

**Speedread:**

- According to the Constitutional Court, tax authority cannot perform a tax audit without specifying a reason
- Governmental draft of changes to the Investment Incentives Act proposes to terminate investment incentives for production industry
- Opening of our Ostrava office

## **Tax administration**

### **End of random tax audits?**

On 18 November the Constitutional Court of the Czech Republic issued a decision which could have a significant impact on the performance of tax audits. The court decided that the tax authority can no longer perform tax audits without a relevant reason. This precedent setting decision was issued based on a constitutional complaint from one entrepreneur from Liberec. On the base of a previous tax audit, the tax authority retrospectively assessed tax in the amount of CZK 13,000 to the entrepreneur.

### **There has to be a particular reason for a tax audit**

According to the Constitutional Court, a tax audit, as an interference with the private sphere of an individual, has to be legitimized by concrete reasons and not only based on the fact that this issue belongs to the scope of the state body's competence. In other words, the reason for initiating a tax audit can not only be the pure interest of the state in proper tax collection, which is the object of the Tax Administration Act, but there has to be reasonable suspicion that the tax subject on which the tax audit was initiated did not fulfill his / her tax duty, or did not fulfill it properly.

The Constitutional Court stated: "*Reasons and suspicions have to exist at the moment of initiation of the tax audit, they have to be clearly formulated and reported to the tax subject as well as noted in the tax audit initiation protocol*". The senate of the Constitutional Court involved further justified this decision by claiming that the performance of tax audits at anytime and without any reason "on trial" is considered to be "arbitrary".

### **Impact on practice**

At present, it is still not possible to qualify the overall impact the decision will have on the practice of tax audit performance. It is unlikely that the tax authorities, based on this judgment, will have tendencies to stop performing random tax audits and will be waiting for e.g. a third party input.

The judgment itself is formulated in relatively vague terms. This vagueness could trigger the tax authorities tendency to justify tax audits with reasoned doubts regarding any part of the tax return.

It is also possible to expect that the tax authorities will have tendencies to avoid this judgment and keep on performing random tax audits (which especially in bigger towns are more or less an exception). Tax audits are based mainly on a "chaining principle", which means that the tax authorities initiate a tax audit based on suspicious transactions detected in other tax subjects.

### **Dissenting opinion**

It is very important to point out the fact that the judgment of the Constitutional Court includes the dissenting opinion of one senate member — JUDr Ivana Janů. In her dissenting opinion Dr Janů compares tax audits to audits of the Czech Commercial Inspection when searching for fakery or to police traffic controls. The formulation of judge Janů's dissenting opinion is unusually strong and therefore it is possible that in the future another senate of the Constitutional Court would decide a similar matter differently, and finally the matter will end up in the large plenum of the Constitutional Court.



## **Courts are in favor of tax subjects**

The case-law of the Constitutional Court as well as the Supreme Administrative Court has gradually marked out rules defining borders for tax authorities in the assessment and execution of tax duties. The final impact of the judgment, as was mentioned above, is still not clear, but there is no doubt that the position of tax subjects became stronger and that the chances of defending against unlawful tax audits (e.g. unlawfully repeated) using the legal action (motion) against the unlawful act of an administrative body and consequently avoiding the illegitimate levy of the tax burden have increased.

Still it is necessary to bear in mind the strong dissent to the judgment manifested by relevant officials of the competent state authorities. For this reason, we cannot exclude the possibility that the practice of random tax audits in the future will not change at all.

## **Investment incentives – tax holidays only, end of support for “assembly halls”**

On 26 January 2009 the government approved an amendment of the Investment Incentives Act (Act no. 72/2000 Coll.), which brings conceptual change focused especially on support to technological and strategic service centers. The amendment reduces the provision of support to tax holidays only.

### **Current situation**

At present, the Investment Incentives Act only covers investment incentives in the manufacturing industry, ie incentives for production halls.

Support focused on other fields, especially on technological centers and strategic service centers, is provided on the basis of the Framework Program for Support of Technological Centers and Strategic Service Centers published by government decree.

### **Proposed changes**

The government's proposal counts on terminating support for the manufacturing industry. Support will be newly orientated only on technological centers and on strategic service centers.

The term Technological Centers means centers focused on industrial research, development and innovation of high-tech products, technologies, industrial processes and software used in production. Strategic Service Centers are centers dealing with selected activities of the company, which are distinguished by a significant share of added value, a significant share of skilled labor and are closely connected to information technologies.

Other significant changes proposed by the government are:

- The only form of providing support will be income tax holidays in the amount of 30% to 60% (depending on the region) for the 5 consecutive tax years (periods).
- The minimum amount of eligible investment will be CZK 20,000,000 (approximately € 740,000) for the acquisition of long term assets
- To receive support it will no longer be necessary to create new jobs.
- The influence of the Ministry of Labor and Social Affairs and the Ministry for Regional Development has been deleted without replacement and the influence of the Ministry of the Environment and municipalities has been reduced.

Investors could receive the tax reductions calculated from the amount of investment (cost of property / assets) or the amount of employee gross wages (on jobs directly created by the implementation of the investment).

In conclusion it is necessary to mention the fact that this is only a legal draft of the government and could be significantly changed during the legislative process.

## Our new Ostrava office

We are pleased to announce that as of 2 March 2009 we have opened a new office in Ostrava.

Our Ostrava office is now providing clients the same scope and quality of legal advice found in our Prague and Bratislava offices.

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