KPMG

Tax & Legal

Taxes
Legal
World news
Case law
In brief

November 2017

Editorial

The recent parliamentary elections ended with an unclear outcome that certainly will affect the ease with which new legislation will be passed. Political parties had many plans in the tax area, yet, finding a consensus to put them through, even just partially, will be hard.

The Czech Republic is nevertheless also bound by its commitments ensuing from passed EU legislation. During 2018, we should be transposing a directive that translates into national legislations some conclusions of the OECD initiative known as BEPS. Of these, the new rules limiting the deductibility of interest, which should replace the thin capitalisation rules for non-financial entities by 2019, will have the biggest effect. The question remains whether it will be possible to complete the entire legislative process before the end of 2018.

We are also due for the ratification of a multilateral convention, yet another outcome of the BEPS initiative. Through its passing, changes will be implemented to all double tax treaties. The multilateral convention most importantly adds to the double tax treaties a new rule to counter treaty abuse contrary to the economic substance of business transactions.

In this respect, please also note that other outcomes of the BEPS initiative have come to life as a result of an amendment to the OECD Transfer Pricing Guideline and an amendment to the Commentary on the OECD Model Tax Convention – i.e. without any need to reflect them directly in the legislation.

Also, changes will come our way not only from new or amended regulations. Case law has to be watched as well, sometimes bringing new perspectives on established approaches. Thus, even without the tax revisions arising from political parties' platforms, the changes ahead will be plentiful.

Pavel Rochowanski
Partner
KPMG Czech Republic

GFD guideline on research and development

Case law of the Czech Supreme Administrative Court confirms that a flawless research and development project represents a necessary precondition for claiming a research and development deduction in a tax return. The General Financial Directorate (GFD) issued information that summarises all court decisions in this respect in one document. Any deviation from the legal requirements described in the document may result in a higher risk of dispute.

Michaela Thelenová
mthelenova@kpmg.cz

Hana Greiff
hcurikova@kpmg.cz

To some extent and with a degree of exaggeration, the GFD's information can be regarded a sort of cookbook containing research and development recipes for taxpayers. The question is, however, whether the recipes include all ingredients prescribed by law.

First, according to the GFD, a research and development project must be prepared and approved before any actual research and development activities commence. Prior to commencement, a company's basic identification data must be consistent with the company's As-Is state. The project must be put down in writing and include comprehensive and compact information specifically prepared for the purpose of the project to be subsequently carried out by the taxpayer. The GFD's information further emphasises that it is not the tax administrator's duty to actively unify a number of documents to help fulfil all the project documentation's legal requirements.

Another essential element of any research and development project is the definition of project objectives. According to the GFD, the project must specify the substance of research and development activities and should describe the current situation at a company (As-Is state) and relating limits and deficiencies, which helps provide reasons why the situation should change. The result of the new (To-Be) state can be an entirely new and unique solution. On the other hand, the GFD admits that the result itself may be in its substance similar to a solution already known and used but the To-Be state achieved through research and development activities must significantly differ from the As-Is state.

The GFD also puts emphasis on maintaining documentation and records of project solution procedures on a continuous basis, among other things for their future review and assessment. When maintaining this type of evidence, taxpayers should focus on the evaluation of the set goals. To keep supporting documentation may only be recommended, although the law itself does not directly stipulate such a duty.

Finally, the GFD indicates that if the taxpayer fails to meet all legal requirements applicable to the research and development project, the tax administrator may not accept the research and development deduction. Obviously, the tax administrator is most likely to pay attention especially to the formal aspects of research and development projects. We therefore recommend paying increased attention to the description of performed activities. Should you be interested, we will review your documentation on the claimed deduction and assess whether the financial administration would, in our opinion, find it sufficient.

Are you renting out on Airbnb? Then you are liable to tax, says financial administration

Accommodation providers using internet portals such as Airbnb should be on their guard. The General Financial Directorate's Information published in October 2017 draws attention to tax obligations in this area, covering income taxes, value added tax and electronic reporting of sales.

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

Barbora Havlíková
bhavlikova@kpmg.cz

In its information, the financial administration notes that, according to the VAT case law of the Court of Justice of the EU, activities carried out by lodging providers via internet platforms such as Airbnb are to be treated as accommodation services rather than a lease.

From a personal income tax perspective, it is crucial whether the provision of lodging fulfils all the criteria of a business activity (i.e. a gainful activity carried out independently, on one's own account and responsibility, in the form of a trade or in a similar manner, with the intention to do so consistently for profit). If so, income from accommodation is subject to personal income tax as income from an independent gainful activity. If lodging providers do not claim expenses in their actual amount, they may claim expenses as a fixed percentage - 60% or 40% - of income, depending on whether they hold a trade licence.

If accommodation services are provided by legal entities, they must report income from accommodation services in their corporate income tax returns, as the income from all activities and the disposal of all assets is liable to this tax.

In terms of VAT, according to the GFD, the provision of accommodation services is the performance of economic activities and a person who provides such services is a person liable to VAT. Such supplies are thus included in the calculation of the turnover decisive for mandatory VAT registration. If the lodging provider is already a VAT payer, the provided accommodation services represent taxable supplies that must be reported in VAT returns. Lodging providers must also take into account services that they receive from entities operating the internet portal (e.g., Airbnb). If such an entity is not resident in the Czech Republic and provides electronic services, such as service fees for the internet portal use, the lodging provider must declare and pay VAT on this type of supply. If the lodging provider is not yet a VAT payer and receives electronic services from an entity not residing in the Czech Republic, the lodging provider must register as a person identified for VAT.

Lodging providers should not also forget their duties associated with the electronic reporting of sales. If providers receive payments in cash, by credit card or in any other similar way, they must report them pursuant to the Act on Electronic Reporting of Sales. Although the GFD' s information does not mention social and health insurance, the financial administration's interpretation also affects statutory contributions to the social security and health insurance schemes.

The information primarily targets shared services provided via internet portals such as Airbnb. Owing to the considerable variability of situations that may arise in real life when using items of real property, we are sure that

it will not be an easy task to apply the information on specific cases in practice. It is therefore quite possible that the GFD's information will have to be amended in future.

VAT: Do you know you should have known?

In their data boxes, selected VAT payers have recently received a notice whose purpose at first sight is not entirely clear. In the Notice on Taking Adequate Measures the tax administrator lists recommended preventive measures.

Petra Němcová
pnemcova@kpmg.cz

Veronika Výborná
vvyborna@kpmg.cz

Taxpayers already have gotten used to receiving frequent notices from tax administrators requesting them to change, add or confirm data in connection with VAT ledger statements. Now the notices seem to have taken on yet another form and purpose: thanks to VAT ledger statements and the declared data, tax administrators now have gained perfect knowledge of individual taxpayers' transactions; and, obviously, are able to identify potential risks of VAT fraud even before the VAT payers themselves can.

At least this is what the notice implies. In the notice, the tax administrator may for instance inform you that they have taken notice of your transaction with a supplier engaged in the provision of labour, regardless of the form or manner of the legal relationship. The tax administrator is of the opinion that entering into transactions with entities carrying our business in this field may lead to involvement in VAT fraud, namely where the entity does not sufficiently collaborate with the tax administrator or proceeds in a non-standard manner.

In this regard, the notice contains a list of non-standard aspects that while not usually illegal themselves may in aggregate indicate that the transaction is affected by VAT fraud. Notably, this is the first time ever that the tax administrator has officially released clues that may give taxpayers some idea on how tax administrators assess risky transactions.

Furthermore, the tax administrator calls upon you to take all relevant preventative measures to avoid the risk of liability for unpaid tax. The taxable supply recipient is liable for tax unpaid by the supplier, among other reasons, in cases where they knew or should have known that the tax would intentionally not be paid by the supplier. According to the tax administrator, simply receiving the notice means that you knew or could and should have known of the risk. This indicates that the tax administrator is changing their strategy and building a position for a possible tax dispute.

An option here is securing the tax by the supply recipient, as mentioned in the notice. This means that the supply recipient would pay the tax directly to the tax authority's account, not to the supplier's bank account. In such a case, we suggest concluding a written agreement with the supplier to this effect.

We cannot but recommend that should you receive the notice, consider securing the tax along with implementing the relevant preventative measures.

PSD2: Amendment to payment services regulations

An amendment to the Act on Payment Services, implementing PSD2, the Second Payment Services Directive, into the Czech legal system, was passed a few days ago. The amendment introduces important changes in the area of online payments.

Iva Baranová
kpmg@kpmg.cz

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

Directive No. 2015/2366/EU, on payment services in the internal market, known under its abbreviation of PSD2, introduces a number of changes designed to enhance payment security. Internet payments will require secure customer authentication combining at least two of the following: access data; a code sent via SMS or generated via token – these methods are already being used relatively frequently – and biometrical data such as fingerprints or face recognition. A new account information service has also been introduced. This service will enable clients obtain information about all their payment accounts using a single application. The cardholder's liability for unauthorised transactions resulting from the loss, theft or misappropriation of a payment card will be reduced from EUR 150 to EUR 50. Surcharging for card payments will be prohibited. The blocking of funds on payment accounts, typically used for making hotel reservations or car rentals, will also be regulated in a stricter manner.

Another change PSD2 introduces is the banks' duty to inform clients about any changes to concluded contracts (including, for example, general terms of business or pricelists) not only via their internet banking application but also via email. This also ensues from the Court of Justice of the EU's January judgment, according to which the delivery of a new wording of a contract into a client's internet banking page does not suffice, as customers do not consider internet banking a regular communication channel and do not expect to receive such information in this manner. Consequently, it is necessary to use other, more appropriate channels to communicate such matters.

EU member states must implement PSD2 into their legal frameworks by 13 January 2018. A draft amendment to the Act on Payment Services has been in the chamber of deputies since spring. However, deputies refused to vote on the amendment in the first reading and passed a motion to amend it, changing it in such a way that the draft amendment no longer prescribed the above duty. The senate had to make an uneasy decision: pass the proposed law in its far-from-ideal wording or return it back to the chamber, which, however, would not have the time to discuss it before the end of the electoral term and the Czech Republic would thus miss the transposition deadline.

The amended payment services legislation must be interpreted in conformity with EU regulations, i.e. the transposed EU directive, and the Court of Justice of the EU's case law. Banks should therefore adhere to the stricter interpretation, and the clients' rights should not be affected. It is highly regrettable that whereas the majority of banks have already begun quite intensive and thorough preparations for these legislative changes, the legislator adopted an imperfect regulation only at the very last minute.

Quiet revolution in dividend payment?

With the effective date of the Corporations Act four years ago, a new chapter of corporate law started to be written. While some old concepts have explicitly been abandoned by the new law, some changes are only appearing gradually, as the interpretation of individual provisions of the act becomes clear. Over the last year, the interpretation of the act that companies are no longer bound by the six-month time limit to decide on dividend payment has been intensively discussed.

Irena Kolárová
ikolarova@kpmg.cz
+420 222 123 724

David Flutka
kpmg@kpmg.cz

For nearly ten years, Czech companies have accepted the time limit for using financial statements as a basis for decision on dividend payments as a reality. If the general meeting of a company wants to pay a dividend, this may be done based on an ordinary, extraordinary or interim financial statements, while the financial statements must not be older than six months. Notably, the rule was never stipulated directly by law – in 2009, it was deduced by the Supreme Court in a judgement rejecting a decision on dividend payment that a general meeting adopted ten months after the date of the last financial statements and based on these financial statements (that had been previously duly approved by the general meeting within the statutory six-month time limit). The reason for this judicial law-making was the Supreme Court panel's idea that more than half a year after their preparation, financial statements cannot give a true view of the company's financial position and therefore cannot serve as basis for such an important decision as dividend payments.

At the time, the decision was viewed as rather controversial: both academic and practicing experts criticised it as they felt that its main argument did not stand the test of logic: in some companies, things may change extremely quickly, making even week-old financials obsolete, while in others, the development is slower, meaning that year-old financials may still give a fair view. Setting a flat six-month limit thus does not make much sense.

The authors of the Corporations Act that in 2014 replaced the Commercial Code, instilled in it, among other things, a philosophy of not binding companies' statutory bodies with rigid one-size-fits-all rules. On the other hand, this loosening of rules is compensated by more responsibility on the part of statutory bodies, with the possibility of the executives' disqualification or punitive liability. A crucial element is the insolvency test: a statutory body's duty to make a qualified judgement whether a decision they are to make would expose the company to the risk of insolvency. This rule is to protect the shareholders/members and, in particular, creditors. Over the last year, the opinion that this duty sufficiently serves the purpose of the six-month time limit applied to dividend payment under the old legislation (which, in fact did not work very well anyway) has been frequently voiced in professional training sessions and in literature. Under the new legislation, even if the general meeting decides to pay dividends, the statutory body simply cannot pay it if it would mean breaching this duty.

This opinion is now cautiously being presented by experts from around the Supreme Court, the institution that coined the original rule in the first place. It seems that companies have finally freed themselves of these needless chains and may happily decide on dividend payment based on older financial statements if their statutory bodies have carried out the insolvency test as appropriate. This opinion has already been voiced in many respected commentaries – it is therefore just a matter of time until it finds its place in the Supreme Court's case law.

A big amendment to Labour Code is out of game

Already in February 2016, the Ministry of Labour presented its draft amendment to the Labour Code, aiming to significantly change this fundamental labour law. The deputies, however, did not manage to discuss the draft before the term end. As much as this points to legislators' inefficiency, it is actually good news for employers: despite proclamations, the amendment would have mostly made the labour-law regulation stricter. As the changes have been much discussed in the media, we include a summary of what employers do not have to get ready for (at least not yet).

Iva Baranová
kpmg@kpmg.cz

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

A flagship of the amendment was a new manner of calculating vacation. Instead of a week, an hour was to become the basic unit. The purpose of the change was to eliminate unjust effects of the current system on employees working in shifts of uneven length. The amendment, however, would have forced the recalculations also on employers whose employees work in even shifts; also, many employers who distribute their employees' working hours unevenly had already been recalculating their vacations per hour, even without the statutory regulation. The biggest effect of the amendment would thus have been extra cost and administrative burden for employers.

The stricter regulation of agreements on work performed outside employment was included as a concession to trade unions: a guaranteed wage, not just the minimum wage, would have applied to workers working under "agreements"; the regulation of working hours for these workers was also to be tightened – employers were to provide them with breaks in the same scope as applicable to employees, with the duty to keep records of hours worked accordingly. Another change that would have made the agreements to perform work less flexible was the shortening of the compensatory period for the calculation of average working hours.

The Labour Code will also not be enriched by a new category of employees – top managers. These were supposed to distribute their working hours themselves, in a scope of up to 48 hours a week. The practical use of this provision, however, would have been hampered by strict definition criteria for this new group. The regulation of home office will not change yet either. This means that the employers may continue to set the conditions of work from home flexibly, as need be, and not worry about their new duty: to prevent the social isolation of their home-office staff.

Employers will also no longer have to worry about supporting the rather hard-to-grasp duty to prevent employee stress, prevent the risk of violence and harassment at the workplace, or to keep the same job for an employee returning from both maternity and parental leave.

The Labour Code has been in effect for less than 11 years and has changed more than sixty times during this time. Employers may thus be assured that the new chamber of deputies will have a new batch of amendments ready for them in due time.

When to expect definitive VAT system for EU?

A long-awaited draft amendment to the VAT Directive, intended to specify the outlines of the definitive VAT system for intra-EU supplies of goods, was published by the European Commission on 4 October 2017.

Aleš Krempa
kpmg@kpmg.cz

Petra Němcová
pnemcova@kpmg.cz

The fact that the current VAT system for intra-community supplies of goods is temporary and requires radical changes has been generally known for a long time. The draft amendment was finally published: what news does it bring? While breathlessly expecting details of a new concept of the intra-community supply of goods, we are instead provided with only the basic pillars of the definitive VAT system. The draft deals with issues, further discussed below, that are largely connected with the definitive system. According to the draft amendment, EU member states should implement appropriate provisions into their legislations with effect from 1 January 2019.

The first issue the draft amendment elaborates on is the certified taxable person status. A new uniform system of attestation should be introduced, allowing for a particular business entity to be globally regarded a reliable taxpayer. The certified taxable person status can be compared with the authorised economic operator status known from the customs area. The criteria for obtaining both statuses will be similar. The certified taxable person status is associated with a number of VAT advantages and seems to be one of the preconditions for the smooth operation of business activities on a multinational basis.

The second issue put forth is the simplification of call-off or consignment stock scheme, which involves the delivery of goods via a warehouse to customers - determined in advance - in another member state. The simplification measures should only apply to certified taxable persons in all member states.

A novelty in the draft amendment, but nothing new for Czech VAT legislation is the application of a VAT exemption on intra-community supplies only by recipients registered for VAT and the supplier's duty to check the recipient's VAT identification number via the VIES system. The draft also responds to member states' request for clear rules for determining the supply within a chain of transactions to which intra-community transport should be ascribed and determines the principles along which this should happen.

Finally, the draft proposal for the definitive VAT system confirms the *destination principle*, i.e. the taxation of an intra-community supply at its destination. The fact whether the supplier and the recipient are certified taxable persons will also be crucial. Taxation will be performed via the *One-Stop-Shop* (similar to the Mini-One-Stop-Shop, MOSS) when tax is collected in one member state and subsequently distributed to relevant member states. The legislative draft of the definitive VAT system should be prepared during the course of 2018.

Pressure to verify the reliability of business entities operating on a multinational basis and obtain the certified taxable person status will be substantial. It is necessary to get ready. The draft amendment is a significant step towards setting the definitive system but the road ahead of us is long.

ECOFIN meeting: Taxation of digital economy and definitive VAT system

The main tax issues discussed at the Economic and Financial Affairs Council's October meeting were the taxation of the digital economy and the implementation of a definitive VAT system. The ECOFIN approved a draft directive implementing a new system for the resolution of double taxation disputes within the EU.

Luděk Vacík
kpmg@kpmg.cz

Klára Nesvadbová
kpmg@kpmg.cz

At the meeting, the European Commission presented its communication on the taxation of businesses operating in the digital economy. The communication primarily provides short-term solutions, such as an equalisation tax on the turnover of digitalised companies, a withholding tax on digital transactions and a levy on revenues generated from the provision of digital services or advertising. The taxation of the digital economy intends to primarily target companies that do business in new ways, such as Facebook, Amazon or Netflix. Eventually, the objective will be to select the most appropriate taxation method to be applied to these companies on a global basis in the long-term.

In the area of VAT, the European Commission presented its proposal to implement a definitive VAT system, aimed to reform and replace the current VAT system in effect in the EU since 1993. The new system should ensure the same tax treatment of both cross-border and domestic supplies of goods and services, thus fulfilling the Commission's goal to reduce tax evasion and VAT fraud.

The ECOFIN approved a draft directive implementing a new system of resolving disputes arising from the interpretation of double tax treaties within the EU. The dispute resolution mechanism should be mandatory and binding, with clear time limits and an obligation to achieve results. The tax administrations of the states concerned should resolve a dispute within two years. If the time limit is exceeded, the dispute will be taken to an arbitration court where it will be resolved by an independent arbitration panel. The directive should ensure higher certainty in resolving double taxation disputes. The EU member states should implement this directive into their legal frameworks by 30 June 2019.

Case law

SAC: Tax administrator's authority to register taxpayers for VAT subject to time limit

In its decision 10 Afs 329/2016-55, the Supreme Administrative Court (SAC) confirmed that the tax administrator's authority to register persons liable to tax as VAT payers by virtue of office is not time-unlimited, similarly as any other intervention of the state into the private sphere.

Veronika Výborná
vvyborna@kpmg.cz

Martin Krapinec
mkrapinec@kpmg.cz

In December 2009, a taxpayer in a singular instance exceeded the turnover decisive for mandatory registration for VAT and, in compliance with legislation effective at that time, had to file an application for VAT payer registration by 15 January. The taxpayer did not exceed the turnover threshold again in the following years. As the taxpayer did not register for VAT, on 18 December 2013 the tax administrator ex officio registered the taxpayer as a VAT payer retroactively from 1 January 2013.

The taxpayer did not agree with the tax administrator's course of action and claimed that the tax administrator had decided on the ex officio VAT registration more than three years after the statutory deadline for filing a VAT registration application. The tax administrator rebutted that the right to register a taxpayer for VAT by virtue of office was in principle not subject to any time limit.

But the SAC found the tax administrator's opinion to be unacceptable, unconstitutional and leading to absurd implications. Although the taxpayer undoubtedly had turned into a VAT payer by operation of law, the tax administration's interventions in taxpayers' tax rights and obligations must be time-limited. The SAC held that if the tax administrator fails to rectify an unlawful situation in time and within the statutory deadlines, no negative implications for the taxpayer should be deduced from the violation of the duty to register for VAT.

According to the SAC, the tax administrator's authority to register a business entity as a VAT payer is time-restricted under Section 20 (2) of the Tax Procedure Rules. This time limit is very closely connected with the deadline for assessing tax. Only within this period must the taxpayer bear the tax administrator's procedures and other acts. Hence, the start of the time limit is crucial in this respect.

The SAC concluded that if the deadline for VAT registration expires, the taxpayer must be considered a person that has never been a VAT payer. The deadline for assessing tax is understood to be not just the period during which taxpayers may be subject to additional tax duties but also the only period during which the tax administrator may seek the fulfilment of the registration duty.

Case law

CJEU: Leases with option to purchase considered delivery of goods?

There are various forms of leases from a tax perspective. For VAT, the crucial question is whether, after the end of the lease term, the ownership title to a leased asset is automatically transferred from the lessor to the lessee. If this is the case, such a lease is considered the delivery of goods and thus subject to VAT on a one-off basis upon delivery. If not, it is regarded as a service. For leases with the option to purchase where the transfer of the title to a leased asset is only one of a number of options, VAT is paid on each individual lease instalment. In the Court of Justice of the EU's opinion, the existence of a mere option to buy does not suffice. Other criteria must be met to treat a lease as the provision of services.

Ladislav Malůšek
lmalusek@kpmg.cz

Jana Fuksová
jfuksova@kpmg.cz

The CJEU evaluated various options of how the British representation of Mercedes Benz had been providing cars. On a general level, the court at first confirmed the existing treatment. If a lease contract contains a provision on the transfer of the title to a leased asset and, simultaneously, in the normal course of events, the title to a leased asset is automatically transferred at the end of the lease term, such a lease is regarded as the delivery of goods at the date of delivery. If the transfer of the title is not automatic and is only one of the options provided to lessees, the transaction must be treated as the provision of services.

But, according to the CJEU, there is more to evaluate: contracts containing an option to purchase a leased asset must also be treated as finance lease agreements (meaning the delivery of goods) if it can be inferred from the financial terms of the contract that exercising the option appears to be the only economically rational choice that the lessee will be able to make at the appropriate time if the contract is performed for its full term. In other words, the CJEU believes that:

- f lease instalments paid during the course of an operating lease correspond to the market value of a leased asset and
- if a customer does not have to pay a significant amount for using the option to purchase a leased asset,

the lease agreement shall be treated as the delivery of goods and not the provision of services at the time the leased asset is delivered.

Before amendments to the VAT Act harmonising Czech regulations with the EU directive came in to effect, under the Czech VAT Act, a lease contract had to explicitly specify the lessee's *obligation* to acquire the respective goods if the lease contract was to be treated as a delivery of goods. Currently, it is sufficient to agree in the lease contract that the ownership title to a leased asset will be transferred to be able to treat such a lease as the delivery of goods.

The potential impact of the CJEU's decision in the Mercedes Benz case will therefore have to be considered on an individual basis, taking into account the specifics of the products at issue.

SAC: Tax deductibility of expenses requires providing evidence about real supplier

In its two recent decisions, the Supreme Administrative Court (SAC) again concluded that legal entities claiming tax deductible expenses must document and prove circumstances under which these expenses were incurred, as well as provide information about the person of the supplier.

Veronika Červenková
kpmg@kpmg.cz

Karolína Tomsová
ktomsova@kpmg.cz

In the case in question, a corporation claimed cost of goods delivered as deductible for income tax purposes. The tax authority asked the taxpayer to specify for whom the invoice for the purchased goods had been issued, who had ensured the transport and loading of goods, where the goods had been stored, with whom the taxpayer had agreed on these transactions and how these transactions had been paid. Even though it was indisputable that the goods had been delivered and accepted, it was unclear who had delivered the material.

The SAC drew attention to its previous rulings, according to which, on one hand, formal deficiencies of accounting documents may not on their own affect the possibility to claim deductibility of expenses but, on the other hand, in such cases it is necessary to prove the real circumstances of a transaction by other means. According to the SAC, the fact that the declared supply had indisputably been delivered does not suffice, as the taxpayer must also prove that tax deductible expenses were incurred in relation to a specific person. If entities partaking in a specific transaction are not clearly identifiable, such expenses may not be treated as deductible for income tax purposes.

The SAC believes that such a requirement is fully consistent with the logic of income tax: expenses that are claimed as deductible by one taxpayer represent another taxpayer's taxable income. It is therefore in the financial administration's interest to determine all persons involved in a transaction.

For income tax purposes, it is therefore not entirely necessary to prove that a supply was delivered by the entity stated in accounting documents but it is essential to determine who the real provider of the received supply was to be able to treat related expenses as tax deductible.

Re-invoicing excluding VAT? Only when no ancillary supply is involved

The Supreme Administrative Court (SAC) recently agreed with the tax administrator that the re-invoicing of accident insurance is a supply ancillary to the lease of a motor vehicle and, consequently, should be liable to the same VAT regime as the principal supply. This relatively surprising decision significantly reduces the applicability of Section 36 (11) of the VAT Act, despite the financial administration's information that is still in effect.

Martin Šandera
kpmg@kpmg.cz

Martina Valachová
mvalachova@kpmg.cz
+420 222 124 370

In this particular case (2 Afs 345/2016 – 34), the taxpayer operated as the lessor of racing cars and, simultaneously, provided accident insurance for these cars. The insurance was always re-invoiced to customers in compliance with contractual terms and conditions. Whereas the lessor invoiced payments for the lease of cars as taxable supplies including VAT, the lessor did not apply any VAT on the re-invoiced accident insurance, claiming to proceed pursuant to Section 36 (11) of the VAT Act and related Ministry of Finance's Information Ref. No. 18/86 193/2008.

The SAC dealt in detail with the question whether the re-invoicing of accident insurance may be regarded as a separate supply or whether it is part of a principal supply (the lease of cars) that must be liable to VAT. According to the SAC, the re-invoiced accident insurance does not represent a separate service, as it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied.

The court's decision significantly restricts the practical applicability of Section 36 (11) of the VAT Act. Despite the fact that the Ministry of Finance's information largely justifying the taxpayer's approach is still available on the financial administration's website, the SAC dismissed it out of hand, claiming that the methodology described in the information cannot be applied in this particular case. Consequently, Section 36 (11) of the VAT Act is only applicable where the re-invoiced supply does not have the nature of an ancillary supply.

The SAC's decision will substantially affect a large group of taxpayers, not only lessors. We therefore recommend carefully evaluating individual re-invoiced supplies for their potential link to other provided supplies.

Case law

Proving inter-company services and determining transfer prices

Almost all multinational groups of companies ensure part of their activities on a central basis and re-invoice shared services to group companies. This often involves significant amounts. It is therefore not surprising that tax administrators have started to pay increased attention to this area and are evaluating the adequacy of invoiced amounts.

Václav Baňka
vbanka@kpmg.cz

Zdeněk Řehák
zrehak@kpmg.cz

In its recent decisions (10Af 5/2016, 50Af 11/2017), the Regional Court in České Budějovice dealt with the issue of inter-company services and in both cases ruled against the taxpayers.

In the first case, the taxpayer was to prove the price for which respective services had been provided. The taxpayer had submitted various items of evidence commonly available in multinational groups, such as e-mails, training presentations and action plans for production implementation, documenting the continuity and nature of the provided services. However, the tax administrator did not accept any of these as evidence supporting the extent and the price of the provided services. The tax administrator found it especially inadequate that the taxpayer only provided aggregate numbers without specifying (based on the hours spent on individual activities) a fee charged for a particular service and the proportion of this fee in the total invoiced amount.

The Regional Court also agreed with the tax administrator's rejection of some other pieces of evidence submitted by the taxpayer, such as witness statements, claiming that these would not bring any new information to determine the price. After analysing discrepancies in documents submitted by the taxpayer, the tax administrator concluded that the taxpayer had prepared transfer pricing calculations retroactively during the evidence proceedings. The court agreed with these conclusions. The submitted means of proof were also refused for the fact that it took the taxpayer more than two years to provide evidence, repeatedly asking for the extension of the time limit. In addition, relevant contracts had been concluded as late as during the provision of the services.

The Regional Court did not challenge the performance of services but their price and agreed with the tax administrator that the taxpayer had not sufficiently proven the invoiced fee. The court also approved the tax administrator's decision to assess the price using whatever information and materials available, in this case the Amadeus database, based on which the usual percentage of management services in the total turnover was determined. This led to the exclusion of a substantial portion of the invoiced amount from deductible expenses.

In the second case, the taxpayer was not able to prove the provision of services at all, which led the tax administrator to exclude the entire invoiced amount from deductible expenses. The court held, inter alia, that the mere submission of flawless documents and written contracts does not suffice to prove that services have really been delivered. The taxpayer did not submit any concrete piece of evidence other than a concluded contract to reliably prove that the supply claimed had really been delivered (i.e. the date the services were rendered, the scope of these services and the fee charged).

In both cases, the regional court decided in the first instance, so it is highly likely that the court's judgments will be

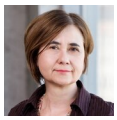
subject to cassation complaints filed with the Supreme Administrative Court.

We recommend paying increased attention to the preparation of adequate documentation on inter-company services provided during the year. The documentation should mainly reflect the substance of provided services and include details on how transfer prices were determined.

In brief

Latest news - November 2017

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



Lenka Fialková
lfialkova@kpmg.cz

- Notice of the Ministry of Labour and Social Affairs No. 349/2017 Coll., prescribing the reduction limits to adjust daily assessment bases for sickness insurance in 2018, has been published in the Collection of Laws.
- Notice No. 346/2017 Coll., on the binding template for the confirmation of a jobseeker's temporary inability to fulfil a jobseeker's obligations owing to sickness or accident and on a binding template for the confirmation of the jobseeker's medical treatment at a health facility, has been published.
- Government Decree No. 343/2017 Coll. prescribes the following: the general assessment base for 2016, conversion rates to adjust the general assessment base for 2016, reduction limits to determine the calculation base for 2018, basic retirement pension amounts for 2018 and pension increases in 2018. The data specified in the decree affect not only the amount of retirement pensions granted from 1 January 2018 but also the maximum assessment base for mandatory contributions to the social security scheme. The average wage set for 2018 is CZK 29 979 and the maximum assessment base for contributions to the social security scheme for 2018 is CZK 1 438 992. The respective data will also affect the minimum amount of social security and health insurance prepayments paid by self-employed persons as well as the monthly income giving rise to participation in sickness insurance.
- An amendment to the Act on Employment, covering the employment of persons with disabilities, mediation of employment by the labour office and requalification, was published in the Collection of Laws under no. 327/2017.
- The financial administration draws attention to new prescribed forms for income tax on employment for the 2018 taxable period.
- The financial administration published a Notice for the Payers of Tax on Income from Employment Relating to the Employees' Payroll Tax Statements, in which it draws attention to the fact that under new regulations employees will also be allowed to submit and sign their payroll tax statements (to claim tax credits) electronically.
- The president signed amendments to laws associated with the adoption of the Act on Payment Services, one of which is an amendment to the VAT Act, setting requirements for the content of VAT ledger statements.
- In compliance with an amendment to the budget rules, signed by the president, the Administrative Procedure Rules will be applied when providing subsidies and refundable financial assistance from the state budget.
- Under an amendment to the Anti-Discrimination Act, signed by the president, the Public Defender of Rights Office will monitor whether foreign nationals from the EU countries are not discriminated against in the

Czech Republic owing to their foreign nationality.

LinkedIn | Twitter | Facebook | Instagram

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