Executive summary
Effective from 2015, the statutory members of limited liability companies in the Czech Republic will be taxed on their remuneration in the same way as the directors and supervisory board members of joint stock companies.

As a result, income earned by such executives who are Czech tax non-residents will be considered to be Czech source income irrespective of the location of the physical performance of the executive’s activity. In addition monthly payroll tax prepayments are replaced by final tax withholding for tax non-residents who will therefore not be subject to the solidarity tax charge.

Clarification as to how to deal with payroll for 2014 is expected before the end of the year and limited liability companies with non-resident executives should be prepared to amend their 2014 payroll operations for such individuals if necessary.

Background
The Limited Liability Company (commonly referred to as an “s.r.o.”) is a common legal form for a business entity in the Czech Republic.

The taxation of income earned by executives of such entities who are Czech tax non-residents, where only income from Czech sources is subject to taxation, has been subject to extensive discussion since the beginning of 2014 due to differing definitions and interpretations in the new Civil Code versus the Business Corporations Act (BCA) and the Income Tax Act (ITA).

Under the new Civil Code executives, who were considered a statutory body until the end of 2013, are now considered members of the statutory body, which would suggest that they should be taxed in the same way as the members of the statutory bodies of joint stock companies.

However, certain provisions of the BCA, the accompanying explanatory report and the explanatory report accompanying the ITA amendment effective 1 January 2014 differed from this interpretation of the Civil Code.

After lengthy discussion a new ITA amendment, effective from 2015, has confirmed the categorization of executives as members of statutory bodies and deleted the provisions of the ITA which were not in line with the Civil Code. According to the explanatory report on this amendment, a natural person shall always be a member of the body of a legal entity, and not the body itself.

The explanatory report talks of legislative clarification effective from 1 January 2014, however, doubts remain among professionals as to what the right approach is for 2014. The position of executives as members of statutory bodies or as the bodies themselves has a fundamental impact on both the manner and scope of their income taxation and the tax rate.

Tax implications
Up to 2013, executives of limited liability
companies were considered to be a company statutory body and their income for performing their duties fell under the definition of income from a “dependent activity”. Generally, this income was taxed in the Czech Republic only when the activity of the executive was performed in the Czech Republic. The income was subject to monthly payroll tax prepayments irrespective of the tax residency status of the executive and, as such, to the solidarity tax charge effective from 2013.

As statutory body members, an executive’s income continues to be taxed as income from a dependent activity. However, for Czech tax non-residents, the income is now considered to be Czech source income irrespective of the location of the physical performance of the executive’s activity. This means that the source is determined in the same manner as income of members of boards of directors, supervisory boards and other bodies in previous years. For Czech tax non-residents, monthly tax prepayments are replaced by final tax withholding, which is calculated from the same supersgross tax base (the sum of the employee’s gross income and the employer’s portion of social security and health insurance contributions) as a payroll tax prepayment. However, the solidarity tax charge (additional tax due on income exceeding approximately EUR 50,000) does not apply.

Owing to the doubts regarding the correct approach for 2014 the General Financial Directorate promised to issue an opinion on this matter primarily in order to increase the legal certainty of taxpayers, as companies have proceeded in different ways over the course of the year depending on the information available to them. In light of ongoing discussions, the Chamber of Tax Advisors decided to submit this question to both the Coordination Committee of the Chamber of Tax Advisors and the General Financial Directorate. Therefore we anticipate that an official opinion on the taxation of executive income in 2014 should be available by the end of the year.

If income of executives who are Czech tax non-residents is subject to final withholding tax, they are not obliged to declare this income on their Czech personal income tax return. However, if they do declare it, the income is automatically subject to the solidarity tax charge if the EUR 50,000 threshold is exceeded, which means that they are subject to a higher effective tax rate. However, certain tax base deductions and tax reliefs which will reduce the overall tax burden may be claimed through the individual’s tax return.

Next steps
Limited liability companies should review the tax residency position of their executives and follow the official opinion of the General Financial Directorate for 2014 once published. They should also consider retrospective replacement of monthly payroll tax prepayments made for tax non-residents with final tax withholding in 2014, as significant tax savings can be achieved in some cases. Finally, limited liability companies should start calculating the final withholding tax in respect of the remuneration of executives who are Czech tax non-residents no later than 1 January 2015.

Affected executives who are Czech tax non-residents should decide whether they will declare their executive income subject to final tax withholding on their Czech personal income tax return. Based on the decision, their final tax liability may change significantly depending on their personal situation.