

Tax Flash

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Czech Republic

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Contact

David Borkovec

+ 420 251 152 561

Prague Office

Kateřinská 40, 120 00 Praha 2
+420 251 151 111

Brno Office

náměstí Svobody 20, 602 00 Brno
+420 542 520 111

Ostrava Office

Zámecká 20, 702 00 Ostrava
+420 595 137 111



Unrealised FX gains no longer taxable!

In its newly published decision 5 Afs 45/2011 z 19. 4. 2012, the Supreme Administrative Court came to the conclusion that unrealised FX gains do not qualify as taxable income under the Income Tax Act.

Case discussed

In 2004-6, a company took long term loans denominated in foreign currency for financing its real estate project. Unrealised gains from currency translation were accounted in the profit and loss account in line with the applicable accounting laws and thus increased the accounting result of the year. The company taxed these FX gains in its regular corporate income tax return, but immediately made an appeal against this treatment by filing a supplementary tax return demanding exclusion of the FX gains from the tax base due to the following:

- the accounting method under which the unrealised FX differences must be accounted through the accounting result of the year is incorrect and in contradiction to the true and fair view recognition principle
- unrealised FX gains do not qualify as income under the Income Tax Act regardless of whether or not they are included in the accounting result

Neither the tax administrator nor the Municipal Court in Prague agreed with the taxpayer's position. The company filed a complaint to the Supreme Administrative Court. The Supreme Administrative Court did not agree that accounting into the P&L is incorrect. However, it agreed that unrealised FX gains do not qualify as taxable income. The reason is that unrealised FX gains, unlike realised gains, do not represent real income but only arise for accounting purposes.

Implications for the taxpayers?

This is a ground breaking court decision as it fundamentally changes the approach to unrealised FX gains. The court decision does not explicitly deal with unrealised FX losses. The language however implies that also unrealised FX losses might need to be excluded from the tax base. Although the court decision does not represent law in the Czech Republic, it may be reasonably assumed that if a taxpayer follows this interpretation, the tax administrator should not challenge it.

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