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Obsah

Editorial

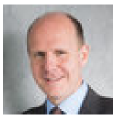
I recently heard a GDPR joke. Two friends were chatting over a beer. One asked: “do you know of a good GDPR consultant?”. “Yes” replied the other, “My adviser. He’s excellent”. “Oh, could you provide me with his contact details?” asked the first. “No.”, answered the second…

But seriously, while data privacy is now a topical theme, in the world of tax there is a counteracting trend, not towards privacy but arguably away from it, with increasingly detailed information disclosure requirements being imposed upon taxpayers and intermediaries.

The latest in a line of transparency-related initiatives undertaken by the EU imposes a requirement upon certain “intermediaries”, including tax advisers, to notify their local tax administration, which will then make onward disclosure to other EU Member States, if they assist clients on implementing certain defined tax planning arrangements. This notification requirement will not be effective until 1 July 2020, but is expected to cover relevant tax planning arrangements initiated after June 2018.

There is clearly a tension between pressure for personal privacy on one hand but transparency on the other. The various international transparency initiatives do incorporate safeguards designed to preserve confidentiality of personal data of individuals affected. But governments too are exposed to risk of data leaks, or worse, and the scale of some of the international initiatives is unprecedented. For instance, over 100 countries have committed to operating automatic exchange of information under the OECD’s Common Reporting Standard.

This has led some commentators to question whether systems for maintaining data protection will be uniformly robust across all governments.



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Taxes

Changes to 2019 tax package: corporate income tax

The proposed amendment to the Income Tax Act has passed through external comments and is now available in the government's public electronic library, with some fundamental changes to its wording compared with the previous version.

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The present wording to be discussed by the government no longer contains the abolishment of the 'super-gross wage' and the related change in the personal income tax rate. Both the super-gross wage and the flat 15% personal income tax rate are thus likely to remain in place.

The proposed amendment to the Income Tax Act mainly contains provisions implementing the EU Anti-Tax Avoidance Directive (ATAD). The following has been proposed:

- Limiting the deductibility of exceeding borrowing costs in transactions with both related and unrelated parties above the set limit. The limit is the higher of CZK 80 million or 30% of earnings before interest, tax, depreciation and amortisation (EBITDA). Borrowing costs will include, apart from interest on loans, also related FX differences and interest contained in the acquisition cost of assets or finance costs embedded in financial leases. The new rule will apply even to borrowing costs arising from financial instruments entered into before the effective date of the amendment (yet, it shall not apply e.g. to interest contained in the acquisition cost of assets put into use before 17 June 2016). Financial institutions such as banks or insurance companies will be exempt from the new rules. The rules limiting the deductibility of borrowing costs due to thin capitalisation will remain in force for all taxpayers.

- CFC rules, i.e. the taxation of income of controlled foreign companies by their Czech controlling company if the foreign companies are not engaged in any substantial economic activity or if their tax liability abroad is lower than one half of the tax liability that would have been paid by a Czech company on such activity.

- Exit taxation upon the relocation of assets without a change of ownership (e.g., the rule will apply when Czech tax residents transfer assets to their foreign permanent establishments or when Czech companies change their tax domicile). The transfer of the assets will then be taxed in the Czech Republic similarly as if it were a sale of assets.

- Taxation of gains or losses on equity securities voluntarily classified as measured at fair value through equity (IFRS 9), by adjusting the taxpayer's tax base.

- A new manner of taxation of revenues from equity certificates / instruments measured at fair value, again by adjusting the taxpayer's tax base.

- Rules neutralising the effects of hybrid mismatch arrangements, such as a 'double deduction', when one amount reduces the tax base in more than one jurisdiction, or a ‘deduction without inclusion’, when the tax base is reduced in one jurisdiction without the same amount being included in the tax base in another jurisdiction.

Most of the above changes are planned to be effective for taxation periods starting on 1 January 2019; exit tax and hybrid mismatch rules are to be effective for taxation periods starting on 1 January 2020. Since the proposed changes follow from the EU Directive that has to be implemented into Czech law by 31 December 2018, we expect that the Chamber of Deputies will make efforts to meet the proposed deadlines.

Changes to 2019 tax package: new reporting duty and abuse of right concept

The 2019 tax package, in its external comment procedure since February, is about to be submitted to the government. The comment procedure brought a number of changes: the Ministry of Finance added a new duty to report income flowing abroad and clarified the abuse of right concept. What in particular do these changes entail and what do they mean for taxpayers?


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Abuse of right

From the very beginning, the draft tax package aimed to include a general anti-abuse rule into the Tax Procedure Code. Historically, this principle has been applied based on case law. During the external comment procedure, the Ministry of Finance clarified the wording of this rule: transactions with no proper economic grounds whose main purpose or one of the main purposes is to obtain a tax or other advantage contrary to the meaning and purpose of the tax legal regulation will be regarded as abuses of right.

Compared with the original version, the new wording is much more similar to the rule currently being applied by the Supreme Administrative Court. However, the concept is a bit wider: to qualify a juridical act or a fact as an abuse of right, it will be sufficient if a tax advantage is one of the main purposes and not just the only purpose. In its explanatory report, the ministry promises that the financial administration's existing practice will not change dramatically. However, we will have to wait for its real application in practice, as the actual apportioning of the burden of proof will be vital. Taxpayers will be pleased that under the new explicit regulation the lack of proper economic grounds will continue to have to be proven by the tax administrator.

Reporting duty

The Ministry of Finance proposes to introduce an entirely new reporting duty relating to income flowing abroad. The new reporting duty will replace the current reporting of withholding tax but on the other hand will significantly extend the scope of reported payments. According to the new regulation, on a monthly basis, taxpayers should not only report payments to foreign entities from which tax was withheld but also transactions generally liable to withholding tax but exempt from tax in particular cases based on either national legislation or relevant double taxation treaty. Income payments flowing abroad that were not taxed will have to be reported if they exceed CZK 100 000 monthly per taxpayer. The explanatory report mentions foreign dividends but practical implications might be much broader and include not only dividends, royalties and interest paid abroad but also gratuitous income.

The draft preserves the possibility to ask for a release from this reporting duty, but in its new version only for a period of five years. The existing release options remain effective over one year of the amendment's effective date but only with respect to income from which tax was really withheld. Untaxed foreign payments will be liable to the new reporting duty once the amendment enters into effect.

Apart from the need to collect data for obligatory cross-border information exchange purposes, the amendment's authors justify the changes in their draft by the alleged substantial outflow of income from direct foreign investments, which is unique on an international scale. The Ministry of Finance thus plans to introduce another tool to fight unlawful tax optimisation structures. Along with the proposed establishment of analytical tax records, i.e. a certain universal data collection point, this may significantly enhance the effectiveness of sharing and analysing data collected across the financial administration, elevating it up to the level of big data, using the right tools.

2019 amendment to VAT Act: first four biggest changes

The amendment to the VAT Act has passed through its comment procedure and is about to be submitted to the Chamber of Deputies. Below we present the first four most significant changes.

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Reinvoicing of lease-related services
The proposed amendment actually re-introduces the old fiction of determining the date of supply for the reinvoicing of services directly related with leases. Such services are not part of a lease contract and represent separate and mutually separable supplies, i.e. janitorial, security or gatekeeper's services, etc.

The fact that the date of supply will only be determined once the lessor ascertains the actual reinvoiced amount is a significant relief for the majority of lessors now having problems to adhere to existing legislation that sets the date of supply generally as the date the service is provided (unless an invoice is issued earlier), i.e. at a moment lessors usually do not yet know the reinvoiced amount.

Adjusted deduction of VAT on repairs of real estate costing more than CZK 200 000
Another change relates to VAT deductions claimed by the taxpayer on repairs of real property. According to the proposed amendment, taxpayers who have carried out repairs of their real property costing more than CZK 200 000 (please note: this amount excludes VAT!) would have to monitor whether the real property is sold within a period of ten years of the date the repair is carried out. The decisive factor is the amount of all received taxable supplies relating to the repair.
In the case of a VAT-exempt sale of the real property in the ten-year period, the VAT deduction originally claimed would have to be corrected. If this provision is implemented, taxpayers will have to keep accurate records of any performed repairs to help them assess the correct VAT regime upon the sale of real estate.

Changes in assessing subsidies
Entities receiving subsidies from various sources, including subsidies towards the results of operations, should take note. The amendment proposes to exclude the current definition of a price subsidy, according to which subsidies towards the results of operations are not included in the tax base. This may be in effect from the beginning of 2019.

It would generally be necessary to assess whether received subsidies directly relate to provided supplies and whether these subsidies have a direct effect on the price charged to customers. If so, such a subsidy would represent a payment for the relevant supply from which VAT must be paid (if this involves a taxable supply). According to the explanatory report, the above criteria will also apply when subsidies towards the results of operations are received.

Duty to make the necessary effort to deliver a tax document
Under the new amendment, taxpayers should prepare for another duty when issuing tax documents, as the amendment explicitly requires that taxpayers make all efforts necessary to deliver tax documents within the deadline for issuing tax documents. According to the explanatory report, taxpayers must ensure that a tax document is sent to the recipient’s contact address no later than on the last day of the time period. This will not be deemed fulfilled if taxpayers send tax documents within the deadline but at the same time know or could know that the recipient is not staying at the given address, is unknown or uncontactable.

Further changes brought by the amendment will be discussed in the next issue of Tax and Legal Update.

Another step towards a common capital market

In March 2018, the European Commission prepared a set of legislative proposals aiming to promote alternative sources of financing and remove barriers to cross-border investments. The EU thus continues its efforts to create a Capital Markets Union, one of the priorities the present Commission aims to achieve by 2019.

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The Capital Markets Union is an EU initiative to integrate capital markets of all member states. Current legislative proposals are mostly aiming to facilitate the cross-border distribution of investment funds, promote a market for covered bonds, and ensure greater legal certainty in cross-border transactions in securities and claims.

Investment funds are important players in the capital market. The cross-border distribution of investment funds is currently hampered by numerous regulatory obstacles that the new directive and regulation should remove. The proposal unifies the rules of distribution for collective investment funds and qualifying investor funds. For the sake of transparency, member states will be obliged to publish applicable national regulations on the investment funds' offerings, including an English-language summary, and the amount of fees connected with cross-border offerings on the internet.

The package also contains proposals on covered bonds, unifying the fragmented and partial regulation of covered bonds by EU law. The extent to which covered bonds are used in individual states differs significantly. With the new regulation, the EU aims to enhance the use of covered bonds as a stable and cost-effective source of funding for credit institutions. Subject to meeting stipulated conditions, together with the specific national name, issuers will also be allowed to use the 'European Covered Bond' label.

The final part of the regulation is aimed at cross-border transactions in securities and claims. The proposed regulation stipulates the law applicable in disputes involving the cross-border assignment of claims. According to the general rule, the law of the country where assignors have their habitual residence would apply, regardless of which member state's courts or authorities examine the case. With its recommendations, the Commission also endeavours to eliminate any uncertainties as to what national law applies when determining who owns a claim. According to the Commission, the proposals should significantly promote factoring and securitisation.

In the legislative process, it is now the European Parliament's and the Council's turn. Both have been asked by the Commission to swiftly adopt the proposals as a step towards a Capital Markets Union.

Legal

Labour Inspection's statistics: breaches of Labour Code not worthwhile

The State Labour Inspection Office conducted nearly 25 thousand inspections and collected over CZK 218 million in fines in the past year, according to the published results of inspections of compliance with labour-law regulations. Inspectors mainly focused on agency employment, the illegal employment of foreigners, 'Svarc' systems, and occupational safety and health protection. The statistics also confirm a recent trend: the majority of inspections are triggered by complaints.

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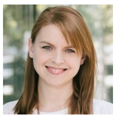

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Agency employment has been under the Labour Inspection's scrutiny for some time. The current rather strict regulation makes prohibited practices look tempting, despite the sanctions amounting to millions. The Labour Inspection conducts regular checks as well as large-scale unscheduled inspections. Nearly one in five inspections ends in a fine, while the 'evergreen' offence is the failure to pay the same remuneration to agency employees working for a company as is received by the company's own employees. Companies may also get into trouble if they fail to provide the agency with accurate information on their employees' remuneration. Apart from common agency employment, the Labour Inspection also looks into concealed agency employment, whereby a company not licenced as an employment agency seemingly delivers services or work, but in effect just rents staff to the customer. The Labour Inspection plans to continue in its focus on agency employment this year as well.

Another area frequently inspected is illegal employment, in particular employment of foreigners without a permit, and the 'Svarc' system. When inspecting the legality of work carried out by foreigners in the Czech Republic, the Labour Inspection cooperates with the police, checking whether foreigners have valid residency and work permits corresponding to the scope of work contracted. Last year, over two thousand illegal foreign workers were detected by random checks and large-scale inspection projects. And it is not just the foreigners facing the penalty, but also their employers and companies for whom they work, even on a temporary basis – whether posted there by a contractor or by a parent company. The Labour Inspection also detected nearly eight hundred instances of 'Svarc' systems. For both mentioned forms of illegal work, the penalty for allowing its performance is up to ten million crowns.

A substantial portion of detected offences involved breaches of general labour-law regulations. Inspections focused on compliance with occupational safety and health rules, obligations in concluding and terminating employment contracts, and regulations on remuneration and working hours. If an offence is detected, it can hurt the company in a number of ways: apart from a severe fine, the company may be prevented from drawing subsidies or obtaining work permits for its employees. Employers should also note that more than one quarter of the inspections were initiated upon complaints, which could have been lodged by almost anyone, even a dishonest competitor or a disgruntled employee. We can but recommend that companies devote increased attention to ensuring compliance with applicable labour-law regulations.

OECD issues release on reviews conducted within BEPS

The Organisation for Economic Cooperation and Development (OECD) has issued a release that updates the results of preferential regime reviews conducted by the Forum on Harmful Tax Practices (FHTP) in connection with Action 5 under the Base Erosion and Profit Shifting (BEPS) initiative.


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The governments of individual states continue to adopt legislative measures to make their preferential tax regimes compliant with BEPS Action 5: countering harmful tax practices more effectively. FHTP published the results of its reviews on preferential tax regimes, stating that:

- In Lithuania, Luxembourg, Singapore and Slovakia, new regimes have been designed that comply with FHTP standards, meet all aspects of transparency, exchange of information, and substantial activities; these have been found not harmful in regards to tax competition.
- Four regimes, in Chile, Malaysia, Turkey and Uruguay, have been abolished or amended to remove harmful features.
- The last three regimes (one in Kenya and two in Vietnam) have been found to be outside the scope of the FHTP as they do not concern taxation of business or cross-border activities and therefore do not pose any BEPS Action 5 risk.

FHTP's last update identifies eleven new preferential regimes, bringing the total to 175 regimes in over 50 jurisdictions. Of these, 31 regimes have been amended and for 81 regimes legislative amendments are underway and yet to be completed. 47 regimes have been determined not to pose a BEPS risk, 12 regimes are still under review and four regimes in three countries (Jordan, France and Turkey) have been found to have harmful or potentially harmful features. The harmful tax practice in France consists in a reduced rate for long-term capital gains and profits from the licensing of IP rights.

For more details, view an interactive map on the OECD website showing key indicators and results of the reviews in international tax matters.

Case law

Tax penalty with a prison sentence on top?

One of the topics frequently discussed by Czech judiciary and tax professionals is the concurrence of administrative and criminal sanctions. A crucial issue here is the relationship between a penalty imposed in tax proceedings, and a subsequently initiated criminal prosecution. The Court of Justice of the EU (CJEU) has provided a new view of the matter in its recent judgment No. C-524/15, dealing with the compliance of Italian legislation with the ne bis in idem principle guaranteed by the EU law.

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The dispute concerned an Italian taxpayer who failed to pay properly reported VAT on time. Under Italian tax law, the taxpayer was charged a penalty of 30% of the unpaid tax (a flat penalty for the default). The tax proceedings were closed and the taxpayer paid the first instalments. However, as the owed amount exceeded the limit stipulated by the criminal code, criminal proceedings were also initiated against the taxpayer, with a possible sentence of up to two years of imprisonment.

As the Charter of Fundamental Rights of the EU prohibits double punishment for the same act (ne bis in idem), and as the VAT Directive requires member states to adopt measures to prevent tax evasion, the Italian court referred to the CJEU for a preliminary ruling on whether it was possible, under the EU Charter of Fundamental Rights, to initiate criminal proceedings although the taxpayer had already been charged a final administrative penalty.

The CJEU first held that the ne bis in idem principle stipulated by the EU Charter generally applied to all types of sanctions of a criminal (punitive) nature, irrespective of how they are named or viewed by the member state's law. A flat 30% penalty fine for a failure to pay tax clearly is of a punitive nature. According to the court, however, the ban on double punishment is not absolute and can be limited by the state's legitimate effort to combat tax evasion in the VAT area. Applying criminal-law sanctions concurrently with administrative sanctions (of a punitive nature) is possible, albeit subject to strict conditions. The states must namely ensure that:

- individual sanctions pursue objectives of general interest and are complementary (for instance the penalty in administrative proceedings applies also to the unintentional failure to pay tax, while sanctions under criminal law are only imposed for offences that are provably harmful to society),

- individual proceedings are coordinated to put as little pressure on the taxpayer as possible (it is not desirable for the taxpayer to be subjected to lengthy investigations by separate institutions for a single offence),

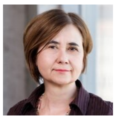
- the severity of sanctions is proportional to the seriousness of the offence (the penalty imposed in tax proceedings has to be taken into account in the criminal proceedings).

The judgement is rather pragmatic: on one hand, the CJEU confirmed the possibility of concurrently, or rather subsequently, applying administrative and criminal sanctions, while on the other hand it suggested that punishing of taxpayers has its limits and cannot be excessive. In the Czech context, it will be interesting to see whether the judgement will have any effect on the approach applied by tax administrators and, in particular, public prosecutors, as there is now a visible trend towards prosecuting tax-related offences more often.

In brief

Latest news - June 2018

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



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- The new mandatory disclosure requirements for intermediaries and relevant taxpayers will enter into force on 25 June 2018, i.e. twenty days after their publication in the Official Journal on 5 June 2018. These are the most recent amendments to the Directive on Administrative Cooperation in the Field of Taxation (“DAC 6”), which must be implemented by member states before 31 December 2019 and which will apply from 1 July 2020. Intermediaries and relevant taxpayers will also be required to disclose information on reportable cross-border arrangements, whose first step is to be implemented between 25 June 2018 and 1 July 2020. This information should be filed by 31 August 2020.

- The Ministry of Finance issued a notification clarifying the accounting treatment of virtual currencies. According to the ministry, a virtual currency is viewed as a digital medium of value. While the motive for holding virtual currencies may vary among users, regardless of the holders’ intentions, the ministry recommends recording them as “special-type” inventories, reporting them in work in progress, finished products or goods in the balance sheet and disclosing information about the purpose of their acquisition and holding and the method of their valuation in the notes to the financial statements.

- The Ministry of Industry and Trade published an updated timetable of calls to participate in the Enterprise and Innovations for Competitiveness Operational Programme in 2018. According to the new timetable, other calls to take part in the popular Innovation and Potential Programmes, designed also for large businesses, are planned for autumn 2018. The timetable is available for downloading on the API’s or the ministry’s websites.

- The May ECOFIN Council (the council of European finance ministers) adopted DAC6 rules aimed to enhance transparency and prevent aggressive cross-border tax planning. DAC6 focuses on intermediaries such as tax advisors, accountants and lawyers who propose or recommend tax planning arrangements. According to DAC6, intermediaries will have to report arrangements that may be aggressive. The ministers also agreed on excluding the Bahamas and the Federation of Saint Christopher and Nevis from the EU list of non-cooperative jurisdictions, since these countries have committed themselves on a high political level to rectify areas that are problematic from an EU perspective.

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