# European Tax Newsalert

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## *Czech Republic announces new tax measures*

The Czech government recently announced new tax measures for 2013-2015 that are designed to keep the state budget deficit below three percent of Czech gross domestic product.

The package focuses on the increase of individual income tax and health contributions at both the employee and employer levels. Other important measures include increases in VAT, excise taxes, real estate transfer taxes, and withholding tax on non-resident income.

US multinationals with operations in the Czech Republic may wish to understand the proposed measures and monitor their progress.

The newsalert summarizes the most important proposed changes plus other important developments in Czech tax law.

### *Amendments proposed for 2013*

- Introduction of a seven percent "solidarity contribution" for employment income over $5,000 per month. The measure would expire after three years.
- Cancellation of a health insurance cap for both employees and employers (currently $90,000 per year). This measure would expire after three years.
- An increase in VAT rates of one percentage point to 21 percent (standard) and 15 percent (reduced). This measure also would expire after three years.

- An increase in the real estate transfer tax of one percentage point to four percent.
- Increases in excise duties for certain products, including tobacco and green fuel.
- An increase in withholding tax on income derived by foreign tax residents from the Czech Republic from 15 to 35 percent.

These amendments have been approved by the Government, but have not been discussed in the Parliament.

## *Amendments proposed for 2014*

- An increase in the personal income tax rate from 15 to 20 percent, except for dividend income, which would continue to be taxed at 15 percent.
- Cancellation of the "supergross" salary scheme and a return to the gross salary payroll calculation (the income tax currently applies to a tax basis that includes social security and health insurance paid by the employer). As a result the increased rate of 20 percent would apply to a lower taxable basis. Overall, taxes paid would increase and individuals' net income would decrease by a corresponding amount.
- Increases in excise duties for certain products, such as petroleum oils, solid fuels, natural gas, and still wines.

These amendments have been discussed, but not approved, by the government; legislative language is not yet available.

## *Amendments proposed for 2015*

- An increase in the personal income tax rate from 15 to 19 percent; presumably this will change if the amendment for 2014 is enacted.
- Cancellation of the "supergross" salary scheme and return to the gross salary payroll calculation (if not already implemented in 2014).
- An increase in the health insurance contribution for employees by two percentage points to 6.5 percent.
- Cancellation of the basic tax allowance for persons with monthly income greater than $5,000.
- Introduction of a 32.4-percent "levy from the sum of salaries" that would replace the social security and health insurance contributions paid by the employer. The current combined rate is 34 percent, applied to a lower taxable basis. Overall, the employer's cost would increase.
- Introduction of an exemption from both personal and corporate income tax for dividend and liquidation proceeds received from subsidiaries located in the Czech Republic, EU, Switzerland, Norway, and Iceland (the exemption currently applies only to corporations that meet the conditions in the EU Parent-Subsidiary Directive). The tax exemption will apply only to dividends paid out of profits generated after this amendment enters into force.

These amendments have been signed and announced, effective in 2015. The government wants to move the effective date forward, to 2014.

## *Other important developments*

**Unrealized foreign exchange gains are no longer taxable**

The Supreme Administrative Court recently concluded that unrealized foreign exchange gains and losses do not qualify as taxable income under the Income Tax Act. This ground-breaking court decision fundamentally changes the approach to unrealized foreign exchange net income and loss. Such income or loss previously was included in the tax base when recognized in the accounting books (i.e., on an accrual basis). The language implies that unrealized revaluations from derivatives and securities also may be excluded from the tax base.

Although the court decision does not represent law in the Czech Republic, if a taxpayer follows this interpretation, the courts might agree. We expect further development in this area; discussions with the tax authorities on this issue are ongoing.

**Tax treatment of cross-border payments from derivatives**

The Czech tax authorities published their interpretation of the tax treatment of cross-border payments arising from derivatives. The authorities believe that any payments from derivatives should be treated as a Czech-source income. However the law's language states that only interest-like income from derivatives should be regarded as Czech-source income.

The interpretation is not legally binding, but as a matter of practice the tax administrators should follow it strictly during tax audits. Therefore, taxpayers should expect the Czech tax administrators to assess withholding tax on the Czech payer of any cross-border payment from derivatives (not only on interest-like payments), unless an applicable double tax treaty states otherwise. Market practice is inconsistent at this stage as some do not agree with this approach.

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