



Praha

Martin Kováč
Hybernská 32
110 00 Praha
Tel: +420 221 111 611
Email: mkovac@bakertillyczech.cz

Brno

Lucia Rábllová
Česká 17
602 00 Brno
Tel: +420 542 425 823
Email: lrablova@bakertillyczech.cz

Refinement and tightening in taxes |

Tax deductibility of accruals for bonuses for employees Tightening of tax controls on transfer pricing VAT increase

| 1. Tax deductibility of accruals for annual bonuses paid to employees

On 31 March 2011, the Supreme Administrative Court of the Czech Republic issued a decision, where it examined in detail the admissibility of passive accruals for the annual bonuses paid to employees. Costs of annual bonuses, which are formally granted and paid to employees in the following year, were booked as tax deductible costs. According to the Supreme Administrative Court, how the conditions of a legal entitlement for this payment are adjusted is conclusive in this case – it depends on whether the obligation to pay the bonuses arose in the current period and its exact amount just was not known or this obligation will arise in the next period. Annual bonuses, where the legal entitlement has not arise to employees yet, should be booked to non-tax-allowable reserves.

| 2. Tax controls on prices agreed between related parties

Fiscal controls over the assessment of transfer pricing between related parties will be more stringent – it is based on the suspicion that the prices these people charge are often significantly different from the usual market prices, due to which the state loses a considerable part of its income. According to the tax legislation, transfer pricing must, in fact, correspond to market prices and the burden of proof lies with the taxpayers. Since Czech legislation does not specify clear rules for setting transfer prices, not only taxpayers but also tax authorities are unsure in this area. Financial Directorate therefore established special groups of inspectors who undergo special training and they will focus exclusively on transfer pricing between related parties in the future.

| 3. The tax reform - increasing the reduced VAT rate

The government approved a proposal of an amendment to the VAT Act, which would result in increase of reduced tax rate from current 10% to 14% since the beginning of 2012. In addition, according to this proposal, a unified rate of 17.5% should be applied in 2013. As compensation for the increase in prices of goods subject to reduced rate of VAT, the amendment proposes to increase tax benefits for dependent children in the amount of 13,404 CZK per year (the tax benefit is in the amount of 11,604 CZK in 2011).

However, this proposal still has to go through the approval process in the Chamber of Deputies and the Senate, therefore it may undergo significant changes and adjustments.

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