

14. Corporate Tax and Depreciation

Corporate income tax is levied on income from the worldwide operations of Czech tax residents and on Czech-source income of Czech tax non-residents. Czech tax residents are considered to be entities with their registered office or place of effective management in the Czech Republic. The **tax base** is calculated from the accounting profit/loss shown on the relevant financial statements prepared according to the Czech Accounting Act and Czech accounting standards and is further adjusted by non-deductible costs and non-taxable revenues and other non-accounting adjustments. Czech legislation allows taxpayers to change their accounting period from calendar year to fiscal year and vice versa by notifying the Tax Office about such a change. When changing the accounting period, taxpayers are required to enter into a transition period that could be shorter or longer than 12 months.

The standard rate of corporate income tax is 19% for tax periods starting in 2010 and afterwards. For certain types of legal entities (pension funds, investment funds) special 5% corporate income tax rate applies.

CALCULATION OF TAX BASE

+/-	Accounting profit/loss before tax (as shown in the taxpayer's financial statements prepared in accordance with the Czech Accounting Standards)
+	Non-deductible costs
+/-	Difference between accounting and tax depreciation
-	Non-accounting adjustments in the form of tax-deductible costs recorded in the subsequent accounting period but related to the accounting period for which the corporate income tax return is prepared
-	Non-taxable income or income not subject to corporate income tax
+	Non-accounting adjustments in the form of taxable income recorded in the subsequent accounting period but related to the accounting period for which the corporate income tax return is prepared
	Adjusted tax base
-	Non-utilised investment allowance (the 10% investment allowance was abolished with effect from the 2005 tax period but non-utilised allowance may still be applied)
-	Accumulated tax losses carried forward from previous years (tax losses from previous 5 years may be utilised)
-	Gifts to charities (up to 5% of the tax base)
-	R&D allowance of up to 100% of certain expenses incurred in connection with research and development projects
	Tax base adjusted for gifts, investment allowance and tax losses
x	Tax rate/100
	Tax before tax relief
-	Tax relief (e.g. based on granted investment incentives)
	Final tax

TAX-DEDUCTIBLE COSTS

The list of tax-deductible costs is similar to those common in other countries. Generally, costs are tax-deductible if incurred in order to generate, assure and maintain the taxable income (for instance, tax depreciation of assets, purchased material and services, wages and salaries including social security and health insurance contributions paid by the employer, etc.).

The law defines certain types of costs which are deemed tax deductible regardless of whether the above test is met. On the other hand, in the case of some other costs, there are further conditions stipulated by the Czech Income Tax Act limiting their deductibility; for example, some costs are deductible only when paid by the end of the relevant tax period (e.g. contractual penalties). Some other costs are tax deductible only up to the related revenues (e.g., sale of share in a limited liability company).

All costs considered in the relevant tax period as tax-deductible should be supported by accounting documentation proving their relation to the relevant tax period as well as providing information about the goods/services for which the costs were incurred.

EU DIRECTIVES

Four EU directives have been implemented in Czech income-tax law. Most took effect on 1 May 2004. The directives are the parent/subsidiary directive, merger directive, royalties/interest directive and savings directive. (The royalties/interest directive applies to royalty and interest payments starting from 2011.)

Withholding tax

Certain types of payments such as dividends and profit shares are subject to withholding tax. Withholding tax rate ranges from 5% to 15% depending on the type of income. The payer of withholding tax is the person/entity that pays the income which is subject to the withholding tax. The list below summarises income that is subject to the withholding tax.

15%	license fees, royalties, rents and operating lease payments, copyright fees, etc. paid to a non-resident of the Czech Republic without a Czech permanent establishment
15%	dividends*, profit shares and other related distributions paid to a non-resident of the Czech Republic without a Czech permanent establishment
15%	dividends, profit shares and other related distributions, lottery prizes, public-competition prizes, interest from deposit accounts and other personal deposits, etc. paid from a Czech source to a Czech resident or non-resident
5%	financial lease payments paid to a non-resident of the Czech Republic without a Czech permanent establishment

*Dividends paid within the EU, Norway, Iceland and Switzerland may be exempt from withholding tax under certain conditions.

The withholding tax rate is eliminated by Czech local law if requirements according to the applicable EU directive are met. The tax exemption on dividends (and capital gain from the disposal of share) applies automatically when the conditions are met (exemption applies only to limited liability company and joint stock company where the parent company holds at least 10% share for at least 12 months) while the exemption on royalties and interest applies based on the decision of the Czech tax authorities.

Furthermore, the withholding-tax rate is also reduced under a double taxation treaty concluded between the Czech Republic and the country where the recipient of the payment is a tax resident. As of 1 January 2012, the Czech Republic has concluded double-taxation treaties with 77 countries. The exemption under the treaty applies automatically and it is not subject to notification or approval of tax authorities.

TAX-DEDUCTIBLE ALLOWANCES

Research and development cost allowance

Up to 100% of the costs associated with the projects of research and development and incurred in a given tax year or period for which a tax return is filed can be deducted from the tax base as a special tax allowance (this means that these costs are in fact deducted twice for tax purposes – once as a normal tax-deductible cost and then as a special tax allowance).

The following costs can be included in the tax allowance:

- Direct costs (e.g. personnel costs of research and development engineers, consumed material, etc.)
- Tax depreciation of fixed assets used for R&D activities
- Other operating costs directly related to realisation of R&D activities (telecommunications fees, electricity, water, gas, etc.)

Eligible costs must be incurred in the course of generating, assuring and maintaining the taxable income (i.e. tax-deductible costs), and must be recorded separately from the taxpayer's other costs. This allowance does not apply to the costs of purchased services and intangible results of research and development acquired from other entities (e.g. licenses), except for costs incurred in connection with certification of the results of research and development projects. The costs supported from public sources cannot also be deemed eligible for this tax allowance.

The eligible costs must be incurred during implementation of research and development projects in the form of experimental or theoretical works, design or construction works, calculations, technology proposals, preparation of a functioning sample or product prototype or part thereof; and costs associated with certification of results achieved through research and development projects qualify for a deduction.

The non-utilised allowance (e.g., due to tax loss in current year) can be carried forward for three subsequent years.

The taxpayer can apply the local competent Tax Office for a binding ruling in respect of research and development costs in the event that the taxpayer is not sure if particular research and development costs can be regarded as costs eligible for the allowance.

Accumulated tax losses carried forward from previous years

Losses incurred in the tax period can be carried forward for five subsequent tax periods and it is up to the taxpayer when such losses are actually utilised against taxable profits within this five-year period. This does not apply to companies that have received investment incentives in the form of tax relief. Such companies must utilize all previous losses against declared profits before they may claim the tax relief.

There are additional restrictions for utilisation of accumulated tax losses if the company's ownership structure changes by more than 25% or the company is merged or subject to another type of restructuring. In such case, the "same business" test applies which compares the activities causing the tax loss before the change of control or the merger and the activities generating the tax profit (which should be reduced by the tax losses) after the change of control or the merger. In case of doubts, the taxpayer may apply the Tax Office for a binding ruling whether the tax loss may be utilised in given year.

Charitable donations

The tax base may be decreased by gifts donated for specific reasons set forth by the Income Tax Act (social, health, education, etc.). The minimum value of a tax-deductible donation is CZK 2,000; the maximum reduction is 5% of the tax base reduced by deductible allowances, the R&D allowance and utilised tax losses. Again, a company that has received investment incentives in the form of tax relief must reduce its tax base by tax-deductible donations before it may claim the tax relief. In the case of donations to secondary schools and higher vocational schools for the purpose of acquiring materials or equipment or for repairs or improvements of equipment used for practical training, donations to universities and public research institutions, the tax base can be further reduced by up to an additional 5%.

Investment incentive tax-relief

Companies that have received a Decision to Grant Investment Incentives can claim tax relief up to the maximum amount of state aid (i.e., the specific percentage of state aid is applied to the total amount of eligible costs specified in the Act on Investment Incentives and previously in the Decision to Grant Investment Incentives). Under the Czech Investment Incentives Scheme, investors may receive either partial (for investors who expand their existing business activities in the Czech Republic) or full tax relief (for investors who are newly commencing their business activities in the Czech Republic). Both kinds of tax relief can be utilised during five consecutive tax periods.

Full tax relief is almost equal to the value of the tax liability for the relevant tax period (tax relief does not cover tax derived from interest income). The aim of partial tax relief (i.e., for expansion projects) is to offset the tax above the "base tax". Partial tax relief in the relevant tax period is equal to the difference between the tax liability for the period for which tax relief will be claimed (adjusted by certain items and interest income) and the "base tax" liability ("base tax" is adjusted by the sector price-inflation index). The "base tax" liability is the higher tax liability shown in one of two tax periods immediately preceding the tax period for which tax relief may be claimed for the first time, i.e., in which general and special conditions were fulfilled. The "base tax" liability is calculated using the tax rate valid in the taxable period of the tax-relief calculation.

The amendment to the Act on Investment Incentives should come into force in spring/summer 2012 if approved by the Czech Parliament. It should significantly extend the public support for investments in the Czech Republic. The main proposed changes are as follows:

- next to manufacturing companies also companies focused on R&D activities, strategic services and technological centres (e.g. software development) will be eligible for investment incentives support;
- the period for which the tax relief can be utilised will be extended from 5 to 10 years;

an institute of so called strategic investor will be introduced.

DEPRECIATION OF FIXED ASSETS

Tax depreciation is different for tangible and intangible assets. The Czech Income Tax Act sets forth the definition of tangible assets and intangible assets.

Tangible assets are assets with an input price above CZK 40,000 and whose expected operational and technical life exceeds one year (moveable assets). For buildings and structures the limit is CZK 1. Land is not depreciated for tax purposes. Tangible assets are divided into six depreciation categories with different depreciation periods. The classification of tangible assets by depreciation category is shown in the following table.

Depreciation category	Minimum depreciation period (in years)
1. computers and office equipment, measuring and control devices, etc.	3
2. cars, buses, machinery and equipment, lorries and tractors	5
3. metal structures, motors, metal products, machinery and equipment for the metals industry, ships, lifts, cranes, electric motors, ventilation and cooling units, etc.	10
4. electric mains, gas and oil pipelines, water mains, pillars, chimneys	20
5. buildings (factories), bridges, roads, tunnels, water works, cableways	30
6. buildings (hotels, administration/business/shopping centres)	50

A company can use either straight-line or accelerated tax depreciation for tangible assets. However, once a method of tax depreciation is selected for a particular asset, this method may not be changed later. If a tangible asset is sold/liquidated during a tax period, half of the annual tax-depreciation charge can be claimed in such tax period (together with the tax residual value of the disposed asset). In case of partial liquidation of asset, special regulations apply.

Below is a table with a comparison of the straight-line and accelerated methods of depreciation. In 2009 a new tax depreciation method for tangible assets acquired between 1 January 2009 and 30 June 2010 was introduced as a part of anti-crisis measures. This method can be applied only for new tangible assets in the first and second depreciation categories. Under this method, tangible assets in the first depreciation category can be depreciated for 12 months and tangible assets in the second depreciation category for 24 months.

Depreciation category	Straight-line depreciation			Accelerated depreciation		
	Annual depreciation rates (%)			Coefficients for accelerated depreciation		
	first year	subsequent years	for increased input price	first year	subsequent years	for increased input price
1	20	40	33.3	3	4	3
2	11	22.25	20	5	6	5
3	5.5	10.5	10	10	11	10
4	2.15	5.15	5.0	20	21	20
5	1.4	3.4	3.4	30	31	30
6	1.02	2.02	2	50	51	50

For the purposes of tax depreciation, intangible assets are divided into three groups:

1. Intangible assets acquired before 1 January 2001 (tax depreciation differs from accounting depreciation)
2. Intangible assets acquired between 1 January 2001 and 31 December 2003 (tax depreciation equals accounting depreciation)
3. Intangible assets acquired after 1 January 2004 (tax depreciation differs from accounting depreciation). If the purchase agreement stipulates a period during which the intangible assets can be utilised, the annual tax depreciation is calculated as the input price divided by the period agreed in the contract. In other cases, straight-line monthly depreciation is applied for the following periods:

- Audio-visual works are depreciated over 18 months.
- Software and results of research and development are depreciated over 36 months.
- Incorporation expenses are depreciated over 60 months.
- Other intangible fixed assets are depreciated over 72 months.

As for intangible assets acquired between 1 January 2001 and 31 December 2003, their minimum price ceiling must be defined in the company's internal directives. Intangible assets acquired after 1 January 2004 are considered to be intangible assets with an acquisition price above CZK 60,000 and with an expected useful life longer than one year.

TRANSFER PRICING RULES

Prices charged between related entities (i.e., one company directly or indirectly participates in another company/companies through at least 25% of the capital or voting rights of such company/companies, or where the same persons participate in management or control of the respective companies, etc.) may not differ from prices that would be agreed between unrelated entities under comparable circumstances. If the prices differ, the relevant Tax Office may adjust the tax base of the relevant entity by this difference.

If the prices differ and the relevant company is entitled to claim investment incentives in the form of tax relief (i.e., in any five-year incentives period), the right to claim tax relief ceases to apply and the company will have to submit additional tax returns for all taxable periods in which tax relief was claimed.

As of 1 January 2006 the taxpayer can apply the respective Tax Office for a binding advance pricing agreement (APA). The Tax Office issues a binding decision based on the submitted documentation if the prices in a business relationship are at arm's length.

Czech Ministry of Finance has issued non-binding guidelines regulating the eligible transfer pricing policies and documentation of the applied transfer pricing policies which may be used by the Czech taxpayers. The Ministry's guidelines follow the OECD Transfer Pricing Guidelines. The Czech tax legislation does not prescribe any obligation to maintain any transfer pricing documentation. Nevertheless, as such documentation is very likely to be required by the Czech Tax Authorities during a potential tax audit, it is highly recommended that such documentation is prepared in advance, as the deadline is usually very short.

TAX ADMINISTRATION

Generally, taxpayers must file tax returns within three months following the end of the tax period. Czech legal entities that are required to prepare audited financial statements or whose tax return is prepared by a registered tax advisor must file their tax returns within six months following the end of the tax period. In certain cases (e.g., a merger), the statutory period for submission of the tax return is reduced.

Corporate income-tax liability (i.e., the difference between the sum of the advance tax payments paid during the relevant tax period and the total tax liability) is payable by the deadline for submission of the tax return. If the reported tax liability exceeds the statutory threshold, the taxpayer is obliged to pay advance tax payments on a quarterly (if the last known corporate income tax liability exceeded CZK 150,000) or half-yearly basis (if the last known corporate income tax liability was between CZK 30,000 and CZK 150,000). If the last known corporate income tax liability is less than CZK 30,000, no advance payments are required.

If the tax return is not filed or not filed on time, the tax authorities levy against the taxpayer a penalty of 0.05% of due tax per each day of such delay, up to 5% of the tax liability. In case of tax loss, the tax authorities levy a penalty of 0.01% per each day of such delay, up to 5% of the tax loss. The penalty cannot exceed CZK 300,000. The fine does not apply in the first 5 days following the deadline.

If the tax is not reported and paid correctly and the Tax Office discloses such incorrectness then the Tax Office assess additional due tax (or lower tax loss) and levy a penalty (fine) and a late-payment interest on the taxpayer. The penalty is calculated as 20% of the additionally assessed tax or 1% of a reduced tax loss, and the late-payment interest is calculated as the repo rate of the Czech National Bank effective as of the first day of each half year increased by 14%.

ACCOUNTING

The Czech accounting system is based on the double-entry bookkeeping and is largely consistent with the International Financial Reporting Standards with certain minor difference regarding, for example, financial leasing and depreciation of fixed assets.

Joint-stock companies, limited liability companies and other companies which, as of the end of the current and immediately preceding accounting periods, fulfil or exceed two (for joint-stock companies only one) of the following conditions are subject to statutory audit:

1. gross balance sheet total of over CZK 40 million
2. annual net turnover higher than CZK 80 million
3. average number of employees, according to the Statistics Act, exceeding 50

Companies that have issued securities traded on regulated stock exchanges in EU member states (e.g., shares, bonds) should apply the International Financial Reporting Standards when preparing their annual financial statements and consolidated financial statements. However, for calculation of corporate income tax, the accounting result must be calculated based on the Czech Accounting Standards and unaffected by the International Financial Reporting Standards.