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# Editorial

Last year's record state budget surplus amounted to approximately CZK 62 billion. Whatever the actual reasons, the financial administration is making an obvious effort to make tax collection more efficient. Once the exact figures are known, we will probably see that the year was unprecedented also in terms of additionally assessed tax. And the effort to collect it has grown as well: we have been seeing the application of some previously marginal concepts such as tax securement or the immediate enforcement of tax. Unfortunately, the statistics will not tell us what portion of the tax additionally assessed will end up being successfully defended in court – the proceedings now pending show that not all cases of additional tax assessment will withstand scrutiny.

In 2017, an election year, no significant changes can be expected from the financial administration. This turns our attention to the debate on the concurrence of sanctions imposed under tax and criminal laws. The recent judgement of the European Court for Human Rights in the A and B v. Norway case is an interesting contribution to the debate, as it does not fully exclude the concurrent imposition of both sanctions. The stance that the Czech Supreme Court will take is bound to be one of the hot topics of this year.

As for changes to tax regulations, not much is expected, except for the long-discussed tax package yet to be passed. The legislative process takes time and the autumn elections do not favour conceptual changes. The Ministry of Finance has thus been concentrating on amendments to tax laws effective from 2019 instead. Perhaps the only thing we will be watching with some anticipation is whether the parliament will pass the amendment to the regulation of VAT ledger statements (repealed by the Constitutional Court effective from 1 January 2018). The failure to pass the amendment may in some cases complicate the filing of VAT ledger statements after this date.

In practice, in the upcoming period we will continue to deal with the consequences of electronic reporting of sales by retail companies, required from 1 March 2017. The question remains what effect some proposed changes that have yet to pass but may enter into effect from 1 April 2017 will have on the ERS – some transactions (such as e-shops) might even be excluded from the reporting duty.

Regardless of the described pitfalls, I wish you a successful year in your professional and personal life.

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# Amendments to tax laws at third reading

Amendments to tax laws (Print No. 873) will be subject to a third reading in the Chamber of Deputies, likely to occur after 10 January. The amendments should become effective on 1 April 2017. Discussions within the third reading will be quite complicated, as a large number of motions to alter the amendments were filed during the second reading, including motions from coalition deputies and the minister of finance. We draw attention to the major motions subject to vote.

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- Restriction of expenses claimed as a percentage of income: the budget committee proposes to reduce the maximum amount of expenses that can thus be claimed by self-employed persons. To compensate for this restriction, the committee proposes to cancel the restriction to apply tax credits for one's spouse and for dependent children.

- Tax determined as a lump sum: Minister of Finance Babiš proposes to extend the application of tax assessed as a lump sum. It would be possible to use this concept in cases of concurrence of self-employment and employment as well as where self-employed persons employ staff. Currently, the concept cannot be applied in these cases. Hence, taxpayers make use of it only sporadically. In addition, such persons would not be subject to electronic reporting of sales (ERS).

- Binding rulings regarding profits allocated to a permanent establishment of a foreign entity: the budget committee proposes to extend the possibility to use binding rulings to non-residents having permanent establishments in the CR.

- Refund of VAT to tourists: the budget committee proposes to reduce the limit from CZK 2 000 to CZK 1 500.

- Non-application of ERS to e-shops and other exceptions: with respect to Minister Babiš's motion, the budget committee does not give any recommendation. Deputies will also discuss other similar motions, for example one filed by KDU-ČSL Deputy Klašek (a motion not to apply ERS to farmers' markets and minor subsidiary activities).

# GFD clarifies VAT regime upon resale of telecommunication services

Owing to a considerable degree of ambiguity primarily with respect to the resale of telecommunication services, the General Financial Directorate (GFD) decided to respond to frequent inquiries by publishing an appendix to the previously issued Information on Electronic Communication Services. The appendix, still in its draft form, should be published shortly. After a long period of waiting, will the time really come when businesses can be certain about the reinvoicing of expenses for private calls? Or parent companies about the reinvoicing of expenses for telecommunication services to their subsidiaries within holdings?

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Based on available information, the GFD's draft appendix clarifies criteria under which the reverse-charge mechanism may be applied, providing also illustrative example transactions.

The basic condition for applying the reverse-charge regime is that both the service provider and the service recipient be businesses operating in electronic communications. In other words, the service recipient must purchase telecommunication services for the purpose of resale and with the intention to generate profit. Only then should the service provider (operator) apply the reverse-charge mechanism on the provision of services.

In contrast, purchases of telecommunication services for one's own consumption purposes, i.e. with no intention to generate profit, should not be subject to the reverse-charge regime. The term "own consumption" means one's own consumption of services or the facilitation of consumption to end users. This involves situations in which private calls or additional SIM cards for family members are reinvoiced to employees without a margin.

Another exception to the reverse-charge application is, for example, the purchase of electronic communication services within a holding of companies when the parent company reinvoices expenses to individual subsidiaries without a margin. In such cases, the service operator (provider) should invoice the provision of services to the parent company including VAT. The GFD recommends that the service recipients' intentions always be declared in writing so that the service provider will know how to proceed accordingly.

# International tax information exchange extended

Another amendment to the Act on International Cooperation in Tax Administration is to introduce a new duty to share information about financial results, performed activities, staff numbers and many other indicators.

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The government approved another amendment to Act No. 164/2013 Coll., on International Cooperation in Tax Administration, on 19 December, thus responding to the requirements of Council Directive (EU) 2016/881 of 25 May 2016 aiming to introduce the automatic exchange of information by countries (country-by-country reporting).

The amendment introduces new duties for multinational groups of companies with a consolidated turnover exceeding EUR 750 mil. The parent company of such a multinational must submit a country-by-country report providing extensive information about all group companies. The required data include, for example, generated revenues broken down into transactions with related and unrelated parties, the results of operations before taxation, paid income tax, current income tax payable, registered capital, number of employees, value of tangible fixed assets and other.

The Czech tax administration must know whether the country-by-country report will be submitted for a particular multinational and where. Consequently, the amendment introduces a duty to provide information about a group's parent company and about who will file the report for the group and where. This notification should be provided to the Specialised Tax Authority electronically, using a prescribed form, before the end of the first reporting period. Where the first reporting period represents the calendar year of 2016, the notification must be filed before 31 December 2016. But as the amendment neither has been approved nor is yet effective, there is a transitional provision stipulating that notifications relating to any periods ending before 30 September 2017 must be provided by 30 September 2017. The notification should be filed only once with respect to the first reporting period. After that, it will be necessary to report only changes in information, always within 15 days of the date of a change.

Where a Czech company is the reporting entity for the entire group, it shall file the report with the Specialised Tax Authority, within 12 months from the last day of the reporting period. For 2016 as the first reporting period, this will be until 31 December 2017.

Should a Czech parent company not fulfil its reporting duty to the Specialised Tax Authority, a penalty of up to CZK 1.5 million may be imposed, as stipulated by the draft amendment. The current version of the amendment is expected to come into effect on 5 June 2017.

# Stricter control over employees' personal data protection

The legal framework regulating the handling of employees' personal data is going through significant changes. One of them is the adoption of the EU General Data Protection Regulation (GDPR), substantially changing the rules for the treatment of personal data. Another not as ground- breaking change has been overshadowed by the aforementioned measures, even though it also deserves our attention, as it establishes stricter control over the observance of employers' duties to protect employees' personal data.

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Employers' duties when handling employees' personal data are regulated both by the Personal Data Protection Act, and by Section 316 of the Labour Code. The list of duties and their content are not changing yet (until the effective date of the mentioned GDPR in May 2018), but the manner of control over the observance of the stipulated duties may: the Chamber of Deputies is presently discussing a draft amendment to the Labour Inspection Act, which introduces new administrative delicts in the area of employee privacy protection.

Currently, the only entity authorised to inspect the observance of duties when handling personal data of employees is the Office for Personal Data Protection. It checks the adherence to all responsibilities ensuing from both mentioned laws. Yet, according to the intention of the Ministry of Labour, the observance of the duties stipulated by the Labour Code should from now on be checked by an authority specialised in labour-law issues, i.e. the Labour Inspection Authority.

The Labour Inspection Authority would primarily check whether employers observe all relevant duties when monitoring employees through camera systems, GPS monitors in company cars, the recording of telephone conversations, or when inspecting internet use or internal e-mail systems. The authority would check not only the manner of monitoring, but also whether the employer had a legitimate reason to do so. If it were to determine that the employer had been infringing on employees' privacy in an unpermitted manner, it could impose a penalty of up to CZK 1 million. Failure to meet the duty to inform of monitoring being carried out could involve a penalty of up to CZK 100 000.

Thus, instead of one, two authorities may soon be supervising employers: the Personal Data Protection Office will continue checking the observance of duties ensuing from the Data Protection Act, while the Labour Inspection Authority will supervise the observance of privacy protection rules as stipulated by the Labour Code. The probability that employers will get under the scrutiny of one of the authorities will thus increase significantly. If the proposed amendment gets through the legislative process, it will enter into effect 15 days after its promulgation in the Collection of Laws. This means that employers will only have a short time available to make their entire employee monitoring practices compliant with the law.

# Employees back on supervisory boards

The historically first amendment to the Corporations Act found its way through the legislative process and a day before year-end was promulgated in the Collection of Laws under No. 458/2016 Coll. With it, for some companies, the familiar duty of having employees represented on supervisory boards has come back.

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Until the end of 2013, the obligatory representation of employees on supervisory boards (also referred to as co-determination) had been stipulated by the Commercial Code: joint-stock companies with more than 50 employees had to have at least one third of the seats on their supervisory boards held by staff representatives. With the recodification of private law, this duty ceased to exist. Due to the absence of transitional provisions, disputes arose as to how the new regulation affected existing joint-stock companies: it was not entirely clear whether, at the stroke of midnight on 1 January 2014 the offices of the existing employees' representatives terminated, or whether their offices continued according to the previous regulation. Nor was it clear whether co-determination, despite not being explicitly provided for by law, could still be stipulated in the company's statutes (by-laws) on a voluntary basis.

The present amendment, initiated by the deputies, does not address the mentioned issues. It re-establishes co-determination without any link to the previous legal regulation. The new regulation will not affect as high a number of companies as the previous one: the duty will only apply to joint-stock companies with more than 500 employees (not including labour relations other than employment or agency employees). The companies will have to have a number of supervisory board members divisible by three, and one third will be elected to the board by employees. The statutes of the company may increase this number, although not above the number of members elected by the general meeting. Employees may also remove their appointed representatives from the supervisory board. The law will also explicitly permit co-determination to be stipulated by the company's statutes even where the number of employees is lower than the statutory limit. This means that even a joint-stock company of 20 employees may, theoretically, invite employees' representatives onto its supervisory board; we do not, however, expect this option to be used broadly.

The amendment enters into effect on 14 January 2017. For companies already in existence, the legislator provides a two-year time allowance to make their statutes and supervisory board composition compliant with the new regulation. Should they fail to do so, they will face a penalty imposed by the registry court: it will call upon them to rectify the situation, providing a time limit beyond which it will initiate the process of company dissolution with liquidation.

Apart from this significant but from a legislative perspective minor change, users of the Corporations Act are also in for an overall amendment of the act; its draft, however, has not yet left the realms of the Ministry of Justice.

Legal

# Into the new year with an amended Civil Code

Two days before the third anniversary of the Civil Code's effective date, its first overall amendment was published in the Collection of Laws as Act No. 460/2016 Coll. It has brought about some significant changes, the most crucial of which we summarise for you below.


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The amendment to the Civil Code addresses some of the pressing issues that the private law recodification has initiated and that have been questioned by the professional public. For instance, the new law explicitly stipulates that if a married person acquires a share in a business corporation, the other spouse does not automatically also become a member of the corporation. It also addresses the issue of powers of attorney for juridical acts where a form of a notarial record is required: for such powers of attorney, an official verification of the signature of the principal (person granting the power of attorney) will suffice; the amendment determines as sufficient also powers of attorney with a verified signature drafted before its effective date. Furthermore, the much-criticised duty of collective statutory bodies to authorise one of their members to act towards employees has been cancelled. In contrast, the co-owners' pre-emptive right, which had been suppressed by the recodification, celebrates a comeback: it will generally apply to transfers for consideration as well as to gratuitous ones, unless the transferee is a close person.

Rather extensive changes have been made to the regulation of trusts. A trust (unless established mortis causa) shall be incorporated upon its registration in the register of trusts, same as, for instance, commercial companies. The amendment thus also affects the Public Registers Act: it introduces the record-keeping of trusts in a similar manner as the amendment to the Act on Certain Measures against Legalisation of Proceeds from Crime did for the record-keeping of beneficial owners.

Of the other changes, we should mention the cancellation of the prohibition of the unilateral off-setting of receivables against wages or salaries amounting to more than half of the regular payments. Under the new law, such receivables may be unilaterally offset without any such limitation. For leases, the maximum limit on security deposits to be provided to landlords has been reduced from six-times to three-times the amount of monthly rent. The duty of previously existing associations and unit owners' associations to change their names according to the requirements of the new Civil Code has been abandoned, which should ease the administrative burden for these entities.

Apart from the pre-emptive right provisions and the record-keeping regulation for trusts, which enter into effect on 1 January 2018, most of the mentioned changes will apply from 28 January of this year.

# An end to malicious insolvency petitions?

The Senate is currently debating an amendment to the Insolvency Act, aiming, among other things, to introduce the preliminary assessment of insolvency petitions if maliciousness is suspected. The amendment should also limit the influence of creditors who have acquired their receivables in a non-transparent manner, including related parties.

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According to the explanatory report, only approximately one percent of all insolvency petitions filed are malicious – in the sense that their only aim is to cause reputational or economic damage to another entity. However, if such insolvency proceedings are initiated, the consequences for the affected entity may be destructive. Currently, insolvency proceedings are initiated once the insolvency petition is delivered to the respective court. The effects connected with initiating the proceedings take place as soon as the court publishes the notice on the initiation of proceedings in a publicly accessible insolvency register; this should take place within two hours from the delivery of the petition to the court. At this point, the court has not even examined the justification of the petition yet, only its formal essentials. Whether the alleged debtor is indeed insolvent is only examined at later stage.

This means that insolvency proceedings may be initiated even against a healthy firm. The court will eventually discontinue the proceedings, but only after several days. It either can refuse the petition as clearly groundless or decide that the company is not insolvent. The public, however, does not distinguish between these procedural nuances, and the victim of such a malicious petition is quickly labelled an insolvent entity. Under the new regulation, if maliciousness is suspected, the court may postpone the publication of the notice of initiating insolvency proceedings for up to seven days after receiving the petition. During this time, it may preliminarily assess the creditor's petition and refuse it right out, without publishing any information on the insolvency proceedings. The negative effect of the publication would thus be fully eliminated.

Another novelty is the enhanced transparency of certain creditors who may have a decisive influence on the course of insolvency proceedings. This concerns creditors who did not acquire receivables in a standard manner, i.e. from trade relations with the debtor, but through a receivable transfer (assignment) or in any similar fashion. Such creditors may have acquired the receivables for dubious asset liquidation schemes. Moreover, they are often registered in jurisdictions where seeking any potential damages would be difficult. Thus, under the new law, creditors who acquired receivables by transfer (assignment) or in a similar manner within six months before the initiation of insolvency proceedings have to attach to their receivable an affirmation stating their beneficial owner, similarly as required under anti-money laundering legislation. This procedure aims to determine whether the creditor and the debtor are in fact related parties. If so, the creditor is then excluded from voting on certain crucial steps of the insolvency proceedings where a conflict of interest may arise, including the liquidation of the debtor's assets.

# ECOFIN postpones extension of ATAD

At their December session, the EU finance ministers (ECOFIN) negotiated the anti-tax avoidance directive, ATAD2. Some issues remain open, such as the financial sector's exception from the rules and the member states' date of transposition of the new legislation. At the session, the European Commission also repeated its commitment to submit a legislative proposal on a reverse charge by 2016, which is pursued by the Czech Republic.

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On 21 December 2016, the European Commission passed a legislative proposal on the temporary application of a generalised reverse-charge mechanism. According to the proposal, the mechanism cannot be applied directly to supplies in excess of EUR 10 000, but only upon a permit granted by the commission. Member states may apply for an application ruling only if they fulfil three predefined criteria: their VAT gap according to the most recent EU study is at least the EU median +5 percentage points; carousel fraud accounts for at least 25% of a state's total VAT fraud and the state has established that it is not able to effectively fight tax VAT evasion (carousel fraud) by any conventional measures. The commission will then review the application and decide on granting the permit.

As a part of its fight against tax avoidance, ECOFIN adopted a proposal granting tax administrators access to information gathered under the Anti-Money Laundering Directive. This involves mainly information on beneficial owners and on processes carried out by financial institutions to check their customers (due diligence). This regulation will be contained in the Directive on Administrative Cooperation and should apply starting from January 2018.

The Council did not reach an agreement on the proposal to extend the rules on hybrid mismatches also to structures between EU member states and third countries (ATAD2), to make the rules compliant with Point 2 of the BEPS Action Plan (OECD). As the wording of the proposed extension was modified at the very last minute, some states asked for time to deliberate it within their national parliaments. The Netherlands ask that the implementation deadline be postponed to 1 January 2019.

Please also note that the Commission released its proposal for Common Consolidate Corporate Tax Base C(C)CTB in November. National parliaments and member state governments are currently commenting on the proposal. In early December of last year, the Dutch parliament decided not to support the proposal. The position of other governments remains unclear. The Czech Republic has not yet issued its official standpoint: while the finance minister has taken a negative stance on the proposal, arguing that it partly limits the national sovereignty in tax policy, the prime minister has welcomed the proposal, pointing out that fighting tax evasion is the coalition's priority and must concern not just small-scale entrepreneurs, but also large corporations, including multinationals.

The media have been also quoting academic research results indicating that the Czech Republic would earn up to CZK 6 billion per year for the state budget by participating in the system. The new European rules for the taxation of large corporations would affect approximately one thousand companies in the Czech Republic.

So far, it seems that the proposal in its current shape has no chance of being passed, as EU proposals concerning tax have to be passed unanimously by all 28 member states. It is also possible that within the enhanced cooperation procedure it will be adopted by only some of the member states.

Case law

# What information may the tax authority ask from your bank?

How resistant is bank secrecy against a call made by the tax authority? What questions about your account must your bank answer? Will the tax administrator learn from your bank that you use internet banking and who has disposal rights to your account? A new Supreme Administrative Court's judgment may help find answers to the above questions.

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To some extent, the Tax Procedure Rules breaks through bank secrecy rules, as they clearly impose the duty on banks to provide information such as account numbers, account owners, account balances, cash movements in accounts as well as information about provided loans, upon the tax authority's request. This information may then be used by the tax administrator to enforce tax arrears and assess additional tax. In practice, though, the tax administrator often requests much more, for example, information about the names of persons with the right of disposal, internet banking details or account owner contact information.

The Supreme Administrative Court (the SAC) has recently considered a very similar matter. In this particular case (4 Afs 177/2016), the tax administrator requested, among other things, information about persons with the right of disposal, an e-mail address and the phone number used for remote access to the respective account. The bank repeatedly refused to provide such information and the tax administrator imposed a fine on the bank. The case then ended up before the SAC, which decided in favour of bank secrecy. The SAC judges clearly held that the bank or any other payment service provider is obligated to only provide information explicitly stipulated by law and that the scope of information cannot be extended by mere interpretation. The SAC confirmed that the tax authority is not authorised to request information about persons holding the right of disposal to an account.

The court thus partially stood up against the tax authority's attempts to request an ever-increasing amount of information from banks. Also, the duty to provide information to the tax authority applies not only to banks but also to any other entities whose information is vital for the tax administration. In practice, usually the tax authority decides what information is essential in this respect. The respective judgment however shows that resistance against excessive tax authority demands for information may be worthwhile.

# The SAC: Are statutory representatives liable to VAT?

In its recent judgment (2 Afs 100/2016–29) the Supreme Administrative Court held that the performance of an office as statutory representative in a limited liability company meets the criteria of an independently performed economic activity and statutory representatives are therefore liable to VAT. Hence, tax administrators cannot challenge the practice of statutory representatives who invoice their services including VAT. The tax administration's argument that under effective tax legislation the performance of such office is a form of employment not subject to VAT is unacceptable.

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The SAC considered a case in which a statutory representative of a limited liability company invoiced his services including VAT. The tax authority rejected the company's entitlement for VAT deduction arguing that the statutory representative's services represented employment.

Pursuant to the EU VAT Directive, persons liable to VAT are persons who independently carry out economic activities. The SAC concluded that, under the Court of Justice of the EU's case law, in order to assess the autonomous nature of an economic activity it is vital to decide whether the respective person's relationship with the company is on a subordination basis. To assess this, it is necessary to consider whether the person carries out an activity in their own name, on their own account and on their own responsibility as well as whether the person bears any economic risks associated with exercising their offices. The SAC stated that it is mainly important to assess whether the person bears their own economic risks when carrying out the office and whether the person is liable for any potential damage incurred during the performance of the office.

The SAC held that, pursuant to effective Czech private-law regulations, the statutory representative of a limited liability company represents the company by acting on its behalf and on its account while the company itself bears responsibility. In addition, however, the SAC also lists potentially negative effects that may be associated with the performance of an office as statutory representative, summarising that statutory representatives bear their own rather substantial economic risk when exercising their offices. According to the court, statutory representatives are not subordinate in relation to the company and, most of all, do not perform their activities following the company's instructions.

The SAC concluded that the performance of an office of a statutory representative for a consideration is an autonomous economic activity. Also, the explicit exclusion of the activities performed by the statutory representative as an individual (natural person) from the VAT system would result in an unacceptable inequality in the VAT regime applied depending on whether the statutory representative is a natural or a legal person, as under the Czech VAT Act, statutory representatives as legal persons (corporate entities) are not excluded from the scope of persons liable to VAT. The SAC voiced the opinion that the EU VAT Directive had been incorrectly transposed to

Czech legislation. As a result, relevant provisions of the EU VAT Directive defining persons liable to tax (Articles 9 and 10) have a direct effect here and, therefore, the company at issue is entitled to VAT deduction on input.

Owing to the fact that the current wording of the Czech VAT Act excludes activities subject to income tax on employment from the group of independently carried out economic activities, the tax administrator may neither challenge the opposite procedure when statutory representatives do not invoice their services including VAT and do not consider themselves persons liable to VAT under the Czech VAT Act.

We recommend monitoring the future reactions of legislators and the financial administration to this judgment and adapting the VAT regime applied to remuneration paid for the performance of an office as statutory representative to have it take into account any changes in Czech legislation, related interpretations and practical applications.

# The limits of formality in bank guarantees

The recodification of private law in effect from 1 January 2014 was meant to bring a reduced level of formality in legal relations. Even this, however, has its limits, as shown by a recent decision of the Supreme Court. Discussing a case involving a bank guarantee, the court held that the omission of a single word in a creditor's call to a bank to perform its duties may result in the creditor not receiving any performance.

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According to the court, if a guarantee instrument prescribes the wording of a call, the creditor must fulfil all the formal requirements. Even one missing word (the word due was missing in this particular case) may result in the fact that the creditor's right to a bank's performance will not arise. Moreover, where the bank guarantee allows the creditor to request performance by the bank based on a creditor's declaration that the debtor has not paid on time, the bank must provide the relevant performance even if such declaration is not true.

The case at hand involved the issue of a number of bank guarantees by one leading financial institution in favour of the creditor, a producer of metallurgical products. The guarantee instruments stated that the bank had obligated itself to make appropriate payments without examining a relevant legal relationship (purchase contracts in this case) and without any objections. The payment should have been performed without undue delay after receiving a written creditor's call in which the creditor should have declared, inter alia, that the debtor "did not meet its due payment obligations connected with the supply of goods".

After the debtor did not pay its debt, the creditor asked the bank for performance but forgot the word due in its call. The bank refused to perform, claiming formal deficiencies of the creditor's call such as the call's inconsistency with the guarantee instrument. The first instance court took the side of the creditor and held that the mere omission of one word in the text does not give grounds for rejecting performance where it is not clearly stated in the guarantee instruments that the wording of the call for performance must be identical with the text specified in the guarantee instruments. The appellate court, however, changed the first instance court's decision and rejected the creditor's motion.

The creditor filed an appeal against this decision arguing that the requirement to strictly follow the text specified in the guarantee instruments represents unjustified formalism unsupported by law. The Supreme Court, however, viewed it differently and held that the bank was not authorised to examine the maturity of receivables and the creditor was obligated to use the text specified in the guarantee instruments when calling for performance. The bank's duty to perform was linked to the strict fulfilment of the call's formal essentials. Since the creditor omitted one essential element, in this case just one word, the bank's duty to perform in connection with the bank guarantee did not arise.

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