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The legislative process is always slow-paced during summer, even more so in a parliamentary election year. And the present government will not be able to squeeze in much. Hence, it will be more interesting for us to watch the Supreme Administrative Court's rulings and the application of existing legislation in practice.

Over the summer, we have seen a number of interesting decisions that may significantly change the old ways. In this issue of Tax and Legal Update, we present a ground-breaking ruling on the deductibility of write-offs of insured receivables. Although the described case is specific, we believe that the principles formulated here could be applied not just to the area being discussed, but generally also to certain revenues related to tax non-deductible expenses.

In the previous issue, we wrote about a decision regarding the determination of tax base for immovable property acquisitions; it confirmed that the tax base should not include value added tax. Although the tax administration initially resisted the application of the ruling, its most recent press release is much more open to compromise: where the immovable property acquisition tax is to be paid by the transferor, and the contracted price was paid including VAT, the tax administration will now assume that for the purposes of determining the tax base, VAT shall not be included. For other circumstances, the tax administration's approach is not yet certain. There may thus be room for filing additional tax returns.

The information on the growing number of unreliable payers is also interesting. Although a large number of these entities are probably inactive already, the growth indicates that the tax administration is devoting increased attention to the area. We may thus expect a more frequent application of the liability for unpaid tax from trading with these entities.



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Fast-growing number of unreliable payers

The unreliable payer concept has been in the VAT Act since 2013. According to the GFD, in combination with the taxable supply recipient's liability for unpaid VAT, this concept should serve as an effective tool to fight VAT evasion, whereas the number of unreliable payers has been growing significantly every day.



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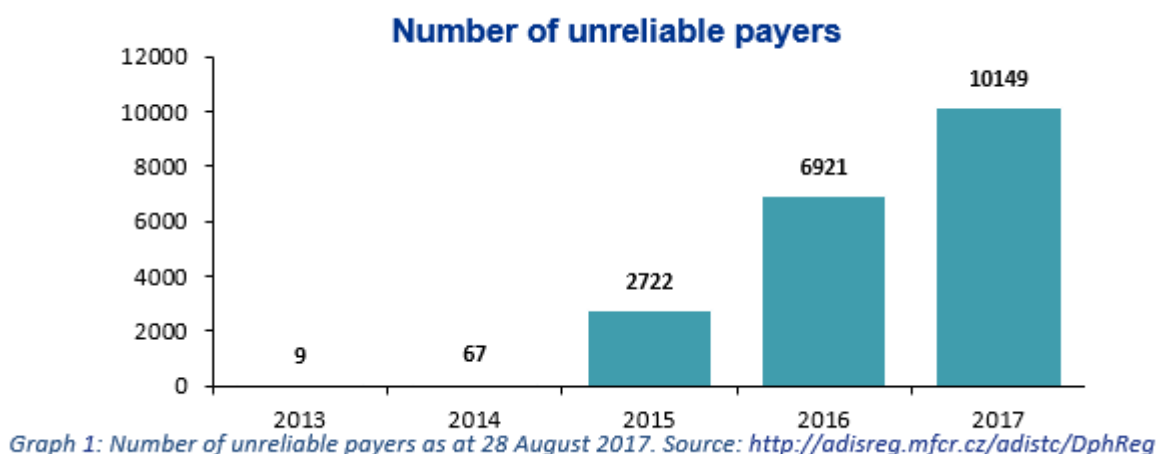
The VAT Act imposes a duty on the supply recipient to be liable for VAT unpaid by a supplier if the fact that the supplier is an unreliable payer had been made public at the date of supply or, under the July amendment to the VAT Act, at the date of providing consideration. The decisive date is the moment this information was made public. Supply recipients are also liable for VAT unpaid by suppliers if they make payments to unregistered bank accounts.

The GFD's original Information on the Application of the Unreliable Payer Concept ("the Information") slightly changed following the July amendment to the VAT Act. The Information summarises circumstances under which VAT payers become unreliable. Generally, these involve cases in which public interest in the proper collection of VAT has been jeopardised.

To be more concrete, these involve for instance situations where the VAT payer reports a cumulative VAT undercharge for at least three calendar months. The amount of the permitted undercharge is now CZK 500 thousand, compared to CZK 10 million as per the original Information.

You can generate a list of all unreliable payers (and persons) directly at the Tax Portal (adisreg.mfcr.cz). More than 10 000 unreliable payers were reported at the end of August 2017, accounting for about 2% of all VAT payers in the Czech Republic.

It is therefore quite vital to set appropriate control mechanisms, review the reliability of suppliers and make payments only to registered bank accounts.



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VAT Act amendment lets tax administrators cancel VAT group registrations earlier

The amendment to the VAT Act effective from 1 July 2017 accelerates the process of terminating VAT group registrations. Where the registration is terminated ex officio, the registration terminates at the moment the tax administrator's decision enters into legal force.



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The amendment to the VAT Act continues to prescribe two methods of cancelling VAT group registrations: either upon the VAT group's request, or ex officio. Nothing changes where a VAT group itself files a request to cancel its registration before 31 October of a calendar year. In this case, the tax administrator cancels the group's registration on the last day of the respective calendar year while members of the cancelled VAT group become separate VAT payers from 1 January of the following year.

The amendment provides a new regulation of the cancellation of VAT group registrations by virtue of office. Where a VAT group no longer meets the requirements set for VAT groups by the VAT Act or where the tax administrator learns that none of the VAT group members meet the VAT group membership criteria, the VAT group ceases to be a VAT payer on the date the decision to cancel the group registration enters into legal force, i.e. the tax administrator may cancel the group registration earlier than on the last day of the respective calendar year.

The amendment also directly defines the reporting duty of a member representing the VAT group. Once this group member determines that the group no longer meets the criteria prescribed by the VAT Act, the member must immediately report this fact to the tax administrator. The tax administrator then issues an ex officio decision to cancel the group's registration. The explanatory memorandum on the amendment provides that immediately means within 15 days of the date the relevant fact occurred. A member representing the VAT group not fulfilling this reporting duty may be subject to a penalty of up to CZK 500 thousand.

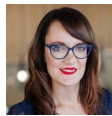
This means that under the new amendment, all changes relating to group registration conditions must always be immediately reported to the tax authority, even those that may subsequently not result in the tax authority's cancellation of VAT group registration.

Not only personal income tax under Supreme Audit Office's scrutiny

From June 2016 to this spring, the Supreme Audit Office (SAO) examined personal income tax administration and its examination outcomes do not spare the financial administration from criticism. In its report, the SAO estimates how much the administration of this tax has been costing employers, and also indicates a new direction in which the financial administration should or will be headed.



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Among other things, the Supreme Audit Office looked into the tax administrators' procedures and assessed the overall effectiveness, purpose and efficiency of personal income tax administration. The system itself has come under major criticism, with auditors pointing to the lack of transparency and the overall complexity owing to a large number of exceptions.

The SAO also identified deficiencies in handling electronic submissions. In 24% of the cases, submissions were rejected for reasons that did not obstruct the proper determination and assessment of tax but mostly involved only formal deficiencies. In more than 5% of the cases under review, the tax authority unlawfully imposed a penalty for the failure to file an income tax return without calling on the taxpayer to remove submission deficiencies. The SAO also pointed out that tax administrators did not sufficiently examine whether conditions for claiming deductions and tax credits had been met, primarily owing to the administrators' inability to check – on an automatic basis – the eligibility of deductions, i.e. whether conditions for claiming deductions had been fulfilled. Since 2016, the tax administration system has been using the central records of dependent children to improve the administration of personal income tax. The financial administration has recently also discussed possible cooperation and information exchange with the Czech Insurance Association and the Czech Social Security Administration.

The Supreme Audit Office also views as a shortcoming that the financial administration does not have at its disposal information about individuals subject to personal income tax on employment, not allowing for a better focus of its inspection activities on risk areas. In 2013 – 2015, a total of 21 408 inspections focusing on personal income tax returns were carried out and CZK 663 million was additionally assessed. A total of 12 989 inspections were carried out in respect of personal income tax on employment and CZK 250 million was additionally assessed. On average per an entity under review, CZK 19 thousand was additionally assessed with respect to personal income tax on employment and CZK 31 thousand with respect to individuals filing personal income tax returns.

The administration of personal income tax was found to be relatively efficient. Whereas expenses of CZK 1 for the administration of all tax account for an income of CZK 73 from all taxes, approx. CZK 156 is generated from personal income tax. According to the SAO, the efficiency is significantly higher owing to the transfer of the major part of tax administration responsibilities to payers – employers who, according to the SAO, bear expenses of CZK 948.5 million a year associated with personal income tax administration.

The financial administration's response to the SAO's report was quick. The Ministry of Finance agreed with the

SAO that the personal income tax system is too complex and lacks transparency and offered a cure in form of a new Income Tax Act, currently in preparation. The ministry promises a simpler law that will be more resistant to frequent introductions of tax exceptions. The ministry also stood behind their officials who have made errors. According to the ministry, human failures identified by the SAO “can be rectified via appeals against penalty decisions”. However, the question lingers how many of these errors remain unrectified.

The financial administration also points out that it continues to work on the MOJE daně (My Taxes) project, aiming to simplify tax administration, where MO stands for modern and JE for jednoduché, i.e. simple. The new electronic system and portal puts a lot of trust in modern information technologies. Hopefully, the selected technological solution will indeed be modern and will remain so. Alas, the T602 programme used for the current ADIS information system was also top-of-the line in the nineties of the last century.

SAC on direct link between non-deductible expenses and taxable revenues

The Supreme Administrative Court (SAC) issued a ground-breaking ruling relating to problematic Section 24 (2)(zc) of the Income Tax Act effective until the end of 2014, giving the opportunity to reassess the treatment of non-deductible expenses with directly related revenue and possibly achieve additional tax savings.



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The above Income Tax Act provision generally made it possible to treat expenses with directly related revenue as deductible even where such expenses would otherwise be regarded as non-deductible under the Income Tax Act. Although worded quite generally, the provision has been interpreted restrictively by the tax administration in the past years. As a result, taxable entities often adopted a conservative approach to the matter in line with the tax administration's interpretations. However, the ruling now provides an opportunity to reassess such cases and, where appropriate, file additional returns claiming a tax liability reduction.

This particular ruling dealt with a write-off of insured receivables. The court examined, among other things, the question of a direct link between non-deductible expenses arising from the write-off of insured receivables and revenue generated from an insurance company. According to the court, a direct link is understood to be a sufficiently intensive and unmediated logical connection. In this specific case, receivables in question were justifiably written-off to expenses upon the receipt of a relevant insurance settlement, as it made no sense to report receivables from which, in accordance with relevant contractual terms and conditions, the insured could not be satisfied under any circumstances (even if the debt corresponding to these receivables was later settled). The SAC believes that there is a logical and unmediated connection between the payment of the insurance settlement and the write-off of receivables. As a result, expenses arising from the write-off of receivables originally treated as non-deductible could therefore be treated as deductible up to the amount of the received insurance settlement.

Despite the specifics of the case in question, the court's reasoning could be extended to numerous other practical situations. However, as each case is unique, specific arguments for linking expenses and revenues must always be reviewed.

The ruling applies to the wording in effect until 2014, but some arguments can be applied analogously to later periods as well. Should you be interested in reviewing the potential benefits of the SAC ruling for your company, please do not hesitate to contact us.

Public call for the energy sector's THETA programme to be announced in autumn

In autumn, the Technology Agency of the Czech Republic will announce the first public call for participation in the THETA programme, aiming to support applied research, experimental development and innovation in the energy sector. The programme is expected to continue in 2018–2025 with public calls announced every year until 2023.



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The programme is divided into three sub-programmes. Projects that will be supported focus, inter alia, on the following:

- enhancing the reliability of energy generation, transmission and distribution systems;
- technologies relating to secondary sources of energy;
- technological and system components of smart networks, etc.

Programme announcement date and aid amount

It is expected that the first public call will be announced at the end of October 2017. Aid should be provided starting from 2018. Projects must be carried out within a period of eight years.

The amount of provided aid will depend on the category of individual activities (industrial research or experimental development) and on whether a project will be carried out in cooperation with a research organisation. Large enterprises may receive 15–65% of eligible project expenses. The least amount of aid will be provided to innovations; the highest to industrial research carried out in cooperation with a research organisation.

Eligible expenses

The programme will reimburse operating expenses, in particular:

- personnel expenses;
- expenses incurred for tools and equipment used over the duration of a project and for a project's purposes;
- expenses for contracted research, technical knowledge and patents purchased under a licence;

- additional indirect and other operational expenses.

Detailed information will be available after the first public call is announced.

Three changes to employee taxation

Tax exemption of employee benefits expanded. New deductible item for bone marrow donation. Further increase in minimum wage in 2018.



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Starting 1 January 2018, more employee benefits will be exempt from tax on income from employment: tax-exempt status will now also apply to printed books, including children's picture books, except books containing more than 50% of advertising. As a standard, employers will have to provide the benefits in non-monetary form, for instance in form of a voucher for the purchase of books. The expense is then tax non-deductible for the employer.

The President of the Czech Republic has signed an amendment to the Income Tax Act that increases the item deductible from the tax base for each blood donation from CZK 2 000 to CZK 3 000. Also, from now on taxpayers may reduce their tax base by CZK 20 000 for each donation of hematopoietic cells. The tax savings in this regard may be up to CZK 3 000. Both deductible items can be applied in the tax return for 2017 already.

The government approved the Ministry of Labour and Social Affairs' proposal to increase the monthly minimum wage. From 1 January 2018, it will be increased from the present CZK 11 000 to CZK 12 200. Accordingly, the minimum hourly wage will increase from CZK 66 to CZK 73.20. The government thus continues to implement the intention declared in its policy statement, i.e., to gradually increase the minimum wage so that it approximates 40% of the average wage. The increase will also affect the minimum health insurance premium payment for employees: where an employee's settled income is lower than the minimum wage, the employer will have to calculate and pay additional amount to meet the statutory minimum premium, which is CZK 1 647 per month.

Private enforcement of competition law made easier

The new Act on Compensation of Damage in the Area of Competition has successfully passed through the legislative process. It should make it easier to claim civil damages for the infringement of competition laws through cartels or abuse of dominant position. The act was published in the Collection of Laws under No. 262/2017 Coll. and is effective from 1 September 2017.



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The act transposes Directive 2014/104/EU, which aims to strengthen the position of those who suffered harm from an infringement of competition law and unify their status in proceedings across the EU. The changes it brings to the Czech law certainly deserve some attention. Unlike the general regulation of the scope and manner of damage compensation, the act stipulates that damage be compensated in full; this means that the discretionary power of a judge to reduce/mitigate damages shall not be admissible here. If damage has been caused by several entities acting jointly, as is typical for cartels, all of them shall be liable jointly and severally; this means that the court cannot decide that an infringer shall pay damages only in the amount corresponding to their involvement.

The plaintiff's (claimant's) position in the proceedings concerning cartels has been strengthened significantly: the law stipulates a rebuttable presumption that infringement of competition in form of a cartel results in harm; the burden of proof is thus transferred on to the defendant who has to prove that the infringement did not cause damage. A special regulation as to the limitation has also been introduced: a longer limitation period of five years is stipulated, which shall start to run on the day when the claimant knows, or at least could and should have known, of the damage, the identity of the person liable for the damage, and the infringement. The limitation period shall not begin to run before the infringement of the competition ceases.

The act also aims to further improve the position of the injured party (the claimant) and to remedy the information asymmetry that makes claiming damages difficult: it introduces a special procedure to provide the injured party with access to evidence. Even before initiating the proceedings for damages, the claimant may propose that the court order those who have control of any evidentiary documents to disclose these to the claimant. The penalty for the failure or refusal to comply can be up to CZK 10 000 000 or 1% of net turnover. To secure any damage that may arise from such a disclosure, the claimant has to make a security deposit of CZK 100 000 or more, if so requested by the court and depending on the circumstances of the case.

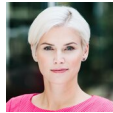
The new act should make actions for damages from the infringement of competition law easier. Only practice will show to what extent damages will actually be claimed by injured parties.

Less administration for entrepreneurs

The senate has passed an amendment to the Trade Licensing Act that brings some administrative simplifications. Among other things, it abandons the entrepreneurs' duty to provide to the trade licensing authority certain data available from the Trade Licensing Register and other public registers.



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The proposed amendment is now waiting to be signed by the president. It primarily aims to further reduce the administrative burden for entrepreneurs. Presently, for instance, they have to provide the trade licensing authority with the identification data of members of the firm's statutory bodies, even though the trade licensing authority may just as well obtain them from public sources. Moreover, in practice, it quite often happened that a different person was recorded in the Trade Licensing Register than in the relevant public register (typically the Commercial Register).

Similarly, entrepreneurs will no longer have to document the legal title to the premises of their registered offices where the trade licensing authority may verify it by checking the basic registers.

The amendment should also extend the scope of activity of central registration points and make them more efficient, allowing entrepreneurs to register for income or road tax when notifying their trade or applying for a licence with the trade licensing authority.

The amendment also introduces the possibility to ask for the issuance of a spreadsheet containing information on individual entrepreneurs, both in paper or electronic form. The spreadsheet will only contain entrepreneurs' basic identification data and information such as the scope of business or place of business. For personal data protection reasons, information given in the spreadsheet will be used exclusively for the applicant's personal need, for instance obtaining the contact information for other entrepreneurs.

Additional changes proposed in the amendment concern terminology or restrictions in carrying out a trade.

SAC: tax provisions for assets repairs have to be sufficiently supported with documentation

In its decision No. 9 Afs 149/2016-34, the Supreme Administrative Court (SAC) confirmed that where provisions are created for assets repairs, adequate documentation has to be available and the repairs have to be sufficiently concretised. It also pointed out the importance of a possible change in technical parameters of the asset in the distinction between a repair and a technical improvement.



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In 2012, a taxpayer replaced the windows of their real property. In preceding years, the taxpayer had created a provision for repairs of fixed assets for this purpose and claimed additions to this provision as a tax-deductible expense.

The tax administrator opposed this approach. In its opinion, the taxpayer had not documented the additions to the provision sufficiently, as it was not clear from the documents presented how exactly the repair was to be carried out and how the amount of the provision had been determined. The tax administrator also concluded that the mentioned window replacement should have been treated as a technical improvement rather than a repair, as double-glazed windows were replaced with triple-glazed ones. This was also obvious from the submitted minutes of the general meeting during which the creation of the provision had been approved. The tax administrator thus challenged the deductibility of the created provision and assessed additional corporate income tax.

The taxpayer tried to reverse the tax administrator's decision by filing an action with the Regional Court in Ostrava and, after its dismissal, a cassation complaint with the Supreme Administrative Court (SAC). The SAC, however, confirmed the tax administrator's conclusion: it agreed that the replacement of double-glazed windows with triple-glazed ones is generally a technical improvement; triple-glazed windows usually have better heat and sound permeability parameters than double-glazed windows. The SAC also stated that despite having produced the supporting documents (e.g., the provision records), the taxpayer had not sufficiently proved their assertion that a repair (not an improvement) was to be carried out. While an expert statement could have been used as evidence, in this concrete case, the expert was unable to ascertain the original and the planned condition of the windows from the documentation.

Technical improvement is an undefined legal term. The difference between repair and technical improvement is that the latter is repair of a higher quality. This opinion – previously confirmed by case law – is in line with GFD Instruction D-22, which views a higher number of window glass layers as a change in the technical parameters of an asset. The SAC stated that when claiming a tax deductible provision for tangible asset repair, the taxpayer must be able to support (with appropriate documents) the original and the planned condition of the asset to be repaired, as well as the process of carrying out the repair. A detailed budget of the project also has to be available, based on

which the amount of the provision is to be determined.

Interest on retained excess deductions yet again before Court of Justice of the European Union

The Court of Justice of the European Union confirmed yet again that tax administrators should refund excess deductions to taxpayers within a reasonable time. If they fail to do so, the taxpayer is entitled to late payment interest (default interest); however, such interest is not due for any delay caused by the taxpayer.



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Legal regulations of value added tax in individual EU member states are based on Council Directive 2006/112/EC (the “VAT Directive”). Recently, the Court of Justice of the European Union (CJEU) has repeatedly dealt with the issue whether national regulations that restrict the payment of the default interest on retained excess deductions or do not award such interest at all are compliant with EU law.

In the latest instance, the compliance of Hungarian legal regulations with EU law was in question. Hungarian law stipulates that if a taxpayer has been fined for failing to cooperate in an investigation of an excess deduction, the default interest is to be calculated only as of the date on which the formal report on the findings of the investigation was delivered.

According to the CJEU, this provision of Hungarian law is obviously inadequate: it does not take into consideration the concrete circumstances of the delay on the taxpayer’s part; as a result, tax administrators may retain an excess deduction for a rather long time, even without the taxpayer being entirely at fault for the delay. It is thus always necessary to determine the proportion of the duration of the tax investigation procedure that can be attributed to the taxpayer, and take it into consideration when calculating the default interest on the retained excess deduction. If the investigation of the excess deduction takes longer because the taxpayer refused to cooperate with the tax administrator, the taxpayer then cannot claim default interest for the period of delay caused by such lack of cooperation.

Finally, the CJEU emphasised the national courts’ obligation to interpret national law in conformity with EU law. In other words, when exercising their jurisdiction, national courts may refuse to apply a provision of national law if it is in conflict with community law, while it is not necessary for the courts to request or to await the prior setting aside of that provision of national law by legislative or other constitutional means.

To summarise: the CJEU requires that tax (excess deduction) must be refunded within a reasonable time. If that is not the case, the fiscal neutrality principle requires that the financial loss caused to a taxable person must be compensated by the payment of default interest. This approach has to be applied by all courts within the EU, irrespective of whether it is stipulated in national legislations. The same opinion was voiced by the Supreme Administrative Court in its judgment approximately two weeks ago.

Latest news - September 2017

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



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- At its August meeting, the CNB Bank Board adjusted interest rates, increasing the two-week repo rate to 0.25% p.a. The two-week repo rate is used as a basis to calculate default interest under the Civil Code, i.e. as per Government Decree No. 351/2013 Coll. The default interest is determined depending on the moment the default occurred, thus amounts to 8.05% p.a. for the entire period of default where the default occurred before 31 December 2017. The CNB two-week repo rate is also taken as a basis by tax administrators when determining default interest under Section 252 of the Tax Procedure Rules. In this case, the default interest is calculated starting on the fifth working day following the due date up to the payment date (including that date) and corresponds, per annum, to the CNB repo rate effective on the first day of the respective calendar half-year increased by 14 percentage points. Thus, for the period of default from 1 January 2014 to 31 December 2017, default interest under the Tax Procedure Rules amounts to 14.05% p.a.
- On its website, the General Financial Directorate published information aiming to acquaint the public with changes in the application of VAT by company shareholders resulting from the adoption of Act No. 170/2017 Coll., amending certain tax legislation.
- The senate approved a bill according to which insolvency cases will be allocated to judges using an automatic and random system. The government originally proposed to apply this system to all court proceedings, but the chamber of deputies limited its application via an amendment to the Civil Procedure Rules. The bill has yet to be signed by the president.
- It is likely that non-profit organisations will not have to be recorded in a register to obtain publicly beneficial status. Today, the senate approved an amendment to the Civil Code in a wording by which the chamber of deputies replaced the controversial government bill on the publicly beneficial status. The amendment has yet to be approved by the president.
- The senate intends to increase state contribution to employers for wages paid to employees with disabilities to CZK 12 000 a month. The contribution nowadays amounts to CZK 9 500 a month and the chamber of deputies approved its increase to CZK 10 500. The senate's version of an amendment to the Act on Employment will be discussed by deputies at their September session.
- The Senate approved an amendment to the Act on International Cooperation in Tax Administration aiming to fight tax evasion on an international basis and imposing a duty on multinational companies to inform about their financial situation in individual countries in which they operate. The amendment has yet to be approved by the president.
- The chamber of deputies and the senate will be allowed to mutually amend changes to constitutional and electoral legislation to achieve consensus on their wording. Deputies would therefore no longer have to approve senate-proposed changes of amendments they themselves want adopted. This is the intention of

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the Act on Principles of Negotiation and Communication between the Chamber of Deputies and the Senate, approved by the Senate today.

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