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Introduction

The global economic crisis has prompted various governments around the world to consider new tax measures that often have unprecedented effects on taxpayers. Material tax provisions adopted in 2012 – 2013 by various countries in response to the economic crisis are summarized in further detail in this issue of the Global Tax Report.

Editor's Note
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"Open for Business"...Really?: The UK's Corporate Tax Response to the Continuing Global Financial Crisis

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The Conservative Government (which is a misnomer; it is actually the unfortunately named "Lib-Con" coalition Government) was voted into power in 2010, right in the middle of arguably the worst financial crisis seen in global history. In contrast to many other countries that were focused on introducing additional taxation measures to increase tax revenues, the new UK Government announced a rather radical fiscal policy approach. Coined "Open for Business," this policy sought to make the UK a more liberal and business-friendly corporate tax regime.

The UK Government continues to pursue this policy, and various legislative developments have taken place in the last year to further this objective. However, the continued flat-lining of the UK economy has meant lower (than anticipated) tax revenues. The UK Government has, therefore, been unable to meet its own targets to cut the fiscal deficit of the UK. This means that the UK Government now has a rather unenviable (and some might say impossible) objective—to continue to present the UK as an attractive corporate tax jurisdiction while actively increasing tax revenues.

"Open for Business"

The UK Government remains undeterred in its desire to present the UK on the global stage as "Open for Business" and continues to repeat this mantra. It has chosen to do this through a combination of modernizing existing rules and introducing some new ones, which are outlined below.

Rate of Corporation Tax in the UK

Underpinning the "Open for Business" theme is the desire for the UK to compete with other more traditionally attractive jurisdictions (such as Luxembourg and the Netherlands) on, at least, the headline corporation tax rate.

The UK has, in recent years, aggressively cut its main Rate of Corporation Tax. From a main rate of 30 percent less than five years ago, the headline rate has been reduced to 23 percent in 2013. In a surprise move, the UK Government announced a further reduction in the main Rate of Corporation Tax for 2014 from the expected 22 percent to 21 percent, which would make the UK corporation tax rate the lowest in the G-20. The reduction to 21 percent in 2014 would mean that, in the words of the UK Chancellor of the Exchequer, the UK corporation tax rate will be "the lowest rate of any major western economy" and act as "an advert for our country that says: Come here; invest here; create jobs here; Britain is open for business".

Patent Box

UK corporate groups have historically preferred to house their intellectual property (IP) assets in overseas corporate vehicles to avail themselves of preferential tax treatments not available in the UK.

To encourage UK (overseas) groups to develop, retain and exploit IP from the UK, the UK has introduced a favorable tax regime for companies holding patents (the "Patent Box" regime). It is to be noted that this regime is elective and applies only to patents and not generally to other forms of IP (e.g., trademarks or copyrights).

The new Patent Box regime allows companies to elect to apply a 10 percent rate of UK corporation tax from April 1, 2013, to profits attributable to qualifying patents. The full benefit of the regime will be phased in over the next four financial years with the full reduced rate applying from April 1, 2017. Other non-qualifying profits in these companies will continue to be taxed at the main rate of UK corporation tax (see page 2).

Broadly, in order to benefit from the regime, a company must hold "qualifying IP rights" or an exclusive licence in respect of "qualifying IP rights". "Qualifying IP rights" include patents granted by the UK Intellectual Property Office, the European Property Office or under the law of a specified list of countries in the European Economic Area (as well as other rights considered to be similar to patents).

If the company is a member of a group, it must also either have developed substantially its entire portfolio of "qualifying IP rights" itself or be actively managing substantially its entire portfolio of "qualifying IP rights". In essence, this effectively means that both patent-owning and patent-managing companies are entitled to the benefits of the Patent Box regime, and thus, the regime recognizes the common industry practice of separating ownership from development and management of the IP in question.

The Patent Box regime contains detailed provisions for calculating the profits of a company attributable to qualifying IP rights, the details of which are outside the scope of this article.

Controlled Foreign Companies regime

The modernized CFC regime as referred to in the December 2011 edition of the *Global Tax Report* is now in force and will apply to accounting periods of CFCs beginning on or after January 1, 2013.

The "old" rules worked on the basis that all activities that could have been undertaken by a UK company within the group should be taxed as if that had been the case, unless one of a number of prescribed exceptions applied. In recent years, the original CFC rules were seen as increasingly outmoded in scope and responsible (at least in part) for a number of multinational groups migrating to other more favorable jurisdictions.

The stated purpose of the new CFC regime is to protect UK tax revenues against the artificial diversion of profits from the UK while having a CFC regime that is territorial in approach, in order to make the UK a more attractive location for holding companies of multinational groups. In contrast to the original CFC rules, which were written on the basis that all profits of a CFC are included in the UK tax net unless a specific exemption applies, the modernized CFC regime works on the principle that all CFC profits are "out" unless they are brought in.

Under the modernized CFC regime, the CFC charge applies only in respect to a CFC's "chargeable profits". A CFC's chargeable profits are, in turn, defined to mean that part of a CFC's profits pass through the "CFC charge gateway". The gateway is a series of definitions of profits that may fall within the CFC regime with different chapters in the new legislation designed to deal with different types of profits that pass through the gateway. Even if profits pass through the CFC charge gateway, it is only those profits identified by the further application of the detailed provisions of the chapters relevant to the type of profit in question that will be the subject of a CFC charge.

There are also five "entity-level" exemptions which, if they apply, will exempt all the profits of a CFC from the CFC charge. Such exemptions include a 12-month temporary exemption for newly acquired groups with CFCs, a whitelist of excluded territories and exemptions for jurisdictions in which CFCs pay a local tax amount of at least 75 percent of the corresponding UK tax. With the current reductions in the main UK rate of corporation tax, there is more of a risk of the UK itself being considered a CFC jurisdiction, rather than the other way around!

In addition to the exemptions mentioned above, there is an exemption for finance companies that will allow multinational companies to ensure that the profits of their overseas finance companies that satisfy the conditions for the exemption are taxed in the UK at a low effective rate (generally 5.25 percent once the headline rate of UK corporation tax has been reduced to 21 percent as from April 1, 2014).

To the extent that a CFC has chargeable profits that pass through the CFC charge gateway and none of the entity-level exemptions apply, then, as was the case under the original rules, the profits of the CFC are apportioned to and taxed in the hands of a UK resident company with a 25 percent or greater interest in the CFC.

Her Majesty's Revenue & Customs ("HMRC") has spent a lot of time and effort on (and consulted widely in relation to) the new CFC regime in trying to ensure that only those profits that have been artificially diverted from the UK are subject to UK tax. However, this has been at the expense of over-complexity (including a large number of anti-avoidance measures), and as the detailed provisions for determining chargeable profits themselves place reliance on OECD concepts, the administrative compliance burden on multinational groups is likely to be significant.

"Open for Business"…Really?

The phrase *Open for Business* is obviously catchy and recent measures, some of which are outlined in the first part of this article (particularly the aggressive cuts in the UK corporate tax rate), make the UK appear to be an attractive jurisdiction for businesses from a corporate tax perspective.

While there is no doubting the UK Government's intention to make the UK the most attractive tax jurisdiction in the G-20 from a corporate tax perspective, the prolonged economic downturn has meant that the UK Government has had to introduce more "populist" measures to demonstrate their seriousness in collecting adequate revenues from high-value taxpayers. These measures are best encapsulated by the two often-repeated governmental slogans: "we are all in this together" and "everyone should pay their fair share of tax".

Historically, taxation in capitalist economies has been seen as a democratically sanctioned expropriation by the state without imposing on the taxpayer any moral obligation. The UK courts have

affirmed this basic principle that there is nothing fair or unfair about taxation (e.g., in the 1935 House of Lords case of *IRC v. Duke of Westminster*, which remains good law) and that, no matter how unpalatable this may be to the tax authority, every man is entitled to arrange his affairs in the most tax-efficient manner.

However, the measures (described below) introduce a novel concept of "moral" taxation in the UK, whereby taxpayers now have a positive obligation to "telepathically" determine (by gauging the mood and sentiments of the nation) and then pay "their fair share of tax".

General anti-abuse rule (GAAR)

The need for a general anti-avoidance rule (along the lines of other jurisdictions such as Australia) has long been debated but consistently rejected on the grounds that it would create unacceptable uncertainty for businesses.

However, the onset of the global economic crisis provided the opportunity to the UK Government to clamp down on what has long been a thorn in the tax authority's side and introduce such a general anti-avoidance rule.

Following the recommendations of a study group report commissioned by the UK Government and a period of prolonged consultation, the UK Government is introducing a general anti-abuse rule ("**GAAR**") targeted at "highly abusive, contrived and artificial" tax avoidance schemes. The GAAR will apply to counteract, on a just and reasonable basis, the "tax advantage" (see below) that would otherwise have been obtained under the scheme. The GAAR will be an additional tool for HMRC to tackle tax avoidance rather than a replacement for existing targeted anti-avoidance rules.

The GAAR will apply to "tax arrangements" that are "abusive" and entered into on or after the date the Finance Bill 2013 receives royal asset (i.e., Summer 2013). It is worth noting that this draft of the GAAR provides that arrangements pre-dating this commencement date should be ignored by HMRC when considering whether arrangements entered into after the commencement date, which form part of the pre-commencement date arrangements, are abusive (but may be taken into account as evidence that the post-commencement date tax arrangements under consideration are not abusive).

An arrangement is a "tax arrangement" if, with regard to all the circumstances, it would be reasonable to conclude that the obtaining of a "tax advantage" (which is defined widely to include a relief from tax, a repayment of tax or the avoidance or reduction of a charge or an assessment to tax) was the main purpose (or one of the main purposes) of the arrangement. The GAAR will also apply to abusive tax arrangements as a result of which UK tax advantages are obtained by virtue of provisions in a double-tax treaty. The wide definition of "tax arrangement" has been criticized as being contradictory to previous announcements made by the UK Government that a "broad spectrum" anti-avoidance rule would not be beneficial to the UK, as such a rule would risk compromising the certainty that is vital to provide the confidence to do business in the UK. However, it is for HMRC to show that on the balance of probabilities, the arrangements are tax arrangements.

The concept of whether a tax arrangement is "abusive" is central to the GAAR. The draft legislation prescribes that a tax arrangement is abusive if the entering into or carrying out of that arrangement cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions with regard to all the circumstances (commonly referred as the "double-reasonableness" test). Those circumstances include consideration of the policy objectives behind the relevant tax provisions and whether the means of achieving the results of the arrangements involve contrived or abnormal steps.

The full details of the procedural requirements which must be adhered to if HMRC wishes to apply the GAAR are beyond the scope of this article but include (i) a right of the taxpayer to make written representations to both HMRC and an advisory panel (consisting of a Chair appointed by the UK tax authority with non-UK tax authority members from the industry) and (ii) an obligation on HMRC to seek the opinion of an advisory panel as to whether the tax arrangements are a reasonable course of action before deciding whether or not tax advantages are to be counteracted under the GAAR. The purpose of this advisory panel is to bring in an "independent" perspective to the application of the GAAR. However, there is no advance clearance mechanism.

Logically, the burden of proof is on HMRC to prove (before a court or a tribunal) that any counteraction of tax advantage(s) based on the application of GAAR is just and reasonable.

To illustrate the compliance burden that GAAR introduces on taxpaying companies, such companies need to self-assess (each year), in the absence of any advance clearance mechanism, whether the GAAR applies to any transaction such companies have undertaken and adjust, on a just and reasonable basis, the tax advantage(s) arising from any abusive tax arrangement that is relevant to that self-assessment!

Residential property

There has been a populist clamor against wealthy foreign individuals owning "expensive" residential properties through overseas corporate vehicles and thus avoiding paying the UK taxes that a UK resident would otherwise have to pay.

The Chancellor of the Exchequer announced in his Budget Speech on March 21, 2012, a package of three measures to ensure that individuals and companies pay tax on high-value UK residential property transactions and to tackle avoidance, in particular, the wrapping of property in corporate and other "envelopes". One of the measures, a 15 percent rate of stamp duty land tax on UK residential properties costing more than £2 million when acquired by certain "non-natural" persons, took effect immediately. The other two measures, an annual charge on UK residential property owned by "non-natural" persons and an extension of the UK capital gains regime, are currently being consulted on by the UK government to be legislated in the Finance Bill 2013 and will take effect beginning April 6, 2013.

The extension of the UK capital gains tax regime to apply to the disposal of UK residential property by certain non-UK resident "non-natural" persons marks a significant departure from the territorial focus that otherwise seems to be running through the UK Government's fiscal policy.

Conclusion

The UK Government is treading a fine line (the uncharitable would say that the UK is pursuing a mutually incompatible policy) in seeking to attract inward investment by promising a "business-friendly" tax regime while at the same time promising its domestic audience that it will aggressively pursue taxpayers and collect taxation that it considers to be "morally" payable.

This has seen some bizarre results—Starbucks, for example, has, under immense media pressure and scrutiny at the minimal amounts of corporation tax it pays in the UK, recently "volunteered" an additional £20m as its fair share of UK corporation tax. This is akin to Starbucks asking its customers to decide how much to pay for a cup of its coffee!

The UK Government's obsession with anti-avoidance rules has now reached a stage whereby most corporate taxpayers in the UK may, depending on their precise activities, have to deal with four different sets of anti-avoidance rules: (a) the GAAR (as outlined above); (b) the TAAR (Targeted Anti-Avoidance Rules); (c) the "Ramsey doctrine" (being the case law developed anti-avoidance rules); and (d) the "*DOTAS*" (Disclosure of Tax Avoidance Scheme), which requires taxpayers to disclose certain transactions exhibiting specified hallmarks. There is also the ECJ concept of "abuse of rights" (commonly referred to as the "Halifax principle", which applies to VAT). Furthermore, the UK Government continues to stick to its policy of avoiding a general advance tax clearance/ruling regime for corporation tax.

All these combine to create a corporate tax system that provides an attractive regime at the cost of a level of certainty—it is arguable if any tax system can be attractive without delivering this minimum acceptable level of certainty.

Post-Script: *The continuing disparity between the UK corporation tax main rate (expected to be 21 percent from 2014) and the UK income tax rate (currently up to 50 percent reducing to 45 percent from April 5, 2013) may be seen as sending a somewhat mixed message to foreign investors—this being that generally corporates are welcome but their highly-skilled, well-paid employees are really not.*

Recent French Tax Reforms: "The Biggest Effort in 30 Years"

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In light of the Spring 2012 elections of President Hollande and his socialist government, the tax laws enacted at year-end 2012 clearly confirm the trend of the past related to increasing the tax pressure for political[1] and budget[2] reasons on both companies and individuals, as has occured for the past two years, subject to the introduction of a corporate tax credit to preserve a competitive marketplace for French companies.

Measures of Interest to Companies

Tax loss carry-forwards

Until now, tax loss carry-forwards were able to be offset with no restriction up to €1 million and up to 60 percent of taxable income exceeding €1 million. The 60 percent limit is decreased to 50 percent for fiscal years ("FYs") ending as of December 31, 2012. The remaining tax losses may still be carried forward without any time limitation.

In view of numerous restructurings in the French market, a specific provision has been introduced so as to mitigate the above restriction, as it allows the companies that grant or receive a debt waiver (conceded in the framework of legal insolvency proceedings) to increase the €1 million threshold by the amount of such forgiveness of debt.

Restriction of the deductibility of interest

For budget reasons, a new general deduction cap (applicable in addition to the existing thin-cap rules and other anti-abuse mechanisms) and partly inspired by the German tax barriers, was introduced for FYs ending as of December 31, 2012, pursuant to which the deductibility of the net financial expenses, is limited to 85 percent in FYs 2012 and 2013 and 75 percent afterwards. In order to preserve small and medium-sized companies, this restriction is not applicable if the net financial expenses are lower than €3 million.

Net financial expenses are equal to the difference between (i) the eligible interest expenses (i.e., accrued on loans granted by unrelated and related parties and after application of the thin-cap rules as well as the other anti-abuse measures), plus the rents related to operating leases on movables assets (with related party), and the rents accrued under financial leases (after deducting the annual depreciation of the assets) and (ii) the interest income.

Increase of the taxable portion of capital gains under the French participation exemption regime

For FYs ending December 31, 2012, the taxable portion of capital gains realized on the disposal of qualifying participations (more than 5 percent held for more than two years) is increased from 10 percent to 12 percent (hence, a maximum CIT liability of 4.33 percent [12 percent x 36.1 percent]). This taxable portion is now computed based on the gross amount of capital gains (meaning that capital losses on qualifying shares no longer reduce the capital gains).

Other important measures have been enacted: Introduction of a competitiveness tax credit (basically 4 percent of the wages paid); increase from 19 percent to 45 percent of the flat taxation on foreign shareholders on the disposal of French substantial shareholdings; and modification of the French VAT rates.

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1 The reforms aim at creating a "fairer and more efficient tax system for both households and businesses".

2 The tax changes also aim at returning the French economy to a balanced budget position by 2017.

Increased Tax Pressure on Individuals: "Those Who Have the Most Should Pay More"

In a difficult budgetary environment, President Hollande has announced during his campaign the need for increasing the tax pressure on high-income and wealthy individuals.

Capital gains on shares

Capital gains on the disposal of shares (subject until now to a flat 34.5 percent income and social taxes rate out of which 19 percent were tax) will be taxed beginning January 1, 2013, (specific rules apply for 2012) based on the progressive tax scale (which is increased through the introduction of an additional tax bracket of 45 percent applicable to income exceeding €150K) not taking into account the social levies up to 15.5 percent. The effective taxation will be reduced through a progressive allowance on the capital gain, depending upon the holding period of the shares sold (20 percent for a minimum holding period of two years, 30 percent for a four- to six-year holding period and 40 percent for more than six years).

The 19 percent flat tax rate remains applicable to capital gains realized by certain sellers, who have been exercising eligible functions in the company sold during a certain period of time.

The "75 millionaire tax"—between election promise and embarrassment

The socialist government also wants the portion of income higher than €1 million to be taxed at 75 percent. As the corresponding section of the December bill was considered invalid by the Constitutional Court, a new proposal is expected in the coming weeks.

Other important tax measures have been enacted, revealing not only technical but also political challenges: The wealth tax rates will increase and shall range from 0.5 million to 1.5 million even though the total aggregated amount of wealth tax and income tax is capped at 75 percent of the net income; the contribution of shares to a company followed by the sale of the contributed shares may now trigger taxation at the level of the contributing individual, increasing social levies on the worldwide income.

Germany's Recent Tax Measures Within the Context of the Current Global Economic Crises

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Germany's economic situation has suffered from both the international financial crisis and the euro crisis, but compared to the situation in the southern European Commission (EC) member states, such as Greece, Cyprus, Portugal and Spain, the economic downturn has been fairly moderate. German companies reported tremendous positive figures in 2012, and the stock market index DAX recently climbed to the highest level of the decade. Such recent successes are not so much based on a strong national demand, but on a recovery of world markets, in particular in the Far East and America.

As economic recovery continued in Germany throughout 2012, there was little need for changes in the tax environment to overcome the crises. The German Government attempted to make some adjustments before year-end, but as the opposition did not accept a package of changes, which also included a proposed tax treaty with Switzerland that would have allowed taxpayers to clean up their tax affairs on an anonymous basis at lump-sum charges, the entire tax legislation failed and did not pass the parliamentary process before December 25, 2012, as originally planned.

Against this background, there are some additional changes that may arise in the foreseeable future.

The Financial Transaction Tax (FTT)

The financial sector was the major cause of the crises starting in 2008, and it received substantial government support over the past few years aimed at overcoming financial instability. To ensure that the financial sector makes a fair contribution to public finances, the European Commission proposed a new tax called the Financial Transaction Tax ("FTT"). It soon became obvious that this tax would not find global consent (the United States always rejected

this type of transfer tax). Moreover, many of the EC Member States are also not in favor of this new tax, including the UK and Sweden. France and Germany, however, were immediately in support of this new tax kit and, based on requests from nine other Member States, the EU Council adopted a measure authorizing the 11 Member States to move ahead with enhanced cooperation on the common system of implementing FTT on January 21, 2013.

The European Commission proposed a first draft of the FTT and now, after the decision has been made to introduce the tax in at least 11 EU countries, the proposal will be further engineered and developed. Additional Member States are welcomed to join the project at a later stage.

The FTT is based on a concept that was proposed by Nobel Prize winner James Tobin in 1972. The current plan of the European Commission envisages a tax rate of 0.1 percent on financial transactions involving shares and bonds, and a tax rate of 0.01 percent on derivatives. It can be expected that the scope of the tax, as well as the tax rates, will be subject to long-lasting discussions among the Member States. The most critical factor of such a tax, however, will be its geographic reach. To be successful, there must be assurance that the market participants will not relocate their transactions abroad in order to circumvent the FTT. Therefore, the triggering event of the tax is not where the transaction takes place but that a party to the transaction is established in a Member State that charges FTT.

While the European Commission wants to implement this new tax as a basis for the EU budget, the national governments insist on obtaining expected additional funds for their own purposes.

The FTT would be a second charge on the financial sector, as some governments, as a reaction to the financial crisis, like the German Government, have also introduced a bank levy from 2011 onwards. The bank levy (annual levy) is calculated at a progressive rate of 0.02 to 0.04 percent of the balance sheet total less certain liabilities and derivatives, and is limited to a maximum of 15 percent of the net profits.

Improvement of Utilization of Losses

A further example that might also have a background in the financial crisis is the amount of losses that can be carried back to the preceding tax year. The amount of the tax losses that can be carried back will be increased from €511,500 to €1,000,000. For small and mid-sized operations that particularly suffered from the financial crisis compared to their global counterparts and even more than the global players, this change provides unprofitable businesses with additional interest-free cash.

Discussion of Net Wealth Tax

In 1997, the net wealth tax was abolished as it was found to have jeopardized constitutional principles. Meanwhile, however, the interpretation of this tax has changed, and as Germany is going to elect a new government in fall of 2013, the opposition is campaigning for more tax justice in Germany. It is proposed that net assets held by companies and individuals will become subject to a 1 percent wealth tax, whereby private individuals will benefit from a tax exemption if their net assets do not exceed €1,000,000. These additional revenues are to be used to improve the national deficit, which has badly suffered as a result of the financial crisis and the support given to the financial sector.

In this context, it must be noted that the administration of a net wealth tax is very complicated and cost-prohibitive because, for instance, the fair market values would have to be calculated for all real property; for example, relative to the additional funds that could be raised, the administrative costs would be disproportionate.

2013 Tax and Social Security Changes in the Czech Republic

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In the last days of 2012, the Czech Parliament approved several amendments to the Czech tax and social security and health insurance ("SSHI") law. The main purpose of these amendments was, according to the official standpoints, to decrease the budget deficit of the Czech Republic and keep it below 3 percent of the GDP. Although the last increase of value-added tax (VAT) rates (in 2012) did not fulfill the expectations of the Czech Government with respect to income collected from the taxpayers, the new amendments establish additional increases of tax rates (VAT and also personal income tax) and the government again believes that the state collections will improve.

Personal income tax

The new tax amendment introduced a solidarity tax surcharge of 7 percent, which should apply (in addition to the standard 15 percent personal income tax) to annual gross income (of an employee) or an annual tax base (profit of the independent entrepreneurs) exceeding the cap for calculation of the social security contributions (CZK 1,242,432, i.e., approx. €49,700). The solidarity tax surcharge will apply during the next three years (i.e., from 2013 to 2015). Individuals subject to the solidarity tax surcharge will be obliged to file an annual personal income tax return. The surcharge is not defined as personal income tax, which may bring uncertainty for individuals who may be obliged to pay income tax in countries outside the Czech Republic. It is currently unclear whether foreign income tax may be credited against the tax surcharge. The policy is presently being prepared.

From 2013 to 2015, no cap on health insurance contributions will apply. Previously, a cap of approximately CZK 1,800,000 (€72,000) applied. This change will result not only in higher health insurance contributions, but also in higher effective taxation for employees (employer SSHI contributions are added to the tax base of employees).

The last temporary change concerns retired persons who have concurrent taxable income (from employment, independent activities or rental income). From 2013 to 2015, these individuals may not apply for the basic tax relief of approximately CZK 25,000 (€1,000) per calendar year.

For certain categories of self-employed individuals, lump-sum expense deductions will be capped. From 2013 onwards (with no time limitation), individual entrepreneurs such as physicians, dentists, attorneys and tax advisors, as well as individuals with rental income, will only be able to apply 30 percent and 40 percent lump-sum expenses up to income not exceeding CZK 2 million (approx. €80,000). The maximum lump-sum amounts are, therefore, limited to CZK 600,000 (approx. €24,000) and CZK 800,000 (approx. €32,000), respectively.

Furthermore, such individuals using lump-sum expenses (regardless of the percentage) who earn a majority of their income as entrepreneurs, will not be allowed to apply the yearly tax reliefs for spouses (CZK 24,840, approx. €1,000) and children (CZK 13,404, approx. €536 per child).

The last permanent change of the income tax law concerns the introduction of the withholding tax of 35 percent for income paid to certain non-residents who are not tax residents of the European Union or the European Economic Area, or tax residents in a country with which the Czech Republic has concluded an international double-taxation treaty, a treaty on exchange of information in the tax area, or a similar multilateral agreement and such agreement is in full force.

Value-Added Tax (VAT)

For the next three years (from 2013 to 2015), the standard VAT rate has been increased to 21 percent and the reduced VAT rate to 15 percent (from 20 percent and 14 percent in 2012).

From 2013 onwards, many healthcare materials previously subject to the reduced rate of 14 percent are now subject to the standard VAT rate of 21 percent.

The VAT Act amendment also introduces new enforcement tools to combat VAT fraud. Specifically, the amendment provides for a deemed guarantee of the provided VAT payment in the instance that the payment is made to an unregistered bank account, or if the service provider/seller is included on the public list of "unreliable" taxpayers. This list will be monitored by tax authorities.

Other, more positive, changes in the VAT Act were also introduced from 2013, including the requirement that tax documents may be stored in electronic form only.

Other Taxes

From 2013, the real estate transfer tax increased from 3 percent to 4 percent. In addition, the favorable tax regime for the so-called green fuel was limited for 2013 and will be definitely canceled from 2014 onwards.

Fuel Distribution Tax Frauds

The government has also tried to tackle the relatively frequent tax fraud schemes concerning the importation of fuels (both VAT and excise tax). One of the measures is the above-mentioned VAT guarantee, which also applies to cases when the provider of fuels is not officially registered as a fuel distributor at the registry administered by the customs authority.

Other measures already in force include penalties for avoiding registration as a fuel distributor and trading with unregistered distributors. Further measures proposed and expected to come into force in 2013 include a CZK 20 million (€800,000) security deposit for each registered distributor and licensing of the fuel distribution business by the state authorities.

Pension Reform

The current pension system in the Czech Republic is operated as a pay-as-you-go system with active individuals contributing to the state system from which retirement pensions are paid. Due to demographic changes, the pension system, as it is currently constructed, is slowly becoming underfunded. The pension reform was, therefore, introduced effective as of January 2013.

Before 2013, the social security contribution of employees was 31.5 percent of gross income (subject to a cap), partly paid by an employee, partly by an employer. Under the new pension rules, individuals will have an option ("opt-out") to redirect a certain part of their payments—3 percent—to their private pension accounts. However, they will then be obliged to pay an additional 2 percent to their private pension accounts (the private pension funds will receive 5 percent income of the employee). In principle, the same rules apply to independent entrepreneurs.

Participants in this so-called "second column" will be significantly limited in how they would be able to distribute their funds. In principle, there will be no possibility to revisit the opt-out. Also, once they reach retirement age, participants will only be allowed to choose from the following fund payments methods: lifelong pension payments, lifelong pension payments with agreed payment of inheritance pension for three years, or retirement pension for 20 years.

Avoiding the Cliff: Economic Stimulus in the American Taxpayer Relief Act of 2012

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Introduction

By now, it is common knowledge that America avoided going over the so-called "fiscal cliff". Traversing that precipice could have caused a steep economic drop. The Congressional Budget Office (CBO), a non-partisan arm of the US Government, estimated that the US jobless rate would have increased to 9.1 percent and US economic output would have dropped by 0.5 percent. To avoid these dire economic consequences, Congress enacted, and President Obama signed, the American Taxpayer Relief Act of 2012 (ATRA). In light of continued economic uncertainty, the ATRA contained a number of stimulus provisions. This article highlights attempts to use tax law to stimulate the US economy.

Income Tax Rate continuity

The ATRA maintains lower tax rates in order to avoid negative economic impact. The Economic Growth and Tax Relief Reconciliation Act of 2001 contained reduced individual income tax rates that were colloquially known as "the Bush tax cuts". The individual tax rates were reduced to the following levels: 10 percent, 15 percent, 25 percent, 28 percent, 33 percent and 35 percent. These lower tax rates were set to expire December 31, 2012, and revert to pre-2001 levels—namely, 15 percent, 28 percent, 31 percent, 36 percent and 39.6 percent. The ATRA maintains tax rates at levels established by the Bush tax cuts. However, for taxpayers whose income exceeds US$400,000 (single status) or US$450,000 (married filing jointly status), the ATRA re-establishes a top tax rate of 39.6 percent. As the US tax system is progressive, taxpayers who meet this income threshold still benefit from lower tax rates on all income below the US$400,000 or US$450,000 level. The income levels to which the various tax brackets apply are indexed to inflation, so the threshold for the top rate will increase with future inflation.

The economic rationale for maintaining lower tax rates is straightforward. The less tax people pay, the more they are likely to spend—thus stimulating the economy. The CBO estimated that maintaining the Bush tax cuts on income levels below the US$400,000 and US$450,000 income levels would boost US GDP by slightly less than 1.25 percent by the end of 2013. Maintaining the status quo for all income levels would have boosted GDP by a little less than 1.5 percent. Therefore, the decision to increase rates on those taxpayers with income exceeding US$400,000 (or US$450,000) is not expected to have a severe economic impact. Maintaining the existing tax rates on the lower income levels is projected to result in a loss of tax revenue of US$319.711 billion over ten years.

Dividend and Capital Gain Rate Continuity

The Bush tax cuts lowered the US tax rate for certain dividends and long-term capital gains to either 0 percent (for individual taxpayers with income levels below the 25 percent bracket) or 15 percent (for individual taxpayers with income levels at the 25 percent bracket and above). Dividends paid by US corporations and by corporations residing in countries with which the United States has a comprehensive income tax treaty (referred to as "qualified dividends") were generally eligible for the reduced tax rates. Absent action to extend these tax rates, the maximum rates of taxation applicable to individual taxpayers on all dividends would have reverted to 39.6 percent and the maximum rate of taxation on long-term capital gains would have reverted to 20 percent. The ATRA extends the reduced tax rates for all individual taxpayers with income levels below the 39.6 percent bracket. For taxpayers in the 39.6 percent bracket, the tax rate on capital gains and qualified dividends is set at 20 percent. The lower rates of taxation on capital gains and qualified dividends were maintained in the belief that such tax rates would spur investment which would, in turn, lead to job creation. Maintaining the reduced rates of taxation as described above is estimated to result in reduced tax revenue of US$289 billion over ten years.

Certain Temporary Tax Credits Extended

The ATRA extended a number of tax credits that primarily benefit low- and moderate-income taxpayers. First, the American Opportunity Tax Credit was made available for an additional five years. This tax credit, 40 percent of which is refundable to taxpayers, grants a taxpayer a credit for up to US$2,500 of educational tuition expenses. Second, the increase in the child tax credit from US$500 to US$1,000 per child was maintained. The enhanced refundability of the credit was also maintained. The lesser of the unused portion of the child tax credit or 15 percent of the person's earned income exceeding US$3,000 is refundable. Third, the increase in the value of the earned income tax credit (a credit for employed, low-income taxpayers) up to 45 percent of a working family's first US$12,570 for families with three children is made permanent. Fourth, the increase in the value of the dependent care credit, which allows a tax credit for care for a child under age 13 or a disabled dependent, is maintained. Lower-income taxpayers are expected to spend a greater percentage of their income on a current basis than higher-income taxpayers. Therefore, these credits are believed to provide economic stimulus by enabling enhanced consumer spending. The total cost of these programs is anticipated to be US$136.035 billion over ten years.

The AMT Is Patched

The alternative minimum tax (AMT) is a parallel taxation system designed to ensure that taxpayers who have a large number of deductions still pay a minimum level of tax on their income. AMT is computed by first calculating a taxpayer's alternative minimum taxable income without the benefit of various deductions and exclusions available to taxpayers under the regular income tax computations, and then applying a reduced rate of taxation to the AMT income amount. When the AMT was first enacted, there were exemptions built into the system to ensure that the AMT did not affect low- or moderate-income taxpayers. However, the exemption amounts were not indexed to inflation and thus remained at historic levels. The Bush tax cuts raised the exemption amounts. The ATRA maintained the increased exemption amount and also indexed the AMT exemption amount to inflation. The 2013 AMT exemption amount is set at US$51,900 (single status) and US$80,750 (married filing jointly). Therefore, taxpayers with AMT income at or below the exemption amount will not be subject to the AMT. Additionally, certain non-refundable tax credits may now be credited towards the AMT liability. Had the AMT not been patched, millions of taxpayers would have become subject to the AMT for the first time. This would have significantly increased the complexity of filing a tax return and had a significant economic impact due to the uncertainty it would have created for millions of taxpayers. At an estimated tax cost of US$1.8 trillion, patching the AMT is the most expensive tax provision in the ATRA.

Section 179 Deductions

Code Section 179 allows certain small businesses to take a current deduction for capital equipment purchases in the current year rather than depreciating them over time. In response to the financial crisis, the amount of expenditures available to eligible small business as a current deduction was increased, and the option to take a current deduction was made available to more small businesses. For 2012 and 2013, small businesses with net income of less than US$2 million can currently deduct up to US$500,000 in equipment purchases. After 2013, the deduction amount is scheduled to be limited to US$25,000 for small businesses with income of US$200,000 or less. Increasing the tax deduction for capital equipment purchases is expected to make such expenditures more economically attractive in the short term. Incentivizing spending on capital equipment is intended to spur economic growth by encouraging businesses to spend, rather than save, their money, in the face of continued economic uncertainty. The enlarged Section 179 deduction is projected to cost US$2.3 billion over ten years.

Bonus Depreciation

When a business buys a capital asset, it can deduct the cost of that asset over time through depreciation. For 2008 – 2010, businesses were entitled to take a current deduction for 50 percent of the cost of certain depreciable assets in the first year the assets were placed in service, rather than spreading out the depreciation over the life of the asset. The remaining 50 percent of the cost basis for the assets is depreciated over the useful life of the asset. The ATRA continues 50 percent bonus depreciation for assets placed in service before January 1, 2014, or January 1, 2015, for certain aircraft and longer production property. As with the Section 179 deduction, bonus depreciation is thought to incentivize immediate, rather than delayed, capital asset purchases. Enhanced capital spending is expected to increase both the demand for capital goods and productivity because firms purchasing capital goods will be able to produce more. The extension of bonus depreciation is expected to cost US$4.9 billion over ten years.

Other Capital Asset Purchase Incentives

The ATRA includes a number of accelerated depreciation provisions targeted to specific industries or sectors. These include: leasehold, restaurant, and retail improvements; improvements to property used for motorsports entertainment complexes; and business property situated on Native American reservations.

Research and Experimentation Tax Credit Extended

Increases in research and experimentation expenditures incurred by a business prior to 2012 could result in a tax credit of up to 20 percent of the increase in such expenditures over a base amount of such expenditures. The base amount of such expenditures and the amount of the credit were subject to detailed calculations that are beyond the scope of this survey. However, the ATRA retroactively extended the research and experimentation credit until December 31, 2013. Extending the tax credit may encourage investments in research and development, and may lay the foundation for future economic growth. The extension of the credit is estimated to cost US$14.3 billion over ten years.

Conclusion

The ATRA extended several measures whose primary function is to stimulate US economic growth. As the US economy improves, there may be a move to eliminate certain of the above-described stimulus measures. The dynamic political environment in the United Sates makes these changes impossible to predict.

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