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# Daňovky

## Daňové a právní aktuality

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December 2017

# Obsah

# Editorial

Six weeks after the Czech parliamentary elections, it is still not clear who the new finance minister will be. One name is mentioned most frequently: Alena Schillerová. Yet, when asked at the Prague Tax and Legal Forum what her priorities would be if she became finance minister, she answered that she did not like any "ifs". We will just have to wait and see what priorities the newly appointed government will outline on December 13.

One thing is for sure: the new cabinet will not have time to prepare any last minute tax changes before the year-end – in recent years, these have become a regular thing, assuring especially "happy" holidays for finance and IT staff. Still, the new government will have many tasks ahead: the ratification of the Multilateral Instrument (MLI), joined by more and more states, will be one of the easier ones; preparing and bringing to life an entirely new concept of the income tax act – an idea that has been contemplated for some time now – a rather ambitious one.

In early November, the OECD published a survey of basic transfer-pricing information prepared by the state administrations of individual countries. The information about the Czech Republic does not offer any surprising insights, but one topic that deserves mentioning is documentation: it is not obligatory in the Czech Republic, only recommended by the administration. And although the General Financial Directorate's instructions on transfer pricing are to be amended in 2018, nothing is to change in the mentioned approach as to the introduction of obligatory documentation. Information on countries that do not sufficiently cooperate in tax matters is rather more interesting: the presence of Panama on the blacklist is not really surprising, the inclusion of South Korea and United Arab Emirates more so.

Before wishing you many Christmas presents, I would like to draw your attention to one small present from the tax administrator: late or incomplete filings by a reporting entity within CbCR will not be penalised if the entity files the notification or removes the errors before the end of the calendar year; for more details, see one of our articles. Have a peaceful Christmas, with optimism soaring as high as bitcoin prices to date.

**Daniel Szmaragowski**
Partner
KPMG Česká republika

Taxes

# Top eight tax news items for employers and employees in 2018

The maximum assessment base for social insurance and the minimum wage will increase, which will affect the amount of some other mandatory payments and tax credits. Employees will also be allowed to complete their statements of payroll tax electronically. Paternity leave will be introduced. Below you may find information about the most significant changes in taxation in 2018.


**Iva Krákorová**
ikrakorova@kpmg.cz

**Mária Marhefková**
mmarhefkova@kpmg.cz


- The maximum assessment base for social insurance premiums in 2018 will be CZK 1 438 992. A maximum assessment base for health insurance has not been set.
- The 15% income tax rate on the super-gross salary and the 7% solidarity tax surcharge remain applicable. The monthly limit for solidarity tax payments will increase to CZK 119 916.
- With effect from 1 January 2018, the minimum wage will increase to CZK 12 200 (which is higher by CZK 1 200 than in 2017).
- The minimum monthly health insurance premium calculated from the minimum wage will be CZK 1 647.
- The tax credit for placing a child into pre-school facilities will increase in line with the new minimum wage. The tax credit amount is identical with the minimum wage amount.
- Increased tax credit of CZK 19 404 or CZK 24 204 for second, third and subsequent children for 2017 has been applicable in the calculation of wages since July 2017; employees can claim the remaining part of this increase for the January to June 2017 period within the year-end payroll tax prepayments settlement or their income tax returns for 2017.
- In 2018, it will be possible to use a new simplified prescribed (pink) form for the employee's payroll tax statement and to complete and sign it electronically. However, employers will have to ensure the unambiguous identification of each individual employee.
- Fathers will be entitled to paid one-week leave within six weeks after the birth of their children. They will receive a paternity allowance from the health insurance scheme, which is similar to a maternity allowance for women. This type of allowance will be available for fathers of children born after 21 December 2017.

# Country-by-country reporting's most common first-phase errors

In 2017, we repeatedly discussed the amendment to the Act on International Cooperation in Tax Administration introducing country-by-country reporting – CbCR. 31 October 2017 was an important date of the first phase of CbCR.

**Veronika Červenková**
kpmg@kpmg.cz

**Soňa Saidlová**
ssaidlova@kpmg.cz

All Czech entities whose first reporting period ended before 31 October 2017 had to file a notification by 31 October 2017 informing the Specialised Financial Authority which company of a group of companies will submit a country-by-country report. This date is now behind us, and we can look back to see how Czech entities fared in fulfilling this duty.

According to information provided by the financial administration, a total of 3 500 notifications were filed as at 31 October 2017. The most common error was an incorrect form of submission: despite the fact that the only permitted method was an electronic filing via the EPO application, many entities submitted their notifications via their data boxes. The financial administration attempted to call the entities' attention to these errors as quickly as possible so that they could rectify their situation and still file their notifications on time via the EPO application.

It is almost unbelievable how diverse and tricky situations in multinational groups of companies can be. In some cases, it was relatively hard to find the ultimate parent company; in other cases, it was difficult to initiate communication with group members unknown until that time. Consequently, the second most frequent error was an unclear identification of the reporting entity, i.e. the entity that should file a country-by-country report for the entire multinational group of companies. Although only one company – usually the ultimate parent – should be filing a country-by-country report for a group of companies, according to information from the received notifications, for some groups, CbCR would be filed by several entities at the same time.

Another very frequent mistake, caused by the failure to distinguish *ohlášení* (notification) from *oznámení* (country-by-country report) in Czech, was the incorrect notification of a Czech entity as the reporting entity.

Owing to the fact that CbCR is an entirely new duty for Czech taxpayers, the tax administrators decided to be relatively benevolent. Based on information received from the financial administration's representatives, where the tax administrators identify faults that are described above or are of another nature, they will informally call the taxpayer to rectify the situation. If the taxpayer removes the error by the end of the calendar year, the tax authority will not penalise them for a late filing of a notification. Please note that the filing of a notification is a one-off duty, as opposed to the submission of country-by-country reports. A new notification must only be filed when the notified information changes. Consequently, notifications need not be filed every year.

# Binding rulings for permanent establishments

From 1 January 2018, taxpayers may ask tax administrators for binding rulings on the manner of determining the tax base of a permanent establishment (or a registered branch of a foreign entity) located in the Czech Republic.

**Václav Baňka**
vbanka@kpmg.cz

**Zdeněk Řehák**
zrehak@kpmg.cz

Binding rulings should bring legal certainty to foreign entities, as binding rulings represent the tax authority's official standpoints on the method of determining the tax bases of permanent establishments. Taxpayers have not yet officially had this chance. Historically, foreign entities agreed the manner of determining the tax base with the appropriate tax administrator via a protocol (usually as a percentage of expenses or revenues).

Determining the tax base of a permanent establishment is ambiguous in many cases, complicated mainly by the fact that a permanent establishment is not a separate entity and intra-company flows without existing contracts must be considered. The most problematic situations arise when supplies are delivered between the head office and the permanent establishment (e.g. various support services or the transfer of goods for the purpose of their sale by the permanent establishment) or when the permanent establishment deals with customers, suppliers and business partners but does not issue any invoices to third parties. Many times, another question must also be answered: whether a permanent establishment should be entitled to a margin on sold goods or gains from other activities/functions performed in favour of the entity that has established the permanent establishment.

Binding rulings are usually issued for three subsequent taxable periods. Applications for binding rulings are subject to an administrative fee of CZK 10 thousand and should in addition to the formal essentials include appropriate documentation proving that the selected method of profit allocation (determining the tax base) of a permanent establishment reflects the functions, assets and risks borne by the permanent establishment in the relevant transactions. We also draw attention to the fact that binding rulings issued in this area will be subject to the information exchange duty between individual member states in compliance with the Council Directive 2011/16/EU, on administrative cooperation in the field of taxation, similarly to advanced pricing agreements.

We recommend considering applying for a binding ruling even where foreign entities had previously entered into agreements with their tax administrators on determining the tax base of their Czech permanent establishments.

# Stricter rules for VAT exemption of transport connected with exportation of goods

The EU Court of Justice's judgment of 29 June 2017 tightens conditions for the exemption from VAT of transport services connected with the exportation of goods outside the EU.

**Tomáš Havel**
thavel@kpmg.cz

**Hana Hašková**
hhaskova@kpmg.cz

The Court of Justice of the EU recently considered a case in which the exporter of goods authorised a carrier to transport goods to a third country. For capacity reasons, the carrier was unable to transport the goods and asked a sub-supplier (another carrier) to carry out the transport of goods in its stead. The court confirmed the local tax authority's decision to reject the sub-supplier's application of VAT exemption on the transport of goods, on the grounds of it being connected with the exportation of goods. The sub-supplier effecting the transport of goods should have considered this service a standard transport service liable to VAT.

The tax authority's decision thus interprets Article 146 of Council Directive 2006/112/EC, on the common system of value added tax, in a more restrictive manner. The exemption from VAT of the transport services connected with the exportation of goods is conditional upon a direct contractual link between the exporter and the carrier of goods in question. The judgement thus implies that the exemption of transport services upon the export of goods may only be applied by the carrier that was authorised to perform these services directly by the exporter.

The court's approach tightens the rules for applying an exemption of the transport of goods on exportation, as the existing interpretation of the Czech VAT Act allows sub-suppliers to claim this exemption.

The judgment only deals with the transport of goods exported to a destination outside the EU. The question remains what the court's view would be on the transport of goods imported to the EU. Both the VAT Directive and the Czech VAT Act offer another VAT exemption option relating to transport services connected with the importation of goods: if the value of transport is included in the tax base upon the import of goods, transport services are deemed services exempted from VAT, i.e. if the carrier is certain that the value of transport will be included in the tax base upon the import of goods, these services may be exempt from VAT with an entitlement to VAT deduction, despite the fact that no direct contractual relationship exists between the carrier and the importer.

In connection with this judgment, the General Financial Directorate is preparing Information on uniform approach to the application of VAT exemption of transport services directly connected with the importation or exportation of goods.

Taxes

# Third call for applications under Energy Saving programme announced

On 1 November 2017, the Ministry of Industry and Trade announced a third call to participate in the Energy Saving programme. The programme focuses on the support of measures aiming to reduce energy consumption leading to the overall improvement of the business sector's energy performance.


**Karin Stříbrská**
kpmg@kpmg.cz

**Pavlína Stachová**
kpmg@kpmg.cz


***Application deadline and aid amount***

Applications for support are accepted electronically from 1 November 2017 to 30 April 2018. The amount of provided aid depends on the size of an enterprise: large enterprises may receive up to 30% of eligible expenses. Subsidies per project may amount to a minimum of CZK 500 thousand and a maximum of CZK 400 million. In addition, CZK 350 thousand is the limit of aid provided for energy efficiency assessments that form an obligatory part of the applications for support.

***Supported activities and eligible expenses***

Supported activities will be as follows:

- modernisation and reconstruction of electric installations and gas and water supply systems in buildings and energy management facilities of manufacturing plants;
- implementation and modernisation of measurement and regulation systems, such as hardware and networks, including appropriate software;
- modernisation of lighting systems for buildings and industrial sites (only where obsolete technologies are being replaced with new efficient lighting systems, e.g. LED); this activity should not be a separate project but combined with another supported activity;
- measures having effect on the energy efficiency of buildings;
- use of waste energy in manufacturing processes;
- installation of renewable sources of energy for an enterprise's own consumption, etc.

***Eligible expenses will be related to the following items:***

- tangible fixed assets;

- intangible fixed assets;
- energy efficiency assessment.

***Other conditions and restrictions for obtaining aid***

The programme is intended only for projects taking place outside of Prague. Within the third call, a business entity may submit a maximum of fifteen applications for support. Applicants must unambiguously prove their ownership title or any other rights to the real property (incl. land) in which a particular project will be carried out. The project implementation period may not exceed three years.

If you are interested in obtaining subsidies, we will be happy to discuss any aspects of your project and other specifics of the relevant programme.

# Justice ministry prepares procedural law recodification

The Minister of Justice has presented an outline of the new civil procedure rules under preparation and intended to replace the current Civil Procedure Code.

**Viktor Dušek**
vdusek@kpmg.cz

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

Following the recodification of the civil and commercial codes, the time has now come for civil procedure. The currently valid Civil Procedure Code dates back to 1963, and, understandably, has been extensively amended since. An expert working group has now come up with a concept for a new regulation. The new code will mainly focus on contentious proceedings, while non-contentious proceedings will remain separately regulated in the Act on Special Court Proceedings from 2013.

Highly innovative is the planned involvement of the public in the preparation of the wording of the bill – the 293-page concept will be available for comments on at http://crs.justice.cz, a website created for this purpose.

To unify civil proceedings, the concept takes three main principles as its basis. First, civil procedure's dispositive principle, meaning that proceedings rest on the parties' initiative, should be strictly observed, as should be the accusatorial principle. More emphasis should be placed on procedural economy, denoting correct, swift and at the same time the least costly proceedings. The amendment therefore e.g. proposes to shorten the deadlines for filing for appellate reviews, which should also become a regular remedy, meaning that judgements would only enter into force after a decision by the Supreme Court (if any).

The minister plans to finalise the wording of individual sections of the bill within the present term of office. We can but hope that he will manage to harmonise the seemingly opposing changes in the concept of appellate review with the mentioned economic efficiency of proceedings.

# Pitfalls of outsourcing: The ‘Švarc system’ and agency employment

With the recent economic growth, the demand for employees has been increasing, making them scarce goods. Shortages of staff may be partly resolved by outsourcing some activities. This approach, however, entails numerous pitfalls, most importantly the prohibited ‘Švarc system’ (using sole traders/self-employed workers instead of employees) and agency employment contrary to law.

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

**Daniel Szpyrc**
kpmg@kpmg.cz

Employers, or service recipients/clients, tread on rather thin ice here: depending on the nature of the carried out activity, there is a risk that it may be viewed as employment. Public authorities then may assess additional charges/contributions to the public budget, and levy a penalty.

The Supreme Administrative Court (SAC) in its case law distinguishes between three types of activities. The first one are independent activities involving no risk for the client; this may ensue from the law (for instance for court bailiffs, public notaries), or from the nature of the activity (e.g. a complex manufacturing activity). The second type involves activities of an ambiguous nature. Finally yet importantly, there are purely dependent activities that can only be carried out under employment.

The problematic ‘Švarc system’ concerns the ambiguous activities. The SAC considers these to include activities by small-sized sole traders, assistance activities or liberal professions. However, if the content of the activity implies that it is a dependent activity, then it can only be carried out under employment. The SAC considers a dependant activity to be the one that meets certain ‘material’ characteristics: if the activity is carried out in one place, exclusively for a single employer issuing binding instructions, and if it involves a mutual and lasting relationship for consideration, then it is most likely a dependent activity that as such cannot be outsourced without circumventing the law.

This year, a case pointing to yet another manner of finding workers attracted the media´s attention – the outsourcing of certain activities to ‘pseudo’ employment agencies. In response to this case, rather than facilitating the employment of foreign workers, legislators came up with an amendment to the Employment Act, making it even harder. It defines ‘disguised agency employment’ and creates new types of offences, committed by those who mediate employment in a disguised manner. The new provision seems rather redundant, as even before the amendment, the regulation contained a similar offence, i.e. the mediation of employment without a licence. The difference consists in the severity of the penalty, which is now five times higher. It is also unclear whether both penalties may be levied simultaneously.

All employers who use one of the above mentioned types of outsourcing should therefore be very cautious when assessing whether the nature of the requested activity allows for its provision by a person other than an employee, or whether it is not in fact a purely dependent activity.

# EU to enhance rights of posted workers

For a long time, the EU has been fighting inequalities in the remuneration of workers posted abroad, and the subsequent competitive advantages of companies from countries where labour is cheap. To approximate the rights of all those working at the same time in the same country, the Posted Worker Directive stipulates that workers posted abroad are entitled to a rate of pay at least equal to the minimum wage in the host country. Now the EU wants to stipulate that they should also obtain all other constituent elements of remuneration received by local employees. For employers from Central and Eastern Europe this would mean a significant increase in the costs of their engagements carried out abroad, and a more complex administration.

**Iva Baranová**
kpmg@kpmg.cz

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

Under the directive, a posted worker is a person assigned by an employer abroad to carry out tasks under a contract concluded with a foreign customer or to work at a company within the same group of companies; possibly also a person posted abroad by an employment agency within cross-border agency work. Under the current wording of the directive, these workers are guaranteed a rate of pay at least equal to the minimum wage in the host country, including extra pay for overtime work, where the foreign rate of pay is more advantageous for the employee.

According to the Council of the EU, the current wording of the directive no longer provides a sufficient tool to fight inequalities in remuneration and does not guarantee fair competition in the EU market. The Council thus proposes that, apart from the minimum rate of pay (wage), posted workers should be entitled to all remuneration components available to employees commonly working in the host country. In practice, these would include various types of extra pay, bonuses, contributions and other benefits, whether provided under the law or under collective bargaining agreements.

The Council now aims to initiate the legislative process for the draft amendment in the European Parliament. It will not be easy, as the merit of the amendment is perceived differently in various countries: Western countries welcome the change, as it would partly limit the competitive advantage of suppliers from countries with cheap labour; Eastern countries understandably do not wish to give up this advantage.

In any case, for employers, the amendment would bring many problems in practice. Its main downside is the increased cost of posting workers westwards, as the postings are already quite expensive due to the minimum-rate-of-pay requirement. Yet another issue is the availability of information on what the workers are entitled to under foreign legislations, not to mention collective bargaining agreements. Quite likely, employers would not be able to do without hiring a foreign legal counsel. Paradoxically, the change may not be welcome even by the workers themselves – while the amendment would approximate the rights of employees working at the same time in the same country, it would, on the other hand, deepen the differences between employees of the same employer doing the same work, just in different countries.

# Delivery of goods from EU to consignment stock in Germany not necessarily subject to VAT registration duty

Until now, German tax authorities used to consider the delivery of goods from member states to a consignment stock in Germany as a transfer of goods, requiring the supplier's registration for VAT in Germany. On the date of taking the goods from the consignment stock, the supplier effected a local taxable supply involving the payment of the relevant German tax. Subsequently, subject to meeting general criteria, the customer could claim VAT deduction. However, new information from the German Ministry of Finance changes the procedure in effect so far.

**Petr Toman**
ptoman@kpmg.cz

**Martin Krapinec**
mkrapinec@kpmg.cz

The German Ministry of Finance's information amending the German VAT Act is associated with a decision of the Federal Finance Court, according to which it is essential to consider the contractual arrangement between individual entities as well as the way in which the entire transaction is carried out, rather than to simply follow the model described above. In many cases, registration for VAT in Germany is not at all necessary.

In accordance with the new information, the tax authorities should view the delivery of goods from member states to a consignment stock in Germany as a single transaction involving the acquisition of goods from another member state. The court nevertheless held that the customer to whom goods are to be delivered must be known at the moment the goods are dispatched. Another condition voiced by the court was that goods in a consignment stock may only be stored there for a short period of time, usually for a few days or weeks. The time condition is a bit vague, so we will have to wait for its real application in practice. The Federal Ministry of Finance's information also states that the customer should be resident in Germany before the goods are dispatched. It is the customer's initiative to choose delivery via the consignment stock and, therefore, the customer has unlimited access to the goods.

The tax administration's information also deals with situations when goods are dispatched to a consignment stock in Germany from countries outside of the EU. Under the previous approach to the delivery of goods to a consignment stock, the right of disposal of goods was only transferred to the customer once the goods were withheld from the consignment stock, even if the customer was in charge of handling all importation technicalities.

The supplier was thus supposed to pay VAT on import, and only the supplier was simultaneously entitled to deduct VAT on import. The new approach changes how these situations are dealt with in practice. If the right of disposal of goods is transferred before the goods are dispatched from a third country and if importation formalities are taken care of by the customer, this should only involve a single transaction with goods: the import of goods. If importation technicalities are handled by the supplier, the existing procedure should be applied.

Case law

# SAC confirms 'tax inspections beyond regional borders'

Increasingly often, the financial administration has been concentrating related tax inspections into the hands of a single tax administrator. This concept, referred to as 'delegation', considerably simplifies the work of the tax authorities. For taxpayers, however, this means that their tax liabilities may be inspected by a tax authority from the opposite end of the country. How does this approach comply with the rules of tax procedure? The Supreme Administrative Court (SAC) recently dealt with this issue.

**Jana Fuksová**
jfuksova@kpmg.cz

**Veronika Červenková**
kpmg@kpmg.cz

In a 'multi-territorial' inspection, a single tax administrator reviews mutually related transactions at various taxpayers, irrespective of the administrator's local competence. Typically, this approach is applied when reviewing a chain of transactions on the part of the supplier as well as on the part of the customer; when uncovering complex fraudulent chains; or when carrying out a parallel inspection of transfer prices within a group of companies. In the case recently before the SAC, the tax authority in Pardubice carried out a tax inspection at a VAT payer even though it did not have local competence. The reason was the taxpayer's suspected involvement in a fraudulent chain that this particular tax authority had already dealt with in other proceedings.

Administrative courts in both instances sanctioned this approach, referring to efficiency and efficacy of tax proceedings. In their opinion, a multi-territorial inspection was the only way to obtain a comprehensive overview of the relationships within the chain and thus to be well positioned to uncover the fraud. The courts emphasized that it would have been extremely complicated to transfer information obtained by individual local tax administrators; moreover, some procedures, typically witness interrogations, would have had to be repeated, leading to needless costs. The administrative courts thus confirmed the tax authorities' practice that can be come across increasingly often.

This attests to the general trend of the financial administration trying to distribute tax inspections and other procedures among tax administrators across the country. The change in local competence from the formal registered address to the actual place of business was the first harbinger of this tendency.

The Specialised Financial Authority has also recently declared its intention to create industry-specialised offices across the country. It thus seems that the times when entities with registered addresses in Prague were due for a tax inspection just once in about a hundred years are finally over.

# Technical improvements and advertising services once again on the SAC's agenda

The Supreme Administrative Court (SAC) in its recent judgement dealt yet again with the issue of repairs vs technical improvements and the application of related depreciation by a tax administrator during a tax inspection. The court also opined on the manner of proving the provision of advertising services, and on the reasonableness of their price. While this is by far not the first judgment in this area, it clearly shows some review approaches applied by the tax administrators, and the courts' requirements for proving advertising as a tax deductible expense.

**Veronika Červenková**
kpmg@kpmg.cz

**Miroslav Zatloukal**
mzatloukal@kpmg.cz

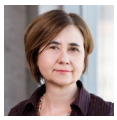
The SAC dealt with a situation where a tax administrator challenged the deductibility of expenses for the repair of a chair lift, as, in its opinion, the case involved a technical improvement. The SAC held that the Income Tax Act's provision defining non-deductible expenses (Section 25) prevails over Section 24 defining deductible expenses. Expenses listed in Section 25 can therefore not be accepted as tax deductible, even if expended to generate taxable income. It is thus clear that even bringing an asset into a condition to make it compliant with requirements of an applicable regulation may be a technical improvement and thus a non-deductible expense. If taxpayers want to apply the tax deprecation of a technical improvement within a tax inspection, they should actively request this during the tax inspection or file an additional tax return after the end of the tax inspection.

The court also dealt with proving that advertising in form of banners with the taxpayer's logo placed at a football stadium during matches had actually taken place. Invoices produced by the taxpayer, the oral testimonies of third persons and written statements by the football club were found to be insufficient by the tax administrator. The court also reviewed photographs and video recordings obtained from the football club, as the tax administrator stated that he had seen the banners in only two of the sixteen matches he had watched. The arguments that some shots had been taken before the match and that some banners had been placed out of the cameras' sight were not granted by the SAC. Despite the existence of perfect accounting documents and witness testimonies, the court did not accept the evidence as sufficient and held the expenses to be non-deductible. Apparently, the requirements in this area are stricter than ever, therefore it is crucial not to underestimate the necessity of adequate (photo) documentation.

The tax administrator also reviewed the price of the purchased advertising services, comparing it to prices of similar advertising services negotiated by the football club with other entities. Although such knowledge is often not available to the taxpayer, it is exactly this kind of information that the tax administrator often chooses to review. This approach was also approved by the SAC.

# Latest news - December 2017

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



**Lenka Fialková**
lfialkova@kpmg.cz

- According to the London Appeal Tribunal, Uber drivers have employment rights. In contrast, Uber claims that its drivers are self-employed persons and has appealed against the tribunal's decision.
- The Czech Ministry of Justice has submitted the substance of a special law on collective redress, allowing groups of consumers to enforce their rights within single proceedings.
- A Notice of the Ministry of Foreign Affairs on the double taxation treaty between the Czech Republic and Chile regarding the taxation of interest has been published in the Collection of International Treaties.
- Decree No. 401/2017, determining basic foreign meal allowance rates for 2018, has been published in the Collection of Laws.
- A government decree on the exclusion of certain sales from the reporting of sales has been published in the Collection of Laws under No. 376/2017.
- The European Commission has unveiled new tools to combat extensive VAT fraud. These measures should form the basis for a new common EU definitive VAT system.
- In December, the ECOFIN approved an EU list of non-cooperative jurisdictions as well as the Commission's Communication on a Fair and Efficient Tax System in the EU for the Digital Single Market. In addition, the council adopted proposals relating to VAT on e-commerce that should help on-line businesses fulfil their VAT duties.
- The OECD approved an update of the OECD Model Tax Convention for 2017.

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