

GRAND AMENDMENT TO VAT ACT

On 17 July 2008, the Senate approved a bill to amend the VAT Act. The Amendment, subject to the President's approval which is expected to be granted, will not take effect before 1 January 2009, but we would like to inform you well in advance of the major changes to be introduced due to the fact some of them will require adjustment of accounting systems and redrafting of commercial agreements.

The changes to be introduced by the Amendment address the issue of VAT collection after the Czech Republic's accession to the EU and, in certain instances, unify and harmonize the provisions of the VAT Act with EU Directives. The explanatory report indicates simplification of certain rules, introduction of new terms and cancellation of some current ones. The Amendment introduces changes resulting from amendments to EU Directives and Regulations. There are 313 changes and six paragraphs of transitory provisions in total.

One of the first-sight disadvantages of the Amendment is that it is difficult to read. Further, some stipulations and rules migrate between individual Sections: some definitions are found at the beginning of the Act while others are attached to the applicable special provisions.

Since the information on essential changes to be introduced that we provided in the previous issue (Tax News No. 3 – page 1, May 2008) was brief, this issue provides more details on these changes.

1. New Leasing Rules:

The Amendment cancels the currently applicable definition of **financial lease (leasing)**. Leasing is no longer defined independently. The VAT Act only sets forth that *"the transfer of the right to use leased goods or real estate under a contract imposes a duty on the lessee to acquire the goods or real estate, which is subject to such contract, shall be deemed to constitute delivery of goods or transfer of real estate"*. This change has impact on determining the date of taxable

supply. The VAT Act preserved the so-called partial supply and it can be expected that leasing agreements will be subject to new provisions whereunder the partial supply rules will continue to apply. The provisions applicable to leasing contracts are very likely to adjust the terms and conditions for the acquisition of the leasing item after the leasing contract has expired. Pursuant to EU rules, all VAT should be paid on leasing upon the physical release of the item. Pursuant to Czech law, this shall happen only where the contract requires the lessee to acquire the item. Where there is the right to acquire the leasing item only upon the expiration of the contract, the situation shall be deemed to constitute provision of services rather than delivery of goods.

Please be aware that the amended provisions on leasing are hidden in the Amendment because the entire section with the current definition is to be deleted and, moreover, was renumbered just before the deletion. The contents of the new provisions imply they apply to the delivery of goods without using any terms such as financial lease or leasing that are used in business.

Taking into account the transitory provisions of the Amendment and the previous legislation, various forms of a leasing contract are likely to be encountered and their treatment in terms of VAT will differ very much. One may still encounter contracts with 5% and 22% VAT rates these days.

2. Canceling the Re-Invoicing Rule

The Czech specificity – the VAT Act's provisions on special rules on so-called re-invoicing that were in effect even after the Czech Republic joined the EU – has been finally abolished. The Czech law has been fully harmonized in this respect.

The Amendment abolishes the rule pursuant to which supplies can only be deemed to be exempt if the re-invoiced amount does not exceed the purchase price. These applicable provisions are to be deleted entirely as well as the rule for



Prague Main Office

Jungmannova 24, 110 00 Prague, Czech Republic
tel.: +420 / 224 103 316, facsimile: +420 / 224 103 234
e-mail: ksbp Praha@ksb.cz

Karlovy Vary Office

Na Vyhliďce 53, 360 21 Karlovy Vary, Czech Republic
tel.: +420 / 353 225 996, facsimile: +420 / 353 227 781
e-mail: ksbkv@ksb.cz

Brussels Office

36, avenue d'Auderghem, 1040 Brussels, Belgium
tel.: +32 / 223 032 15, facsimile: +32 / 223 033 47
e-mail: brussels@ksb.cz

determining the date of taxable supply. General rules are to apply to services that are re-invoiced to a third party. Exempted supplies shall be deemed VAT-exempt upon re-invoicing regardless of the amount to be re-invoiced. This rule applies unless the contents of a particular service are changed upon the re-invoicing.

3. Correcting Erroneously Charged Tax

If a taxpayer makes a mistake and applies a VAT rate higher than they should have applied they will be able to remedy the erroneous payment. This is not possible under the currently applicable rules and the taxpayer is able to claim correction only with the support of EU legislation.

4. Tax on Contributions of Movable Items

Beginning 1 January 2009, contributions in kind shall be subject to VAT under all circumstances as compared to the current situation in which the only contributions subject to VAT are contributions to companies that are not VAT payers. This may result in deteriorating cash-flow due to a later return of VAT.

5. VAT and Improvement

The Amendment finally removes ambiguities regarding application of VAT to improvements of leased property upon termination of the lease. For VAT purposes, the improvements shall be newly considered to constitute independent property and shall be subject to the rules applicable to tax deduction depending on the manner of use. The rules on the deduction shall newly apply to legal successors and assets acquired as a part of sale of a business or transformation of a company. These provisions are designed to prevent tax evasion.

6. Other Changes to Take Effect on 1 January 2009

Another change to be introduced for the first time ever (although it is not a change to be introduced by the Amendment) is group registration for VAT. Although group registration was contained in the 2007 tax reform, it can be practically used beginning 1 January 2009. The introduction of group

VAT registration is subject to a group application to be filed by a corporate group no later than 31 October 2008.

Please address your queries regarding VAT to Mr. Václav Pátek.

KSB VAT AMENDMENT WORKSHOP

Since the VAT Act introduces many changes effective 1 January 2009 and preparation well in advance is highly desirable, KSB will hold a workshop specializing on VAT.

The workshop is to take place on 1 October 2008. We will inform you of details in the near future.

Judgment Summary

In its judgments dated 18 June 2008, the Supreme Administrative Court confirmed that customs offices were not authorized to apply higher customs duties on the grounds of the amended customs rate list after the Czech Republic joined the EU until 27 August 2004, since applicable law (EU Regulations) had not been translated into, and published in Czech (see judgment Ref. No. 1 Afs 21/2008-98 and other). The applicable EU Regulations were published in Czech in the Official EU Bulletin on 27 August 2004. The Supreme Administrative Court added that such procedure cannot be applied to cases that were not challenged by a remedy before 11 December 2007. The December date is essential since it is the date on which the ECJ decided that EU law can be enforced against individuals only after it has been published in the particular national language.

KSB Tax Team:

Tel. 22410 3316

Fax 22410 3234

e-mail: hnavratilova@ksb.cz

pblazkova@ksb.cz

rkucerova@ksb.cz

ajuric@ksb.cz

vpatek@ksb.cz



Prague Main Office

Jungmannova 24, 110 00 Prague, Czech Republic
tel.: +420 / 224 103 316, facsimile: +420 / 224 103 234
e-mail: ksbp Praha@ksb.cz

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Na Vyhliďce 53, 360 21 Karlovy Vary, Czech Republic
tel.: +420 / 353 225 996, facsimile: +420 / 353 227 781
e-mail: ksbkv@ksb.cz

Brussels Office

36, avenue d'Auderghem, 1040 Brussels, Belgium
tel.: +32 / 223 032 15, facsimile: +32 / 223 033 47
e-mail: brussels@ksb.cz