



Dear clients and business partners,

After the summer break, we are sending a new issue of our regular Tax News. Considering the current situation on the Czech political scene, there are not many amendments to tax law in the approval process. On the other hand, it means there is room for thought on tax reality and current acute tax cases that you can find in our Tax News. Moreover, we inform about planned news related to holding of real estate and lease of real estate and their repairs, and about applying VAT on renting real estate.

KempHoogstad is on the market for 13 years now. The firm is expanding its portfolio of legal firms and provides their clients

with tax advisory services related to their legal cases. Also, KempHoogstad expands its portfolio of clients and provides them with transactional and compliance advisory services requested by their business activities. We appreciate your support and are looking forward to our future cooperation. KempHoogstad Team

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## Inspection done by financial administration – do you tax your income from Airbnb correctly?

The General Financial Directorate has gained access to data about persons that provide accommodation via Airbnb and currently, the GFD uses the data for inspection. Their aim is to check whether the respective persons have taxed their income from this kind of accommodation properly and correctly. The landlords -either private individuals or legal entities - are being contacted by the financial administration, and if the financial administration has any doubts about possible discrepancies between the declared and real income of such persons/entities, it will require an explanation or will call on the persons/entities.

Some time ago, the financial administration published its opinion on the taxation of such income. According to the opinion, in most cases such income is considered income from providing accommodation services by its very nature. This means that such income should not be taxed by private individuals as income from renting real estate but as income from running a business, and as such, is subject to health insurance and social security contributions. Income from Airbnb can be affected by VAT aspects as well because accommodation services are subject to VAT, contrary to income from renting real estate which can be VAT exempt. Also commission paid to agents is subject to VAT, which means that landlords who are VAT non-payers can become liable for VAT registration as a "VAT identified person" and subject to VAT payments from such commission.

Because no taxation or incorrect taxation of landlords' income from Airbnb can result in sanctions due to the failure of meeting tax duties, it would be appropriate for landlords to review the nature of their income and consider which tax regime they are subject to. If any discrepancies are found, it is recommended that an additional tax return be submitted to reduce any possible sanctions.

## Refund of claimed VAT deductions on substantial real estate repairs

In real estate, an important change awaits VAT payers which can be a rather unfavourable one. A proposal for the VAT amendment (with expected effectiveness from 2019) should introduce an obligation to retroactively adjust VAT deductions claimed on substantial repairs made to real estate if the real estate is transferred within 10 years of the repairs.

### **Current treatment of VAT deductions on real estate**

The current wording of the law imposes on payers the obligation to retroactively reduce the VAT deduction claimed when acquiring real estate or realising its technical appreciation if, within a period of 10 years, the manner of using the real estate changes and the new manner of using the real estate does not allow or restricts VAT claims. A typical example could be using real estate or a part thereof for tax-exempt rent. In such a case, the payer is obliged to calculate and return part of the formerly claimed VAT.



On the other hand, the deduction can be adjusted in a positive way if the payers were not entitled to claim the deduction when the real estate was acquired or when the technical appreciation was performed or if they were only entitled to a limited deduction; the payers become subsequently entitled to the claim or its increase because of the change in use of the real estate.

An important aspect is that such a subsequent adjustment to the VAT claim has so far not been related to received supplies other than the VAT claimed when acquiring real estate or performing its technical appreciation.

### **New treatment of VAT deductions on real estate repairs if subsequently delivered**

The newly proposed subsequent adjustment of VAT deductions on substantial repairs means that the obligation will be extended. But, contrary to the adjustment of VAT deductions claimed at acquisition and technical appreciation of real estate, the new obligation to adjust the VAT deduction on repairs does not arise for any change in using real estate which generally means a change in the claim but only if the real estate is delivered.

The reason for adjustment of the deduction claim regarding repairs will be only a transfer of real estate which (with respect to its VAT exemption or VAT non-exemption) is a change in use of the real estate compared to the moment the deduction claim on repairs was applied. An adjustment should not be applied if - for example - real estate was rented as tax non-exempted and then as tax exempted.

### **What repairs will be related to the possible adjustment of VAT deductions?**

According to the amendment, substantial repairs will mean repairs that are considered repairs for accounting purposes (e.g. there will be a similar difference between repairs and technical appreciation as in accounting) if the amount of all relevant received supplies excluding VAT is above CZK 200,000.

Adjustment of deductions will be mandatorily applied to all repairs which start after the amendment is effective (most likely 1 January 2019). Repairs that started before but are finished after the amendment is effective can be adjusted but no obligation to subsequent adjustments of the terminated deductions should arise for the payers (e.g. if originally there had been no deduction claim but the subsequent delivery of real estate had given rise to a deduction claim).

In practical terms, it will be necessary to specify which of the received supplies are to be assigned to one "repair" for the purpose of stipulating the above-mentioned limit of CZK 200,000 or specifying the start and finish of a repair. Often there are a number of supplies received from various suppliers for a relatively long period.

## **Is renting flats, family houses, or residential premises always VAT exempt?**

According to the current VAT Act, renting real estate is VAT exempt. However, if the tenant is a VAT payer who uses the premises for economic activity, the landlord can apply VAT on the rent and claim the input VAT deductions on related received supplies. Those can be, for example, repairs or improvements on the real estate.

The prepared VAT amendment, which is now being debated in Parliament, should reduce the application of VAT on renting real estate. The aim is to restrict the claim of VAT deductions.

## **Mandatory exemption of renting residential premises from VAT**

From 2021, VAT exemption should always apply to renting flats, residential premises, family houses, or buildings where at least 60 per cent of the floor area is residential premises, including renting plots of land or the right of a building where the building is part of it. Landlords who rent the above-mentioned real estate to other payers for their economic activities (e.g. offices, seats, shops) or other entrepreneurial purposes will not be allowed to apply VAT to such rents.

## **Termination of VAT claim deduction**

From 2021, such landlords will not be allowed to apply VAT on purchased services and goods used for such rents. Moreover, they will be obliged to verify whether they are obliged to adjust VAT claims deducted in the past with respect to their real estate because of the newly applied VAT exemption. Namely, these can be VAT deductions claimed at acquisition or reconstruction of real estate that were performed in a period of 10 years before the exempt rent started.

## **Practical issues**

There will surely be uncertainties as to what real estate will be affected by the above-mentioned limitation. According to the explanatory memorandum, the change focuses on buildings, parts of buildings, units, building rights, and plot







of land with a part which is fully or partially premises designated for permanent housing. In reality, there are often discrepancies in - for example - the purpose of a building as it was approved and registered in the land registry and how it is really used.

Even though the obligation relating to VAT exemption is planned for 2021, we recommend that landlords who can be affected assess the specific impact on them as soon as possible, because this can influence some other decisions concerning their real estate.

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