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For the Ministry of Finance, presenting a comprehensive amendment to tax regulations in early spring and planning its effectiveness from the start of the following year has already become a sort of tradition. However, last year was different. The ministry in fact did present a tax amendment last spring but the related legislative process took so long that said amendment was only signed by the president last week. Right now, nothing can keep it from becoming effective, but we may only speculate when exactly this will happen; unofficial sources talk about sometime during mid-year.

This year promises to be different as well: larger amendments to tax regulations hardly ever get introduced in an election year. Yet, the Ministry of Finance has shifted its focus to a long-term vision of direct taxes, in particular a new Act on Income Tax. The ministry plans to present a new income tax concept called tax recodification to a new finance minister right after the elections. The new regulation may introduce positive changes very much desired by taxpayers, such as group taxation or the possibility to apply results reported under IFRS.

The ministry will have to assess any additions or changes from a long-term and timeless perspective. A lecture by the Bishop of Pilsen Tomáš Holub, given at a meeting of family business owners organised by the Economia publishing house, may serve as an inspiration for them. At this session, Bishop Holub compared qualities and values shared by both the church and successful family businesses. As most important, he saw the willingness to consider what may lie in store for the next but one generation. This perspective is vital not only for family-run but for non-family businesses as well and we would do well not to lose sight of it in our hurried everyday lives.

Finally, I'd like to share with you a recent success by the Tax and Legal Update's team of authors. Last month, we received two corporate media awards, Zlatý středník (Golden Semicolon) and Fénix Content Marketing. We highly appreciate these awards as they make us committed to the future.

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When will Income Tax Act amendment become effective?

An amendment to the Income Tax Act, already signed by the president, is set to come into effect on the fifteenth day of its publication in the Collection of Laws. According to unofficial sources from the Ministry of Finance, the publication will be timed to ensure effectiveness from 1 July 2017. It has been a while that an amendment to the Income Tax Act came into effect mid-year and its timing naturally adds greater importance to transitory provisions and their interpretation. For example, when will it be possible to depreciate technical improvements made by sub-lessees? Answers to such questions can be found in the Ministry of Finance's interpretation of the transitory provisions presented to the professional public.

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The amendment's transitory provisions contain a total of 22 points. The first general rule prescribes that the new regulation will apply to taxable periods started during the time of the amendment's effectiveness, i.e. most often the 2018 taxable period. A number of amended rules are additionally governed by an individual transitory provision, for example, the new depreciation rules may only be applied to fixed assets and technical improvements put into use after the amendment's effectiveness. According to the ministry, both rules apply simultaneously, which in practice means that a sub-lessee will be allowed to depreciate technical improvements put into use after 1 July 2017 but will be allowed to utilise related depreciation charges only in the taxable period started after this date, i.e. usually from 2018.

According to the ministry, the same interpretation of effectiveness should be applied to the extension of the period over which intangible assets are depreciated. In the 2017 taxable period, taxpayers must depreciate intangible assets over the periods prescribed by law. It will not be possible to extend the depreciation periods - and thus reduce depreciation charges - in respect of intangible assets put into use after the amendment's effectiveness earlier than in the 2018 taxable period. From 2018, intangible assets will be depreciated on a straight-line basis using their net book values.

The Ministry of Finance's conclusions as to the application of the new withholding tax rules are also surprising. These will mainly affect non-profit entities and unit owners associations as well as financial institutions paying interest income to these entities. The amendment extends the scope of the 19% withholding tax to interest on deposits. Arguing that withholding tax is just another income tax collection method applied in a respective taxable period, the ministry concludes that the effectiveness of the new regulation shall be governed by the taxable period of the interest recipient, and not by the moment the interest is paid. Thus, in these cases, withholding tax is not likely to be applied earlier than from 1 January 2018. This interpretation imposes additional requirements on banks and savings and credit cooperatives. According to the new provisions, these entities will have to ascertain the taxable periods of selected entities. For the sake of completeness, we point to the fact that the new withholding tax rules should also apply to the gratuitous income of non-residents.

Transfer pricing: financial administration's number one hit

For the last five years, transfer pricing issues have undoubtedly attracted a lot of attention from the financial administration.

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Increasingly often, we can hear abbreviations such as ATAD, BEPS or about country-by-country reporting, master files or local files. Appendix 12 to income tax returns, summarising related-party transactions, has become an integral part of corporate taxpayers' lives. As an example of the prevalence of this issue we may include the tax authorities' automatic demand for the submission of local transfer pricing documentation in tax inspections. All of this significantly increases the administrative burden on taxpayers.

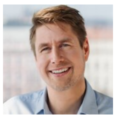
In the past, tax officials preferred to avoid transfer pricing issues and inspections were quite rare. Today, it is an entirely different situation: every official claims to be a transfer pricing expert, many times holding rather unorthodox opinions on what corporations should have done under specific economic circumstances. In many cases, the tax authorities' procedures verge on abuse of the state administration's power, similarly as in the case of issuing securing orders. The financial administration's growing interest is also evident from the development of additionally assessed tax because of transfer pricing. In 2016, the financial administration carried out ca. 900 inspections, showing a year-on-year increase of more than 10%.

Year	Additionally assessed tax in CZK	Increase in the tax base in CZK	Reduction of tax loss in CZK
2013	71 759 104	336 386 414	131 267 918
2014	59 402 410	259 612 320	244 221 586
2015	446 263 377	2 431 935 440	390 970 153
2016	886 116 252	4 783 203 802	8 502 980 932

Transfer pricing inspections as well as technical news, including our experience with cross-border dispute solutions, will be discussed at KPMG's traditional **Transfer Pricing Forum**, taking place on **Tuesday, 23 May**. You may register for the event here.

Increasingly restrictive measures to secure tax collection

The tax authorities have recently adopted increasingly restrictive measures to collect as much tax as possible. One of these measures is the extended application of securing orders and their subsequent enforcement within a very short time. This, however, is not all.



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Securing orders serve to collect funds on the tax authority's account where the future collection of the estimated tax liability appears to be endangered. Securing orders may be used before the actual tax liability is determined or before a tax inspection is completed, largely depending on the tax authority's discretion. The deadline for depositing the funds does not exceed three workdays. However, often there is no time for such a voluntary provision of security, as together with issuing securing orders, the tax authorities also freeze bank accounts and attach other assets, especially in VAT-related matters.

According to published tax administration statistics, the number of cases in which the tax authorities decide to enforce taxpayers' assets based on securing orders has increased dramatically over the last years. We know from practice that the tax administration often tends to target amounts that are incomparably lower than those inspected in the past, focusing also on other taxes than just VAT. These actions, usually undertaken very quickly, may have the effect of paralysing, or even terminating a corporation's business activities. We have also noticed a growing number of court decisions stating that securing orders were issued and related enforcement was performed unlawfully. The financial administration does not always take these court decisions into account, albeit officially declaring that it proceeds with securing orders with more prudence and that their enforcement is professionally supervised.

The tax authorities also increasingly often issue enforcement orders ordering taxpayers' debtors or business partners to pay their debt, often a specific invoice, directly to the tax authority's account. This trend is the result of submitting VAT ledger statements, due to which the tax authorities have gained a better understanding of taxpayers' business partners and relations.

Practices that we have met with show that the financial administration has begun to proceed very diligently. At the end of tax inspections resulting in additional tax assessments, the tax authorities quite commonly examine the property owned by taxpayers to assess the (non-)fulfilment of the criteria to subsequently issue securing orders. They usually do so irrespective of whether the amount of an additionally assessed tax is insignificant. They usually also examine whether taxpayers have proceeded in compliance with the Act on the Restriction of Cash Payments.

We recommend that taxpayers pay increased attention to their tax matters and, when contacted by the tax authority, continue to communicate and adopt measures to avert or mitigate any negative effects. They should also be more careful when choosing their business partners. And, if necessary, they should be ready to defend their rights before administrative courts.

Change in VAT relating to the realisation of security

Already signed by the president, an amendment to the VAT Act introduces a considerable change for banks and other VAT payers who secure the future payment of their receivables with movable and immovable property. According to the new amendment, likely to become effective from 1 July, the realisation of these types of security will be subject to the reverse-charge mechanism. The amendment gives rise to some uncertainty, which the General Financial Directorate's information currently in preparation should hopefully remove.

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The amendment to the VAT Act introduces the application of the reverse-charge mechanism on the supply of goods provided as security by one taxable person to another when realising this security. The legislators' intention is to improve the collection of VAT; it can be expected that insolvent debtors who do not meet their secured obligations will not also have sufficient funds to pay related VAT. Similarly as in the EU VAT Directive, the amendment uses the term security without providing a closer definition. The GFD's information under preparation clarifies that the new regime will primarily apply to the sale of the object of the securing transfer of an ownership title or a pledge to a third person.

The GFD's information confirms the existing approach that no taxable supply arises when a pledge is established or a securing transfer of a title is contracted. The taxable supply arises once the object of the security is realised (sold). And the security realisation does not result in only one supply but two at the same time: a taxable supply occurs between the debtor and the creditor (usually a bank) and, simultaneously, between the creditor and a third party. The application of VAT on the delivery of the object of security to a third person does not change at all: this supply continues to be subject to a VAT regime depending on the type of transaction in compliance with general VAT rules. But new rules govern the supply between the debtor and the creditor, prescribing the application of the reverse-charge mechanism. The debtor will have to issue a tax document stating that VAT will be paid by the customer. The VAT base will always be the price for which the creditor sells the object of security to a third party, irrespective of the amount of outstanding debt. A potential difference between proceeds from the realised security and outstanding debt will be refunded to the debtor and the refund will not be subject to VAT. The creditor, typically a bank, will report and pay output VAT and, simultaneously, will be entitled to VAT deduction under standard conditions, i.e. if the delivery to a third person is connected with the entitlement to deduct VAT.

The above VAT regime will only apply where the general conditions for the application of the local reverse-charge mechanism are met. Above all, both the debtor and the creditor must be VAT payers and the object of security must be goods pursuant to the VAT Act and not, for example, financial guarantees or guarantees in form of securities.

The GFD's commented draft information is not yet final. The draft does not deal with certain issues; for example, the tax regime of lapsable pledges or situations where the object of security is not sold to a third person but the creditor decides to keep it.

Subsidies: also available for large enterprises?

In the second half of April, the Investment and Business Development Agency ceased to accept applications for support under the Potential and Innovation Programmes, falling under the Enterprise and Innovations for Competitiveness Operational Programme. What's the outlook for future subsidies? Will large enterprises be allowed to continue to draw them? What other investment support options are available?

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According to the latest information, total funds allocated to both programmes have almost been exhausted. The summary of final balances relating to these programmes should be available sometimes in mid-May. New calls for applications under the Potential Programme (support of research and development) and the Innovation Programme (support to introduce new technologies and products in manufacturing) are expected to be announced at the end of June or at the beginning of July 2017. Information about the final balances of applications filed within these programmes will be crucial for deciding whether large enterprises will also be allowed to apply for subsidies during the summer calls.

Within the Enterprise and Innovations for Competitiveness Operational Programme, calls remaining open are as follows: Energy Saving (support of measures saving energy; applications accepted until 30 March 2018), Low-Carbon Technologies (support of electric mobility; applications accepted until the end of May 2017), and Renewable Energy Sources (support of energy generation and distribution; applications accepted until mid-July 2017). Large enterprises may also draw subsidies from these programmes.

Moreover, other investment support options applicable for large enterprises are programmes announced by the Technology Agency of the Czech Republic to support applied research and experimental development. Currently open programmes are, for example, the EPSILON programme (applications accepted until 17 May 2017). Within the DELTA programme, the agency plans to announce the fifth public tender intended to support research and development on an international cooperation basis.

In addition to direct subsidies, it is possible to make use of investment incentives granted to support the introduction or expansion of production, or technological and strategic centres (shared services centres or data centres, etc.). These offer ten-year tax holidays or other forms of aid in selected regions. The Ministry of Industry and Trade is also currently preparing a number of interesting changes within a new amendment to the Act on Investment Incentives.

Amendment to the Act on Foreign Nationals' Residence in the Czech Republic introduces new types of permits

The Act on Foreign Nationals' Residence in the Czech Republic regulates the conditions under which foreigners may enter our territory and sets the rules for issuing residency permits and visas. Its amendment, which is now being discussed in parliament, widens the range of residency permits, introducing a special type of permit for foreign investors and seasonal workers. It also sets special rules for foreign employees posted in EU member states within multinational business groups. The new types of permits were not the Czech legislators' idea, but instead a response to EU directives.


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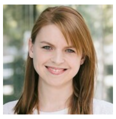
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The long-term residency permit for investment purposes will make stays easier for foreign nationals who intend to make a 'significant investment' in the Czech Republic; this means an investment of at least CZK 75 million and the creation of at least 20 jobs. To attract investors, various exceptions from the duty to produce some otherwise obligatory documents will be allowed; in return, applicants will have to submit a credible and feasible business plan. The permit will then be issued for the time it takes to make the investment, but not for more than two years.

The permit application process will be easier for seasonal workers as well. While the Employment Act already provides for foreigners coming to the Czech Republic to carry out seasonal work by regulating their work permits, the regulation concerning special residency permits for this type of stay has so far been missing. This gap is now being filled by a seasonal worker visa that may be granted for up to six months of one year. Applications of workers coming to the Czech Republic repeatedly to carry out seasonal work will be attended to on a priority basis. The areas where seasonal workers may work have also been defined: agriculture, gardening and tourism.

Foreign employees of companies with registered addresses outside the EU who are posted by their employer to work in EU-based companies of the same group or branches, may newly apply for an intra-company transferee card, which doubles as a work and residency permit. Business groups present in a number of EU countries will appreciate simplified conditions for the mobility of posted employees across the EU. A holder of an intra-company transferee card issued by another EU member state may work in other member states without limitations for up to 90 days. Should the work in another EU state take longer, workers may apply for a special permit that, in effect, will recognise the validity of the foreign card.

The amendment was passed by the chamber of deputies in April and is now to be discussed in the senate. Its effective date is rather rushed – planned for the fifteenth day of its promulgation, as the deadlines for transposing the relevant directives already expired last year.

Abolishment of investment limits for qualified investor funds

The government passed a long-awaited amendment to the decree on investing of investment funds and the techniques of their management. Starting from 1 June 2017, qualified investor funds no longer have to diversify their assets in compliance with statutory investment limits.

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Since its adoption, Governmental Decree No. 243/2013 Coll., on investing of investment funds and the techniques of their management, has unreasonably restricted the investment strategies of qualified investor funds. Under the existing legal regulation, funds have not been allowed to invest more than 35% of the fund capital into a single asset. Diversification rules thus prevented the establishment of single-asset funds and placed high demands on the planning of asset structures to comply with the statutory requirements over the entire existence of a fund. Not even numerous complicated exceptions, based, for instance, on the number of investors or the fund's capital, had the desired effect of providing the flexibility necessary to carry out the wide range of investment objectives held by qualified investor funds. What's more, the interpretation and application of individual exceptions has not always been unambiguous. Also, the assumption that asset diversification is the only model that will protect investors has since been overcome in practice.

The amendment to the decree abolishes all diversification rules for qualified investor funds. From now on, investment limits will only be regulated by the fund's statutes. As a number of qualified investor funds incorporated the decree's provisions concerning asset structure into their statutes, fund managers will now have to change the statutes if they want to make a full use of the new opportunities. Such a change will not be subject to prior approval by the Czech National Bank, as is the case for collective investment funds intended for retail investors.

For qualified investor funds whose managers are authorized pursuant to AIFMD, the decree still stipulates qualitative requirements as to using leverage on the fund's account and providing investment instruments from the fund's assets as collateral or another form of security.

EC presents additional tools to fight aggressive tax planning

The launch of an application to report illegal business practices and the establishment of a special unit of the European Commission – these measures are intended to help the EU tackle aggressive tax planning. Information gained through these tools should make the investigation of illegal business practices faster and more efficient. The special unit will, among other things, focus on state aid in the context of EU law.


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The European Commission presented a new tool that will allow whistle-blowers to anonymously report business practices that might be in violation of EU law. The application will primarily serve to gain information on possible violations of competition rules, the existence of cartel agreements and other illegal practices in awarding public contracts.

The new tool follows the existing whistle-blower programme whereby companies may report their own involvement in cartel agreements in exchange for mitigated sanctions. The application is accessible on the European Commission’s website.

The OECD is not lagging behind in this respect, either. In March, it released a report on technological tools to fight tax evasion and tax fraud, outlining how governments may use technologies to identify tax fraud and tax evasion.

Another measure is the establishment of a special unit within the EU Directorate General for Competition. The department will deal with aggressive tax planning and cases of state aid that might be in violation of EU law. A task force for dealing with tax planning practices and illegal state aid was established as far back as 2013 as a temporary tool of the Commission; now it will be a permanent unit within the Directorate General.

Stricter conditions for tax deductibility of expenses?

Some rulings by the Supreme Administrative Court (SAC) have surprising outcomes and de facto narrow the space for recognising expenses as tax-deductible by requiring proof that that a service was received from a specific supplier.

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The difference between the requirements for deductibility of expenses under the Income Tax Act and those for granting an entitlement to VAT deduction for the same expense under the VAT Act seems to be fading. At least this is implied by two Supreme Administrative Court judgments issued within a year. It may therefore happen in the future that taxpayers will have to prove that a supply was actually provided by the person stated in the tax document also for income tax purposes.

In one of its judgments last year, the SAC rather unexpectedly sided with the tax administrator who argued that an expense could not be recognised as deductible if, considering all the circumstances of the case, it was obvious that the customer knew or could have known that the work invoiced was carried out by a person other than the one who issued the document confirming the receipt of a payment for the work. So far, the issue of good faith and (no) knowledge of suppliers' misconduct has only been typical for VAT.

A similar opinion was expressed in the SAC judgement of March this year. The case in question did not involve a dispute as to whether the work was carried out and paid for. The heart of the disagreement was proving whether the work was carried out by workers of the supplier as stated in the pertaining tax document. As the taxpayer was not able to prove that the work had been carried out by the company listed in the document, the expenses were treated as non-deductible.

These judgments imply that the tax administrators' efforts to set even stricter conditions for the deductibility of expenses are escalating. In the future, it may even be the case that where the entitlement to VAT deduction is denied on the grounds of failing to prove the supplier, the same expense will automatically be treated as non-deductible for income tax purposes.

Supreme Court: end of zero tolerance to alcohol at work

Although the Labour Code bans employees from entering the workplace under the influence of alcohol, the Supreme Court in its recent judgment stated that not every breach of this duty is automatically a justified reason for dismissal. According to the court, employers have to consider the detected level of alcohol in the blood, but also the employee’s previous work discipline. The judgement sets a dangerous precedent that may be taken advantage of by employees.

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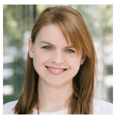

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In the case in question, an employee underwent a breath analysis upon entering the workplace, which detected 0.32‰ of alcohol. In a repeated measurement half an hour later, the level dropped to 0.23‰. A subsequent blood test measured 0.11‰ alcohol in the blood. The employer assessed this misconduct as a serious breach of duties and gave the employee notice of termination. The employee argued that he had not consumed any alcohol and challenged the validity of the termination in court.

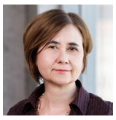
The Supreme Court sided with the plaintiff and declared the termination invalid. The court considered the blood alcohol level to have been too low to have actually influenced the employee and based its opinion on the conclusions of an expert witness. The expert stated that influence by alcohol is only relevant where the blood alcohol level is at least 0.5 ‰, as a lower level only proves that alcohol was consumed but not that it influenced the individual. The court also challenged the results of the measurement by breathalyser, stating that a blood analysis was the only reliable test. The employee’s previous behaviour also worked in his favour, as he had worked for the employer without major problems for eighteen years. Thus, while the court concluded that the employee did indeed breach his duties, it classified the breach as less serious and not in itself a sufficient reason for giving notice of termination.

This benevolent approach of the Supreme Court is even more surprising considering that the employer did not penalise the breach with the strictest sanction available – immediate termination of employment – but terminated the employment by notice, which meant that the employee had two months of paid notice to look for a new job. Moreover, the employee was working at a steelworks, where the risk of injury is high.

The judgement is one in a series of rulings where the Supreme Court has sided with employees. Employees no longer have to be concerned when entering the workplace under the influence, knowing that it will not be easy for their employer to penalise them. For employers, it can only be recommended not to rely solely on breath analysers, and to have positive results confirmed by blood tests. Also, they have to act quickly, before the level of alcohol drops below 0.5 ‰. If the employer proceeds to terminate the employment, they should have other arguments ready to support the employee’s problematic past.

Latest news - May 2017

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



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- In the course of May, a third call within the TRIO programme is to be announced. According to the schedule, it should be the last call of this programme focusing on support for research and development. Unlike other programmes, the support is also available to applicants from Prague. The time available for submitting the projects should be at least 43 calendar days, and the results should be known by the end of 2017. Supported projects can be implemented starting from January 2018.

- A Notice of the Ministry of Labour and Social Affairs announcing the amount equal to 50% of the average monthly wage in the national economy for the purposes of the living and subsistence minimum and amounts of 50% and 25% of the average monthly wage in the national economy for the purposes of state social support was published in the Collection of Laws under No. 121/2017. Starting from 1 July, the amount equal to 50% of the average monthly wage in the national economy is CZK 13 700.

- A Notice of the Ministry of Labour and Social Affairs on the amount of the average gross annual wage in the Czech Republic for 2016 for the purposes of issuing blue cards under Act No. 326/1999 Coll., on Foreign Nationals' Residence in the Czech Republic. For the period from 1 May 2017 to 30 April 2018 the average gross annual wage in the Czech Republic is CZK 331 068.

- Tax exemptions do not apply to residential units in newly constructed family houses. The financial administration published this warning in its information on the application of tax on the acquisition of immovable property when acquiring an ownership title to a residential unit in a family house.

- The European Commission issued a document on the future social dimension of the European Union, summarising the social situation in individual member states and outlining possible cooperation scenarios in the social area. A long-awaited package of measures intended to harmonise work and private life was also released. The information was published by the Ministry of Labour and Social Affairs on its website.

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