KPMG

# Tax and Legal Update

**Tax news**
**Legal news**
**World news**
**Case law**

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**Dear readers,**

Ten years ago, if you had asked your friends what they thought about taxes, they would probably not have said much; nowadays, everybody in Britain is talking about them. This is how Gregory Morris, a transfer pricing expert and guest at the May Transfer Pricing Forum describes how taxes have become a hot topic. And it seems that they are to stay on the title pages of newspapers all through this year's Indian summer.

The end of the summer was also marked by the planned introduction of the electronic reporting of sales. While Czechs were returning from the beaches of Bulgaria and Croatia, where ERS has been in place since 2012 and 2013, respectively, the Ministry of Finance issued an ERS textbook – symbolically, one day before getting back to school. For those who do not want to diligently study all of its 42 pages, we summarize the most important issues below.

Another bombshell was the additional tax assessment of EUR 13 billion for Apple. The European Commission has made it clear that it does not consider local tax authorities' rulings sacred. In the future, binding rulings of tax administrators will be under close scrutiny – and the possibility of their reversal brings further uncertainty.

What is certain, on the other hand, is the tax administration's growing interest in transfer pricing. In this respect, I would like to bring to your attention an article on the morality of corporate tax behaviour written by Gregory Morris for the current issue of Marwick magazine.

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# What justifies not filing a VAT ledger statement?

An amendment to the VAT Act, in effect from 29 July 2016, introduces the possibility to waive other penalties for the failure to file a VAT ledger statement in addition to the automatic waiver of one penalty of CZK 1 000 a year for a delay in submission. Where a VAT ledger statement is not properly filed for justifiable reasons, the taxpayer may apply for the waiver of the related penalty for a fee of CZK 1 000. New General Financial Directorate's instruction D-29 specifies the exact boundaries within which penalties can be waived and defines individual justifiable reasons.

Applications for the waiver of penalties for the failure to file a VAT ledger statement will be assessed in several phases. First, the tax administrators will examine whether the applicant has seriously breached any accounting and tax regulations in the last three years. After that, they will assess whether justifiable reasons for non-filing exist. Between 50% and 100% of the penalty can be waived for these reasons. According to the GFD, reasons that are deemed justifiable are in principle only poor health, natural disasters and a non-functioning tax portal on the last day of the deadline for filing VAT ledger statements. But justifiable reasons may not suffice to waive the penalties, as the tax administrator also takes into account to what extent taxpayers violated their tax duties in the past. Certain violations may significantly reduce the penalty amount that is waived.

In practice, it will be quite hard to meet all the requirements set out to be granted a waiver of penalties. The GFD highlights that applications must include precise justifiable reasons and all stated facts must be properly documented. The tax administrators will decide only based on information included in the taxpayer's file, the ADIS information system and the filed application, not asking for any additional information if the reasons given are insufficient or inadequately supported.


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# Interest on long-retained excess deductions: there is still time

**This month it will be exactly two years since the Supreme Administrative Court issued a breakthrough decision in the Kordárna case. The court confirmed that the VAT payer is entitled to interest of more than 14% for the period over which the tax authority retained the VAT payer's excess deductions. After this, a number of similar duels between taxpayers and the tax authorities took place, all ending up victoriously for taxpayers. Those who have not asserted their claims may still ask for the payment of interest by the tax authority.**

For understandable reasons, the financial administration interpreted the court's decision in the Kordárna case as a unique ruling that did not have the nature of case law and whose conclusions should not therefore be applied to other cases. In the meantime, however, a number of Czech courts identified with the given conclusions, or even referred to them directly, which ultimately undermined the financial administration's position. A parallel dispute was discussed before a court in Slovakia (the Kovozber case), involving also a ruling on a prejudicial question issued by the Court of Justice of the European Union.

In addition, in the two years after the Kordárna case decision, the financial administration quickly but also hastily introduced a 1% interest charge for the retention of excess deductions as a result of procedures to remove doubt commenced after 1 January 2015. The financial administration admits that neither the total absence of legal regulation of interest in the past nor the concept of interest currently in place comply with EU law. Hence an amendment that should regulate the interest parameters significantly in favour of taxpayers from 2017 is presently in legislative preparation.

The situation two years ago was unclear; today, however, judicial decisions issued since then offer much clearer interpretation of the matter and related issues, such as the procedure of how to proceed in practice when claiming interest on long-retained excess deductions. Moreover, the news that one taxpayer has won the court proceedings regarding his entitlement to such interest from the tax authority has recently come through.

Hence, the time has come to reconsider the possibility to challenge the tax authority and to claim the payment of interest. The latest developments show that the initial scepticism was not justified and that taxpayers may have a real chance of success. If taxpayers choose an adequate procedure, they may apply for the payment of interest on deductions retained in the past and refunded years ago. We will be pleased to discuss with you any specific situations and issues and recommend steps to put forward your claim. For higher amounts of retained deductions, the 14% interest is certainly worth thinking about.

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# Changes in Intrastat reporting

A new Customs Act and a government decree to implement certain provisions of the Customs Act relating to statistics have been in effect since 29 July. Intrastat reporting has been amended and changes should first be reflected in the August 2016 Intrastat declaration.

Intrastat declarations for August 2016 and subsequent periods are subject to new rules on the translation of foreign currencies to Czech crowns. Whereas foreign exchange rates proclaimed by the customs administration were used in the Intrastat declarations until the end of July 2016, foreign exchange rates that are used for VAT returns should apply now. The amount of goods in the August Intrastat declaration must therefore be translated using the rate announced by the Czech National Bank or the European Central Bank on the date on which a tax document is issued or on the 15th day of the month following the month in which goods were acquired/dispatched (the earlier date should always be used). In all other aspects, Intrastat reporting of data remains unchanged.

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# Potential programme – an increase in funds for distribution within first call

It appears that the Potential subsidy programme is continuously evolving. At the end of July an extraordinary call entitled Potential II was unexpectedly announced and subsequently cancelled at the end of August following a decision of the Ministry of Industry and Trade to increase the amount of funds for distribution within the Potential I first call. The assessment part of the first call is still in process.

In practice, this means an increase in funds for distribution on projects that are part of the applications filed within the first December 2015 call. The reason is that the total funds requested in the submitted applications significantly exceeded the CZK 1.5 billion originally earmarked for distribution, 40% of which was intended for projects submitted by large enterprises.

Taking into account the above and based on negotiations with the Ministry of Regional Development, the Ministry of Industry and Trade decided to increase the amount of funds for distribution within the Potential I call to CZK 2.92 billion. The funds intended for distribution to large enterprises remain at a maximum of 40 % (CZK 1.168 billion).

The extraordinary Potential II call has been cancelled and projects in preparation can be submitted within an ordinary call Potential III, to be announced in October, in accordance with the current timetable of 2016 calls. We will keep you informed about the call and related conditions and requirements.

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# Quicker issuance of employment cards to Ukrainians

**At the end of July, the government approved a special treatment regime for qualified personnel from Ukraine that aims to accelerate the acceptance and handling of employment card applications filed by Ukrainian candidates.**

The special regime is exclusively designed for qualified personnel from Ukraine. According to the CZ-ISCO employment classification, Ukrainians may perform jobs in the Czech Republic that mainly fall into the main manufacturing, services and public sector categories 4–8. The Ministry of Industry and Trade has clarified that the new regime is primarily meant for technical professions. Employers must also fulfil certain criteria to be included in the programme.

Under this regime, Ukrainians do not have to arrange a meeting to file their employment card applications via the Visapoint system. The dates on which Ukrainians may file their applications within this regime are set by the Consulate General in Lvov. Applications are accepted by the consulate and later handled in the Czech Republic within the deadlines set by law.

Another benefit of the regime is the acceptance of applications filed by not only Ukrainian qualified personnel and but also by their family members who are not included in similar programmes. Up to 5 000 candidates a year may join the programme, 3 800 of whom should be employment card applicants, while 1 200 slots should accommodate their family members.

A programme for highly qualified personnel from Ukraine works on a similar basis. The programme was approved in November 2015 within the Special Procedures for Highly Qualified Personnel from Ukraine project.


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# Government fights tax evasion in telecommunications

**At its last August meeting, the government approved the extension of a reverse-charge system to selected telecommunication services provided on a wholesale basis, effective from 1 October 2016. The objective is to stop detected tax evasion in form of fraudulent supply chains and eliminate the transfer of these fraudulent practices from neighbouring member states to the Czech Republic.**

The reverse-charge regime should apply to electronic communication services provided based on contracts for the connection or access to electronic communication networks and upon the resale of such services. This combination of words includes a wide range of various services, mainly relating to the telecommunications wholesale business.

The reverse-charge system should mainly apply to businesses operating in electronic communication services registered with the Czech Telecommunication Office. It should also apply to entities that have not fulfilled their registration obligation but render selected types of services nevertheless. The reverse-charge regime will not apply where electronic communication service providers provide specific services such as calling, SMS or data transfers to end customers (VAT payers).

The reverse-charge regime will be imposed on the selected services regardless of the taxable supply amount. The limit of CZK 100 000 that plays a decisive role in whether to apply the regime in the case of certain commodities will not be relevant in this case.

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# Electronic reporting of sales: clearer picture

Last week, the GFD issued **a methodical guidance on the electronic reporting of sales**, which discusses certain issues associated with reporting and clarifies the information so far available, especially the initial scope of the reporting duty. The points that should primarily be taken into account are as follows:

- From 1 December 2016, only sales generated from accommodation services (NACE 55) and meal and catering services (NACE 56) will be reported electronically. According to the GFD, it is necessary to follow the definition of services for VAT purposes in distinguishing between the provision of meal and catering services and other types of services. The reporting duty will then primarily apply to services that are currently liable to a 21% VAT rate. The reporting of sales generated from this segment will derive from the type of services that are rendered at an entrepreneur's business premises (either private or public) and the method in which these services are provided.
- In the first phase the reporting duty should not apply to services such as meal delivery, the over-the-counter sale of food (without restaurant facilities) or the sale of popcorn in cinemas, etc. From 1 December 2016, the sales from these services may however be reported on a voluntary basis where it is technically simpler for businesses.
- The guidance defines sales from secondary activities that do not have to be reported if an entity's duty to report these services occurs sooner than the same entity's duty to report its principal activities. Secondary activities are activities that are carried out jointly with other activities at the same business premises whose sales neither exceed 49% of the total sales generated by the business premises nor exceed CZK 175 000 in one calendar year. These criteria should be assessed for each individual business premises separately.
- Security deposits that are accepted to secure oneself against any potential damage, destruction or loss of a (borrowed) thing, or in any similar instances, will not be subject to the electronic reporting of sales. The guidance further prescribes how to proceed with refundable deposits (e.g. relating to bottles and other containers).
- Refunds (for example, as a result of cancellations or corrections) will be reported similarly as regular sales but with a negative sign. Refunds in cash relating to payments that are not subject to the reporting duty (for example, where the original payment was made by a bank account transfer) should not be reported electronically. According to the GFD, the reporting of such payments should not be challenged by the tax authority, however.
- The guidance provides details regarding the possibility of reporting payments under a simplified regime upon the regular transport of passengers.
- The authentication data allocation for the electronic reporting of sales purposes started on 1 September 2016. To set the electronic reporting of sales system adequately, it will be possible to use a trial regime from 1 November 2016.
- According to the guidance, the Ministry of Finance is preparing a receipt lottery for mid-2017.

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# Changes ahead for bonds

The Ministry of Finance has released for comments its draft amendment to the Act on Bonds and related laws. The proposed changes reflect the current trends in the financial sector: legislation should reflect market practices and adapt the legal environment to them, thus increasing the Czech capital market's ability to compete. The ministry also suggested that the chamber of deputies approve the amendment in its first reading, so as to pass it on to the senate before the elections in October of 2017.

The amended act will explicitly allow issuing bonds with no yield. Up to now, this has been deduced from the freedom of contract principle and from the private-law premise that everything that is not forbidden is allowed. The amendment has now made it certain, including a (rather theoretical) option to issue bonds with negative interest or imposing another duty on their owner.

Another significant change is the new concept of security agents, who will play a similar role regarding bonds as they do in credit financing. The legislators have thus responded to pressure from market participants, who preferred security agents to the previously proposed trustees. In practice, the concept has already been used in bond issues, but with no statutory basis, thus rendering the outcome of any potential future disputes unpredictable. The proposed wording opts for a rather brief and, importantly, directory (non-mandatory) regulation. Agents will be acting in their own name, on the owners' account, under an agreement concluded with the issuer; moreover, the agent will not have to own any bonds.

The amendment also extends the regulation of convertible bonds to the effect that bonds do not have to be convertible solely to other bonds or shares, but also to other securities, including those representing an interest in a business company, or directly, to the interest itself. The act should also mention obligatorily convertible debt securities that are not actually redeemed but converted to other securities upon maturity, while the conversion may also involve equity securities. These securities will continue not being considered bonds.

The amendment also introduces an entirely new covered bond regulation, replacing the current mortgage bonds regulation – as mortgage bonds should now be a sub-category of covered bonds. The amendment also provides for some situations concerning, for instance, issuer's insolvency, while regulating the status of other entities involved (a representative of covered bonds' owners, an asset pool monitor), and bringing a number of terminological and formal changes.


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# Consumer loans no longer quick and easy?

In the beginning of August, new Act No. 257/2016 Coll., on Consumer Credits was published in the Collection of Laws. Effective from 1 December 2016, it will fully replace the existing regulation of the area. Consumer protection will be significantly extended and will cover also some forms of credits that are outside the scope of the existing law. The act also substantially changes the status and duties of non-banking providers and intermediaries.

The new act replaces currently valid Act No. 145/2010 Coll., taking over existing definitions and providing a more detailed regulation of the main consumer protection concepts: the right to early repayment, pre-contract information, content essentials of contracts, etc. Unlike Directive 2008/48/EC (CCD) that is being implemented by both the existing and the new act, the new Czech regulation does not include the exception for either consumer credits up to CZK 5,000 ('microcredits') or consumer credits in excess of CZK 1,880,000; this means that the new act will apply to all credits irrespective of their amount.

The act also implements Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property and amending other directives (MCD). Consumer credits for residential purposes are defined as a specific type of consumer loans. This means that all known consumer protection instruments, including consumers' right for early repayment, will now also apply to mortgages.

The new regulation will primarily have a significant effect on non-banking providers, as they will have to obtain a Czech National Bank licence and meet the stipulated conditions for carrying out the activity, including requirements for qualified personnel and a relevant control and management system. Consumer credit providers' and intermediaries' staff taking part in the activity, including statutory body members, will have to pass a professional exam at an accredited entity.

Apart from the above, the amendment also introduces stricter requirements as regards assessing the creditworthiness of consumers and imposes sanctions for the failure to meet them. In assessing creditworthiness, all consumer credit providers will have to follow general instructions published by the European Banking Authority (EBA).

On credit providers and intermediaries, the act also imposes extensive duties to inform consumers; for consumer credits for residential purposes, information will have to be provided to consumers in the European Standardised Information Sheet (ESIS) format.

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# Summer at the CJEU

**During the summer, the courts of the EU member states were busy supplying the Court of Justice of the EU (CJEU) with requests for preliminary rulings. Below we summarise the most interesting ones.**

Yet again, the CJEU will be dealing with the beneficial ownership of income issue. This time, Danish courts have inquired about a more specific definition of a beneficial owner in the context of 'conduit companies'. A preliminary ruling request has been lodged in six disputes, four of which concern the interpretation of beneficial ownership of interest and royalties, while the remaining two concern dividends. In the disputes, Danish tax authorities believe that the companies in question should not be deemed beneficial owners of the received dividend, interest or royalty for the purposes of EU directives, as they are only empty shells carrying out no real economic activities and only passing on payments. If the CJEU denies these companies the entitlement to the advantages enjoyed by beneficial owners, this may have a substantial effect on Czech companies that pay dividend, interest or royalties to their foreign holding companies.

Apart from beneficial ownership, the CJEU will be ruling on German transfer pricing rules: whether they may be in violation of the freedom of establishment (Hornbach-Baumarkt C-382/16). In the Czech context, the CJEU ruling may be of interest in particular to providers of free-of-charge guarantees within a group.

The case in question involves a German parent company that provided guarantees to banks issuing loans to its foreign subsidiaries, without requesting consideration in return. The German tax administrator subsequently adjusted (increased) the parent's tax base by the amount of the fee that the parent should have received for the guarantee, in accordance with the arm's length principle. However, under German transfer pricing rules, such an approach would not have been applied had the guarantee been provided within Germany. The German court of justice thus has referred to the CJEU for a preliminary ruling the question whether German transfer pricing rules are compatible with the freedom of establishment, as German tax laws in fact do apply different transfer pricing rules to cross-border transactions than to intra-state ones.

In the taxpayer's opinion, there is no economic reason to prove the arm's-length amount of guarantee fees. The taxpayer, as an ultimate beneficiary of its subsidiaries' successes, will always have economic justifications for providing guarantees to its subsidiaries at a price lower than common between independent parties (even free of charge). Although the German dispute is built around the possible violation of the freedom of establishment, it connects with a debate currently going on among the Czech professional public concerning the effect on a guarantee provider's income tax base if the guarantee is provided to a subsidiary free of charge.

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# The best judgement of the last two years

The ruling of the Supreme Court of Justice of the Czech Republic dealing with abusive (frivolous) insolvency petitions received the Homage to Case Law award at the Karlovy Vary Law Days legal conference in June. The award annually goes to rulings that through their high quality contribute to the interpretation and resolution of difficult legal issues. Legal professionals are polled to determine the winners. And it must be said that this year's winning judgement fully deserves the award.

One of the principles of insolvency proceedings is that none of the participants shall have an unjust advantage. Creditors filing an insolvency petition should be certain that their assertions are well founded. According to awarded Supreme Court Ruling 8 Tdo 1352/2014 of 26 February 2015, it is possible to prosecute creditors for filing an 'abusive' insolvency petition; i.e. an insolvency petition containing knowingly false, untrue or fabricated information. In such cases, creditors face the risk of being indicted and sentenced for blackmail and slander. Up to one per cent of insolvency petitions filed in the Czech Republic may be abusive, accounting for hundreds of cases per year.

According to the ruling, filing an insolvency petition by which one party intends to force the other to make an unsubstantiated supply may be qualified as a threat of other grievous harm in the sense of the elements of the crime of blackmail. At the same time, persons filing such petitions are also committing slander – using false information for the purpose of being published through a public computer network in the insolvency register and thus publicly available. By doing so, offenders are pursuing their own interest, attempting to harm the person against whom the insolvency petition has been filed and to force them to act in a certain way, all the while without that person actually being bankrupt.

In its ruling, the Supreme Court made it clear that insolvency petitions that pursue other than their legal purpose, i.e. resolving a debtor's bankruptcy, cannot be tolerated. We can only agree with this conclusion. Filing an abusive insolvency petition may have far-reaching consequences for the debtor purportedly in bankruptcy: it may lead to a loss of reputation and make honest entrepreneurs who are not actually facing bankruptcy seem insolvent or irresponsible. Thankfully, apart from having to provide damage compensation under civil law, persons that have filed abusive insolvency petitions may now also face punishment under criminal law.


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# Tax depreciation also for defunct assets

Does your balance sheet contain a stationary truck or a vacant apartment house? The Supreme Administrative Court in its recent judgment confirmed that tax depreciation may be applied in the full amount even when the assets are temporarily not being used.

If assets are not used, fully or in part, for whatever reason, it is quite appropriate to ask whether the tax authority may challenge their tax depreciation. These concerns have now been dissipated by the Supreme Administrative Court in one of its recent rulings (4 Afs 24/2016). It concluded that tax depreciation can be applied even in these cases.

The case in question involved an apartment house and a garage that were intended by their owner solely for renting, i.e. to generate taxable income. Due to their poor technical condition, some apartments and the garage were not rented and remained vacant for several years. According to the tax administrators, the owner should have reduced the tax depreciation charges, as the assets were used to generate taxable income only in part. The Regional Court was of the same opinion. Not so the Supreme Administrative Court: it concluded that unless the assets are used by the taxpayer for private purposes, they are still assets intended to generate taxable income despite their temporary disuse, for instance for technical reasons. It is therefore not necessary to suspend or reduce tax depreciation. Unless you use your right to suspend depreciation, the temporary defunctness of assets or, for instance, the inability to rent out owned property does not have to be reflected in terms of tax depreciation.

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# SAC: late payment interest not a punishment

**The Supreme Administrative Court (SAC) dealt with yet another issue regarding the application of punishing principles in tax law. The ruling of the extended panel of judges in autumn of last year concluding that tax penalties have to be viewed as a punishment and thus be governed by the principles of administrative punishing raised taxpayers' hopes and tax advisors' creativity. However, no such punishing nature was concluded for late payment interest, according to the SAC.**

Attributing a punishing nature to anything in tax law may have vast consequences: among others, it is possible to apply the later legal regulation, if more favourable for the taxpayer (for instance a lower penalty rate). Plus there is the principle of not punishing the same act twice.

A taxpayer tried to convince the Supreme Administrative Court that a late payment interest under the Tax and Duties Administration Act (in the wording valid in 2007) had the nature of a punishment. Had he succeeded, the taxpayer could have used the double punishment defence, as, upon the additional assessment of the tax, a tax penalty was also imposed. According to the taxpayer, the late payment interest at the repo rate plus 14% combined with the 20% tax penalty would be in breach of the proportionality principle. Yet, the judges of the seventh panel unequivocally denied the punishing nature of the late payment interest. Nor did they accept the argument of the interest being disproportionate, pointing out that under the legal regulation valid before the end of 2007, penalties could amount to up to 73% per year, and even such penalties had not been found disproportionate by case law at the time. According to the court, late payment interest reflects the cost of money and represents the compensation of the damage incurred by the state as a result of the taxpayer's delay in tax payment.

In the present situation, when interest paid to finance state debt amounts to nearly zero, we may, from an economic perspective, have some justified reservations about this conclusion. However, the decision has been made and we have to acknowledge that the Supreme Administrative Court does not view late payment interest as a punishment for an administrative delict. The promising argument of 'no double punishment for the same act' has thus become rather shaky, at least for the time being.

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# In brief

- One third of 85 000 pension insurance clients involved in the Pillar 2 pension scheme, cancelled earlier this year, have not yet informed their pension insurance companies about what should be done with their pension savings from the cancelled funds. The Ministry of Finance therefore strongly appeals to those clients to decide on this matter by its deadline on 30 September 2016 at the latest.
- The Ministry of Finance informed about the following publications in the Collection of International Treaties: Tax Information Exchange Agreement No. 34/2016 with the Cook Islands (whose provisions will be implemented from 10 May 2016 with respect to criminal matters and from 1 January 2017 with respect to other matters) and Tax Information Exchange Agreement No. 41/2016 with the Netherlands in relation to Aruba (whose provisions will be implemented from 1 August 2016 with respect to criminal matters and from 1 January 2017 with respect to other matters). An up-to-date list of tax information exchange agreements is on the Ministry of Finance's website.
- The Senate approved a motion to establish a central register of accounts filed by the Ministry of Finance and the Czech National Bank. The register will enable authorised persons to determine in which bank a suspicious person has an account within 24 hours of filing a single request.
- An up-to-date list of double taxation treaties is on the Ministry of Finance's website. It also contains a new treaty with Iran, which entered into force on 4 August 2016 and will be effective from the beginning of 2017.
- The GFD published information about an amendment to the senate's statutory measures on immovable property acquisition tax.
- The Ministry of Finance completed its preparations of a long-term strategy for the development of the customs administration in criminal proceedings. The ministry is planning to expand the customs administration's competencies with respect to criminal proceedings regarding tax evasion as well as give the customs administration competence to investigate criminal acts, and search for and secure proceeds from criminal activity. The mutual relations between the customs administration and the financial administration will be closer and will allow a more effective fight against carousel fraud.
- The European Commission has ruled that Ireland granted Apple an undue tax benefit amounting to EUR 13 billion. This is considered by the Commission illegal state aid as the corporation was allowed to pay much lower taxes than comparable businesses. Ireland will now have to recover these funds from the corporation.
- The Convention on Mutual Administrative Assistance in Tax Matters (OECD/Council of Europe) has already been signed by 103 states, with Liechtenstein becoming the most recent signatory. The convention enables the global automatic exchange of information about taxpayers' incomes.