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# In brief

## Latest news - January 2019

# Editorial

Apart from a great deal of snow, the first days of the new year also brought a flurry of tax changes both passed and unpassed. So much for the promises that tax laws will be adopted sufficiently in advance so that entrepreneurs may prepare for the changes. Perhaps you ask whose fault it is: this time, certainly not just our legislators' procrastinations, but vis major in the form of the ominous bark beetle that kept deputies so busy at the beginning of summer. After the bark beetle calamity came the summer vacations, and the chamber awarded themselves the longest ever holidays of 61 days. Which is why the tax package was only passed in the third reading just days before Christmas.

As the Czech Republic did not manage to adopt the changes contained in EU directives within the stipulated implementation deadline, the new VAT regime for vouchers and digital services will start to apply by operation of the directives' direct effect, from 1 January 2019.

Better times are ahead for taxpayers claiming a research and development allowance, as the amendment to the Income Tax Act introduces a more favourable regulation of claiming the allowance. A regional "road show" of entrepreneur associations and financial administrations should follow, aiming to fix the damaged reputation of the R&D allowance caused by the formalistic approach of the tax authorities in tax inspections. In the meantime, some taxpayers decided not to try their luck and avoided the allowance altogether. Yet, there is a group of taxpayers – recipients of investment invectives in form of tax credits – who are obliged to claim the allowance in their tax return.

To conclude, let me wish you a successful 2019.



**Tomáš Kroupa**
Partner
KPMG Czech Republic



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Taxes

# Chamber of Deputies passes tax package – highlights

Just before the holidays, the Chamber of Deputies passed the so-called tax package (Print No. 206). The draft amendment still needs to be discussed by the Senate in January. Below, we draw attention to some changes in personal income tax and VAT.




**Mária Marhefková**
mmarhefkova@kpmg.cz



**Iva Krákorová**
ikrakorova@kpmg.cz



**Petra Němcová**
pnemcova@kpmg.cz


The maximum amount of expenses that can be claimed as a percentage of income from self-employment and lease will increase as follows:

- CZK 1 600 000 instead of CZK 800 000 for income from agricultural production, forest and water management, and handicrafts;
- CZK 1 200 000 instead of CZK 600 000 for income from trade;
- CZK 800 000 instead of CZK 400 000 for other income from independent activities;
- CZK 600 000 instead of CZK 300 000 for income from the lease of assets, whether business or private.

The percentages of these expenses (80%, 60%, 40%, and 30%) remain unchanged. Entrepreneurs find themselves back in 2016 and 2017, when the maximum amounts of expenses claimed as a percentage of income corresponded to a gross income of CZK 2 million. The new maximum limits will be applied already for the taxable period in which the amendment enters into effect.

In connection with an increase in the income decisive for mandatory participation in sickness insurance of employees to CZK 3 000 monthly from 1 January 2019, the limit of income from dependent activity (employment) up to which withholding tax is applied will also increase. This change will become effective on the first day of the calendar month following the month in which the amendment enters into force.

Concerning VAT, an amending proposal was passed that will hopefully soothe the heated discussion regarding expected changes to the regime of limited liability company statutory representatives. The existing legal regulation under which the activities of persons taxed as income from dependent activities (employment) do not represent independent economic activities remains applicable.



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In addition, a proposal to cancel changes to the concept of subsidies was also passed. And finally but importantly, lease companies may celebrate, as the newly defined principles and concept of finance lease arrangements (deriving from the Court of Justice of the EU's case law) should not enter into effect in Czech legislation earlier than on 1 January 2020. This should give lease companies sufficient time to prepare for this change.

As certain provisions of an amendment to the VAT Act derive from EU legislation whose implementation is mandatory and the implementation deadline of 1 January 2019 was not met, the GFD issued its Information on the Application of a Direct Effect of Council Directive (EU) 2017/2455 and Council Directive (EU) 2016/1065.

This mainly involves changes in provisions regulating the place of supply when providing telecommunication services, broadcasting services and electronically-rendered services to persons not liable to VAT and when registering for a special (non-EU) Mini One Stop Shop regime by non-EU persons liable to VAT and changes in the treatment of vouchers. See the report on the financial administration's website.



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# Changes to R&D allowances already in legislative process

A working group consisting of representatives of business federations and associations, the Ministry of Finance and the General Financial Directorate has agreed on changes to the R&D allowance. These have recently been passed as part of the tax package by the Chamber of Deputies and are now heading to the Senate. Below we summarise the most important ones.



**Michaela Thelenová**
mthelenova@kpmg.cz



**Bohumil Dopita**
kpmg@kpmg.cz

The most significant change relating to research and development allowances is the postponement of the deadline for preparing and approving a project until the end of the time limit for filing a tax return for a period in which the taxpayer claimed an R&D allowance for a particular project for the first time.

According to the amendment, taxpayers will have to notify the tax administrator about their intention to claim an R&D allowance for a particular project before the project commences. If they fail to do so, expenses incurred for this project will not be included in the allowance. The notification should contain basic identification data about the taxpayer (company name, address, tax identification number) and the name of a project conveying the project's focus.

Another change is that a project may be approved not only by a company's statutory body but also by a person the statutory body authorises to do so. The project will also no longer have to specify the place where it was approved.

We expect that the amendment will enter into effect in the first half of 2019. According to transitory provisions, the new regulation will be applied to projects initiated after the amendment's effectiveness. For projects commenced before the effective date (and simultaneously in the taxable period in which the amendment entered into effect), taxpayers will get to choose whether they will use the existing or new regulation.



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# How not to turn a mole hill into a (tax) mountain

Did you buy, sell or acquire real property in 2018? Did you make changes to the real property or in the Real Estate Cadastre in 2018? Take care when filing your real property tax return, since even a small tax amount can get very expensive!



**Mirka Malá**
mmala@kpmg.cz



**Hana Greiff**
hgreiff@kpmg.cz

Real property tax returns must be submitted by 31 January 2019. This should not be underestimated, as the penalty for late filing (or the failure to file a tax return for a higher tax liability) is determined from the overall tax liability and not just from a year-on-year tax difference. The penalty amounts to 0.05% of the assessed tax for each day of default, but only up to 5% of the total tax. The penalty cannot be waived and, as a result, may result in an unexpected tax non-deductible expense.

On the other hand, a tax return need not always be submitted, e.g. when only the tax rate, coefficient or local jurisdiction change from the preceding taxable period. The tax authority usually sends payment assessments to companies' data boxes but is not obliged to do so. Instead, it is the responsibility of each legal entity and individual to monitor the dates on which their real property tax is due. Standardly, the tax is payable in two equal instalments by 31 May and 30 November of each individual year.

A piece of positive news is that no significant legislative changes occurred in this area in 2018. However, a change in the financial administration's approach to the taxation of real estate bears mentioning. Until recently, the tax authorities applied a clearly formalistic approach by relying on information recorded in the Real Estate Cadastre, referring to the principle of material publicity and the provisions of the Act on Real Estate Cadastre, according to which the Real Estate Cadastre is, inter alia, a source of information for tax purposes.

According to recent court decisions, the tax administrator must perform all acts to determine the tax correctly. Consequently, when assessing tax on buildings and land, the tax administrator must take into account the actual legal situation. If there is any doubt, the tax administrator should examine whether information recorded in the Real Estate Cadastre reflects reality, i.e. the actual use of real property (tax on buildings) or the existence of final and conclusive administrative decisions (tax on land). It is to be expected that the tax administrator will call on taxpayers to provide supporting documentation regarding actual situations, since the Real Estate Cadastre remains their primary source of information



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# Deputies pass GDPR-adapting act

In December of last year, the Chamber of Deputies passed a long-awaited bill on personal data processing, designed to replace the existing Act on Personal Data Protection. Its adoption follows the new rules set out in the EU General Data Protection Regulation (GDPR). Even though the GDPR is directly applicable in the EU member states and an implementing regulation is not therefore necessary, the member states may deviate from the wording of the GDPR in some aspects. This is what Czech lawmakers are indeed planning to do.



**Ladislav Karas**
lkaras@kpmg.cz



**Kateřina Randlová**
kpmg@kpmg.cz

The bill primarily affects the public sector, but also determines certain deviations and clarifications for the private sector. It regulates, for example, personal data processing conditions for journalists who, under certain circumstances, will not have to inform about personal data processing (such as the taking of pictures of someone with the intention to publish them) especially when the provision of such information is not feasible or would require unreasonable effort. This may typically involve the filming of participants of a public gathering or demonstration. The bill also allows journalists to postpone their information duties for a necessary period of time. According to the relevant explanatory report, the bill aims to allow filming with a hidden camera or making news stories undercover or under a false identity.

Journalists will also be authorised to process sensitive personal data revealing, for example, racial or ethnic origins, political views, religious and philosophic beliefs where such processing is necessary to achieve the justified goal and when the justified interest in personal data processing prevails over the justified interest of data subjects concerned.

A large number of motions to amend this bill were submitted during the legislative process; some of them were passed and some dismissed. For example, deputies rejected a proposal to reduce the age limit to 13 years to be able to give consent with personal data processing in connection with an offer of services by search engine providers, e.g., to use social networks independently. The age limit of 15 years, proposed originally and corresponding to the age limit for criminal liability, thus remains applicable.

The bill also regulates the competencies and organisation scheme of the Personal Data Protection Office, which is to become, inter alia, a review administrative body dealing with instances when liable persons do not comply with requests pursuant to the Act on Free Access to Information or the Act on the Right to Environment Information.

The bill is now heading to the Senate where other amending proposals are to be expected.



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# What's new in immigration law?

Discussions concerning immigration law have recently been fairly lively. While the Chamber of Deputies is currently deliberating an extensive amendment to the Act on Foreign Nationals' Residence, in November, the Constitutional Court cancelled a number of provisions of this act and the Act on Asylum for their unconstitutionality. What has or what will change in the future?



**Ladislav Karas**
lkaras@kpmg.cz



**Václav Bělohoubek**
kpmg@kpmg.cz

The Constitutional Court sided with a group of senators and repealed, among other things, a provision disadvantaging the family members of Czech citizens compared with the family members of citizens of other EU member states, which is a paradox, as the provision prohibited the legalisation of residence of a foreign national who is a family member of a Czech citizen (but not of a foreign national who is a family member of a citizen from another EU member state) when the foreign national resided in the CR unlawfully at the time an application for residence was submitted.

The Constitutional Court also repealed a provision under which proceedings to review the lawfulness of restricting foreign nationals' personal freedom are discontinued once they have already been released or deported. In such cases, the foreign nationals could not later claim compensation for damage incurred despite the fact that statutory conditions for the restriction of their personal freedom had not been met. The reason is that to claim compensation, the unlawful decision would have to be cancelled first, which is impossible if the proceedings have been discontinued.

Major changes to the Act on Foreign Nationals' Residence are expected with the amendment currently being discussed in the chamber. The EU directive's transposition should significantly improve the situation of university students and scientific personnel who, after they finish their studies or scientific work, will be allowed to stay in the CR for a period of up to nine months to search for employment or commence business activities. Moreover, holders of long-term residency permits for the purpose of studying or scientific research issued by another EU member state will be allowed to stay in the CR for a year without a visa.

The amendment introduces the duty of non-EU foreigners to attend an eight-hour adaptation and integration course within one year of the date they receive their permanent or long-term residency permit. The course should help them gain a better understanding of their new environment and acquaint them with rights and duties associated with residence in the CR as well as with local habits and values.

To regulate the movement of workers, the amendment proposes the introduction of quotas. The government will regularly determine these quotas by means of government decrees, for specific countries of origin, sectors of the Czech economy and type of work. Simultaneously, if there is a labour shortage on the Czech labour market, the government will be able to activate the granting of extraordinary work permits for a temporary period of time by means of decree, allowing certain categories of workers to obtain work permits for a period of up to one year on an accelerated basis.

Right now, it is hard to predict what the amendment to the Act on Foreign Nationals' Residence will look like or whether the amendment will actually be passed. However, it is quite evident that frequent changes are to be



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expected in this area in the upcoming months and year.



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# Uncertainty regarding electronic sick notes and waiting period (karenční doba)

Work on and approval of legislative changes to social security law have recently been reminiscent of Westerns. Whereas the cancellation of the waiting period (karenční doba) was passed by the Chamber of Deputies after years of discussion and subsequently repealed by the Senate, the electronic sick note project was first approved, then postponed, and again proposed in alternative form for discussion among deputies. What is then awaiting us in this respect in 2019?



**Barbora Cvinerová**
bcvinerova@kpmg.cz



**Václav Bělohoubek**
kpmg@kpmg.cz

It was employers who insisted on linking the cancellation of the waiting period with the introduction of electronic sick notes, as they were afraid that the waiting period cancellation would result in an increase in the number of employees' short-term inability to work, which is currently very hard for them to check. Electronic sick notes should allow employers a more efficient check of the compliance with regime ordered to the sick employee by their physician.

In the first fourteen days of an employee's sickness, employers are authorised to check whether the employee fulfils the basic duties of an insured who is temporarily unable to work (such as that they indeed dwell at the given address and adhere to the scope and time of permitted absences from home). This check may only be carried out after the employee delivers a sick note stating the place of stay and the scope of permitted absences from home. More extensive checks over the entire period of sickness may also be performed by the Czech Social Security Administration (the "CSSA"), receiving information about the temporary inability to work directly from attending physicians.

Despite the fact that employees must deliver sick notes to their employers immediately after they fall ill, in practice, sick notes are often submitted to employers with several-day delays, especially when employees choose to deliver them by post. Employers' call to accelerate communication between employers, patients, physicians and the CSSA is therefore quite justified. However, the Ministry of Labour's electronic sick note project responds to their call only partially.

An amendment to the Sickness Insurance Act dealing with electronic sick notes proposes three main measures: the first one shortens the deadline for reporting the inability to work by the attending physician to the CSSA from three to one day. The second one determines the attending physician's duty to perform such reporting only electronically. The third one introduces the CSSA's duty to provide information to the employer about the employee's inability to work based on the employer's request within eight days.

While the communication between physicians and the CSSA may really accelerate and be carried out online owing to the proposed amendment, reporting towards employers does not change at all. As before, they will have to rely on paper sick notes to be delivered by employees. They may request information about their employee's inability to work from the CSSA but the response time is impractically long.



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Both the electronic sick note project and the waiting period cancellation are proposed to enter into effect from 1 July 2019. Whereas the discussion of the amendment introducing electronic sick notes is only at its beginning, the amendment cancelling the waiting period will again be voted upon in the Chamber of Deputies. As the waiting period cancellation had broad support among deputies already during the first approval process, it can be expected that the Senate's verdict will be overruled.

The introduction of electronic sick notes simultaneously with the waiting period cancellation are one of the government's priorities. We can only hope that lawmakers will prioritise quality over the adoption deadline and the draft amendment will be redrafted yet again.



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# No deregulation for investment funds

In 2019, we expect further regulatory changes in the investment fund sector, mainly concerning reporting and stress testing. The European Securities and Markets Authority (ESMA) is now finalising guidelines on stress test scenarios for money market funds. It will also become necessary to get ready for an extended reporting duty regarding securities financing transactions (SFTs).



**Filip Horák**
kpmg@kpmg.cz



**Kristýna Tupá**
kpmg@kpmg.cz

In the long run, the European Union has been tightening the regulation of funds: the hot topic of sustainability in capital markets or the debate on disclosures for investors in qualifying investor funds are just an example. In the US, the trend is quite the opposite: as surprisingly the financial crisis was not followed by mass requests for pay-outs from funds, a loosening of the rules for investment funds is yet again on the table. This approach is strongly opposed by the European Central Bank (ECB), which has repeatedly called for stricter regulation: the interconnectedness of the banking and the fund sectors and risks arising from derivatives trading and SFTs are seen as the biggest threats.

A number of major European banks are connected with entities of the fund sector; this is perceived by EU bodies as a systemic risk. The pressure on limiting this interconnection is likely to grow, also in light of the predicted upcoming recession and related efforts to maintain financial stability. This may bring more duties for the entities involved, in particular in the area of conflicts of interest (as we have seen for group product distribution under MiFID II), reporting, etc.

According to statistics, up to 7% of funds trade in credit default swaps (CDS), and SFTs are also widely used in the investment fund sector. Under certain circumstances, this may lead to a lack of liquidity for such funds. European regulatory bodies are therefore stipulating extensive reporting duties in the SFT regulation, further specified by an implementing regulation in December 2018.

The regulation does not bring just reporting duties: for entities engaged in repurchase transactions, buy-sell back transactions, margin trading transactions, etc., it will also directly affect trading and internal processes.

Disclosures will now have to contain information on the composition and characteristics of the loan and the collateral, information on counterparties and other entities involved, information on whether the collateral is available for reuse or has been reused, etc. Although the reporting duty will only apply from 2020, entities involved should start getting ready for the new requirements.



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# Brexit: time for a deal running short

Although the exit agreement between the United Kingdom and the EU is ready, it has not yet been ratified. The key vote in the British parliament lies ahead: if the deal is not passed, there will most likely be a no-deal Brexit. In this uncertain situation, the European Union has intensified preparations for Britain leaving the EU without a deal.



**Pavel Gorel**
pgorel@kpmg.cz
+420 222 123 553



**Lucie Leopoldová**
kpmg@kpmg.cz



**Lukáš Sova**
kpmg@kpmg.cz

At the end of the past year, the European Commission prepared a contingency action plan outlining actions in the event of a no-deal scenario. These actions only cover selected priority areas where the EU has to protect its interests.

### Indirect taxes and customs duties

In terms of VAT and customs duties, these documents mainly address what will happen to goods whose transportation has been commenced before Britain's departure from the EU, but is to be completed after that date. The European Commission's answer is already known: if there is no deal at the moment when the goods arrive at the EU customs border, the goods will no longer be considered EU goods. This means that the goods will be subject to customs duties and, at the same time, the supply will not be an intra-Community supply of goods, but an import, which is subject to VAT.

Another practical question arises in connection with reclaiming VAT: as it is not yet clear whether under a no-deal scenario Britain will still allow to reclaim VAT on goods exported to the EU, we recommend applying for VAT refunds as soon as possible. Applications may be filed for a quarter or for a year.

Access to a joint application for reclaiming VAT will not be the only one closed off after Brexit: the provision of digital services to the UK will no longer be covered by MOSS schemes either. Taxpayers from third countries registered in MOSS in the UK will therefore have to reregister in another member state.

### Immigration

One of the European Commission's main interests is to preserve residency rights of UK citizens in EU member states, provided that EU citizens keep similar rights in the UK on a reciprocal basis. The European Commission has been encouraging EU member states to take necessary actions to ensure timely legalisation of residence of UK citizens currently residing in their territories.

Already mid last year, the Ministry of Internal Affairs issued a recommendation to UK citizens residing in the Czech Republic: if they want their rights preserved after Brexit, they should apply for a certificate of temporary residence. The certificate may be issued for stays in the Czech Republic lasting longer than three months. If they have lived in the Czech Republic for at least 5 years, they may apply for a permanent residence.

Although these permits are not a precondition for residence in a member state's territory, they will provide



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conclusive evidence that the UK citizen did legally reside in the given territory before the departure date of the United Kingdom, and therefore in timely manner will legalise the citizen's residence in case of a no-deal scenario. The citizen's existing rights in the EU states will thus remain unchanged.

The final conditions for the stays of UK citizens in the Czech Republic will be contained in the Act Regulating Some Relationships in Connection with the United Kingdom of Great Britain and Northern Ireland Leaving the European Union (the Brexit Act), which has already been approved by the Czech government. It aims to regulate some relationships between the Czech Republic and the United Kingdom in case of a no-deal Brexit. The bill addresses the issues of citizens' residence, access to the labour market, public health insurance, supplementary pension insurance and construction savings, as well as direct taxes: in this respect, for the purposes of tax liability for the taxable period in which this act enters into force, British tax residents will be considered tax residents of a EU member state; however, this rule should not apply to withholding tax and securing the tax, where the UK would be viewed as a third country from the date of exiting the European Union.



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# Early termination penalty subject to VAT?

The Court of Justice of the EU (CJEU) in its judgement C-295/17 (MEO – Serviços de Comunicações e Multimédia SA) dealt with the question whether a fee received for early termination of a contract is subject to value added tax.



**Marcela Hýnarová**
kpmg@kpmg.cz



**Tomáš Havel**
thavel@kpmg.cz

MEO provides telecommunication services in Portugal. As a part of this, the company also concludes short-term contracts stipulating that, should the customer terminate the contract before its term, the company is entitled to compensation for the loss of earnings, meaning that the customer still has to pay the contracted amount (even for the months in which the service is not provided). Therefore, the total amount paid by the customer always equals the amount for the full term, even though the services are not actually rendered until the end of such term. The company treated the amounts thus charged to customers upon early terminations as contractual penalties. As such a penalty is not subject to VAT, no VAT was paid on this amount.

CJEU previously held that if there is a direct link between the service provided and the consideration received, using the service is a customer's right, even if it is not actually used. In the case in question, such right involves the use of telephone services. In the event of an early termination, customers choose not to use the right, despite having to pay the same price as if they had used it.

Taking the business and economic reality, the main criterion for applying the common EU system of VAT, as a basis, the early termination of a contract by a customer does not change this reality. In fact, the company maintains the same level of revenue as if the services had not been discontinued. CJEU thus concluded that such a pre-set amount paid by the customer shall be treated as a consideration for rendering services, and as such be subject to VAT.

The fact that the contractual purpose of the amount invoiced is to deter customer from disregarding the tie-in period or that it is regarded as a contractual penalty under national law does not affect this conclusion. In both situations, the company received identical income, the CJEU confirmed.

In the light of this judgement, companies rendering services for which they charge their customers a pre-set amount in advance should review the VAT treatment of these transactions.



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Case law

# Regional Court opposed to tax administrator's approach to R&D allowance

The Regional Court of Justice in Hradec Králové in judgment No. 52 Af 18/2016 dealt with a case where a tax administrator challenged a research and development (R&D) allowance claimed by a taxpayer. The court in particular opined on the moment of the commencement of R&D project work and the duty to maintain separate records of projects costs, and confirmed yet again that if there are doubts as to the presence of a valuable element of novelty or technology uncertainty, an expert witness has to be appointed.




**Hana Greiff**
hgreiff@kpmg.cz



**Lucie Petanová**
lpetanova@kpmg.cz


The tax administrator primarily insisted that the taxpayer failed to meet formal requirements for claiming the research and development allowance, arguing that the R&D work had been commenced before the projects were completed, and that the taxpayer did not maintain separate records of R&D costs. The tax administrator's conclusion on the late preparation of the projects were deduced, for instance, from the existence of binding orders that had been received before commencing the project work. In the tax administrator's opinion, by accepting these orders, the taxpayer in fact confirmed that the products could be produced, with certainty. From this, the tax administrator then deduced that the project solution and its aims must have been known even before the R&D projects were prepared. The tax administrator also supported these conclusions by referring to the wording of an internal policy on the methodology of carrying out research and development activities, which it applied on R&D projects regardless of the date of policy and of the individual projects.

The failure to maintain separate records was deduced from the fact that the taxpayer did not claim all costs incurred in connection with the implementation of the R&D projects. From this, the tax administrator mistakenly deduced that the costs were not recorded separately from the moment of commencement of R&D project work, as these activities were actually carried out before this time.

The Regional Court disagreed with the tax administrator's assertions. According to the court, the tax administrator must again assess whether the formal requirements for claiming the R&D allowance were met in the context of a more precise interpretation of the term "commencement of R&D project solution". In the court's opinion, R&D project work only commences at the point when a project is approved, and from that time the taxpayer is also obliged to maintain separate records of costs. It is solely up to the taxpayer what activities they carry out before approving the R&D project (as long as the costs of these activities are not claimed within the R&D allowance), and it is also up to the taxpayer what costs they claim within the allowance (and what they do not).

The court also dealt with the issue whether the project contained a valuable element of novelty and eliminated technological uncertainty. The tax administrator concluded that the technological uncertainty that was to be eliminated in the project was non-existent, as the parameters of the orders were exactly defined. According to the tax administrator, the taxpayer also failed to sufficiently prove the existence of an element of novelty, despite producing an expert opinion: the tax administrator considered the expert opinion inconclusive and unreliable, while also stating that they had staff with sufficient expertise to make conclusions needed for its decision. While



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agreeing with the tax administrator that the expert opinion submitted did not prove the compliance with the material requirements for R&D projects, the Regional Court stated that the tax administrator erred by not obtaining further evidence in form of a new expert opinion.

This judgment is yet more good news for taxpayers claiming R&D allowances.



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Case law

# CJEU on transport: excise duty regime not relevant

The Court of Justice of the EU (CJEU) in its December judgement (C-414/17) regarding Czech company AREX CZ dealt yet again with the issue of allocating transport in a chain of transactions. This time, it concerned fuel subject to excise duty and its transport under the excise duty suspension arrangement.




**Tomáš Havel**
thavel@kpmg.cz



**Kateřina Klepalová**
kklepalova@kpmg.cz


Arex purchased fuel originating in Austria from Czech suppliers, while this was preceded by a chain of transactions. The transport of the fuel from Austria to the Czech Republic was provided by Arex by means of its own vehicles. The fuel was transported to the Czech Republic under an excise duty suspension arrangement; the excise duty was paid by the Czech suppliers.

In its Czech tax return, Arex claimed VAT on tax documents issued by the Czech suppliers. In a tax inspection, the tax administrator challenged these entitlements, arguing that the place of acquisition was in Austria, as Arex obtained the right to dispose of the goods as an owner already in Austria.

Before the Supreme Administrative Court (SAC), Arex argued that when goods are transported under an excise duty suspension arrangement, economic ownership does not pass, as the goods cannot be disposed of during the transportation.

SAC referred several prejudicial questions to the CJEU, the key one being whether the transport should be allocated to the acquisition by the Czech suppliers who then sold the fuel to Arex, as they were the ones obliged to pay the excise duty.

As in many previous judgements, the CJEU confirmed that in chain transactions, transport has to be allocated to just one transaction. The SAC thus had to determine at what time the right to dispose of the goods as an owner had passed on to Arex. If this had happened before the transportation of fuel from Austria, then the transport must be allocated to the transaction effected by Arex, and that transaction has to be treated as acquisition of goods from another EU member state.

CJEU also held that it was not possible to allocate the transport automatically to the supply effected by the entity that is obliged to pay excise duty. CJEU thus confirmed its previous conclusions on allocating transport, while it also stated that the excise duty regime is not relevant for such allocations.

The financial administration commented on the judgement on its website, also with respect to issued tax securing orders. In our opinion, however, their interpretation goes beyond the wording of the judgment.



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# New case law on offsetting

Offsetting is widely used in the business sphere to settle debts. By offsetting, a creditor's and a debtor's mutual debts of the same kind (usually monetary) cease to exist. The Supreme Court has recently issued two decisions bringing several pitfalls in the use of this legal concept. What to watch out for when offsetting?



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



**Petr Kučera**
kpmg@kpmg.cz

In its first decision, the Supreme Court dealt with the question whether it was possible to offset a debtor's monetary supply in Czech crowns against a creditor's receivable that was to be paid in foreign currency. The mentioned supply was provided by the debtor before the contract was concluded, based on an invoice issued by the creditor, and was to equal, in Czech crowns, to the supply contracted in foreign currency. The SC deduced that if the contractual arrangement between the debtor and the creditor only assumed a supply in euros, it is not possible to offset a supply in Czech crowns against such a contractual debt, as the debtor's contractual obligation to pay the contracted price to the creditor in an agreed-upon manner would not have been met at all.

The court based its decision on its previous case law, where it adjudicated that the content of the debtor's obligation is to supply what was agreed (in this case to pay the contracted price in the stipulated currency), even if such a supply becomes disadvantageous for one of the parties.

This means that Czech law does not currently allow for offsetting receivables in any other than the agreed-upon currency to settle debts. The only way how to make this possible is by amending the contractual arrangement between the debtor and the creditor. Otherwise, there is a high risk that in the event of a court dispute the supply in other than the agreed-upon currency will not be considered a supply under the contract, with all implications this entails, such as default, etc. And the situation may even be more critical in case of insolvency proceedings, as offsetting of this type (i.e. without sufficient contractual basis) may be challenged by the insolvency trustee.

**Offsetting multiple receivables**

In the second case, the SC dealt with the required essentials of offsetting a higher number of receivables, mainly regarding the specification of which receivables are being offset and whether and in what amount they become extinct.

In the case in question, the debtor offset receivables from contractual penalties against the creditor's receivable from a purchase price payment. The juridical act by which the debtor effected the offsetting did not specify which specific receivables thus become extinct, while the debtor's receivables from contractual penalties exceeded the creditor's receivable from the payment of the purchase price. This debtor's approach would seem correct, as the new Civil Code contains rules for cases where the debtor does not specify which receivables (of a number of receivables) and in what amounts are covered by the offsetting.

Yet surprisingly, the SC viewed the case along the lines of its existing case law, which is based on the old Civil Code and does not yet reflect the new rules of offsetting mentioned above. This means that even with the new legislation in effect, the court applies the same stance to cases where a debtor offsets a number of receivables that at the same time exceed the creditor's receivable: the offsetting act in which the debtor fails to specify which of the receivables being offset become extinct is indeterminate and therefore null. The reason is that the creditor would be unable to



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determine what receivables and in what amount they still have to settle.

When offsetting a number of debtor's receivables that exceed the creditor's receivable, it is thus recommendable to specify precisely what receivables are being offset against.

While simple at first sight, offsetting of receivables is a legal tool that entails certain risks when used in practice. As the SC's decision implies, attention has to be paid mainly to the juridical act by which the offsetting is effected, and to whether the receivables are actually eligible for offsetting.



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Case law

# SAC: difference between receivable's nominal amount and purchase price may be subject to VAT

According to the recent Supreme Administrative Court judgement, the difference between the nominal value of a receivable and its purchase price upon its transfer may be viewed as a factoring consideration, which is subject to value added tax.




**Jana Fuksová**
jfuksova@kpmg.cz



**Martina Babičová**
kpmg@kpmg.cz


In the case in question (4 Afs 143/2018), the court dealt with the regular purchasing of short-term receivables that were not overdue or hard to recover at the time of transfer (assignment).
The purchase price of the receivables being transferred was set at 95.17% of their nominal value. No other consideration was contracted in the factoring contract. In the court's opinion, the difference between the nominal amount of the receivables and their purchase price comprised a consideration for the factoring service. The SAC did not accept that the difference would reflect the actual economic value of the receivables at the time of their transfer. Yet, the risk level of the receivables was not subject to detailed proving.

The court did not accept the arguments referring to the Court of Justice of the EU judgment in the GFKL case (C-93/10) that held that a transfer of a receivable at a price lower than its nominal value was not a provision of a service for consideration. The GFKL case involved a one-off transfer of highly risky receivables. According to the SAC, both cases were so different that the conclusions made in the GFKL case could not be applied to the case in question. The court pointed out that in the case in question, the difference between the nominal value of the receivables and their purchase price was not due to a decrease in their market value.

The SAC thus concluded that the difference in the amount of 4.83% of the receivables' (nominal) amount was a consideration for a factoring service, and as such was subject to VAT. It is not relevant that the consideration was not explicitly agreed-upon in the contract. The court's decision-making might have been influenced by the fact that, originally, the consideration had been agreed-upon in the contract and the purchase price of the receivables had been 100% of their nominal value; only subsequently, by an amendment to the contract, the price of the receivables was reduced and, at the same time, the commission stopped being charged.

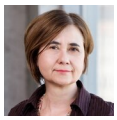


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In brief

# Latest news - January 2019

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



**Lenka Fialková**
lfialkova@kpmg.cz

•The financial administration informed that at the end of 2018, the parliament passed an amendment to the VAT Act proposed by the deputies, reducing the tax rate for the mass transport of passengers and their luggage, namely road transport (excluding ski-lifts) and water transport, from 15 to 10 per cent.

•The financial administration published Instruction D-39 setting uniform currency rates for the taxation period of 2018.

•The following items were published in Financial Bulletin No. 11/2018:
- a list of taxes and parts thereof for which tax authorities keep personal tax accounts
- A possibility to pay real estate tax by means of a collection from bank accounts ("SIPO")
- Information on how to pay VAT in the Mini One Stop Shop regime
- Amendment No. 3 to GFD Instruction D-29, No. 94112/18/7100-20118-012287
- GFD Instruction D-29 on waiver of penalties for failure to file a VAT ledger statement, as amended by Amendment No. 3 (No. 111096/16/7100-20116-050484)
- a list of countries exchanging country-by-country reports under Section 13zb(2) of Act No. 164/2013 Coll., on International Cooperation in Tax Administration and on the Amendment to Certain Related Acts, as amended
- a list of contractual states applying the common standard for reporting and governing dates published under Section 13b (2), Section 13e (7), Section 13g (5) and Section 13p (2) and a list for the purpose of complying with the reporting duty under 13s (1) of Act No. 164/2013 Coll., on International Cooperation in Tax Administration and on the Amendment to Certain Related Acts, as amended.

•On its website, the Ministry of Labour and Social Affairs has published changes and news for 2019.

•On its website, the General Directorate of Customs provided information about an increase in the threshold for Intrastat reporting for both dispatching and receiving goods from the current CZK 8 million to CZK 12 million, starting 1 January 2019.



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Tel.: +420 222 123 111

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