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Legislation news

Page 1

Amendment to the VAT Act allowing deduction of VAT in respect of passenger cars and amendment to the Income Tax Act changing the rules for tax deductibility of interest

Amendment to the decree concerning the Accounting Act

Page 2

Full wording of the Social Security Act

Considered amendments

Further amendment to the Income Tax Act

Page 3

From judicature

Resolution of the Supreme Administrative Court concerning the term "in connection with business activities"



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LEGISLATION NEWS

Amendment to the VAT Act and the Income Tax Act

On 26 March 2009 the Senate approved an amendment to the VAT Act which allows the deduction of VAT in respect of passenger cars. This amendment also includes an amendment to the Income Tax Act changing the rules for the tax deductibility of interest on loans and credits. This regulation was signed by the president on 27 March 2009 and will be published in the Collection of Laws on 1 April 2009 under No. 87/2009, Coll. The act becomes effective at the moment of such publication.

Amendment to Decree No. 500/2002 Coll., implementing certain provisions of the Accounting Act

Decree No. 500/2002 Coll., implementing certain provisions of Act No. 563/1991 Coll., the Accounting Act (the "Decree"), was amended effective 1 January 2009. The Decree is applicable to businesses carrying out double-entry bookkeeping.

The amendment imposes a new duty on accounting units to disclose further information in an attachment to the final accounts. Accounting units which qualify under at least two of the three prescribed criteria (aggregate assets of CZK 350 million, annual aggregate net turnover of CZK 700 million and the average recalculated number of employees to amount to 250 or more) must disclose information on transactions with an affiliate and, if such transaction are not entered into on an arm's length basis, the accounting unit must include the amount of any such transaction, including the nature of its relationship with the affiliate.

Further, all public limited companies must include in the final accounts information on transactions carried out directly or indirectly between the particular accounting unit and its majority shareholders and between the accounting unit and the members of administrative,

management and supervisory bodies, if such information is necessary in order to understand the financial situation of the accounting unit, provided that the transaction is substantial and was not entered into under standard market terms and conditions.

Yet another provision introduced by the amendment is the requirement for a depreciation plan to be maintained, including updates to reflect any changes in the course of using the assets. It is further possible to apply the anticipated residual value of the assets.

The new Section 56a of the Decree introduced the possibility of applying "component" depreciation of assets as from the accounting period commencing on 1 January 2010. A "component" means a certain portion of assets or a set of assets or a designated inspection of defects whose period of use differs substantially from the period of use of assets or a set of assets. "Components" may be depreciated during their period of use independently from other components and the rest of assets. The component depreciation method is not mandatory.

The amendment to the Decree further sets forth rules for the keeping of records in respect of new assets items A.II.4 "Depreciation Differences Resulting from Corporate Transformation Revaluation" and A.II.5 "Corporate Transformation Differences". The keeping of records in respect of these new balance-sheet items is associated with, without limitation, amended Section 54 and new Section 54a of the Decree applicable to cross-border mergers. If a foreign company proceeds during transformation in a manner other than that required by the Decree, the surviving Czech accounting unit must keep a record of the evaluation and any differences resulting from corporate transformations in the balance sheet in accordance with the Decree.

Collection of Acts

Issue No. 21/2009 of the Collection of Acts disclosed on 12 March 2009 contains and officially announces the unabridged Act No. 582/1991 Coll., the Social Security Organisation and Implementation Act, as amended (<http://www.mvcr.cz/clanek/sbirka-zakonu-stejnopisy-sbirky-zakonu.aspx>).

PENDING AMENDMENTS

Amendment to the Income Tax Act

In addition to the changes outlined in our Tax News No. 3, the Lower House, during the third reading of the government draft bill to amend the Value Added Tax Act (House's Printout No. 605), approved new terms and conditions for the tax deductibility of rent payments under financial leases of assets. The minimum term of the lease for the assets within the first, second and third depreciation classes was determined to be 36, 54 and 114 months respectively. The new provisions will be subject to transitory provisions: tangible assets acquired under a financial (hire-purchase) lease with a subsequent purchase of the leased assets entered into prior to the effective date of the amendment shall be subject to the Income Tax Act, as amended, until the end of the financial (hire-purchase) lease.

Yet Another Scheduled Amendment to the Income Tax Act

The government submitted to the Lower House for discussion a draft amendment to the Income Tax Act (MP Printout No. 768/0) which would reduce the term of depreciation of newly acquired class 1 and 2 assets. The draft is aimed to stimulate tax payers to acquire tangible assets and constitutes a part of the anti-crisis measures. It has been suggested that the new asset depreciation rules apply to assets acquired between 1 January 2009 and 30 June 2010. The legislative process is difficult to predict since the draft was not put on the agenda of the March session. The first reading will take place during the special

session of the Lower House scheduled for 3 April 2009.

Under the current rules, 1st depreciation class tangible assets are depreciated for 3 years while the new rules would reduce such term to 12 months and the 2nd depreciation class tangible assets (current depreciation term – 5 years) would be depreciated for a mere 24 months. If businesses wish to depreciate assets during such reduced terms, they must commence depreciation in the month following the day on which all conditions for depreciation are met.

Assets in the second depreciation class shall be depreciated as follows: the payer will be able to depreciate 60% of the asset value during the first 12 months and the remaining 40% shall be depreciated in the following 12 months.

Rather than increasing the input price of the assets subject to (at the taxpayer's discretion) the reduced depreciation term, the technical improvement (modernisation) of these assets shall be deemed to constitute a separate tangible asset. Such technical improvement shall be included in a depreciation group depending on the nature of the assets which were technically improved and shall be depreciated under the currently applicable rules.

The minimum required term of hire-purchase leases should similarly be reduced for assets depreciated in the first or second depreciation groups, i.e. the minimum term of 12 months should be prescribed for assets within the 1st group while the second group of assets should be depreciated for 24 months. These new requirements cannot be applied to agreements entered into prior to the date of the amendment.

Another amendments of the Tax Acts

In the first reading that took place on 31 March 2009, the Lower House discussed a bill to support economic growth and social stability (MP Printout No. 743/0). The bill, among other things, amends the Income



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Tax Act, VAT Act, Bank Act, Waste Act, etc. The tax-related amendments include, without limitation, an increased personal income tax rate from 15 to 30 percent for each tax base exceeding CZK 1,200,000 and corporate income tax rate from 19 to 21 percent, both to applying to the tax period commencing in 2010. At the same time, the amended Income Tax Act imposes new rules on the depreciation of class 1 and 2 assets (rules similar to the draft amendment in the MP Printout No. 768/0). The VAT Act amendment suggests reducing the reduced VAT rate from 9 to 6 percent. The amendment to the Waste Act is intended to introduce a state-provided cash incentive to be paid for each car wreck properly disposed of (the so called "scrap incentive") in the amount of CZK 25,000 provided that the applicant buys a new car worth up to CZK 1,500,000 and CZK 50,000 if the applicant buys a new electric car (the draft act contains a new definition of an electric car). The amendment to the Bank Act introduces a new amount for bank deposits to be guaranteed by the state. A guarantee of up to EUR 100,000 has been proposed. These as well as other changes are to be discussed by the committees for the economic, budget and state policies and the deadline for discussion was reduced from the standard 60 to 20 days.

JUDICATURE

The Supreme Administrative Court comments on the term "in connection with business operations" used throughout tax legislation.

In judgment No. 2 Afs 112/2008-44 dated 24 February 2009, the Supreme Administrative Court commented on the term "in connection with business operations". The need for an explanation of the term is the result of a dispute between a taxpayer and the tax authority over a father's donation of assets to his son, the father and son both having originally been engaged in the same business. The tax authorities believed the assets were donated in connection with business and thus subject to income tax while the taxpayer disagreed and demanded that the assets be subject to donation tax, which, however, was not

applicable since the assets were tax-exempt under the Donation Tax Act. The Supreme Administrative Court ruled that the term "in connection with business" must be interpreted as follows: there must be close relationship between the business operations and the acquisition (receipt) of the donation. The quoted provisions must be interpreted restrictively to distinguish the primary motive of business operations from ones lacking any business-oriented motivation (such as, typically, settling family affairs – as in the case in question). This case was dealt with similarly to the case decided by the Supreme Administrative Court in its judgment No. 2 Afs 23/2008 – 66 dated 28 August 2008.

This summary provides only basic information that in no way can substitute the full wording of the relevant acts. If you require further information, or wish to resolve specific tax problems, please contact any KŠB tax adviser. We will be pleased to provide you with more information on the above.

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