

# Tax, Legal & Business News

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Tax, legal, accounting, advisory and assurance newsletter

May 2012

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## Topic of the month

### As I see it

#### New package of measures

The Government's recently published package of measures which aims to increase the income of the state budget is, in my opinion, ambivalent. I will now omit the fact that the proposed changes are the result of a compromise where the authors of the proposal needed in many cases to make a political agreement. I will look at it pragmatically. At the beginning I would like to point out that I appreciate the efforts of the Government to address the fiscal problems before reaching the dimensions we see in Southern Europe. However, what I miss in the proposed package in particular is a clear concept linking all individual measures. These measures look more like a quickly tailored set of partial interventions rather than a conceptual modification of the tax burden. This impression is supported by the number and frequency of amendments envisaged during

the last half of the year and the speed at which the final version was approved. I am convinced that Czech entrepreneurs and companies would welcome mainly stability and a clear direction in relation to the tax system. This, unfortunately, is not supported by the set of measures introduced.

The second problem that I see in the proposed package is an aggressive increase in the overall tax burden on employees with higher qualifications and thus with higher income. For an illustration I can state an example of an employee with an income of e.g. CZK 150,000/month with one child and a wife on parental leave. The net annual income of such a family would be more than CZK 40,000 lower next year than under the existing legal regulation. It will be of course more difficult for Czech companies to employ qualified experts as a result of this change. Such an outcome in fact does not support the long-term strategy of the Czech Government of supporting

sectors with high added value, technology centres and of building the so-called knowledge economy.

A more appropriate way to increase the revenue of the state budget would, in my opinion, be a greater transfer of taxation to the field of indirect taxation, VAT in particular. The estimated contribution of one percent of VAT for the revenue of the state budget is approximately CZK 10 billion. If VAT were increased by a further one or two percentage points, instead of the proposed 15 % and 21 %, the Government would not have to introduce such a significant increase in income tax, the increase in real estate transfer tax and other problematic changes. In addition, indirect taxes are easier to collect and have much less of a de-motivating character than does income tax. The negative impact on retired persons which would be increased by having a higher VAT could be offset by, for example, using the valorisation of pensions.

The best way to strengthen tax revenue would, of course, be a more consistent collection of existing taxes. A focus on the correct payment of existing taxes, as opposed to the introduction of new taxes is, however, missing in the Government's proposal. Under the current measures the tax changes will impact mainly employees.

There is no doubt that the need to increase state budget revenue in connection with efforts to reduce the level of debt is at present entirely legitimate. It is also understandable that no step that the Government will take in this direction will be very popular and there will always be someone who will not be comfortable with the steps taken. Nevertheless, I believe that the way to achieve this goal could have been more prudent.

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**Topic of the month**
**New package of measures for the years 2013 and 2014**

The Government has approved the additional economic measures which should keep the deficit of the state budget in the next three years under three percent of gross domestic product. The revenue side of the budget should be supported by the following changes according to the ideas of the Cabinet:

**from 2013**

- Introduction of the three-year “solidarity contribution” amounting to 7 % of the tax base over the limit for the payment of insurance premiums for social security, i.e. above approximately CZK 100,000 a month.
- The limit for the payment of insurance premiums for public health insurance, which is now approximately CZK 1.8 million per year, will be cancelled for three years. The limit for the payment of social security will be maintained.
- Self-employed persons will be able to apply a flat-rate expenditure in the amount of 30 and 40 percent but only if their annual income does not exceed CZK 2 million.
- All self-employed persons claiming any flat rate expenditure will not be able to use some tax discounts, e.g. for the wife/husband without

their own income or child tax benefits.

- Real estate transfer tax will increase by one percentage point and will be 4 %.
- Working pensioners will lose the basic discount, that every taxpayer is currently entitled to, for three years.
- Withholding tax on income of foreign tax residents rises to 35%. This rate will apply to income from sources in the territory of the Czech Republic, e.g. the profits and royalties that are gained by residents of countries with which the Czech Republic has not yet concluded a double tax treaty.
- Increase in VAT rates to 15 % and 21 %. The increase in VAT rates will only apply in the years 2013 to 2015. The extent of supplies subject to a particular rate will not change with the exception of the transfer of some medical devices and children’s nappies to the basic VAT rate as application of reduced VAT rate on these products is in violation of EU legislation.
- Farmers will no longer benefit from the refund of a part of the excise duty on fuel consumed by them, so-called “green fuel”.
- The excise duty from cut tobacco will be increased. The aim of this measure is to gradually reduce the difference in the tax burden on cigarettes and cut tobacco.

- Introduction of a new indirect tax from prescribed insurance premium. Details of this tax and term of its introduction will be specified later.

**from 2014**

- Cancellation of super-gross wage and the introduction of a single rate of 20 %.
- Cancellation of the planned employment flat rate amounting to CZK 3,000 in exchange for maintaining the tax exemption of meal tickets and advantageous canteen meals.
- The excise duty from cut tobacco will be increased in a second step.
- Increase of excise duty from still wine from current nil rate to CZK 10/litter. Production of small-scale wine growers will be exempt from excise duty.
- Introduction of the emission component of excise duty on heating oils, solid fuels and duties on natural gas and some other gasses.
- Cancellation of the exemption from the tax on gas in the case of the gas consumed in domestic boilers, convector heaters and gas cookers.

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**Tax**
**Tax news in international relations – what has happened and what can we expect**

The Czech Republic will start to apply a new double tax treaty with Hong Kong from January 2013. However, in Hong Kong, it will apply from as late as April 2013. Dividends will be subject to a maximum 5% withholding tax and licence fees will be subject to a maximum 10% withholding tax in the resource country. This treaty will facilitate the business activities and investments between both parties as so far Hong Kong was not covered by the existing treaty between the Czech Republic and China.

The ratification process is underway for the protocol to the double tax treaty with Austria and Croatia. New double tax treaties with Poland and with Colombia are also being prepared. Regarding the double tax treaty with Bahrain, only a mutual exchange of documents is needed for the completion of the ratification process and the treaty shall enter into force from January 2013.

There is also news regarding the exchange of information in the tax field in the context of the fight against tax evasion. The treaty with Jersey will enter into force from January

2013; however, the provisions relating to tax crime have already applied since April of this year. Also, treaties with the island of Guernsey, Isle of Man and British Virgin Islands are close to being applied and negotiations are under way for the conclusion of treaties with Andorra and the Bahamas Archipelago.

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**Shortages and damages subject to VAT based on repeated judicial decision**

The Supreme Administrative Court decided (7 Afs 13/2012) that, in a situation where a decrease in fuel is discovered in the inventory and at the same time there is no indication that the fuel was stolen or destroyed, the decrease should be considered as a taxable supply with the liability to pay VAT. The reason is that the assets were used for purposes not related to the economic activities of the entity. In this particular judgment, it was discovered during the tax audit, from the inventory documents submitted, that there was a fuel shortage several times greater than the substantiated losses during transportation and storage regulated in the respective Decree.

## Tax

### Important notice:

It is possible to avoid having to pay VAT on shortages by, for example:

- the existence of an economically justified norm
- proof of theft or destruction
- charging shortages to employees as compensation
- offsetting shortages and surpluses, or keeping stock records so that on the shortages account is not incorrectly charged a material that was, in fact, consumed but incorrectly not written off to consumption.

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## Legal

### Amendment to the Act on Public Procurement is effective from 1 April

The last amendment to the Act on Public Procurement in greatly expands the number of contracts to which the regulation will apply. The amendment reduces the limit for small-scale contracts for goods and services from CZK 2 to 1 million and for contracts for construction work in two stages, first by the end of the year 2013 from CZK 6 to 3 million (from 2014 to CZK 1 million). A further extension of the scope of public procurements subject to the regulation is the obligation of

## Legal

the subsidized ordering party to also proceed under this Act in respect of public procurements that are under the above mentioned limits.

Also the obligations of the ordering party have been extended. The ordering party will in particular be obliged to publish the prior notification in which the effectiveness of the contract must be justified as well as the adequacy of the criteria and the commercial and technical conditions of the contract. For significant public contracts, the ordering party must use the person from the list of assessors held by the Ministry for Regional Development.

Further changes that should lead to more transparent public procurements are:

- cancellation of the possibility to gradually limit the number of applicants
- the obligation to cancel the proceedings if there is only one candidate
- increase in fines assessed by the Office for the Protection of Competition

The amendment also ruled out the possibility to set up, as a partial evaluation criterion, the contractual terms and conditions. The Act no longer requires proof of the economic and financial qualifications. These are now replaced with a formal declaration on competence to fulfil the contract.

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## Accounting

### The latest IFRS news - Progress update on key projects

Currently, the following four major projects on new IFRS standards are still open: revenue, leasing, financial instruments and insurance.

**Revenue:** The comment period for the updated exposure draft, 'Revenue from contracts with customers', closed last month.

Most comments received by IASB were concerned with how to identify separate performance obligations and how to perform the onerous assessment at the performance obligation level, and naturally the volume of disclosures. The new effective date of the standard will be no earlier than 2015.

**Leasing:** This is one of the most discussed standards which introduces recognition of, more or less, all leasing relationships on the balance sheet. The lessee recognises an asset - the right of use and, at the same time, the liability for future payments. Current topics are – the depreciation period for the rights of use, definitions of a short-term lease and the lessor accounting (so far a model of receivable and the residual asset is being preferred). A revised exposure draft is not expected until the second half of 2012.

**Financial instruments:** The planned modifications to IFRS 9 are mainly

concerned with the classification, measurement, impairment and hedging that should ensure more frequent use of hedge accounting. These changes

are expected to be re-exposed in the second half of 2012.

We shall inform you about the issue and content of the above-mentioned new or amended standards.

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## Employees

### Exceptions from the work permit requirement

Foreign nationals from countries outside the EU who are studying or attended high school, higher technical school or university in the Czech Republic may benefit from a derogation from the obligation to have a work permit for employment. The employer is, however, still liable to provide the required information to the Work Office.

This exemption may only be applied in the event that it is an accredited study subject. We recommend that you verify on the website of the Ministry of Education, Youth and Sports whether the subject is accredited before applying for this exception.

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### Health insurance of foreign nationals

Do you face the question what kind of health insurance, if any, needs to be provided for foreign workers and their families? The Act on the Residence of Foreign Nationals requires each foreign national staying in the Czech Republic to have health insurance. The type of required insurance depends on the type of visa or residency permit that the foreign national holds. Short-stay visa holders need health insurance



**Employees**

concluded with any health insurance company (Czech or international) with a cover of EUR 30,000, including emergency evacuation and repatriation; for long-term visas the coverage must be increased to EUR 60,000. Together with an application for a long-term stay or the extension thereof submitted in the Czech Republic, it is necessary to submit a complex health insurance contract concluded with health insurance companies registered with the Czech National Bank. The immigration authorities accept a health insurance card instead of the above types of insurance regarding workers for whom it is the responsibility of the employer to pay health insurance and social security. The insurance must always be presented for the entire period for which the visa or the residence is valid, including an officially certified translation into the Czech language contract of the insurance and the general terms and conditions of insurance policies and proof of payment of the insurance.

It's easier for citizens of the European Union who, as the holders of a European health card – so-called EHIC, do not need any other proof of health insurance when submitting a request for a temporary stay.

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**The Academy****Taxes – how to tackle them?**

The Academy seminars on current tax issues

**Preparation of the tax return**

Do you want to discover the secret of how to correctly prepare a tax return? During the training we will advise you how to systematically check your corporate income tax calculation, how to utilise the items deductible from the tax base and mainly how to verify that all costs declared as tax non-deductible are really tax non-deductible. After participating in this training, you will also understand the foreign income exemption and credit of tax paid abroad. We also guarantee that Annex “C” will never scare you.

**Date:** 15 May 2012  
**Price:** CZK 8,900 + VAT  
**Venue:** PwC premises, Kateřinská 40, Praha 2

**How to reserve a place?**

For more information and for registration, please fill in the registration form at [www.pwc.cz/academy](http://www.pwc.cz/academy) or write an e-mail to [the.academy@cz.pwc.com](mailto:the.academy@cz.pwc.com). Should you have any questions, please contact Martina Kopsová, tel.: +420 251 151 816.

**We invite you**

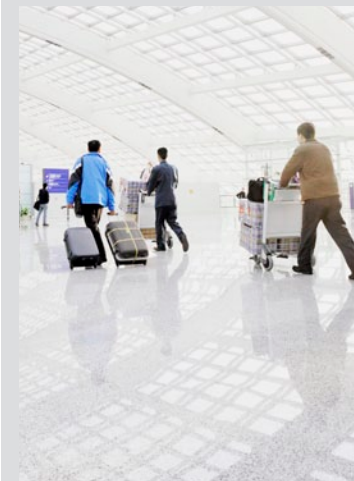
We organise technical seminars, trainings and conferences for our clients and business partners and we would be pleased to welcome you to any of these.

**At the moment we are preparing:**

- Specific transaction not only for tax specialists
- Feel free to be sent working abroad - Brno
- Amendment to the Act on Investment Incentives



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