Tax change coming on on subleases and fit-outs

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At present, the Czech income tax act does not consistently address all the tax aspects of specific lease relations, which makes otherwise standard commercial arrangements more complicated. Most notably, this concerns the cases of a sublease or a lease assignment. To improve the situation, specific provisions have been included in the recent amendment of the income tax act, currently in an advanced stage of the ratification process.

More specifically, under the current legal framework, the sub-lessee does not have the right to depreciate any technical improvements (i.e. essentially any fit-out works) made at its own expense, in the end leading to a loss of any tax effect on such expenditures. Even if removed at the end of the lease, no tax effect can be retained, since the sub-lessee's technical improvement is perceived as a non-depreciable property, the write-off of which is treated as tax non-deductible.

The amendment now close to ratification aims to rectify this situation. If approved (which seems likely at this point), the sub-lessee will be given the right to depreciate its newly made technical improvements under the same conditions as those that apply to the tenant-landlord relationship. As a consequence, the remaining tax value at the end of the lease will also be tax deductible (provided further standard conditions are met). This should help to clarify and simplify sub-lease arrangements, which are currently distorted due to these negative tax implications.

The situation in the case of lease assignments is a more complicated one, the crucial part being whether the "new" tenant has the right to compensate the "old" tenant for the technical improvement made in the premises and continue in its tax depreciation. This has been open to academic dispute for a long time and consensus still has not been reached. However, the issue was also addressed in a relatively recent ruling of the Supreme Administrative Court, where any possibility for tax depreciation by the "new" tenant was denied.

As the negative tax implications again hinder otherwise economically reasonable commercial arrangements, the amendment of the income tax act should have clarified this issue as well, at least based on the legislator's explanatory report to the amendment. However, the wording of the amended provisions fails to deliver. This area is therefore likely to be subject to further

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academic discussion and, more importantly, continuing uncertainty for taxpayers. It is also interesting to note that another, more recent decision of the Supreme Administrative Court recognizes this area as unclear and tries to draft basics on how to reach tax deductibility of the fit-out compensation paid in such scenarios without resorting to tax depreciation.

To sum up, if you had complications in sub-lease arrangements connected with the above, the amendment should bring good news, soon. However, with regards to any implications of lease assignments, the amendment does not seem to bring final clarity to the matter.