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March 2018

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Editorial

With the first day of March, meteorological spring officially started. While we yet have to wait for a warm spring breeze, a fresh wind is already coming from the Supreme Administrative Court in Brno, as it has finally put a brake on tax administrators' far too vigilant fight against VAT fraud. The court has made clear that there must be some limits to the liability for unpaid tax and to denying the entitlement for tax deduction.

Good news for the business world also come with the findings of the KPMG Pulse survey of the economy: it indicates that Czech firms are doing well and are planning future investments. They primarily intend to invest in employees – with 91% of companies planning to raise wages this year, and in innovations – three of every four Czech firms want to support them and new technologies.

On a less positive note: managers have become less optimistic, with Czechs being the biggest pessimists in the region: only 29% of directors surveyed believe that the economy will improve this year compared to last year; 44% expect it to remain unchanged and one in four believe the economic situation will worsen year-on-year. I hope that you will have reason to join the ranks of those with an optimistic outlook this March.

Tomáš Kroupa, Director

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Taxes

Fourth public tender under Epsilon programme announced

Through the Technology Agency of the Czech Republic (TACR), businesses may apply for support to applied research and experimental development under the Epsilon programme. On 28 February 2018, the fourth public tender was announced, focusing on support for priority research projects, namely Industry 4.0 and autonomous mobility.

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Deadlines

Applications are accepted electronically from 1 March 2018 to 12 April 2018. Project work may be initiated no sooner than on 1 October 2018 and no later than on 1 March 2019.The project must be completed within 48 months from starting the work, however, no later than by 28 February 2023.

Aid amount

The percentage of aid depends on the size of the business. For large businesses, up to 25% of eligible costs for experimental development and up to 50% for applied research may be provided. If two independent businesses can prove their effective collaboration, the aid amount may be increased by an additional 15% for both. The agency expects to distribute CZK 500 million among recipients in 2018 – 2019.

Supported activities

The following activities will be supported within the project:

- technologies in the automotive industry
- research and development in the field of batteries
- development of new technologies and achieving new utility properties of products using new knowledge in the field of chemistry
- designing optimum general conditions for establishing new operating and innovative technology models and mobility models for transportation companies or transportation network operators
- advanced technologies for automation, digitalisation and data-connection systems for more efficient and safer transportation
- innovation and optimisation of technologies for the recycling of contact and other thermal insulation systems.

Project outputs must be in one of the defined forms:

- industrial design
- applied design/utility model

- prototype
- functional sample
- medical treatment
- conservation method
- software
- pilot plant
- verified technology
- other.

The following items can be included in eligible project expenses:

- **Direct costs**
  - personnel/payroll costs for researchers
  - costs of protection of intellectual property rights
  - operating and other costs
- **Indirect costs**
  - costs incurred in direct connection with project work

Other conditions for obtaining aid

The public tender introduces the role of an 'application guarantor', i.e. an individual or a corporate entity with a registered address in the Czech Republic showing interest in receiving the products resulting from the project and applying them in practice; for each project at least one application guarantor should be mentioned in the project application.

If you are interested in obtaining such support, we will be happy to discuss with you the individual criteria of your project and specific conditions of the tender in further detail.

Truckers' fight for minimum wage heats up

For years, EU regulations guarantee the rights of posted workers to the working conditions applicable in the country of the posting, if such conditions are more advantageous. This rule also covers remuneration. Until recently however, the protection of workers, and, consequently, of West European companies against competitors from Eastern Europe where labour is cheaper, was rather theoretical. Now, Germany and France have picked up the proverbial gauntlet and adopted rules setting high minimum wages.

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The situation has escalated primarily in transportation, where the posting of workers abroad is, logically, most frequent and at the same time easy to check. Compliance with the regulations is being checked by foreign authorities, and the posted workers themselves also speak up. A pioneer in the fight for the topping-up of wages to the minimum German level is a Southern Bohemian truck driver, who has now won a dispute over an additional wage settlement of more than a quarter of a million Czech crowns, using the assistance of a German organisation founded to support posted workers from countries of Central and Eastern Europe. His success has encouraged more of his colleagues, who intend to follow in his steps.

Czech carriers are thus facing an uncertain future, even though in this case the German customer had to top-up the wages instead of the Czech employer, as EU regulations allow the member states to stipulate in their national legislation the (co)liability of service recipients. In the future, however, Czech employers will not escape their duties so easily: under the Posting of Workers Directive, service recipients may free themselves of their liability if they prove that they had taken all reasonable care to meet the duty. To prove this duty of care, Czech carriers are being asked to provide a confirmation of compliance with their duties in the field of remuneration. This may also make the organisation of assignments more difficult, as there will be more demand among workers for trips to countries with a higher minimum wage. Differences in wages not depending on work results or difficulty are likely to become a breeding ground for disputes.

Yet another issue is the lack of coordination between national regulations: while the Czech Labour Code compensates workers for the higher costs of working abroad through meal allowances of EUR 45 per diem for Germany, this is not viewed by German authorities as a part of wages; per diem thus does not reduce the amount of the obligatory topping-up of wages.

The European Union is now trying to make the regulation even stricter, proposing that, apart from the foreign rates of minimum wages and extra-pay for overtime, posted workers should also be entitled to all bonuses, contributions and other benefits under applicable foreign regulations or collective bargaining agreements. Wherever the time of the posting exceeds 18 months, the workers would be subject to foreign labour law to its full extent. Meeting these duties would be demanding financially as well as in terms of administration.

Because of conflicting national interests, the wording of the amendment has been under discussion in Brussels for nearly two years. According to the latest agreement between the countries, the amendment should not apply to road transport – the posting of drivers should be regulated on a separate basis. However, negotiations are far from finished.

Virtual currencies – a risk-free chance to get rich?

Are you planning to invest in virtual currencies? Beware: according to EU regulatory bodies, trading in bitcoins and other similar units entails more risks than one would expect.

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Virtual currencies are a digital expression of value. Yet, they are not issued by any state and do not have a status of legal tender; hence, their acceptance by a counterparty is not guaranteed by anybody; neither are they linked to any commodity prices and their value is based solely on investor trust.

Perhaps the biggest surprise for potential investors may be that the exchange of or payment in virtual currencies is not regulated in any manner. Unlike standard means of payment, it is not possible to complain about a transaction or to approach the Czech National Bank if problems occur.

Significant price fluctuations, up to hundreds percent per day, are typical for virtual currencies. And extreme changes in value mean yet another thing: a complete absence of price transparency, i.e. the manner in which the value of the virtual currency is set. It may thus easily happen that the value of an investment may drop to its fragment within minutes, never to recover. And even when the value of a virtual currency is stable, it does not mean that all is good for the investor as there are no guarantees that the virtual currency will eventually be bought from them and its value converted to money.

When transacting in virtual currencies, technical problems may pose a serious challenge: no compensation is provided to virtual currency holders in the event of a technical breakdown, and the limited functionality may be permanent; if technical problems persist, investments may depreciate completely.

At present, virtual currencies are not specifically regulated by Czech accounting or tax legislation. It is thus impossible to say with certainty what the tax treatment of virtual currencies or their mutual exchange or the exchange to a conventional currency will be. The only official information available in this respect is the General Financial Directorate's statement in the mass media to the effect that the financial administration considers virtual currencies intangible, movable and substitutable items. According to the financial administration, virtual currencies are not to be viewed as classic currencies, which is in line with the Czech National Bank's statement. The income generated from the sale of virtual currencies may be subject to personal income tax either as income from business, if generated as part of independent gainful activity (or if a part of business assets), or as other income. Expenses to be deducted from such income are governed by the general regulations of the Income Tax Act.

Despite the above described risks, virtual currencies are becoming increasingly popular. It will be interesting to see how the regulation in the area develops. So far, the European Union has focused solely on the prevention of money

laundering, leaving aside the regulation of exchange offices for virtual currencies. A harbinger from overseas is the U.S. SEC (Securities and Exchange Commission) standpoint that virtual currencies should be viewed as investment instruments.

EU Court of Justice rules in Deister Holding and Juhler Holding cases

At the end of 2017, the Court of Justice of the European Union (CJEU) issued a long-awaited judgment in the joined cases Deister Holding and Juhler Holding, concerning the application of the EU Parent-Subsidiary Directive and involving a dispute over one of the fundamental EU freedoms, the freedom of establishment. In the cases in question, both the EU Directive and the freedom of establishment were infringed by German anti-treaty-shopping rules.

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In both cases, the German tax authorities denied a tax exemption of dividend paid by German subsidiaries to their parent holding companies domiciled in other EU member states. The tax exemption was not possible under German anti-treaty-shopping rules valid at the time, as the owners of the holding companies would not have personally qualified for the exemption under the directive had the dividend been paid to them directly rather than through the holding companies. The companies challenged these conclusions, claiming compliance with the tax exemption rules under the directive and the freedom of establishment.

The court held that the German rules that generally exclude a certain group of taxpayers from the entitlement to the relief under the directive were in breach of the directive and contrary to the freedom of establishment. The Court argued *inter alia* that special shareholding structures and the existence of holding companies did not in themselves indicate treaty shopping. Consequently, the rules prohibiting the relief under the directive should be very specific and aimed at concrete cases. The existence of the German provisions was also found contrary to the freedom of establishment, as it may deter taxpayers from carrying out economic activities in Germany.

Case law

SAC sets limits to fighting VAT fraud

Where a supply has been affected by VAT fraud, the tax administration demands almost investigative checks of suppliers to maintain the entitlement for VAT deduction; and this may happen at any point in the chain. The Supreme Administrative Court (SAC) has now set the first limits to these demands.

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In the case in question, a single general contractor supplied high-tech machinery and equipment, while a number of subcontractors also participated in the project. It was ascertained by the tax administrator that one of the subcontractors had not paid VAT. The tax administrator viewed this as tax fraud that the final customer at least could have known of and therefore denied him the entitlement to the deduction of input VAT of three times the missing tax ascertained at one of the subcontractors. The SAC stood up for the taxpayer.

According to the SAC, it is up to the tax administrator to prove that the VAT payer knew or could or should have known that the supply received had been affected by VAT fraud and that their entitlement to VAT deduction was thus not protected by good faith. In proving this, the tax administrator must equally assess the evidence in favour of and against the taxpayer, and cannot ignore one and highlight the other. Common business practice must also be taken into consideration, while facts only occurring ex post cannot be used against the taxpayer.

According to the SAC, the liability for receiving a supply affected by VAT fraud must have its limits. Any unpaid tax does not necessarily mean VAT fraud on the grounds of which it is possible to limit the taxpayer's entitlement to deduction. It is necessary to distinguish the failure to meet tax duties from a knowing enrichment by not paying VAT. Most importantly, the SAC refused the taxpayers' unlimited liability for checking the trustworthiness of business partners throughout the chain of suppliers and deemed a strict (no-fault) liability for any VAT not paid within the chain inadmissible.

To conclude, the SAC appealed for a change in the current approach. In its opinion, fighting tax fraud cannot mean that the tax administrator focuses on the "most lucrative" entity in the chain and collects the tax from them. Let us hope that this new approach will also hold in other cases awaiting adjudication, and that it will also influence the inspecting and decision-making practices of tax administrators.

Case law

New rules of liability for unpaid VAT according to SAC

The Supreme Administrative Court has specified the conditions of a supply recipient's liability for VAT unpaid by the supplier: a payment to a foreign account cannot automatically give rise to liability.

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Previously, the Regional Court in Ostrava held that liability for unpaid VAT when a payment is made to a foreign account is contrary to EU law. A long-awaited SAC judgement now denied this, yet provided more details on how the conditions of liability should be interpreted in conformity with EU law. SAC emphasised that when applying laws, it is necessary to also consider their meaning and purpose (not just the language), and that the interpretation compliant with EU law must be given preference.

SAC noted that making a payment to a foreign account is entirely legal and in many cases not at all unusual. Within the EU, it is moreover protected by the free movement of capital. Foreign payments thus cannot automatically establish liability, although the literal wording of the law may suggest so. Apart from the payment itself, there must be also the circumstance that the payer knew or could have known that the purpose of paying abroad was not to pay tax. Conditions stipulated in the Tax Procedure Rules also have to be taken into account: the supplier remains the primary debtor, and the tax administrator has to prove that they at least tried to collect the tax from them, yet to no avail.

Moreover, it is up to the tax administrator to prove that the conditions for liability have been met. It is irrelevant that the VAT payer may eliminate the risk of liability by a special manner of securing tax, i.e. paying the VAT on the invoice directly to the tax administrator's account; this procedure may also cause complications in business relations. To conclude, the SAC stated that the public interest in tax collection cannot be limited solely to gaining income for the state budget: a fair collection of tax from those who have the primary tax burden is equally important.

Case law

Exemption from withholding tax on interest and royalties may be applied retrospectively

The Supreme Administrative Court held that the exemption of interest or royalties from withholding tax may be applied retrospectively for up to two years from filing the application for exemption with the tax authority.

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In the case in question, a taxpayer paid licence fees to abroad. On these fees, the applicable withholding tax under the Income Tax Act was withheld and paid in 2011 and 2012. In 2013, the taxpayer applied with the tax authority for the exemption of the licence fee payments from withholding tax, on the grounds of a provision regulating these payments between related parties (the provision is an implementation of the EU directive on the common system of taxation of interest and royalties). In the application, the taxpayer also asked for a retrospective exemption of licence fees, on which the withholding tax had already been paid in 2011 and 2012. The tax administrator only ruled on the tax exemption for 2013; the entitlement for exemption for 2011 and 2012 was denied by the tax administrator arguing that a ruling cannot be issued with retroactive effect. According to the tax administrator, the exemption is conditional upon the issuance of the respective ruling, and as the ruling had not been issued for 2011 and 2012, licence fees paid in those years cannot be exempted from the withholding tax.

This tax administrator's argument was also accepted and supported by the Appellate Financial Directorate, and by the municipal court of justice. The case thus appeared before the Supreme Administrative Court, which disagreed with the lower-degree rulings and reversed the municipal court's decision.

According to the SAC, the possibility to exempt licence fees from withholding tax retrospectively is in line with the mentioned directive: under the directive, it is possible to apply tax exemptions retrospectively (i.e. to refund the withholding tax already paid) for up to two years from its payment. According to the SAC, while member states have the option to make the exemption conditional upon issuing a ruling by a tax administrator, such a ruling has only a declaratory nature, confirming that the general conditions for exemption as stipulated by the directive have been met. This means that if these general conditions had also been met in the previous two years, and the taxpayer is able to prove this, then the taxpayer is entitled to the refund of the withholding tax paid on the grounds of an additional exemption, even though they did not have the ruling on the exemption at that time. The same mechanism should apply to the tax exemption of interest.

Cameras or privacy?

The monitoring of premises by CCTV cameras is common enough nowadays. Usually, the reason for installing them is the protection of property against theft or vandalism. Yet, as the European Court of Human Rights emphasised in its recent judgment, we have the right to privacy even in publicly accessible areas; video surveillance must not disproportionately interfere with this right.

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The recent case concerned installation of a CCTV system in the auditorium of a university in Montenegro. Its purpose was not just to protect persons and property, but also to monitor the quality of teaching. Two of the lecturing professors complained about this, and the Montenegrin office for personal data protection agreed with them that the video surveillance was unlawful. However, when the professors wanted to claim damages for non-proprietary (non-pecuniary) loss, national courts denied their claim, and the case thus appeared before the European Court for Human Rights.

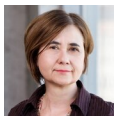
The ECHR confirmed that the right to privacy also applies to public areas (such as the auditorium) and to performing a professional activity (teaching). Any intrusion into privacy must be justified by a legitimate goal, necessary and proportional. In the case in question, these conditions were not met. The monitoring of the quality of teaching was not a legitimate goal for installing the surveillance under the Montenegrin law; the protection of persons and property was not found a sufficient reason either, as it had not been proved that these values were in any danger in the auditorium. The court thus ruled that the monitoring was contrary to Montenegrin personal data protection laws and awarded damage compensation to the professors. According to the judgement, everything would have been OK had the cameras been placed at the entrance to the building, not in the auditorium.

The issue of CCTV surveillance, i.e., what is still considered acceptable, is a hot topic in the Czech Republic as well. In our legal context, the methodology on operating CCTV systems published by the Office for Personal Data Protection may offer useful guidance. Yet, the interpretations of laws develop constantly. Soon, the new EU General Data Protection Regulation (GDPR) will enter into effect and introduce higher sanctions for all operators of camera systems recording data. We thus recommend paying proper attention to setting and operating camera systems appropriately.

In brief

Latest news - March 2018

Last month's tax and legal news in a few sentences.



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- The government passed a proposal to adopt the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). The Czech Republic's reservations form an annex to the convention. The Czech Republic intends to cover all its valid double tax treaties in the area of income tax and wealth tax through the Convention (except for the treaty with the Republic of Korea, which has been recently renegotiated and already approved by the Czech government and which contains all required modifications), while it will implement all the agreed-upon minimum standards regarding the explicit stipulation of the purpose and meaning of the double tax treaties, introducing a rule against treaty abuse in the form of a principle purpose test preventing the application of the tax treaties in situations created solely for the purpose of obtaining tax benefits without any other (legitimate) economic substance.

- In February, the Court of Justice of the EU ruled in the case of Slovak health insurance companies (T-216/15). According to the court, any activity involving offering of goods or services (including statutory health insurance) shall be viewed as an economic activity carried out by an undertaking. It is irrelevant whether the objective or the result of such activity is to generate profit or whether social, solidarity or regulatory aspects are of primary importance. To meet the definition, some level of competitive activities in the market of health insurance providers carried out to attract clients is deemed sufficient.

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