KempHoogstad
Tax Advice & Solutions

Tax News March 2023

Dear clients,

The beginning of the year is successfully behind us and spring is knocking on the door. The tax season is approaching and to make sure we are all well prepared for the coming months, we bring you information about new developments in the sphere of taxation.

From January this year, employers can claim a discount on social security contributions in respect of vulnerable groups of employees. Moreover, the limit for social security payments has – as in most years – just been increased, and thus for the application of the higher income tax rate of 23%. After almost 20 years, the income threshold for filing personal income tax returns has also been raised and the income threshold for filing returns for income earned in addition to employment income has also been raised. A new Income Tax Act guideline (D-59) also came into force in January, replacing the original D-22 guideline. It introduces a minimum effective tax rate of 15% for multinational enterprise groups and large domestic groups. Member States must implement it by the end of 2023. Finally, we bring news of two interesting court judgments. The first one concerns the deductibility of interest on a loan for the acquisition of a share in a business and the second one concerns the provision of proof of services rendered by a parent company.

We wish you a most peaceful end of winter and beginning of spring and we are at your disposal for any questions you may have. We look forward to further cooperation.

Bohdana Pražská and the KempHoogstad Team

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News in the area of employee taxation

Since the beginning of the year, changes have been introduced in the taxation of employees and in the area of social security and health insurance. The maximum assessment base for social security contributions has been increased; thus, the limit for taxation at the higher tax rate of 23% has also been raised. A new discount on contributions for vulnerable employees has also been introduced. At the same time, after almost twenty years, the income limit for filing personal income tax returns has been significantly increased.

The maximum annual assessment base for social security contributions has been increased to CZK 1,935,552 (i.e. CZK 161,296 per month). At the same time, employee income exceeding this amount is taxed at a higher tax rate (23%). Up to this limit, the 15% income tax rate continues to apply.

As of January 2023, the minimum wage has been increased from CZK 16,200 to CZK 17,300, and the minimum guaranteed hourly wage has also been increased to CZK 103.80. For this reason, the minimum monthly assessment base for health insurance for employees has also increased. Therefore, the discount on placing a child in a pre-school institution (the nursery fee) and the income limit for entitlement to the tax bonus per child have also been increased. The limit of taxable income when the obligation to file an income tax return has increased from CZK 15,000 to CZK 50,000 per year. In the case of employees, taxable income from sources other than employment may reach a maximum of CZK 20,000 per year for the 2023 tax year without the obligation to file a tax return (instead of the previous CZK 6,000).

As of 1 February 2023, employers can take advantage of a 5% discount on social security contributions for certain employees (e.g. those under 21 years of age or over 55 years of age.) working part-time. Instead of the standard 24.8% of the employer's assessment base, they can pay only 19.8%.

In the event that the condition of using assets for vocational training was not met in the given period, the amendment would consider this condition to have been met anyway; hence there would be no negative consequences related to failure to comply with the condition. Further, the period during which assets should be used will be prolonged by the same number of tax periods during which the condition was not fulfilled (but was considered to have been fulfilled).

New guideline D-59 on the Income Tax Act

A new Income Tax Act guideline (D-59) replaced the original D-22 guideline as of January 2023. The new guideline mainly contains clarifications from recent case law and coordination committee decisions. In practice, however, there are no significant changes from the former version of the guideline.

In general, the D-series guidelines are not legally binding, but taxpayers and tax authorities should follow the guidelines when interpreting the corporate part of the Income Tax Act. It is therefore practical to become thoroughly familiar with the guideline. What are the main changes:

- Exemption from withholding tax on royalties and interest: the exemption can be claimed retrospectively for periods in respect of which the tax assessment period has not yet expired. In order to claim the exemption, it is necessary for the Tax Authority to first issue a decision granting the exemption.
- Gifts: when assessing the minimum value of a gift (i.e. CZK 2,000), it is important how precisely the value of the gift in question is described in the contract. For example, if a legal entity agrees on a donation to a non-profit organisation in the amount of CZK 2,400 per year with monthly payments of CZK 200 per month, this donation may be considered to be deductible from the tax base. On the other hand, if a legal entity donates CZK 200 each month, the minimum-value threshold will not be reached because the donations will be treated individually and it will not be possible for them to be considered as items that can be deducted from the tax base.
- Meal vouchers for employees: the value of the meal is not determined by the value of the meal voucher but is determined by the employer's internal directive. Therefore, an employer may provide more than one meal voucher per meal (e.g. three meal vouchers worth CZK 30).
- Depreciation: the conditions for commencing the depreciation of tangible assets can also be applied to a building in trial operation (if the building is completed according to the project documentation and permission is subsequently granted for its permanent use).
- Depreciation of technical appreciation by a person other than the lessee: the guideline specifies that this may be, for example, a subtenant, a borrower, or a user under an unspecified contract.
- Claiming a tax loss retrospectively: the new guideline specifies that a tax loss can be claimed in respect of two preceding tax years. Also, the guideline indicates when tax can still be assessed in respect of periods during which a tax loss is created. According to the guideline, the decisive point is whether a tax loss *could* be claimed, not whether it was *actually* claimed.

Introducing a minimum tax rate in the EU

EU Member States have agreed to introduce a minimum effective tax rate, and before Christmas the Directive on ensuring a global minimum level of taxation for multinational enterprise groups and large domestic groups came into force. Member States must implement it by the end of 2023.

The aim of the Directive is that profits realised by large multinational and domestic groups or companies should be taxed at a minimum effective tax rate of 15% in each country in which the companies operate. The rules apply to EU-based companies that are part of groups with consolidated revenues of at least EUR 750 million for at least two of the four preceding periods. If the effective tax rate for companies in one country does not reach the required 15%, a so-called top-up tax is payable. The purpose of the income inclusion rule is to ensure that the tax is topped up at the level of the parent company tax if the profits of each subsidiary are not sufficiently taxed. If the tax cannot be topped up using this rule (e.g. if the parent company is based outside the EU), the under-taxed profits rule applies at the level of the subsidiaries.

The income inclusion rule will start to apply from 2024 and the undertaxed profits rule from 2025. The consolidated income criteria will be determined on the basis of historical data, so it is possible to make a preliminary determination now regarding whether the minimum effective tax rules will apply to a particular group.

Court decision on the deductibility of interest on a loan given for the purpose of acquiring a share in a business

The Regional Court in Prague judged the situation of a company that claimed interest on a bank loan for the purchase of a share in a Czech company with which it was subsequently to merge. The loan had been granted by a group of banks to an entire investment group, and the debt was subsequently transferred to the Czech company that had made the purchase of the shareholding.

The tax authority ruled that the interest on the bank loan could not be deducted because it deemed the restructuring transaction to have been a special-purpose transaction that had been entered into with the sole intention of obtaining a tax advantage. According to the tax administrator, the company had not proved that it had incurred the interest and financial costs related to the loan for the purchase of the business share in a manner that was in accordance with the law and had therefore unduly reduced its tax base. However, the Regional Court saw the main economic reason for the transactions as enabling the group to be taken over by a new investment group. It also pointed out that the terms of the loan had been set by the lending banks and that it could not therefore be assumed that the banks had deliberately set conditions that would lead to the creation of an artificial structure. The Regional Court therefore annulled the decision of the tax administrator. The Appellate Financial Directorate has lodged a cassation complaint with the Supreme Administrative Court, so we must wait for the final decision in the case.

Judgement on proving services provided by the parent company

The case concerned a taxpayer that had claimed on its income tax return the cost of consultancy services from its parent company, consisting mainly of management, advisory services, dealings and reporting.

The service contract was structured on a variable basis, and services were to be provided on an on-demand basis with a fee set per person per day. The tax authority considered that although the services were provided by the managing director of the tax entity, the managing direct was in fact exercising the functions of a statutory body. Furthermore, the tax authority stated that the documentation provided was not formally sufficient (it did not contain the order for the services, handover report, etc.), and that the documentation provided did not show what output the subsidiary actually received from the services in question. The added value for the audited entity was therefore not demonstrated. As part of its investigation, the tax administrator also approached the foreign tax administrator by way of an international request in order to verify the actual provision of services. The Regional Court acknowledged that it could be expected that documentation concerning intra-group relations would be less formal than that between independent persons. On the other hand, the court noted that a routine meeting or exchange of information between an owner and an owned person will not generally give rise to a deductible expense because it will not go beyond the normal relationship on the part of the business owner. Moreover, the material received as a result of the international request showed that there was probably no actual transfer and receipt of services at all. Thus, the taxpayer did not meet the burden of proof and the costs incurred for group services were considered to be non-tax deductible.

It was therefore confirmed once again that properly prepared and continuously updated documentation is essential to justify the tax deductibility of costs – in this case specifically, documentation and records of outputs showing the actual provision of services by the parent company, as well as documentation regarding the receipt of those services and the benefit to the subsidiary as the recipient of the intercompany services, together with an adequately presented methodology for calculating the remuneration for the services (with an emphasis on the application of transfer pricing).

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