

TAX TREATMENT OF TAX NON-RESIDENTS IN THE CZECH REPUBLIC

General Features of Personal Income Taxation in the Czech Republic

Determination of an individual's tax residence

Personal income taxation in the Czech Republic is regulated by Act No. 586/1992 Coll., the Income Taxes Act, as amended ("ITA").

Under Czech tax legislation, individuals who have either their home address (i.e. the place where they reside and circumstances indicate that they intend to live there permanently) in the Czech Republic or stay in the Czech Republic for at least 183 days in the relevant calendar year (even intermittently) are regarded as Czech tax residents. Czech tax residents are subject to Czech personal income tax on their worldwide income, Czech tax non-residents are subject to Czech personal income taxation only on their Czech sourced income.

If an individual fulfils the tax residence criteria under both Czech tax legislation and the tax legislation of another country, his/her final tax residence status is determined according to the provisions of the Double Taxation Treaty ("DTT") concluded between the Czech Republic and the respective foreign country. If there is no DTT, the individual is regarded as a Czech tax resident regardless of his/her tax residence status in the other country.

According to the DTT concluded between the Czech Republic and Sweden ("Czech-Swedish DTT"), individuals are tax residents of the country in which they have a permanent home. If they have a permanent home available in both states, they are regarded as tax residents of the state with which their personal and economic relations are closer (where their centre of vital interest is situated). If it is not possible to determine the tax residence based on an individual's centre of vital interest or if he/she has a permanent home in none of the states, the individual is regarded as a tax resident of the state where he/she habitually abodes. If it was not possible to determine the tax residence status in a particular situation based on the above criteria, the individual would be regarded as a tax resident of the state of which he/she is a national or (if he/she is a national of both states or neither of them) his/her tax residence status would be determined by mutual agreement between the Czech Republic and Sweden.

Basic principles of income taxation in the Czech Republic

In the Czech Republic, personal income can be subject either to a standard tax of 15 percent (12.5 percent in 2009) or to a special withholding tax (also 15 and 12.5 percent respectively).

Withholding tax is usually applied to gross income not reduced by related expenses and without taking into account any tax allowances or tax reliefs. Withholding tax is withheld and transferred to the Czech Tax Authorities by the payer of the respective income and the receiver obtains already net income. Taxation by withholding tax is final and the receiver of the income does not have any further reporting or tax obligations with respect to this income in the Czech Republic.

Generally, income subject to a standard tax rate is to be taxed by the individuals themselves by filing an annual Czech personal income tax return. In this case, the income tax base is usually determined as the individual's taxable income (i.e. income subject to tax which is not tax exempt)

reduced by related tax deductible expenses. In the case of the standard tax rate, taxpayers can apply tax allowances and tax reliefs to which they are entitled.

Special tax treatment concerns employment income which is subject to the standard tax rate, though to simplify the tax procedure the respective tax is usually withheld and transferred to the Czech Tax Authorities by the employer (for more detail see Income from Employment Activities).

Income of Czech Tax Non-residents Subject to Taxation in the Czech Republic

As stated above, Czech tax non-residents are subject to taxation in the Czech Republic only on their income arising from Czech sources. Under the ITA, income from sources in the Czech Republic includes for instance:

- Income from employment (dependent activities) performed in Czech Republic,
- Income from business activities performed in the Czech Republic,
- Income from business activities done through a Czech permanent establishment¹,
- Capital gains income received from Czech tax residents,
- Income from renting real estate situated in the Czech Republic,
- Income from selling real estate situated in the Czech Republic,
- Income received from Czech tax residents for selling shares in legal entities (including joint-stock companies) seated in the Czech Republic.

However, the above may be modified if the respective DTT states specific rules for determining whether a particular income can be regarded as taxable in the Czech Republic (the other contracting state).

Under the Czech-Swedish DTT, for example, the income of Swedish tax residents from the sale of shares in legal entities seated in the Czech Republic whose property is not mainly formed by real estate can be taxed only in Sweden. For rules concerning the taxation of income from employment activities please see below.

Basic Taxation Features of Selected Income Types

Below is a general description of the basic taxation features with respect to the most common types of Czech tax non-residents' income.

Income from employment

Income from employment includes mainly income from work done under an employment contract, income from work done by executives of limited liability companies and remuneration paid to members of statutory and other bodies of legal entities. Any income received in relation to an individual's employment is regarded as employment income even if received from a person who has not concluded an employment contract with the individual.

¹ Permanent establishment refers to a fixed place of business through which the business is carried on. It includes e.g., a branch, an office, a factory or an installation or construction project lasting for a certain period (to be stipulated by the respective DTT). A permanent establishment may, however, be created also based on a mere provision of services in the territory of the respective state for a certain period or activities of a dependent agent (to be stipulated by the respective DTT).

Under the ITA, the income of Czech tax non-residents for dependent (employment) activities in the Czech Republic received from employers seated (residing) outside the Czech Republic is tax exempt if the period related to this work performance does not exceed 183 days in any 12 consecutive months and the respective activity is not performed in a permanent establishment.

If the Czech Republic concluded a DTT with the respective country, it is necessary to apply the provisions of this DTT. Under the Czech-Swedish DTT, income from employment performed by tax non-residents in the Czech Republic is subject to taxation in the Czech Republic except if:

- The individual is present in the Czech Republic for a maximum 183 days (on aggregate) in the calendar year,
- The remuneration is paid by (on behalf of) an employer who is not a Czech tax resident,
- The remuneration is not borne by a Czech permanent establishment of the foreign employer.

If all these conditions are simultaneously met, the employment income is taxable only in Sweden. Otherwise, it can be regarded as income from Czech sources and consequently, taxable in the Czech Republic.

Mainly except for remuneration paid to non-resident members of a legal entity's body, the employment income of Czech tax non-residents is subject to a standard personal income tax rate. The employment tax assessment base is stipulated as the gross employment income (i.e. income not reduced by the employee's portion of mandatory social security and health insurance contributions) increased by the related employer's portion of mandatory social security and health insurance ("SSHI") contributions or contributions to mandatory foreign SSHI if the individual is subject to a foreign SSHI scheme. In the latter case the amount of foreign SSHI, including SSHI rates and potential SSHI caps, is relevant. The above employment income cannot be reduced by any related employment expenses of the employee.

Specifically, even if the employment income is subject to a standard tax rate, the respective tax is to be withheld and transferred to the Czech Tax Authorities by the individual's employer via monthly payroll tax advances. When calculating the monthly payroll tax advances for tax non-residents, the employer takes into account the basic tax relief and the tax relief for students (if applicable)². Under the conditions stipulated by the ITA, non-resident employees who do not have any taxable income exceeding CZK 6,000 other than employment income subject to payroll tax withholdings in the respective calendar year (except for tax exempt income or income subject to withholding tax) are generally not obliged to file a Czech personal income tax return³. Anyway, if they intend to apply tax relief² other than stated above they are obliged to do so by filing a Czech personal income tax return.

Regardless of the above, if a Czech tax non-resident's income for work performed in the Czech Republic is paid by a foreign person, who has neither a permanent establishment nor employs people for more than 183 days in the Czech Republic, the employment income is to be taxed by the respective individuals themselves by filing a Czech personal income tax return.

² For details see Tax Allowances and Reliefs.

³ Some of the exceptions to this very general rule are stated below.

Special regulations apply to foreign employers with a Czech permanent establishment created solely as a result of the provision of services in the Czech Republic, and foreign embassies. Despite their presence in the Czech Republic in these cases, the respective tax is to be settled by the employees themselves by filing a Czech personal income tax return.

Specific tax treatment also concerns employees, who are “hired-out” by their foreign employer to a Czech person (“economic employer”). In this case, the economic employer is regarded as an employer of these employees for the purposes of taxation with all the related consequences (mainly the related obligation of maintaining a payroll tax agenda) even if these employees remain legally employed and paid by the foreign entity. Is the respective employee subject to a foreign SSHI scheme, the economic employer has to consider also the foreign employer’s SSHI contributions accordingly.

The income of non-resident members of a legal entity’s bodies is subject to a withholding tax of 15 percent (12.5 percent in 2009) to be withheld and transferred to the Czech Tax Authorities by the payer of the income.

Tax treatment of the most common employment benefits

Regardless of the tax residence status of employees, most employment benefits are subject to taxation in the Czech Republic (for employees subject to the Czech SSHI scheme also SSHI contributions). However, under the ITA, certain employment benefits of both Czech tax residents and non-residents are tax exempt (tax exempt benefits are also exempt from SSHI).

The most common tax exempt employment benefits involve for instance:

- Value of temporary accommodation (apart from accommodation when on a business trip) up to CZK 3,500 per month if provided in non-monetary form unless the town or village where the accommodation is corresponds to the employee’s home address,
- Value of food provided by employers to employees for consumption at the workplace in non-monetary form or as part of workplace catering facilities provided by another entity (including meal vouchers),
- Additional training for employees in relation to the employer’s business activity provided in non-monetary form.

Moreover, travel allowances provided to employees up to the limits stipulated by the Czech Labour Code for employees in the state sector are not subject to taxation.

Capital gains income

Generally, capital gains income received from Czech tax residents is regarded as income from sources situated in the Czech Republic subject to a withholding tax rate of 15 percent. The respective DTT can stipulate different tax treatment.

As a result of the application of a DTT, certain types of income can be excluded from taxation in the Czech Republic and/or a lower tax rate can be set with respect to some income types.

Under the Czech-Swedish DTT, for instance, dividends received by a Swedish tax resident individual from a Czech company (tax resident of the Czech Republic) can be subject to withholding tax of 10 percent only. A more favourable tax treatment is stipulated for example also

for interest received by Swedish tax residents from the Czech Republic, which can be subject to taxation only in the tax residence state of the receiver of the interest income.

Sale of shares in Czech entities

Under the ITA, income from the sale of shares in a Czech limited liability company or in a Czech joint-stock company received from a Czech tax resident (regardless of whether an individual or a legal entity) is regarded as income from Czech sources. DTTs concluded by the Czech Republic (including the Czech-Swedish DTT) usually change this rule by stating that income from the sale of corporate shares is taxable only in the residence state of the seller. Exceptions to this rule commonly cover income from the sale of shares in entities whose property is formed mainly by real estate, which can be taxed in the contracting state where the property is located (this tax treatment is applied in the Czech-Swedish DTT as well).

To determine an individual's tax base related to the sale of shares, the respective income can be reduced by the share's original acquisition price. This type of income is to be taxed by the standard tax rate by filing a Czech personal income tax return.

Tax Allowances and Reliefs

Under the ITA, an individual's Czech tax base can be reduced by certain tax allowances, including interest paid on a loan provided from a housing savings scheme, a mortgage and other similar housing financing schemes reduced by the related state contribution. The maximum amount of interest applied may not exceed CZK 300,000 per household per year. Czech tax non-residents may apply this allowance only if they generate at least 90 percent of their total income from sources in the Czech Republic (except for income not subject to taxation, tax exempt income or income subject to a withholding tax rate) and they have to apply it by filing a Czech personal income tax return. Further tax allowances relate mainly to contributions to voluntary pension and life insurance schemes.

The tax calculated based on the income subject to a standard tax rate may be further reduced by tax reliefs reflecting the personal situation of the taxpayer. The main (annual) 2008 tax reliefs are as follows:

- Basic tax relief (per taxpayer) – CZK 24,840,
- Tax relief for a spouse not having income exceeding CZK 38,040 in the tax period – CZK 24,840,
- Tax relief for students – CZK 4,020,
- Tax relief (bonus) per child – CZK 10,680.

Except for tax relief for students, Czech tax non-residents may apply the above tax reliefs only if they generate at least 90 percent of their total income from sources in the Czech Republic (except for income not subject to taxation, tax exempt income or income subject to a withholding tax rate). Moreover, they can apply the tax reliefs conditioned this way only by filing a Czech personal income tax return and the proportional part of these tax reliefs cannot be taken into account by employer when calculating the monthly payroll tax advances.

As far as the basic tax allowance is concerned, the application of the condition of 90 percent in this case was implemented with effect from 1 January 2008. However, the Ministry of Finance rapidly

initiated a legislative amendment abolishing this condition with respect to basic tax relief. This amendment will take effect on 1 July 2008. As a result, non-resident taxpayers (regardless of the amount of their income taxable in the Czech Republic) will be allowed to reduce their Czech tax by the basic tax relief. Moreover, they will be allowed to apply this relief for the purposes of the payroll tax advances in course of the tax period without further obligation to apply this tax relief via personal income tax return.

To bridge the period before the effect of the amendment the Ministry of Finance issued a measure, based on which payers of the payroll tax (i.e. employers) may reflect a non-resident taxpayer's basic tax allowance when calculating their 2008 payroll tax advances even before the amendment takes effect.

Paying Agent

In compliance with European legislation anybody paying out, transferring or crediting a settlement of interest-type income or any similar savings income ("paying agents") is obliged to inform the Czech Tax Authorities of any income distributed to natural persons with their home address in another EU member state. Upon receipt of information from the paying agent on the distributed income and its receiver, the Czech Tax Authorities accordingly inform the respective foreign Tax Authorities.

Please note that the above information is only a brief and very simplified description of the basic principles of taxation of tax non-residents in the Czech Republic. This review is only for information purposes and should not be understood as a complex analysis of the issues described. We remain entirely at your disposal if you require a detailed analysis in this respect or with respect to a particular situation.

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