KPMG

# Tax & Legal

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July 2022

# Editorial

The time for holidays has arrived, covid restrictions are – hopefully not just temporarily – gone, and we can go on vacation. If you are travelling by air, our feature on the Court of Justice of the EU ruling on air passengers' personal data and the prevention of terrorism in air transport may help pass the time while waiting to check-in. However, considering the current situation at airports, you may probably want to go back a few editions, and refresh on the feature about compensations for flight delays or lost luggage.

On the home front, we look into the consequences of the latest interest rate increase. You may be interested to know that starting 1 July, late payment interest shall be calculated at a rate of 15% p.a. This increases the costs associated with the late payment of tax, but also the importance of steps with which you can reduce the amount of interest. You will learn more about how default interest is calculated and how to reduce it.

The shortage of labour in the domestic market could to some extent be solved by the arrival of workers from Ukraine. In this context, it will certainly be interesting to read about the Supreme Administrative Court's judgment concerning the Svarc system and disguised mediation of employment.

And if you do not have time to check your data box during the holidays, at least check the Supreme Administrative Court's decision in the age-old dispute over the delivery to data boxes by fiction.

Have a nice summer!

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# Amendment to Lex Ukraine tightens conditions for temporary protection

Already during the adoption of the original wording of Lex Ukraine it became obvious that an amendment would soon be necessary. This amendment has been published three months after the original law's effective date and the changes it contains will mainly affect the rules for the provision of humanitarian allowances, the procedure for granting temporary protection, the accommodation of temporary protection holders, and the possibility for the government to regulate the acceptance of applications for residence permits for citizens of Russia and Belarus outside the state of emergency.

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The amendment expands the grounds for not granting or withdrawing temporary protection status in the Czech Republic. Apart from previous applications for temporary protection in another EU member state, applications for international protection have now also become an obstacle. Temporary protection in the Czech Republic also automatically ceases if a foreign national submits a similar application in another EU member state. The amendment also excludes applications for temporary protection if a refugee holds the citizenship of another EU state in addition to Ukrainian citizenship. It also introduces a 60-day time limit for processing particularly complex applications that cannot be processed immediately upon application submission.

### New rules for accommodation

Other changes concern accommodation. If the foreigner has not been automatically granted accommodation, they must provide a certificate of accommodation with their application in accordance with the Act on the Residence of Foreign Nationals. This document does not have to include a certified signature of the owner or authorised representative. If the temporary protection holder changes the address of their residence in the Czech Republic and plans to stay at the new address for more than 15 days, they are obliged to notify the Czech Ministry of the Interior of this change within three days at the latest. The amendment also defines in detail the conditions for providing accommodation, both in the form of emergency accommodation and temporary shelter, including the provision of compensation to accommodation operators.

### Tightening conditions for public insurance

The amendment also introduces changes in social and public health insurance, while also tightening the conditions for a humanitarian allowance of CZK 5,000. If a foreigner who has been granted temporary protection is provided with free accommodation, food and personal hygiene products, this allowance cannot be paid. The humanitarian allowance may be paid on a long-term basis, but for a maximum of five months, only to foreigners who reside in the Czech Republic and prove their need. Except for children and the elderly over 65 years of age, public health insurance costs are automatically covered by the state only for the first 150 days. After this period, temporary protection holders must pay for their own insurance unless they fall under one of the statutory

exemptions.

**Regulation of visas for Russian and Belarusian citizens**

The amendment establishes the possibility for the government not to accept applications for visas or residence permits that are contrary to the foreign policy interests of the Czech Republic. Currently, the restriction applies to citizens of the Russian Federation and Belarus.

Lex Ukraine will remain in force until 31 March 2023, even after the amendment. The amendment does not state what options temporary protection holders will have for staying in the Czech Republic after 1 April 2023, hence it is likely to be amended again in the coming months.

# Tax priorities of the Czech EU Presidency

During the Czech Presidency, the EU Council will have to deal with several tax regulations that are in various stages of preparation or approval.

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According to the Ministry of Finance, the CR will focus on the following tax areas:

- simplifying the tax system and reducing the number of unjustified tax exemptions;
- preparation of an amendment to the Directive on Taxation of Energy Products and Electricity and its adaptation to current climate targets;
- simplifying and modernising VAT rules to reflect the development of digitalisation and fight tax evasion more effectively;
- setting the taxation of the digital economy (OECD Pillar I) and implementing the OECD Global Agreement on Taxing Multinational Enterprises (OECD Pillar II) into the EU legal framework;
- updating the European list of non-cooperative jurisdictions for tax purposes.

The French presidency came close to approving a **directive to introduce a 15% minimum income tax** for multinational enterprises. Adoption was blocked by Hungary at the last minute, but negotiations to finalise the directive are expected to continue.

Negotiations are also ongoing on an amendment to the **Energy Directive**, aimed to introduce a new tax rate structure based on the energy content of fuels and electricity and their impact on the environment while also extending the tax base by including more products and removing existing exemptions (e.g., for kerosene used as fuel in the aviation industry and heavy oil used in the maritime industry). However, the current energy crisis has complicated the adoption of this directive, as many member states are concerned about its impact on maintaining EU competitiveness and its consequences for households.

At the same time, the European Commission is finalising the preparation of a **directive laying down rules to prevent the misuse of shell entities** for tax purposes and a **directive on a debt-equity bias reduction allowance**. Both may be adopted during the Czech Presidency.

Tips and tricks

# Default interest: how it arises and how to reduce it

At the end of June, the Czech National Bank raised the repo rate again, this time to 7% p.a. This significantly affects the amount of interest under the Tax Procedure Code. From 1 July 2022, default interest will be calculated at a rate of 15% p.a. This increases the costs associated with the late payment of tax, but also the importance of steps that can be taken to reduce the interest.


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### How is default interest calculated?

Default interest on unpaid tax begins to accrue on the fourth day after the tax is due for each additional day of default and is calculated on the unpaid tax multiplied by the interest rate composed of the CNB repo rate applicable on the first day of the calendar half-year (i.e., 1 January or 1 July) plus a fixed part of 8 percentage points. The tax administrator assesses default interest if the interest has reached at least CZK 1,000 on the date the tax payable is settled.

The interest rate structure means that its amount varies depending on the repo rate, not only with respect to the specific due date of a particular tax but also during the period of default in the payment of a single tax underpayment. This is further confirmed by the Ministry of Finance's Instruction (MF-18). Default interest under the Tax Procedure Code differs in this respect from default interest under the Civil Code where the moment at which the default occurred determines the rate. Therefore, this year there will be two rates of default interest: 11.75% until 30 June 2022 and 15% from 1 July. Despite the latest amendment to the Tax Procedure Code significantly reducing default interest from 1 January 2021 (the fixed part of the interest fell from 14 to 8 percentage points), interest rates will again exceed 14%.

More so now than in the past it is therefore necessary to ensure that all taxes are paid on time and in the correct amount. Default interest is calculated identically whether the tax is increased because of a voluntarily filed supplementary return or due to a lengthy tax inspection. However, filing a supplementary return offers the possibility of waiving up to 20% of the interest.

### How to reduce interest?

Taxpayers can obtain a reduction in interest if they apply for a deferment of the tax payment, thus postponing the due date or spreading the tax into instalments. For the period of deferment, they only pay interest on the deferred tax amount, which is half the default interest (for the second half of 2022, the interest on the deferred tax amount will be 7.5%).

It is also possible to apply for a waiver of interest once the outstanding tax has been paid, in which case there is a fee. After considering the grounds stated in the taxpayer's application, the tax authority may grant the request and reduce the interest by 20 to 100%. When formulating the statement of grounds, it is advisable to consider GFD

Instruction D-47, providing waiver examples including relevant percentages.

If a taxpayer is aware of potential additionally assessed tax (e.g., because of a tax inspection), the taxpayer may limit the interest expense by paying the tax amount to their tax account before the tax itself is additionally assessed. If there is such overpayment in the tax account, which then must really be used to pay the tax, default interest will only accrue for the period from the original due date of the tax to the date the tax was prematurely paid to the tax account.

# Subsidies to support digitisation

On 9 June 2022, the Ministry of Industry and Trade announced the first calls for support for enterprise digitisation from the National Recovery Plan. Support in the form of subsidies for the purchase and implementation of advanced digital technologies is intended for businesses in Czech and foreign markets. Applications are being accepted from 16 June to 16 September 2022.

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### Call I Virtual Enterprise

The call is aimed at projects focusing on the investments or acquisition of new services in information and communication technologies - software and hardware. These investments must help bring about a **significant progress in the digitisation** of companies, e.g., support data automation and digitisation or a more efficient interconnection and management of company processes.

CZK 200 million is available for large enterprises, out of total funds for allocation of CZK 600 million. If there is an excess of good-quality projects, total funds may further be adjusted. The aid intensity for large enterprises is 20% of total eligible costs, throughout the entire Czech Republic. The maximum support amount per project is at least CZK 0.5 million, up to de minimis.

### Call I Digital Enterprise

The call will support investments or the acquisition of new services in information and communication technologies. These investments must result in a **fundamental change in the overall production process or an expansion of the capacity of an existing facility or an extension of the existing product range**. Large enterprises will receive support only in the North-West, North-East, Central Moravia and Moravia-Silesia regions.

Planned funds for allocation are CZK 1.5 billion, with CZK 0.5 billion intended for large enterprises, but the overall allocation may further be adjusted. The aid intensity for large enterprises in the North-West region is 40% of total eligible costs, and 30% in the North-East, Central Moravia and Moravia-Silesia regions. Subsidies must amount to at least CZK 1 million and shall not exceed CZK 15 million per project.

### Eligible costs

For both calls, eligible costs comprise costs incurred for tangible and intangible fixed assets, services, and other costs (e.g., software costs such as cloud services). At least 80% of total eligible costs must be expenditure falling under the category of advanced technologies and services, while the remaining 20% of the costs may be expenditure on basic technologies and services.

# SAC clearly interprets Svarc system in context of contracts for work concluded between legal entities

The Supreme Administrative Court recently issued another judgment concerning Svarc system and disguised employment mediation. In the court's opinion, to assess whether there is a relationship of (an employer's) superordination and (an employee's) subordination, it is decisive how the position is perceived by the employee; this conclusion shall not be affected by contracts for work having been concluded or invoices issued between the company where the work was performed (the customer) and the company that provided the workers (the contractor). The SAC thus agreed with the Labour Inspectorate and the lower courts and confirmed a fine of more than one million crowns.

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In the case at hand, a customer had concluded contracts for work with several companies – contractors of the work. The actual work at the customer's workplace was performed by several foreign workers. The customer had no contract with them. The SAC dealt with the question whether the fact that a contract for work has been concluded between the customer and the contractor with invoicing taking place, while there has been no contract concluded between the customer and the foreign workers **could affect the assessment of the relationship between the customer and the foreigners as the performance of dependent work or false self-employment**, i.e., a Svarc system set up.

The foreign workers worked at a joint workplace with the customer's employees. They performed the same or similar work, were trained, supervised, tasked, and rewarded by the customer's employees. They took meals in a joint cafeteria and stayed at the customer's accommodation facility. According to the court's findings, no employees of the contractor were present at the workplace to assign work to the foreigners. Most of the foreigners concerned did not have any contract with the contractor; on the contrary: all foreign workers considered the customer to be their employer. The internal position of the foreign workers at the workplace was thus in no way different from that of the customer's employees. The SAC thus confirmed the conclusion of both the Labour Inspectorate and the lower courts that the performance of the work by the foreign workers had fulfilled all the characteristics of dependent work in relation to the customer, and therefore it was false self-employment, i.e., a Svarc system set up.

The SAC commented that the above conclusions were not affected by the fact that a contract for work had been concluded, and invoicing took place, between the companies. This contractual relationship was assessed by the SAC as having the sole purpose of concealing that the foreigners performed dependent work for the customer. The SAC deduced this, among other things, from the fact that it had not been proven in the proceedings that the foreigners were in a contractual (employment) relationship with the contractor. On the contrary: they considered

the customer to be their employer, even though they had not concluded any contract with them. If it had been proven that a contractual relationship existed between the foreign workers and the contractor, it would probably not have been a Svarc system set up, but instead the disguised mediation of employment. According to current legislation, a 10 million fine for disguised employment mediation would threaten not only the contractor, but also the customer.

For years now, **inspections of illegal employment** have been on the Labour Inspectorates' agenda, and the penalties are severe: both for those who allow the illegal work and for those who provide the workers. And it is no different for this year. To illustrate, last year, 677 fines were imposed for illegal employment in an aggregate of CZK 165 million; 134 fines were imposed for disguised employment mediation in an aggregate of almost CZK 67 million. Among illegal workers, foreigners significantly outnumber Czech workers.

**We recommend that employers carefully review their current and future contractual relationships with contractors, both in terms of the content of the contractual documentation, and in terms of and how the cooperation has been or will actually be taking place.**

# CJEU limits processing air passengers' personal data

The beginning of the summer holidays was marked by the Court of Justice of the EU (CJEU) ruling concerning air travel, passengers' personal data, and prevention of terrorism. The CJEU primarily addressed the validity of the Passenger Name Record (PNR) Directive and the compliance of the processing of air passengers' personal data with EU law. In its judgment, the CJEU concluded that EU law precludes national legislation requiring a systematic processing of passengers' personal data without the existence of a genuine and foreseeable terrorist threat.

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The PNR Directive allows for the systematic collection of personal data of air passengers entering and leaving the EU to prevent, detect, investigate, and prosecute terrorist offences and serious crimes. Personal data include, for instance, the name, contact details, date of issue of the air ticket, seat number, luggage information, and even information about the passenger's frequent flyer programme.
Member states may also apply the directive to flights within the EU. In the case in question, Belgian legislation required air carriers to collect their passengers' personal data for intra-EU flights. However, according to the League of Human Rights organisation, such an extension of the scope of the directive may infringe the right to respect privacy and protect personal data. It may also indirectly reinstate border controls, disrupting the free movement of people within the EU.

The CJEU admitted that the **PNR Directive entails serious interferences with the rights guaranteed by the EU Charter of Fundamental Rights**, as it seeks to introduce continuous, non-targeted, and systematic surveillance, including the automated assessment of the personal data of all persons using air transport services. According to the CJEU, interference with these rights by a member state must meet strict conditions.

Thus, a member state can extend the application of the PNR Directive to all intra-EU flights in principle only in a situation where:

- it faces a terrorist threat which appears to be genuine and present or foreseeable on the basis of sufficiently solid grounds;
- the processing of such passengers' personal data is proportionate to the potential threat;
- the application of the directive does not go beyond the scope and time of what is strictly necessary to combat terrorism.

In the absence of such a threat, the transfer of passengers' personal data must be limited to certain routes, travel

patterns, or certain airports where there are indications of a potential threat. The processing of passengers' personal data will also be subject to further restrictions. For example, the data can neither be processed for the purpose of detecting ordinary crime nor, with some exceptions, used after six months from being transferred by the air carrier to the competent authority. The CJEU also commented on the use of artificial intelligence (machine learning systems) in the preliminary assessment of PNR data and for identification of persons who should be further screened prior to arrival or departure. The competent authorities cannot use these technologies, in particular because of the margin of error.

To conclude: when processing air passengers' personal data, air carriers and competent authorities of the member state must comply not just with applicable aviation legislation (e.g., the Civil Aviation Act), but also with EU legislation and case law on personal data protection. Otherwise, they may face severe fines for breaches of personal data protection rules.

# SAC: no delivery on weekends and holidays, not even by fiction

The Supreme Administrative Court (SAC) has ruled on an age-old dispute: the fiction of delivery to a data box can only occur on a working day. Therefore, if the 10-day period from the date of delivery of a message to the data box elapses on a weekend or public holiday, the message is deemed delivered on the next working day, not before.

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The dispute arose because of a penalty for the late filing of a subsequent VAT ledger statement which the tax administrator assessed for three days of delay. In the case in question, the call to file a subsequent VAT ledger statement was sent to the taxpayer's data box and delivered by legal fiction after the period of 10 days had elapsed, which corresponds to the period for which letters are deposited at the post office for classic mail. In this case, the end of this deposit period fell on a Sunday. From that day, the five days for filing the VAT ledger statement were counted, and the deadline thus ended on Friday.

The taxpayer disagreed: in their opinion, the tax administrator should have applied the rules for counting time stipulated by the Tax Procedure Code, therefore the message could not have been delivered by fiction on a non-working day, but only on Monday. If delivered on Monday, the deadline for filing the VAT ledger statement would fall on the next Saturday, which means it would be postponed until the following Monday. And on that Monday, the VAT ledger statement was in fact filed by the taxpayer. Thus, in their opinion, the penalty was imposed wrongfully.

The taxpayer succeeded with this argument in the regional court, which agreed with their approach. And it was also eventually approved by the Grand Chamber of the SAC, which surpassed the existing SAC case law. Although, according to the Grand Chamber, there are no theoretical reasons why the deadline for delivery by fiction could not end on weekends, in the end the court sided with an interpretation more favourable to the taxpayer. One of the reasons was that the legislators had not been careful in correctly defining the terms 'deadline' and 'period of time', therefore, a strict theoretical interpretation might lead to a conclusion harming the taxpayer. The judgement's statement of grounds clearly shows the court's effort to clarify the rules regarding the deposit deadlines/periods as much as possible.

Thanks to the Grand Chamber's decision, the approach to delivery by fiction has been unified for physical and electronic mail and across branches of law: the Supreme Court arrived at the same conclusion for civil and criminal matters already in 2017. For most, however, the conclusion that the deadline for delivery by fiction shall not elapse on weekends or public holidays will be the most important aspect.

# SAC on default interest waivers

In its judgment 4 Afs 311/2021-33, the Supreme Administrative Court (SAC) addressed whether it is possible to grant a taxpayer's request for a waiver of default interest that has arisen from incorrect VAT treatment. The entity themselves actively corrected the mistake by filing additional tax returns and paying the tax. However, the tax administrator classified their conduct as a repeated breach of obligations in tax administration and did not grant the waiver.

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The taxpayer, a German company, erred in applying the correct VAT regime to transactions carried out: instead of paying the tax in the Czech Republic, they paid it in Germany. Without being called upon by the tax administrator, they realised the mistake, and took all corrective measures: they retrospectively registered for VAT, filed additional tax returns in the Czech Republic, and paid the tax owed.

Subsequently, the taxpayer applied for a waiver of default interest on the owed tax. However, the tax administrator classified the taxpayer's conduct as a repeated breach of tax regulations and did not grant their application. The case thus proceeded to court.

The SAC agreed with the taxpayer's argument that the waiver of default interest is a privilege for those who cooperate with the tax administrator and act honestly, fairly, and in a sincere effort to correct their mistakes. Therefore, the conduct in the given case should not be equated to that of entities who repeatedly and purposefully fail to cooperate with and thwart the actions of the tax administrator. The court also agreed with the taxpayer's view that their errors constituted a single act, not a repeated breach of tax regulations.

The SAC thus sided with the taxpayer, emphasising their cooperative, honest and fair approach during the proceedings.

# Statutory body liable for unpaid VAT?

Advocate General Juliane Kokott has recently dealt with whether the general joint and several liability of a statutory body falls within the scope of the VAT Directive (due to a company's inability to pay its VAT debt). She also commented on whether national legislation may provide for the direct liability of a member of the board of directors who behaved wrongfully, if, because of their conduct, tax cannot be collected in due and timely manner.

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The Bulgarian Administrative Court referred prejudicial questions to the Court of Justice of the European Union (CJEU) in the following case: a non-taxable natural person exercising the office of a statutory body had deliberately and regularly increased their remuneration for exercising the office, thereby rendering the company unable to pay its debts, including its VAT obligations to the Bulgarian tax authorities. Since the Bulgarian national legislation provides for a direct (accessory) liability for debts of any unpaid tax in the event of wrongful conduct on the part of the statutory body, the Bulgarian tax authority approached the company's statutory body member directly.

The Bulgarian administrative court asked whether the general joint and several liability of a statutory body was within the scope of the VAT Directive. The Advocate General concluded that, by its nature, it is not the subject of the VAT Directive, and the legislation in question thus does not fall within the scope of EU law. For this reason, the CJEU does not have the power to rule on the matter.

She added, however, that a **direct liability of a member of a statutory body for tax not paid by a third-party was not contrary to the VAT Directive or incompatible with the protection of EU's financial interests**. In her opinion, it is necessary to adopt national legislation to deter management bodies from engaging in wrongful conduct and to achieve the legitimate objective of collecting the tax for the state budget; she sees such a provision in national legislation as proportionate and in line with the principle of proportionality. In the Czech environment, we may compare this to the ‘due managerial care’ concept.

It will certainly be interesting to see if and how the CJEU itself will comment on the case.

# News in brief, July 2022

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

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## DOMESTIC NEWS

- The chamber of deputies has approved the rati⊠cation of a treaty between the Czech Republic and the Republic of San Marino on the prevention of double taxation relating to income and property taxes and on the prevention of tax evasion and tax avoidance. The government has also negotiated a double taxation treaty with Qatar and has already referred it to the chamber of deputies.
- A government bill on the abolition of electronic reporting of sales passed its first reading in the chamber of deputies.The government has submitted to the deputies a draft amendment to several tax laws, proposing, inter alia, to increase the limit for VAT registration, modify the lump-sum tax regime, and extend the use of extraordinary depreciation.
- An amendment to the Excise Duty Act containing the transposition of the recast version of Council Directive 2020/262/EU has been published in the Collection of Laws.
- The Ministry of Finance's Financial Bulletin 9/2022 has published an overview of double taxation treaties valid in the Czech Republic as at 21 June 2022.
- Financial Bulletin 10/2022 published a decision on the waiver of value added tax due to an extraordinary event. Subsequently, the Ministry of Finance issued a press release on this decision revoking the waiver of VAT for the supply of electricity or gas for November and December 2021, with legal effects only from the date the decision in the review proceedings becomes final and conclusive. The Ministry of Finance has clarified that there will be a change in VAT-related obligations for the taxable periods in question: taxpayers will not be obliged to file, e.g., additional tax returns for November, December or the fourth quarter of 2021 nor will they be entitled to an additional VAT deduction. Consumers will not have to refund VAT already waived. The annulment of the original decision does not entail any additional interventions in the accounting area. The original decision was revoked because of insufficient reasoning and inconsistency with EU law.
- The financial administration recommends that payers of road tax obliged to file a tax return for trucks and trailers with a maximum authorised weight of 12 tonnes or more check whether they have not breached their obligation to declare and pay tax on trucks and trailers for the 2021, 2020, and 2019 taxable periods. The financial administration has also published information summarising the new features of the amendment to the Road Tax Act with effect from 1 July 2022.
- The GFD has issued information for public benefit taxpayers on how to properly complete their corporate income tax returns for the purpose of limiting deficiencies in asserted data.
- The financial administration has simplified access to the Moje Daně portal, allowing access to foreign persons not recorded in the Register of Persons and therefore ineligible to access the portal via a data box or a guaranteed identity (NIA). The financial administration will now allow applying for the activation of a user account via a one-page electronic form.
- Amendment to the Income Tax Act No. 142/2022 Coll. has reduced the calculation of non-cash income in form of the free provision of a low-emission motor vehicle to an employee for business and private purposes to 0.5% of the vehicle's input cost. The amendment is effective from 1 July 2022 but applicable for the entire 2022 taxable period. The GFD has issued information in this respect addressing in particular the

question of how employers (payers) should proceed during the annual settlement of employees' income taxor when issuing a certificate of taxable income from employment where an employee files their own income tax return.
- The GFD has published a follow-up to the FAQs, including practical examples, concerning the reporting obligation on reportable cross-border arrangements (DAC6).

**FOREIGN NEWS**

- The European Parliament has issued a draft report on the Directive to Prevent the Misuse of Shell Entities for Tax Purposes, recommending that the text be approved with certain modifications (e.g., postponing the effective date to 1 January 2025). The Members of the European Parliament could vote on the draft directive at the end of the year. The crucial factor will then be its approval by all member states in the EU Council.
- The OECD has published comments on the rules for excluding regulated ☒nancial services from the Pillar 1 framework (allocation of a share of profits from the sale of goods or consumption of a service to the country of sale or consumption), as well as on two other documents relating to Pillar 1. These documents concern the rules for determining Amount A to be taxed in the market country and the process for resolving disputes between the market country and the country in which the profit has so far been reported under the existing rules.
- EU finance ministers have adopted a directive extending the period of application of the optional reverse charge mechanism for goods and services with a high risk of VAT fraud until 31 December 2026.
- The European Commission has published its annual report on taxation for 2022, highlighting that EU member states' tax revenues have fallen for the first time since the 2009 ☒nancial crisis. The accompanying report describes the most significant tax trends in member states over recent years.

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