

1. Company tax rate and company tax base

Company tax is levied on a company's taxable income at a flat rate. Over the last ten years, the company rate has fallen significantly – from 46 per cent in 1993 to 31 per cent from 2001. The high level of company taxation at the beginning of the 1990s was related to the transition from a centrally planned economy to an open market economy. Further tax cuts are being considered, potentially down to 28 per cent starting in 2004.

These company tax rate cuts and some tax breaks available to foreign direct investors have considerably reduced the tax burden imposed by the Czech Republic on capital invested – in particular by foreign investors – at company level. They have also boosted foreign direct investment and contributed to its steady inflow over the last few years.

In general, the reduction of company tax rates has not been directly associated with any other measures that would systematically increase the corporate tax base or reduce any concessionary (deductible) elements. The overall company tax level has thus effectively decreased. At the same time, tax legislation has been significantly amended with the objective of gradually closing loopholes existing during the first few years following the introduction of the new tax system in 1993 (and thus bringing it in line with a level comparable with corporate tax regimes in other European countries). These adjustments have involved restrictions on deductibility costs in connection with sales of securities or trading in financial derivatives.

Investment funds, mutual funds and pension funds are subject to company tax at a rate of 15 per cent.

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2. Nature of the company/shareholder tax system

2.1. Dividends

This section examines the operation of the company shareholder tax system applicable to dividends, and retentions between a Czech resident company with resident shareholders and Czech-source income.

The current system of taxation on distribution of dividends¹ is based on a traditional system with a special concession (imputation element) made available under certain conditions – to the company paying the dividends. The company is taxed on its corporate income at the rate of 31 per cent and the shareholder is taxed on dividends at the rate of 15 per cent.

The tax on dividends fell from 25 per cent in 2000 and applies to both individual shareholders and corporate investors. Hence the tax rate applicable to dividend income differs in comparison with tax on other individual or company income since, as a general rule, an individual's income is subject to progressive tax at a varying rate from 15 per cent to 32 per cent, while a company's income is taxed at a flat rate of 31 per cent.

The 15 per cent tax on dividends is collected by way of withholdings from the dividends distributed by the company paying the dividends. The withholding tax is a final tax and dividend income is not included in a company's or individual's tax base, nor is it disclosed in a tax return. The following calculation illustrates how the company shareholder tax system operates, based on an income of 100 (before tax), assuming company income is fully distributed to an individual shareholder.

<i>Company</i>	
Company income	100.00
Corporate tax at the rate of 31%	31.00
Company income after tax	69.00
<i>Shareholder</i>	
Dividend	69.00
Individual's income	69.00
Individual's tax at the rate of 15%	10.50
Net shareholder tax	10.50
<i>Result</i>	
Total tax	41.50
Shareholder income after tax	58.50

In addition, tax relief is also available to a company paying out dividends to shareholders. The company may deduct half of the tax withheld, i.e. 7.5 per cent

from the dividends distributed in a given tax period from its corporate tax liability for the year in which the distribution is made. Consequently, the withholding tax revenue for the state is reduced to 7.5 per cent in all cases when the company paying the dividends has sufficient company tax liability for the year in which the dividends are distributed. This tax relief cannot be carried forward.

The operation of the additional tax relief for the company is shown in the following calculation based on 100 of before-tax company income is fully distributed to an individual shareholder.

<i>Company</i>	
Company income for year X	100.00
Company tax at the rate of 31%	31.00
Company income after tax	69.00
<i>Shareholder</i>	
Dividend paid in year X + 1	69.00
Individual's income	69.00
Individual's tax at the rate of 15%	10.50
Net shareholder tax	10.50
<i>Company</i>	
Company tax in year X + 1	
- 50% of withholding tax on dividends	-5.25
<i>Result</i>	
Total tax relating to dividends	36.25
Shareholder income after tax	58.50

Further taxation of dividends received through a chain of companies is limited. Relief applies to double taxation of dividends upon onward distribution thereof to a company or individual shareholders by proportionate exclusion of dividends received by the company making the distribution from the 15 per cent withholding tax base, provided that the company's participation (shareholding) in the company from which the dividends are received is at least 20 per cent. This 20 per cent participation test does not apply to investment and mutual funds. Consequently, any dividends received by investment or mutual funds are taxed only once – upon distribution by a company paying dividends to an investment or mutual fund. Dividends taxed (by withholding 15 per cent tax) and received by a pension fund are not included in the fund's tax base. Hence the 15 per cent tax on dividends collected upon payment to a pension fund is a final tax.

Taxation of dividends does not form part of any special broader taxation system, as the Czech Republic does not tax income differently from capital and earned income.

2.2. Retained earnings and capital gains tax

Capital gains are not subject to a special capital gains tax or taxation regime. Any capital gains are taxable only upon realisation. Upon a sale of shares, a company

¹ "Dividend" is also used in circumstances where, under the Commercial Code, the distribution of company profits (after tax) is not deemed to constitute a dividend, rather a profit distribution to participants in a company that does not issue shares.

includes the sales revenue in its general corporate tax base subject to usual company tax at the rate of 31 per cent.

Capital gains arising upon a sale of securities (i.e. shares in a joint stock company by individual shareholders) are exempt from tax, provided that the shares are not included in the business assets of the individual and more than six months have elapsed between the date of acquisition of the shares and the date of sale. Similarly, capital gains arising upon the sale of an ownership interest in a company, whose registered capital is not divided into securities, are exempt if more than five years have elapsed between the date of acquisition and sale of the interest, and the interest has not been included in the business assets of the individual shareholder. If all heads of this test cannot be satisfied, the capital gain is included in the individual's tax base and will be subject to personal income tax at a progressive rate of up to 32 per cent.

Hence a bias for retaining profits under a traditional system of taxation of dividends is, in relative terms, mitigated by several factors: tax withheld from dividends represents final tax on the shareholder, it is significantly lower than the company tax on income and the capital gains tax (equal to company tax or personal tax subject to the exemption) is higher than the tax on dividends.

The operation of current company shareholder taxation of capital gains is demonstrated by the following sample calculation. It is assumed that the initial investment in shares is 10 and that the company earns an income of 100. Further, the value of the shares is based on the amount invested in the shares and the income of the company after tax. Hence following distribution of dividends, the value of the shares equals the initial investment of 10. In the Czech Republic the second shareholder cannot offset the loss on sale of the shares against the dividends received. The reason is that dividends are taxed by withholding tax and loss on sale cannot be set off by any other income. In the sample calculation, the first shareholder sells the shares before a dividend is paid, the company pays the dividend to the second shareholder and then the second shareholder sells the shares at the price equal to the initial investment.

In Table 1 the individual shareholder (a) does not qualify for exemption from the tax on capital gain on sale of shares or (b) qualifies for the capital gains tax exemption as he holds the shares for more than six months and has not included them in his business assets. In the third calculation (c), in addition to the capital gain exemption for the individual shareholder, the tax relief for the company making the distribution of dividends is taken into account, as if a similar distribution of dividends had been made in the preceding tax period. It is also assumed that the sales price reflects the initial investment plus the tax relief (50 per cent of withholding tax on dividends) available for the year in which the dividends were paid.

As the second shareholder must pay 15 per cent tax on dividends and sells the shares at a price equal to the initial investment plus – in case (c) – increased by a corporate tax relief in the year of payment of the dividends, the second shareholder ends up with a loss on such a transaction. The second shareholder may, however, use the loss incurred on the sale of securities against capital gains on the sale of other securities in the same tax period.

Table 1

Company	(a)	(b)	(c)
Company income	100.00	100.00	100.00
Company tax at the rate of 31% (subject to relief)	31.00	31.00	25.84
Company income after tax	69.00	69.00	74.16
<i>First shareholder</i>			
Costs of shares	10.00	10.00	10.00
Sale price of shares	79.00	79.00	84.16
Individual's income (in the form of capital gain)	69.00	69.00	74.16
Individual's tax (assumed top rate 32%)	22.08	0.00	0.00
<i>Second shareholder</i>			
Dividend	69.00	69.00	74.16
Tax on dividends	10.35	10.35	11.12
Total income from dividend	58.65	58.65	63.04
Costs of shares	79.00	79.00	84.16
Sale price of shares	10.00	10.00	15.16
Loss on sale of shares	(69.00)	(69.00)	(69.00)
<i>Result for first shareholder</i>			
Total tax	53.08	31.00	25.84
Shareholder income after tax	46.92	69.00	74.16
<i>Result for second shareholder</i>			
Total tax	10.35	10.35	11.12
Shareholder income after tax	68.65	68.65	78.20

The Czech tax system does not involve any special rules to deal with retained income. In conclusion, tax relief in the form of a reduction on a company's tax liability by 50 per cent of the tax withheld from dividends moderately stimulates distribution of dividends.

3. International taxation and company/shareholder taxation

The following analysis is based on the assumption that the individual has no control over the company in which the investment is made ("portfolio dividend"). The investment by a company resident in one country is made in a company resident in another country and such investment qualifies for an underlying foreign tax credit or participation exemption ("direct dividend").

même, les gains en capital réalisés sur la cession d'une participation dans une propriété sont exempts au bout de cinq ans. Dans tous les autres cas, les gains en capital sont inclus dans l'assiette fiscale ordinaire.

En outre, l'impôt sur les gains en capital est plus élevé que l'impôt sur les dividendes.

La perte subie sur la cession de valeurs mobilières ne peut être compensée que par les bénéfices réalisés sur la cession de valeurs mobilières, sauf pour ce qui concerne les titres nominatifs, lorsque aucune limite n'est fixée pour les déductions de pertes.

La retenue à la source sur les dividendes payés à un associé non-résident est réduite automatiquement en vertu de la convention de double imposition applicable. Le taux de l'impôt sur les dividendes en portefeuille est habituellement plus élevé que le taux applicable aux dividendes directs. Les conventions de double imposition interdisent la perception d'un impôt sur les dividendes payés par une société qui est une résidente d'un Etat partie à la convention à un résident d'un Etat tiers, à moins que ces dividendes ne soient attribuables à un établissement stable de l'associé en République tchèque.

Si la République tchèque est le pays de la résidence de l'associé tant pour les associés qui sont des personnes physiques que pour les associés d'une société, une assiette fiscale partielle est prise en compte pour l'imposition des dividendes de source étrangère. Un impôt de 15 pour cent est perçu sur le montant brut du dividende; les crédits d'impôt peuvent être déduits, à condition que l'impôt sur les dividendes soit recouvré dans le pays de la source conformément aux dispositions de la convention de double imposition applicable. Aux termes de plusieurs conventions de double imposition, le revenu du dividende est exempt d'impôt en République tchèque.

Bien que, d'une manière générale, les revenus résultant de la cession d'actions d'une société tchèque résidente constituent des revenus de source tchèque, il n'existe pas de mécanisme spécial pour le recouvrement de l'impôt. Il convient de signaler une exception, lorsqu'un résident tchèque achète des valeurs mobilières d'une société tchèque. Dans ce cas, l'acheteur est tenu de retenir une garantie fiscale de 3 pour cent sur le prix d'achat des actions (10 pour cent en cas d'acquisition d'une participation dans une propriété). Aux termes de la plupart des conventions de double imposition, le droit de prélever un impôt sur des gains en capital réalisés sur des actions de sociétés tchèques résidentes est accordé à l'Etat de la résidence de l'associé.

Zusammenfassung

Senkungen des Körperschaftsteuersatzes sowie einige Steuererleichterungen für ausländische Direktinvestitionen haben dazu beigetragen, dass die Körperschaftsbesteuerung auf eine mit den meisten Ländern Europas vergleichbare Ebene abgesenkt wurde.

Die Besteuerung von Dividenden (aus Erträgen aus tschechischen Quellen), die eine tschechische Körperschaft an ansässige Gesellschafter ausschüttet, beruht auf einem klassischen System, wobei die dividendenzahlende Körperschaft Anrechnungs-möglichkeiten hat. Die Körperschaft wird in Bezug auf ihre Erträge zu einem Satz von 31 Prozent besteuert, und Dividenden unterliegen einer Quellensteuer von 15 Prozent. Die Quellensteuer auf Dividenden ist endgültig und sowohl für Portfolio- als auch für Direktdividenden gleich. Die Körperschaft, die Dividenden zahlt, kann die Hälfte der Quellensteuer (7,5 Prozent) von ihrer Körperschaftsteuerschuld für das Jahr, in dem die Ausschüttung erfolgt, abziehen. Eine weitere Entlastung gibt es bei der Weitergabe von Dividenden, indem von der ausschüttenden Körperschaft vereinbarte Dividenden nicht in die Besteuerungsgrundlage einbezogen werden, vorausgesetzt, die Körperschaft ist an der

Tochterfirma, von der die Dividenden zufließen, zu mindestens 20 Prozent beteiligt. Dividenden, die einem Investmentfonds zufließen, werden nur einmal besteuert.

Kapitalgewinne bestimmter Gesellschafter aus der Veräußerung von Wertpapieren sind steuerfrei, sofern bestimmte Voraussetzungen erfüllt sind, insbesondere die Einhaltung einer Sechsmonatsfrist seit dem Erwerb der Anteile. Ebenso sind Kapitalgewinne aus der Veräußerung einer Beteiligung nach fünf Jahren steuerfrei. In allen anderen Fällen werden Kapitalgewinne in die normale Steuerbemessungsgrundlage einbezogen.

Hinzu kommt, dass die Steuer auf Kapitalgewinne höher ist als die Steuer auf Dividenden. Verluste bei der Veräußerung von Wertpapieren können nur gegen Gewinne aus der Veräußerung von Wertpapieren aufgerechnet werden, was allerdings nicht für Namensspare gilt, bei denen es keine Beschränkung von Verlustabzügen gibt.

Eine Quellensteuer auf Dividendenzahlungen an nicht ansässige Gesellschafter wird automatisch aufgrund der geltenden Steuerabkommen reduziert. Der Steuersatz für Portfolio-dividenden ist üblicherweise höher als der Satz für Direktdividenden. Steuerabkommen verhindern eine Besteuerung von Dividenden, die eine in einem Vertragsstaat ansässige Körperschaft an Ansässige eines Drittlandes zahlt, es sei denn, diese Dividenden sind einer Betriebsstätte des Gesellschafters in der Tschechischen Republik zuzuordnen.

Wenn natürliche Personen und Körperschaften ihren Sitz in der Tschechischen Republik haben, gilt für die ihnen als Gesellschafter zufließenden Dividenden aus ausländischen Quellen eine partielle Steuerbemessungsgrundlage. Auf den Brutto-Dividendenbetrag wird eine Steuer von 15 Prozent erhoben. Steueranrechnungen können geltend gemacht werden, sofern die Dividendensteuer im Quellenland in Übereinstimmung mit dem geltenden Steuerabkommen erhoben wird. Aufgrund einer Reihe von Steuerabkommen sind Dividenden-erträge in der Tschechischen Republik steuerfrei.

Obwohl Einkünfte aus der Veräußerung von Anteilen an einer Körperschaft mit Sitz in der Tschechischen Republik im Allgemeinen Einkünfte aus einer tschechischen Quelle darstellen, gibt es keine besonderen Steuereinziehungsvorkehrungen. Eine Ausnahme bildet jedoch der Fall, in dem ein Ansässiger in der Tschechischen Republik Wertpapiere eines tschechischen Unternehmens erwirbt. In diesem Fall ist der Erwerber verpflichtet, vom Kaufpreis 3 Prozent Steuerkaution einzubehalten (10 Prozent bei Erwerb einer Beteiligung). Nach den meisten Steuerabkommen hat der Staat, in dem der Gesellschafter seinen Sitz hat, das Recht, realisierte Kapitalgewinne mit Anteilen an Körperschaften in der Tschechischen Republik zu besteuern.

Resumen

Las reducciones del tipo impositivo sobre sociedades y algunas exenciones en las inversiones directas extranjeras han contribuido a minorar la carga fiscal de las sociedades hasta un nivel comparable al de la mayoría de países europeos.

La tributación de dividendos (procedentes de fuente checa) distribuidos por una sociedad checa residente a accionistas residentes se basa en un sistema clásico con un elemento de imputación a la sociedad pagadora. La sociedad tributa por sus rentas al 31 por ciento y los dividendos sufren una retención en la fuente del 15 por ciento, de carácter definitivo e idéntica para los de cartera y los directos. La sociedad que distribuye los dividendos puede deducir la mitad de la retención en la fuente (7,5 por ciento) del impuesto de sociedades (IS) del ejercicio en que tiene lugar la distribución. Se aplica otra desgravación a la distribución de dividendos mediante la exclusión proporcional de los percibidos por la sociedad distribuidora, a condición de que la participación en la filial generadora sea de al

menos el 20 por ciento. Los dividendos percibidos por mutualidades y fondos de inversión tributan sólo una vez.

Las plusvalías por la venta de valores inmobiliarios de accionistas personas físicas no tributan con ciertas condiciones, fundamentalmente que hayan transcurrido seis meses desde la adquisición de las acciones. Asimismo, las plusvalías por la venta de participaciones en una propiedad resultan exentas a los cinco años. En el resto de los casos, las plusvalías se integran en la base imponible ordinaria.

Además, el gravamen sobre plusvalías es superior al impuesto sobre dividendos.

Las pérdidas y ganancias en la venta de valores mobiliarios sólo pueden compensarse entre sí, excepción hecha de los títulos nominativos, en que no existe limitación en la deducción de pérdidas.

La retención en la fuente de los dividendos pagados a un accionista no residente se reduce automáticamente en virtud de la aplicación de un convenio de doble imposición (CDI). En general, el tipo impositivo aplicable a los dividendos en cartera es superior al de los directos. Los CDI prohíben gravar los dividendos distribuidos por una sociedad residente de uno de los estados contratantes a un residente de un tercer estado, salvo que sean imputables a un establecimiento permanente del accionista en la Rep. Checa.

Cuando es la Rep. Checa el país de residencia del accionista (persona física o sociedad), se establece una base imponible parcial en la tributación de dividendos de fuente extranjera. Se percibe el 15 por ciento sobre el montante bruto de los dividendos y, si tributan en el país de la fuente, pueden deducirse los créditos fiscales conforme a las disposiciones del CDI aplicable. Según disponen numerosos CDI, la renta por dividendos no tributa en la Rep. Checa.

Aunque, en general, las rentas por venta de acciones de una sociedad checa residente constituyen ingresos de fuente interna, no existe ningún mecanismo especial de recaudación del gravamen. Una excepción es la adquisición de valores mobiliarios de una sociedad checa por un residente nacional: el comprador debe retener el 3 por ciento (garantía fiscal) del precio de adquisición de las acciones (10 por ciento en las participaciones). Según la mayoría de los CDI, la potestad impositiva sobre plusvalías por la venta de acciones de sociedades checas residentes corresponde al estado de residencia del accionista.

1. Company tax rate and tax base

Since 2001 the Danish company tax rate has been 30 per cent. This rate is the (provisional) result of a number of tax cuts made since 1990, when the company tax rate was 50 per cent. The Danish government justified the most recent tax cut from 32 per cent to 30 per cent with reference to the development of Denmark's external environment, particularly the development in neighbouring countries that have cut tax rates and broadened their tax bases.¹

The substantial reduction of the company tax rate was coupled with a broadening of the tax base. Several tax advantages enjoyed by companies have been removed or limited, tax-exempt income categories (particularly capital gains) have become liable to tax, the scope for making provisions for depreciation has been limited, etc. In addition, part of the tax rate reduction has been financed by generally requiring companies to pay tax in the year the income is earned and not, as previously, in the following year. The average effective company tax rate has not been fully reduced in line with the reduction of the nominal company tax rate.

Moreover, a reduced company tax rate will result in larger dividends/capital gains on shares and this in turn will increase tax revenue at the shareholder level.

2. Nature of the company/shareholder tax system

2.1. Dividends

The Danish company/shareholder tax system is based on the classical system when the shareholder is an individual, but the effect of the economic double taxation is mitigated by reduced tax rates. Dividends received by individuals are

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See the comments by the Danish Ministry for Taxation on Bill L. 30 of 4 October 2000.

3.1. Dividends

The scenario that follows examines situations where a Czech resident company pays dividends to non-resident shareholders, or where a non-resident company deriving profits from the Czech Republic pays a dividend from those profits to a non-resident shareholder. It has been assumed that the shares in respect of which dividends have been paid are not attributable to any permanent establishment the non-resident shareholder may have in the Czech Republic.

Dividends paid by a Czech company to a foreign shareholder constitute Czech source income² subject to tax at the rate of 15 per cent. This rate is mostly reduced under an applicable bilateral tax treaty. Distribution of dividends to shareholders who are residents of non-treaty countries is subject to 15 per cent tax.

The Czech Republic does not impose tax on dividends paid by non-resident companies out of profits earned in the Czech Republic, although taxation of permanent establishment income earned in the Czech Republic under the same rules as those governing a Czech company constitutes the first layer of company income taxation. Tax treaty provisions prevent levy of tax on dividends paid by a company resident in a treaty state to a shareholder not resident in the Czech Republic, unless such dividends are attributable to a permanent establishment of the shareholder in the Czech Republic.

The tax on dividends paid to non-resident shareholders is collected by a withholding tax mechanism subject to the same compliance requirements as those applicable to dividends paid to domestic shareholders.³ The withholding tax rate reduction available under the relevant tax treaty applies automatically. The payer of dividends has a duty, loosely set out in a government regulation, to obtain evidence relating to the country of residence of the dividend beneficiary. The payer is required to obtain a tax residence confirmation issued by the shareholder's tax administrator only in circumstances where the shareholder's country of tax residence is not apparent, or if the payer is in doubt on this point.

The company paying the dividends has a duty to withhold tax upon payment of the dividends not later than the end of the third month following the month in which the general meeting of shareholders approves a distribution of the dividends. Tax on a distribution of dividends paid on registered (i.e. publicly traded) shares must be withheld by the end of the month following the month in which the general meeting of shareholders approves the distribution. The company paying the dividends is then required to pay withholding tax to its local tax administrator by the end of the month following the month in which the obligation to withhold tax arose.

Any default on the obligation to pay withholding tax attracts penalties under the rules governing other tax arrears. Tax underpayment may also be enforced as tax arrears.

ITA does not provide for any different tax rates on portfolio dividends and direct dividends. The single 15 per cent withholding tax applies to both. How-

ever, under tax treaties concluded by the Czech Republic, the tax rate on portfolio dividends is usually higher than the rate on direct dividends. In most treaties these two rates vary from 0 per cent to 15 per cent.

Table 2 shows applicable withholding tax rates on dividends paid by Czech resident companies to shareholders resident in the countries that rank best in terms of total direct investments made to the Czech Republic over the last few years.

Table 2

Country of residence	Portfolio investment definition	Tax rate (%)	Direct investment tax rate (%)
The Netherlands	Less than 25%	10	0
Germany	Less than 25%	15	5
USA	Less than 10%	15	5
Austria	Not defined	15	15
France	Not defined	10	10
United Kingdom	Less than 25%	15	5
Switzerland	Less than 25%	15	5

There are no special rules for taxation of dividends paid to foreign investment funds, mutual funds or pension funds.

ITA extends this uniform mechanism to provide company shareholder double taxation relief to both resident and non-resident shareholders, as it imposes no restrictions on applicable provisions with regard to non-resident shareholders. Hence by operation of law, the same rules for double taxation relief on dividends apply equally to both domestic and foreign shareholders.

There follows an analysis of a situation where a Czech resident shareholder receives dividends from a non-resident company.

Similarly to the case discussed above where the Czech Republic is a source country of dividends, there are no specific rules for company shareholder double taxation relief if the Czech Republic is the residence country of the shareholder receiving dividends from a foreign company. Portfolio dividends are subject to the same tax treatment as direct dividends.

For both individual and corporate shareholders a partial tax base is available⁴ for taxation of foreign-source dividends. A 15 per cent tax is levied on this partial tax base involving the gross amount of dividends. Relief is available on international double taxation in accordance with the relevant provisions of bilateral tax treaties. Both the method of exemption with progression and the credit method are used to provide relief on double taxation of dividends received by shareholders who are Czech tax residents.

Clearly, the tax credit relating to foreign-source dividend income cannot be greater than the tax that would be collected on equal amounts of dividends, in the event of distributions by resident companies. The tax collected from dividends in

² S. 22 subs. 1 letter (g) point 3 ITA.

³ S. 38(d) ITA.

⁴ Ss. 16 and 20(b) ITA.

the source country must be documented to the local financial office in the form of a confirmation issued by the tax administrator in the source country. In justifiable cases documentary evidence of tax withheld may also be provided by way of a confirmation issued by the payer of the dividends. The law does not define "justifiable cases", hence it is up to the shareholder to demonstrate to the tax administrator that a confirmation issued by the payer of dividends constitutes adequate evidence as to the amount of tax withheld in any particular case.

The underlying condition whereby the Czech tax authorities will recognise a foreign tax credit is that tax on dividends must be collected in the source country in accordance with the applicable tax treaty. Should any distortion in collection of tax on dividends occur for any reason in the source country, the tax on dividends paid in the source country will not be taken into account for Czech tax credit purposes.

If dividends are received from more than one treaty country, the tax credit is used on a case-by-case basis. If the method of dividend exemption applies, total gross dividends will be exempt from the shareholder's tax base.

Should the confirmation of tax withheld from dividends not be available by the income tax return filing deadline, the shareholder may use estimated amounts of dividends paid or tax withheld in connection with dividend income received in the period for which the tax return is filed. If the estimated amounts and the amounts actually subsequently confirmed differ, any such difference must be included in the tax base for the period in which the confirmation from the source country is received.

Taxation of dividends received from non-resident companies forms no part of any broader, special taxation system, as the Czech Republic does not tax income differently from capital and earned income.

3.2. Retained earnings and capital gains

The tax treatment of capital gains is examined in a situation where a non-resident shareholder sells shares in a resident company. For this purpose it is assumed that the shares in respect of which capital gains have been made are not attributable to a permanent establishment that a non-resident shareholder may have in the Czech Republic.

In general, income from a sale of shares in a company with a registered office in the Czech Republic constitutes Czech-source income, subject to Czech tax.⁵ However, there is no special collection mechanism allowing the Czech tax authorities to collect tax on such capital gains, and shareholders are expected to pay tax on their capital gains in respect of shares in the Czech resident companies on the basis of an income tax return. Clearly, such payments are difficult to enforce.

Most tax treaties concluded by the Czech Republic affect the tax treatment of capital gains under the ITA, since under the terms of these treaties, the right to

levy tax on realised capital gains ensuing from shares in Czech resident companies is granted to the state where the shareholder resides. Only very few treaties do not incorporate this rule, although a notable one is the treaty with Germany. Under article 13 of the German-Czech tax treaty, capital gains on sales of shares in a company with its registered office in the Czech Republic may be taxed in the Czech Republic. All tax treaties concluded by the Czech Republic prevent levy of tax on capital gains attributable to shares in non-resident companies in accordance with article 13 paragraph 4 of the OECD model tax convention.

ITA incorporates special provisions governing the collection of tax on capital gains,⁶ whereby a taxpayer paying for shares in a Czech company must withhold a tax surety amounting to 3 per cent (in the case of acquisition of securities representing shares in a joint stock company) and 10 per cent (in the case of acquisition of an ownership interest, e.g. in a Czech limited liability company).

For these purposes, taxpayers are defined as both individual and corporate persons resident in the Czech Republic and permanent establishments of foreign tax residents located in the Czech Republic. The liability to withhold the tax surety arises when the consideration for the shares is paid, transferred or credited to the account of the recipient by the payer, but not later than on the day that the liability to pay the price for the shares is booked by the taxpayer. The withheld tax surety must be paid to the tax administrator by the end of the month following the month in which the liability to withhold tax arose. The taxpayer is also required to report to its local tax administrator details of the person and the transaction in respect of which the tax surety has been withheld. The tax administrator may view the tax surety as constituting the final payment of tax on the relevant capital gain. In practice, this is a common approach. However, if the seller of the shares so wishes (in particular where the tax surety exceeds the tax due on the capital gain) the seller may file a tax return. The tax administrator will, upon request of the seller of the shares or the taxpayer, issue confirmation setting out the amount of capital gain and tax surety withheld.

ITA makes no provision for taxation of capital gains on shares in a non-resident company that derives profits from the Czech Republic. Such a capital gain is not considered to be Czech-source income.⁷

The Czech Republic has no rules dealing with retained company income that affect companies with non-resident shareholders.

There follows a discussion of the situation where a Czech tax resident makes capital gains from selling shares in a non-resident company.

Capital gains by resident individuals on shares in foreign companies are taxed under the same rules as capital gains on shares in domestic companies. The capital gains tax exemption is also available to individual shareholders in respect of shares in foreign companies under the same conditions, in particular, that the securities are held for more than six months and have not been included in the shareholder's business assets. For the purpose of this exemption securities are shares in a company the capital of which is divided into shares in the form of

⁵ S. 38(e) ITA.

⁶ S. 22 ITA.

⁷ S. 22 subs. 1 letter (g) point 7 ITA.

securities. Similarly, capital gains made on sale of an ownership interest in a foreign corporate body (although its capital is not divided into securities) are exempt from personal tax if more than five years have elapsed between the date of acquisition and the date of sale of the interest, and the interest has not been included in the business assets of the individual shareholder.

Most tax treaties concluded by the Czech Republic affect the tax treatment of capital gains as the right to levy tax on capital gains on shares in foreign companies is granted to the Czech Republic. Tax treatment of capital gains does not differ according to whether the shareholding is a direct or portfolio shareholding. There are only a few treaties that do not grant the right to tax capital gains to the Czech Republic, in particular the tax treaty with Germany. Hence the Czech investor has to pay tax on capital gains arising upon a sale of shares in a company whose registered office is in Germany. Relief on international double taxation is granted by way of crediting tax paid on capital gains in Germany against Czech tax due on such capital gain.

ITA has no specific rules governing retained income in foreign companies.

3.3. Circular and conduit international situations

If the income of a non-resident company is derived through a branch of the company or through a subsidiary resident in the Czech Republic, there are no special Czech income tax law rules that require different treatment of such income in comparison with the situation where the income is derived directly through a company resident in the Czech Republic, i.e. in the country of residence of the shareholder. The tax treatment of both dividends and capital gains is governed by the general rules.

From the perspective of the Czech Republic as a source country, i.e. a residence country of a conduit company, there is no special tax treatment of the conduit company nor does any such treatment arise under general rules. Hence the capital gains made by the conduit company on sale of shares in another country are taxed in the same way as all other capital gains, and dividends paid to non-resident shareholders are treated as normal dividends, irrespective of the actual source of profits distributed in the form of dividends.

4. International tax planning to relieve company/shareholder double taxation

As the Czech Republic is a country that administers a traditional system of dividend taxation, opportunities to reduce the tax burden on dividend income are limited. The favourable tax treatment of dividends under the tax treaty with the Netherlands seems to be one of the few cases where relief on international double taxation may be granted. There are other treaties where under withholding tax the dividends is reduced to zero. These, however, are rarely given consideration for

the purposes of structuring international groups of companies due to other constraints or the limited scope of potential investors from such countries.

Under certain circumstances, distribution of shares in capital reduction may serve as a form of deferral of tax on distributions from the Czech resident company to the shareholders. Similarly, various techniques of dividend stripping may be used in cross-border situations in some circumstances. There is always the risk, however, that a tax inspector may challenge the transaction on the grounds that the legal form of the transaction is seeking to hide the substance, which differs from the form.

The Czech tax administration authorities rely on general anti-abuse and anti-avoidance legislation when seeking to challenge aggressive tax planning techniques.

5. Discussion and suggestions

Realistically, only very limited options of eliminating double taxation of dividends in the Czech Republic currently exist.

One of these could be to exempt inter-company dividends from taxation, particularly where both companies are tax residents of the Czech Republic. Another possibility is to implement the Parent-Subsidiary Directive when the Czech Republic becomes a member of the European Union.

Résumé

Des réductions du taux de l'impôt sur les sociétés et quelques exemptions d'impôt pour les investissements directs étrangers ont contribué à une diminution de l'imposition des sociétés à un niveau comparable à celui de la plupart des pays européens.

L'imposition des dividendes (provenant de revenus de source tchèque) distribués par une société tchèque résidente à des associés résidents est fondée sur un système classique comportant un élément d'imputation accordé à la société qui paie les dividendes. La société est imposée sur ses revenus au taux de 31 pour cent et les dividendes sont frappés d'une retenue à la source de 15 pour cent. La retenue à la source sur les dividendes est définitive et la même pour les dividendes en portefeuille et les dividendes directs. La société qui paie les dividendes peut déduire la moitié de la retenue à la source (7,5 pour cent) de l'impôt sur les sociétés dû pour l'année au cours de laquelle la distribution est effectuée. Un autre allègement est accordé sur la distribution en cours des dividendes par l'exclusion proportionnée des dividendes reçus par la société distributrice, à condition toutefois que la participation de la société à la filiale d'où les dividendes sont obtenus soit d'au moins 20 pour cent. Tous les dividendes reçus par un fonds d'investissement ou une caisse de mutualité ne sont imposés qu'une seule fois.

Les gains en capital résultant de la cession de valeurs mobilières par des associés qui sont des personnes physiques sont exempts d'impôt sous certaines conditions, en particulier sous réserve que six mois se soient écoulés depuis la date d'acquisition des actions. De