains such a rule, so it has long been an unresolved question whether it also applies in civil law or not.

The subject of the cited case was a dispute (apparently between former spouses, although this was not explicitly mentioned) over division of their community property. The default rule in such cases is equal division of the community property, i.e., that the shares of both (former) spouses are the same. The court of first instance based its decision on this rule.

The plaintiff disagreed with the decision and appealed it. To the plaintiff's surprise, even though the appellate court had outlined its arguments to comply with the principle of predictability of court decisions, it reversed the first instance decision and departed significantly from the equal division of community property to the appellant's considerable disadvantage (the appellant was to receive 30% of the proceeds of the sale of the property and the defendant 70%, whereas the original decision was based on a 50:50 division of the proceeds).

The plaintiff strongly disagreed with the decision of the appellate court and filed an extraordinary appeal with the Supreme Court. In his arguments, he relied mainly on the aforementioned rule of the prohibition of "reformatio in peius", i.e., that his position cannot be worsened in appellate proceedings, unless the other party to the dispute has also lodged an appeal, which was not the case here.

The Supreme Court upheld the plaintiff's appeal. In its reasoning, it relied in particular on one of the fundamental principles of civil procedure, which is the principle of disposition. That principle addresses, inter alia, the questions of who initiates civil proceedings and who defines the subject-matter of the proceedings, i.e. what (and at whose request) the court is to deal with in civil process. According to the Supreme Court, the same should apply to appellate proceedings. This idea can be demonstrated by the following example: if, for example, an action for payment of CZK 100,000 is brought and the action is partially upheld as to CZK 75,000 and partially dismissed as to CZK 25,000 and if the plaintiff appeals the partial dismissal, while the defendant does not appeal, the court may fully or partially grant the plaintiff's appeal or dismiss it, but it cannot interfere with the judgment on the remaining CZK 75,000, since no one has challenged it as both the plaintiff and the defendant appear to be happy with it.

In the present case, the wife did not seek to be awarded more of the assets of the dissolved community property than the amount awarded to her by the court of first instance, while the husband did. The subject-matter of the appeal was thus limited by the appellant to a question whether the appellant was entitled to a greater part of the assets of the dissolved community property, and not whether the other party was allowed to a greater share, when the party had not made any such claim. The appellate court had deviated from the defined subject-matter of the appellate proceedings, which is only permissible in a very narrowly defined range of cases (which does not include disputes on division of community property).

Thus, the principle of disposition and the resulting principle of prohibition of "reformatio in peius" can clearly be seen in the will of the litigatants, which the courts are obliged to respect. If only one party to a dispute appeals, it cannot end up being worse off (with minor exceptions) after the end of the appellate proceedings than it was after the decision of the court of first instance.

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The current Civil Code effective from 1 January 2014 deals in its Section 2914, first sentence, with liability for damage caused to third parties and sets forth that whoever uses an agent, employee or other person (a non-independent agent) in order to act on behalf of him/her, shall remedy any damage caused by that agent, employee or other person as if he/she had caused it himself/herself.

The Supreme Court took an unambiguous position in the interpretation of this provision in 2021 when it ruled on the liability of an employee for damage caused to third parties in the course of his work for the employer. The Court emphasized the employee's attachment to the employer on whose behalf the employee performs work and his subordination to the employer's instructions given in order to supervise the employee's actions and ruled that if the employee does not deviate from this framework in case of a damage event, the provisions of the first sentence of Section 2914 of the Civil Code must be interpreted in such a way to make the employer the only person liable for the damage caused by the employee, as if it had been caused by the employer itself, even if it was caused by the employee's personal actions (Supreme Court judgment no. 25 Cdo 1029/2021 of 26 October 2021).

A new perspective has been provided by a recent decision of the Supreme Court in case no. 25 Cdo 1319/2022, where the Supreme Court ruled on a damage claim resulting from a car accident negligently caused by a company's managing director during a business trip, where the managing director was both an employee and a shareholder of the company.

The Supreme Court emphasized that when interpreting the Section 2914 of the Civil Code, the degree of autonomy or, on the contrary, dependence of the agent on the principal is decisive for assessing whether the principal's liability prevails or whether the agent's autonomy is sufficient to give rise to his or her own liability and obligation to remedy the damage together with the principal.

Therefore, in the case at hand, the Court held that the actions of the managing director could not be considered dependent work performed in a relationship of superiority and subordination between the employer and the employee, since the defendant was the controlling person of the company in which he was employed. Thus, he himself supervised his own work and decided to take the business trip during which the accident happened. The Supreme Court concluded that the defendant could not be characterised as a (non-independent) agent within the meaning of Section 2914 of the Civil Code, for whom the employer was obliged to remedy the damage caused to the injured party, since, although he had negligently caused the injury to a third party in the course of a work activity carried out for the employer, he had not carried out that activity in the position of a subordinated employee who was bound by the employer's instructions.

This is not a final decision since the case has been remanded to the appellate court, but the legal opinion of the Supreme Court is binding on the appellate court which is therefore expected to rule along the lines set out above.

The reasons for the Supreme Court's decision are not completely clear and it is not possible to ascertain whether the Supreme Court considered the partnership or the directorship of the defendant to be the decisive element in the case. However, insofar as it is relatively common for a shareholder to also act as a company's managing director and, where appropriate, to also be employed by the company, there will be cases when – in accordance with the above ruling – such a person will be liable to third parties for damage. It is not possible to be released from this liability and the only possible preventive solution therefore is to examine the existing insurance coverage and its adjustment or renewal, if necessary.

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FROM THE LIFE OF LTA

- How to use the variable license / service fee as a tool for managing the profitability of the contract manufacturing company will present on 21.6. from 4 p.m. our transfer pricing expert Lenka Pól Brožková within the Pride Partners International network. Registration is free and is possible via the link on our LinkedIn profile. The presentation is conducted in English.

- We are preparing a webinar on the topic of new developments in the area of whistleblower protection under the approved Whistleblower Protection Act, on Monday 19.06.2023 from 9.30 to 11.00 a.m. Free registration for our clients. Registration by 16.06.2023.

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DID KNOW THAT...

...the average price of electricity for the purpose of providing travel allowances has increased from 6 CZK/kWh to 8.20 CZK/kWh from 1 April 2023?

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