



## Client Information

Czech Republic  
September 2019

### Bad debts - when can we collect VAT on unpaid invoices?

*Does your customer owe you money? Are you actively recovering your debts and wondering if you can recover your VAT from the government on such an outstanding invoice? This issue will be discussed in the following article.*

*The amendment to the VAT Act from April this year brought significantly wider possibilities of VAT recollection from bad debts. An entrepreneur must be actively recovering his/her claim in order to prove to the government that the debt is indeed bad. For large bad debts we recommend checking not only the terms given by the Czech VAT Act, but also current European judgments, which may be more beneficial.*



### The VAT Act

The supplier typically reduces the VAT paid to the government on the carried out performance at the moment when the customer returns a shipment or an advance payment, when an additional discount is agreed, or a quantity/financial bonus is provided. These situations are already known in terms of VAT. But what if you fail to agree with the customer on payment and end up with a bad debt?

In the past, in order to protect the state budget, legislation allowed entrepreneurs to claim VAT back on issued invoices only from receivables from debtors who were in insolvency proceedings as a result of being declared bankrupt by an insolvency court. However, the supplier was discriminated against by losing this financial advantage if he/she ceased to be a VAT payer.



According to European regulations the supplier has the right to reduce the original VAT if he/she does not receive the remuneration in part or in full after the transaction is realized. As of April 1, 2019, in response to European court decisions, Czech law has defined bad debts more widely - where the supplier can, under certain conditions, claim **back** from the government VAT previously **paid on issued invoices**.

These include:

- Debts enforced through **execution proceedings**, where at least 2 years have passed since the first execution order was issued;
- Debts enforced through execution proceedings, which were terminated due to the debtor's lack of assets;
- Debts in **insolvency proceedings** where the bankruptcy of the debtor's assets has been declared;
- Debts in insolvency proceedings where a court has decided to convert reorganisation into bankruptcy;
- Debts in insolvency proceedings where the Debt Relief Report makes it obvious that the debt will wholly or partially not be paid;
- Debts in insolvency proceedings which have been terminated and the court decision makes it clear that the debtor's assets are completely insufficient to satisfy creditors;
- Debts where it is clear from the outcome of the completed **inheritance proceedings** that they will wholly or partially not be paid;
- Debts in the above proceedings where the conditions for correcting the tax base have not yet

been fulfilled and 5 years have passed since the end of the taxable period in which the original unpaid transaction took place.

The law lists the terms under which a reduction in the outgoing VAT is not allowed - for example, the debtor must not be capital-related or personally related to the payer. The customer was not an unreliable VAT payer at the time of making the deal. The customer is not a VAT payer any more.

**The new rules on the outgoing VAT reduction apply to debts recovered through proceedings commenced after April 1, 2019.** It therefore also covers debts created earlier.



The VAT can be claimed back from the government **within 3 years** and this period does not include the time(s) of execution/insolvency and/or similar proceedings. If an entrepreneur receives the VAT back from the government, he/she is obliged to monitor the development of the debt for a **further 5 years** and to correct the refunded VAT if necessary.



Source: „Soudní dvůr Evropské unie“

The entrepreneur shall issue a corrective tax document for the reduced VAT and deliver it to the customer. Only then he/she can reduce the total tax by the VAT on the unpaid invoice in his/her tax return. On the other hand, the customer-debtor shall return the previously claimed VAT on this unpaid invoice to the government.

**We strongly recommend investigating the possibility of VAT refunding in the light of current European judicial practice for large bad debts. This may be more favourable to taxpayers than Czech law in some cases.**

In case of any questions please do not hesitate to contact us.

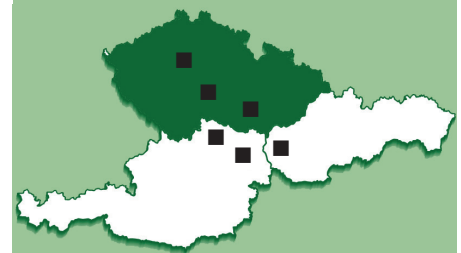


**ING. JANA ŠNAJDROVÁ**  
Tax advisor  
T: +420 224 800 416  
jana.snajdrova@auditor.eu

## AUDITOR in Central Europe

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### Office Prague

Haštalská 6, Prague 1

T: +420 224 800 411

praha@auditor.eu

### Office Pelhřimov

Masarykovo nám. 30, Pelhřimov

T: +420 565 502 502

pelhrimov@auditor.eu

### Office Brno

Dominikánské nám. 2, Brno

T: +420 542 422 601

brno@auditor.eu

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