

Supreme Administrative Court confirmed that leasehold improvements made by tenant cannot be sold



26th May 2020

In its recent judgment, the Supreme Administrative Court (“SAC”) discussed tax deductibility of leasehold improvements made and depreciated by a lessee when they are transferred to a new lessee in a transaction designated by the parties as a “sale” immediately before the termination of the lease.

A company used the premises of a former electrical substation under a lease arrangement; the company rebuilt and transformed the facility into a manufacturing hall for finishing works in glass production. In addition, the company installed a sliding entrance gate and access and handling communications in the facility. The competent Tax Administrator (and the SAC) assessed all these changes as leasehold improvements.

Before the termination of the lease, the company sold the leasehold improvements to a new lessee of the facility. Subsequently, the lease between the company and the owner of the facility was terminated. No settlement for the leasehold improvements was agreed between the company and the owner of the facility. The company recognized the proceeds from the sale as taxable income and the residual value of the sold leasehold improvements as a tax-deductible expense. The tax residual value was significantly higher than the proceeds from the sale.

The Tax Administrator challenged the tax deductibility of the above expense and assessed additional tax, including penalties, to the company. The Appellate Financial Directorate, the Regional Court and the SAC, in turn, supported the Tax Administrator’s decision. In its judgement, the SAC referred to its previous judgments and once again confirmed that the rights to technical improvements of leased assets could not be transferred in a private juridical act (e.g., sold), as they constitute non-transferable public rights. Thus, the requirement of a “sale of tangible assets” pursuant to Section 24(2)(b)(2) of the Income Taxes Act has not been met and, consequently, the residual value of the leasehold improvements cannot be considered a tax-deductible expense.



Martin Novák
martin.novak@cz.ey.com
+420 603 577 929



Filip Šenfeld
filip.senfeld@cz.ey.com
+420 735 729 367