New developments in tax legislation

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Content:

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Although the amendments valid from the beginning of 2011 may not have become part of our business experience in full, we already face new changes and information that can significantly affect the procedures in tax and accounting practice.

1. The validity of the VAT Amendment

As we already informed you in our December tax newsletter, the Amended VAT Act brings a number of significant changes. After the president of the Republic signed the Act, it is clear that the Amendment will take effect on 1 April 2011. For this reason we would like to remind you of some most significant changes.

1.1. The obligation to keep a tax document after a deduction is claimed

Under the existing regulation, the recipient of a document may claim a deduction in the period in which the supplier was required to include it in the tax returns, thus according to the taxable performance date (TPD). Under the new regulation, the recipient may claim a deduction only in the period in which a tax document was received, whereas the tax document must meet the minimum requirements (identify the supplier and recipient through a tax identification number (DIČ) and state correctly the tax base and tax rate).

Example:

On 5 May the supplier issues a document for services provided during April (or for goods supplied on 30 April), states on the TPD 30 April and sends it to the recipient that receives it on 6 May.

Under the existing regulation the supplier is required to include the performance in the VAT returns for April, the recipient is allowed to claim a deduction in the April returns.

Under the new regulations, the supplier continues to include the performance in the April returns, but the recipient is required to claim a deduction only in May tax return because the document arrived in May.

The VAT payer may incur a negative cash flow consequences which will be reflected in the returns for the first tax period after the amendment takes effect (thus for April 2011 or the 2nd quarter of 2011). We recommend preparing for this fact. Generally it can be recommended to recipients that they request from their suppliers, in particular in the case of larger amounts, to issue and deliver documents in the month of the actual taxable performance. If the decline in the claim for a deduction is significant in the first period and the VAT duty would increase significantly, it is possible to request the relevant Tax Administration for the payment of the relevant tax in instalments or for a deferment.

1.2. The possibility to adjust the tax for receivables during insolvency proceedings

Newly there will be the possibility to amend the amount of the tax for unpaid receivables from debtors (recipients) in insolvency proceedings that arose no later than six month before the relevant court decided on bankruptcy.

Based on this provision the creditor (supplier) has the right to issue an adjusting tax document and after it is delivered to the debtor claim the VAT amount originally paid in the returns. The debtor incurs a “mirror” duty to return the earlier claimed VAT. The system corresponds roughly to the current issuance of credit note. In the case of a subsequent (partial) payment of a receivable the creditor would issue a tax document again for the relevant amount and pay the corresponding VAT amount.

The new regulation does not contain any transitory provisions, and in our view it can also be applied to insolvency proceedings that started earlier. In the case of taxpayers that recorded receivables from debtors in insolvency proceedings, this is an interesting possibility of a partial repayment of the receivables by the state

1.3. Tax guarantee

A completely new institute in the VAT area is the tax guarantee when the supplier and recipient of the taxable performance have a joint responsibility for correct VAT payments. In the case when the enforcement of the tax due from the supplier

is not successful, the tax administrator may also turn to the recipient.

A certain security for the recipient is the provision under which the guarantee is only used in two instances, whereas the tax administrator must prove the fulfilment of the criteria. The first instance is a situation in which the recipient knew, should have known, or could have known that the supplier intended not to pay the tax or damage the state differently; the second is a trade in which a significantly lower or higher price is used without any economic justification.

If the recipient that receives a taxable performance has doubts regarding the supplier or if a significant amount in involved, the recipient may, based on an agreement with the supplier, pay the tax directly to the account of the relevant Tax Authority and inform about this the relevant tax administrator. When using this option we recommend entering into an agreement in relationship for this procedure.

1.4. VAT in the case of bonuses to recipients

There is also a change in the common practice when the recipient receives a financial bonus from the turnover, for example for a timely payment or for ordering good above a certain limit. Currently the payer, if it is not clear to which previous performance the bonus relates, may choose to keep the returned bonus outside the VAT regime, issue no tax document and keep the tax base in the returns as is.

Under the new law, each returned amount has the nature of a decreased tax base and the payer is newly required, in the case of the discount or bonus, issue an adjusting tax document and include it in the returns.

Nevertheless the Ministry of Finance tries to keep the existing system but if there will be no official standpoint issued by April, it will be necessary to proceed according to law and consider bonuses a decrease in the tax base.

2. Aspects of an employment simultaneous with a statutory body function

Over the days media discussed the decision of the highest Administration Court, which confirmed again the existing interpretation practise according to which an individual who performs a statutory body function in a company – executive director ("jednatel"), board of directors member ("člen představenstva") or is a supervisory board member ("člen dozorčí rady"), may not enter with the company into employment for work which is identical with the activities of the statutory body (this ensues from the provisions of the Commercial Code). The Court concluded that an employment contract with this object of work activities is invalid from its beginning (***ex tunc***).

Below we would like to draw your attention to consequences in the case of simultaneous employments for an employee as well as a company in the area of taxes, social and health insurance. Further potential consequences of the invalidity of a contract may result from labour or commercial law.

Although the below mentioned interpretations are in a significant part in favour of individuals as well as entities, this procedure only follows the interpretation of the State Administration. Therefore in order to increase the legal security we recommend bringing the structure of relationships in line with valid laws and judicature. The basic options include (i) structuring the entire remuneration of employees with simultaneous employments as a remuneration to a statutory body member (according to the judicature this procedure is more correct and there is not risk of it being questioned; whereas this procedure may not be as ineffective as it may seem at first sight) or (ii) wherever possible define the work in an employment contract very differently from that of a statutory body member (the risk that such a contract would be questioned cannot be entirely excluded).

Currently, the Ministry of Justice is preparing minor amendment to the Commercial Code that would explicitely allow simultaneous performance of both activities. Should the amendment pass the legislative proceedings, it would clear up any unclarity in the future. However until the amendment adoption companies should still follow current interpretation.

2.1. Pension insurance and sickness insurance premiums

The Social Security Administration (SSA) representatives confirmed their existing view that SSA will consider the insured with simultaneous employments separately for each of their relationships and will not question the validity of a labour-law contract (thus the creation of an insurance relationship).

Only in cases where questions regarding the validity of a labour-law relationship were expressed, for example by a court and the reason for which the insurance relationship started to exist (by entering into an insurance policy) will cease to exist, SSA will return the paid insurance, and an individual will not be considered to have a pension insurance (only in the case of board of directors members and supervisory board members) or sickness insurance (also in the case of executive directors), if they do not have at the same time another income subject to insurance. The non-existence of pension insurance in the years in question would have a significant impact on the period that can be used for the calculation and the income for the purposes of pension calculations, the most significant impact of the absence of sickness insurance is, apart from the cases of work inability, also when claiming financial assistance during the maternity period.

2.2. Health insurance premium

Board of directors members, supervisory board members, and executive directors of limited liability companies have a health insurance policy similarly like employees and there is no issue in relationship to them or in relationship to a re-qualification of salaries to remuneration.

2.3. Tax deductibility of salary expenses

It was also discussed whether simultaneous salary expenses of employees will be tax deductible expenses for a company (according to the general rule any remuneration of board of directors members and supervisory board members are not tax deductible as opposed to the salaries of employees). The General Financial Directorate (GFD) stated in its Communication that if a tax subject proves that the relationship of an employee and a company that is remunerated meets the conditions of an employment under § 6(1)(a) of the Income Taxes Act, it will not question the tax deductibility of such expenses. If however it is ***indisputably*** clear that this relationship ***in full*** means the payment of some remuneration to a board of directors member (bolded in the GFD communication), expenses for this remuneration will not be tax deductible.

This issue does not relate to limited-liability companies because any remuneration to executive directors is always recognised a tax deductible expense.

We trust that you will find the legislative and interpretation changes favourable to a larger degree. We will be pleased to discuss any impacts of the above changes on to your company or how they may work in practice.

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