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Tax & Legal

Taxes
Tips and tricks
Legal
Subsidies
Case law
In brief

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Editorial

During celebrations on Prague's Střelecký (Archer's) Island (and not only there), we commemorated the Czech Republic's 20-year membership in the EU. For younger generations, this may not be anything special or noteworthy, but 'old-timers' like me are acutely aware of how much this has affected the business environment and society as a whole and that we have come a long way in increasing our standard of living since 2004.

To cultivate the business environment even further, legislative support continues to be crucial. Which is why we again are serving up a good portion of legislative changes in the May issue of the Tax and Legal Update.

The chamber of deputies has passed amending proposals to the Income Tax Act and other laws being amended as a part of the consolidation package. This will eliminate some inaccuracies, e.g., those regarding non-financial employee benefits or agreements on work outside employment.

The much-discussed 'flexibility' amendment to the Labour Code is heading for comments. Its main objective is to increase the flexibility of labour relations, make employers more competitive, and promote the work-life balance of employees. As a consensus on dismissals without reasons given has not yet been reached, the final wording of the amendment is still in question.

Unlike the 'flexibility' amendment, the amendment to the VAT Act has already gone through its comment procedure. In addition to clarifying some interpretation ambiguities, this amendment changes the rule for determining the tax base where an employer provides supplies to employees or their relatives at a symbolic price. We are discussing the changes in this issue and will also take a closer look at them in our upcoming events. We'd be delighted to have you join us!"

Pavel Otevřel
Director
KPMG Czech Republic

Technical amendment to consolidation package approved by chamber of deputies

During the discussion of an amendment to the Act on Investment Companies (Print 570), the chamber of deputies approved proposals to amend the Income Tax Act and other laws amended at the end of 2023 within the consolidation package. The proposals aim to remove several of its inaccuracies. The amendment is expected to be smoothly approved by the senate and signed by the president.

Lenka Nováková
lnovakova@kpmg.cz

Iva Krákorová
ikrakorova@kpmg.cz

Mária Marhefková
mmarhefkova@kpmg.cz

Personal income tax

Events organised by employers

The amendment specifies the scope of tax-exempt cultural and sports events organised by employers for employees and their family members and redefines them as employer-organised social events, including those having cultural or sporting elements. This confirms the interpretation that these events may include Christmas parties, company anniversary parties, St Nicholas Day parties, etc. The amendment highlights that the employees' income from these events should be in non-financial form. The condition that the events must be ordinary and reasonable in scope and form, for a limited number of participants, and that related expenses are not tax deductible for the employer continues to apply.

Determining the amount of non-financial income related to pre-school facilities

The amendment provides for a special method to determine the amount of non-financial income of an employee using facilities caring for pre-school children. The employee's income will be either the price commonly charged at the place and time for a pre-school facility established by a public entity (e.g., a state, region or municipality) or the highest monthly payment for pre-school education according to the Decree on Pre-School Education, i.e., **a maximum of 8% of the minimum monthly wage** applicable in a given month (i.e., **CZK 1,512** for **2024**). The measurement method shall be chosen by the employer for each employee's child separately. It is also necessary to consider the period during which the child uses the pre-school facility in a given month. The employee's non-financial income will then be the difference between the amount determined as described above and any payment made by the employee to the employer. This regulation will apply retroactively from 1 January 2024.

Meals for former employees

The amendment expands the range of employees for whom it will be possible to exempt from tax up to the statutory limit the non-financial benefits in the form of meals for direct consumption at the workplace or for direct consumption at a catering facility operated by another entity. This will also apply to employees having worked for the employer immediately before retiring on an old-age pension or a third-degree invalidity pension. In aggregate, **up to 70% of the upper limit of the meal allowance** provided to employees receiving salaries on a domestic business trip of 5-12 hours (i.e., **CZK 116.20** for **2024**) may be exempt from income tax. Thus, these former employees will not be required to have worked at least three hours per shift/calendar day to qualify for the exemption. The exemption will be applicable to income provided as early as **1 January 2024**. This change does not affect monetary meal allowances or multi-purpose meal vouchers, which will continue to be subject to the legislation currently in force.

Less strict condition for exempting income if used for one's own housing needs

The amendment changes the notification condition for the exemption of **income from the sale of real estate** in which the taxpayer has resided for less than two years or has owned for less than 10 years if the taxpayer uses the funds to provide for their own housing needs. Such an exemption will no longer be conditional on submitting the notification. The taxpayer will still be obliged to submit the notification to the tax administrator by the end of the deadline for filing the tax return, however, failure to comply with the notification obligation will not lead to losing the entitlement to exemption, as is the case now. It will be penalised despite its non-financial nature, but the tax exemption will remain in existence. According to the transitional provision, the amendment will already apply retroactively for the 2023 taxable period.

Statutory insurance premium payments for employee stock option plans

The amendment synchronises insurance regulations with the already valid tax regulations concerning the acquisition of shares in a business corporation or (transferable) options to acquire such shares by an employee under employee stock option plans. The point in time when income is subject to insurance premiums will be linked to the point in time when the income is taxed (more on the tax-related changes in the January 2024 and November 2023 issues of the Tax and Legal Update). At the same time, if the employer reduces this income due to a decrease in the market value of the share under the Income Tax Act, the reduced income will be subject to the relevant insurance premiums.

Income tax and statutory insurance payments for concurring agreements to perform work (outside employment)

The problematic changes resulting from the consolidation package concerning agreements to perform work outside employment, which were due to come into force on 1 July 2024, will be abolished. The amendment introduces a new system: a special 'notified agreement' scheme, which should enter into effect on 1 January 2025. For employees under the notified agreement scheme, the obligation to participate in sickness and health insurance will only arise in the relevant month once the **threshold of 25% of the average wage** (**CZK 10,500** per month if this were **2024**) is reached. If an employee's income from all agreements to perform work with an employer who has used the notified agreement scheme does not reach this threshold, the obligation to participate in the insurance scheme shall not arise. At the same time, this special scheme will also be applicable for the purposes of tax on income from employment: the employer will be able to apply withholding tax on such income if the employee has not signed their payroll tax statements and the amount of such income from the agreement or agreements with the registered employer does not reach the limit in the given month.

Income from agreements to perform work generated with other employers, i.e., those not using the notified agreement scheme, will be subject to sickness insurance payments and thus also to statutory social and health insurance if remuneration of at least **CZK 4,000** per month has been agreed on or if the relevant income in a given

month is at least CZK 4,000.

Only the employer who first notifies the Czech Social Security Administration (CSSA) in a manner similar to that for claiming the tax credit by part-timers will be able to apply the preferential notified agreement scheme to the employee in a calendar month. If the employer applies the notified agreement scheme, they will have no further obligation towards health insurance companies, as these will obtain the information directly from the CSSA.

According to the amendment, the above scheme applicable to agreements to perform work will become effective on **1 January 2025**. The current regulation, which is valid but not yet effective, will be repealed, with an immediate effect. Until the end of 2024, the existing approach to taxation and insurance payments will thus be applied to agreements to perform work. However, employers' obligation to register all agreements to perform work already from 1 July 2024 remains in application.

Corporate income tax

Exclusion of unrealised FX differences from income tax base and transition to functional currency

The consolidation package introduced the possibility for taxpayers to apply the regime of exclusion of unrealised FX differences for corporate income tax purposes. The amendment extends the range of cases where this regime automatically ceases, by operation of law, to situations involving a transition to a functional currency in accordance with the Accounting Act. When switching to a different accounting currency, taxpayers shall follow the same procedure as in other situations (e.g., entering into liquidation) and adjust their result of operations for any previously excluded unrealised FX differences arising from the original accounting currency.

Functional currency and foreign currency translation for the purpose of income tax return preparation

Taxpayers who use their functional currency in their accounting must still file their income tax returns in Czech crowns. Their fixed assets, debts, provisions created for tax purposes, and other items whose method of creation or application is regulated by the law governing income taxes are then recorded in the accounting currency. The amendment specifies the FX rates to be used to translate fixed assets, debts, provisions created for income tax purposes, and other items measured in the accounting currency that arose in a currency different from the accounting currency. For items that are kept in the accounting records (e.g., the input costs of assets for tax depreciation purposes), taxpayers shall use the general FX rate applied in the accounting records. The general FX rate announced for the last day of the taxable period will now be only used as a secondary method of translation where there is no link to accounting and therefore no FX rate for accounting purposes. A criterion specified in Czech currency in a legal regulation (e.g., the threshold for tangible assets) shall be translated into the accounting currency at the exchange rate for the last day immediately preceding the taxable period or the period for which the tax return is filed. The purpose of this rule is to convert the criteria specified in legal regulations in Czech currency into the accounting currency so that the taxpayer can compare the two amounts directly in the accounting currency. The new rule shall also apply to fixed assets, debts, provisions created for tax purposes, and other items recorded in the accounting currency.

Non-deductible expenses related to employee benefits

The employer's expenses for social events, including those with cultural or sporting elements, are to be added to the list of expenses non-deductible on the employer's part so that the wording matches the one for the purposes of exemption of such expenses on the employee's part. As regards the calculation of non-deductible expenses in facilities designed to meet the needs of employees (expenses exceeding the income from these facilities are considered deductible for income tax purposes), the amendment clarifies that for the purposes of this calculation, expenses that are non-deductible under other provisions of the Income Tax Act shall not be included.

Most provisions on corporate income tax are proposed to take effect on **1 July 2024**, or their effective date has been linked to their publication in the Collection of Laws.

Changes in income taxes resulting from amendment to ICIF Act

The Chamber of Deputies of the Czech Parliament has passed an amendment to the Investment Companies and Investment Funds (ICIF) Act. It includes a technical amendment to the Income Tax Act that responds to changes in the ICIF Act and introduces several practical adjustments concerning sub-funds.

Ladislav Malůšek
lmalusek@kpmg.cz

Jana Švecová
jsvecova@kpmg.cz

The amendment also amends some parts of the consolidation package adopted in the form of amending proposals, reported on here. In this article you will find an overview of the key changes and their impact on income tax pertaining to investment funds.

Corporate income tax payer

Since under the ICIF Act it will now be possible to create **sub-funds** also within a limited partnership on investment certificates as well as within the newly introduced legal form of a joint stock company with fixed share capital (SICAF), the corporate income tax payer definition is being adjusted accordingly. The taxpayer will generally be any **sub-fund of an investment fund**; so far, the law only mentioned sub-funds of a joint-stock company with variable share capital (SICAV) as under the current wording of the ICIF Act, it is not possible to create sub-funds for other legal forms of investment funds.

Basic investment fund

In this context, a similar change is being made to the definition of a 'basic investment fund', i.e., a fund taxed at **a lower, 5% income tax rate**. Subject to meeting a 90% asset value test, a sub-fund shall also be a basic investment fund, regardless of the legal form of the investment fund.

Investment fund sub-funds created under the ICIF Act will also be considered basic investment funds if they meet, among other things, the condition of their shares being accepted for trading on a European regulated market.

Other areas

As taxpayers without a legal personality, sub-funds will now also be treated as **depreciators of the tangible assets** they comprise. Until now, this possibility was not explicitly mentioned in the law.

The amendment also extends the application scope of provisions that have so far applied only to SICAVs to all sub-funds, or only to SICAF sub-funds where the provision in question only applies to shares.

The provisions of the Income Tax Act applicable to a limited partnership and the limited partner's interest shall apply mutatis mutandis to the sub-funds of a limited partnership on investment certificates.

Effective date and transitional provisions

The effective date of the amendment to the ICIF Act as a whole has been proposed for **1 July 2024**. Regarding income tax, transitional provisions propose the following (differing) effective dates:

- To tax obligations for taxable periods commenced before the effective date of the amendment, the Income Tax Act as in effect before that date shall apply.
- Where the only consequence of the amendment is that a provision newly mentions all sub-funds rather than only SICAV sub-funds, the new wording shall apply from the effective date of the amendment.
- Similarly, the new wording shall apply from the effective date of the amendment also as regards the provision under which rules applicable to a limited partnership and the limited partner's interest shall apply mutatis mutandis to the sub-funds of a limited partnership on investment certificates.

Provisions intended to clarify the tax treatment of valuation differences and the amount of equity of investment funds were not included in the adopted amendment to the Income Tax Act.

Fuel sales: new GFD interpretation of windfall tax

The Czech Statistical Office has updated the classification of activities according to the CZ-NACE. This may affect the scope of payers of windfall tax relating to the sale of fuel.

Petr Toman
ptoman@kpmg.cz

Tomáš Havel
thavel@kpmg.cz

The General Financial Directorate (GFD) has modified its interpretation of activities falling under wholesale and retail sale of fuel and related retail or wholesale intermediary activities. This may have implications for determining whether a company was subject to windfall tax already for 2023. In some cases, the sale of fuel via fuel cards (in a buy-sell model) could qualify as fuel wholesale and therefore be subject to windfall tax for 2023.

Changes may also concern other areas like the regular sale of fuel from a public fuel station dispenser. Here, the type of customer may be decisive for the assessment of the activity's nature (sales to professional customers under a contractual relationship constitute wholesale activity).

We therefore recommend fuel station operators re-examine whether they have become taxable on windfall profits. In the first stage, they have to test whether they have had income liable to windfall tax of at least CZK 2 billion for the first accounting period ending after 1 January 2021.

The financial administration's communication can be found here; the original 2023 classification here, and the updated classification of 3 May 2024 here.

Amendment to VAT Act 2025 heads to chamber of deputies

Below, we are bringing you up to date on the amendment to the VAT Act 2025. The draft amendment has already gone through the comment procedure, and the version for the government meeting has been published. It contains several changes after the comments were settled.

Tomáš Havel
thavel@kpmg.cz

Michaela Moučková
mmouckova@kpmg.cz

The proposal changes the rule for determining the tax base where employers provide supplies to their employees (or close persons) for a symbolic price. In such cases, the tax base should be determined based on the supply's usual price. Nonetheless, the rules have been relaxed and the tax base equal to the usual price will only apply for the supplies of immovable property. This change will therefore not ultimately affect all supplies provided to employees.

As regards the (narrower) scope of financial activities exempt from VAT, there have been no changes to the list of activities that will not be exempt from VAT (for details, see here: Amendment to VAT Act to narrow scope of exempt financial activities). However, it is expected that the effective date will be postponed to 1 January 2026 to give the institutions concerned more time to prepare for the changes. The only exception to this postponement is the management of individual portfolios, which will already constitute a taxable supply from 1 January 2025.

Other changes include corrections of the tax base for irrecoverable receivables. The new draft implies that the correction will be voluntary and not mandatory as the Ministry of Finance originally proposed. New grounds for these corrections and the relaxation of certain conditions have been preserved, which will be discussed in detail in the next issue of our Tax and Legal Update.

As regards the time limits, the only change has been made to the right to deduct on the basis of a credit note where the time limit for claiming the right will now coincide with the general time limit for the application of the VAT deduction. This time limit remains reduced to a maximum of two years.
In general, the comment procedure has resulted in the clarification of some interpretative ambiguities. However, some other rules have also been added, e.g., stricter conditions for triangular transactions, and changing the definition of medical devices and their accessories.

Unfortunately, the draft does not remove or softens certain negative adjustments originally proposed, such as the supply recipient's obligation to refund the VAT deduction where the liability is not paid within six months, or keeping the burden of proof on the part of the payer within the concept of liability for unpaid tax.

Adjustments to top-up taxes: what will forthcoming amendment change?

The Ministry of Finance has published a draft amendment to the Act on Top-Up Taxes, which incorporates the rules contained in the OECD's documents. In addition to many legislative changes and additions in the area of safe harbours, the draft changes the conditions for filing top-up tax returns and top-up tax information returns.

Ladislav Malůšek
lmalusek@kpmg.cz

Václav Baňka
vbanka@kpmg.cz

Iveta Košťálová
ikostalova@kpmg.cz

Here is an overview of selected proposed changes:

- Instead of a taxable period, a reporting period is to be used, i.e., the period for which the consolidated financial statements are prepared. If the constituent entity's accounting period or taxable period for the tax concerned differs from the reporting period, for top-up tax purposes, data shall be allocated to the reporting period in the manner used for the preparation of the consolidated financial statements.
- The amendment specifies what revenues from the consolidated financial statements shall be relevant for determining the threshold of EUR 750 million. The threshold is vital for determining which corporate groups are subject to the top-up tax.
- The amendment clarifies the definition of an investment fund, replacing the condition of "a large number of investors" by the condition of "at least two investors".
- The possibility of using the medium-term decision on the application of the taxable profit split method for investment entities is to be extended to insurance investment entities.
- A medium-term decision on the inclusion of all profit shares shall be introduced. If this option is used, qualifying profit or loss is not adjusted for excluded profit shares.
- The possibility to apply safe harbour rules to joint ventures is to be extended to all types of safe harbours.
- The taxpayer that is the ultimate parent entity shall have the obligation to file a Czech top-up tax return if no low-taxed Czech constituent entity within a large domestic or large multinational corporate group exists or no low-taxed Czech constituent entity has generated excess profit.
- A top-up tax information return shall be filed by the payer of Czech top-up tax or allocated top-up tax regardless of whether there is a low-taxed constituent entity within a large national or multinational group or whether such constituent entity has generated excess profit.
- Under the transitional provision, the deadline for filing the top-up tax information return cannot end before 30 June 2026. The same rule could apply to the top-up tax return.
- Exceptions from the obligation to file top-up tax information returns remain in application. They can only be used if the information obligation has been fulfilled by another entity in the corporate group.
- The provision governing the transfer of assets in connection with the group's opening period is to be extended to transactions similar to asset transfers. The explanatory report provides examples of such transactions.

- The amendment extensively modifies the transitional safe harbour rule deriving from the information contained in country-by-country reports. This follows the OECD's Safe Harbours and Sanctions Relief and Methodological Guidance from December 2023.
- A permanent safe harbour rule based on simplified calculations of routine profits, de minimis (revenue and profit), and the effective tax rate has also been added. However, it should only be possible to apply these safe harbours in relation to non-material constituent entities (i.e., those not included in the consolidated financial statements and whose revenue does not exceed EUR 50 million).

A special transitional provision provides for a mixed tax regime for controlled foreign operations.
The amendment is only at the beginning of the legislative process. The proposed effective date is the day it is promulgated in the Collection of Laws. It should already apply to periods beginning after 31 December 2023.

News on double taxation treaty with Russia

On 8 August 2023, Russia discontinued the application of key articles of its double taxation treaty with the Czech Republic and other 37 countries. In the Czech Republic, this suspension has been legally effective from 29 September 2023. The financial administration has issued its information which follows its previous communication of 29 September 2023 and explains in more detail the implications for the payments of income to Russian residents and income flowing to Czech residents from Russia.

Václav Baňka
vbanka@kpmg.cz

Monika Sychrovská
msychrovska@kpmg.cz

Income flowing to Russian residents from the Czech Republic

The decisive date for the change in the approach to the payment of taxable income from the Czech Republic to Russian tax residents is 29 September 2023. From this date, payers must proceed in accordance with the Czech Income Tax Act and disregard the previously applicable double taxation treaty. The decisive date for determining the tax treatment is the moment when the payer is obliged to withhold tax or secure tax under Czech regulations. However, Russia has not withdrawn from the Convention on Mutual Administrative Assistance in Tax Matters. This means that instead of the 35% withholding tax rate, the standard 15% rate will apply.

Income flowing to Czech residents from Russia

In the period from 11 August to 28 September 2023 when the treaty was not consistently implemented by both states, the financial administration offers Czech tax residents with income from sources in Russia a choice between two regimes:

- They may avoid double taxation under the treaty (but the tax can only be offset to the extent that income under the treaty can be taxed in Russia) and potentially use the tax that has not been offset as a tax expense under the Income Tax Act.
- If it is more advantageous for the taxpayer, they may claim the entire tax paid in Russia as a tax expense under the Income Tax Act.

From 29 September 2023, only the Czech Income Tax Act applies to income from and to Russia, which allows only the second option mentioned above.

The key point in determining the tax treatment of one-off (non-recurring) income subject to Russian withholding tax is when the taxpayer is obliged to withhold tax in Russia. If this moment cannot be determined precisely, the financial administration allows to determine the tax regime based on the moment of generating the income under the Czech Income Tax Act. The same procedure applies to income that is taxed in Russia through income tax returns. The financial administration's information also specifies how to proceed for one-off and gradually accruing income. Income generated gradually must be divided into income before 28 September 2023 and income after that date, or income between 11 August and 28 September 2023 when the taxpayer has the option to choose the relevant regime.

If income from the Russian Federation is attributed to a Russian permanent establishment, it is subject to the same tax treatment as one-off or gradually accruing income, which requires the allocation of expenses and revenues over different periods. All expenses and revenues for the 2023 calendar year attributable to the Russian permanent establishment should be allocated into two periods, namely (i) the period from 1 January 2023 to 28 September 2023 and (ii) the period from 29 September 2023 to 31 December 2023. Alternatively, (iii) the period from 11 August 2023 to 28 September 2023 when the taxpayer has the option to choose the relevant tax regime may also be used.

Tax cooperation on crypto-assets: what does draft implementing law contain?

The Ministry of Finance has prepared an amendment to the Act on International Cooperation in Tax Administration, which implements the EU directive on the introduction of the automatic exchange of information reported by providers of services with crypto-assets (DAC 8). Crypto-asset service providers will be required to collect data on service users and their transactions and subsequently provide it to the financial administration for the exchange of information within the EU.

Václav Baňka
vbanka@kpmg.cz

The definition of a reporting crypto-asset service provider follows the EU Regulation on Markets in Crypto-Assets and anti-money laundering legislation. It primarily applies to providers of these services that are authorised to provide their services by the CNB. According to the explanatory report, there are dozens of such providers operating in the Czech Republic.

For the purposes of DAC 8, a crypto-asset is defined by reference to the EU Markets in Crypto-Assets Regulation as "a digital representation of values or rights that can be transferred and stored electronically using distributed ledger technology or similar technology", excluding central bank digital currencies and electronic money. However, in addition to this definition, all other crypto-assets that can be used for payment and investment purposes and all virtual assets under anti-money laundering legislation are also considered to be crypto-assets for the purposes of DAC 8.
A reportable user is defined as a person or entity that uses the services of a reporting crypto-asset service provider and is a resident of an EU state or a third country that has concluded a relevant international treaty with the Czech Republic.

A reportable transaction includes any crypto-asset exchange transactions and transfers. An exchange transaction means the exchange of crypto-assets for official currency or for other crypto-assets regardless of the transaction value. A transfer of crypto-assets involves the transfer of crypto-assets to another user's account or outside the operator's sphere of disposition, including transfers to non-hosted addresses or within reported retail transactions where the value of the goods transferred exceeds USD 50,000.

The reporting provider is required to register and submit an annual report that will include the identification data of the crypto-asset service providers (address, Corp. ID number, Tax ID number, etc.), the details of the reportable users, the name of the crypto-assets, the number of transactions, and the total amount received and paid by the user during the reporting period. The reported information will be shared between financial administrations. The penalty for non-compliance with this reporting obligation may amount to up to CZK 1,500,000. This penalty should not be levied for non-compliance with other reporting obligations (e.g., DAC 6). The amendment is proposed to take effect on 1 January 2026.

The amendment also extends the scope of the automatic exchange of information to tax rulings with a cross-border element issued to individuals (DAC 3). It also proposes that the reporting of cross-border arrangements (DAC 6) should include a description of the relevant arrangements and any other information that could assist the relevant authority in assessing the potential tax risk.

Tips and tricks

Tax administration principles: non-publicity, confidentiality, and personal data collection

Certain procedural principles, such as the principles of legality, speed, and economy, apply in various areas of public law. Other principles are specific for the administration of taxes, such as the principles of confidentiality, non-publicity, and personal data collection, and will be discussed in more detail below.

Tomáš Kočař
tkocar@kpmg.cz

Adéla Weczerková
aweczerkova@kpmg.cz

Given the nature of information provided to the tax authorities, tax administration is non-public, which is manifested in the **principle of non-publicity**. This principle should ensure that taxpayers have confidence in the proper functioning of the tax administration and that the data provided to the tax administration is not accessible to the public and only used for tax administration purposes.

Intricately linked to the principle of non-publicity is the obligation of confidentiality (the **principle of secrecy**). Officials and persons involved in tax administration are bound by this principle, and the obligation of confidentiality continues even after the end of the administrator's procedure (e.g., tax inspection) or after the termination of their employment with the tax administrator.

Confidentiality does not apply to publicly available information. A breach of confidentiality shall not be deemed to include (i) the disclosure of generalised information (e.g. for statistical purposes) unless it is apparent which persons it relates to, (ii) the provision of information to other officials in the course of administrative or criminal proceedings, (iii) the provision of information to a person involved in the administration of taxes to the extent that their rights and obligations are affected by the administration of taxes, or (iv) the provision of information to the Financial Analysis Office, the Ministry of Labour and Social Affairs, the courts and other entities, under the conditions laid down in the Tax Procedure Code. In contrast, the use of information obtained in the course of tax administration by an official for their personal benefit or for the benefit of another person shall be considered a breach of confidentiality.

The obligation of confidentiality does not apply to the taxpayer, as the principle of confidentiality is intended to protect and not restrict them. If necessary, the taxpayer may exempt the tax administrator or the person concerned from the obligation of confidentiality.

Another related and indispensable principle in tax administration is the **principle of personal data collection**. The tax administrator cannot avoid collecting personal data during tax proceedings, obtaining them directly from the individuals concerned, other data controllers, and publicly available sources. However, the tax administrator is entitled to collect only the personal data necessary for the administration of taxes and can thus only request information from taxpayers relevant to their activities and may only provide information about the taxpayer to another person or data controllers under specified conditions, such as for the purposes of criminal proceedings.

New chance for temporary protection holders: conversion to long-term residence

Following a consensus at the European Union level, the Ministry of the Interior of the Czech Republic is planning further changes concerning the residence of Ukrainian citizens who have fled their country in connection with the Russian aggression. In addition to setting rules for a repeated extension of the temporary protection status, the amendment now introduces the long-awaited possibility of converting it to long-term residence. The new rules will bring significantly more stability for temporary protection holders and their Czech employers.

Barbora Cvinerová
bcvinerova@kpmg.cz

Vojtěch Kotora
vkotora@kpmg.cz

Extension of temporary protection

Temporary protection is the specific residence title currently used by Ukrainian refugees. Its validity is limited to one year after which it can be extended always by one year. For this purpose, the relevant law had to be amended on an annual basis, while the last amendment in fact only postponed (by one year) the deadlines and dates for the implementation of the individual steps of the process. Also, because of the length of the legislative process, extensions were usually enacted relatively close to the expiry of the current validity period, leaving both the protection holders and their employers in a state of uncertainty as to their future residence status and possibility to work.

EU member states have now agreed to continue to grant and extend temporary protection. The ministry has therefore prepared a practical amendment proposing to introduce general rules for renewing the temporary protection status every year. The amendment will remove specific dates from the law, leaving only deadlines for each step of the process. No changes are planned for these, and the extension of temporary protection would remain a two-step process requiring initial registration in the ministry's system and then a visit to the relevant office for a new visa sticker.

Conversion to long-term residence

Since the introduction of temporary protection, the impossibility for its holders to switch to standard long-term residence has been a highly debated topic. The amendment partially deals with this: while it does not allow for obtaining standard residence permits, it proposes introducing the possibility of converting to a new, **special long-term residence title**: "long-term residence in connection with the armed conflict in the territory of Ukraine caused by the invasion of the Russian Federation". This is not a protective residence permit, but a long-term residence permit under the Foreigners' Residence Act that could be granted to holders of temporary protection who have been residing in the Czech Republic continuously for at least two years. Other conditions necessary to allow such a conversion are, e.g., sufficient income, a clean criminal record and registration with a health insurance company.

The authorities expect that many of the more than 300,000 current holders of Czech temporary protection will be

interested in this permit. For capacity reasons, the granting of special long-term residence **would not be preceded by a standard administrative procedure**. The ministry plans to verify in the state administration's information systems which temporary protection holders meet the conditions for conversion. As a next step, a process remarkably similar to the extension of temporary protection is proposed – registration in the FRS system, a visit to the authorities to take biometric data and possibly to provide the necessary documents, and then the issuance of a residence card. For capacity reasons, the validity of the card should be longer than that of the normal long-term residence, i.e., five years.

Specifics of special long-term residence

Foreigners with the special long-term residence permit **should have free access to the labour market**. They will neither be able to switch back to temporary protection, nor will they be allowed to change their purpose of stay to another type of long-term residence, and the granting of another residence permit will terminate the validity of the special long-term residence permit. The amendment also proposes an obligation for all family members to convert at the same time to avoid different residence statuses within the same household.

The amendment is now at the beginning of the legislative process, and the proposed regulation may still be subject to changes.

Flexibility amendment to Labour Code headed into comment procedure

A flexibility amendment (flexinovela in Czech) to the Labour Code recently presented by the Minister of Labour and Social Affairs has already been sent to official commenting points. Its main objective is to increase the flexibility of labour relations, make employers more competitive, and promote the work-life balance of employees. The amendment affects many areas of the Labour Code, including the origination and termination of employment.

Ľubica Čáp
lubicacap@kpmg.cz

Tereza Fojtů
tfojtu@kpmg.cz

One of the key changes is **the possibility of concurrence of agreements to perform work / to carry out a job (outside employment) with parental leave**. This means that under one of the agreements on work outside the employment concluded for the duration of parental leave, employees will be able to perform the same work with their employers as they did before taking parental leave. The amendment is also more supportive to employees returning to work after parental leave: while currently an employee is guaranteed the return to 'the same chair' only after returning from maternity leave, the same would also apply to employees returning from parental leave before their child turns two.

Other major changes concern **the termination notice period**: it should start to run from the date the notice is delivered to the other party. It will also be possible to shorten the period for punitive notices to one month.

Flexibility should also be promoted by **increasing the maximum length of a trial period** to up to four months for ordinary staff and eight months for senior staff, with the possibility of extension during the trial period. In this respect, however, the amendment may run up against the EU Directive on transparent and predictable working conditions, which requires the length of the trial period to be reasonable. Under the directive, trial periods should in principle (with exceptions) not exceed six months.

Changes introduced by the amendment should also clarify **employees' rights** in the event of invalid termination of employment and regulate the right to special compensation in the event of termination of employment due to an accident at work or occupational disease; this special compensation should be reimbursed to employers from statutory insurance.

The Labour Code should newly allow for **self-scheduling of shifts by the employee at the workplace,** which is currently only possible for employees working remotely. Employers will also be able to pay wages in a currency other than the Czech currency in more cases and during the summer holidays employ minors above 14 years of age who have not completed their compulsory schooling. The proposal also includes the possibility for employers to reduce the mandatory daily rest period of employees to six hours in emergency situations.

The above list of changes to the Labour Code is not exhaustive, and the further development of the amendment will depend on the outcome of the comment procedure. Individual areas may still undergo substantial changes in the course of the legislative process. A widely discussed but not yet agreed upon topic is the termination of employment without giving a reason. The final wording of the law is therefore still in question.

Employers' information obligation towards Labour Office to be fulfilled electronically only

Following an extensive amendment to the Employment Act, the Ministry of Labour and Social Affairs has presented a new plan for digitisation, with a view to simplify its administration and improve its services. Among other things, this digitisation will fundamentally change how employers of foreigners ensure compliance with their statutory information obligation.

Vojtěch Kotora
vkotora@kpmg.cz

Michal Mikovčík
mmikovcik@kpmg.cz

Under the law, employers are obliged to report the commencement, termination, and changes to the employment of foreigners. At present, this obligation is fulfilled by notification via data box, email, fax or, if necessary, by handing over a printed form to the relevant branch of the Labour Office of the Czech Republic. Subsequently, the employees of the Labour Office manually input the data into internal systems, which means a considerable administrative burden.

Under the new system, employers will have three options to comply with their reporting obligation:

- by filling in a new web form available on the website of the Ministry of Labour and Social Affairs, from which the data will be automatically entered into the central database
- by sending an information card in XML format via a data box
- by directly integrating their system to the interface of the Ministry of Labour and Social Affairs, i.e., by automatic transcription of data from the employer's internal systems directly into the office's database.

The full digitisation of this administrative agenda should minimise the need for manual tasks on the part of the Labour Office.

New reporting mandatory from July

Currently, employers can use both the existing and the new channels to comply with their information obligation. From 1 July 2024, everyone will have to switch to the new reporting and use one of the three ways described above. Until then, the ministry will hopefully use the concurrence of both methods to fix the emerging technical and practical problems.

Importantly, this system does not apply to notifications of the posting of workers from abroad to the Czech Republic within the provision of services: from 1 July 2024, this agenda will be transferred to the State Labour Inspection Office, which will use its own electronic system.

The digitisation of government systems is a welcome step forward. Authorities in the Czech Republic often use outdated and inefficient systems, and only a minimum of operations has so far been automated. However, the

proposed changes may require some investment on the part of employers to implement new systems, and the time for preparation is relatively short. However, currently we see a bigger problem in the incompleteness of the notification forms, which do not allow the inclusion of all the information that the employer is legally obliged to report. At the moment, it is possible to report missing information in free form, i.e., outside the standardised forms, but from 1 July this will no longer be possible. Thus, there is currently no way for employers using the option of sending a file in XML format to fully meet their obligation. Concerns have also been raised by the lack of further information on the system for reporting the posting of foreign workers, even though the date of full operation is approaching.

Register of representations – revolution in registration of powers of attorney

The government's amendment to the Basic Registers Act brings a significant change in the registration of legal representation. It will now be possible to choose between the traditional paper form, and the modern electronic form of power of attorney. A key part of the new legislation is the introduction of the register of representations: a centralised information system for the registration of digital powers of attorney to which the authorities will have access. The law has already been signed by the president.

Pavlína Rampová
prampova@kpmg.cz

Kateřina Lesáková
klesakova@kpmg.cz

Easier representation

The launch of the representation register, planned for later this year, will open up the possibility of digital legal representation. Individuals and legal entities will no longer have to submit printed and signed powers of attorney in person. It will be sufficient to enter their data via the Public Administration Portal and verify their identity using a citizen's digital identity. Registration with assistance will also be possible through CzechPoint. The register will contain pre-completed templates for various types of (statutory and contractual) representation authorisations, which will facilitate the process of issuing and managing powers of attorney. These powers of attorney can be used, e.g., when filing tax returns or handling mail for other persons.

Increased legal certainty

Powers of attorney entered in the register will remain valid until revoked or expired. Unlike the paper version, electronic powers of attorney will terminate automatically upon revocation, thus increasing legal certainty. The authorities themselves will verify the existence and validity of the power to represent.

Use of the register

The government expects the new register, which should also support substitute powers of attorney, to be used both by citizens and businesses. The register will be managed by the Digital and Information Agency. The first authority to be involved will be the Ministry of Transport, which hopes to facilitate transfers of vehicle ownerships.

Chamber of deputies passes amendment important in company conversions

The Chamber of Deputies has passed an important amendment to the Act on Conversions of Commercial Companies and Cooperatives (the Company Conversion Act). Its main novelties deal with the transfer a company's registered office outside the European Union, and a new form of company conversion: the demerger by separation.

Jan Kiss
jankiss@kpmg.cz

Petr Janíček
pjanicek@kpmg.cz

At present, transfers of the registered offices of legal entities (including corporations) to and from non-EU countries are governed by a brief regulation in the Civil Code, with the rules stipulated in the Company Conversion Act not applying to these transactions at all. The amendment to the Company Conversion Act provides greater legal certainty and a more comprehensive framework for companies that decide to move their registered office to the Czech Republic from a non-EU country, or the other way around.

A transfer of the registered office is usually accompanied by a change of tax residence, although this may not always be the case. And vice versa, an entity's tax residence may change even without it relocating its registered office. The legal regulation now passed thus also includes **an amendment to the Income Tax Act setting rules for tax residence transfers**:

- A taxpayer who has changed their tax residence to abroad shall file a tax return for the period preceding the change of their tax residence. If they continue to have income from sources in the Czech Republic after the transfer of tax residence (e.g., because of the existence of a permanent establishment in the Czech Republic), they shall file their subsequent tax return for the period from the transfer of their tax residence to the end of their taxable period.
- In their tax return, the taxpayer shall claim a half of the depreciation charge for tangible assets for the period up to the transfer of their tax residence abroad. If the assets remain in the Czech Republic even after the change of their tax residence, the taxpayer may claim the second half of the (tax-deductible) depreciation in the tax return for the period from the transfer to the end of the taxable period.
- If, within a tax residence transfer into the Czech Republic, tangible assets are transferred that are depreciated (for tax purposes) abroad, these assets will be depreciated in the same way as a non-monetary contribution from abroad.

The second major change – **the introduction of a demerger by separation** as a new form of company conversion – allows companies to separate parts of their assets and liabilities and contribute them into newly created or existing entities. Unlike in a spin-off where the members/shareholders of the (demerging) company from whom the assets and liabilities are being transferred become the members/shareholders of the (receiving) company to which the assets and liabilities are transferred, in a separation, the (demerging) company from whom the assets are being separated becomes a member/shareholder of the receiving company. In economic terms, this process can be viewed as a specific type of contribution, whether to one or more newly created companies, or to an existing company or companies (separation with merger).

Unlike for the transfer of the registered office, there is no specific provision regulating corporate income tax issues of demergers by separation. Thus, their tax treatment must be deduced from t**he current income tax law**.

Apart from expanding the possibilities of transferring registered offices and introducing a new form of company conversion, the amendment implements EU directives and introduces changes required by practice. These include the clarification of certain accounting rules, the abolition of the appointment of an expert by the court, and changes to publication obligations, creditor protection rights, and formalities in cross-border conversions.

The act will now be discussed by the senate and if subsequently signed by the president, will enter into force on the thirtieth day after its promulgation in the Collection of Laws.

Class action act heading to senate

The Act on Collective Proceedings has passed its third reading in the chamber of deputies and is awaiting approval by the senate. It transposes an EU directive and aims to ensure better protection of collective consumer interests in disputes with businesses.

Tomáš Kočař
tkocar@kpmg.cz

Veronika Halalová
vhalalova@kpmg.cz

Scope of application of collective proceedings

The originally submitted bill limited the applicability of collective proceedings solely to consumers' claims against businesses; this was the minimum scope under the (EU) directive on representative actions for the protection of collective interests of consumers. However, the amending proposal raised in the course of the legislative process extended this possibility also to 'micro-businesses': entrepreneurs who employ fewer than ten people and whose annual turnover or annual balance sheet total does not exceed CZK 50 million.

Plaintiff's fee

A fundamental change from the original bill was made to the maximum amount of remuneration of the plaintiff in collective proceedings. For their activities, attorneys should be awarded a portion of the awarded amount, adequately covering their costs and risks. This amount has been the subject of disputes from the outset, which is why the first draft envisaged two variants (5% and 25% of the awarded amount), with the government eventually approving the 5% variant. In the end, the chamber of deputies increased the maximum plaintiff's fee to **16%**. Also, a cap of CZK **2,500,000** was introduced for fees set as lump sums. However, there are concerns that too high a fee may lead to speculative actions.

The chamber has also added to the bill the possibility for the court to reduce the fee. In situations where the amount of the fee is set as a percentage of the awarded amount, and that amount exceeds CZK **100,000,000**, the court may reduce the percentage of the fee by up to half, without a motion, if its amount no longer seems reasonable in view of the actual complexity and length of the collective proceedings.

Opt-in regime

In other EU member states, collective proceedings are conducted either in an opt-in regime, which requires the active registration of the parties, or in an opt-out regime, in which all potential victims are parties until they de-register. The bill passed by the chamber of deputies envisages the more moderate opt-in regime. A proposal that participants with claims not exceeding CZK **3,000** would be under an opt-out regime (and thus have to de-register if they do not want to be parties to the proceedings) did not pass either. However, **the number of registered consumers** (and micro-businesses) required to initiate collective proceedings was reduced from 20 to 10.

Exposing illegal work and disguised agencies labour inspectorate's main focus

The State Labour Inspection Office carries out almost 20,000 inspections each year. In 2023, there were 19,977, i.e., 1.5 thousand more than in the previous year. The largest number of inspections focused on work safety, but inspections of illegal employment, employment agencies and compliance with the regulation of working conditions and labour relations also accounted for a significant share.

Barbora Cvinerová
bcvinerova@kpmg.cz

Veronika Halalová
vhalalova@kpmg.cz

Inspections aimed at detecting illegal employment are a long-term priority of the Office. Last year, the regional inspectorates detected 2,801 illegally employed persons. These included 2,156 foreigners from non-EU countries (mostly Ukraine, Moldova, and Vietnam), 583 Czech citizens, and 62 citizens of other EU member states. 296 inspections uncovered illegal work in the form of a Svarc system set-up. Total penalties imposed for illegal employment in 2023 amounted to CZK 134,121,500. The number of inspections focusing on this area increases every year.

The Office also pays attention to disguised mediations of employment. This means hiring out workers to another entity without fulfilling the legal conditions for employment mediation, in particular obtaining a permit for carrying out the activity of an employment agency. In 2023, 309 disguised employment agencies and 183 users of these disguised employment agencies were detected. 80% of the detected disguised employment agencies have a foreign ownership structure and employ large numbers of foreigners, often illegally or under poor working conditions. Total penalties imposed in this area in 2023 amounted to CZK 116,870,000.

Increased number of employee-initiated inspections

An integral part of the Office's activities are also inspections based on complaints, especially by employees who draw attention to possible violations of law by their employers. Last year, labour inspection authorities received 6,268 such complaints, which is 826 more than the previous year. 3,470 complaints concerned labour-law relations; 1,608 illegal employment, 758 work safety, and 197 related to the Employment Act.

According to the annual plan of inspections for 2024, the Office plans to carry out at least 6,700 inspections in the area of employment, focusing on disguised employment mediation (agencies), illegal employment of Czech and EU citizens and foreigners from third countries, equal treatment and non-discrimination in exercising the right to employment, compliance with the mandatory quotas for employing persons with disabilities, and the provision of childcare services in children's groups. Further inspections are planned in the areas of labour relations and occupational safety. The detection of illegal work and disguised employment mediation will remain a priority for this year.

Penalties can run into millions of Czech crowns

Penalties for misconduct imposed by the Labour Inspection Office can be very severe, with the highest fines amounting to millions of Czech crowns; for some offences in the area of illegal employment or disguised employment mediation a ban of activity for up to two years may be imposed. Are you being inspected by the labour inspection authorities, or are you interested in an audit of your compliance with labour-law obligations? Do not hesitate to contact us!

New rules of work through digital platforms under way

The European parliament has approved the text of a directive on improving working conditions in platform work. The main aim of the directive is to improve the working conditions of platform workers, regulate the way platforms use algorithms, and prevent illegal employment. The directive is considered a breakthrough for the rights of digital platform workers in the EU.

Ľubica Čáp
lubicacap@kpmg.cz

Tereza Fojtů
tfojtu@kpmg.cz

More than 28 million people in the EU work for digital platforms, including taxi service providers, couriers, translators, and others. While the growth of these platforms has been beneficial for the labour market, it has created a grey area for their workers, particularly in terms of their employment status.

Although platform workers are often formally registered as self-employed, many are bound by the same obligations as employees but are not granted the same labour and social rights under EU law. Self-employment is therefore only formal – factually, it is an employment relationship between the platform and the worker.

Presumption of employment

The fundamental change brought by the directive is the introduction of a legal presumption of employment into the member states' national law. This rebuttable legal presumption will apply if the relationship between the worker and the platform shows characteristics of control and management. Workers for digital platforms will be able to invoke this presumption, and it will be up to the digital platform to prove that there is no employment relationship. The directive thus represents a major step in fighting false self-employment schemes, in the Czech Republic also known as the Svarc system.

Regulating algorithmic management in platform work

Platform workers currently face a lack of transparency, in particular as regards decision-making and the use of their personal data. Automated processes overlook numerous factors that affect worker performance, such as traffic or obstacles on the part of customers. Digital platforms will now be obliged to properly inform their workers about the use of automated monitoring and decision-making systems, e.g., in the area of working conditions or remuneration. The directive will also introduce a ban on the use of algorithms in certain areas, such as the processing of workers' biometric data or data on their psychological state. Workers will also have the right to the human monitoring of these algorithms, including the right to an explanation/consultation and a review of the decisions taken.

Once the final wording of the directive has gone through the EU legislative process, member states will have two years to implement it in their national laws. In this context, a question arises how the directive will affect the prices and availability of these types of services.

Subsidies for charging stations in Czech Republic and EU

The European Commission has announced another call for proposals under the CEF2 grant programme, with total funds for allocation of up to EUR 1 billion. The programme supports the construction of public chargers for electric vehicles, hydrogen filling stations, etc. The Ministry of Transport also announced a similar call this March.

Silvie Beranová
sberanova@kpmg.cz

Markéta Jakobová
mjakobova@kpmg.cz

Monika Svobodová
monikasvobodova@kpmg.cz

CEF2 programme

The EU CEF2 grant programme supports th**e construction of publicly accessible charging stations for electric vehicles** (cars and trucks). The call also supports the construction of hydrogen filling stations for vehicles. The condition is that the infrastructure must be built along the TEN-T, i.e., the trans-European transport network. In particular, international projects building charging and refuelling infrastructure in parallel in several EU countries are an appropriate type of project for this programme. Legal entities, including large businesses, can be applicants, even in the form of joint ventures.

Support for the construction of charging stations is provided either as a fixed contribution per charging station or a percentage of eligible costs. For a charging station with a capacity of 150 kW, applicants can obtain support of EUR 20-30 thousand or 30-50% of eligible costs. The specific aid intensity varies depending on the country of the applicant and the power of the charging station.
The first round of applications is open from the end of February until 24 September 2024. At the same time, the Commission has announced further rounds of applications, with the second round closing on 11 June 2025 and the third on 17 December 2025. To be assessed by the European Commission, an application for funding from the CEF2 programme must first be approved by the Ministry of Transport.

Operational Programme Transport

Support for the **construction of public charging infrastructure** can also be applied for at the national level under the Operational Programme Transport. At the end of March 2024, two calls were announced under this programme, focusing on the development of charging infrastructure with battery storage and on the development of fast charging infrastructure for passenger vehicles. Compared to the CEF2 programme, these calls are for smaller scale projects and must take place in the Czech Republic.

Eligible applicants are owners of charging infrastructure with public access, while large companies can also apply for support. The aid intensity for these calls is 55-60% of eligible costs. Applications can be submitted before 27 June 2024.

If any of the calls are relevant to you or if you are interested in more information, please do not hesitate to contact us.

Innovation Fund offering subsidies for innovative low-carbon technologies

The Innovation Fund is one of the largest subsidy programmes aimed at supporting low-carbon and innovative technologies. The programme is announced and managed by the European Climate, Infrastructure and Environment Executive Agency (CINEA) and funded by the Emissions Trading Scheme.

Silvie Beranová
sberanova@kpmg.cz

Lukáš Otýpka
lotypka@kpmg.cz

Calls under the Innovation Fund support **highly innovative projects** aimed at decarbonising energy-intensive industries, innovative renewable energy production (e.g., hydrogen), energy storage, carbon capture, storage and utilisation, or decarbonisation in sea, air, rail, and road transport.

New calls are expected to be launched towards the end of this year. Key for the eligibility of projects is their potential to mitigate greenhouse gas emissions and promote activities leading in particular to the saving of carbon dioxide. An application for aid should include a calculation of the expected GHG emission avoidance.

The first three Czech forerunners

On 11 April 2024, in connection with the Innovation Fund and the need to promote sustainable technologies, the European Commission organised a conference on **sustainable innovation and promotion of clean green technology production** in the EU. The conference was attended by representatives of the private sector and CINEA, Innovation Fund project managers, as well as representatives of successful projects that have already received support from the Innovation Fund. Three projects have so far been implemented in the Czech Republic.

One of them is a project aimed at building a new line for the **production of battery coolers for electric vehicles**. The originally energy-intensive production process was replaced by a new laser welding technology using new materials, which will reduce energy consumption by around 50% and emissions by around 224,000 tonnes of CO2 in the first ten years of operation, while increasing material recyclability. Another project obtaining aid from the programme was the design and construction of a new hybrid glass furnace combining electric melting and gas combustion. The new process is expected to reduce emissions by around 193,000 tonnes of CO2 in the first ten years of operation compared to a facility burning predominantly natural gas. The last project receiving support in the Czech Republic consists of hydrogen production in a 2 MW electrolyser fed by a photovoltaic power plant and a biomass cogeneration system. The amount of hydrogen produced is to be equivalent to the annual diesel consumption of 30 local buses.

Applying for aid is very challenging - we will be happy to help

In addition to the Innovation Fund's strategy, i.e., the need to move industry towards more energy efficient solutions with reduced greenhouse gas emissions, part of the debate focuses on the overall complexity of preparing

a grant application. The information, inputs and annexes of the application need to be elaborated in great detail, therefore the application for aid including annexes can be 600 to 900 pages long.

If you are interested in obtaining support from the Innovation Fund, it is necessary to start preparing the application as soon as possible so that all documents can be submitted in the required quality and on time. If you would like more information on this programme, we will be happy to discuss with it you while focusing on your projects and the possibility of obtaining support for them.

Estimated payables as seen by recent case law

The Supreme Administrative Court (SAC) has recently issued two judgments dealing with estimated payables and their effect on the income tax base. The court's reasoning provides taxpayers with important general information on what to have ready for an inspection by the tax administrator.

Filip Svoboda
fsvoboda@kpmg.cz

Jana Doškářová
jdoskarova@kpmg.cz

Judgment No. 7 Afs 317/2022 – 30: estimated payables for unfinished work

A taxpayer undertook to build infrastructure on building land sold and, for this purpose, concluded a contract for work in 2015. The application for a zoning decision was filed in 2015, although the zoning decision and building permit did not enter into force until 2016.

The taxpayer created an estimated payable for the price of the work already in 2015, arguing that the contractor commenced the work already by filing the application for the zoning decision. The tax administrator disagreed with this approach and held that these were not costs (expenses) incurred in 2015. In the tax administrator's opinion, the contractor could have commenced the work only once the zoning decision had entered into force. The zoning decision entered into force in 2016, and (except for one invoice) no evidence of specific materials supplied or work carried out was provided for the estimated payable. Moreover, the contract between the contractor and the subcontractor carrying out the building work was concluded only in 2017.

The regional court agreed with the tax administrator's opinion, concluding that one of the prerequisites for accounting for an estimated payable is proving the existence of a payable for an actually effected supply that in terms of subject matter belongs to a certain accounting period at the end of which the exact amount of the payable is not known.

The SAC agreed with the regional court and reiterated that the estimated payable had been created wrongly. The following arguments led the SAC to its conclusion:

- (i) a prerequisite for accounting for an estimated payable is the proof of the existence of a payable for an actually effected supply that in terms of subject matter belongs to a certain accounting period, while its exact amount is not known;
- (ii) the taxpayer could have carried out the work only after the issuance and entry into force of the zoning decision and building permit (i.e., in 2016); and
- (iii) the taxpayer did not provide evidence of any specific supplies of materials or work in 2015.
- The SAC also emphasised that the mere conclusion of a contract or the origination of a claim for the consideration for a supply is not sufficient reason to account for an estimated payable.

Judgment No. 2 Afs 79/2023 – 62: estimated payables for employee bonuses

In this case, the issue was whether a taxpayer correctly accounted for bonuses for holding employee shares, for which an estimated payable had been created. The case was first considered by a regional court.

In the course of the proceedings, the taxpayer presented their wage policy governing employee remuneration. It did not contain any specific information on bonuses for employee shareholders but stated in its annex that to provide a bonus, an audit was a necessary precondition, and that there was no entitlement to a bonus as a component of wages. The taxpayer also presented a document in which the CEO had approved annual bonuses for certain categories of employees; the taxpayer believed that based on this document, bonuses became a component of wages to which employees were entitled.

According to the regional court, the decisive factor for the creation of an estimated payable is whether employees are legally entitled to the bonus in the civil-law sense. This followed neither from the text of the wage policy nor from the CEO's document. Also, the taxpayer only considered the total amount of the annual bonuses, while amounts of bonuses granted to individual employees within that amount were open to changes. In the court's opinion, unless the recipients of the bonuses are named and the amounts intended for them fixed in a document by the CEO, employees cannot claim the bonuses in the future, and thus there can be no civil-law entitlement. Therefore, the taxpayer should not have created an estimated payable for the bonuses.

The taxpayer demanded the situation to be resolved by the tax administrator claiming the costs (expenses) for bonuses incorrectly claimed in the previous period (as an estimated payable) and actually paid in the inspected taxable period as expenses in that period. In this regard, the court stated that it is not possible to correct a taxpayer's error by the tax administrator claiming costs (expenses) incorrectly claimed in the previous period in the inspected period. The only option was to file an additional tax return.

The taxpayer filed a cassation complaint against the regional court's decision with the Supreme Administrative Court, which was limited to the tax administrator's failure to 'transfer' the incorrectly claimed bonuses to the correct taxable period, to resolve the situation fairly. The SAC agreed with the regional court's conclusions: the only option was to file additional tax returns for both periods in question. However, this was no longer possible as the deadlines for assessing tax had already expired.

What should we take away from the above decisions?

When creating estimated payables, taxpayers should pay due attention to the conditions for their creation and have sufficient documentation available to support their recognition.

Interest on retained VAT deduction: SAC verdict closes another chapter

In its recent judgment, the Supreme Administrative Court (SAC) has ruled that the statutory rate of interest on retained VAT deductions for the 2017 to 2020 period was in line with EU law. This dashed the hopes of many taxpayers who following a series of favourable decisions in this area believed they would receive a rate equal to the CNB repo rate increased by 14 percentage points, not just two points, also for the period from 2017 to 2020.

Jana Fuksová
jfuksova@kpmg.cz

Martin Král
mmkral@kpmg.cz

History of interest on retained deduction

The rate of interest on a withheld tax deduction appeared in the Tax Procedure Code only in **2015**, after the Supreme Administrative Court (SAC) found in the Kordárna case (7 Aps 3/2013) that its absence was contrary to EU law. The SAC filled the legislative gap by awarding interest on refundable overpayment of **14% + CNB repo rate**.

The legislator responded to the threat of lawsuits and high costs for the state treasury by introducing interest to the Tax Procedure Code in 2015: however, not at the rate corresponding to the Kordárna judgment, but at **1% + the CNB repo rate**, i. e., lower by 13 percentage points. For taxpayers whose deductions the tax authorities were withholding, this was not sufficient. The assessment of this was yet again up to the Supreme Administrative Court, which held in the EP Energy Trading (1 Afs 445/2019-47) case that this regulation was not compatible with EU law: the new rate was too low to compensate the taxpayer for the costs they would have to incur for a loan to cover the loss of cash flow. Instead of that rate, the SAC again awarded the interest rate on the refundable overpayment at **14% + the CNB repo rate**.

In response to case law and numerous public comments, the legislators increased the interest rate to **2% + repo rate** as of **1 July 2017**. This rate remained in effect until **1 January 2021** when it was changed for the third time. Currently, the interest rate is set at one-half of the default interest rate, i.e., **half of 8% + the CNB repo rate**.

The last piece of the puzzle?

Many taxpayers did not consider the interest rate of 2% + CNB repo rate applied in the period from

1 July 2017 to the end of 2020 correct and took the tax administration to court. One of these disputes has recently appeared before the Supreme Administrative Court (No. 8 Afs 274/2022). The taxpayer claimed that the interest rate did not cover the costs they would have had to incur for a loan equal to the non-refunded VAT deduction The tax administrator disagreed with this view and, after losing before the Regional Court in Brno, turned to the SAC.

In the case under review, the SAC concluded that the interest rate corresponding to **2% + the CNB repo rate was sufficient** in the period between 2017 and 2020 to **cover the interest expense for a loan** the taxpayer would have to take out. The court compared interest rates on loans to non-financial entities with the statutory interest rate and

concluded that they did not differ significantly. The resulting rate followed the development of interest rates on loans, and was also close to the rates on overdrafts, revolving loans, and credit cards. The SAC also concluded that, although the difference between the original rate increased by 1% and the new rate increased by 2% may seem relatively small, the low CNB repo rate meant that the statutory interest rate in the period from January 2015 to June 2017 of 1.05% did not reach the level of interest rates on loans (then averaging 2-2.5%); on the contrary, the statutory interest rate of 2% + repo matched the interest rates on loans in the period from July 2017 to December 2020.

The SAC also compared the interest on the withheld deductions with other types of interest in the Tax Procedure Code. The SAC, nevertheless, concluded that other types of interest differed from the interest on a withheld deduction, primarily by their **penalty component**; in the end, the court did not find a similarity even with interest on deferred amount of tax, where the penalty component is insignificant, mainly because of their different objectives: while the aim of interest on (withheld) deduction is to compensate damage, there is no such intention of interest on deferred tax. Therefore, the SAC concluded that the **rate chosen by the legislators in 2017 was in order**.

SAC on determining reference price

In assessing transfer prices, the Supreme Administrative Court (SAC) emphasised that it is necessary to distinguish between a hypothetical estimate supported by logical and rational reasoning and economic experience on the one hand, and a hypothetical possibility to obtain the desired commodity (or service) for that reference price on the other.

Zdeněk Řehák
zrehak@kpmg.cz

David Kronovetr
dkronovetr@kpmg.cz

In the context of transfer pricing, tax administration considers advertising services to be a risky area and focuses on them in tax inspections. A case recently closed (8 Afs 189/2020-127) involved a taxpayer who rented advertising space at several football stadiums and a golf course in 2013 and 2014. The services were provided by three advertising agencies. The total amount of the supply by far exceeded the purchase prices that the advertising agencies had themselves contracted directly with the sports clubs.

In the tax administrator's opinion, the taxpayer was an (otherwise) related party to the advertising agencies and had entered into the relationship primarily for the purpose of reducing the tax base. The tax administrator supported this conclusion by arguing that they had ascertained a significant difference between the purchase price of advertising charged by the sports clubs, and the contractual price charged by the advertising agencies; the tax administrator therefore assessed additional tax on the difference between the reference price corresponding to the prices charged by the sports clubs and the price contracted with the advertising agencies.

The taxpayer defended themselves by arguing that they had no real chance to obtain the advertising space from the sports clubs because the clubs had long-term contracts with agencies. The price contracted with the agencies was thus, logically, up to several times higher than the price of renting the advertising space directly from the sports clubs. The taxpayer further argued that the advertising agencies also provided related services (VIP rooms, etc.). In the taxpayer's opinion, only the prices for the advertising space offered by the agencies should be regarded as comparable prices, not the rental prices charged by the sports clubs.

The Regional Court in Ostrava agreed with the taxpayer. In the court's opinion, the tax administrator did not prove that the taxpayer had a real and not just hypothetical possibility to contract the required advertising directly with the relevant club, as the advertising space had already been contracted by the agencies. The tax authority thus did not determine the transfer price correctly.

The Appellate Financial Directorate filed a cassation complaint against the judgment, arguing that the existence of a realistic possibility was irrelevant to the correct determination of the reference price, as it was essentially a price simulation.

The Supreme Administrative Court dismissed the cassation complaint, explaining that it was not possible to set such a reference price that the taxpayer could only achieve hypothetically, not actually, and that it was not possible to use a price 'out of nowhere'. A hypothetical estimate must be supported by logical and rational reasoning and by economic experience. Otherwise, there would only be a hypothetical market where the reference price would only be a 'hypothetical possibility' and would not fulfil a comparative function.

To conclude: the tax administrator should always assess whether the taxpayer could have actually obtained the

supply at the reference price.

Case law

Importance of detailed documentation for claiming R&D allowance

In its recent decision, the Supreme Administrative Court (SAC) confirmed that detailed and structured documentation is essential for successfully claiming R&D allowances. The absence of clear documentation may lead the tax authority to deny the allowance without further examining the material content of the project.

Barbora Halatová
bhalatova@kpmg.cz

Kateřina Horáčková
khorackova@kpmg.cz

The decision in question involved project documentation using sub-projects within a single project. As the documentation did not sufficiently define the method of project review and assessment, the tax authorities were unable to verify whether the project review and assessment had taken place and, if so, whether the records of the review could be used to support the right to claim an R&D allowance. The SAC confirmed that if the documentation does not meet the formal criteria, the tax authorities do not have to proceed to the assessment of the material content of the project and its benefit.

In this context, it should be emphasised that **the amendment to the Income Tax Act**, which will apply to tax inspections initiated after 1 January 2024, allows to prove the content of the project documentation by further means of evidence if the tax administrator has doubts. This, however, does not mean that the taxpayer can supplement an approved project documentation already submitted to the tax authority if it does not meet the essential requirements stipulated by law. The new legislation in fact only allows to supplement further evidence to the submitted documentation.

In light of the outcome of the dispute, taxpayers should continue to approach the preparation of project documentation with the utmost care and consistency. In their projects, they should focus on the clear definition of project objectives, and the methods of reviewing the projects and verifying their results. For efficient documentation, it is recommended to divide the project into logical parts, specify their sub-objectives including the parameters to be achieved, the manner of achieving them, the expected outputs, and how their achievement is to be verified. This not only increases transparency and control over the project, but also makes it easier to defend allowances in tax inspections.

Case law

SAC on definition of beneficial owner of royalties

In a recent judgment, the Supreme Administrative Court (SAC) confirmed the key criteria for determining a beneficial owner in the context of licensing agreements. The court indicated that a beneficial owner can be identified in the course of tax proceedings even if they are not the same as the person stated as the recipient of royalties in a licensing agreement.

Jan Kiss
jankiss@kpmg.cz

Jiři Škorpil
jskorpil@kpmg.cz

In the case under review (SAC 6 Afs 56/2023), the taxpayer paid royalties to distributors of television programmes who were part of its corporate group. The payments were then in full passed on to the programme producers. According to the tax administrator, the reduced rate under the double taxation treaty between the Czech Republic and the jurisdiction of the programmes' distributors should not have been applied, as the distributors were not the beneficial owners of the royalties. Instead, the taxpayer should have applied a withholding tax rate of 15%, as prescribed by Czech laws.

The case concerns the period before the adoption of important tax rulings by the Court of Justice of the EU (CJEU) and the amendment to the EU directive on the common system of taxation of interest and royalties which clarifies the beneficial owner definition. However, the SAC emphasised that even these later sources of law can be used as an interpretative aid to understand the beneficial owner concept correctly.

Recent case law defines the beneficial owner of royalties by the following characteristics:

- **Receipt of income into the sphere of disposition:** The beneficial owner must actually receive the income and have control over it.
- **Freedom to dispose of income:** The beneficial owner must be free to dispose of the income. This includes the right to control, use and enjoy it without being restricted by contractual or legal obligations to pass on the income to others.
- **Economic benefit:** The beneficial owner should benefit economically from the income, which means that they can benefit from the income without having to pass it on.

In the course of the proceedings, it became apparent that the beneficial owner had probably been the producer of the programmes, a resident of a state whose double taxation treaty is in fact even more favourable to the Czech Republic than the treaties of the distributors' states. However, the SAC confirmed that the tax administrator had not been obliged to take this into account (the look-through principle) without explicit evidence provided by the taxpayer. The court stressed that the burden of proof lies with the taxpayer, and they must prove that the royalty payments were passed on to a beneficial owner within the meaning of the international treaties.

This SAC decision therefore indicates that during tax proceedings, it is possible to determine the actual owner of the royalties even if they are not the same as the entity stated as the recipient of the royalties in the agreement. By this important step, the court confirmed that when assessing beneficial ownership, the broader context of the transactions and their economic implications must be considered, not just the formal data stated in the contracts.

SDEU: prepaid cards single-purpose vouchers for VAT purposes?

In its judgment, the Court of Justice of the European Union (CJEU) held that prepaid cards constitute single-purpose vouchers if the place of supply and the VAT due are known at the time of issue. The CJEU further concluded that transfers of multi-purpose vouchers may give rise to a tax liability.

Martin Krapinec
mkrapinec@kpmg.cz

Victorie Kubínová
vkubinova@kpmg.cz

M-GbR purchased prepaid cards ('X-Cards') that allowed users to top up their user accounts to purchase digital content from an online store. The X-Cards with the country code DE were intended exclusively for customers who were resident or habitually resident in Germany and had a German user account. The question was whether the vouchers in this case were single- or multi-purpose vouchers.

The CJEU emphasised that to qualify as a single-purpose voucher, two conditions have to be met cumulatively at the time of the vouchers' issuance: the place of supply of the goods or services to which the voucher relates must be known, as must the VAT due be. This applies regardless of whether the voucher is the subject of transfers between several taxable persons.

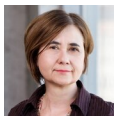
As to the first condition, the CJEU held that at the time of issuing the X-Cards, the place where the digital content was to be delivered to the end consumer was known, since the cards could only be used by customers residing in Germany and holding German user accounts. Thus, the place of supply was Germany.

If the digital content obtained through the X-Cards were subject to the same tax base rules and the same VAT rate in Germany, then the cards would also meet the second condition of a single-purpose voucher. However, if the digital content were subject to different rules for determining the tax base or different VAT rates in Germany, the qualification of the cards as a single-purpose voucher would not be possible.

As for multi-purpose vouchers, the CJEU then stated that their transfer is generally not subject to VAT. However, should the X-Cards qualify as multi-purpose vouchers, M-GbR may provide distribution or promotional services when reselling them, which themselves might be taxable. These services thus might be subject to VAT if provided to a taxable person who as a consideration for the vouchers provides digital content to the end consumers.

News in Brief, May 2024

Last month's tax and legal news in one or two sentences.



Lenka Fialková
lfialkova@kpmg.cz

Václav Baňka
vbanka@kpmg.cz

DOMESTIC NEWS

- An amendment to Act No. 383/2012 Coll., on conditions for trading greenhouse gas emission allowances, has been published in the Collection of Laws under No. 80/2024, effective from 9 April 2024.
- On 1 May 2024, the Non-Performing Loans Market Act (84/2024 Coll.), the decree implementing the act (86/2024 Coll.) and the accompanying act (85/2024 Coll.) came into force. These laws implement EU directives and aim to create a single EU market with a portfolio of bank loans classified as 'non-performing' (loans that have not been repaid for a certain period of time or whose repayment is at risk). The Non-Performing Loans Market Act contains the public-law regulation of the administration of non-performing loans that has so far been subject only to general civil-law regulation.
- The Ministry of Labour and Social Affairs has announced the average gross annual wage in the Czech Republic for 2023 for the purposes of issuing blue cards under Act No. 326/1999 Coll., on the residence of foreign nationals in the Czech Republic (Notice No. 98/2024 Coll.).
- An amendment to the Act on Certain Measures against the Legalisation of the Proceeds of Crime and the Financing of Terrorism and a decree to that effect have been published in the Collection of Laws (107 and 108/2024 Coll.)
- The government has approved a draft act on digital finance, which aims to implement EU regulations such as the Digital Operational Resilience Act (DORA) and the Markets in Crypto-Assets (MiCA) Regulation. The draft includes a modified categorisation of offences as well as the powers of the CNB, which will license crypto-asset service providers, supervise compliance with established obligations and address potential breaches.
- The Government has approved the pension reform proposal submitted by the Ministry of Labour and Social Affairs. The reform includes, e.g., linking the retirement age to life expectancy, as well as a number of other important changes.
- From 1 April 2024, social enterprises can again apply to the National Development Bank for an interest-free loan of up to CZK 25 million under the S-Enterprise Plus programme. The Ministry of Labour and Social Affairs has allocated a total of CZK 270 million for their support.
- The New Zealand market is opening up more to Czech companies thanks to the EU-New Zealand Free Trade Agreement, which entered into force on 1 May. In addition to the removal of all tariffs on EU imports, the agreement simplifies the provision of services, introduces equal treatment in public procurement tenders, and removes barriers to digital trade.
- Community energy sharing will be launched in the second half of this year. The details are set out in the Electricity Metering Decree, which has undergone an inter-departmental comment procedure. To be able to share electricity in energy communities, households and businesses must have flowmeters installed.
- On 30 April, the Ministry of Justice announced a public consultation on the preparation of a new Action Plan of the Czech Republic - Open Government Partnership for 2025 and 2026. The intention is to gather proposals that fulfil the principles of open government (transparency, accountability for one's actions and public involvement in decision-making processes, providing meaningful feedback). Proposals can be submitted in writing no later than 28 May 2024 or presented at a public workshop on 14 May 2024.

- In his opinion on the case of the Dutch taxpayer, the Advocate General has concluded that the tax deductibility of interest on loans between related parties can be challenged for the abuse of law even if the interest is at arm's length.
- The Advocate General has also dealt with a Swedish withholding tax on investments of Finnish public pension funds concluding that a restriction on the free movement of capital had been identified. The referring court has to verify (on the basis of the criteria set out in the Advocate General's opinion) whether a Finnish pension fund is objectively comparable to a Swedish public pension fund whose dividends are exempt from tax.
- The European Parliament had adopted its resolution on the proposal for a Council Directive on Transfer Pricing, which supports the Commission's original proposal but with some changes. The resolution does not recommend a dynamic reference to the current version of the OECD Transfer Pricing Guidelines. As a result, the directive retains the references to the 2022 OECD guidelines, with the Commission having the power to adopt amendments by means of Commission delegated acts. The resolution also proposes to re-launch the Joint Transfer Pricing Forum (JTPF) under the new name of the European Transfer Pricing Forum (ETPF), to be chaired by the European Commission, which should contribute to maintaining a uniform methodology across the EU. The European Parliament proposes an effective date as early as 2025, with member states having until 31 December 2024 to implement the regulation. However, the resolutions adopted by the European Parliament are only of a recommendatory nature for the Council.
- On 25 April 2024, the OECD/G20 Inclusive Framework on BEPS issued a Consolidated Commentary on the Global Rules Against Base Erosion under Pillar 2. This commentary incorporates the various documents approved since the original commentary issued on 14 March 2022 and integrates them into the consolidated commentary. At the same time, an updated document with illustrative examples, originally issued on 14 March 2022, has also been published

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