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Tax & Legal

Taxes
Legal
World news
Case law
In brief

June 2017

Obsah

Editorial

Taxes

New Income Tax Act: what to expect?

New investment incentives?

Not only (one-crown) bonds under the financial administration's scrutiny

MLI: Czech Republic choses minimum standard approach

Legal

ePrivacy to protect online data

World news

Independent groups of persons under CJEU scrutiny

CJEU opens way to recovering twice paid VAT from state

Case law

Liability for VAT in payments to foreign accounts contrary to EU law

Full damage compensation in car accidents

Meeting conditions for exempted delivery

In brief

Latest news - June 2017

Editorial

At least 1 519 taxpayers will experience a hot summer this year, as this is the exact number of one-crown bond issuers who will be under the financial administration's scrutiny, with "Let the chips fall where they may" as its slogan. Undoubtedly, the taxpayers' individual circumstances will decide about the outcome of the tax administration's investigations. We recommend utilising all means of defence, since a lot is at stake: not only additional tax assessments but also reputational risks with potential criminal-law implications. Moreover, it is expected that many cases will only be resolved before a court.

In connection with one-crown bonds, a non-standard draft amendment to the Act on Investment Incentives has appeared, bringing no changes in support provided to investments but aiming to tax one-crown bonds. Tax would be applied to interest on bonds where the owner and the issuer of a bond were related parties at the moment the bonds were issued or acquired. The amendment may actually be discussed and approved already in its first reading, i.e. within the fast-track legislative process, and may become effective as early as on 1 January 2018.

A "real" amendment to the Act on Investment Incentives cannot be expected earlier than after the October elections, with anticipated effectiveness from January 2019. Irrespective of the elections, however, the Ministry of Industry and Trade made it clear that its primary intention is to enhance the attractiveness of investment incentives for technologically advanced investments, with an emphasis on research and development. Proposed changes currently discussed are the increase of monetary financial support and an adjustment of the condition stipulating the minimum number of created jobs. Especially investors in expansive projects view the condition to create a minimum number of new jobs negatively, mainly with respect to the current situation on the labour market.



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New Income Tax Act: what to expect?

A new Income Tax Act has been the declared priority of the Ministry of Finance for a long time. Based on information behind the scenes, the wording of the new law arranged according to sections is currently under preparation and should be ready for the new minister after the autumn elections.



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The ministry revealed its revised summary of solutions to innovate the regulation of taxation and public insurance charges on income. The new document is much more extensive compared to the version presented by the ministry in autumn. Although it again does not contain any specific suggestions, it indicates the direction of the new act. Below, we summarise the most interesting issues.

- Certain entities might be able to determine their tax base from the result of operations under IFRS. Banks and insurance companies are likely to be the first entities that will be allowed to do so.

- The introduction of voluntary income tax consolidation is being discussed, currently taking into account three levels of consolidation: from a mere transfer of tax bases to a single entity to consolidation similar to the one we know in accounting.

- A number of suggestions concerning assets included in the previous version remain in the latest document, such as a reduced number of depreciation groups, an option to apply pool depreciation, and the re-definition of technical improvements. The full tax deductibility of expenses for assets as they are incurred is also still under consideration.

- Radical changes are expected not only in fixed assets but also in receivables. The ministry is considering the option to repeal tax adjustments and define only receivables that can be written off, which, according to the ministry, would significantly simplify the overall administrative procedure. However, high expectations will be placed on a clear definition of the moment a receivable will be allowed to be written off for tax purposes.

- Banks and other credit providers may finally see a fundamental change in adjustments to receivables from loans. The ministry considers creating tax adjustments based on time tests similar to those relating to receivables that on their origination are accounted for in revenues, without calculating annual adjustment creation limits. The ministry also plans to reassess who will be allowed to create adjustments and to what receivables from loans these adjustments will be established.

- A revolutionary idea is the option to carry forward tax losses for an unlimited period of time. A less attractive proposition is the extension of the time period for determining tax. However, the ministry may consider a barter: the possibility to give up a prior period tax loss in exchange for the time period for determining tax.

- For the insurance sector, discussions regarding the tax deductibility of insurance provisions will be critical: the ministry is currently questioning whether the amount of insurance provisions determined under accounting legislation or Solvency II will be decisive for tax purposes.

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New investment incentives?

Proposed changes to investment incentives are currently being discussed in the Czech Republic. Investment incentives are mostly appreciated by investors operating in manufacturing as they provide them with tax holidays for the expansion of existing or the introduction of new production facilities. What is the reason for the proposed changes? What changes in investment incentives are to be expected and when?



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The reason for submitting an amendment to the Act on Investment Incentives is the need to respond to developments in the Czech economy and the low flexibility of the existing investment incentive system, as the system does not allow for the preferential treatment of projects that are technologically advanced, are closely connected with research and development or require a greater involvement of highly qualified personnel. In contrast, the need to use investment incentives as a tool to support employment has now been overcome.

The new investment incentives should primarily be directed at the enhancement of support to technological centres and shared services centres, focusing on two areas: increasing the limit of monetary financial support for the acquisition of fixed assets to up to 20% of total eligible costs at the expense of tax incentives and providing financial support to such centres for the creation of new jobs in all Czech regions (except for Prague, in which regional aid is not permitted). This change significantly expands the local applicability of direct subsidies for the acquisition of fixed assets within the investment incentive regime.

Another change should concern the existing condition to create and staff twenty new jobs, as the methodology applied to prove the meeting of this condition in relation to the number of employees of the entire company differs from the methodology used to prove compliance in relation to the activity that is being supported. Meeting this condition can be difficult for many investors, mainly where it relates to investment into the expansion or modernisation of existing productions. The amendment proposes to unify the approach and monitor the meeting of both conditions only with respect to a specific activity that is being supported, which would be much simpler. The further alleviation or complete omission of this condition is being discussed, as compliance with this condition is the main obstacle to the expansion of existing investment projects with high added value, implementing a high level of automation but not creating the required number of jobs.

For support granted to manufacturing companies, the amendment expects to introduce a new condition, calling for the payment of a minimum wage to employees of a manufacturing company that would be determined as a certain percentage of the average wage in a respective region. The application of other conditions is also under discussion: this involves both the tightening and alleviation of certain rules currently in application. The Ministry of Industry and Trade expects to submit the substance of the law to the government by the end of June. The amendment will not be discussed before the elections to the chamber of deputies and will not therefore be effective earlier than on 1 January 2019.

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Not only (one-crown) bonds under the financial administration's scrutiny

In past weeks, the financial administration commenced blanket investigations in the financing area, primarily focusing on entities that issued one-crown bonds before 2013. And its coordinated investigation procedures are not only limited to withholding tax.



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Tax reviews of one-crown bond issuers recently initiated by the financial administration are carried out on a coordinated basis along a common pattern. It is therefore obvious that the financial administration has prepared a methodology to be applied by the tax authorities without exception. Reviews are usually commenced as on-site investigations that, often before their completion, quickly turn into standard tax inspections. The practical relevance of such investigations is therefore not entirely clear. It is, however, clear that information obtained from an on-site investigation may be used by the tax administration in a subsequent tax inspection and also in other proceedings, i.e. during tax inspections of other entities.

Generally, the tax administration's procedures not only focus on the method of applying withholding tax on issued one-crown bonds or on the potential application of the abuse of right concept (where the tax inspectors aim to prove that no economic substance for the issue of such bonds existed), but also examine other aspects, such as the amount of an interest rate in relation to the arm's length principle provisions or the need for additional financing at the time of issue in relation to general provisions on the tax deductibility of expenses. The areas subject to investigation as well as specific questions usually coincide for most entities under review.

It should also be pointed out that inspections do not usually only focus on the examination of conditions pertaining to the issue of one-crown bonds but also on conditions of additional financing (including credit financing both from related parties and third persons) and potentially also on conditions of other bond programmes. It is therefore possible that the financial administration will also use their findings in its inspections of other entities.

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Taxes

MLI: Czech Republic choses minimum standard approach

Mid May this year, the government approved a proposal to enter into the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting. Less than a month before the official signing, the Czech Republic now joins the convention only in the scope of the minimum standard.



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The multilateral convention or multilateral instrument (MLI) is an OECD tool aiming to prevent tax treaty abuse through the shifting of profits to countries with zero or low taxation.

The MLI consists of two types of provisions: minimum standard provisions and optional provisions. The minimum standard provisions have to be implemented in all tax treaties. The optional provisions depend on the agreement of the contractual parties and do not have to be implemented at all, if the parties concur. Until now, it was not clear what approach to MLI the Czech Republic would take. The governmental proposal now indicates that the Czech Republic will only adopt the minimum standard, i.e. the rule to prevent treaty abuse (the principal purpose test) and the rule allowing for the effective resolution of disputes by mutual agreement (dispute resolution).

The Czech Republic intends to subject all its valid tax treaties to the multilateral convention, except for the treaty with South Korea, as it already includes the required provisions. Modifications to the individual bilateral treaties will only be made if the other contractual state also subjects the treaty to the regime of the convention and if both parties agree on the identical wording of the provision. How the convention will affect concrete bilateral treaties will thus depend on further bilateral negotiations. This means that the implementation may eventually take place in a wider scope than the minimum standard presently proposed by the Czech Republic.

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ePrivacy to protect online data

Early this year, the European Commission released the first official draft of its ePrivacy regulation, a special regulation to the General Data Protection Regulation (GDPR). Both should enter into effect already on 25 May 2018. Yet, for ePrivacy, the legislative process is only in the initial stages, while GDPR has already been passed. The deadline thus seems rather short.



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In the future, ePrivacy is to replace existing Directive 2002/58/EC on privacy and electronic communications. ePrivacy will affect not only providers of electronic communications services, public directories and software enabling electronic communication, but also all entities sending marketing communication online or collecting data on the terminal equipment of individual end-users. ePrivacy has the ambition to simplify rules on cookies, ensure better protection of metadata (such as time, place and length of communication), and introduce stricter condition for unsolicited offers.

WP29, an advisory body consisting of representatives of national regulators, has already opined on the ePrivacy draft. They appreciated the wide personal scope of the regulation, covering also providers of over-the-top (OTT) services (such as WhatsApp or Facebook Messenger). The regulation makes it possible to protect not just individuals/natural persons, but also legal entities that may also fall victim to unsolicited messages or interceptions of communication.

On the other hand, WP29 voiced its concerns about some provisions, mainly the setting of conditions for the monitoring of terminal equipment locations using WiFi-tracking. WP29 also misses an explicit ban of tracking walls that make access to a website conditional upon granting consent to the gathering of user data. Such an approach is contrary to the principle set in GDPR, which states that the provision of a service must not be conditional upon granting such consent. In general, WP29 emphasises the necessity to interpret ePrivacy in a manner that would guarantee at least the same level of protection as GDPR.

Similarly to GDPR, breaches of ePrivacy may be penalised with fines of up to EUR 20 000 000 or 4% of annual turnover. In light of such high penalties, entities affected should watch the legislative process closely. On the other hand, users of online communications services may look forward to better protection of their data.

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Independent groups of persons under CJEU scrutiny

Four cases dealing with VAT exemptions for independent groups of persons are currently before the Court of Justice of the European Union (CJEU) waiting for a ruling. The CJEU's conclusions in these individual cases may strongly affect the conditions for claiming tax exemptions in the Czech Republic as well. Will these rulings bring a realistic chance for using independent groups of persons also in the financial sector?



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In its final ruling in the Commission vs. Luxembourg case, CJEU concluded that tax exemptions for independent groups of persons cannot be limited only to groups whose members exclusively carry out tax exempt activities or activities in relation to which they are not taxable persons. Yet, this is precisely the interpretation constantly advocated by the Czech financial administration: in its opinion, a single Czech crown of taxable income automatically rules out a tax exemption, which makes the groups effectively unusable in practice. This is, however, in stark contrast to the CJEU's opinion: it is convinced that the services of a group whose members also carry out taxable activities can be exempt to the extent to which the services are necessary for carrying out the non-taxable activities.

However, the financial sector should not get overexcited prematurely. The CJEU is yet to rule on the three other cases and will have to deal, among other things, with the applicability of the exemption on services of independent groups in the financial and insurance sectors. The advocates general have already published their opinions, yet have reached no agreement. According to Advocate General Kokott, the exemption cannot be applied in the financial sector at all. Contrariwise, Advocate General Wathelet is convinced that nothing prevents the exemption of group services in the financial and insurance services sector. Independent groups of persons are covered by VAT exemptions in the public interest (Article 132 of the Directive). Typically, this area includes healthcare, culture, and education. The heart of the dispute between the two advocates general is whether the exemption only applies to groups operating in these areas or not. We may yet have to wait for a definite answer.

Other issues that CJEU will have to clarify include, for instance, whether the groups can operate on a cross-border basis or whether they really have to have the form of a legal entity, as is required by the Czech VAT Act. Many such questions remain open, and some answers may even necessitate a change to VAT Act legislation.

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CJEU opens way to recovering twice paid VAT from state

The incorrect application of a VAT regime may have far-reaching consequences for taxpayers even if the state budget does not actually lose out. If the tax administration finds that the reverse charge regime has not been applied even though prescribed by law, it will additionally assess the tax, regardless of whether the supplier has already paid it once. A recent CJEU judgement has now opened the way to recovering from the state the VAT thus paid double.



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In practice, a supplier may fail to apply the reverse charge and bill the customer in a general regime, including VAT. This often happens because the line between situations where a standard regime is to be applied and situations where a reverse charge is prescribed is not always clear.

If the customer pays the whole amount of the invoice including VAT for a supply that should have been subject to reverse charge, the tax administrator may challenge this and assess additional tax to the customers, which in fact has already been paid once. Notably, the application of the reverse charge is the responsibility of the customer, not the supplier, despite the fact that the supplier is the one who issues the tax document.

In reality, this means denying an entitlement for deduction, although technically it is an additional assessment of output VAT. It does not help customers if they can prove that they paid the tax to the supplier, not even if the supplier reported and paid the tax to the state. In practice, absurd situations thus may happen when VAT is assessed and paid twice on one transaction. Also, the supplier may not be able to fix the error and issue a corrective document, as the three-year period from the end of the taxable period in which the supply was effected may have already expired.

In April, the Court of Justice of the EU (CJEU) dealt with the Tibor Farkas case (No. C-564/15), where a standard VAT regime was applied, although under local legislation a reverse charge regime should have been applied. Based on an incorrectly issued invoice, tax was paid by the buyer, and reported and paid to the state by the seller. The Hungarian tax administrator nevertheless assessed additional output tax to the buyer.

In this case, CJEU confirmed that it is not contrary to EU legislation to assess additional tax in cases like this. At the same time, however, it stated that the customer must get the chance to recover the VAT thus paid by the supplier from the state. A necessary precondition, according to the CJEU, is that it would be impossible or unreasonably difficult to claim such incorrectly charged VAT from the seller, for instance due to their insolvency. Czech legislation does not provide a specific procedure for such a situation, but this does not mean that a member state

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may simply deny the entitlement to a refund of the tax.

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Liability for VAT in payments to foreign accounts contrary to EU law

A supply recipient's liability for unpaid VAT if the payment for the supply is made by a transfer to a foreign account is contrary to EU law, according to a regional court's recent decision (file No. 22 Af 102/2014).



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In the judgement in question, the regional court, referring to the case law of the Court of Justice of the EU (CJEU), noted that the price may be one of the indicators to assess (non)involvement in tax fraud: if goods are offered for a price lower than can be reasonably expected, it may indicate that they are being sold without VAT, meaning that VAT probably will not be paid.

However, the main issue the regional court dealt with was liability for VAT where payment has been made to a foreign account. Article 21(3) of the Sixth VAT Directive in principle allows member states to provide that a person involved in the transaction may also be liable for VAT. Under the concept of liability as currently stipulated in the Czech VAT Act, a person becomes liable de facto just because they have made a payment to a foreign account. Yet, current legislation does not give the persons thus liable any chance to free themselves from such liability, not even by producing evidence proving that the supply recipient did not, and could not have known that VAT is not going to be paid by the supplier. Even proving that he had nothing else to do with the debtor will not help. According to a CJEU advocate general, this gives rise to a system of no-fault (strict) liability, which goes beyond the scope of what is necessary to protect payments to public budgets.

Referring to several CJEU rulings, the regional court thus ruled that the existing concept of a supply recipient's liability when payments are made to a foreign account is contrary to EU law. The question now stands what the tax administration's next step will be. If the same conclusion is reached by the Supreme Administrative Court, we may be even looking forward to a change in legislation. Be that as it may, it is certainly advisable to use the regional court's arguments as a defence in similar situations.

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Full damage compensation in car accidents

The Constitutional Court again ruled on compensation of damage in car accidents. After a series of rulings dealing with the amortisation of spare parts used to repair crashed cars, the court now looked into the issue of compensation for damage equalling the difference between the price of a car before an accident and after repair.



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In the past, the Constitutional Court had already ruled that, when calculating the actual amount of damage to a car involved in an accident, it could not be simply stated that if a car had been repaired using new spare parts, the amount of the compensation could be reduced to reflect the technical improvement to the car. According to the Constitutional Court, such an approach to determining the total amount of actual damage was not sufficient. Already in that ruling, the court stated that it is always necessary to consider whether a car involved in a crash would sell for a lower price than a comparably equipped car that had not been in an accident. The Constitutional Court held that courts always have to examine nuances in market value, taking also into account the nature of the parts replaced. Thus, reducing the claimed damage compensation by 50%, for instance, arguing that the use of new spare parts in fact increased the value of the car, is inacceptable.

In its previous ruling, the Constitutional Court also stated that the injured party did not arrive at the situation through their own fault – on the contrary, the car repair was in a way forced onto them. Thus, if the repair effectively aims to eliminate the consequences of the event inflicting the damage, it would be unjust for the injured party to have to pay anything for getting the car back into working order.

Notably, the mentioned rulings related to the regulation under the previously valid Civil Code. The new Civil Code now explicitly stipulates that the amount of the damage is to be determined taking into account everything which the injured party had to efficiently incur to restore or replace the function of a thing.

In recent ruling TZ 39/2017, the Constitutional Court proceeded along the lines of its previous opinions when dealing with a complaint of a corporation that, apart from the cost of repair of a damaged car, sought also compensation of damage equalling the difference between its market value before the crash and after the repair. The Constitutional Court stated that the common courts' approach to pay only the cost of repair and not to reflect the difference in the market value of a thing was contrary to the right to damage compensation and ownerships protection. According to the Constitutional Court, statutory provisions regulating damage compensation should be construed extensively to cover all expenses that the injured party had to face as a result of the wrongdoing. Thus, unless the injured party acts excessively in repairing the crashed car, they are entitled to full damage compensation, including the difference between the market value of the repaired car and the car not involved in an accident.

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Meeting conditions for exempted delivery

Proving the entitlement for VAT exemption when delivering goods to another member state is becoming increasingly difficult due to the growing demands of the tax administrators. Taxpayers will thus surely be happy to hear of any ruling that may make their life slightly easier in the future, or at least give them some hope. Supreme Administrative Court (SAC) judgement No. 1 Afs 253/2016 – 29 may be one of them.



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In the case in question, a Czech VAT payer supplied metal scrap to a customer in Germany and therefore considered the supply VAT exempt. In a subsequent tax inspection at the supplier, the tax administrator demanded that the supplier produce documents proving that the conditions for exempting the supply were met.

When proving the entitlement for VAT exemption, three conditions have to be met cumulatively. The goods must be delivered to a person registered for tax in another member state; the goods must be dispatched or transported to another member state; and the transportation must be arranged by the payer, the acquirer, or a third person authorised by them.

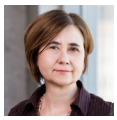
The tax administrator objected that the customer was not registered for VAT in Germany at the time of the trade. They also pointed out the carelessness of the Czech supplier who did not seek more information on the transportation of the goods and failed to prove that the goods physically left the territory of the Czech Republic. The supplier and the customer had agreed on the EXW term, meaning that the customer was paying for the transportation. This was supported by a statement of the customer's statutory representative, who was subsequently questioned by the tax administrator as a witness. The supplier also submitted delivery notes and a confirmation of the customer's registration for VAT in Germany to the tax administrator.

While it was true that the customer was not in fact registered for VAT in Germany at the time of the trade, this did not yet show in the European VIES system. In the SAC's opinion, the fact that entities involved in international trade in metal scrap are prone to conclude informal arrangements is not at all surprising and does not in itself indicate that they are committing tax evasion. Moreover, if the tax administrator had any doubts as to the veracity of any evidence submitted, they should have considered the supplier's good faith, following the CJEU's ruling in the Teleos case. The SAC thus dismissed the tax administrator's cassation complaint, stating that it cannot imagine how else the supplier could have proved meeting the conditions for the entitlement for VAT exemption.

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Latest news - June 2017

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



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- Based on available information, the call under the Innovation Programme is to be announced during summer, where a small portion of the allocation – approximately MCZK 300 – will be also available for large businesses. The call under the Potential Programme will only available for small and medium-sized businesses.

- The General Financial Directorate (GFD) issued information on tax liabilities of taxable persons providing passenger transport through the UBER mobile application.

- In connection with the amendment to the VAT Act expected to enter into effect on 1 July 2017, the scope of supplies subject to the reverse charge regime is to be expanded. Starting from 1 July 2017, a reverse charge will permanently apply also to the mediation of deliveries of investment gold, the delivery of immovable items in a forced sale, the provision of workers for construction and assembly work, the delivery of goods originally provided as a guarantee, and the delivery of goods after the transfer of a reservation of ownership.

- The Senate rejected stricter conditions for foreigners' residence and employment in the Czech Republic as per the proposed amendment to the Foreigners' Act. The senators decided that they were contrary to the Constitution, EU law, and the human rights commitments of the Czech Republic. The amendment will be returned to the Chamber of Deputies for renewed consideration.

- An amendment on the blanket introduction of ID cards with an electronic contact chip was passed by the Senate. ID cards containing a chip will be issued free of charge, not for CZK 500, as is the case today. The bill will now be submitted to the President for signature. Citizens may apply for express issuance of an ID card or a passport and for a fee, the document will be issued within one working day or within five days from filing the application.

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