KPMG

Tax & Legal

Taxes
Tips and tricks
World news
Subsidies
Case law
In brief

September 2024

Editorial

This year's summer has witnessed a wave of interest-focused tax inspections. Tax authorities have been intensively questioning taxpayers to check the tax deductibility of certain expenses. In this issue, we cover in detail the experience gained from these inspections.

Another focus are the major changes brought by the new Accounting Act. Although its proposed effective date has been postponed to 1 January 2026, due to transitional provisions, some of the new rules will apply to the preceding accounting period, i.e., to accounting periods ending after 31 December 2024.

The changes will among other things affect the categorisation of entities, as the thresholds for assets and annual net turnover will increase for all categories. Another key topic is the new sustainability disclosure obligation (ESG reporting), which will apply not only to large corporations but eventually also to SMEs and companies operating outside the EU. Preparations to meet these demanding requirements must therefore start as soon as possible.

We are also seeing a slight postponement of the deadline for the e-invoicing digitisation project, as member states have not been able to resolve several burning issues. In this update, we mention the new dates expected for the introduction of e-invoicing for intra-community and domestic supplies.

During the summer, changes to personal income tax and insurance premiums also entered into force. We will discuss them at our upcoming seminars in Brno and České Budějovice. Please consider yourselves cordially invited.

Alena Hatalová
Director
KPMG Czech Republic

Taxes

What will amendment to Accounting Act bring?

The draft amendment to the Accounting Act approved by the government will change the categorisation of entities and introduce new obligations regarding sustainability reporting. During the comment procedure, the originally proposed effective date has been postponed to 1 January 2026. However, due to transitional provisions, some of the new rules will apply to preceding accounting periods.

Václav Baňka
vbanka@kpmg.cz

Ondřej Novák
ondrejnovak@kpmg.cz

Anna Vaníčková
avanickova@kpmg.cz

Change in categorisation of entities

Following Directive (EU) 2023/2775, the criteria for determining the category of an entity will be increased as follows:

- For a micro-entity, the threshold for assets has been increased from CZK 9 million to CZK 11 million, for annual turnover, from CZK 18 million to CZK 22 million. The criterion for the number of employees remains at 10.
- For a small entity, the threshold for assets has been increased from CZK 100 million to CZK 120 million, for annual turnover, from CZK 200 million to CZK 240 million. The criterion for the number of employees remains at 50.
- For a medium-sized entity, the threshold for asset has been increased from CZK 500 million to CZK 600 million, for annual turnover, from CZK 1 billion to CZK 1.2 billion. The criterion for the number of employees remains at 250.
- Thus, the thresholds for a large entity are CZK 600 million for assets, CZK 1.2 billion for annual turnover, and 250 for employees.

An entity belongs to a relevant category if it does not fit within the preceding categories and does not exceed at least two of the thresholds as at the balance sheet date. Public interest entities and selected entities are automatically categorised as large entities.

According to the transitional provisions, the new criteria for determining the size of entities should already apply to accounting periods ending after 31 December 2024 (even after the postponement of the proposed effective date, the current wording of the amendment indicates this date, which corresponds to the directive). Among other things, the amendment will influence an entity's obligation to have its financial statements audited as it automatically applies to large and medium-sized entities, while to other entities, it only applies if certain further conditions are met.

Sustainability reporting

Another significant change brought by the amendment is the gradual extension of the obligation to prepare a sustainability report. This obligation is based on Directive (EU) 2022/2464 of the European Parliament and of the Council and its extension is divided into several phases.

Companies that are already subject to the reporting obligation under the Non-Financial Reporting Directive (NFRD), i.e., all listed companies as well as large companies with more than 500 employees, will prepare their reporting for the financial year 2024 (in the annual report to be published in 2025). In 2026 (reporting for the financial year 2025), the obligation will be extended to all large companies that meet at least two of the following criteria:

- more than 250 employees
- turnover of at least EUR 50 million
- total assets of at least EUR 25 million.

In subsequent waves, the reporting obligation will also apply to small and medium-sized enterprises listed on the stock exchange and to companies outside the EU. Some Czech companies will be affected by the obligation indirectly if they are part of the value chain of companies that will be obliged to report.

In addition to extending the reporting obligation to more companies, the scope of information that companies will disclose about themselves and their value chain will be widened. Among other things, this information will be a mandatory part of the annual report and subject to a limited assurance review.

It is possible that the draft amendment will undergo further changes during the legislative process.

Government approves draft amendment to Act on Top-Up Taxes: 15 key changes

Among the most important changes are adjustments to the conditions and deadlines for filing top-up tax information returns and top-up tax returns, a simplification of the obligation to file top-up tax information returns, and adjustments aimed at incorporating rules contained in the OECD documents and achieving a qualified status for the Czech top-up tax. The amendment will enter into force on the day after its promulgation in the Collection of Laws but should already apply to taxable periods starting after 31 December 2023. The amendment will now be discussed by the parliament.

Ladislav Malůšek
lmalusek@kpmg.cz

Václav Baňka
vbanka@kpmg.cz

Iveta Košťálová
ikostalova@kpmg.cz

We already reported on the development of the amendment here and here. Below, we summarise 15 selected changes to the draft amendment that have been approved by the government:

1. Instead of a taxable period, a **reporting period** shall 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.
2. The amendment specifies which **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.
3. The definition of a **tax credit** has been clarified: it means a credit with a direct effect on the tax liability (a discount, bonus). Deductions from the tax base (allowances), accelerated depreciation charges, and similar items shall not be considered tax credits for the purposes of the top-up tax although they also reduce the effective tax rate. A refundable tax credit is one that is paid to the taxpayer in cash. If it is paid within four years of its origination, it is a qualified tax credit that shall not reduce the amount of tax for the purposes of calculating the effective tax rate and will be included in the calculation of qualifying gain or loss (essentially, it shall be treated as a subsidy whereby the tax credit shall be added to the tax payable and at the same time increase the qualifying gain). Other refundable and non-refundable tax credits shall reduce the effective tax rate.
4. Following the model rules, adjustments have been made to the **definition of decisions** (one-off, short-term, medium-term, and long-term) which shall only be made within the top-up tax information return and not in a separate filing.
5. **Currency conversion rules** have also been clarified. All calculations of top-up tax shall be made in the currency in which the accounting records are kept for the purposes of the consolidated financial statements (the reporting currency). To convert amounts determined in another currency to the reporting currency, the same method as in the preparation of the consolidated financial statements shall be used. Subsequently, for

the purposes of tax payment and administration, the amounts calculated in the reporting currency shall be converted into the Czech currency at the foreign exchange market rate announced by the Czech National Bank for the last day of the taxable period. Where the law stipulates a condition that is based on an amount expressed in euros, to assess (compliance with) that condition, the amounts in the reporting currency shall be converted to euros at the average exchange rate announced by the European Central Bank for the month of December preceding the reporting period.

6. A medium-term **decision on the inclusion of all profit shares** shall be introduced. If this option is used, qualifying profit or loss shall not be adjusted for excluded profit shares.
7. 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".
8. 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.
9. The amendment extensively regulates 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.
10. 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).
11. **Joint ventures** can now use all types of safe harbours.
12. The explanatory memorandum emphasises the finance ministry's priority to ensure the **qualified status of the Czech top-up tax** and thus let the Czech top-up tax meet the safe harbour rules. For this reason, the draft amendment:
    - extends the range of payers of Czech top-up tax to joint ventures and their affiliates (a joint venture group), stateless (not resident in any state) main entities whose activities are carried out in the Czech Republic provided that these activities can be taxed in the Czech Republic under the relevant international treaty, and tax transparent entities established under Czech law that are not resident in any state.
    - defines a sub-group as a set of entities for which the calculation of the effective tax rate and jurisdictional top-up tax is made separately from other taxpayers (i.e., not jointly within one jurisdiction).
    - removes the option to choose a different standard for Czech top-up tax purposes than the one used in the calculation of the allocated top-up tax; the rules on the use of the accounting standard will be based on the rules for the allocated top-up tax as per the model rules.
13. The **deadline for filing tax returns** for the allocated and Czech top-up tax has been unified to 22 months from the end of the reporting period (i.e., for the calendar year 2024, it will be 31 October 2026).
14. The **deadline for filing information returns** for the allocated and Czech top-up tax is 15 months from the end of the reporting period, 18 months in the case of the first-time period. The deadline for filing the information returns for the first-time period of calendar year 2024 is thus 30 June 2026.
15. A new option regarding the **information obligation** for the Czech top-up tax has been introduced: the obligation can be met by filing an information return on the allocated top-up tax if the return contains the essential information as required for the information return on the Czech top-up tax and if the taxpayer

Taxes

Government approves amendment to Tax Procedure Code and deletes problematic proposals

At the end of August, the government approved a comprehensive amendment concerning tax and customs administration, which also changes the related procedural rules in the Tax Procedure Code. Based on comments from the Chamber of Tax Advisors, the three most problematic changes were deleted. The amendment will now be discussed by the parliament.

Václav Baňka
vbanka@kpmg.cz

Pavlína Rampová
prampova@kpmg.cz

Richard Hajdučík
rhajducik@kpmg.cz

The amendment to the Tax Procedure Code, which we discussed here, intended to introduce some problematic changes (the fiction of being notified regarding certain electronic messages, changes to the taking of evidence, and an extended information obligation for legal and natural persons). As these changes would be unfavourable for taxable entities, the Ministry of Finance agreed to delete them from the bill during the comment procedure.

The amendment to the Tax Procedure Code is part of a partial reform of the customs administration. In addition to the changes related to this reform, the amendment contains several other changes that respond to practical developments in tax administration and related case law:

- changes to interest and penalties:
  - following recent case law, the possibility of anatocism (the charging of interest on interest) is ruled out as a general rule for all types of interest
  - the possibility for the tax administrator to waive penalties in full (currently a maximum of 75% of penalties can be waived individually)
  - mass waivers of tax and related penalties and interest or tax deferment will be implemented by a government notice based on a proposal of the Minister of Finance
- introduction of a possibility to file an appeal against the tax administrator's decision in proceedings on the taxable entity's objection
- clarification of the procedure when the Supreme Administrative Court reverses a decision of the regional court
- clarification of a procedure to cancel a tax registration, which is done through a notification of a change in registration data
- introduction of rules for the administration of a tax liability and the transfer of the tax liability upon the dissolution of a trust (the tax liability passes proportionally to the person who received the assets in connection with the dissolution of the trust)

- changes to service/delivery of documents to addresses abroad
- clarification of the structure of a tax submission through a prescribed form (difference between the content structure of the submission set out by the decree and the data structure of the submission set out and published by the tax administrator)
- changes to enforcement procedure under the Tax Procedure Code (subsidiary use of the Code of Civil Procedure, introduction of new concepts such as an additional bid exceeding the highest bid at an auction (předražek), a list of assets according to records, protected accounts, or seizure of virtual assets).

Most provisions of the amendment are proposed to come into force on **1 July 2025**, while some of them will not become effective earlier than **1 January 2026**. The government approval is only the first step in the legislative process, with the first reading in the chamber of deputies expected to take place in mid-September.

Inspections by tax authorities targeting interest

Summer usually brings rest and holidays, but for some taxpayers it can be a time of increased attention from the tax authorities. In recent weeks, the tax authorities have been actively contacting taxpayers to verify the tax deductibility of certain expenses.

Přemysl Klas
pklas@kpmg.cz

Lukáš Otýpka
lotypka@kpmg.cz

The tax authorities have recently been selecting taxpayers for their inspections based on analyses of their filed tax returns, financial statements, and summaries of related-party transactions for previous years. These analyses have enabled them to identify facts that may indicate potential inconsistencies in the recognition of claimed expenses. From our practice, we know that most enquiries are directed at verifying the tax deductibility of interest expenses.

Interest, i.e., financial expenses related to business activities, is generally treated as deductible for income tax purposes. However, there are certain limitations, and the thin capitalisation rule is one that the tax authorities often pay attention to. If a taxpayer incurs financial expenses on loans received from related parties, it is necessary to exclude as a non-deductible expense that part of the related financial expenses by which the aggregate of the loans from related parties in the taxable period exceeds four times the equity (six times in the case of banks and insurance companies), or the entire amount of financial expenses if the company reports negative equity.

Another case where it is necessary to treat financial expenses as non-deductible are the expenses of the parent company incurred to hold a share in a subsidiary. This includes interest on a loan received in the six months prior to the acquisition of the share in the subsidiary unless the taxpayer can demonstrate that the loan is unrelated to the holding of the share.

In the event of a tax inspection, the taxpayer should be able to provide the tax administrator with documentation (contracts, calculations of the non-deductible part of financial expenses, etc.) that confirms the correctness of the approach applied in their tax return. If the taxpayer is uncertain or has some specific questions, we recommend consulting a tax advisor to ensure that the tax authorities are not provided with incorrect or misleading information.

Finance ministry on future of windfall tax

The Czech Ministry of Finance reports that the state's extraordinary revenues from tax on windfall profits and levies on surplus revenues and wealth gains have not yet covered its extraordinary expenses related to the energy crisis. Although not explicitly stated, it is thus not to be expected that the ministry will propose an early termination of the windfall tax to the government. Under current legislation, this tax should apply to calendar years 2023, 2024, and 2025.

Tomáš Havel
thavel@kpmg.cz

Daniela Sommer
ddsommer@kpmg.cz

In its earlier statements, the finance ministry made its proposal of an early termination of the windfall tax conditional upon achieving a balance between the extraordinary expenses triggered by the energy crisis and the one-off tax revenues that were to finance them. However, an analysis summarised in its statement shows that the balance between extraordinary expenses incurred from 2022 onwards and the so far generated extraordinary revenues of the state will be negative as at the end of 2024 and amount to CZK 35 billion.

In this context, the ministry regards items incurred in the 2022-2024 period, totalling almost CZK 130 billion, as one-off extraordinary expenses. These include, e.g., support for enterprises in energy-intensive sectors, a cost-saving tariff (i.e., a subsidy for energy costs for households), temporary waiver of fees to support RES, and extraordinary compensation.

To cover these expenses only revenues from windfall tax and levies on surplus revenues and wealth gains can be used. These revenues are expected to amount to CZK 95 billion over the 2023-2024 period.

Therefore, the proposed state budget for the next calendar year will most likely still count on windfall tax revenues.

Tips and tricks

Provision of company car to employee

A common employee benefit is the possibility to use a company car for private purposes. How to provide this benefit correctly? What is the effect of the vehicle's emission parameters? How to proceed when a vehicle is provided exclusively for private use or was acquired by the employer under finance lease arrangements? How much additional income tax to pay when the employee contributes to the vehicle provided to them, and how to tax privately consumed fuel paid by the employer? Answers to all these questions can be found in our article.

Iva Krákorová
ikrakorova@kpmg.cz

Marie Smékalová
msmekalova@kpmg.cz

Provision of a vehicle for both business and private purposes

If an employee is provided a road motor vehicle (meaning also e.g., a motorbike) free of charge for both business and private use, their related taxable income is determined based on a specified percentage of the vehicle's entry??input price. This also means that no account is taken of the wear and tear or age of the vehicle. For the purposes of determining additional tax (on the employee's non-financial income), the entry price must include VAT, if any.

For a long time, the percentage to determine additional taxable income has been set uniformly at **1% of the entry price** of the vehicle per month. From 1 July 2022, the law added the option to determine the taxable income at only **0.5% of the entry price** when low emission vehicles are provided. 2024 then brought another change: for zero emission vehicles, the taxable income shall be **0.25% of the entry price** of the vehicle.

The limit of CZK 2 million for the tax depreciation of vehicles, introduced in January 2024, is irrelevant for determining the additional tax; the amount of the non-financial income should always be calculated on the full entry price of the vehicle.

The minimum amount of the employee's taxable income shall always be at least CZK 1,000 for each commenced month of providing the vehicle. In accordance with GFD Instruction D-59, it is not decisive for the origination of taxable income whether the employee actually used the vehicle for private purposes but that they had the possibility to do so.

If more than one vehicle is provided to an employee within one month consecutively, the taxable income shall be determined based on the vehicle with the highest entry price. However, if the employee can use more than one vehicle in a given month simultaneously, the taxable income for each vehicle provided must be included in the tax base.

Where employer and employee agree that the employee should pay a certain amount for the provision of a vehicle, the taxable income shall be determined as the difference between the employee's payment and the income determined based on the percentage of the vehicle's entry price.

Low and zero emission vehicles

A low emission vehicle is defined by the Act on the Promotion of Low Emission Vehicles through Public

Procurement and Public Services in Passenger Transport (No. 360/2022 Coll.). Until 31 December 2025, these vehicles (in categories M1, M2 and N1) are defined as vehicles not exceeding a CO2 emission limit of 50 g/km and 80% of the emission limits for air pollutants in real operation. Compliance with the limits can be assessed based on the vehicle's Certificate of Conformity. Information on CO2 emissions can be found in the vehicle's large technical certificate, under Emissions, item V.7 CO2 [g/km] (after the abolition of large technical certificates, some data are only recorded electronically). From 2026 until the end of 2030, only de facto zero emission vehicles will be regarded as low emission vehicles in these categories.
Zero emission vehicles are those with zero CO2 emissions.

Company vehicles for private use

A different taxation regime must be applied if the employee is provided with a vehicle solely for private use. In such a situation, the employee's income will be the price determined in accordance with the Property Valuation Act: i.e., the usual price at which the employee would have rented the car, or the price that the employer would have charged other persons for providing the car.

Vehicles acquired by the employer under finance lease arrangements

A common situation is that the employer acquires the vehicles they provide to employees under a finance lease. For the purposes of determining the additional income tax, it is necessary to take as a basis the entry price of the vehicle at the original owner – the leasing company, even if the vehicle is subsequently purchased.

Fuel for private travel

Fuel consumed for employees' private travel must also be considered for taxation purposes. If all fuel, i.e., also fuel used during private travel, is paid for by the employer, it also constitutes the employee's taxable income, pro rata to their business and private travel, based on the vehicle's fuel consumption and the respective fuel price (again, including VAT).

VAT perspective on e-invoicing in EU

The digitisation of the tax agenda and the related introduction of electronic invoicing (in the form of e-invoicing) is becoming increasingly relevant. During its EU presidency, Belgium pushed forward negotiations with other member states and managed to reach partial agreement over the summer.

Veronika Výborná
vvyborna@kpmg.cz

Lukáš Arazim
larazim@kpmg.cz

ViDA Directive

The digitisation reform is covered by the VAT in the Digital Age (ViDA) Directive, which focuses on three main areas:

- digital reporting and e-invoicing
- platform economy
- single registration and extension of the One-Stop-Shop scheme.

This is already the third draft of the ViDA Directive. For the first and third areas of the reform, there is agreement among all member states on the main idea. The second area, i.e., the platform economy and the introduction of the deemed provider concept, was vetoed by Estonia during the June debate, holding that the draft directive as it stands would infringe on the neutrality of VAT and adversely affect smaller traders who operate below the threshold for mandatory VAT registration. It therefore looks like we will get to see a fourth version of the draft.

E-invoicing

For e-invoicing, the most pressing issues remain to be resolved, regarding the proposed EN 16931 standard according to which the entire e-invoicing system should be set up. At the same time, member states have agreed to further postpone the whole digitisation project. We should join e-invoicing for intra-community transactions in **July 2030** at the earliest. Domestic transactions would then be covered by e-invoicing under EU standards no earlier than from **2035**.

Under the current Hungarian presidency of the EU, we cannot count on faster developments in tax digitisation. At the same time, there are ongoing negotiations between member states on the content of individual areas covered by the ViDA Directive.

Overview of current and expected subsidy programmes

In our overview, we focus on selected programmes and calls under the Operational Programme Technology and Applications for Competitiveness, as well as on calls under the Modernisation Fund and programmes of the Technology Agency of the Czech Republic.

Silvie Beranová
sberanova@kpmg.cz

Lukáš Otýpka
lotypka@kpmg.cz

Currently open subsidy programmes

Call title	Supported activities	Funds for allocation	Acceptance of applications – closing date
High Speed Internet – Call I	Deployment of public broadband electronic communications networks	CZK 4 billion	31/10/2024
ENERG ETS No. 1/2024	Modernisation of sources, technologies, and equipment in industry in the EU ETS	CZK 15 billion	15/11/2024
Renewable Energy Sources – Small Hydropower Plants – Call I	Construction and modernisation of small hydropower plants	CZK 0.5 billion	13/12/2024
Renewable Energy Sources – Biomethane Injection – Call I	Treatment of biogas into biomethane and its filling or injecting into distribution network	CZK 1 billion	13/12/2024
Sustainable Water Management – Call I	Water saving measures and water use optimisation in business	CZK 1.2 billion	27/12/2024
RES+ No. 1/2024	Installation of new PV plants with an installed capacity of 10 kWp to 5 MWp	CZK 3 billion	31/12/2024
Digital Enterprise – Digital Enterprise – Call I*	Digital transformation of the enterprise	CZK 1 billion	31/03/2025
Renewable Energy Sources – Wind Power Plants – Call II	Construction of wind power plants	CZK 3 billion	31/10/2025

Call title	Supported activities	Funds for allocation	Acceptance of applications – closing date
Energy Savings – Call II	Reduction of energy consumption in business real property and energy savings in enterprises	CZK 5 billion	31/10/2025

** The call is only open to small and medium-sized enterprises.*

Planned subsidy programmes

Call title	Supported activities	Planned funds for allocation	Acceptance of applications – planned opening date
Infrastructure Services – Call II	Expansion and construction of innovation infrastructure facilities	CZK 1 billion	4Q/2024
Potential – Call II*	Establishment or development of industrial research, development and innovation centres	CZK 1 billion	11/2024
Applications – Call II**	Industrial research and experimental development with a special focus on SW	CZK 1 billion	4Q/2024
Applications – Call II**	Industrial research and experimental development	CZK 3 billion	4Q/2024
Renewable Energy Sources – Biomass – Call I	Energy production from biomass	CZK 0,5 billion	09/01/2025
Sustainable Water Management – Call II	Water saving measures and water use optimisation in business	To be specified	1Q/2025
TRANSPORT 2030 – Call III	Applied research and innovation in transport	To be specified	04-06/2025

** In the last call under the Potential programme, only SMEs, small companies with mid-market capitalisation, and mid-cap companies were eligible to apply for support.*
*** Large enterprises that are not small companies with mid-market capitalisation or mid-cap companies can only apply for support on the condition that the project is implemented in effective cooperation with an SME.*

Taxpayers entitled to interest on interest

The possibility of charging interest on outstanding interest in tax disputes was subject to several conditions formulated mainly in the Supreme Administrative Court's judgment in the ERAMENT Trading case. However, the recent Constitutional Court's judgement No. III. ÚS 3082/23 has brought a jurisprudential turnaround. The judgement challenges the recent decision-making practice of the Supreme Administrative Court and supports the conclusions of its previous case law, which were favourable for taxpayers. Thanks to the Constitutional Court's judgement, the Supreme Administrative Court changed its approach to interest on late interest and opened the way for taxpayers to obtain compensation for the tax administrator's delay.

Martin Král
mmkral@kpmg.cz

Richard Hajdučík
rhajducik@kpmg.cz

The issue of interest on interest has undergone considerable development. Significant in this respect was a 2017 judgment (No. 2 Afs 148/2017) in which the Supreme Administrative Court (SAC) admitted that in the event of late payment of interest, second interest shall separate ("crystallise") and form a separate principal which the tax authorities are obliged to credit to the taxpayer's tax account. However, by a subsequent judgement, the SAC limited this possibility to cases where the tax administrator had acted unlawfully from the outset (No. 9 Afs 52/2021). This followed from the analogous application of the Civil Code allowing the charging of interest on interest arising from unlawful conduct. Thus, according to the SAC, secondary interest could not possibly arise in a lawful examination of VAT deductions.

In its judgement, the Constitutional Court dealt with a situation where a taxpayer was awarded interest on interest, but only for the part of the delay after 2014. The tax administrator refused to award any interest on late payment interest arising before 1 January 2014 because the Civil Code was not yet in force then. This was subsequently confirmed by the administrative courts to which the taxpayer turned.

The Constitutional Court did not agree with these conclusions. The Constitutional Court compared the individual arguments of the SAC's judgments and concluded that the SAC had not sufficiently dealt with the objection of the original idea of "crystallised interest", which did not require any analogy with the Civil Code. The Constitutional Court also referred to the earlier conclusions of the SAC according to which charging interest on interest vis-à-vis taxpayers is not prohibited by the Tax Procedure Code, which further weakens the argumentation by the prohibition of interest-on-interest principle. Finally, the Constitutional Court also rejected the SAC's view that the taxpayer should have claimed the interest from the state via an action for damage compensations. On these grounds, the Constitutional Court vacated the judgments in the taxpayer's case.

The good news is that the Supreme Administrative Court quickly familiarised itself with the Constitutional Court's opinion and changed its decision-making practice accordingly. This is confirmed by recent judgments in our clients' cases, where the SAC disagreed with the reasoning of the tax administrator who had based the rejection of the interest on interest on the prohibition of interest-on-interest principle and on the SAC's earlier case law. Thanks to these judgements, the tax administration has now confirmed that they will change their practice and will award interest on interest to taxpayers in similar cases. Please note, however, that the draft amendment to the Tax Procedure Code approved by the government, reported on here, will likely exclude the possibility of interest on

interest in the future.

Case law

Time factor and standard of proof in tax inspection

In its recent judgment, the Supreme Administrative Court (SAC) dealt with the issue of proving the right to deduct VAT on supplies of assembly work and the amount of evidence that the tax administrator may require considering the time elapsed between the supply and the subsequent tax inspection. The court held that the time factor should be taken into account by the tax administrator.

Veronika Výborná
vvyborna@kpmg.cz

Zuzana Černá
zcerna@kpmg.cz

A company engaged in the production of building accessories (steel stairs and railings) supplied its products to German customers. The company carried out the production using its own employees, but occasionally, for larger orders, also used an external supplier. The supplier's employees then carried out the work at the company's production facilities. Within a tax inspection initiated in June 2017, the tax administrator assessed additional VAT on the taxable supplies (assembly work) received from this supplier for tax years 2015 and 2016, on the grounds that the company failed to prove that they had received the assembly work in the declared scope and at the declared price.

The company **provided a range of evidence to** prove the delivery of the assembly work, including documentary evidence (e.g. tax documents/invoices, purchase orders, contracts for work, handover protocols, underlying documents for billing that contained the link between the work carried out and the company's specific orders, lease agreements) and witness evidence (testimony of a company employee on the presence of the supplier's employees on the company's premises and on the performance of the assembly work).

In its own investigation, the tax administration verified, *inter alia*, that the transactions had been declared in the supplier's VAT ledger statements, that VAT had been paid on the transactions in due and timely manner, that the payments had been made to the published bank accounts, that the turnover had been reported by the supplier in the financial statements filed in the collection of deed of the commercial register, and that the supplier had been registered in the register of employers. Nevertheless, **the tax administrator found the evidence** submitted by the company **insufficient** and considered it to be merely formal and not proving the actual scope and object of the supplies.

Court: excessive evidence cannot be required

In its judgment, the court admitted some of the tax administrator's doubts regarding the supplies as justified (e.g., non-standard price arrangements between the company and the supplier, the supplier and its subcontractors not being fully available during the tax inspection, etc.). Nevertheless, the court considered the documents, together with the company's explanations, sufficient for the tax proceedings.

Both the SAC and the Constitutional Court had previously ruled that requiring an excessive standard of proof to establish a certain fact may violate the fundamental rights of a party to the proceedings. No past facts can subsequently be proved with absolute certainty and there will always remain a question of some degree of probability. The tax authorities therefore cannot require the taxpayer to meet a standard of proof that would render it virtually impossible to bear the burden of proof.

Implications of the verdict for practice

In our view, the judgment may, at least to some extent, **help with proving facts in tax proceedings initiated with a time delay,** and may be relevant, e.g., when proving marketing or intra-group services. According to the SAC, the tax administration should set a reasonable level of certainty for proof based on which it would be possible to draw certain conclusion from the evidence beyond serious doubt. In this respect, it is also necessary to consider the time elapsed since the occurrence of the facts being proved.

Although the conclusions of the judgment are favourable for taxpayers, we would still recommend archiving as much relevant and non-contradictory evidence as possible during the course of a particular transaction.

Case law

Proving costs of light advertising

The Supreme Administrative Court (SAC) dealt with the tax deductibility of costs incurred for advertising that broadcast a video spot on a LED screen. The tax administrator had doubts about the spot's broadcasting frequency and assessed the costs as non-deductible for income tax purposes. The tax administrator then assessed additional corporate income tax plus a penalty. The SAC upheld this conclusion.

Tomáš Krenický
tkrenicky@kpmg.cz

Magdaléna Lukášová
mlukasova@kpmg.cz

In the 2015/2016 taxable period, a taxpayer claimed significant costs for advertising in the form of video spots played on a LED screen in Brno's city centre. During a tax inspection, the tax administrator raised doubts as to the extent of the supply: according to the tax administrator, the information in individual advertising contracts concluded between the company and the advertising supplier and the information in the subsequently presented playlists contradicted each other. According to the contracts, the spot was to be broadcast twice an hour and at least 26 times a day. The playlists indicated a lower frequency of two to three times in three-hour intervals, with a total of 19 times a day.

The company argued that the condition of two playbacks per hour in itself satisfied the requirement for at least 26 playbacks per day. They also corrected the information given in the playlists: the spot was to be played two or three times within one hour, not in three-hour intervals, although this was not clear from the playlist description. As evidence, the company produced photographs of the relevant LED screen and related metadata images. There were also witness testimonies.

Request to allow essential expenses also denied

The tax administrator held that the entity did not dissipate its doubts and thus assessed the total amount of the advertising as not tax-deductible. The tax administrator also did not accept the company's request to allow at least its essential expenses, i.e., the portion of advertising costs that had been proven.

In agreement with the regional court, the SAC confirmed that the ambiguity of the contractual arrangement may have caused the tax administrator's doubts, although one of the conditions (two playbacks per hour) may have automatically met the other condition (at least 26 playbacks per day). In the SAC's opinion, it was not clear why the second condition should even be a part of the contract. The SAC referred to earlier contracts between the company and the supplier, which provided for the same frequency of two playbacks per hour and at least 48 playbacks per day. The SAC also found inconsistencies in the submitted playlists, which contained different information on the number of times the advertisement was to be broadcast and made them not sufficiently credible.

According to the SAC, evidence in the form of photographs of the LED screen and images of metadata could not be considered capable of proving the frequency of broadcasting an advertising spot, as they only proved that the advertisement was broadcast, which was not disputed in this case. For these reasons, the SAC dismissed the cassation complaint. The SAC also disallowed the company's essential expenses, since the conditions for the assessment of tax using auxiliary mechanisms had not been met, which is a prerequisite for allowing the deduction of essential expenses.

Case law

SAC on claiming R&D allowance

In its recent judgment, the Supreme Administrative Court (SAC) has addressed whether to allow claimed research and development (R&D) allowances. In the relevant case, the tax administrator disallowed these costs on the grounds that the basic requirements for the project had not been met, the main reason being that the taxpayer failed to bear the burden of proof as to carrying out the R&D project themselves.

Michaela Thelenová
mthelenova@kpmg.cz

Jana Barotová
jbarotova@kpmg.cz

A company claimed an R&D allowance in its 2013 and 2014 tax returns, primarily relating to the development of a central information system. The tax administrator challenged the company's compliance with the statutory requirements for deducting these costs.

Why did the tax administrator disallow the costs?

The company carried out an R&D project partly through their own activities. According to the tax administrator, the company was unable to support how the supplies received from a supplier differed from the activities that were to be carried out by the company's own employees. In fact, the supplier's obligation was formulated in the contract for work similarly as the subject matter of the company's R&D project. Other areas of dispute were, e.g., project evaluation and review, where the company had no documentary evidence (minutes from meetings), and the duty to keep separate records of personal costs for R&D projects, whereby according to the tax administrator the formal requirements for an R&D project were not met.

What did the company argue?

According to the company, the subject matter of the contract with the supplier did not exclude its own R&D activities, and it had been the company who had developed the individual algorithms and functionalities, while the supplier was only to set up and implement them. The company also argued that the development activity was confirmed by an expert opinion. According to the company's representatives, project evaluations took place on a weekly basis at internal meetings, while them being only oral did not mean they did not happen.

Why did the SAC dismiss the cassation complaint?

The SAC upheld the tax administrator's view and dismissed the company's cassation complaint on the grounds that it could not sufficiently prove its involvement in the development activity. The submitted contract between the company and the supplier did not make it possible to distinguish between the parties' supplies, nor was it possible to make an assessment based on the summary records of costs, which, although they listed the names of the employees and their time worked, did not contain any description of the activities. It was therefore impossible to ascertain from them what exactly the company's employees had worked on within the R&D, or, in fact, whether it was R&D-related work at all.

To the contrary, some of the presented minutes of meetings between the company and the supplier indicated that

the company was merely making requests to the supplier regarding the information system being developed, while no development activities by the company were apparent from the minutes. The SAC also stated that the company's own development activity could not have been supported by an expert opinion, since according to sources referred to in the expert opinion, the experts did not have any underlying information to assess this.

In addition, according to the SAC, the company was unable to sufficiently prove that internal evaluation meetings had been held (not even after questioning the company's CFO and the expert), and therefore, the method of project evaluation and review as set in the project documentation had not been complied with.

Recommendations

The judgment shows the importance of thorough documentation in the event of a company's own engagement in R&D projects. At the same time, it is necessary to ensure that other requirements are met, such as the impeccable preparation of project documentation, the implementation of the evaluation and review methods chosen and described, and the proper and detailed keeping of separate records of costs for each project.

Case law

Preliminary question for CJEU: is minimum technical equipment overhead cost?

The Supreme Administrative Court (SAC) referred to the Court of Justice of the EU (CJEU) the preliminary question whether the minimum technical equipment (in this case, defibrillators purchased by a hospital) can be considered general (overhead) costs directly related to the economic activity of the hospital.

Veronika Výborná
vvyborna@kpmg.cz

Petra Němcová
pnemcova@kpmg.cz

Katarína Sedláčková
ksedlackova@kpmg.cz

Within its economic activity, a Czech hospital provided mainly medical services which do not give rise to the right to deduct VAT. The hospital also provided other services giving rise to the right to deduct VAT (e.g., clinical studies of the effects of drugs, accommodation of patient escorts, extra services for hospitalised patients, doctors' internships, administrative tasks, sterilisation of instruments for third parties, etc.). To be able to provide these services, hospitals must hold a licence for the provision of health services. The prerequisite for obtaining the licence is compliance with the minimum technical requirements laid down in the Ministry of Health's Decree No. 92/2012 Coll. These technical requirements also include defibrillators, which the hospital purchased and on whose purchase they wanted to deduct VAT in a reduced amount: in the context of the above, the hospital considered them to be overhead costs.

Proof of direct link to economic activity

However, the Czech tax administrator disagreed with this interpretation and rejected the hospital's (reduced) entitlement to VAT deduction on the purchased defibrillators, as they did not see a sufficiently direct link between the purchase of the defibrillators and the taxable activity (with the right to deduct VAT). The hospital lodged a cassation complaint with the Supreme Administrative Court.

The SAC referred to the previous CJEU case law which stated that the right to deduct VAT may be granted even in the absence of a direct and immediate link between a particular input supply and the output supply giving rise to the right to deduct VAT, provided that the costs of the services in question are part of the general costs and contribute to the price of the goods or services. Such costs have a direct and immediate link to the overall economic activity.

On the other hand, as an argument in favour of the financial administration's conclusions, the SAC stated that the aim of the ministry's decree is clearly to guarantee the availability of health services (i.e. not all services provided by a healthcare facility) at a certain quality. The hospital confirmed that it did not purchase the defibrillators to provide services with entitlement to VAT deduction (e.g., clinical trials), but to use them for services without the entitlement to VAT deduction (i.e., regular medical services). The link between the purchase of the defibrillators

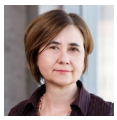
and services with the right to deduct VAT was therefore unclear.

The SAC thus referred to the CJEU the preliminary question whether the minimum technical and material equipment of healthcare facilities, a precondition for the provision of healthcare services, can be regarded as general (overhead) cost directly and immediately related to the overall economic activity of the hospital (thus giving rise to a reduced VAT deduction entitlement) and whether in this case there is a sufficient link between the costs incurred and the economic activity of the hospital.

Once the CJEU answers the preliminary questions, we will address the topic in a future issue of the Tax and Legal Update.

News in Brief, September 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

- Decree No. 250/2024 Coll. on the percentage share of individual municipalities in the national gross revenue from value added tax and income tax with effect from 1 September 2024 has been published in the Collection of Laws.
- In the Collection of Laws, the Ministry of Finance has announced the forecast of the average gross monthly nominal wage in the national economy for 2025 (No. 251/2024).
- A list of contracting states applying the common reporting standard and decisive days and a list for the purpose of fulfilling the information obligation under Act No. 164/2013 Coll., on International Cooperation, have been published in Financial Bulletin No. 6/2024.
- In August, the government approved the National Action Plan for Clean Mobility (NAP CM). The strategic document focuses on the development of infrastructure for alternative fuels, the modernisation of the road transport fleet, and the decarbonisation of transport. The targets and plans set are broken down into milestones for 2025, 2030, and 2035.
- The government has approved a bill on the digital economy, preparing the Czech Republic for the adoption of the EU's Digital Services Act and Digital Governance Act, which regulate the digital space in the EU, protect public debate from censorship, and introduce new rules to protect users from illegal content, among other things.
- The senate has referred back to the chamber of deputies an amendment to Act No. 253/2008 Coll., on certain measures against the legalisation of crime proceeds and the financing of terrorism and certain other regulations, with amending proposals.

The government has approved the following bills now pending discussion in the chamber of deputies:

- A bill amending Act No. 563/1991 Coll., on Accounting, Act No. 93/2009 Coll., on Auditors, and Act No. 416/2023 Coll., on Top-Up Taxes. More detailed information in this respect can be found in this issue of Tax and Legal Update.
- A bill amending certain laws concerning tax administration and the competence of the Customs Administration of the Czech Republic. More detailed information in this respect can be found in this issue of Tax and Legal Update.
- An amendment to the Labour Code whose main objective is to increase the flexibility of employment relations.
- An amendment to Act No. 164/2013 Coll., on International Cooperation in Tax Administration. The proposal mainly regulates the implementation of the EU directive on the reporting obligation with respect to crypto-assets (DAC 8).
- A comprehensive amendment to Act No. 150/2002 Coll., the Code of Civil Procedure, which aims to respond to the requirements of application practice after 20 years of the act's effectiveness.
- A new bill on the residence of foreign nationals.
- The Ministry of Finance has submitted a bill on the EU's Carbon Border Adjustment Mechanism (CBAM) for

comments. The bill mainly regulates the division of competences defined by the EU's CBAM Regulation between the customs authorities and the Ministry of Finance.
- The government has approved a business package containing 22 measures aimed to reduce bureaucracy.

FOREIGN NEWS

- From October 2024, there will be a change in the allocation of preliminary rulings. Until now, the Court of Justice of the European Union itself has decided all cases. However, this will change, and the EU General Court will now rule on special areas such as the common VAT system, excise duties, the customs code and the tariff classification of goods in the combined nomenclature, and the trading system with greenhouse gas emission allowances.
- For more information, please see the summary of changes in direct taxes in the EU and internationally prepared by KPMG's EU Tax Center, including updates on Pillar 2 legislative developments (Austria, Cyprus, UK, Turkey).

LinkedIn | Twitter | Facebook | Instagram

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