

Taxation – Lecture 4

DIRECT TAX SYSTEM: PERSONAL INCOME TAX (EVIDENCE FROM THE CZECH REPUBLIC)

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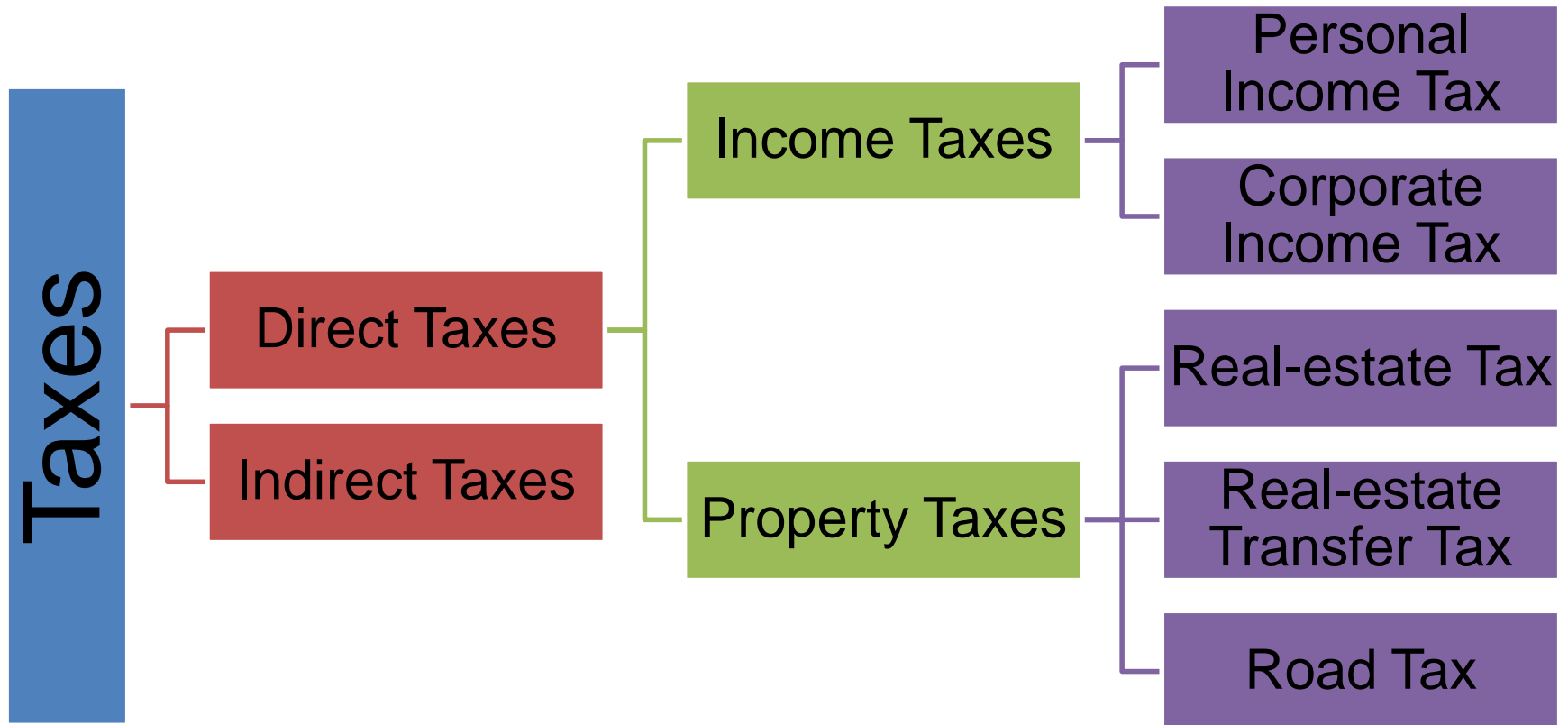
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Direct tax system in the Czech Republic

- **The system of direct taxes in the Czech Republic is very similar to other developed European countries.**
- Relevant legislation for direct taxes:
 - ❑ **Income tax** – act. No 586/1992 Coll.
 - ❑ **Real-estate tax** – act. No 338/1992 Coll.
 - ❑ **Real-estate transfer tax** – act. No 340/2013 Coll.
 - ❑ **Road tax** – act. No 16/1993 Coll.
- The act. No 586/1992 Coll., as amended, **Income tax, is divided into:**
 - ❑ **Personal income tax**
 - ❑ **Corporate income tax**
 - ❑ **Common regulation**

Direct tax system in the Czech Republic



Personal income tax (PIT)

- The **taxpayer of the personal income tax is a person** (resident or nonresident of the Czech Republic).
- The **object of the tax** is:
 - ❑ Income from **dependent activity** (employment)
 - ❑ Income from **self-employment**
 - ❑ Income from **capital assets**
 - ❑ Income from **rent**
 - ❑ **Other** income
- Each of these incomes, is described individually and **for each of them it is necessary to calculate so called partial tax base**, and then **sum up them to get the tax base**.
- Some incomes can be tax-exempt (only several of them will be mentioned):
 - ❑ **income from the sale of a family house** or a flat including the land related there, if the seller had his **residential address**

Personal income tax (PIT)

- there **for at least 2 years** immediately before the sale,
- ❑ income from the **sale of real-estate**, flats or **non-residential premises** (spaces), if the seller owned that property **for at least 5 years**,
- ❑ **compensations** received **for damages**,
- ❑ **social welfare benefits**, **state social support grants**,
- ❑ state or school **stipendium for students**,
- ❑ **rewards paid to donors** of blood and other human biological materials,
- ❑ incomes from **volunteering**,
- ❑ **alimony payments**, etc.

PIT – dependent activity (employ-t)

- Income from dependent activity is every income arising from:
 - ❑ **employment**,
 - ❑ **official or membership relationship** (the taxpayer in these relationships must follow employer's instructions),
 - ❑ **rewards paid** to members of the authorities of legal entities,
 - ❑ **other incomes** similar to these.
- The income is even **1%** (but not less than 1 000 CZK) **of the input price of a motor vehicle in each month** if the employee **can use it not only for business but for himself too**.
- There are several **incomes that are not liable to the personal income tax from dependent activity** such as:
 - ❑ **reimbursement of traveling expenses**,
 - ❑ **the value of food provided by the employer** for employees who are on a business journey,
 - ❑ **working clothes**,

PIT – dependent activity (employ-t)

- **items for the purposes of hygiene and work safety, etc.**
- There are also some **tax-exempt incomes from dependent activity**:
 - an amount for **additional education needed for work**,
 - the value of food and non-alcoholic beverages (**food vouchers**),
 - employer's contribution to the state-contributory supplementary pension insurance, etc.
- Every month the employer calculate and withhold advance tax of our wage (salary). The **withhold advance is 15% of sum of the wage (salary) and social security and health insurance which the employer has to pay for the employee (gross wage)**.
- If the employee works on base of signed **Agreement on work performance** and his **wage is lower than 10 000 CZK/month**, the **employer can withhold the „withholding tax“**. The withholding tax is also 15%, but in this case **it is calculated only from the wage** (because in this case the **employer do not pay social security and health insurance for the employee**).

PIT – dependent activity (employ-t)

- If the taxpayer has **incomes only from dependent activity from one employer, he has no obligation to fill the tax return.** He can ask his employer to fill the annual tax return. **It must be submit before 31st March.**
- The employer calculates the tax liability for his employee (using tax allowances/credits) and **decreases his liability by advance taxes or withholding taxes paid during the tax period.**
- **The tax rate of personal income tax is 15%.**
- **The taxpayer can reduce the tax base by tax allowances/credits:**
 - ❑ 24 840 CZK/year **for each taxpayer** (basic tax allowance),
 - ❑ 24 840 CZK/year **for a spouse** living with the taxpayer in one household (**if the spouses´ s own income do not exceed 68 000 CZK in the taxable period**),
 - ❑ 2 520 CZK/year for the beneficiary of a **partial disability pension** (1st or 2nd stage of disability),

PIT – dependent activity (employ-t)

- ❑ 5 040 CZK/year for the beneficiary of a **full disability pension** (3rd stage of disability),
- ❑ 16 140 CZK/year for the **SPH/H card holder**,
- ❑ 4 020 CZK/year **for the student up to 26 years** (28 years for students in doctoral study programmes),
- ❑ To send child to the **kindergarten** – 9 200 CZK (in 2015)
- ❑ The value of **gifts donated for charitable purpose** (the total value of gifts in the taxable period must exceed 2% of the tax base or 1 000 CZK and the total maximum allowable deduction shall be 15% of the tax base); as **gift for medical purpose** is considered donation of blood or organs (one donation of blood is assessed for 2 000 CZK, one donation of organ for 20 000 CZK),
- ❑ The amount equal to **the interest paid** in the taxable period **on a loan provided** from a housing saving or on a mortgage loan,

PIT – dependent activity (employ-t)

- **Contributions to the state-contributory supplementary pension insurance scheme** paid by the taxpayer reduced by 12 000 CZK to the maximum amount of 12 000 CZK,
 - **Private life insurance premiums** paid within the taxable period to a maximum amount of 12 000 CZK in one taxable period
 - 13 404 CZK/year for every **dependent child** living with the taxpayer in one household.
- This last amount can be used as a **tax reduction** (up to zero tax duty) or called **tax bonus** (minus tax duty, at minimum 100 CZK to maximum 60 300 CZK in one taxable period).

PIT – private entrepreneur (self-employ-t)

- **Incomes from self-employment belongs to the personal income tax.**
- **Income from dependent activity** is every income arising from employment. It means „**I work for somebody else**“. On the other hand, **income from self-employment** is income from self-employment business – „**I work for myself**“.
- Incomes from self-employment are incomes from:
 - ❑ **agriculture production**, forestry and fish farming,
 - ❑ self-employment based on **business licence**,
 - ❑ **other entrepreneurship** except a) and b),
 - ❑ **shares of partners in profits** of general commercial partnership and general partners´ shares in profits of a limited partnership,
 - ❑ **the use or provision of industrial or other intellectual property** and from copyright,
 - ❑ pursuit of an **independent profession**,
 - ❑ activity carried out by a **bankruptcy trustee**,

PIT – private entrepreneur (self-employ-t)

- income of an **expert, an interpreter, an arbitrator,**
- **Partial tax base** for the income from self-employment is created by the above mentioned incomes **reduced by the expenses incurred to generate, assure and maintain the incomes.**
- If the taxpayer does **not have enough expenses,** he may use **lump sum expenses:**
 - **80 % of income from agricultural production,** forestry and fish farming and from self-employment craftsmanship business,
 - **60 % of income from self-employment business** (other than craftsmanship),
 - **40 % of income from other entrepreneurship** except those above (at maximum of 800 000 CZK).
- **If the taxpayer:**
 - **has incomes only from self-employment** according to a), b) or c),

PIT – private entrepreneur (self-employ-t)

- ❑ and **has no employees nor cooperating fellow workers,**
- ❑ and **his income from self-employment from previous 3 consecutively taxable periods does not exceed 5 milion CZK,**
- ❑ and **he is not a partner in any company,**

then tax administrator can determine his tax liability as a lump amount.

- Income from self-employment can be split between other cooperating people living in the same household with the taxpayer (spouse, children).
- The portion for cooperating spouse must be no more than 50% of total income from self-employment (max. 540 000 CZK per year or 45 000 CZK for a month of cooperation).
- The portion for other cooperating person must be no more than 30% of total income from self-employment (max. 180 000 CZK per year or 15 000 CZK for a month of cooperation).

PIT – income from capital assets

- **Income from capital assets**, if it is not the income from employment and income from self-employment, **is**:
 - ❑ **profit shares from ownership interest in equity of joint stock companies**, limited liability companies and limited partnerships, profit shares of membership of a cooperative and interest and other income from securities holdings
 - ❑ **profit shares of a company**,
 - ❑ **profit sharing of the silent partner** participating in a business,
 - ❑ **interest, winnings and other income from deposits on deposit books**, the interest from cash in the account,
 - ❑ **income from the one-time deposit**,
 - ❑ **supplementary pension insurance and pension insurance benefit**,
 - ❑ **private life insurance benefit**,
 - ❑ **interest and other income from loans, default interest**,

PIT – income from capital assets

- ❑ **interest and other income from holding bills of exchange,**
 - ❑ **payments from the trust fund earnings after taxes.**
- Above mentioned incomes a)-f), h) and i) generated from sources in the Czech Republic, have separate tax base for the taxation by special tax rate (15%).
- **If a taxpayer has income only from capital assets generated from sources in the Czech Republic, he can not use items deductible from the tax base.**
- Above mentioned incomes a)-f) coming from sources abroad, have partial tax base of personal income tax. Income under e)-f) may be reported reduced by the relevant expenses.

PIT – income from capital assets

- **Example:** Determine which of these incomes shall be taxable under Income from capital assets:
 - Mary bought Czech government bonds and she wants to hold them until the end of maturity.
 - John bought CEZ shares in January and sold them 3 weeks later with income of 5 000 CZK.
 - MONEY, joint stock company, that deals with securities trading:
 - bought NWT shares in January and sold them in February with income of 50 000 CZK.
 - bought Unipetrol shares 2 years ago, gains dividends and continue in their possession.

PIT – income from capital assets

- **Solution:**

- Mary bought Czech government bonds and she wants to hold them until the end of maturity. – Income from capital assets
- John bought CEZ shares in January and sold them 3 weeks later with income of 5 000 CZK. – Other income
- MONEY, joint stock company, that deals with securities trading:
 - bought NWT shares in January and sold them in February with income of 50 000 CZK. – Corporate income
 - bought Unipetrol shares 2 years ago, gains dividends and continue in their possession. – Corporate income

PIT – income from rent

- **Income from rent**, if it is not the income from employment, from self-employment and from capital assets, **is**:
 - income from the **rent of immovable property** or apartments,
 - income from the **rent of movable property, except for occasional rent.**
- The above described incomes derived from the marital property is taxed only at one of them.
- **The above mentioned incomes of a non-resident are separate tax base for the taxation of a special tax rate (15%).**
- **Partial tax base are incomes mentioned above reduced by expenses incurred to obtain, secure and maintain them.**
- If the taxpayer **does not apply proven expenses** incurred to generate, ensuring and maintaining **income, can claim expenses in the amount of 30% of the rental income, but only up to the amount of 600 000 CZK.**

PIT – income from rent

- **Example:** Tom rents a flat to Jerry for a whole year. Tom's rental income is 10 000 CZK per month. Tom's expenses associated with the maintenance of the flat is 20 000 CZK per year. What will be the annual income tax?

PIT – income from rent

- **Example:** Tom rents a flat to Jerry for a whole year. Tom's rental income is 10 000 CZK per month. Tom's expenses associated with the maintenance of the flat is 20 000 CZK per year. What will be the annual income tax?

- **Solution:**

Income from rent = $12 \times 10\,000 = 120\,000$ CZK

Proven expenses = 20 000 CZK

Expenses by percentage (30% of income) =

$120\,000 \times 0,30 = 36\,000$ CZK

Tax base = $120\,000 - 36\,000 = 84\,000$ CZK

Tax rate = 15 %

Final tax = $84\,000 * 0,15 = 12\,600$ CZK

PIT – other income

- **Other income**, if it is not the income from employment, from self-employment, from capital assets and from rent, **is especially**:
 - ❑ **income from occasional activities or occasional rent of movables**,
 - ❑ **income from agriculture** and forestry and water management, which are not operated by an entrepreneur,
 - ❑ **winnings from lotteries**, betting and other similar games and prizes of advertising competitions and raffle,
 - ❑ **income from the transfer of participation in limited liability companies**, limited partners to a limited partnership or a cooperative share transfer,
 - ❑ **income from an inherited rights** to industrial and intellectual property, including copyrights, etc.
- There are some **tax-exempt incomes**:
 - ❑ **income from occasional activities or occasional rent of movables** if the sum up of these incomes do not exceed the

PIT – other income

amount of 30 000 CZK in a taxable period,

- **income from beekeeping** if there are no more than 60 hives and the income do not exceed the amount of 500 CZK per hive in a taxable period,
- **income from sales of securities and from shares** pertaining to a participation certificate when canceling mutual fund, if their sum does not exceed the amount of 100 000 CZK in a taxable period.
- **Gratuitous income (gifts) can be tax-exempt, if it is obtained from:**
 - **relative in a straight line** (children, parents, grandparents, grandchildren) **and the secondary line** (siblings, uncle, aunt, nephew or niece, spouse, spouse of my child, child of my spouse, parents of my spouse or spouse of my parent),
 - **the person with whom the taxpayer has lived for at least 1 year** before obtaining gratuitous income in joint household,

PIT – other income

- **acquired on occasion provided their value does not reach 15 000 CZK.**

Partial tax base is income minus expenses provably incurred to achieve it. If the expenses are greater than income, than partial tax base is equal to 0.

PIT – other income

- **Example:** Determine which of these incomes shall be taxable under other income and which of these could be tax-exempt:
 - ❑ Tomas Berdych (Czech resident) won Davis Cup and received 200 000 000 CZK.
 - ❑ Harry won 20 000 CZK in a lottery.
 - ❑ John is a beekeeper. He has 20 hives and his income is 15 000 CZK in a taxable period.
 - ❑ Margot inherited a car from her grandfather in cost of 240 000 CZK.
 - ❑ Bonnie clean up her old neighbor´s house 4 times per year and she receives 10 000 CZK.

PIT – other income

- **Solution:** Determine which of these incomes shall be taxable under other income and which of these could be tax-exempt:
 - Tomas Berdych (Czech resident) won Davis Cup and received CZK 200 000 000. – **Income from self-employment**
 - Harry won CZK 20 000 in a lottery. – **Other income**
 - John is a beekeeper. He has 20 hives and his income is CZK 15 000 in a taxable period. – **Other income (it cannot be tax-exempt, because his income is 750 CZK per a hive)**
 - Margot inherited a car from her grandfather in cost of CZK 240 000. – **Tax-exempt other income**
 - Bonnie clean up her old neighbor´s house 4 times per year and she receives CZK 10 000. – **Tax-exempt other income**

Social security and health care contributions (SHC)

- Not only high taxes but especially **high social security and health contributions are the worst problem that Czech entrepreneurs have.**
- Czech or foreign employers or Czech branch offices of foreign employers, **all foreigners who work for a Czech employer or are on the payroll of a branch office of a foreign company participate in the Czech Republic social security system.**
- **Most Czech legal entities must also make a contribution to an insurance fund for work-related accidents and illness.**
- **The assessment base of social security for employee is sum up of his income** (income that is subjected of the personal income tax). **The assessment base of health insurance is his partial tax base for the income from dependent activity.**
- **The assessment base of social security and health insurance for employer is sum up of assessment bases of his employees.**

Social security and health care contributions (SHC)

- **The assessment base of social security for the self-employed person is the amount he choose** (at least his partial tax base for the income from self-employment). **The assessment base of health insurance is his partial tax base for the income from self-employment.**

Table of social security and health insurance rates in the Czech Republic.

	Employer (%)	Employee (%)	Total (%)	Self-employed persons (%)
Health insurance	9,0	4,5	13,5	13,5
Social security	25,0	6,5	31,5	29,2
Pension	21,5	6,5	28,0	28,0
Sickness	2,3	0	2,3	0
Unemployment	1,2	0	1,2	1,2
Total	34,0	11,0	45,0	42,7

Social security and health care contributions (SHC)

- **The self-employed person must submit annual return for Social Security Institution and Health Insurance Company before 31st March.** If the taxpayer has a tax adviser (agent) the annual return could be filled by the 30th June.
- In this return he calculates **how much he must pay for his social security and health insurance** for the previous year. Every **self-employed person must pay monthly allowances.** After **subtracting allowances he must either pay up the difference or the institutions will return excess of his payments.**

Literature

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