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LEGISLATIVE CHANGES IN REVENUES TAXATION

Ivana Barteczková

Abstract

The economic behaviour of companies in connection with positioning their capital abroad reacts on comparability of tax conditions in single countries. The main task of the tax reform became simplicity, transparency and complicity with the aim of gradual transformation on European legislative conditions. In connection with the entry to the EU the gradual harmonization of the tax system as the whole including single taxes with the European law was seen. Consistent with the general tendency of decreasing taxation of old age pensions and with the gradual shift of the tax burden for the benefit of consumption taxation this trend can be seen in our country as well.

Key words:

Private individuals' income tax, lump-sum expenses, joint taxation of a married couple, income tax of legal entities, cash registers.

1. Introduction

Regarding the negative development in the area of public finance, the political representation have come to agreement concerning the need for a reform¹. The key position is attributed to the reform steps in the taxation area. In the income tax area, a number of changes have taken place since 1 January 2006, which the taxpayers will have to follow sooner or later. The substantial amendment of the act on income tax was conducted at the end of year 2005 by means of Act no. 545/2005 Coll., whose individual provisions are laid down in 3 time moments. Some of the changes will have to be applied already for the taxation period which commenced in year 2005, others (regardless of the type of the taxpayer's taxation period) effective as of 1 January 2006. The most extensive and most significant part shall take effect as of the first day of the taxation period commenced in year 2006. The following text shall present only some of the substantial changes related to the taxpayers, being the private individuals or legal entities.

2. Changes in private individuals' income tax

For private individuals, the amendment shall mean a number of positive changes which may find effects both in reduction of their overall taxation burden and in reduction of administration related to recording and collection of income tax. Some of the adopted changes are, however, advantageous only for some groups of taxpayers.

2.1 Lump-sum expenses

Numerous tax persons shall be affected by dramatic increase in expenses applied as a percentage of their income (so called lump-sum expenses). This is related to a change which shall be applied in the case of a tax period which commenced in year 2005. The new amount of lump-sum expenses should give a better picture of the economic reality of the individual

¹ The concept of public budget reforms, which has been drawn up by the Ministry of Finance, was approved by resolution of the Government no. 624 of 23 June 2003. The reform is carried out as a set of measures related to both the incomes and expenses parts of the public budgets, concentrating on incomes. The efforts aim at achieving a permanent reduction in fiscal deficits.

tax persons, i.e. it should correspond better to the extent of costs expended for achievement, securing and maintaining taxable incomes. Should a businessman or a self-employed person decide that he shall not apply the truly expended costs, he shall be entitled to apply expenses in the following amounts.

Table no. 1: Overview of the change of lump-sum expenses amounts

Changes of lump-sum expenses amounts			
<i>Number of applicable provision</i>	<i>Activity (abridged)</i>	<i>2005</i>	<i>2006</i>
Sect. 7 (1) a)	Agriculture, forest and water management	50	80
Sect. 7 (1) b)	Craft trade	25	60
Sect. 7 (1) b)	Other trade	25	50
Sect. 7 (1) c)	Other businesses as per applicable regulations, authorial works, employment-based work, experts, interpreters and so on.	25	40
Sect. 7 (2) a)		30	
Sect. 7 (2) b) to d)		25	
Sect. 9 (1)	Rental	20	30

Source: <http://www.penize.cz/zivot/dane>

The taxpayers who have not applied lump-sum expenses, which means that they have applied in the actual amounts and would like to apply the expenses by means of percentage of their income already for the tax period of year 2005 should bear in mind the adjustments of the tax base, i.e. Sect. 23 (8) of Act no. 586/1992 Coll., on income tax, as amended. The potential adjustment of the tax base for the taxation period of year 2004 will have to be carried out via a supplementary tax return for the taxation period of year 2004.

2.2 Joint taxation of a married couple

It is the first time in the tax period of year 2005 that a married couple who take care of at least one child living in their household have been entitled to apply a calculation of the tax from the married couple's joint tax base. The news should be primarily a benefit for families where the partners have different incomes, one of them achieving considerably higher income (therefore subject to higher tax rates) than the other one, who for instance takes care of the child and household. Joint taxation may be applied by a married couple even in the case that one of them had in the tax period (calendar year) no income which is subject to private individuals income tax. The conditions for the joint taxation of the married couple must be complied with at the latest at the last day of the tax period in which the married couple intend to apply the joint taxation².

The joint taxation of the married couple is excluded in some cases, for instance in the case that at least one of the partners has applied a lump-sum rate or is bound to determine the tax liability from the minimal tax base, if he calculates the tax from incomes achieved in more tax periods or as a cooperating person and so on.

The joint taxation is applied by both the partners where each of the partners files his/her own tax return, both of the returns being filed at the same date. In the supplement to the tax return, each partner fills out details necessary for calculation of the joint tax base for both the partners and each shall state in his/her tax return one half of the tax base of which the tax is to be calculated.

² <http://www.tiscali.cz>

2.3 Tax rates, non-tax amounts, remission of taxes

Since year 2001, when the last change in the tax bands and tax rates took place, no bands or rates have been valorised in relation to the inflation. This is why, effective of year 2006, the upper limit of the first tax band was raised from the initial CZK 109,200 to CZK 121,200 and the first two rates were lowered from 15% to 12% and from 20% to 19%. Other limits of the tax bands and the two remaining tax rates have remained the same.

Table no. 2: Income tax rates applicable to private individuals as of 1 Jan. 2006

Income tax rates applicable to private individuals (as of 1 Jan. 2006)			
Tax base in CZK		Tax	of the tax base exceeding (in CZK)
from	to		
0	121 200	12 %	---
121 200	218 400	CZK 14 544 + 19 %	121 200
218 400	331 200	CZK 33,012 +25 %	218 400
331 200	and more	CZK 61,212 +32 %	331 200

Source: <http://www.penize.cz/zivot/dane>

Another significant change related to income tax of private individuals rests in cancellation of non-tax part of the tax base and its replacement of tax remission as it is apparent from the table below.

Table no.3: Overview of tax remissions and non-tax parts of the tax base

Overview of tax remissions and non-tax parts of the tax base		
<i>Item</i>	<i>Tax remission (CZK '000)</i>	<i>Current annual deduction of the non-tax part of tax base</i>
Taxpayer	7 200	38 040
The second partner	4 200	21 720
Partial disability pensioner	1 500	7 140
Full disability pensioner	3 000	14 280
Severely handicapped	9 600	50 040
Student	2 400	11 400

Source: <http://www.penize.cz/zivot/dane>

These tax remissions, introduced instead of the former non-tax amounts, with the exception of the tax remission related to taking care of a child, have not character of a tax preference, i.e. provided that the determined tax is lower than the claim to remission, the tax bonus shall not arise. Application of such tax remissions may not be transferred to following years as it is possible in the case of application of a remission related to acquisition or technical improvement of a cash register. This means of tax reduction is advantageous only for the taxpayers with a lower tax base. More than one remission may be applied concurrently, which is why the priority of their application has been adjusted so that the

taxpayer shall reduce the tax stipulated under section 16 of the act on income taxation by the remission under section 35 and 35ba of act on income taxation and only then he shall apply a tax preference related to the child of which care is taken.

2.4 Flat tax and minimal tax base

Commencing in the tax period of year 2006, the taxpayers are offered a possibility to make use of institute of determination of a flat tax. Thus, the limit is raised which makes it possible to apply flat tax by taxpayers whose annual income in the immediately preceding 3 tax periods has not exceeded CZK 5,000,000 (until the end of year 2005 the same figure was CZK 1,000,000). Further, taxpayers have been enabled to make use of flat tax even in those cases when they carry on an activity being assisted by their partner (spouse) provided that also their partner (spouse) files an application as to the determination of the flat tax. For the reasons of legal security of the tax payers, it is necessary to adjust the wording of the law so that no doubts may arise related to the fact that the finally determined flat tax, even after reduction by an applied tax remission (former non-tax part of the tax base) or by a remission related to taking care of a child in a household, amounts to minimally CZK 600 in the tax period. The taxpayer who will expect that in the course of the tax period he shall become entitled to a tax bonus, may not apply such a bonus in the case of determination of the flat tax. He shall determine the tax by a common procedure and in the tax return he shall apply the full tax preference to which he is entitled pursuant to section 35c of the act³.

The minimal tax base shall not be applied by taxpayers, except for the persons mentioned above, whose income comes only from forest management or from subsidies, allowances, grants or contributions which are not exempted from tax. The reasoning is that income from wood exploitation may be achieved after a number of years, but forest management costs must be expended by the taxpayer in the course of many years. It would be unfair that the taxpayer would pay the tax from the minimal tax base in the years when he only expended costs. The change occurred also in the case of taxpayers – tax non-residents where the liability to report the minimal tax base is expected as long as the sum of their incomes from the resources in the Czech Republic makes up 90 and more percent of their total income; with the exception of the income which is not subject to tax or is exempted from tax or income from which the withholding tax is levied pursuant to a special tax rate. This provision has been adopted so that the tax non-residents whose tax liability is limited to their income from resources in the Czech Republic were not in an uneven position as compared with the taxpayers – tax residents in the Czech Republic.

3. Changes in income tax of legal entities

Changes in income taxes however do not concern merely private individuals but income tax provisions related to legal entities have taken place, as well.

3.1 Corporation income taxation

One of the major changes is lowering of the tax rate to 24% from the initial 26%. The Czech Republic in relation to the tax policy for the period of 2004-2006 has commenced a gradual lowering of the said tax rate. This fact is demonstrated by the Graph no.1 below, where the development of income taxation of companies is shown. Table no.4 shows the particular income tax rates for legal entities in the individual years.

³ <http://business.center.cz/business/finance/dane>

Graph no. 1: Development of income tax rates for legal entities in years 1993-2006

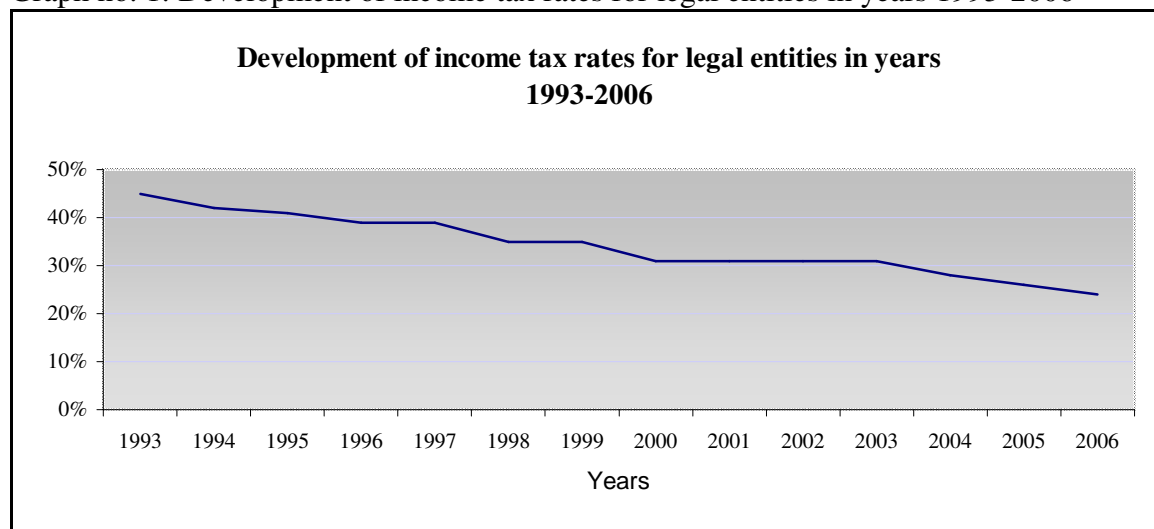


Table no.4: Development of income tax rates for legal entities in years 1993-2006

1993	1994	1995	1996-97	1998-99	2000-03	2004	2005	2006
45 %	42 %	41 %	39 %	35 %	31 %	28 %	26 %	24 %

3.2 Joint system of taxation of mother companies and their subsidiaries

The problems of taxation of dividends, shares in profit and profit transfers pursuant to management and controlling contract has been included in the act on income tax by act no. 438/2003 Coll., which replaced the generally applied regime of taxation by means of so called “withholding tax”, in compliance with directive no. 90/435/EHS, on joint taxation system for mother companies and their subsidiaries, with a regime of exemption in the cases when the respective income is paid out by the subsidiary to the mother company. The condition for application of such an exemption is, besides the residence of the companies in the Czech Republic or another EU member state and required legal form of the company, the legal requirement for continuous holding a specified minimal amount of share in the capital of the subsidiary by the mother company for a period stipulated by the law.

Due to the increase of attractiveness of the business environment in the Czech Republic, the amendment has liberalised the requirements which are to be complied with if the tax exemption is to be applied for the dividends. In particular, such changes include lowering of the minimal qualified share interest of the mother company in the registered capital of the subsidiary from 20% to 10% and the minimal time period of holding the share in the registered capital from 24 months to 12 months. This provision is related to exemption of the dividend income of which the general meeting has decided after 1 January 2006.

Pursuant to the respective contract entered between the EU and Switzerland, the amendment further included exemption of dividend income paid out by Czech residents and their mother companies residing in Switzerland and dividend income paid out by Swiss subsidiaries to their mother companies residing in the Czech Republic. It was also enacted that the Czech and Swiss residents be exempted from withholding tax on interests and royalties, provided that the conditions for application of the exemption are identical as those for other EU residents (including the transitory period until year 2010, in which the royalties in the Czech Republic shall be subject to tax).

3.3 Securities and derivatives

In order to simplify the provisions of taxation of securities and derivatives the amendment laid down that in their taxation the results of economic management ascertained from the accounting regulations shall be taken into account. This provision can be in fact applied for the taxation period which commenced in year 2005. The hitherto unapplied loss from derivatives determined for trade may be deducted from the tax base in up to 3 taxation periods or periods for which the tax return is filed.

3.4 Care of employees

In the area of boarding provided to employees, it is confirmed under the act on income taxation that the employer is entitled to apply a contribution for boarding for one more meal per one employee as a tax-deductible expense (cost), provided that the length of such an employee's shift including the break in work, which the employer is obliged to provide to the employee under a special act, exceeds 11 hours.

In order to improve mobility of workforce, transport of employees to work and their temporary accommodation is newly supported. This is a breakthrough in the hitherto applied restriction in the area of expenses for employees' transport to and from their work. Provided that such transport is provided by the employer by his own or rented vehicles or by vehicles of a contracted carrier, the respective employer's expenses may be considered tax deductible. A vehicle in this connection means a motor vehicle for transportation of ten and more persons. Another change consists in establishment of tax deductibility of expenses for temporary accommodation of an employee with the exception of a temporary accommodation in a family house or flat, in the maximum amount of CZK 3,500 per month.

3.5 Compulsory evaluation of price-making

Trend of a gradual establishment of so called "editing duty" the tax administrator in the extent specifically stipulated in the law, concentrated on problematic areas, is followed also by the recently established institute of the compulsory evaluation of the means by which the price is made agreed between related parties⁴. With effect from 1 January 2006, a new provision has been added in the act on income tax under which the taxpayer is entitled to make a request at the tax administrator of evaluation if the means by which the price has been made in the business relation with the related party complies with the means by which the price would be made in the case of independent relations. It is not the final price which is considered but the method by which it is made. The possibility to make a request with the tax administrator as to the binding evaluation in the mentioned cases follows the introduction of such institute effective from 1 January 2004, when it was enabled for the first time to make a request with the tax administrator to make a binding evaluation in the cases of deduction of tax losses from the tax bases in the period after a substantial change in the structure of partners.

The act on income tax specifies documents and particulars which the taxpayer must attach to the application for a binding evaluation. Regarding the new possibility to make a request of a binding evaluation in the area of transfer prices, the act on administration charges was supplemented, under which the taxpayer is obliged to pay the charge amounting to CZK 50,000 once the decision is given.

⁴ <http://www.sagit.cz>

3.6 Cash registers

Under act no. 215/2005 Coll., on cash registers, the selected entities, natural persons as well as legal entities carrying on a retail business or hostelry activities are subject to the duty to make use of “cash registers” (registration cash desks). By establishing a new tax reduction, the act on income tax makes a specific tax support for the taxpayers consisting in providing a limited amount of tax reduction in the case of acquisition or making a technical improvement. Provided that the cash register commences until 30 June 2006, the tax for the tax period in which the cash register was acquired shall be reduced by a half of the acquisition cost, CZK 8,000 per one cash register at most. Tax reduction may be applied only when the cash register is put into operation for the first time. In the case that technical improvement is to be performed on a present cash register so that it would comply with the legal requirements, no later than 31 December 2006, the tax for the tax period in which the technical improvement was completed shall be reduced by 30% of the value of such an improvement, CZK 4,000 per one cash register at most.

The mentioned advantages may be applied by taxpayers in their computation of tax liability for the tax period commencing in year 2005. If the reduction may not be applied for the reasons of a tax loss or a tax liability lower than the amount of the reduction, the reduction (or, if appropriate, its residual part) may be taken over to the immediately following tax period in which the tax liability was reported. The tax reduction may be taken over within the maximum of three following tax periods.

3.7 Assistance of research and development

Under act. no. 669/2004 Coll., the tax motivation element was incorporated into the system of assistance of research and development consisting in the possibility to apply a tax deductible expenses from the tax base in the amount of 100% costs expended in the course of implementation research and development projects. The amendment stipulates, this time by means of a legal provision, the content specification of the project, which is considered to be a written document in which the tax payer, before commencement of the project work, specifies his activity in research and development. Such a document must be comprised of:

- taxpayer’s essential identification details,
- project time span (date of commencement and date of completion of the project activities),
- project objectives attainable in the time of project completion and measurable after its completion,
- projected expenses (costs) related to project completion in the aggregate amount as well as in the individual years,
- identification details of persons ensuring completion of the project,
- methods of inspection and evaluation of the progress of the project and attained results,
- date and venue,
- first name and surname of the authorised person who approved the project before its commencement.

The possibility of the tax deduction in the proportional part is acknowledged also to the taxpayers who are partners of business company and general partners of a limited partnership.

4. Conclusion

Under act no. 545/2005 Coll., which amends act. no 586/1992 Coll., on income tax, as amended, and other applicable statutory provisions, substantial changes positively affecting tax liability of taxpayers, primarily natural persons, have been approved. Undoubtedly the most significant change consists in reduction of tax burden of private individuals,

simplification of the tax administration by extension of the possibility to make use of the lump-sum expenses and flat tax.

Other benefits are viewed in support of labour mobility by means of tax deductibility of expenses for transportation of employees to their work and temporary accommodation. Attractiveness of the business environment especially for international companies should be facilitated by acceleration of lowering the limit for qualified share interest and shortening of the testing period of holding the share for the purposes of tax exemption of dividends paid out by the subsidiary.

Private individuals as well as legal entities, which shall commence operation of the cash register from 30 June 2006 pursuant to act no. 215/2005 Coll., on cash registers, as amended, may apply tax reduction by a half of the acquisition cost of the cash register, CZK 8,000 per one cash register at most. In the case of technical improvement of the present cash register, the tax may be lowered by 30% of the value of the technical improvement, CZK 4,000 per one cash register at most. The above-mentioned tax reduction may be applied also for the tax period of years 2005.

It is also the first time in the tax period which commenced in year 2005 that the taxpayer is entitled to apply a tax deduction from the income tax base amounting to 100% of costs expended in the course of completion of research and development projects. In this connection, for the purposes of enhancing legal security of the taxpayers as well as tax administrators, the definition of the research and development project has been supplemented into the tax on income tax. Such a project has to be drawn up prior to commencement of its completion.

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