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Editorial

The recent high temperatures seem to have brought on the dull season not only for the media but also in legislation. The lull is quite likely to last for a while, since no significant changes are expected until the autumn elections.

In the previous issues of *Tax and Legal Update*, we brought information about the tax package and planned amendments to the Income Tax Act. This legislation was promulgated in the Collection of Laws and related changes are therefore in effect from 1 July 2017. The most media-discussed hit of the amended act are higher tax credits for children, applicable as early as from July of this year. In contrast, the fact that higher tax credits for children also mean the reduction of expenses claimed as a fixed percentage of income by self-employed persons has not been mentioned much. Thus, the final effect of the change may not be positive for a number of sole traders.

On behalf of all the authors, I wish you a pleasant summer and holiday time!

Jana Bartyzalová
Partner
KPMG Česká republika

Country-by-country reporting – changes on the horizon

At the last session of the Chamber of Deputies of the Czech Republic, further progress was achieved in passing the amendment to the Act on International Cooperation. The Act implements a new information exchange duty, i.e. country-by-country reporting, into Czech legislation

Daniel Szmaragowski
dszmaragowski@kpmg.cz

Soňa Saidlová
ssaidlova@kpmg.cz

The amendment will bring new duties for companies that are a part of multinational groups with a total consolidated turnover exceeding EUR 750 million. For these groups, a *report* will have to be filed containing basic information broken down by individual countries. At the same time, individual companies that are a part of such groups will have to notify the tax authorities of the reporting entity for the group – in the Czech Republic, this duty shall be complied with by giving a *notice*. The *notice* shall be filed with the Specialized Tax Authority, irrespective of the local jurisdiction of the individual company.

According to amending proposals passed by the chamber of deputies in the third reading on 12 July, **31 October 2017 shall be the last day for filing the *notice*** for all periods ended before 31 October 2017. The deadline for filing the country-by-country *report* remains unchanged, meaning it has to be filed within 12 months after the end of the period for which it is being filed. The Act will enter into effect upon its promulgation.

As the deadline for filing the *notice* is approaching, the tax administration is making final cosmetic changes to the electronic form through which the *notice*, and later the *report*, shall be filed. The form shall be completed and sent through EPO, the tax administration's tax portal. This will be the only admissible manner of filing, with a verified electronic signature or identity verification by logging into a data box. Most likely, no other alternatives of filing the *notice* will be offered.

Where a Czech company has the duty to file the country-by-country *report*, it will send the *report* in.xml format, via a uniform EPO form. According to information available to us, the company itself will be responsible for creating the .xml file. The duty to create the .xml file will, nevertheless, only concern a couple of companies in the Czech Republic.

Should you be interested in our assistance with filing the *notice* or preparing the *report*, do not hesitate to contact us.

Taxes

GFD issues information on the amendment to the VAT Act and instructions on how to complete VAT ledger statements

In connection with the approved amendment to the VAT Act effective from 1 July 2017, the General Financial Directorate (GFD) issues information on areas subject to the amendment and amends instructions on how to complete VAT ledger statements.

Veronika Výborná
vvyborna@kpmg.cz

Klára Sauerová
ksauerova@kpmg.cz
+420 222 123 613

The GFD published official information on the duty to balance or adjust VAT deductions for unsupported shortages and damage, on the extension of the reverse-charge mechanism to selected supplies and on the new unreliable person concept. Moreover, it also issued information on the moment VAT on gift vouchers must be paid in the light of new Section 20a of the VAT Act.

Section 20a clarifies the rules how to determine the moment the duty to declare VAT arises with respect to consideration received before effecting the relevant supply. The duty to declare VAT before a taxable supply is effected arises only if the following attributes are known at the moment of receiving the consideration: (i) the goods or services to be delivered, (ii) the VAT rate and (iii) the place of supply. If these attributes are not know at the moment gift vouchers are sold, the amount of the consideration received upon the sale of such vouchers is not subject to VAT at that time. It becomes subject to VAT once the voucher is actually used.

Interpretation uncertainty primarily concerned the accuracy of determining goods or services that can be received for a voucher. From examples included in the GFD's information it now becomes clear that, upon the sale of a voucher for any type of goods or services in a shop in which **only** goods and services **subject to the same VAT rate** can be acquired, the duty to pay output VAT arises at the moment the consideration for such a voucher is received, despite the fact that it cannot be accurately determined at the moment of receiving the consideration what specific goods or services will be purchased when the relevant voucher is used.

With respect to previous interpretations of the VAT Act regarding vouchers, this new GFD's information may affect established practice. We therefore recommend reviewing your organisation's internal systems to pay VAT on the sale of vouchers in compliance with the effective amendment of the VAT Act and the related GFD information. In this way you will avoid any sanctions imposed by the tax authority.

The new GFD information also changes the existing practice of applying VAT on the sale of prepaid phone cards. If this concerns your company, we recommend paying increased attention to this issue. In connection with the new amendment, the GFD has also amended its instructions on how to fill in VAT ledger statements.

Enterprise and Innovations for Competitiveness Operational Programme in full swing during summer

This summer, businesses may apply for support from the Enterprise and Innovations for Competitiveness Operational Programme (OPEIC). What are the programme's news? What calls will be open for large enterprises as well?

Karin Stříbrská
kpmg@kpmg.cz

Tomáš Christián
kpmg@kpmg.cz

In early July, a new call to participate in the popular Innovations programme was announced, involving the provision of support to introduce new technologies and products in manufacturing.

Applications will be accepted from 12 July 2017. Funds for allocation to large enterprises are only CZK 300 million, so the capacity is likely to be used up in a very short time. Applications are planned to be accepted until November 2017, but the programme can be terminated prematurely once double the required allocation amount has been reached (but not earlier than fourteen days after the application acceptance date).

Another call within the Applications programme, focusing on support of industrial research and experimental development, i.e. related operating expenses, is also expected to be announced in July and is likely to arouse interest similar to that invoked by the Innovations programme.

New calls within the Energy Saving programme are Energy-Efficient Buildings and Photovoltaic Systems. The first call, with applications accepted until 17 November 2017, focuses on the provision of support to the construction/expansion of energy-efficient buildings. The Photovoltaic Systems call offers support for the instalment of photovoltaic systems. Applications will be accepted until 16 October 2017 and individual subsidies may amount to up to CZK 100 million. Within the Energy Saving programme, the Energy Saving II call, focusing on the support of energy saving measures, is already in full swing: applications will be accepted until 30 March 2018.

Within the Low-Carbon Technologies programme, a number of new calls were announced at the end of June 2017. These are as follows:

- Energy Accumulation (innovative projects to introduce energy accumulation technologies, e.g. support of public electromobile charging infrastructure) – applications accepted until 17 October 2017;
- Secondary Raw Materials (technologies to obtain secondary raw materials for further use in industrial manufacturing, e.g. used paper, glass, metal) – applications accepted until 17 November 2017;
- Upgrade of Biogas to Biomethane (support to acquire technologies) – applications accepted until 17 November 2017;

- Electromobility (support to acquire electromobiles and charging stations within a company's business premises for the company's own consumption purposes) – applications accepted until 17 September 2017.

These calls are also intended for large enterprises.

A call within the Renewable Energy Sources programme (support of energy generation and distribution) remains open. Applications will be accepted until 15 July 2017.

Should you be interested in more details, please do not hesitate to contact us.

Stricter conditions for agency employment

The long-in-preparation amendment to labour laws that changes the agency employment conditions has successfully passed through the legislative process. Employment agencies and users of agency employees have to get ready for new duties. On the other hand, both will surely appreciate the deregulation of agency employment of foreigners. Legislators are also clamping down on the bypassing of applicable regulations, as the amendment introduces the new offence of 'concealed agency employment'. The amendment will enter into effect 15 days after its promulgation in the Collection of Laws.

Iva Baranová
kpmg@kpmg.cz

Barbora Bezděková
bcvinerova@kpmg.cz
+420 222 123 867

The original plan to set quotas for the number of agency employees or to ban their multiple subsequent fixed-term employments was eventually not put through by the labour minister. Yet, the conditions for agency employment will still get stricter: agencies will have to prove their financial qualification through a security deposit of CZK 500 thousand before even starting their activity; will also be stricter for persons acting as the agencies' 'appointed representatives'.

To prevent bypassing the current regulation of overtime work and breaks, the amendment prohibits assigning agency employees to a user who at the same time will employ them as permanent employees or to a user to whom they have been assigned by another agency in the same month. For any breach of the ban, both the agency and the user of the agency employees will face a penalty of up to CZK 1 million.

The amendment also introduces a penalty for users of agency employees if the agency employees do not receive the same remuneration as comparable permanent employees of the user. So far, the penalty only concerned the agencies. They objected that when setting the agency employees' remuneration, they depend on information obtained from the users, which is frequently false or incomplete. Under the new regulation, such users' behaviour will be subject to a penalty of up to CZK 1 million.

Another novelty, only added to the bill during its discussion in the parliament, is the 'concealed agency employment' offence – legislators responded to the increasingly widespread practice where agencies bypass the rather strict regulation of agency employment by passing the provision of their employees off as a cooperation under a contract for work, whereas the actual subject matter of the contract is not the delivery of complete work, but the provision of labour for consideration. The threat of a penalty of up to CZK 10 million should limit this practice.

A substantial and positive change for employers in need of labour is the abolishment of the ban of agency employment of foreigners needing an employment permit to carry out work in the Czech Republic. The regulation was meant to protect the Czech job market but has proven to be unnecessarily harsh under current circumstances. The ban was in fact one of the reasons for the boom of concealed agency employment.

Legal

MiFIDII implemented by Capital Market Undertakings Act

In late June, the president signed a significant amendment to the Act on Business Activities on the Capital Market (Capital Market Undertakings Act) and other legislation regulating the provision of financial services. The amendment is a part of the implementation of an extensive EU regulation intended to enhance investor protection and increase capital market transparency.

Filip Horák
kpmg@kpmg.cz

Linda Kolaříková
lkolarikova@kpmg.cz
+420 222 123 889

The amendment responds to two fundamental EU regulations: the revised Markets in Financial Instruments Directive (MiFIDII) and the related Markets in Financial Instruments Regulation (MiFIR). These significantly change a number of aspects of financial markets functioning, with an obvious effort to reflect the developments in the field over recent years and the rise of new trading systems – organised trading facilities (OTFs), thanks to which the number of trades realised outside regulated markets (OTC) has dropped. The Capital Market Undertakings Act also sets out rules for algorithmic and high-frequency trading in financial instruments.

Other changes significantly affecting the functioning of the capital market concern the provision and receipt of incentives and the activities of investment intermediaries. Entities providing investment advisory services will have to declare whether their advice is dependent or independent. Advisors who identify themselves as independent could not accept any incentives in connection with their activities; more precisely, they would have to pass them on to the customer. The entire area of investment intermediaries has been revised completely; of the numerous changes, let us mention the duty to make annual payments for a licence – the Czech National Bank expects this to ensure that the list of intermediaries will be updated on a regular basis, unlike now, when over 70% of registered intermediaries are inactive.

The amendment does not only change the Capital Markets Undertakings Act, but also the Act on Investment Companies and Investment Funds. It brings substantial changes for so-called alternative assets managers registered with the Czech National Bank pursuant to Section 15 of the Act on Investment Companies and Investment Funds – it sets new rules of how to calculate the value of the assets managed. Practical changes also affect the functioning of closed-end funds: qualified investor funds will no longer be obliged to enable the redemption of investors' units, after certain time.

The amended Capital Market Undertakings Act, same as the respective EU legislation, will enter into effect on 3 January 2018. Some partial changes, mainly to other acts, will be effective 30 days after the promulgation in the Collection of Laws.

New EU rules on reporting aggressive tax planning

In late June, the European Commission released a draft of new rules imposing the duty to inform tax administrators of tax planning schemes. It is yet another EU initiative to tackle tax avoidance and evasion.

Tomáš Prchal
kpmg@kpmg.cz

Eva Smotlachová
kpmg@kpmg.cz

The draft directive imposes a duty on intermediaries to report any potentially aggressive tax planning scheme in which they are involved as a part of carrying out their profession. The duty is limited to cross-border arrangements, i.e. situations involving more than one member state or a member state and a third country.

Intermediaries are generally understood to be entities who assist taxpayers in designing, organising or implementing tax planning structures or transactions with a cross-border element. In practice, these will be for instance tax and legal advisors, providers of accounting services or banks. Where there is no intermediary (or an intermediary is seated outside the EU), the duty to report will be with the taxpayer using the tax planning scheme.

The directive does not directly define aggressive tax planning. Instead, it lists a transaction's characteristic features indicating tax avoidance. If the transaction, structure or tax treatment shows at least one of the listed hallmarks, it has to be reported to the tax administrator. These include for instance: payments to countries with zero taxation, circumvention of the EU automatic information exchange duty, using jurisdictions with absent or insufficient anti-money laundering legislation, or the failure to comply with international transfer pricing rules.

The reporting of a scheme does not necessarily imply that the arrangement is harmful, but only that it merits scrutiny by the tax authorities. Member states will then have the duty to exchange the information obtained with other member states every three months, using a centralised database. The directive has to be passed unanimously by all member states. The proposed effective date of the new rules is 1 January 2019.

Case law

Misuse of company credit card ruled legitimate reason for terminating employment

The Supreme Court recently dealt with a case involving the controversial use of a business payment card. The employer believed that the employee had misused the card and immediately terminated the employment. The employee objected that he had not received clear instructions on how to use the card, and that the amount had been negligible. Lower degree courts granted the employee's arguments. The Supreme Court, however, was of a different opinion. It concluded that knowingly misusing a company payment card constitutes a particularly gross breach of the employee's duties, regardless of the amount of the damage thus incurred.

Linda Kolaříková
lkolarikova@kpmg.cz
+420 222 123 889

Barbora Bezděková
bcvinerova@kpmg.cz
+420 222 123 867

The terminated employee worked as an office manager. To cover expenses connected with the performance of this work, the employer had entrusted him with a payment card, and only gave him oral advice on the rules regarding the use of the card. The employee then used the card to pay, among other things, a bill of CZK 3 117 in a restaurant where he had met with his subordinates. The party was also attended by a person who had no relationship with the employer. The employee did not inform the employer of the event.

The employer considered the employee's behaviour a particularly gross breach of duty and immediately terminated his employment. The employee objected that the party had been a corporate event, and that the bill had been rather low. Moreover, he also claimed that he had never received binding written instructions on how to use the card. Therefore, he had believed that he could pay such expenses with the card.

Both district and regional courts sided with the employee. They concluded that the employer had erred by not giving the employee exact instructions on how to use the card and that the employee may have thus believed that he could use the card to pay for his colleagues. The amount covering the expenses of the external guest had been too low to constitute a legitimate reason for the immediate termination of employment.

However, the Supreme Court arrived at an altogether different conclusion. It stated that by paying the bill also for a person who had not been related to the employer, the employee had breached his duty to properly manage the employer's funds and to protect the employer's property from harm. The amount of the damage was irrelevant. Regardless of the amount, the trust between the parties of the employment relationship had been seriously compromised. The court also emphasised that as a manager the employee had been obliged to observe legal regulations at work and take measures to protect employer's property.

While the outcome of the case is positive for the employer, considerable expenses surely were spent on the prolonged litigation, pending since 2011. This could easily have been prevented had the employer paid due attention to the preparation of internal policies, including the rules of using funds owned by the employer.

Case law

SAC: Partial payment orders may not be issued

According to the Supreme Administrative Court, the Tax Procedure Rules do not allow the issuance of a payment order for only a portion of tax. This means that VAT payers from whom the tax administrators retain excess deductions sometimes amounting to millions of Czech crowns because of a few invoices can no longer hope for a quicker refund of the indisputable part of the retained excess deductions.

Veronika Červenková
kpmg@kpmg.cz

Jana Fuksová
jfuksova@kpmg.cz

Claiming the tax neutrality principle and other general tax administration principles, last autumn, the Regional Court in Prague decided that it was possible to issue a partial payment order for the indisputable portion of a retained excess deduction (i.e. to issue a payment order for a portion of tax). The court ruled this way even though the Tax Procedure Rules do not recognise such a decision. The court's judgment raised a number of questions, in particular whether it is possible to issue a partial payment order without a tax entity's application. In early summer, the case was discussed before the Supreme Administrative Court following a cassation complaint filed by the financial administration.

The SAC judges agreed with the financial administration's representatives and concluded unanimously that the Tax Procedure Rules do not allow for the issuance of partial payment orders, claiming that administrative procedure concepts such as partial decisions may not be applied to tax matters. Generally, the state can only do what the law allows it to do and, accordingly, the tax authorities may not be given other procedural options reaching beyond the scope of the Tax Procedure Rules. The judges also agreed that the introduction of a new type of decision would significantly affect the entire tax procedure and would in practice give rise to more questions than answers, which also played an important role during their decision-making. Taxpayers must therefore make use of other instruments to alleviate the negative effects of long-retained excess deductions, always considering the specific circumstances.

The refunding of indisputable parts of retained excess VAT deductions should hopefully proceed more quickly with the self-assessment of tax that the Ministry of Finance plans to introduce along with a new Income Tax Act in 2020. . Meanwhile, a self-assessment system has only been applied in the administration of gambling tax. Hence, we will have to wait and see how the self-assessment in VAT or partial payment orders will actually look like.

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www.kpmg.cz
Tel.: +420 222 123 111