

## 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/tax period from calendar year to fiscal year and vice versa by notifying the Tax Office about such a change. When changing the accounting period/tax 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 basic investment funds special 5% corporate income tax rate applies; for pension funds 0% 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 - tax-deductible costs not booked
-	Non-taxable income or income not subject to corporate income tax
+	Non-accounting adjustments - taxable income not booked
	<b>Adjusted tax base</b>
-	Accumulated tax losses carried forward from previous years (tax losses from previous 5 years may be utilised)
-	Gifts to charities (up to 10% of the tax base)
-	R&D allowance of up to 100/110% of certain expenses incurred in connection with research and development projects
	<b>Tax base adjusted for gifts, R&amp;D allowance and tax losses</b>
x	Tax rate/100
	Tax before tax relief
-	Tax relief (e.g. granted investment incentives)
	<b>Final tax</b>

### 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 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.).

In the case of some 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. assignment of receivables).

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 (parent/subsidiary directive, merger directive, royalties/interest directive and savings directive).

## PARTICIPATION EXEMPTION

Capital gains or dividends derived from qualifying subsidiaries are tax exempt. 10% participation in capital and 12-month holding test applies. Other specific conditions set by the law has to be met.

## WITHHOLDING TAX

Certain types of payments such as dividends, interest or royalties are subject to withholding tax. Withholding tax rate ranges from 5% to 35% 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 gives examples of income that is subject to the withholding tax.

<b>15%</b>	royalties, operating lease payments, copyright fees, dividends, other related distributions, etc. <b>paid to a non-resident of the Czech Republic without a Czech permanent establishment</b>
<b>5%</b>	financial lease payments <b>paid to a non-resident of the Czech Republic without a Czech permanent establishment</b>
<b>35%</b>	royalties, operating lease payments, copyright fees, dividends, profit shares and other related distributions, etc. <b>paid to Non-EU/EEA residents from jurisdictions that do not have a Double Tax Treaty or Exchange of Information Treaty in force with the Czech Republic</b>

Dividends, interest or royalties paid to qualifying EU/EEA/Swiss company are exempt from withholding tax (specific rules apply).

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 2016, the Czech Republic has concluded double-taxation treaties with 84 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 100/110% 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 services purchased from listed R&D institutions. The costs supported from public sources cannot also be deemed eligible for this tax allowance.

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. Companies that have received investment incentives in the form of tax relief 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 10% 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.

## 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 ten 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.

Strategic Investor (high-volume investment projects) can receive cash subsidy for acquisition of long-term tangible and intangible assets.

The new Regional Aid Guidelines for 2014-2020 (RAG) have been adopted by the European Commission and have entered into force on 1 July 2014. RAG has decreased the maximum level of permissible state aid to 25% in all regions in the Czech Republic except Prague (with permissible state aid 0%).

The amended Act on Investment Incentives effective from 1 May 2015 newly adopts the following:

- companies focused on R&D activities, strategic services and technological centres (e.g. software development) also data centres and customer service centres are eligible for investment incentives support;
- the new concept of industrial zones is introduced;
- the possibility of restructuring for companies utilising state aid in the form of tax relief;
- the new tax exemption from real estate tax;
- sanctions in case of non-arm's length transfer prices are limited (see also below).

## 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 any buildings/constructions and movable assets with an input price above CZK 40,000 whose useful life exceeds one year (moveable assets). 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.

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

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.

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.
- Other intangible fixed assets are depreciated over 72 months.

## 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, the right to claim tax relief does not cease but the company is required to submit additional tax returns for all taxable periods in which tax relief was claimed and adjust the tax base by this difference.

A 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.

The Czech legal entities which participate in transactions with related parties have new reporting obligation effective 1 January 2014. The taxpayers are obliged to file a separate disclosure form on “Overview of Transactions with Related Parties” together with the corporate income tax return.

## 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 signed 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 penalty 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 percentage points.

## 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.

Effective 1 January 2016, new classification of companies has been introduced:

Company	Net turnover (CZK)	Net assets (CZK)	Employees	Criteria
Micro	18 million	9 million	10	2 of 3
Small	200 million	100 million	50	2 of 3
Medium	1 000 million	500 million	250	2 of 3
Big	above 1 000 million	above 500 million	above 250	

A company shall be re classified as a micro company assuming that at least two of three criteria as at the balance sheet day are not exceeded. Similarly a company shall be classified small company assuming the company is not a micro company and that at least two of three criteria as at the balance sheet day are not exceeded. A company shall be classified a medium company assuming the company is not micro- and small- company and at least two of three criteria as at the balance sheet day are not exceeded. A company shall be classified big assuming at least two of three criteria as at the balance sheet day are exceeded.

A new audit criteria are introduced following the new classification of companies. Statutory audit is always required for big and medium companies. Small companies shall qualify for the statutory audit based on the following criteria:

- legal form of joint-stock company
- at least one of the following criteria is fulfilled as at the balance sheet day of the current and immediately preceding accounting period:
  - net assets CZK 40 million
  - net turnover CZK 80 million
  - employees headcount 50

Other small companies shall qualify for the statutory audit assuming at least two of three of the above criteria are fulfilled as at the balance sheet day of the current and immediately preceding accounting period.

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.