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International Aspects of Taxation in the Czech Republic

SUMMARY

Economic life of the current period is marked by high level of globalization of the economy and ever growing volume of cross-border flows of labor, goods, services and capital. In this situation, issues of international taxation affect not only sporadic cross-border transactions of selected types of subjects but virtually daily tax relations of large numbers of tax subjects, legal entities and individuals. Principles and regularities of international taxation are spreading in an ever growing extent into the intrastate level and are influencing the production of tax laws and everyday application practice of tax administrators.

International aspects of taxation project into intrastate tax relations when there is a certain foreign element present in the tax relation. Such foreign element can show on the level of the subject of a tax relation (e.g. a non-resident taxpayer, permanent establishment, etc.), or the object (e.g. foreign-sourced income), or as the case may be, the tax relation content (e.g. tax liability imposed by a foreign state and the necessity to reflect it in the inland for the purposes of prevention of double taxation, e.g. by a credit method). A foreign element in the tax relation usually indicates the danger of emergence of international double taxation, caused by the parallel (and principally unlimited from the outside) exercise of tax sovereignty of different states. It is the conflict of tax sovereignties of individual states and the international double taxation stemming therefrom, which are considered for many, mainly economic, reasons undesirable, but in some cases it is also the international double non-taxation, which compromises the revenue side of public budgets and which represents the negation of the principle of tax justice, that give rise to the necessity to deal with international taxation in multiple provisions of both domestic and international law.

The clash of tax sovereignties of different states may occur on the level of a conflict of their personal tax jurisdictions, i.e. in respect of whom the states consider their respective tax resident that is subject to unlimited taxation (dual residence), or on the level of a conflict of personal jurisdiction and subject-matter jurisdiction, i.e. in respect of the situation when the income of a taxpayer who is resident in one state, has its source in the other state, or finally on the level of a conflict of subject-matter jurisdictions, i.e. in the situation when one and the same income is deemed to have its source in the territory of each of the two involved states (dual source of income).

In order to eliminate the clash of tax jurisdictions, norms of inland tax law or of international law, in particular treaties on prevention of double taxation may be used. Tax treaties eliminate dual tax residence of taxpayers by applying auxiliary criteria leading to the exclusion of one of the tax residences. In the case of the conflict of personal and subject-matter tax jurisdictions, i.e. in simultaneous taxation in the state of the domicile and the state of the source, the solution resides first in the treaty application of border determiners on the basis of which taxation rights are assigned to one or the other state or to both of them. In the cases when the assignation of taxation rights has not made the conflict of jurisdictions disappear, that is has not caused the elimination of double taxation, the methods of elimination of double taxation determined by the treaties are called to operation. In these methods an apparent shift from the exemption method to the credit method can be observed during the past few decades, and within the credit method a shift from full credit to simple credit can be seen. The simple credit method nowadays represents the predominantly used method of elimination of double taxation.

The character of the tax system in the Czech Republic has undergone remarkable changes in the past 25 years. New institutions of tax law originating in the area of international taxation have been enriching Czech tax laws and application practice. Institutions originally unknown to Czech law, such as the service permanent establishment, reclassification of interest to dividend, place of management as a decisive determinant of tax residence of legal entities, advance rulings, etc. have been spreading into Czech tax regulations and becoming integral elements thereof. The same applies to tax institutions introduced in the Czech Republic as a result of implementation of European law (e.g. exemption of dividends, interest and royalties from tax between certain affiliated persons, strict tax neutrality of mergers and other types of transformations of business corporations, introduction of paying agent, etc.), or as a result of reflection of judicature of the European Court of Justice and the Court of Justice of the European Union in tax matters (e.g. granting the entitlement to tax rebate also to some non-resident individuals who are resident in another EU member state).

While in connection with most aspects of international taxation the legal regulations and tax administrators' practice in the Czech Republic are comparable with developed countries of the world, in sporadic cases the approach of the Czech Republic to the solution of tax situations with a foreign element differs from that which can be encountered in many economically developed countries of the world. This applies, for example, to extensive application of the institution of permanent establishment on cases of service permanent

establishments in the Czech Republic, limited usage of the institution of advance ruling in less than 10 tax situations enumerated by law, the absence of the institution of controlled foreign corporation and its taxation in the Czech Republic, as well as the absence of specific exit tax applicable in cases of loss of Czech tax residence. Not all of these deviations, however, are necessarily to be considered as deficiencies of the Czech tax system.