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Editorial

Amendments to legislation, and not just the tax ones, are a never ending story – what are we in for this time?

First, there is the evergreen of the electronic reporting of sales: following the recent Constitutional Court judgment, the Ministry of Finance has prepared an amendment setting a single date, 1 March 2019, for the launch of the third and fourth phase. The same date has been proposed as the effective date of transferring catering services and sales of draught beer to the lower, 10% VAT rate.

Next March, it will be two years since the United Kingdom announced that it was leaving the European Union. If no agreement is reached by then, Britain will become a third country vis-a-vis the EU and its individual member states. This will have an effect on customs duties and VAT, as well as on direct taxes – it will probably no longer be possible to apply withholding tax exemptions on dividends, royalties and interest.

And one more look into the future: next spring, a new system of investment incentives is to be launched. The legislative proposal is now going through internal comments.

Finally, please note that the duty to prepare the TP attachment to the corporate income tax return now also applies to financial institutions.

I wish you a pleasant read and may summer come soon.

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More changes to ERS and VAT rates?

The Ministry of Finance released for external comments a draft amendment to the Act on Electronic Reporting of Sales and the VAT Act. The proposed effective date is 1 January 2019, excepting the provisions concerning the launch of the last phases of ERS and the amendment to the VAT Act.

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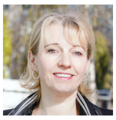

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Act on Electronic Reporting of Sales

The Ministry of Finance is mainly responding to the Constitutional Court judgement which has excluded payments by debit or credit cards from the electronic reporting of sales (ERS). However, the rationale of the judgment does not indicate that the Constitutional Court also meant to abolish the reporting of similar payments; this means that while payments by credit or debit cards shall no longer be subject to electronic reporting, payments by electronic purses, chip cards, coupons, vouchers or similar instruments will remain subject to reporting.

Another change ensuing from the Constitutional Court judgement is the unification of the start of the third and fourth phase of ERS. Businesses falling under these two phases shall start electronic reporting of sales from the third month after the effective date of the proposed amendment. According to estimates, the last phases of ERS will thus be launched on 1 March 2019.

The amendment also extends the range of sales that shall not be subject to electronic reporting. Generally these are sales whose reporting has proved unfeasible or unsubstantiated, such as sales of telecommunication and other services effected through a public mobile network by charging against credit on a prepaid card. Sales from gambling, air transport or sales generated by severely visually impaired persons are also to be excluded.

Another area affected by the amendment is the business activity of 'small entrepreneurs' with a maximum of one employee. For these individuals who are non-VAT payers and whose sales subject to reporting did not exceed CZK 200 000 in the last 12 calendar months and who did not effect more than 1 000 sales transactions (and do not expect any of these figures to increase in the upcoming 12 months), the proposed amendment introduces off-line reporting in paper form.

Czech entities generating sales abroad as well as at home will perhaps welcome the proposal to limit reporting solely to sales effected in the territory of the Czech Republic. Finally but importantly, the amendment to a certain extent clarifies indirect representation and reinstates the duty to state one's tax ID No. on issued payment receipts, provided that it does not contain the individual's birth number.

VAT Act

The ministry has proposed transferring selected services and goods to the second reduced VAT rate (10%). These include catering services, except for the sales of tobacco products and alcoholic beverages (though draught beer is proposed to be transferred to the 10% rate). Specific crafts and professional services, water and sewerage fees and cut flowers should also be subject to the lower tax rate. The effective date of the proposed amendment to the VAT Act is linked to the launch of the last phase of ERS.

Changes in investment incentives

Investors will most likely have to deal with a new system of investment incentives from spring 2019, as significant amendments to legislation regulating investment incentives are under way.

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According to a proposal currently undergoing internal comment procedure, the new rules should respond to economic developments and give support mainly to projects with higher added value. In practice, this means that many corporations that would be granted investment incentives under the current criteria will not be able to apply for them in the future. On the other hand, the biggest obstacle to high-tech projects in manufacturing receiving support, i.e. the condition of having to create and maintain at least twenty new jobs, should disappear.

The specific criteria and parameters of granting investment incentives will surely be discussed during the approval process. Part of the parameters will be regulated by a government decree rather than a law. The government will thus be able to flexibly respond to the state of the Czech economy and potentially adjust parameters as appropriate.

Taxes

Extended information duty towards tax administrators currently in the Senate

In early spring, the Chamber of Deputies approved an amendment to the Tax Procedure Code, expanding the information duty towards tax administrators from financial institutions to attorneys and tax advisors. A draft amendment and motions to amend the draft filed by some deputies arouse a strong response especially from professional chambers. Some motions were approved. The amendment is yet to be discussed in the Senate and signed by the president.

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The amendment to the Tax Procedure Code not only implements the EU Directive on Administrative Cooperation in the Field of Taxation (DAC 5), ensuring access to data ascertained under the AML Act, but also expands the information duty of banks. The original version of the draft amendment from January underwent a number of changes. The tax administrators should not eventually have access to information on internet banking and other remote-access services and their utilisation. They should also not be able to receive information about the equipment used for these services. According to the new regulations, the tax administrators will have access to information about the following: authorised persons; persons who have deposited funds in an account; payment recipients; and established safe deposit boxes.

According to the new information duty of liable persons pursuant to the Act on Some Measures against the Legalisation of Proceeds from Criminal Activity and the Financing of Terrorism (the AML Act), the tax authority may ask various entities for any information they obtained while identifying and checking clients in compliance with this act. This also involves all written documentation and information on how these data were collected.

For certain professions such as attorneys, notaries, tax advisors, auditors and bailiffs, the original draft limited the new information duty only to ensuring international cooperation in the administration of taxes. A motion to amend the original draft submitted during its second reading, requiring to expand the information duty to the domestic administration of taxes involving tax evasion cases exceeding half a million Czech crowns, received wide media coverage. The Czech Bar Association in particular criticised this motion, claiming that it would interfere with attorney-client confidentiality and thus would likely be unconstitutional. In the end, this controversial amending motion was not approved.

The proposed information duty of selected professions will thus remain restricted to international cooperation in the administration of taxes. However, certain changes in this area were approved nonetheless. In accordance with the approved proposal, only the General Financial Directorate will communicate with the above professions on an exclusive basis. A new temporary provision has also been adopted, according to which the information duty of attorneys, notaries, tax advisors, auditors and bailiffs will be restricted to information and documentation obtained only after the effective date of the amendment. In contrast, the tax administrators will be allowed to investigate on a retrospective basis in financial institutions.

Brexit: customs and indirect taxes if Great Britain turns into a third country

The two-year deadline that started on the date Great Britain announced its intention to exit the EU will expire on 29 March 2019. If Britain and the EU do not agree on a specific transitory period by then, any and all primary and secondary EU laws will cease to be effective in Britain on 30 March 2019, turning Britain into a third country for the EU and its member states.

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Considering the latest developments, it seems that Great Britain and the EU will agree on a transitory period that will run until the end of 2020. However, according to the EU representatives, until all has been settled, nothing is certain.

For this reason, the European Commission has issued a large number of announcements drawing corporate sphere’s attention to the implications that may arise when Britain becomes a third country. One announcement refers to customs and indirect taxes.

In customs, the following would apply:

- importation and exportation of goods subject to customs supervision; regular customs formalities including customs declarations; customs authorities’ potential requests for customs debt security deposits
- regular customs nomenclature including the application of appropriate customs rates
- Authorised Economic Operator permits and other customs simplification permits issued by the British customs authorities not valid in the EU customs territory
- goods originating in the United Kingdom that are incorporated in goods exported from the EU to third countries will no longer qualify as "EU content" for the purpose of the EU's Common Commercial Policy.

In indirect taxes, the implications would be as follows:

- Goods acquired by an EU member state from the United Kingdom or goods shipped from an EU member state to the United Kingdom will be regarded as import and export of goods will all relevant implications.

- Persons liable to tax using the mini-one-stop-shop regime will have to register for MOSS in one of the EU member states.
- Persons liable to tax established in the United Kingdom and purchasing goods or services from EU member states will no longer be allowed to claim a refund of input VAT electronically. But the member states will be allowed to refund the paid tax if Great Britain has entered into an agreement on reciprocity.
- EU member states on whose territory entities established in the United Kingdom carry out taxable transactions will be allowed to request the establishment of a tax representative who will be liable for due tax.
- Suppliers from member states delivering goods liable to excise duty to the United Kingdom will no longer be allowed to use the Excise Movement and Control System (EMCS) in respect of supplies under the conditional exemption from excise duty regime.

For the sake of completeness, in direct taxes, the immediate implications of Brexit would primarily mean the inability to claim reduced taxes on the payment of dividends, royalties and interest in a manner set by the appropriate EU directives. Significant will also be the implications in the area of the free movement of persons, both in terms of various administrative permits and in terms of participation in pension insurance schemes. Even though it is more likely that a transitory period agreement will be concluded, it is quite vital to monitor and prepare for the situation that may occur on the date Great Britain exits the EU, i.e. 29 March 2019.

Collection of Deeds one gaping void – what does the new bill say?

The Ministry of Justice has started preparing an amendment to the Corporations Act, aiming to reduce the regulatory burden for entrepreneurs while shedding more light on non-transparent corporate structures. It also intends to enforce the duty to file accounting documents in the Collection of Deeds more effectively. What can we expect in this respect?

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Corporations have to submit to their registration courts documents to be filed in the Collection of Deeds without unreasonable delays, unless the law stipulates other deadlines. Although the existing regulation contained in the Act on Public Registers of Legal Entities and Individuals permits penalties to be imposed on corporations which fail to meet this duty, the manner of enforcing compliance has proved insufficient and often unavailing.

Presently a corporation may be fined repeatedly up to CZK 100 000 if it fails to comply with the registration court's request to file the deeds, and the court may even dissolve the corporation with liquidation. However, if the corporation does not have sufficient assets, its dissolution with liquidation may prove rather costly; therefore registration courts do not resort to this option very often.

The proposed regulation offers a new sanction: dissolution without liquidation. It aims to eliminate inactive companies that only exist formally and do not carry out any economic activity. These entities contribute to the non-transparency of ownership structures and may be used for financial fraud.

According to the proposed amendment, both of the following conditions will have to be met for a corporation to be dissolved without liquidation:

- failure to file annual or interim financial statements for at least two consecutive accounting periods in the Collection of Deeds;
- inaccessibility of the corporation.

Hence, to dissolve a corporation without liquidation, a corporation breaching its duty to file the financial statements in the Collection of Deeds every other accounting period will not suffice. Here the court may still only use the existing tools to enforce the duty. A corporation's inaccessibility means that it is not possible to deliver requests to submit the missing documents according to the rules on delivering notices as provided by the Civil

Procedure Code. Although the Chamber of Deputies has not yet even started to debate the bill, corporations should be more conscientious about filing any required documents in the Collection of Deeds. The registration courts' sanctions are not the only possible implication: the corporation may also be committing an administrative infraction under the Accounting Act.

The amendment also proposes other changes, such as introducing members' statutory pre-emptive right to other members' ownership interests, the possibility to pay cash contributions to a limited liability company in other forms (if the amount of all cash contributions in aggregate does not exceed CZK 20 000), or changes in profit distribution.

Online shopping without borders

We all got used very quickly to the abolition of roaming charges within the EU. And we may also enjoy prepaid Netflix, HBO Go, Amazon Prime, Spotify or Deezer subscriptions while travelling within the European Union. Yet another step towards the digital single market is the EU regulation on geo-blocking, which should significantly encourage e-commerce, effective from December 2018.

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According to surveys, only 15% of Europeans currently purchase goods through websites based in another member state. Among the reasons are geo-blocking practices whereby traders restrict access to their websites, block orders from abroad, offer different prices to customers solely on the grounds of their nationality, or otherwise limit the range of goods and services offered to customers from another member state.

The regulation guarantees to all customers of EU member states identical conditions to access goods and services, as long as the goods are delivered in a member state to which the trader offers delivery or are collected at a location agreed upon with the customer. The traders, however, will not be obliged to deliver goods to all member states: it will remain their choice whether they wish to send their goods to a particular country.

The equal access rule shall also apply to electronically supplied services such as cloud services, data warehousing or website hosting. On the other hand, the regulation will not apply to services featuring the provision of copyright protected content. Therefore video or music streaming or provision of e-books will be excluded from the scope of the regulation. The European Commission will, however, review this exclusion in two years' time and may then extend the scope of the regulation to this area as well.

Traders providing services in physical form, such as accommodation or car rentals, will also be banned from applying different approaches to customers from other member states based on their nationality, place of residence or place of establishment.

The regulation also addresses unjustified discrimination in relation to payment methods. Traders will not be allowed to apply different payment conditions to customers solely on the grounds of their nationality or place of residence. At the same time, the regulation will prohibit traders from blocking or restricting foreign customers from accessing their websites.

Unlike price discrimination, standard price differentiations will not be prohibited: traders will remain free to offer different general conditions, including prices, in various countries (while observing the non-discrimination rules).

Tax planning may be subject to reporting duty

In mid-March, the ECOFIN Council reached political agreement on the rules requiring intermediaries (tax advisors, attorneys, other advisors) or taxpayers to disclose information on potentially aggressive cross-border tax planning arrangements. This information will subsequently be part of the international exchange of information. The new rules will be incorporated into the Directive on Administrative Cooperation in the Field of Taxation (DAC), in particular into its sixth amendment: DAC6.

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In principle, the directive should apply to all types of direct taxes imposed by the member states, but not to VAT, excise duties, customs and mandatory social security premiums.

The directive's central term arrangement is not defined in the proposed text, leaving room for various interpretations. It is therefore important to find out how the directive's provisions will actually be transposed into Czech legislation. Cross-border transactions are subject to the reporting duty if they meet one or more characteristic features (or so-called hallmarks) specified in an appendix to the directive. The arrangement will be tested for some hallmarks while also performing the principal benefit of an arrangement test. This test will generally be deemed positive if it can be determined that the principal benefit or one of the principal benefits arising from the particular arrangement is obtaining a tax advantage. In addition to the principal benefit test, the features that may present a strong indication of aggressive tax planning or the undermining of reporting obligations include, e.g., the taxpayer's obligation to keep the agreement confidential, the artificial use of a loss-making corporation, payments from states or via states offering preferential tax regimes, etc. The existence of certain features will give rise to the duty to report such an arrangement even without it meeting the principal benefit test. This involves, for example, some arrangements relating to transfer pricing and other situations.

The reporting duty is sometimes transferred from intermediaries to taxpayers, e.g., where the intermediary's reservation applicable to a specific profession prevents it from reporting information (e.g. the duty to maintain confidentiality, most likely) or where the taxpayer implements a reportable arrangement without an intermediary's assistance.

The March version of the text changed after certain states expressed their concern regarding the broad extent of reported information:

- The definition of an intermediary has been extended and clarified: the intermediary is defined as any person

who designs, markets, organises, makes available for implementation or manages the implementation of any reportable cross-border arrangement and any person who knows or could reasonably be expected to know that they have undertaken to provide assistance with respect to a reportable arrangement.
- For potential multiple reporting, the text elaborates that the reporting duty applies to all parties concerned, with the exception of situations in which liable persons prove that an arrangement has already been reported by another liable person.
- The text also further explains that if the member state does not immediately respond to the reported information, it does not mean that it automatically agrees with the arrangement and considers it valid.
- While proposed in the original text, retroactivity has been restricted. Nonetheless, it is necessary to begin assessing arrangements implemented on the twentieth day after DAC 6 is published in the EU Official Journal.
- The deadline within which information about the arrangement must be disclosed has been prolonged to thirty days from the original five days after an arrangement's implementation date.
- The European Commission's authority to alter the characteristic features in the appendix has been excluded from the text. Instead, the EC will evaluate and propose changes to the features every two years.

The final DAC 6 is expected to be adopted without further discussion in the upcoming months. The member states must implement DAC 6 in their domestic laws ultimately on 31 December 2019 and apply the new reporting requirements as of 1 July 2020. The important date for taxpayers and tax advisors is the date DAC 6 is published in the EU Official Journal, which may occur sometime in mid-2018. The first cross-border transactions subject to the reporting duty will be those implemented by taxpayers in the period between the twentieth day after DAC 6's publication in the journal and 1 July 2020, when DAC 6 will enter into effect. Information will have to be reported by 31 August 2020.

The reported information must be automatically exchanged each quarter by the competent authorities of each member state via a central directory on administrative cooperation, to be developed by the Commission by the end of 2019. The automatic exchange of information must take place within one month from the end of the quarter in which the information was filed, with the first information having to be communicated by 31 October 2020.

New digital economy taxation rules

In March, the European Commission issued two draft directives on the digital economy: the first one proposes to introduce a tax on digital services; the second one the concept of a virtual permanent establishment.

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The draft directives are being presented several years after the OECD issued a preliminary report to address the tax challenges of the digital economy in which it described in detail individual digital economy models and stated that an agreement on how to tax digital activities between the member states was yet non-existent. The European Commission would have preferred a solution on the OECD level but since one is not in sight, it decided to propose a solution within the EU.

The first draft directive on the common system of a digital services tax introduces a special tax rate of 3% on income from certain digital activities. This is intended as a temporary measure until wider agreement can be reached on the concept of a virtual permanent establishment. This tax would be applied from 2020 on gross income from digital activities whose value creation is in large part dependent on their users and which are difficult to capture under the current tax rules. This would involve income from the following activities:

- sale of advertising space on the internet;
- digital intermediary activities allowing users to communicate with other users, thereby facilitating the sale of goods and services between these users;
- sale of data obtained from users' information.

The tax would be collected by the member state in which users are located and would only involve corporations with total minimum worldwide revenues of EUR 750 million, of which EUR 50 million relates to revenues generated in the EU. By estimation, for member state budgets, the proposed 3% tax rate would generate a yearly income of EUR 5 billion. The EC proposes to establish a single contact point for filing tax returns and paying the tax. Revenues would then be distributed among the members states based on the number of users.

The second draft directive introduces a new concept of a virtual permanent establishment, which would arise based on its digital presence as defined by the directive (such as a web or mobile application, etc.) provided that at least one of the following criteria are met:

- excess of a threshold of EUR 7 million in annual revenues in a member state;
- more than 100 000 users in a member state in a taxable year;
- conclusion of more than 3 000 business contracts for digital services with business users in a taxable year.

The rules specified by the directive will apply to taxpayers in the EU; third-country taxpayers will be involved depending on whether the concept of a virtual permanent establishment is part of the appropriate double taxation treaty. The draft directive therefore recommends that member states adjust their double taxation treaties accordingly. The directive also expects that the digital services tax will be abolished once the concept of a virtual permanent establishment is in effect among the member states.

Both directives must be unanimously approved by all member states. Moreover, the relevant double taxation treaties with non-EU countries will have to be adjusted, which always requires the consent of the other contracting party. The future of both directives is therefore yet quite uncertain.

CJEU: effect of subsequent modifications of transfer prices on customs value of goods

The Court of Justice of the European Union (CJEU) has issued its first ruling on the effect of subsequent adjustments to transfer prices on the customs value of goods imported to the EU. According to the judgement, even if a group's transfer pricing policy allows for the subsequent adjustment of prices, it is not possible to retroactively change the customs value of goods based on such adjustment.

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The CJEU held that while retroactive adjustments of customs values may be admissible in certain situations (such as defects and shortages), EU legislation does not stipulate this for changes in the value of goods as a result of subsequent adjustments of the transfer price. The taxpayer requesting a refund of a part of customs duties paid on these grounds did not succeed, despite the fact that the group's transfer pricing policy had been agreed with the German tax administrator by means of an advance pricing agreement. The ruling did not give a clear answer as to whether the same principle would apply in cases where a subsequent price adjustment resulted in higher customs duties.

In our opinion, some customs procedures could lead to customs duties being paid based on prices reflecting all related price adjustments; however, these would place a considerable administrative burden on both parties and necessitate lengthy negotiations with customs authorities.

How private is one's hard drive at work?

May employers inspect the contents of their employees' work computers? The European Court of Human Rights recently dealt with this issue in the Libert v. France case. It held that employers may search files that are not clearly identified as private. This decision, however, cannot be automatically applied in the Czech Republic, as it is based on a specific French law containing the condition of files being identified as private. How should the situation be approached in the Czech Republic?

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Generally, employees are not allowed to use their employers' computers or other telecommunication equipment for attending to private matters, unless the employers have granted their consent to such use. This consent may be in any form. Often employers grant consent by means of a provision in an internal policy or an employment contract. In certain cases, the long-term and knowing toleration of such employee behaviour may also be deemed consent.

Employers who have not granted such consent may monitor the content of work computers in a reasonable manner. Namely, they may do so to determine whether employees are observing the general prohibition of using their computer's technology for personal purposes. While monitoring, however, employers must respect employees' privacy and not inspect files of a purely personal nature. Before opening a specific file, employers should assess its nature based on its classification in directories, or based on its name. If the personal nature of a file only becomes apparent after it has been opened, the employer has to stop inspecting it immediately.

Czech law is even stricter as regards the monitoring of employees' electronic mail, including text messages and other instant messages, as such surveillance infringes even more intensely on employee privacy. Employers are generally not allowed to check the content of emails or other messages. They may, however, monitor the number of messages sent and received by employees and their identification data, i.e. the sender, the recipient, and the subject.

Employers may open employees' emails on the firm's domain only in exceptional cases, for instance during an employee's long-term absence, if it is necessary for the protection of the employer's rights or if the email is deemed to be of a work-related nature. To assess an email's work-related nature, employers should use solely the address of the sender, the subject of the email, and, possibly, the greeting.

Employers are also obliged to inform their employees of the extent and manner of monitoring of files stored in the firm's computers and other equipment.

Finally, a more reasonable approach to taking over employees?

Not long ago, the Supreme Court (SC) gave employers quite a scare: it held that when continuing an activity previously carried out by another entrepreneur, they might have to take over that entrepreneur's employees, even without the circumstances of the transaction indicating anything to that effect. Its last decision, however, suggests that the SC has decided to correct this extensive and in practice rather problematic interpretation.

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The employers' duty to take over employees of their predecessors in some cases is provided for by the Labour Code. It stipulates that employees are transferred by operation of law when the employer's activities or tasks, or parts thereof, are transferred to another employer. This fairly abstract formulation causes problems to entrepreneurs in practice, as they often do not even know that they have the duty to take over the employees or that they already have taken them over – since the transfer automatically happens by operation of law without any specific arrangement. Employees may thus approach their employer's unsuspecting successor at any time and request to be assigned work or given wage compensation for the time when they were not allowed to work - perhaps because the employer did not even know that they had been transferred.

The Czech regulation implements a relevant EU directive that is backed by an extensive amount of case law of the Court of Justice of the EU (CJEU). However, the SC appears to interpret the Czech regulation much more extensively than required by the EU directive. CJEU case law limits the transactions where employees are transferred from one employer to another by operation of law to transactions involving transfers of economic units, mostly comprising tangible equipment needed to operate the business. Where no equipment is needed to carry out the business activity, an economic unit comprises a group of workers especially and permanently assigned to carry out certain specific tasks.

Until now the SC has ignored the criterion calling for the transfer of economic units. It considered it irrelevant whether equipment or an organised group of workers was being transferred; it sufficed that the new entity carried out activities or tasks similar to those previously undertaken by the preceding entity. The duty to take over employees was thus confirmed, for instance, even between two entities that happened to rent the same café premises in a shopping mall one after the other with no equipment being transferred. In its last judgment, the SC finally acknowledged the CJEU's conclusions as to the necessity of a true economic unit being transferred.

This is good news for employers, as it narrows down the range of situations involving the obligatory transfer of employees by operation of law. Furthermore, admitting that CJEU case law is indeed applicable to Czech cases may help in addressing situations that Czech courts themselves have not yet encountered. We may only hope that the decision is not just a one-off occurrence but the beginning of new, more stable interpretations.

Nevertheless, employees will still be transferred by operation of law not just in a business combination or a sale of (a part of) business where the participating companies are well aware of their duty to take over the employees but also in other cases where the transfer may be less obvious: for instance, when taking over a contract previously performed by another contractor, or when transferring individual parts of business assets. Both the SC and the CJEU case law requires neither a direct relationship between the employers nor the chronological continuity of the activities being carried out by the transferor and the transferee. We therefore recommend consulting legal advisors about the labour-law implications before making any similar business decisions.

SAC did not accept brokerage fee paid to unrelated party as deductible

The Supreme Administrative Court did not accept a brokerage fee (commission) paid to an unrelated party as a deductible expense despite supporting documents and witness testimonies. The burden of proof is on the service recipient who has to prove that the brokerage did actually take place; pleading that this would violate the broker's trade secrecy will not change the burden of proof.


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At the heart of the case was a brokerage fee for negotiating contracts between a local distributor and a manufacturer. Due to a change in the business model, the distribution activity previously carried out by the parent company had purportedly been transferred to the taxpayer (the local distributor). The taxpayer claimed that without engaging a broker it would have been impossible to establish and develop the business relationship with the supplier (manufacturer), and supported this with witness testimonies. The witnesses stated that negotiations on extending the contracts had been significantly more difficult and time consuming without a broker. They, however, did not state anything about the substance or specific circumstances of the services. For the court, the witness statements were so vague that they were found insufficient to bear the burden of proof. The broker's representative, who was purportedly present at the negotiations, also gave testimony during the tax inspection, but his testimony was inconsistent and at times contradictory. The fact that the distributor could purchase and distribute the manufacturer's product long before the brokerage agreement was concluded and the business model changed also did not help the distributor's position.

The SAC emphasised that it is up to service recipients to obtain adequate records to prove that a broker actually negotiated in their interest. Identification of with whom and when the negotiations took place, including the names of concrete persons, is of key importance, as such information would make it possible to determine whether the broker indeed approached persons who reasonably could be expected to be authorised to make decisions or influence the authorised persons in their decision-making. In the case in question, it was the absence of these data that contributed to the conclusion that the witness statements were insufficient. At the same time, the SAC admitted that in some cases it may be difficult to produce such evidence, as a broker's activity may be so intimate in nature that the broker may not be willing to cooperate as necessary. However, this changes nothing about the burden of proof lying with the taxpayer. The fact that the commission was paid or the goods traded does not in itself prove that the broker actually carried out the brokering.

The SAC judgement thus reminds us yet again that in practice, brokerage fees may bring numerous problems, and proving their tax deductibility may be extremely difficult. Taxpayers should remember this when effecting such transactions and gather necessary supporting documentation for a possible tax inspection.

Limits of tax sanctions for Švarc system

In recent years the Supreme Administrative Court has repeatedly ruled in favour of a stricter tax treatment of income from activities carried out by self-employed persons within a Švarc system. However, in its decision of February 2018 the court halted the trend of some regional courts viewing any longer-term business cooperation with elements of exclusivity as concealed employment.

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In the case in question, the Supreme Administrative Court dealt with the characteristic features of dependent activity in the construction industry. The taxpayer, a construction work provider, cooperated with the same subcontractors over a long time, while the cooperation was the sole source of income for most of them. The subcontractors, mostly small sole traders, bricklayers or unskilled labourers, carried out work based on oral contracts for work. Their remuneration was based primarily on the amount of work done, to a certain extent also taking into account the profitability of the project.

In agreement with the financial administration, the regional court held that this type of cooperation concealed its actual status (i.e. employment), and confirmed the assessment of additional tax on income from employment that the taxpayer should have paid on behalf of the individuals. The SAC disagreed with this conclusion, emphasising that while the tax treatment of the situation is to be based on the actual content of legal relations, when assessing contractual arrangements where there are no doubts as to the free will of both parties, deference is appropriate. Therefore, if the nature of the activity allows for various contractual arrangements in the realms of private law (in this case a contract for work as well as an employment contract), the tax administration should primarily respect the type of cooperation chosen by the contractual parties, while the choice of the contractual arrangement may also take into account its tax implications.

The decision implies that when reclassifying a business relationship to employment, it must be proved that the situation involves either a concealed (dissimulated) legal status or abuse of right. This was not the case here, as the substantial characteristics of dependent activity were missing. When ascertaining the actual situation (also with respect to oral contracts having been concluded), the SAC took as its basis mostly the questioning of the persons involved. The SAC also emphasised the necessity of assessing the circumstances on a case-by-case basis, refusing the blanket statement that all relationships lasting longer than six months must be viewed as long-term. The SAC further held that the financial dependence of one contractual partner on the other is common in business relationships and does not in itself make the relationship a dependent activity. In the case in question, the cooperation did not significantly deviate from a reasonable arrangement of relationships. The SAC hence did not establish an abuse of right.

The SAC decision confirms the importance of arranging one's contractual relationships appropriately, taking into account both the legal and tax implications of the cooperation. Mutual understanding between the contractual parties regarding the substance of the relationship is also of crucial importance, because when assessing witness statements the courts often also consider how the cooperation and dependence is perceived by the contractors.

Guidance on determining beneficial ownership

The Advocate General has recently presented her views on a number of cases pending before the Court of Justice of the EU and dealing with beneficial ownership and its interpretation for the purposes of the EU directives. These legal disputes usually involve holding companies acting as the recipients of dividend and interest payments.


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At the beginning of March 2018, the Advocate General of the Court of Justice of the EU (CJEU) published her opinion on the concept of the beneficial owner of income deriving from the payment of dividends and interest, which is covered by Directive 90/435/EEC, on the common system of taxation applicable in the case of parent companies and subsidiaries of different member states (the Parent Subsidiary Directive), and Directive 2003/49/EC, on the common system of taxation applicable to interest and royalty payments made between associated companies of different member states (the Interest and Royalties Directive).

In all cases, a Danish company requested an exemption from the Danish withholding tax levied on the payments of dividends/interest in compliance with the above directives. The Danish tax authorities denied the exemption, arguing that the company receiving the income was a conduit structure and could not be considered the beneficial owner of the payment. In connection with this, the Danish courts subsequently also asked the CJEU to clarify whether Denmark may apply the beneficial ownership concept to deny the benefits of the EU directives and requested clarifications on the applicability of the OECD's Commentaries on the Model Tax Convention or the relevant provisions of individual double taxation treaties between the appropriate states in this respect.

In the case of dividend payments, the Advocate General emphasised that the Parent-Subsidiary Directive does not make the member states' obligation to exempt dividends from withholding tax conditional upon beneficial ownership. In this regard, the only foreseen limitation is the potential application of domestic anti-abuse provisions covering tax evasion, which, however, must comply with the EU law. The AG goes on to observe that the provisions of the Parent-Subsidiary Directive and the Interest and Royalties Directive must be interpreted under EU law independently of the OECD Commentaries and double taxation treaties, which follow a different approach. In the case of interest payments, the AD is of the opinion that the holding company receiving the interest income should be considered as the beneficial owner if it is acting in its own name and on its own account. According to the AD, it is necessary to assess in this respect whether the entity may dispose of such interest income (especially pay its own expenses) and bear potential losses (e.g. as a result of insolvency). If it is so, a mere contract on "conduit" financing, based on which the entity passes on payments to other group companies, does not automatically constitute the reason for denying the exemption from withholding tax. In both cases, the appropriate member state must always identify the person it deems to be the beneficial owner of the income where the entity receiving the payment is not considered the beneficial owner.

The Advocate General has thus provided certain guidance on how to proceed when interpreting beneficial ownership in compliance with the appropriate EU directives. The AG also noted that the existence of an abuse under EU law should be assessed by local courts that must always assess each case on an individual basis and take into account all specifics. The Advocate General's opinion does not represent the CJEU's final decision and may, naturally, differ from the CJEU's decision.

Electricity meters – installation not required for the entitlement to state aid

According to a decision by the Supreme Administrative Court, the entitlement to aid for renewable sources of energy arose in 2010 based on a lawful licence and the first parallel connection to the network, i.e. without an electricity meter having being installed.

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This particular case involved a dispute between the producer of electricity from solar energy and the State Energy Inspection (SEI) whether the installation of an electricity meter was the pre-requisite for the entitlement to aid in 2010. According to the SEI's opinion, an electricity meter had to be installed to consider a power-generating facility having been put into use; yet, the power-generating facility in question did not install the meter earlier than in January 2011. The producer did not agree with the SEI and appealed to the Municipal Court in Prague which, however, sided with the SEI, adding that when putting a power-generating facility into operation it is also necessary that the producer claimed the entitlement to aid for produced electricity already in the year the facility was put into use, i.e. in 2010.

In its decision on the cassation complaint of 8 March 2018, the Supreme Administrative Court (SAC) rejected the interpretation of the Municipal Court in Prague and the SEI, claiming that such an interpretation would in fact extend the scope of conditions that had to be met by the power-generating facility to be considered as having been put into use in 2010 by the condition that the produced electricity had been measured. The SAC stated that the supply of electricity into the electricity network via the first parallel connection is a legal unmeasured supply of electricity within the testing of the facility operations and, consequently, this delivery of electricity fulfilled the conditions for putting the facility into use in 2010.

For the reasons stated it its decision on the cassation complaint, the SAC cancelled the resolution of the Municipal Court in Prague as well as the previous decision of the SEI on imposing a penalty. The case will again be discussed by the SEI, which will have to follow the SAC's decision in its proceedings. It can therefore be expected that the SEI will conclude that the electricity producer did not commit an administrative delict and will suspend the proceedings. The same development is expected with respect to other cases with similar factual basis relating to putting solar-power-generating facilities into use.

Latest news - April 2018

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

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- On its website, the financial administration posted a new prescribed form for the disclosure of transactions between related parties as a separate attachment to line 12 of section I. The form is valid for taxable periods started in 2017 and for parts of the taxable periods started in 2018 with the filing deadline expiring before 31 December 2018. Compared with the form valid in the prior period, the current form requires the disclosure of additional information such as lease-related revenues and expenses or received or granted financial and bank guarantees. The duty to fill in this appendix also applies to financial institutions.

- In July 2016, the European Parliament and the Council of the European Union adopted a regulation on promoting the free movement of citizens by simplifying the requirements for presenting certain public documents in the European Union. This regulation is applicable from 16 February 2019. It introduces multilingual standard forms facilitating the free movement of persons within the Union by removing certain formalities such as translations.

- On its website, the GFD points out that income from accommodation or transport of persons generated by means of internet platforms, such as Airbnb, Booking, Uber, etc., is liable to income tax and should be included in the 2017 income tax returns.

- The Ministry of Finance announced that the double taxation treaty between the Czech Republic and Turkmenistan entered into force on 27 March 2018 with effect from 1 January 2019.

- In March 2018, the OECD issued additional rules for the attribution of profits to permanent establishments. These rules should be used for permanent establishments whose definition was adjusted by the amended OECD Model Convention and primarily apply to permanent establishments arising from activities carried out based on consignment and similar agency contracts or from combined activities. The new rules, dealing with both the creation of a permanent establishment and the allocation of its profit, should be used where a double taxation treaty contains the adjusted definition of a permanent establishment. However, this does not apply to the Czech Republic, as it decided not to include these new rules into its existing treaties. Nonetheless, it can be expected that the new rules will have an impact on the current interpretation of permanent establishments as well as on current business models.

- In March, the European Parliament approved the text of a directive on the common corporate tax base (CCTB) and a directive on the common consolidated corporate tax base (CCCTB). Both draft directives were already submitted by the European Commission in autumn 2016. However, their final adoption is conditional upon the unanimous consent of all EU member states.

- The Supreme Administrative Court has recently challenged the tax administration's approach to the use of securing orders (the AB Chemitrans case). According to the SAC, it is not possible to treat two groups of taxpayers differently, i.e. to require the first group (taxpayers who have already been affected by securing orders) to pay VAT even before the tax is determined by a decision that has entered into legal force, whereas the second group (other taxpayers) would only be required to pay the tax and a penalty after the notice on tax assessment has entered into legal force. In the SAC's opinion, this would constitute a violation of the equal treatment principle. The SAC clarified that the date of determining the tax shall be understood to be the date when the tax is determined by a decision that has entered into legal force.

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