KPMG

cutting through complexity

TAX AND LEGAL UPDATE

10

2015

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Introduction by Jan Linhart

Dear readers,

Starting autumn, deputies again take up their annual fight over amendments that clearly and beyond any doubt have to be passed before the year end, otherwise we would surely fail in being more successful, frugal, greener, happier, safer and more EU conform in the coming year than in the present one.

A positive change this year is that the government has postponed the effective date of an act that, according to the schedule, was, again, in danger of being passed at the very last minute. While introducing the electronic reporting of sales (ERS) was postponed, another measure, aiming in the same direction but targeting a differently defined group of problematic entities, remains: the duty to submit VAT ledger statements starts to apply from the beginning of 2016; this change, however, has been known for some time.

Another difference between these two is that ERS intends to capture any unreported tax at the source, at the level of a high number of small entities, which is demanding and practically impossible to control. On the other hand, VAT ledger statements aim at a small number of companies fraudulently manipulating their tax, but in higher amounts.

In my opinion, the state already has sufficient tools to prevent this – as evidenced by the success of the Tax Cobra team. Blanket measures like the VAT ledger statements seem to go beyond of what the state should demand from taxpayers. Only time will show whether the VAT ledger statements really are a sufficient tool with no adverse effects in, for instance, the area of data protection.

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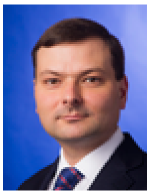
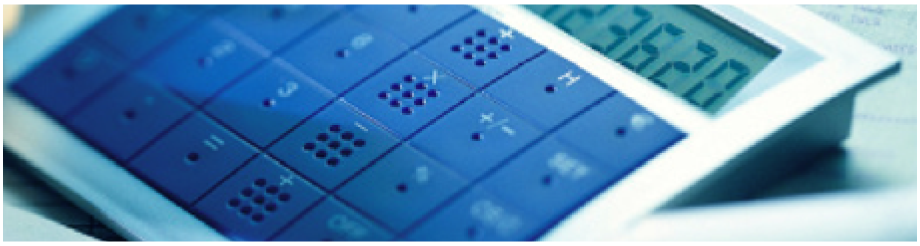


VAT ledger statements – are you ready for the new duty?



We will be happy to help you with the preparation of your VAT ledger statements.
We offer our support **in the following areas**.

The NeverEnding Story of Section 24(2)(zc)

Last month, the Supreme Administrative Court issued its long-awaited verdict regarding the disagreement between the seventh and ninth panel of judges relating to the application of a "magic" provision contained in Section 24(2)(zc) of the Income Tax Act, allowing the re-classification of expenses from non-deductible to deductible.

The reasoning attached to the court's decision is brief and, therefore, did not meet the expectations of the professional public. Like the peasant's wise daughter in Grimm Brothers' fairy-tales, the judges did not in any way oppose the fresh approach of the seventh panel of judges which, in contrast with some strict interpretations made by the tax administration, allowed the re-classification of non-deductible expenses that are one of the items included in the calculation of a fee for provided services to deductible, as these expenses directly affect the amount of the fee charged for such services. Simultaneously, however, the extended panel of judges did not disagree with the conclusions of the ninth panel of judges, agreeing that accounting depreciation is specifically regulated by the Income Tax Act and, as a result, not subject to Section 24(2)(zc) in compliance with the lex specialis derogat legi generali interpretation rule.

The extended panel of judges pointed out the comprehensiveness of the Income Tax Act, which allows taxpayers to claim expenses associated with the acquisition of fixed assets as deductible on a gradual basis, using a detailed timetable of tax depreciation charges. According to the judges, tax depreciation is a unique way of how to claim expenses incurred to acquire fixed assets as deductible for tax purposes. The seventh panel's interpretation was further undermined by the fact that if the interpretation were adopted, taxpayers would be allowed to claim as deductible the part of accounting depreciation in the amount of assets recognised as a result of the remeasurement to fair value subsequent to the contribution of a company into another company. This would in principle involve expenses that have not actually been incurred, which is generally at variance with the principle and logic of tax legislation.

Unfortunately, the extended panel of judges did not give a clear answer to whether it is/was possible to apply "the magic" of re-classification of expenses/revenues where the relevant amounts are one of the items included in the calculation of a fee for provided services. We therefore have to wait for another part of our tale and believe that next time we will have Bastian, the hero of The NeverEnding Story, who will be lucky enough to save the provision at issue from the labyrinth of diverse interpretations which sometimes make us feel like we already crossed the borders of Fantasia.

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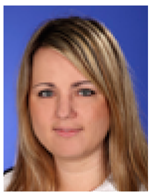

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Amendment may affect preparation and auditing of annual reports

An amendment to the Act on Auditors, published in the Collection of Laws on 10 September 2015, may significantly affect the manner in which annual reports are prepared and audited.

According to the amendment, auditors' reports on the statutory audit of the financial statements issued after 1 January 2016 must also include an auditor's opinion on the relevant annual report. This applies to all financial statements prepared for the period ended sometime in 2015. This may cause problems as many companies are accustomed to preparing their annual reports only after receiving an auditor's report on their financial statements and to receiving two separate auditor's reports, one on the financial statements and the other on the annual report. The amendment disallows this, prescribing that both documents that are to be audited must be submitted for an audit together. Auditors therefore must use a single report to express their opinion on the financial statements, on the compliance between the annual report and the financial statements and on other facts included in the annual report. If auditors are not able to express themselves on both the financial statements and the annual report, they will have to issue a modified audit report claiming scope limitation.

The amendment may also call for the adjustment of a concluded statutory audit contract where the deadline for submitting and auditing the annual report has been set to come after an auditor's report on the financial statements.

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Tax year 2014 under the sign of Tax Cobra

The tax administration issued its annual report summarising its key projects and activities in the past year. Regular readers will not be too surprised that 2014 was a year dedicated to fighting tax evasion.

Within the aim of fighting tax evasion, the General Financial Directorate ("GFD") prepared new comprehensive methodological tools for the exchange of information with foreign tax administrations, delegations to locally competent bodies and the procedure to remove doubt. The tools primarily focus on uncovering chain fraud and on a greater efficiency of the tax liability inspection system. The GFD also started preparing an array of essential tax-collection projects for the electronic reporting of sales and the VAT ledger statement. In the context of enhanced cooperation between tax authorities and investigative, prosecuting and adjudicating bodies, we also want to turn your attention to the project on proving the origin of property.

Tax Cobra, a successful and media-famous tax crime unit, launched its activities in 2014. Its major success was the River campaign during which the unit trailed fictitious alcohol and tobacco product supplies in other EU member states. Together with ten other campaigns, this could potentially supply the state budget with an extra CZK 1.5 billion. Among other major projects, the tax authorities highlighted inspections targeted at insurance brokers, operations with tax havens, claimed R&D deductions or local reverse-charge mechanism applications. Transfer pricing issues also remained a key focus area. Data collected from voluntary questionnaires distributed among selected entities and from statutory annexes to 2014 tax returns enabled the tax authorities to better target their tax inspection on entities and transactions with a risk potential.

According to the tax authorities, the main tax evasion area of 2014 were carousel transactions with a complex organisational structure. Such transactions often involve typically suspect commodities (fuels, rape-seed oil, metal waste, etc.) or various other supplies, particularly services offered by advertising agencies. As far as income taxes are concerned, the tax authorities did very well in dealing with fictitious document "producers" during inspections of tax adjustments and also, not surprisingly, in transfer pricing. The tax authorities claim to have focused on transfer pricing more than ever before and made it clear that they plan to continue with this trend also in 2015.

According to the tax administration, last year was overall very successful from a financial point of view. Additionally-assessed tax rose by 16.8% year-on-year, totalling CZK 9.6 billion in 2014 (VAT again ranking first with 85.9%, total tax additionally assessed coming to CZK 8.2 billion). In terms of VAT collection, the tax administration has, in fact, been extremely successful. For a second year in a row and after a preceding unsuccessful five-year period, it managed to entirely fulfil its tax collection goals and budget. Compared to 2013, VAT collected rose by CZK 14.3 billion in 2014 (compared to a mere CZK 10.1 billion rise in corporate income tax collection, ranking second). The procedure to remove doubt, so debated among the public and so popular among tax authorities, alone changed the tax liability by CZK 5 billion. The above mentioned projects are intended to further boost VAT collection.

We expect that in its fight against tax evasion the financial administration will again increase its requirements on taxpayers in the years to come. We can only recommend always being a step ahead and ready for the tax authorities' new trends.

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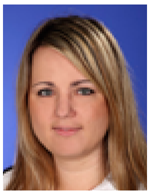

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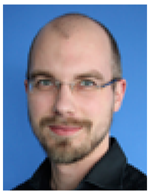

Changes in VAT from May 2016

In connection with the planned adoption of the Customs Procedure Rules, which are to replace the existing Customs Act, a comment procedure is currently under way with respect to another amendment to the VAT Act, which should become effective on 1 May 2016.

The major changes proposed by the amendment are as follows:

- The extension of a reverse-charge mechanism to apply on domestic supplies of goods. Where any types of goods are delivered to a Czech VAT payer in the CR by a person who does not have its registered office in the CR, the duty to pay Czech VAT will be transferred to the consumer of the goods.
- The specification of a six-month period for corrections of VAT for insolvency receivables. The existing and unclear definition of receivables that may be corrected (i.e. receivables arising no later than six months before the court's decision on bankruptcy) will be replaced with a new definition, according to which corrections of VAT will only be performed for receivables older than six months as at the date of the court's decision on insolvency.
- A change in the regulation of supplies to and from the customs-free zone and customs-free warehouse. Deliveries of goods to the Czech customs-free zone or customs-free warehouse will not be regarded as VAT-exempt exports of goods and returns of goods from the Czech customs-free zone or customs-free warehouse will not be regarded imports of goods.

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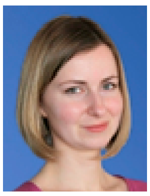

Electronic reporting of sales is far-off

The Ministry of Finance suspended preparations for the introduction of the electronic reporting of sales. As no act on electronic reporting of sales has been adopted, the ministry can neither call for tenders nor develop the necessary technical wherewithal. The electronic reporting of sales has therefore been postponed indefinitely.

In accordance with the Ministry of Finance's original plan, the electronic reporting of sales was to be in operation from the beginning of 2016. Subsequently, the ministry postponed the start first to February 2016, then to April 2016. Another postponement, again proposed by the ministry to allow for the preparation of the necessary IT equipment and software, should extend the period between the force and effect of the law to seven months. Currently, restaurants and hotels, which are the first entities to have to fulfil this duty according to the law, will not start reporting their sales electronically earlier than in mid-2016. However, nothing is certain in this respect as the postponement is primarily due to obstructions created by deputies from ODS and TOP 09 who are planning to block the adoption of the law for as long as possible.

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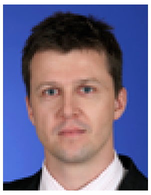

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VAT on transfer of induced investment in fixed assets

In September, the General Financial Directorate voiced its opinion on VAT paid on the free-of-charge transfer of an induced investment associated with construction and development, taking into account income tax aspects. According to the GFD, this VAT should be included in the tax input price of a principal construction. If VAT is included in expenses, these expenses are non-deductible.

In September, the Coordination Committee of the General Financial Directorate (GFD) and the Chamber of Tax Advisors discussed KPMG's contribution submitted for discussion on VAT paid on the free-of-charge transfer of an induced investment associated with construction and development. Pursuant to the Income Tax Act, expenses incurred for an induced investment in fixed assets (i.e. expenses incurred to acquire fixed assets without which a given construction cannot be used or operated) may be included in the acquisition cost of the relevant construction on the condition that these fixed assets are transferred to a third person (i.e. these assets do not remain in the ownership of the construction's owner). In practice, these expenses most often involve expenses incurred to build and develop infrastructure joined to principal assets, i.e. the construction itself. The duty to declare and pay VAT on output may arise on the free-of-charge transfer of an induced investment in fixed assets.

According to the GFD, such a VAT expense should be viewed as an expense arising in the causal relationship with the acquisition of a construction and therefore is non-deductible, but may increase the tax input price of the construction.

This opinion is quite essential for the application of VAT as well. According to the GFD, a VAT payer who upon the acquisition of an induced investment in fixed assets claims entitlement to a VAT deduction must apply VAT on output upon the free-of-charge transfer of an induced investment.

In practice we have come across both approaches, either including VAT on the induced investment in the input price of a construction or including VAT in deductible expenses. The conclusions made by the Coordination Committee are not legally binding; nevertheless, tax administrators tend to follow them in practice. Consequently, the one-off inclusion of VAT in deductible expenses may be associated with a higher tax risk.

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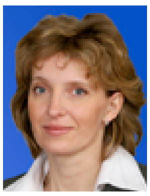

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Delivering to employees correctly

Simple as it may seem, serving documents to an employee's address as recorded by the employer may not always be successful, the new ruling of the Supreme Court shows. It is the duty of the employer to take adequate measures ensuring that the delivery address of an employee in the employer's records is up to date.

According to the Labour Code, stipulated documents have to be delivered to employees' own hands. The employer should always make an attempt to deliver the documents in person or by electronic mail. Only where such delivery is not possible, the employer may use postal services. Delivery by post should then be to the employee's last address as known to the employer.

This year, the Supreme Court commented in more detail on the issue of an employee's last known address. The court stated that the employer should consider relevant any address which has become known to the employer, whether from the employee or from any other trustworthy source, such as other employees, relatives, or public authorities. If there is more than one such address, the employer shall deliver to the one that became known to them as the last one. When considering this, it is of substantial importance that (and when) such address became known to any of the employee's superiors, meaning not necessarily the human resources department of the employer. According to the judgement, the employer is even obliged to deliver documents to an employee's temporary address (for instance when on holidays), provided, of course, that such address has become known to the employer.

In the case in question, the court ruled that the employer should have delivered a notice of immediate termination of employment to the employee's address given in the sick note, not to his permanent residence. Importantly, the new address was also known to the employer from personal visits by the employee's superior, and from the employee's statement claiming tax credits. According to the court, the fact that the new address was not known to the human resources department cannot prejudice the employee. It is the duty of the employer to take adequate measures to ensure that all relevant departments know of employees' current addresses, as this is the only way how to serve documents in compliance with the law, thus with relevant legal effects.

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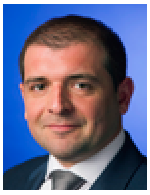

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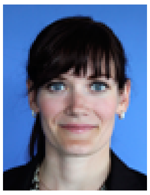

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New rules ahead for supervisory board members

An amendment to the Corporations Act proposed by the deputies reintroduces the employees' obligatory participation in supervisory boards for joint stock companies with more than 50 employees. The total number of supervisory board members will have to be divisible by three; establishing single-member supervisory boards will therefore not be possible.

The government plans to discuss an amendment to the Corporations Act proposed by the deputies, regarding supervisory boards of joint stock companies (Chamber of Deputies' print no. 592). According to the amendment, the number of members on a supervisory board of a joint stock company should always be divisible by three, with three the lowest possible number. Furthermore, in joint-stock companies with more than 50 employees, one third of the supervisory board members would be elected by and from the employees. Also, an opinion of the employee-appointed supervisory board members which would differ from the decision passed by the supervisory board vote would always have to be recorded and presented to the members of the general meeting. The corresponding legal regulation would thus return to the wording effective before 1 January 2014. If the government issues a consenting opinion and the amendment passes as proposed, all joint-stock companies will have to make their supervisory boards (and their statutes) compliant with the amended act within one year from its effective date.

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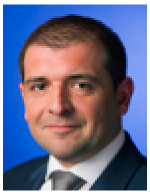

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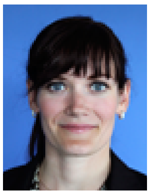

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OECD releases final BEPS package

The Organisation for Economic Cooperation and Development (OECD) has published a final package of measures under the Base Erosion and Profit Shifting (BEPS) Action Plan.

The BEPS initiative of the OECD and G20 countries was released in July 2013, covering 15 key areas on how to identify aggressive tax planning and how to avoid these practices in the modernisation of international taxation systems.

Until September 2014 the OECD had issued reports on seven out of the 15 key points of the Action Plan. These seven reports along with the reports on the remaining eight key areas have now been consolidated into a final report of recommendations. Many countries have already responded to these recommendations and have implemented changes to international taxation.

We will deal with this issue in detail in our November issue of Tax and Legal Update.

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Netherlands to adopt mandatory transfer prices reporting

On 15 September, the Dutch government disclosed its draft budget plan from 1 January 2016. According to this plan, the government will implement a transfer pricing documentation duty into the Dutch Act on Corporate Income Tax. The documentation should comply with the concepts disclosed within the OECD's BEPS initiative.

The Dutch government will incorporate a duty to prepare country-by-country reporting (CbCR), applicable to companies with registered offices in the Netherlands and part of multinational enterprises with an annual turnover greater than EUR 750 million, into Dutch legislation. Dutch tax residents will have to submit their CbCR within twelve months of the end of the previous taxable period (i.e. for the first time in 2017).

Legislative changes proposed by the Dutch government also include recommendations on how to prepare a master file, which should contain information about a multinational enterprise as a whole, i.e. the nature of business activities within the group, transfer pricing policies, a worldwide summary of revenue distribution and economic activities. A local file should contain relevant information allowing for the analysis of transfer prices relating to intra-group activities of Dutch companies. Businesses with registered offices in the Netherlands will have to prepare both master and local files if the consolidated turnover of the group exceeds EUR 50 million per fiscal year.

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Municipal court on the tax nature of membership fees

The Municipal Court in Prague has recently confirmed the non-deductibility of membership fees paid to selected professional organisations for tax purposes. This particular case involved fees paid to the Czech Banking Association.

The Income Tax Act provides that membership fees paid to organisations without legally prescribed membership are non-deductible. In practice, however, some representatives of the professional public claim that the deductibility of such expenses may be justified primarily where the membership clearly benefits the business activities of a specific taxpayer. The truth is that this is only a marginal issue as large banks have been quite transparent in this respect, treating fees paid to the Czech Banking Association as non-deductible expenses in compliance with the established practice.

In our case, the taxpayer had submitted to the court fairly reasonable arguments supporting the relation between the expenses incurred and its business activities liable to tax. The Municipal Court in Prague, however, emphasised in accordance with the existing practice that only membership fees paid to organisations with legally prescribed membership are explicitly tax deductible. According to the court, neither the importance of membership in an organisation or an association nor the reputational implications of such a membership have any impact on tax deductibility. The taxpayer decided not to file a cassation complaint against this decision with the Supreme Administrative Court.

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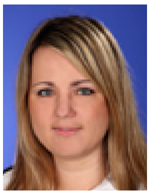

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Is your game promotion prohibited?

Tax authorities have intensified their inspections of promotional competitions, namely with emphasis on the existence of the element of chance in choosing the winners. This trend is confirmed by our current experience, as well as by several recent regional court judgements. Tax authorities now also consider prohibited competitions based on the concept of order. How should you proceed to make your promotional competition compliant with the Act on Lotteries?

Tax authorities have been increasingly favouring the opinion that promotional competitions, namely those where the winner is selected based on sending in a vote in a predetermined order, should be considered consumer lotteries, which are prohibited. It is the tax authorities' opinion that in these competitions the winner is chosen by random selection, and the element of chance remains present even with repeated registrations (although the probability of winning increases). Recently, this interpretation was also confirmed by regional courts.

The relevant judgements also imply that when assessing lotteries, tax authorities no longer respect (and consider overruled) the Ministry of Finance's Standpoint on Consumer Lotteries published in May 2006. The standpoint provided examples of game concepts not containing the element of chance, and for a long time had been followed by professionals when assessing or designing promotional competitions.

The question remains what the final standpoint of the Supreme Administrative Court will be, as it during the summer received a number of cassation complaints regarding the assessment of promotional competitions according to the Act on Lotteries. In particular, it will be interesting to see how the court will deal with organisers relying on the established administrative practice that developed on the basis of the above mentioned standpoint.

Regardless of this not entirely positive development, there are still numerous game concepts that meet the criteria of the Act on Lotteries, and whose organisation should therefore neither attract the attention of tax authorities nor involve penalty risks. We will be happy to advise you on the legal and tax implications of organising promotional competitions for your customers.

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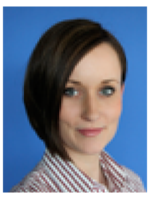

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In brief

- A decree laying down the general assessment base level for 2014, the calculation coefficient for adjusting the general assessment base for 2014, reduction limits for setting the calculation base for 2016, basic assessment of pensions for 2016 and the increase of pensions in 2016 was published in the Collection of Laws. The new provisions will impact not only the level of pensions to be paid out from 1 January 2016, but also the caps for assessment bases for statutory insurance contributions, the minimum statutory insurance advance payments for self-employed persons and the minimum monthly income based on which employees have to participate in sickness insurance, etc. The maximum assessment base in 2016 will amount to CZK 1 296 288.
- A government decree amending Government Decree on Minimum Wages No. 567/2006 Coll., increasing the minimum wage to CZK 9 900 from 1 January 2016, was published in the Collection of Laws.
- The following amendments to accounting decrees taking effect on 1 January 2016 were published in the Collection of Laws: 250/2015 Coll., the accounting decree for businessmen using double-entry bookkeeping; 251/2015 Coll., the accounting decree for banks and other financial institutions; 252/2015 Coll., the accounting decree for insurance companies.
- The Minister of Labour and Social Affairs introduced the first measures based on the results of the Expert Commission for Family Policy. Measures involving home care vacation, paternal new-born-child care and adjusted family allowances are to be introduced by 1 January 2017. A pilot small nursery group project may be opened as early as on 1 January 2016.
- The government submitted draft amendment no. 612 to the Income Tax Act to the Chamber of Deputies.
- The government submitted a treaty to the Chamber of Deputies signed between the Czech Republic and the Netherlands on the exchange of information in tax matters in relation to Aruba (print no. 594).
- The acceptance of final request applications for the Operational Programme Enterprise and Innovation for Competitiveness (OP EIC) has been postponed by two months. The reason is the unsatisfactory technical functionality of the MS2014+ monitoring system.
- The European Commission introduced the Capital Markets Union's Action Plan with the aim of forming a truly single capital market in all 28 member states. Simultaneously, the first and the most urgent measures under this Plan have already been published, including e.g. the putting into operation of a sound securitisation market.
- The European Commission published **a report called Tax Reforms in EU Member States** http://ec.europa.eu/economy_finance/eu/public_finances/taxation/index_en.htm which recognises key factors improving the efficiency of tax systems in lowering the tax burden on labour, broadening the tax base combined with lower tax rates and fighting tax evasion.
- The EU ministers of finance (ECOFIN) have unanimously passed the introduction of the automatic exchange of information on binding decisions of tax authorities. The draft wording of the new directive should be known by the end of 2015.