KempHoogstad
Tax Advice & Solutions

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Dear clients,

The recovery package has introduced some changes to income taxation that have brought a number of uncertainties and questions about how to correctly interpret and apply the relevant legal provisions. As a reaction to this, a new amendment to the Income Tax Act has been prepared (parliament print no. 570/3) which clarifies some changes to-among other things-employee's benefits and which also softens conditions regarding exemption of income from the sale of real estate if the respective income is used to satisfy the seller's own housing needs.

Also, the amendment clarifies questions regarding contracts for work and changes to income tax rules related to investment companies and funds. There is also an amendment in preparation relating to compensatory tax. We also look at two interesting judgements of the Supreme Administrative Court (the "SAC"). One concerns the stipulation of the owner of income and the other one concerns deductions for science and development.

We would be happy to check whether these changes may concern you (and to what extent) and what would be the best way to react. We will keep track of the amendments and inform you accordingly. We wish you a pleasant spring and if you have any questions we are happy to help you; we look forward to further cooperation.

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Changes to income tax

Social events provided by the employer

From January, the Income Tax Act has introduced a new provision relating to tax exemption in respect of income arising from sport and cultural events organised by employers for their employees and their family members in a standard form and to a reasonable extent. Such a provision has been widely discussed and its application in real life will be proved over time.

Nevertheless, the draft amendment changes this provision and specifies that tax exemption constitutes non-monetary income in the form of the presence of employees or their family member at a social event which also includes sport or cultural events if that event is organised by the employer in a standard form and extent and for a limited circle of participants.

According to the General Financial Directory's interpretation there is no need to record the tax-exempt amounts in the payroll slip of the employees in question.

Appreciation of the corporate nursery benefit

From January 2024, a non-monetary benefit provided to the employee in the form of using a pre-school childcare facility is tax-exempt up to an amount equivalent to half of the average wage (CZK 21,983 in 2024).

Effective in 2024, the amendment newly introduces two ways to appreciate such benefits. The employee can chose the manner of appreciation: either (i) the usual price in the given place and time for the use of a kindergarten established by the state, country, municipality or voluntary association of municipalities or (ii) the highest monthly price for pre-school education according to the directive on pre-school education (CZK 1,512 per month in 2024).

Contracts for work – news in 2025

The original changes to the recovery package in the area of taxation of contracts for work ("CfW") could not be implemented because it contained a number of errors and inaccuracies, which is why further changes were made.

The employer may now report one so-called notified CfW per each employee to the Social Security Authority (the "SSA"), for which the limit for participation in the social security contributions and health insurance will be applied at 25% of the average wage (CZK 10,500 for 2024). For other contracts, the obligation to pay contributions will start from the limit of CZK 4,000. This new system will eventually be introduced only from 2025. However, the obligation to report contracts to the authorities from July this year has been retained under the original recovery package and also applies to contracts up to the limit of CZK 4,000. The employer will submit the notification to the SSA electronically.

The new system of two limits, which was originally introduced by the recovery package, has been abolished and it will be the case that, as a matter of principle, CfWs will be treated in the same way as regular employment in terms of the Sickness Insurance Act. CfWs will be considered to constitute small-scale employment without the obligation to pay social insurance under the conditions set out in the Sickness Insurance Act (that is, only up to the limit of CZK 4,000 per calendar month for 2024). However, if the CfW has an income of CZK 4,000 per month or more, this CfW will give rise to insurance participation upon the commencement of employment.

Exemption on the meal allowance for pensioners as former employees

According to the current wording of the Income Tax Act (the ITA), the meal allowance (in both monetary and non-monetary form) is exempt from personal income tax only if the employee works at least three hours per shift or calendar day. Since former employees (for example pensioners who go to the company canteen for lunch at a discounted price) do not work the required three hours and therefore do not meet the above-stated condition, the possibility of exempting their meal allowance ceased in their case as of January this year and the allowance is now subject to personal income tax. This has led to a number of companies suspending the provision of this benefit.

The draft amendment to the ITA therefore introduces a new provision that exempts the meals of former employees from tax if they were working for the employer before they retired from work. However, unlike ordinary employees, meals may only be provided to such persons in a non-monetary form for direct consumption at the workplace or for direct consumption as part of meals provided through another entity. It cannot therefore be claimed as a cash meal allowance or as a meal voucher.

Notification of exempt income from the sale of real estate used for own housing purposes

Under the Income Tax Act, income from the sale of, for example, a family house or a flat can currently be tax-exempt if the seller uses the received financial means for the acquisition of his or her own housing. In order to obtain this tax exemption, the physical person concerned has to submit a notification of exempt income to his or her local financial office by the deadline for filing his or her tax return. The exemption cannot be claimed if this condition is not met.

The amendment mitigates this condition. The notification must be submitted but if the person does not submit it, the exemption still can be claimed; however, a fine will be imposed for failure to fulfil obligations of a non-monetary nature.

Amendment to the Investment Companies and Investment Funds Act (the "ICIF")

The amendment introduces certain income tax changes in the area of investment funds. It is proposed that the entire amendment to the ISIF Act shall take effect on 1 July 2024.

It will now also be possible to create sub-funds within a limited partnership on limited partnership certificates as well as for the newly introduced legal form of a public limited company with fixed share capital ("SICAF"). This is also linked to the new definition of a corporate taxpayer, whereby, in general, any sub-fund of an investment fund shall constitute a corporate taxpayer.

There has also been a change to the definition of a "basic investment fund" – that is, a fund that is subject to the lower 5% income tax rate. If the 90% asset value test is met, a sub-fund will also constitute a basic investment fund, regardless of the legal form of the investment fund – provided that it meets, *inter alia*, the condition for admission of shares to trading on a European regulated market.

Sub-funds will also be able to depreciate the tangible assets of which they are part. This possibility has not yet been explicitly mentioned in the law.

Amendment on compensatory taxes

The amendment is at the very beginning of the legislative process and it implements mainly the rules set out by the OECD; moreover, among many legislative changes to "safe harbour" rules, it also changes conditions for submitting tax returns and informative reports. The proposed date of its coming into effect is the day after its publication in the Collection of Acts and it will probably apply to periods that began after 31 December 2023.

For example, the amendment: specifies the income from consolidated financial statements relevant for determining the threshold of EUR 750 million; clarifies the definition of an investment fund; introduces the term "reporting period" (instead of "tax period"), which is the period for which consolidated financial statements are prepared; extends the possibility of applying the safe harbour rules for joint ventures; and specifies which entities will be required to file a tax return and report for Czech compensatory tax.

Judgement of the Supreme Administrative Court (the SAC) – the beneficial owner of royalties

In a recent judgement, the SAC confirmed the key rules for the determination of the beneficial owner in the application of licensing agreements. It defines the beneficial owner of royalties by the following features: (i) the beneficial owner must actually receive and have control over the income; (ii) the beneficial owner must have the right to freely dispose of, control, and use the income in question without being restricted by contractual or legal obligations to pass the income on to others; and (iii) the beneficial owner should derive economic benefit from the income – that is, it can benefit from the income without any obligation to pass it on.

The Court stressed that the burden of proof is on the taxpayer to prove that it has passed on the royalty payments to the beneficial owner within the meaning of the international treaties. The SAC's decision also suggests that it is possible to determine the beneficial owner of royalties, even if he is not the same as the person named as the recipient of the royalties in the contract (even during tax proceedings, where the wider context and economic consequences of the transactions – and not just the formal details of the contract – must be taken into account when assessing beneficial ownership).

Detailed documentation for R&D deductions is essential to be able to claim tax benefit

In a recent decision, the SAC confirmed that a lack of clear documentation can lead to the tax authorities refusing a deduction without further examination of the content of the project in question. The SAC confirmed that if the documentation does not meet the formal criteria, the tax authority may not even proceed to assess the material content of the project and its contribution.

Moreover, the amendment to the Income Tax Act, which applies to tax audits initiated after 1 January 2024, allows the tax administrator to prove the content of the project documentation by other means of evidence in case of doubt. Thus, the new regulation allows for the supplementation of the already submitted documentation with additional

means of evidence, but does not allow the supplementation of the already submitted approved project documentation if the original documentation does not meet the requirements laid down by law.

It therefore remains the case that project documentation must be prepared with great care. Projects should clearly define the objectives of the research, the methods of control and verification of the results, and all facts should be documented in detail in the event of an inspection by the tax authorities.

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