

allgemeinen die Durchführung von Steuerprüfungen, die andernfalls erst zu einem späteren Zeitpunkt anlässlich der Vorlage einer Einkommensteuererklärung fällig wären. Es handelt sich dabei um unkomplizierte Verfahren, die professionell und kompetent angewendet werden. Die erforderlichen Formblätter und Richtlinien sind unschwer erhältlich.

Die kanadischen Steuerbehörden erteilen auch umfangreiche Unterstützung an Personen, die ihren Wohnsitzstatus für Zwecke der Einkommenssteuer, sowohl im Rahmen des inländischen Steuerrechts als auch aufgrund von DBA, klären wollen. Auch dafür gibt es Formulare und Richtlinien. Unklarheiten über den Sitz von Körperschaften sind weniger häufig, und die Verwaltungsverfahren für ihre Bearbeitung sind weniger stark entwickelt.

Resumen

El principio de autoimposición que constituye la piedra angular de la Administración tributaria de Canadá es también un rasgo característico de la estructura jurídica y administrativa aplicable a los temas amparados por los convenios de doble imposición (CDI). Los residentes y no residentes pueden solicitar los beneficios previstos por los CDI en la declaración de sus rentas en base a las disposiciones de la Ley del Impuesto sobre la Renta (Canadá) ("ITA") modificada por cualquier CDI vigente.

En estos casos, el examen de tales cuestiones por la Administración tributaria comienza tras los hechos o ejercicio fiscal a considerar.

Dicho esto, en ciertas circunstancias del contexto de la imposición de no residentes, los residentes canadienses que traten con no residentes están sujetos a la obligación de declarar o a la retención en la fuente. Esta obligación aparece más cuando existe una transacción o un acontecimiento significativo que a final del ejercicio fiscal o del período declarativo. En algunos casos puede obtenerse la desgravación prevista por el CDI sin que ninguna de las partes haya de cumplimentar declaración de la renta u otro documento (y de hecho con anterioridad a la fecha más cercana a aquella en que tal declaración podría ser legalmente cumplimentada), aunque este sistema, en general, sólo se utiliza cuando un residente ha de efectuar retención por gravamen del no residente, siendo personalmente responsable del menor ingreso del gravamen. Así pues, la obligación de un deudor de retener y reembolsar el impuesto sobre intereses, dividendos, cánones y otros importes al tipo legal del 25 por ciento puede verse aminorada conforme al CDI vigente si se han llevado a cabo las correspondientes gestiones administrativas antes de la fecha en que el importe sea pagado o acreditado al no residente. También han sido establecidos procedimientos especiales para aminsonar, conforme a los CDI aplicables, las obligaciones legales de retención de bienes inmuebles que efectúan pagos por prestación de servicios en Canadá y cesiones de bienes inmuebles sitos en el país, así como de ciertos bienes que constituyen un activo imponible canadiense. En general, los procedimientos aplicables permiten a las Autoridades tributarias canadienses proceder al tipo de examen que podría llevarse a efecto con posterioridad, al presentar la declaración de la renta. Estos procedimientos generalmente son lineales y los agentes cualificados los tratan de forma imparcial. La mayoría de asuntos importantes se tratan por los centros locales repartidos por todo el territorio canadiense. Son fácilmente accesibles los preceptivos formularios e instrucciones.

Las autoridades tributarias canadienses auxilian también de forma apreciable a las personas físicas que precisan información sobre su estatus de residencia a efectos del ITA, bien por medio de la legislación interna, bien con los CDI vigentes. Existen también guías e impresos preparados al efecto. El estatuto de las personas jurídicas en lo que se refiere a su sede no da lugar a tantas cuestiones y los procedimientos administrativos que se siguen para resolver estos temas no son tan complejos.

1. Introduction

This report deals with the procedures and formalities regarding the application of double tax conventions (DTCs) in the Czech Republic. Due to the recent introduction of a new tax system in the Czech Republic, the regulatory framework in the Czech Republic regarding the subject of this report is fairly rudimentary, and the role of literature and case law under this new tax system is still very limited. Therefore, this report is, probably to a greater degree than other country reports, based on practical experience, and on informal contacts with local tax offices and Ministry of Finance officials. We believe, however, that mentioning these experiences will contribute to the practical value of the report.

In view of the state of the Czech economy, in which inbound investment greatly exceeds outbound investment, the formalities and procedures connected with foreign investment in the Czech Republic have attracted the most attention from tax officials, taxpayers and their advisers. This will be reflected in our report.

2. Some relevant sources of law

2.1. Czech domestic law

In the Czech Republic, the substantive law regarding the taxation of the income of both individuals (personal income tax) and legal entities (corporate income tax) is found in one act, the Income Taxes Act,² which was passed by the Czech National Council on 20 November 1992 and came into force on 1 January 1993. The Income Taxes Act constituted a radical change from the previous systems, in an attempt to establish a market economy oriented tax system.

¹ Tax partner at Vorlícková and Partners, Prague
² Act No. 586/1992, as subsequently amended.

The procedural tax law is enacted in the Administration and Collection of Taxes Act³ (hereafter the Tax Administration Act), which came into force together with the Income Taxes Act. The Tax Administration Act contains the provisions concerning tax proceedings, registration, penalties, filing of tax returns, and similar regulations.

Based on article 78 of the Czech Constitution, only the government of the Czech Republic has the power to issue generally binding regulations concerning the implementation of laws. However, specific laws can authorise the executive to issue binding regulations within the scope of that law.⁴ The Ministry has used its power to issue such binding regulations on a few occasions. Most of the Ministry's publications, however, are mere interpretative decrees and instructions, which have no legal force (see section 2.3).

2.2. Tax treaties

The Czech Republic is currently a party to 47 tax treaties. Both the Income Taxes Act and the Tax Administration Act⁵ provide that treaties which are binding on the Czech Republic take precedence over the provisions of those Acts.⁶

Of the Czech Republic's 47 tax treaties, 45 are bilateral tax treaties based on the OECD model tax conventions and the United Nations model tax convention between developed and developing countries. Apart from these bilateral tax relationships, the Czech Republic has inherited the membership of the two CMEA (Comecon) multilateral tax conventions, which are still partly valid (see section 2.2.2 below).

2.2.1. Status of Czechoslovak tax treaties

The majority of the Czech Republic's tax treaties were originally concluded by the Czech Republic's legal predecessors, the Czechoslovak Socialist Republic and the Czech and Slovak Federal Republic. Following the split of the Czech and Slovak Federal Republic with effect on 1 January 1993, the Czech Republic and the Slovak Republic became successors to the tax treaties concluded before that date. The Czech Republic and the Slovak Republic consider themselves bound by the pre-1993 tax treaties, and the counterparties under these treaties have agreed, either explicitly or in practice, to continue the application of these treaties to both new states.

Following the disintegration of Yugoslavia, the Czech Republic has announced that it will continue to apply the tax treaty between Yugoslavia and Czechoslovakia to Bosnia and Herzegovina, Croatia, The Federal Republic of Yugoslavia (Serbia and Montenegro) and Slovenia.

2.2.2. CMEA treaties

Czechoslovakia was a signatory to the multilateral tax conventions of the former Council for Mutual Economic Assistance (CMEA, also known as Comecon), which consisted of Bulgaria, Czechoslovakia, Hungary, Mongolia, Poland, Romania and the USSR. These multilateral tax conventions, the Convention for the Avoidance of Double Taxation of Individuals and the Convention for the Avoidance of Double Taxation of Corporations, provide for almost exclusive taxation of income in the home country of the recipient. The Czech Republic has announced that it will continue to apply the CMEA conventions to the former member countries, until bilateral tax treaties following the OECD model are concluded with such countries. Since the disintegration of the USSR, the Czech Republic has expressed its willingness to apply the CMEA Conventions to its various parts. The Baltic states have not considered themselves bound by the CMEA conventions, and Hungary and Kazakhstan have officially denounced the conventions.

The Czech Republic has now concluded bilateral tax treaties with the Baltic states, Hungary, Poland, Romania, the Slovak Republic and the Russian Federation. Therefore, the significance of the CMEA conventions is in practice limited to a number of former USSR states.

In view of their limited significance, we will not consider the CMEA conventions any further.

2.3. Instructions of the Ministry of Finance

The following Instructions, published by the Ministry of Finance, are relevant in respect of the procedures and formalities for applying DTCs:

- D-90: reduction of withholding tax at source, determination of residency of recipient;
- D-91: application of DTCs in case of book-entered securities;
- D-151: instruction for securing the uniform application of article 6(2) of the Income Taxes Act;⁷
- D-154: procedure for the taxation of income according to article 22(1)(c) of the Income Taxes Act;⁸
- D-132: general instruction regarding the interpretation of a number of provisions of the Income Taxes Act.

⁷ Art. 6(2) of the Income Taxes Act contains the concept of "economic employer", conforming to the Commentary to art. 15 of the OECD model tax convention, para. 8.

⁸ Art. 22(1)(b) of the Income Taxes Act contains the categorisation of services provided in the Czech Republic as a Czech source of income.

³ Act No. 337/1992, as subsequently amended.

⁴ E.g. art. 100 of the Tax Administration Act, art. 39(d) of the Income Taxes Act.

⁵ Art. 37 of the Income Taxes Act, art. 96(1) of the Tax Administration Act.

⁶ This rule does not follow from the Czech constitution.

3. Special situations

3.1. Residency

3.1.1. The residency of individuals

The tax residency of individuals is regulated in article 2 of the Income Taxes Act. In brief, this article provides the following rule:

- a person is resident in the Czech Republic if he has a "place of residence" in the Czech Republic, or if he "usually stays" in the Czech Republic;
- a "place of residence" means a place where a taxpayer has his permanent abode, with circumstances indicating his intention to dwell there permanently;
- "usually staying" in the Czech Republic means staying in the country for at least 183 days in the calendar year;
- there are some special categories of fictitious non-residents, the most important of which are the so-called "foreign experts" (see section 3.1.2 below).

A further description of the concept of "place of residence" is contained in Instruction D-132.⁹ The formalities and procedures connected with obtaining and terminating tax residency in the Czech Republic are clarified in the examples below.

3.1.1.1. Immigration formalities

Example 1: A, who recently immigrated to the Czech Republic, wishes to be treated as a Czech tax resident from the earliest possible date.¹⁰ In this example, it is assumed that A has moved his "place of residence" to the Czech Republic.

From a tax procedural point of view, the requirements to be met by A are fairly simple. According to article 33 of the Tax Administration Act, A is obliged to register himself with the Czech tax authorities if (a) he receives permission to engage in business activity (i.e. if he obtains a "trade-licence"), within 30 days thereafter, or (b) he receives income which is liable to tax, within 30 days from the date of arrival. However, if (a) he is liable only to occasional or non-recurring tax, or (b) his tax liability only concerns real estate, or (c) his income is derived solely from dependent activity, or (d) his income is taxed by way of Czech final withholding tax, there is no obligation for A to register.

In practice, however, this is more complicated. The financial offices in charge of tax registration will register only those persons having a residence permit (or "green card") for the Czech Republic. Obtaining a green card is a cumbersome process, which on average takes two to three months. Because green cards are

⁹ Instruction D-132, No. 15/76368/1995.

¹⁰ This is not an imaginary case. There are several examples of tax-driven immigration to the Czech Republic.

issued only for the purpose of employment, carrying out a business activity, or membership on the board of directors of a Czech company, each applicant for a green card must submit, in addition to other documents, one of the following: (a) an employment agreement showing that the applicant will be employed in the Czech Republic, or (b) a trade licence, or (c) the applicant's appointment to the board of directors of a Czech company.

Obviously, A can claim to be a tax resident on the basis of the relevant provision of the Income Taxes Act as of the first day of his stay in the Czech Republic. Whether he is to be regarded as a resident or not does not depend on his fulfilling the formalities regarding registration, nor from his possession of a green card. On the other hand, to be recognised as a tax resident by the tax authorities without tax registration may be quite difficult. In practice, tax returns are frequently refused and sent back by the competent tax authority, on the basis that the person filing the return is not registered as a taxpayer. Also, without tax registration, it may be problematic to obtain a residency statement from the tax authorities.

Immigrants generally tend to adhere to the practice established by the Czech tax authorities. They apply for a green card on one of the above mentioned grounds, and register for tax purposes after obtaining the green card.

3.1.1.2. Emigration formalities

Example: X, who was a long-term resident of the Czech Republic, has recently left the country for an indefinite period, and wishes to be treated as a non-resident from the earliest possible date after leaving.

The emigration formalities are provided by article 33(14) of the Tax Administration Act. Upon emigration, X is obliged to submit his tax registration document to the tax authorities, with a notification of the emigration. The tax authorities will mark the emigration on X's tax registration document. X will have to file his tax return for the period up to his emigration as usual, i.e. after the end of the calendar year in which he emigrated. X may be regarded as a non-resident from the moment he crosses the state border.

3.1.2. The situation of "foreign experts"

So-called foreign experts make up a special category of non-residents. In the Income Taxes Act introduced in 1993, the Czech Republic created a special regime for any foreigner sent to the Czech Republic by a foreign entity for the purpose of providing expert assistance to a Czech company (a "foreign expert"). Such persons:

- (a) are liable to Czech income tax only on income from Czech sources, even if they "usually stay" in the Czech Republic;¹¹ and
- (b) until 31 December 1996 were entitled to a special deduction for deemed expenses (30 per cent of the Czech labour income in the years 1993-1995, 25 per cent in the year 1996). As from 1997, this deduction no longer exists.

¹¹ See section 3.1.1 above.

One of the conditions for applying the regime is that the foreign expert has his "permanent residence" abroad. In the view of the Ministry of Finance, "permanent residence" must be understood as tax residence.¹²

In his Czech tax return, the foreign expert must mention his address abroad and tick the appropriate box for the foreign expert regime. With the tax return, the foreign expert must submit a salary statement from his foreign employer, and a statement from the Czech company confirming that he is working there as a foreign expert.

In practice, the condition that the foreign expert must be a tax resident of another country has no import. The financial offices seem to presuppose that every foreigner residing in the Czech Republic on the basis of a green card, a copy of which must be submitted upon registration as a taxpayer, fulfils the condition of having his tax residence abroad. Due to lack of understanding of both the financial offices and the foreigners involved, a part of them benefitted¹³ from the regime although they were not considered as tax residents of any other country.

3.1.3. *The residency of companies*

Although almost all Czech tax treaties contain the tie-breaker rule, the significance thereof is in practice very limited.

According to the Income Taxes Act, only companies having their registered office in the Czech Republic are regarded as resident companies. The term "registered office" is to be understood as the statutory seat of the company. Accordingly, companies not incorporated under Czech law cannot in principle be regarded as resident companies. A foreign company having its place of effective management in the Czech Republic will therefore not be regarded as a resident company. However, according to article 26 of the Commercial Code, a company incorporated abroad may relocate its statutory seat to the Czech Republic, provided that the country of origin also allows such a relocation of the statutory seat. After the relocation, the internal relationships of the company continue to be governed by the law of the country of incorporation.

The opposite situation, i.e. a Czech incorporated company becoming a tax resident of another country, is also difficult to imagine under the Czech legal system. Under the tie-breaker rule of DTCs, a Czech company would have to relocate its place of effective management to the other country. However, foreigners (i.e. non-Czech citizens) can only become members of the board of directors of a Czech company if they have a residence permit (green card) for the Czech Republic. It is assumed that in order to relocate the place of effective management to the other country, the company should, among other requirements, have a

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It is clear that as a result of this condition, the exemption from income tax on income from non-DTC sources is only relevant for residents of countries with which the Czech Republic has no DTC. All residents of treaty countries are already exempted from tax on non-Czech sources on the basis of the DTC.

¹³

Since the cancellation of the special deduction for deemed expenses, the regime has no practical significance (see previous footnote).

board of directors which consists of a majority of residents of the other country. This would mean, in practice, that either one or more of the Czech directors of the company would have to move to become a resident of other country, or that one or more residents of the other country would have to apply for a Czech residence permit. Regarding the conditions for obtaining a Czech residence permit, we refer to section 3.2 above.

Therefore, although possible in theory, the formal requirements described above will in practice render the relocation of the residency of foreign companies to the Czech Republic and of Czech companies abroad rather unlikely. In current practice, the tie-breaker rule of DTCs has no significance.

3.2. Withholding taxes

3.2.1. *Domestic provisions*

3.2.1.1. *Outgoing dividends*

The Czech Republic, according to its national tax laws, levies withholding taxes from a variety of payments made to non-residents, at rates of 1 per cent for financial lease payments, 15 per cent on certain types of interest to individuals, and 25 per cent on dividends, most types of interest, licences, services, income of artists and operational lease payments. Withholding taxes always constitute the final tax liability of the recipient. Apart from these withholding taxes, the Czech Republic levies a so-called "security advance". The security advance is a 10 per cent withholding tax, levied from all payments to non-residents which constitute the Czech taxable income of the recipient and which are not subject to normal withholding tax. The security advance is a prepayment, which is offset against the final tax liability resulting from the tax return filed by the non-resident.

3.2.1.2. *Incoming dividends*

As of 1 January 1998, dividends from foreign sources are in the Czech Republic subject to the same taxation as dividends from domestic sources. Dividends from abroad constitute a separate tax basis, subject to income tax (personal or corporate) of 25 per cent, without the possibility of deducting expenses from the tax basis.¹⁴ The Czech Republic grants, by way of unilateral avoidance of double taxation, a credit for "similar taxes" paid abroad. The credit is an ordinary credit, i.e. it is limited to the amount of Czech tax corresponding to the part of the income originating abroad.

If a tax treaty applies, the Income Taxes Act simply refers to the provisions regarding the avoidance of double taxation in the treaty.

In order to prove its entitlement to tax treaty protection, a Czech person can obtain a residency statement. Residency statements are issued by the local

¹⁴ Before 1998, dividends from abroad were included in the income subject to regular tax rates, whereas domestic dividends were subject to the 25 per cent final withholding tax.

financial office competent for the applicant. The tax authorities use a standard form, which contains the following text:

"Certification on taxpayer's residence. Undersigned tax authority in [place of financial office] confirms that the tax payer [name of applicant][address] is a resident of the Czech Republic in the sense of article [number of residency article of the relevant tax treaty] of the Convention between the Czech Republic and [relevant treaty country] on the Avoidance of double taxation no. [number of tax treaty] signed [date of signing the treaty]. [Place, date and signature of competent person]."

3.2.2. Application of DTCs

3.2.2.1. General procedure: reduction at source

The Ministry of Finance has issued two Instructions with guidelines for the application of DTCs.

In Instruction D-90,¹⁵ it is stated that the Czech Republic has not introduced a system for the refund of withholding taxes, and that therefore reduction of withholding taxes on the basis of DTCs is granted at source. The Instruction requires the distributor to collect a residency statement only in case of doubt regarding the residency of the recipient.¹⁶

Instruction D-91¹⁷ concerns the application of DTCs to income from book-entered securities. Instruction D-91 was followed by an Instruction to Instruction D-91,¹⁸ and the latter was followed by an Interpretation of the Instruction to Instruction D-91.¹⁹ In essence, these Instructions provide that the DTC between the Czech Republic and the country of residence of the "real" owner is applicable to income derived from such securities. The Instructions focus mainly on the operation of the Securities Center, where securities are booked in the accounts of custodians (e.g. banks), who hold the securities for another person (the "real owner"). However, as confirmed by the Ministry of Finance, the "real owner" concept has broader applicability than these book-entered securities. It would also apply, for example, to the situation where shares are owned by an agent or nominee for the account of another person. The Instruction requires that the custodian submit (a) a statement that he holds the account for another person, who is the "real owner" and (b) a residency statement of the "real owner".

¹⁵ Instruction no. 251/45502/94, Financial Gazette 7-8/1994, of 30 September 1994.

¹⁶ What is not mentioned in the Instruction is that the distributor can be held liable for the withholding of taxes at an incorrect amount, art. 38d(5) of the Income Taxes Act.

¹⁷ Instruction No. 251/45510/1994, Financial Gazette 7-8/1994, of 30 September 1994.

¹⁸ No. 251/59984/96, Financial Gazette 10/1996.

¹⁹ No. 351/76257/96, Financial Gazette 12/1996.

The Instruction describes the "real owner" as the "final recipient" of the income, without giving any further explanation thereof. In practice, therefore, the "real owner" is the person the custodian claims is the "real owner".²⁰

3.2.2.2. Procedure for refund

The fact that the Czech Republic has not introduced a procedure for the refund of withholding tax, as stated by the Ministry of Finance in Instruction D-90 (see section 3.2.2.1), does in our view not relieve the Czech Republic from granting a refund if withholding tax is levied in excess of the applicable treaty rate. However, there is no clear legal basis for a direct claim for refund from the recipient against the Czech tax authorities.

The Tax Administration Act offers the following possibilities.

(a) *claim of recipient against distributor*: on the basis of article 51 of the Tax Administration Act, a recipient who has doubts about the correctness of the amount withheld, can request an explanation from the distributor. The request has to be filed within 60 days from the day on which the tax was withheld. The distributor is obliged to answer within 30 days of receipt of such request, and to correct any mistakes within the same time limit. If the recipient does not agree with the decision of the distributor, he may file a complaint with the competent financial office within 30 days from the day on which he received the distributor's answer. The financial office has no time limit for making a decision. Both recipient and distributor may appeal the decision of the financial office.

(b) *claim of distributor against the tax authorities*: on the basis of article 64 of the Tax Administration Act, the distributor may file a claim for overpaid tax with the competent financial office. It should be noted that, since the withholding tax is a tax obligation of the distributor, rather than the recipient, the recipient cannot file a claim on the basis of article 64 of the Tax Administration Act. The claim has to be filed within six years from the end of the year in which the last tax assessment in respect of which tax was overpaid became final.

The overpaid tax is used to offset any other existing tax obligation of the applicant. The remainder must in principle be refunded to the applicant within 30 days of delivery of the claim.²¹ The recipient then has a claim against the distributor for the refunded amount.

Obviously, both methods entail substantial disadvantages for the recipient. However, if both procedures fail to return the excess withholding tax to the recipient, he may file a claim for refund directly to the Ministry of Finance. In practice, the Ministry of Finance considers itself authorised, either on the basis of article 39(b) of the Income Taxes Act or directly on the basis of a DTC, to deal with such a claim.

²⁰ Without excluding, of course, that the tax authorities may require further evidence of the custodian's claim.

²¹ This 30-day period is interrupted if the tax authorities require further information, or start a review of the claim.

3.2.3. Determination of beneficial ownership

A number of DTCs contain the clause in the dividend, interest and royalty articles, that in order to benefit from the reduced treaty rates, the recipient of the income must be the beneficial owner thereof,²² or that the beneficial owner of the income must be a resident of the other state.²³ The Ministry of Finance is of the view that the beneficial ownership clause is also implicitly included in DTCs which do not use the term.²⁴

In practice, however, the beneficial ownership requirement is not an issue. In the case of a dividend distributed by a Czech company, the local tax authorities' attention is drawn only to the correct calculation of the amount of tax, the timely payment thereof to the financial office, and the availability of a residency statement of the recipient.

In the reverse case, i.e. a dividend distributed by a foreign company to a Czech resident, the tax authorities of the source state may require a statement regarding the beneficial ownership of the Czech resident. There is no procedure to obtain such a statement. The standard residency statement forms do not contain a reference to beneficial ownership.

3.2.4. Other payments subject to withholding tax

The reduction at source procedure established by Instruction D-91 is applicable to all payments on which the withholding tax or the security advance is mitigated by a DTC. Therefore, the above generally applies to the application of DTCs to payments of dividends, interest and royalties by Czech residents.

The remittance of capital sums is not subject to tax in the Czech Republic; therefore, there are no relevant formalities to be complied with in this respect.

As mentioned above, payments which constitute Czech taxable income for a non-resident and which are not subject to the final withholding tax are subject to the 10 per cent security advance payment, which is also levied by way of withholding. If the recipient is a resident of a country which has a DTC with the Czech Republic, such income is normally taxable in the Czech Republic only if the recipient has a permanent establishment or a fixed base in the country. In that case, the payer is obliged to withhold the security advance, and transfer the amount withheld to the financial office competent for the recipient. If the recipient does not have such permanent establishment or fixed base, application of Instruction D-91 results in a payment free of any withholding. Therefore, the payer has to establish whether the recipient has such a permanent establishment or fixed base. This results in conflicts between the payer, who can be held liable for failing to withhold the security advance, and a recipient who is of the view that he is not liable for tax in the Czech Republic. Obviously, for a payer of the income it may be impossible to determine whether his counterparty has a permanent

²² DTCs modelled after the 1977 OECD model tax convention.

²³ DTCs modelled after the OECD model tax convention including the 1995 amendments.

²⁴ See also Vogel, *Doppelbesteuerungsabkommen*, p. 750.

ment establishment or fixed base or not, and which may be the competent financial office.

There is no convenient solution to this problem. It is not an established practice with the financial offices to issue negative PE statements. Either the payer withholds the security advance, and the recipient claims a refund thereof by filing a nil return after the tax period, or the payer takes the risk, eventually supported by a financial guarantee of the recipient, that the recipient is not deemed to have a permanent establishment or fixed base.

3.3. Business income

3.3.1. Czech resident obtains business income abroad

There are only a few specific tax procedural aspects connected with obtaining business income abroad. Czech residents are taxed on their worldwide profits. Double taxation is avoided unilaterally by granting an ordinary credit for tax paid on the same income abroad;²⁵ if a DTC applies, the Income Taxes Act refers to the relevant provisions of the DTC.²⁶ Most of the Czech DTCs follow the credit system for income obtained through a permanent establishment abroad. Under some DTCs, permanent establishment income is exempted in the Czech Republic. If the tax period of the permanent establishment differs from that in the Czech Republic (calendar year), the Czech resident has to include in his tax return the estimated amount of foreign income.²⁷ If the foreign income turns out to be different from the estimated amount, a corrective tax return has to be filed.²⁸

As starting up a business abroad will imply the opening of a bank account abroad, the transfer of money abroad and similar transactions, the Czech resident will have to comply with procedures and formalities of the Foreign Exchange Act. Although the foreign exchange restrictions have been relaxed over the past years, especially in relation to OECD member countries, in a number of cases notification to or approval from the Czech National Bank is still required for such transactions.

3.3.2. Foreign business obtains business income in the Czech Republic

If a non-resident starts business activities in the Czech Republic, there are basically two procedural ways which may lead to registration as a taxpayer.

- (a) The procedure of article 33 of the Tax Administration Act:
- if the activities constitute a permanent establishment, the non-resident is obliged to notify the tax authorities thereof within 30 days from the start of the permanent establishment.

²⁵ Art. 38f(1) of the Income Taxes Act.

²⁶ Art. 38f(2) of the Income Taxes Act.

²⁷ Art. 38f(4) of the Income Taxes Act.

²⁸ Art. 41 of the Tax Administration Act.

- if the activities are taxable or aimed at creating taxable income, but do not constitute a permanent establishment, the non-resident is obliged to apply for registration within five days after the start of the activities.
- (b) The procedure of article 34(17) of the Tax Administration Act: according to article 34(17) of the Tax Administration Act, individuals, legal entities and permanent establishments in the Czech Republic are obliged to report, without delay, the conclusion of any contract with a non-resident, if the consequence of the contract may be the setting-up of a permanent establishment of the non-resident in the Czech Republic.

Registration on the basis of article 33 is the route normally followed by a foreign business, when it regards its activities as constituting a permanent establishment. Even if the size or the character of the activities render it doubtful that a permanent establishment has been created, foreign businesses often decide to establish a branch office which is then registered as a taxpayer. The reason for following this route is the Czech VAT system, under which Czech input VAT is not refunded to foreign businesses without a registered branch in the Czech Republic. Procedural problems in this area arise from commercial law, rather than from tax law. For example, a foreign business may decide, upon starting its activities in the Czech Republic, that it is desirable to establish a branch office in the Czech Republic, and carry out the activities via the branch. The procedure to establish a branch office may take several months. According to Czech commercial law, however, the branch office may not undertake any business activities before it is formally established.

The procedure of article 34(17) of the Tax Administration Act imposes a very wide reporting duty. In practice, however, the provision is complied with only infrequently, and local financial offices react uncomprehendingly if such a contract is reported.

Non-compliance with non-monetary obligations imposed by the Tax Administration Act, which includes for example the above registration and reporting duties, may be fined with a maximum of CZK 2 million (USD 55,000 approximately). However, fines are only rarely imposed for exceeding the time limits set forth in article 33 Tax Administration Act, or for non-compliance with article 34(17) Tax Administration Act.

Upon registration of a permanent establishment, a request for exemption from the 10 per cent security advance can be filed. The exemption may be granted as early as during the year in which the permanent establishment comes into existence. Regularly, however, the exemption is granted only after the permanent establishment has duly filed its tax return and paid the tax for its first tax period.

3.3.3. Determination of the tax base

A permanent establishment in the Czech Republic is normally obliged to have double-entry book-keeping, according to Czech book-keeping regulations, which is the basis for calculation of the profit of the permanent establishment. However, the Income Taxes Act²⁹ provides that the tax basis of the permanent establishment

²⁹ Art. 23(11) of the Income Taxes Act.

may not be lower than the tax basis of resident businesses engaged in similar business activities, and that the tax basis of the permanent establishment may be computed on the basis of comparable gross income, trade margin or profit/expenses ratios.

The tax authorities do not normally correct the tax basis of permanent establishments on the basis of this provision. However, a practice has been established regarding the determination of profits of permanent establishments engaged in sales promotion activities. Foreign businesses frequently open offices in the Czech Republic which carry out marketing activities and sales promotion. For such activities, a ruling can be obtained which provides that the tax basis of the permanent establishment is based on a certain percentage of the realised sales turnover in the Czech Republic. The percentages vary from 1 per cent to 3 per cent, depending on the type of product or service. The Ministry of Finance has issued a list categorising a number of products and services, with the corresponding percentage ranges.

3.4. Other situations: employment in the Czech Republic

In the wake of opening the centrally planned economy and the privatisation of state enterprises after the Velvet Revolution of 1989, a substantial contingent of foreigners was sent to the Czech Republic in order to start up, turn around and manage Czech businesses which had been sold to foreign investors. This inflow of foreign employees has resulted in the establishment of procedures regarding their taxation.

There are two procedures we would like to discuss.

3.4.1. The deemed permanent establishment concept

Foreign employees are normally sent to the Czech Republic under a management services agreement between a foreign company, which employs the foreign employee, and a Czech company, which is normally a subsidiary or group company of the foreign company. The foreign company pays out the salary to the employee, and charges the salary, plus related expenses and eventually a profit mark-up, under the management services agreement to the Czech company. In order to counter excessive profit mark-ups and to be able to control the due payment of income tax by the foreign employees, the Czech Income Taxes Act provides that the rendering of such services during a period exceeding six months in a twelve-month period is considered to constitute a permanent establishment of the foreign employer in the Czech Republic. In the Czech tax practice, such a permanent establishment is called the "deemed permanent establishment" (DPE). The income of the DPE is the amount charged under the management services agreement to the Czech company minus the salaries of the seconded employees plus related expenses. Accordingly, the tax basis of the DPE is the amount of the profit mark-up. The DPE does not in principle attract taxation of other business profits of the foreign company in the Czech Republic.

Most foreign employers who are resident in countries with a DTC with the Czech Republic are of the view that the DPE does not fulfil the definition of permanent establishment of the DTC, since it does not involve a "fixed place of business".³⁰ However, the Czech Ministry of Finance has always strongly defended the view that the place where the foreign employees carry out their activities constitutes a fixed place of business of the foreign employer, and that accordingly the DPE fulfills the definition of permanent establishment in the DTC.

The Ministry of Finance has issued a number of Instructions, the most recent version of which is Instruction D-154, establishing the procedural aspects of the rendering of management services and the DPE.³¹ In practice, foreign employers have as a general rule accepted the concept of DPE, and comply with the procedures set forth in the relevant Instructions. The DPE now serves as a sort of safe haven rule; upon due compliance with the formalities, the tax implications connected with these activities have become predictable.

3.4.2. *The economic employer concept*

According to the Income Taxes Act,³² a Czech company may for tax purposes be regarded as the employer of persons who are formally employed not by the Czech company but by a foreign entity, if such persons perform their work according to instructions of the Czech company. The income of such persons is deemed to be paid out by the Czech company. The income of such persons is deemed to be at least 60 per cent of the amount paid for their work to the foreign entity.

This provision was introduced on 1 January 1997, primarily to tax the income of the large number of construction workers from other former Eastern Bloc countries in the Czech Republic. However, the scope of the provision is not limited to these persons. The Ministry of Finance has issued an Instruction dealing with the concept.³³

The Instruction contains a further definition of the concept, using largely the same criteria as listed in the commentary to article 15 of the OECD model tax convention, under paragraph 8. Furthermore, it offers some procedural guidelines. A Czech company which is considered to be the economic employer of a person, is obliged to withhold income tax from the payment made for the services of the employee, in the amount corresponding to the income of the employee. If the Czech company has no information regarding the income of the employee, the amount of 60 per cent of the fee paid to the foreign entity seems to be a safe haven.

4. Disputes and unresolved issues

A taxpayer generally has the possibility to appeal against decisions of the tax authorities. Furthermore, the Ministry of Finance has certain powers to take measures to eliminate hardship and discrepancies, and to decide in contentious cases on the taxation of non-residents.³⁴ Finally, the DTCs concluded by the Czech Republic include the mutual agreement procedure. There is no other independent procedure to deal with these issues.

When assessing the procedures regarding disputes and unresolved issues, the following has to be borne in mind.

Among taxpayers in the Czech Republic, there is a general perception of unbalance between the powers given to the Czech tax authorities to enforce the collection of taxes, and the rights of taxpayers. In practice, even unintentional mistakes of minor importance can have severe consequences, like for example a penalty of up to CZK 2 million for non-compliance with non-monetary obligations, or a penalty of up to 100 per cent of the amount of tax due in case of late or supplementary payment of taxes. In case of a dispute, the tax authorities do not take into account whether the view of the taxpayer was arguable or reasonable. A supplementary payment of tax results automatically in a penalty. On the other hand, on a refund of overpaid tax, which can take a considerable amount of time, no interest is paid.

For understandable reasons, the Czech tax authorities and administrative courts lack knowledge and experience regarding the correct application of DTCs. Therefore, disputes may arise at unexpected moments and regarding unexpected issues, and the outcome of any discussion is unpredictable.

Résumé

La République tchèque est partie à 45 conventions de double imposition (DTC) qui s'inspirent du modèle de convention fiscale de l'OCDE, et à deux conventions fiscales multilatérales CMEA qui n'ont qu'une importance limitée. L'essentiel de la législation fiscale interne tchèque se trouve dans la loi sur l'impôt sur le revenu et dans la loi sur l'administration fiscale, toutes deux promulguées en 1993. Le ministère a édicté un certain nombre d'Instructions précisant les procédures à suivre et les formalités à accomplir pour l'application des DTC.

La qualité de résident des personnes physiques en République tchèque peut se définir par le fait d'avoir un lieu de résidence en République tchèque ou de séjourner en République tchèque pendant au moins 183 jours au cours d'une année civile. Toute personne qui décide de résider en République tchèque est normalement tenue de se faire enregistrer auprès des autorités fiscales dans les 30 jours. Toutefois, dans la pratique, les autorités fiscales demandent au requérant de produire un permis de séjour qui ne peut être obtenu qu'après une

³⁰ Some DTCs, however, accept the rendering of services as constituting a permanent establishment after a certain period, e.g. DTC Czech Republic-USA.

³¹ Instruction D-154, No. 251/1890/1997, Financial Gazette 2-3/1997.

³² Art. 6(2) Income Taxes Act.

³³ Instruction D-151.

³⁴ Art. 39 of the Income Taxes Act, art. 96(2) of the Tax Administration Act.

procédure passablement longue et sous certaines conditions. Les personnes qui cessent de résider en République tchèque doivent se faire radier du rôle des contribuables et remplir une dernière déclaration d'impôt après l'expiration de l'année civile au cours de laquelle elles ont émigré. La qualité de résident des sociétés en République tchèque ne peut être fondée que sur l'existence d'un siège statutaire en République tchèque. Une société qui implante son siège de direction effectif en République tchèque n'acquiert pas pour autant la qualité de société résidente. Le transfert de la direction d'une société tchèque à l'étranger se heurte à des obstacles de caractère formel.

La réduction des retenues à la source sur la base d'une DTC est accordée à la source. Si l'impôt est retenu en excédent du taux prévu par la convention applicable, les procédures à suivre pour obtenir le remboursement sont au nombre de trois: (a) le bénéficiaire peut demander au distributeur de rectifier le montant de la retenue; (b) le distributeur peut déposer une demande de remboursement auprès des autorités fiscales et transmettre le montant remboursé au bénéficiaire; et (c) le bénéficiaire peut adresser une demande de remboursement au ministère des Finances. Si le bénéficiaire du paiement agit au nom d'un tiers, la DTC conclue entre la République tchèque et le pays de ce tiers peut être appliquée directement, sous réserve de l'accomplissement de certaines formalités.

Les non-résidents qui tirent des revenus d'une activité industrielle ou commerciale en République tchèque par le biais d'un établissement stable sont tenus de faire enregistrer cet établissement dans les 30 jours. Si le revenu imposable en République tchèque est obtenu indépendamment d'un établissement stable, l'enregistrement doit avoir lieu dans les cinq jours. Les résidents tchèques et les établissements stables sont obligés de déclarer aux autorités fiscales tout contrat passé avec un non-résident pouvant avoir pour conséquence la création d'un établissement stable du non-résident. S'agissant d'établissements stables qui reposent sur un pourcentage du chiffre d'affaires réalisé.

Il existe des accords de procédure spéciaux concernant l'emploi de salariés étrangers en République tchèque aux termes d'un contrat de services de gestion, et l'emploi de salariés étrangers dont une société tchèque est considérée comme l'employeur économique.

La République tchèque possède des procédures strictes pour le recouvrement des impôts. Les contribuables ont généralement le droit de faire appel des décisions des autorités fiscales. Tout paiement d'impôt tardif ou supplémentaire entraîne automatiquement une pénalité, même en cas d'erreur involontaire. Le problème général qui se pose en République tchèque concernant l'application des DTC est le manque d'expérience des autorités fiscales.

Zusammenfassung

Die Tschechische Republik ist Partnerstaat von 45 bilateralen Doppelbesteuerungsabkommen nach dem Muster des OECD-Musterabkommens und 2 multilateralen Abkommen aus der Zeit des CMEA (Ausschluss für gegenseitige Wirtschaftshilfe), denen nur beschränkte Bedeutung zukommt. Das tschechische innerstaatliche Recht beruht im wesentlichen auf dem Einkommensteuergesetz und dem Steuerverwaltungsgesetz, beide aus dem Jahr 1993. Das Ministerium hat mehrere Anweisungen erlassen, die die Verfahren und Formalitäten für die Anwendung von DBA betreffen.

Der Steuerwohnsitz natürlicher Personen in der Tschechischen Republik kann begründet sein in dem Vorhandensein einer Wohnung in der Republik oder in einem dortigen Mindestaufenthalt von 183 Tagen im Kalenderjahr. Die Aufnahme eines Wohnsitzes in der Tschechischen Republik ist normalerweise mit der Pflicht der Anmeldung bei den Steuerbehörden innerhalb von 30 Tagen verbunden. In der Praxis verlangen die Steuerbehörden

jedoch bei der Anmeldung die Vorlage einer Wohnsitzgenehmigung, die nur nach einem langwierigen Verfahren und Erfüllung bestimmter Bedingungen erteilt wird. Bei der Aufgabe des Wohnsitzes in der Tschechischen Republik ist eine steuerliche Abmeldung erforderlich, und nach Ablauf des Kalenderjahres der Auswanderung muss eine letzte Steuererklärung eingereicht werden.

Unternehmen können nur dann ihren steuerlichen Sitz in der Tschechischen Republik haben, wenn sie dort handelsrechtlich niedergelassen sind. Ein Unternehmen, dessen effektive Geschäftsleitung sich in der Tschechischen Republik befindet, hat nicht deswegen seinen steuerlichen Sitz in der Tschechischen Republik. Die Verlagerung der Geschäftsleitung einer tschechischen Gesellschaft ins Ausland stößt auf formelle Schwierigkeiten.

Reduzierte Quellensteuersätze aufgrund eines DBA werden bei Steuerabzug gewährt. Wird eine im Vergleich zu dem DBA-Steuersatz zu hohe Quellensteuer erhoben, können drei verschiedene Verfahren für die Rückerstattung in Frage: (a) Der Zahlungsempfänger kann den Zahler um Berichtigung des Steuerabzugs ersuchen; (b) der Zahler kann bei der Steuerbehörde eine Rückerstattung beantragen und den erstatteten Betrag dem Empfänger überweisen, und (c) kann der Zahlungsempfänger einen Rückerstattungsantrag an das Finanzministerium richten. Handelt der Zahlungsempfänger im Namen eines Dritten, kann das DBA zwischen der Tschechischen Republik und dem Land des Dritten nach Erfüllung bestimmter Formalitäten unmittelbar angewendet werden.

Nichtansässige, die in der Tschechischen Republik über eine Betriebsstätte gewerbliche Einkünfte erzielen, müssen die Betriebsstätte innerhalb von 30 Tagen anmelden. Werden steuerpflichtige Einkünfte in der Tschechischen Republik ohne Betriebsstätte erzielt, muss die Anmeldung innerhalb von 5 Tagen erfolgen. Steuerpflichtige mit Sitz in der Tschechischen Republik sowie ständige Betriebsstätten müssen der Steuerbehörde alle Verträge mit nichtansässigen Unternehmen mitteilen, die die Schaffung einer Betriebsstätte des nichtansässigen Unternehmens begründen können. Mit Betriebsstätten, die Verkaufsförderung betreiben, wird üblicherweise eine Steuerbasis vereinbart, die aus einem Prozentsatz der erzielten Umsätze besteht.

Bestimmte Verfahren regeln die Beschäftigung ausländischer Arbeitnehmer in der Tschechischen Republik im Rahmen von Management-Dienstleistungsverträgen sowie von ausländischen Arbeitnehmern tschechischer Unternehmen, die als wirtschaftlicher Arbeitgeber betrachtet werden.

Die Tschechische Republik hat strenge Verfahren für die Durchsetzung von Steuerzahlungen. Der Steuerzahler hat allgemein ein Recht zur Berufung bei Entscheidungen der Steuerbehörde. Verspätete oder ergänzende Steuerzahlungen lösen automatisch eine Steuerstrafe aus, auch bei unbeabsichtigten Irrtümern. Ein allgemeines Problem der Anwendung von Doppelbesteuerungsabkommen in der Tschechischen Republik ist die mangelnde Erfahrung der Steuerbehörden.

Resumen

La República Checa es parte de 45 convenios de doble imposición (CDI) inspirados en el modelo de convenio fiscal de la OCDE, y de dos convenios multilaterales CMEA de limitada importancia. La base fundamental de la legislación tributaria interna radica en las Leyes del Impuesto sobre la renta y de Administración tributaria, ambas promulgadas en 1993. El Ministerio ha promulgado algunas Instrucciones precisando los procedimientos a seguir y formalidades a cumplir en la aplicación de los CDI.

La cualidad de residente de las personas físicas en la República Checa puede definirse por el hecho de disfrutar de una sede de residencia o de permanecer en el país al menos 183 días del año. Las personas que deciden residir en la República Checa normalmente se empadronan en 30 días. En la práctica, sin embargo, las autoridades tributarias solicitan al requirente un permiso de estancia que sólo puede obtenerse bajo determinadas condiciones y tras un procedimiento relativamente largo. Las personas que dejan de residir en el país tienen que darse de baja del censo de contribuyentes y cumplimentar una última declaración fiscal al finalizar el año en que hayan emigrado. La cualidad de residente de las sociedades se basa en la existencia de una sede social en el país. Una sociedad que implante su sede efectiva de dirección en la República Checa no por ello adquiere la cualidad de residente. El traslado al extranjero de la dirección de una sociedad checa tropieza con obstáculos de carácter formal. La reducción de las retenciones en base a un CDI se otorga en la fuente. Cuando se ha producido retención en exceso del tipo previsto por el CDI aplicable existen tres procedimientos para obtener el reembolso: (a) el beneficiario puede solicitar al pagador rectifique el importe de la retención; (b) el pagador puede interponer demanda de reembolso ante las Autoridades tributarias y abonar el importe reembolsado al beneficiario; (c) el beneficiario puede dirigir su demanda de reembolso al Ministerio de Hacienda. Si el beneficiario actúa en nombre de un tercero, puede aplicarse directamente el CDI concluido entre la República Checa y el país de este último, a reserva de cumplir determinadas formalidades.

Los no residentes que obtengan rentas de una actividad industrial o comercial en la República Checa por medio de un establecimiento permanente (EP) han de inscribir dicho EP en 30 días; en caso contrario, la inscripción ha de tener lugar en cinco días. Los residentes checos y los EP han de declarar a las Autoridades tributarias los contratos concluidos con no residentes que puedan dar lugar a la creación de un EP de estos últimos. Cuando se trata de EP que ejercen actividades de promoción de ventas es habitual negociar una base imponible basada en un porcentaje de su volumen de ventas.

Existen acuerdos de procedimientos especiales sobre empleo de asalariados extranjeros en la República Checa en base a contratos de servicios de gestión o cuando se considera empresario económico a una sociedad checa.

La República Checa tiene procedimientos estrictos para la percepción de los impuestos. Los contribuyentes tienen, en general, derecho a apelar las resoluciones de las autoridades tributarias. Los pagos tardíos o complementarios de impuestos conllevan penalidad, incluso en caso de error involuntario. El problema general que se plantea en el país en la aplicación de los CDI es la falta de experiencia de las autoridades tributarias.

1. Introduction

The double taxation conventions entered into by Denmark are generally based on the OECD model convention although the taxation conventions with developing countries often include elements of the UN model convention.

The purpose of such conventions is to relieve international double taxation arising in situations where a person residing in one of the contracting states receives income from sources in the other contracting state.

The allocation between the state of source and the state of residence of the right to taxation of a given income as well as the method whereby the state of residence is to relieve double taxation are carefully stated in the individual double taxation conventions. However, conventions do not usually lay down whether the state of source, in order to meet its obligation to relinquish taxation in part or in whole, also has to refrain from withholding tax to the extent that such tax exceeds the convention rate. Neither is it stipulated how the taxpayer concerned should act with respect to tax refunds in situations where more tax has been withheld than warranted by the convention.

In the same way, conventions do not usually specify how the state of residence or the taxpayer should act in respect of taxes lawfully levied on a given income for the taxpayer to actually be afforded the relief to which it is entitled pursuant to the convention. As a principle rule, Denmark as the state of residence applies the principle of credit (ordinary credit) but in some, particularly older, conventions the principle of exemption is applied, whereas conventions entered into with developing countries often contain rules providing for a special kind of credit relief – matching credit.

The practical application of the double taxation conventions is entirely entrusted to the internal legislation of the states.

Under Danish rules, the practical application of the double taxation conventions is, with a few exceptions, not specifically mentioned in the legislation. Instead, the practical application follows from and is an integral part of the rules applicable to all Danish taxpayers on the obligation to file a tax return and tax

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