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Editorial

How not to lose speed and be caught off guard by the economic downturn? These and other topics were discussed at our traditional Transfer Pricing Forum conference a week ago. And we went straight to the point: the papers presented, and the questions asked imply that the tax authorities are getting tougher, and not just in transfer pricing area.

The abuse of law argument is being used increasingly often; the judgment concerning the issue of one-crown bonds, covered in this issue of the *Tax and Legal Update,* is a recent example. The number of areas where tax authorities try to apply the abuse of law doctrine has also been growing. Thus, if you want to avoid problems, you must not let up.

I wish everyone a successful start to the summer. Enjoy it without worrying about finances, taxes, abuse of law, or transfer pricing.

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VAT perspective on early termination of energy supplies

At a meeting of the Coordination Committee of the Chamber of Tax Advisors and the General Financial Directorate, the financial administration confirmed that compensation for the early termination of energy supplies or the failure to deliver an agreed quantity is considered the provision of a service and therefore a taxable supply.

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The Coordination Committee recently discussed the application of VAT upon the early termination of energy supplies (meaning heat, electricity, gas, etc.) or the failure to deliver an agreed quantity. The paper submitter outlined two possible situations to the Coordination Committee: the first was the simple termination of the contractual relationship by agreement between the provider and the customer and the failure to deliver the previously agreed energy at previously agreed fixed prices. The submitter had calculated the compensation for non-delivered energy as the product of the amount of non-delivered energy and the difference between the agreed and market price at the time of termination of the contractual relationship. This compensation reimburses for energy not supplied or taken and is subject to value added tax. It is considered as the provision of a service with a place of supply in the Czech Republic subject to the basic rate, as confirmed by the opinion of the GFD.

The second case involves a compression of contracts where a provider and their customer have entered into multiple opposite contractual relations for the same performance. Upon the subsequent termination, the receivables and payables of both parties are offset to the extent that they overlap, and thus cease to exist. The net differences, if any, constitute separate payables or receivables, which, according to the submitter, should not be subject to VAT. Compensation for the undelivered energy shall be calculated on the supply remaining after the compression of the contracts. The GFD disagreed with this conclusion and drew the same conclusion for the compression technique as in the first case discussed above, i.e., energy supply contracts are terminated and one of the contracting parties is entitled to compensation directly attributable to the undelivered supply: on these grounds, the GFD concluded that the second case also involved a provided service (a taxable supply).

Taxes

Increase in VAT registration limit: main tax implications for entrepreneurs

The government has prepared tax changes aimed at simplifying tax obligations for entrepreneurs next year while also proposing to extend the extraordinary tax depreciation regime to 2022 and 2023.

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The Ministry of Finance has prepared an amendment to the VAT Act and the Income Tax Act and other related laws. The most important changes are an increase in the annual limit for obligatory VAT registration from CZK 1 million to CZK 2 million and an increase in the annual income limit for the application of the lump-sum tax regime.

Increase in limit for VAT registration to CZK 2 million

The draft amendment to the VAT Act increases the annual turnover limit for registration as a VAT payer to CZK 2 million. This fits in with the increased limit in the amended VAT Directive of EUR 85,000 from 2025. The Czech Republic's request to increase the limit as early as 2023, i.e., before the amendment to the EU Directive comes into force, has already been approved at the EU level.

The draft amendment introduces the possibility to deregister from VAT with an annual turnover of less than CZK 2 million. According to the transitional provisions, VAT payers will be able to apply for the cancellation of their VAT registration on the grounds of the increase of the turnover limit in the law even before 1 January 2023, i.e., before the law comes into force. Thus, they will not be considered VAT payers as of the beginning of 2023 and will be able to apply the lump-sum tax regime on that date if the decision to cancel their registration is delivered to them before 16 January 2023.

Increase in limit for applying lump-sum tax regime

In connection with the increase in the upper limit for obligatory VAT registration, the ministry proposes to also increase the income limit for applying the lump-sum tax regime to CZK 2 million a year. However, unlike now, the lump-sum tax amount including social security and health insurance contributions should not be the same for all taxpayers, as the amendment introduces several taxation levels. The proposed wording is likely to be subject to changes during the comment procedure, as the public authorities have reservations about the technical feasibility and practical application of the proposed changes.

Extraordinary, accelerated depreciation charges for 2022 and 2023

The Ministry of Finance proposes to extend the regime of extraordinary, accelerated depreciation for assets classified in the first and second depreciation group, acquired in 2022-2023, for which the taxpayer is the first depreciator. This regime was already in place for assets acquired in 2020-2021 to mitigate the impact of the COVID pandemic on businesses. In 2022 and 2023, it will also be possible to depreciate assets classified in the first depreciation group without interruption over 12 months instead of the standard three years, and assets classified in the second depreciation group without interruption over 24 months instead of the standard five years. In the

first 12 months, the taxpayer will be able to claim depreciation of up to 60% of the input cost.

The bill also contains some other points, such as the modification of penalties for the failure to file a VAT ledger statement.

Subsidies

New call to support water saving in industry

On 5 May 2022, the Ministry of Industry and Trade announced a long-awaited call for water saving in industry. This is the first call of its kind under the National Recovery Plan.

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Support will be provided, e.g., for investments in ltration facilities, reduction of leakages in water distribution systems, rainwater harvesting or use, and more. Applications for support will be accepted from 12 May to 30 September 2022. Project implementations must be completed by 31 December 2024.

Who can apply and for how much?

Aid is intended for businesses including those owned by public bodies. Up to three applications can be submitted under one identi cation number if the projects are implemented in different locations. The place of implementation can be the entire Czech Republic including Prague.

A total of CZK 1 billion will be allocated to applicants. Support will be granted for up to 40% of eligible costs. The minimum amount of subsidy is CZK 1 million; the upper limit is CZK 25 million.

What are the eligible costs?

Eligible costs may include costs incurred for machinery and equipment, buildings, utilities, and construction and development activities. However, construction work and supplies are eligible only to the extent that the work is strictly necessary for the implementation of the proposed measure. Investments constituting eligible costs will have to be put out to tender in accordance with the Public Procurement Act.

What are the conditions?

Applicants must submit a business plan, a water audit prepared within the scope set out by the call, a detailed description of the technology to be purchased, and a cumulative project budget including indicative quotations.

Projects that through a water audit fail to demonstrate water savings of at least 5% or 100 m3/year by the proposed measures will not be supported. Similarly, support will not be granted to projects aimed at purifying or changing the quality of water at the inlet or outlet of the undertaking's water management system, water saving projects outside the undertaking's water management system, changing water sources or their capacity, and primary agricultural production.

Subsidies

Support for research and development: DELTA 2 programme opens

On 18 May 2022, the Technology Agency of the Czech Republic (TA CR) announced the fourth call within the DELTA 2 Programme for Support of Applied Research, Experimental Development and Innovation. The programme supports the transfer of international knowledge, sharing of good practice, and penetration into foreign markets.

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The call is intended to facilitate international cooperation in applied research through joint projects of Czech entities supported by TA CR and foreign partners with the expected support from foreign institutions, all this on the condition that at least one foreign applicant from the location where the foreign partner organisation is located must participate in the project together with the Czech applicant. These locations include Brazil, the Republic of Korea, Israel, Taiwan, Jiangsu, Zhejiang, the USA, Québec, and Nigeria.

Applications are open to research organisations and businesses, and project proposals must be submitted in English. The lead applicant can submit an unlimited number of project proposals through the ISTA system.

When you can apply and for how much

The call period runs from 19 May to 13 July 2022 and results will be announced no later than 30 November 2022. Projects with an overall duration of between 12 and 36 months must start during January-March 2023.

There is no limit on the maximum amount of aid per project; the maximum aid intensity has been set at 74%. A total of CZK 250 million will be allocated for distribution under the call. TA CR provides support only to the Czech part of the consortium; foreign participants will be ☒nanced from foreign sources.

Other conditions

TA CR will only support project proposals that have not yet been and are currently not being addressed in whole or in part by another project. Double ☒nancing is not allowed.

The project proposal must include the lead applicant's ☒nancial plan and the expected ☒nancing of the foreign part of the project.

Each applicant must prove their eligibility through an affidavit and an affidavit on the composition of the consortium. Other essential elements to be provided by the applicant are the professional capacity to carry out the project, the authorisation to engage in the activities relevant to the planned project, and the ownership structure of each applicant.

If you are interested in the call, we will be happy to provide you with more information and examine whether you can use it for your activities.

Lump-sum compensation for employers upon garnishment of wages

On 1 January 2022, an amendment to the Enforcement Procedure Code entered into force, addressing multiple enforcement proceedings against a single debtor and amending the rights of parties to the proceedings. Apart from substantially improving the position of debtors in enforcement proceedings, the amendment also affects their employers, as they gain new rights and responsibilities.

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The processing and payment of wages of employees who are subject to enforcement proceedings/garnishment of wages is associated with an increased administrative burden: sometimes, employers even must hire another payroll accountant to deal with all the related paperwork. The legislator has now responded to these increased costs with the above-mentioned amendment, stipulating the employers' right to lump-sum compensation/reimbursement of costs of CZK 50 per calendar month per each employee subject to enforcement proceedings/garnishment of wages. The lump-sum compensation constitutes the cost of the garnishment of wages and is paid to the employer by the employee as the debtor in the enforcement proceedings. The employer shall deduct the amount directly from the employee's wages. Within the enforcement proceedings, the employer shall satisfy their receivable together with other receivables from the first third. Importantly, where the employer carries out garnishment of wages to satisfy several claims against a single employee, the employer is only entitled to compensation once.

The law does not oblige the employer to use this option; therefore, if they are not interested (e.g., because of the administrative burden), they do not have to deduct the amount, whereby their entitlement to the lump-sum compensation terminates.

The amendment also brings new responsibilities to employers: they now have an information obligation towards enforcement officers (bailiffs), to whom upon a written request they must provide information on the wages, garnishments, and information on the employment. If the bailiff asks the wage payer to provide this information after 1 January 2024, communication between them shall take place exclusively via a special printed form or electronic data file; the latter means of communication will usually apply to employers falling under the category of qualified wage payers (those who employ at least 50 employees or whose total annual net turnover for the last accounting period reached at least CZK 100 million).

EU: new rules for customer-supplier contracts

The European Commission has issued a new regulation stipulating exemptions from the ban on vertical agreements. What to watch out for when concluding distribution and other customer-supplier contracts from 1 June 2022?

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Article 101 of the Treaty on the Functioning of the EU (TFEU) prohibits the conclusion of agreements that may affect trade between member states and that have as their object or effect the prevention, restriction, or distortion of competition within the EU internal market. The regulation also applies to vertical agreements (i.e., agreements between undertakings operating at different levels of the market), such as distribution and other similar customer-supplier contracts. Such contracts shall therefore not contain provisions that fix purchase or selling prices or other trading conditions; limit or control production, markets, or investment; share markets or sources of supply; discriminate against certain trading partners; or similar arrangements with an adverse effect on competition.

However, vertical agreements do not pose as great a risk to competition as agreements between competitors. Therefore, in 2010, the Commission established block exemptions which serve as detailed rules or safe harbours under which the contracting parties do not breach competition law when concluding a vertical agreement. However, as the online environment has developed significantly since that date, the Commission has now replaced the existing rules with a new regulation.

The new regulation narrows the rules for dual distribution arrangements whereby suppliers sell goods or services through independent distributors and also directly to end customers. It also narrows the use of the block exemption for parity obligations, i.e., contractual clauses that require the seller to offer the same or better conditions to the buyer as those offered by third parties or by the seller elsewhere (e.g., on their websites). This means that in some cases, dual distribution and parity obligation arrangements so far valid may now be contrary to Article 101 of the TFEU.

On the other hand, the regulation broadens the possibility of applying block exemption for certain restrictions of active sales whereby the seller actively approaches customers. The parties will also have greater freedom when concluding contracts in certain cases of online sales, namely the possibility to set different prices or other criteria for online and offline sales to the same distributor.

The new regulation entered into force on 1 June 2022. Vertical agreements that have so far met the conditions for the use of the block exemption will be subject to a transitional period postponing the effectiveness of the regulation until 31 May 2023. However, we recommend that suppliers and customers find out more about the new rules and consider modifying their contracts as soon as possible.

Draft DEBRA directive allows deducting notional interest on equity financing

The European Commission has published a proposal for a directive that should balance the tax disadvantages of equity financing compared to debt financing (debt-equity bias) by allowing taxpayers to deduct from the tax base notional interest on newly invested equity. The directive also proposes to further limit the tax deductibility of exceeding borrowing costs.

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The debt-equity bias reduction allowance (DEBRA) is to be calculated on the difference between net equity at the beginning and at the end of the taxable period. Net equity should represent the difference between the value of equity and the value of interests in subsidiaries recorded in the balance sheet. A notional interest rate should then be applied to this difference, calculated as a 10-year risk-free interest rate for the currency in question plus a risk premium of 1% (1.5% for SMEs).

The notional interest thus calculated shall be deductible from the tax base in the year of the equity increase and in nine subsequent taxable periods. It should be possible to deduct notional interest in the maximum amount of 30% of the taxpayer's taxable profits (i.e., tax EBITDA) in one taxable period.

Furthermore, if equity for which the allowance had been claimed is subsequently decreased, the directive stipulates the additional taxation of the previously claimed allowance. However, decreases in equity due to accounting loss or a legal obligation to reduce capital should be exempt from such additional taxation.

The directive also deals with possible abuses of the new legislation, laying down circumstances under which the allowance cannot be claimed: for instance, where the equity increase originates from intra-group loans or transfers of shares between related parties. Even in these cases, the taxpayer will have the opportunity to prove that the capital increase had economic justification and that it will not lead to a double deduction.

Limiting interest deduction

To further balance equity and debt financing, the directive proposes to further limit the deductibility of exceeding borrowing costs (i.e., the difference between borrowing costs and borrowing income from related and unrelated persons as defined by ATAD) to the lower of:

- 85% of exceeding borrowing costs
- the current limit on exceeding borrowing costs under ATAD.

If the result of applying the ATAD rule is a lower deductible amount, the taxpayer will be entitled to carry forward the difference (up to 85% of the exceeding borrowing costs) to future taxable periods.

The new rules should apply to all corporate taxpayers in the EU (except for some financial institutions), including the permanent establishments of companies from third countries. The directive is proposed to enter into effect on 1 January 2024.

VAT system fit for digital age now within reach

The forthcoming reform of the VAT system is intended to improve the efficiency, fairness, and collection of tax and reduce VAT fraud. The European Commission is currently preparing concrete proposals on digital reporting, the application of VAT to web interfaces, and the extension of the one-stop-shop (OSS) scheme to all supplies of goods and services to end consumers and to supplies of goods business-to-business.

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The first reform aims to introduce **harmonised digital reporting requirements across all EU member states**. In this respect, the European Commission (EC) carried out research into what data can be collected and how it can be shared between tax authorities to help build on the VIES system and generate reliable real-time transaction data to provide immediate alerts on VAT fraud. Several scenarios are in play, ranging from partial to full harmonisation and offering options with periodic (e.g., monthly) reporting or real-time online recording of transactions. Under partial harmonisation, intra-community transactions with goods and services would be uniformly reported, while the reporting of local transactions would be up to the individual member states. This option seems to be generally preferred by the member states. In its first phase, data collection and their integration in the EU will focus on business-to-business transactions (B2B). The EC hopes to present legislation amending the EU VAT Directive by the end of 2022. Implementation should take place in 2024 or 2025.

The second reform seeks to **modify the VAT Directive to capture the new dynamics created by the sharing and gig economy** (a flexible economy based on short-term contracts) that currently enables millions of private individuals to provide services and goods. The adjustment would include the imposition of full VAT obligations on deemed suppliers of electronic interfaces (platforms and marketplaces) by extending the notional supplier mechanism (a platform in its capacity as a notional supplier for VAT purposes) to multiple supplies that take place via platforms. The reform also considers the need to ensure the stability and transparency of tax obligations for providers, users, and electronic interfaces (platforms and marketplaces), while at the same time seeking to avoid double taxation. This should include rules that are efficient and simple to comply with to reduce the administrative burden and costs for both taxpayers and tax authorities. Finally, the EC aims to level the playing field with the traditional economy.

As part of the third reform, the EC is preparing to publish a **draft amendment to the VAT Directive** in the autumn, **extending the one-stop-shop (OSS) scheme** to all remaining cross-border transactions for end consumers and some or all cross-border supplies of goods business-to-business (B2B transactions). The aim is to reduce the burden of VAT registration and reporting for foreign non-residents, increase tax revenues, and support the

development of the single market. We have written about this change in previous issues of the Update.

Case law

SAC: intermediary services abroad must be proven as well

In a number of countries, trading is virtually impossible without a local intermediary. In its recent judgment (8 Afs 315/2019), the Supreme Administrative Court (SAC) dealt with the burden of proof regarding intermediation of sale of goods in China. The SAC admitted that in view of cultural differences, different means of evidence may be available in foreign trade. However, this does not relieve taxpayers of the obligation to have sufficiently robust evidence supporting the extent of the intermediary services, and the person of the intermediary.

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At a taxpayer importing goods from China, the tax authority was reviewing expenses/amounts charged by a Chinese company for brokerage and goods inspection. Payments for the services were made to an account in the Seychelles. The taxpayer neither submitted any written communication with the intermediary, nor produced any other written evidence of the performance of the services, nor provided an explanation for making the payments to the Seychelles.

For intermediary services to be tax-deductible, taxpayers must submit a coherent and error-free chain of evidence supporting the provision of the services. The SAC emphasised that the taxpayer must not fail their obligation to produce at least some documents confirming the intermediary services. According to the SAC, the primary means of proof is the related communication with the intermediary. It is necessary to prove both the existence of a particular intermediary and the precise scope of the activities they have carried out. In the present case, the problem was that the taxpayer's representative had never been to China himself, although he was supposed to have provided intermediary services in that territory. Contracts, invoices, or customs documents do not themselves prove the provision of intermediation activities, according to the SAC.

The SAC emphasised that in terms of the quality of evidence, the argument of cultural differences when conducting trade abroad will not stand. Foreign trade cannot be a reason for the preferential treatment of taxpayers who are subject to Czech law. Cultural differences may lead to a different type of evidence being submitted to the tax authorities, but they do not relieve the taxpayers of the obligation to prove the intermediary services as such. According to the SAC, the taxpayers must submit evidence of an appropriate quality, especially where the business activity concerned is of a continuous and extensive nature.

Regarding intermediary services, we therefore recommend keeping in mind the burden of proof upon their commencement and then throughout the course of intermediation, and gathering the necessary documents to prove the person of the intermediary and the extent of the activities carried out.

Case law

CJEU: implementation of concentration requiring clearance by competition authority may take place before option is exercised

In its recent judgment in case T-609/19, the General Court of the Court of Justice of the EU (CJEU) emphasised the need to distinguish between concentration and implementation of a concentration. This means that the implementation of a concentration which is subject to the obligation to notify the European Commission may take place even before acquiring control of the undertaking.

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The General Court of the Court of Justice of the EU (CJEU) dealt with the takeover of Toshiba Medical Systems Corporation (TMSC) by Canon. This acquisition was carried out in a rather complex manner, comprising two steps. In the first step ('the interim transaction'), Canon entered into an agreement with Toshiba, TMSC's parent company, whereby Canon acquired an option to purchase TMSC shares. A few months later, this was followed by the second step of the transaction: Canon obtained the necessary clearance for the merger concentration from the Commission and then exercised the option to acquire the shares, becoming the sole shareholder of TMSC (the ultimate transaction). The rationale for the staged acquisition was that the sale of TMSC would be recognised as a capital contribution in Toshiba's accounts and Canon would formally acquire control of TMSC only after having obtained the necessary clearances from the relevant competition authorities.

The Commission initially cleared the concentration. However, subsequently, based on a complaint by a third party, it opened an investigation into the possible infringement of the obligation to notify and the standstill obligation. In its subsequent decision, the Commission found that Canon had infringed on those obligations by prematurely (partially) implementing its acquisition of TMSC through the interim transaction.

Canon defended itself against the decision before the CJEU. The court ruled that a distinction had to be drawn between the concepts of concentration and implementation of the concentration. While a **concentration is only deemed to have been implemented when a lasting change of control over the undertaking takes place** (i.e., a partial concentration is impossible), **the implementation of a concentration can take place as soon as the parties to the concentration implement operations contributing to a lasting change of control over the target undertaking**. And since a concentration can also be implemented by several formally distinct legal transactions which are interconnected and interdependent, it is also possible to implement the concentration in a partial manner even before acquiring control of the undertaking. This was also the case for TMSC, as, according to the CJEU, the interim transaction had a direct functional link to the change of control over TMSC and was necessary for the implementation of the concentration.

It is thus apparent from the judgment that both **the Commission and the CJEU interpret the implementation of a concentration concept very broadl**y. The merging undertakings must therefore **assess** sufficiently in advance **whether and, if so, at what point they will be obliged to notify the competition authorities of the planned concentration**. If they assess this wrongly, they may face the annulment of the concentration or a fine of up to 10% of the net turnover achieved in the last completed accounting period.

Case law

CJEU's surprising conclusion on VAT rate for elevator repairs

The Court of Justice of the EU has ruled on the VAT rate for renovation and repairs of elevators in residential buildings and has also dealt with the VAT rate for the regular maintenance of elevators. In both cases, the conclusions are rather surprising.

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The Portuguese company DSR manufactures elevators and provides elevator repair, renovation and maintenance services. The company applied a reduced VAT rate to its services, while the materials used were charged at the standard rate. The company believed that they had proceeded in accordance with EU law, as they classified services related to elevators, which they regarded as a common part of immovable property, as services relating to private dwellings. However, the Portuguese tax authorities took the view that services relating to the renovation and maintenance of elevators were subject to the standard rate of VAT and assessed additional VAT on those services.

The CJEU first noted that the application of a reduced VAT rate constitutes a derogation from the principle of applying the standard rate, and therefore must be interpreted restrictively. The court then assessed whether the reduced rate could be applied to renovations and repairs of residential elevators, pointing out that it only applies to work, i.e., the services provided, and not the materials used. The CJEU further stated that renovation and repair services are occasional activities and therefore qualify for the reduced rate. On the other hand, elevator maintenance services are provided by the company on a regular and continuous basis and are therefore not subject to a reduced rate.

The court then considered whether a reduced rate of VAT could be applied only for renovation and repair services related to private dwellings. According to the CJEU, private dwellings mean immovable properties used for private housing purposes. For services related to properties used for other purposes, the standard rate of VAT must be applied. For immovable properties that include both units for private housing and units intended for other purposes, VAT rates for elevator renovation and repair services must be allocated proportionally; however, the CJEU did not provide any guidance as to how the taxpayers should determine such proportion.

To conclude: the CJEU rather surprisingly summarised that a reduced VAT rate can only be applied to renovations or repairs of elevators in immovable properties intended exclusively for private housing. For regular elevator maintenance services, the standard VAT rate shall always be applied. For immovable properties where both units for private housing and units intended for other purposes are located, the VAT rate for renovations and repairs of elevators should be allocated proportionately.

Questions surrounding VAT treatment of promotional events

In its recent judgement (No. 10 Afs 179/2020-56) the Supreme Administrative Court (SAC) concluded that a company that organised a promotional event was not entitled to the refund of input VAT on subcontracted supplies. According to the court, these involved the provision of travel services.

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The promotion agency registered for VAT in Germany provided its customers with the complete organisation of events. Between March and July 2014, the agency organised a promotional event for a German customer in the Czech Republic. The organisation of the event involved the provision of complete services: i.e., transport, accommodation, catering, interpreter services, an experiential programme, etc. Some services were provided by the agency itself, others were purchased from Czech subcontractors. The agency then claimed a refund of the VAT paid in the Czech Republic on these subcontracted supplies. The tax administrator denied it on the grounds that the organisation of the promotional event should be regarded as a travel service, for which there is no right to VAT refund.

The Supreme Administrative Court agreed with this conclusion and unequivocally concluded that if the organiser of the promotional event provides tourism services such as transport, accommodation, or catering, which they have acquired from subcontractors, it is a provision of travel services. In such a case, according to the SAC, it is necessary to apply the special VAT treatment for travel services, and the organiser will not be entitled to a refund of VAT paid in another member state even though they are not a regular travel agency and do not have the necessary trade licenses. The actual nature of the services provided is crucial.

In its judgment, the SAC also commented on the principle of legitimate expectations, according to which identical or similar cases must be decided in such a way as not to create unjustified differences. In the SAC's opinion, this obligation is not unlimited: a serious reason justifying the departure from this principle would be the previous administrative decision being contrary to law.

Following from this case law, we recommend that companies organising similar types of events (marketing, promotional, educational, etc.) pay increased attention to the issue to avoid the risk that the tax authorities will subsequently deny them the right to deduct VAT on subcontracted supplies and assess penalties.

Tips and tricks

How to extend the deadline for filing a tax return beyond the regular deadline?

The basic deadlines for filing income tax returns for the 2021 calendar year already passed on 1 April or 2 May, where the three-month or four-month deadline for electronic filing is concerned, respectively. The final statutory six-month deadline, applying to returns filed by taxpayers subject to a statutory audit or those filed by tax advisors, will expire as early as 1 July. What to do if even the six-month deadline does not seem realistic for managing the preparation of a tax return, or if a return should have been filed earlier but for whatever reason was not?

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The situation of taxpayers who fail to file a tax return although they are obliged to do so and are subject to the three-month or four-month deadline has been considerably eased by an amendment to the Tax Procedure Code in effect from 2021. Under the amendment, taxpayers are no longer obliged to submit to the tax authority a power of attorney granted to a tax advisor within the basic (and shorter) deadline for filing a tax return to extend the deadline to six months.

To extend the deadline to six months, it is sufficient for the tax advisor or attorney to file the return based on a power of attorney after the expiration of the basic deadline. Therefore, if you missed your three-month or four-month deadline for filing your 2021 return, you can grant a power of attorney to your tax advisor or attorney and ensure the timely filing of your income tax return through them.

For taxpayers who are subject to the extended six-month deadline and already slightly apprehensive about the 1 July deadline, the Tax Procedure Code allows for an extension of the filing deadline. In fact, at the request of the taxpayer, which must be made before the expiry of the six-month deadline, the tax administrator may grant an extension of up to three months. If the subject of the tax includes income taxed abroad, the tax administrator may grant an extension of the deadline for 10 months from the end of the taxable period.

The application for extension of deadline has no prescribed form or template, but there are elements that must be included. The application also entails the obligation to pay an administration fee of CZK 300 and provide proper justification for the request. The reasons for extending the deadline may include, e.g., the unfinished audit of the financial statements or unclosed accounts due to significant organisational or personnel changes. Another reason may be significant foreign aspects affecting the preparation of the income tax return, such as the above-mentioned income subject to taxation abroad.

However, the deadline extension is not enforceable, and it is purely at the discretion of the tax administrator whether and to what extent to grant the request. Moreover, the approach of individual tax administrators to such requests is far from uniform.

Even if the extension request is not granted by the tax authority, there is a way to get the necessary time to thoroughly prepare the tax return: taxpayers may opt to file a proper return in its best currently possible form and

pay the relevant tax on time, subsequently correcting both through a supplementary return. With the right combination of the amount of tax paid, the tax originally declared and the timing of the supplementary return, it may even be possible to minimise any associated sanctions.

Case law

SAC held issue of one-crown bonds abuse of law

In its recent judgment, the Supreme Administrative Court (SAC) dealt with the issue of one-crown bonds that effectively redirected a portion of funds from a cash pooling structure to one-crown bonds with long-term maturity. The court ruled that the arrangement was an abuse of law and withheld the tax advantage in the form of tax-deductible expenses.

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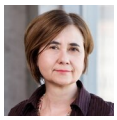
A parent company changed its capital structure by decreasing its registered capital and limited its involvement in group cash pooling. Having considered various cash pooling options, its subsidiary subsequently issued bonds with 10-15 years maturity and a low nominal value. These bonds were underwritten by persons in the management of the parent company, which provided them with interest-free loans to finance them. Because of a planned acquisition, the value of the bond issue was increased. As the acquisition eventually did not come through, the subsidiary redeemed a part of the bonds, and the persons involved used the funds thus obtained to settle the interest-free loans. All these steps took place between October and December 2012. As a result of rounding down, interest on the bonds was not subject to withholding tax upon payment. **The tax administrator assessed the series of transactions as abuse of law**, seeing an unlawful tax advantage in the tax-deductible expenses for the bonds. The SAC agreed with these conclusions.

Under the abuse of law doctrine, the tax authorities disregard any acts whose predominant purpose is to obtain a tax advantage contrary to the purpose and meaning of the law. The court recapitulated the two-component abuse of law test, which includes an objective and a subjective element. According to the SAC, it did not matter that the regional court did not explicitly separate the two elements – the SAC did not do so either. According to the judges, it was crucial that the case involved a **closed circle of mutually and financially directly related transactions** creating a cycle of the group's own funds, driven by the effort to obtain a tax advantage. The tax advantage consisted in reducing the tax liability by deducting from the tax base (as an expense) interest on the bonds issued. The fact that the transactions were decided by the same persons who acted once in the position of statutory bodies, the second time as borrowers, and the third time as bond underwriters, also played a role in the court's assessment.

In essence, part of the funds was simply redirected from the cash pooling structure to the issued bonds. **The court pointed out that these were still funds flowing from the parent company, only in a different way.** The SAC rejected the taxpayer's argument that since interest on cash pooling had not been disputed, it was absurd that the change in funding should be regarded as an abuse of law and lead to the tax non-deductibility of interest. Unfortunately, the SAC provided only a very brief statement of ground for this point, referring to the differences in the manner of funding and the fact that specific circumstances did not exist for cash pooling that did exist for the bond issue. By the circumstances the SAC probably meant the series of transactions leading to the bond issue, which the SAC considered artificial and without economic substance.

News in brief, June 2022

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



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DOMESTIC NEWS

- Social enterprises can apply for zero-interest loans until the middle of next year. Support under the S-Enterprise programme ⊠nanced from EU funds has been prepared by the Ministry of Labour and Social Affairs in cooperation with the National Development Bank.
- The Ministry of Labour and Social Affairs has announced two special subsidy calls for children's groups, allowing them to draw on European funds to quickly create new capacities and respond to the growing demand for child placements in preschool facilities. The ministry has allocated CZK 400 million that could be used to create up to 2,800 placements.
- From June, compensation replacing earnings after work-related injuries or occupational diseases will increase. The amounts will be adjusted by 8.2 percent of the average earnings from which these compensations are calculated. This was published in the Collection of Laws as Government Decree No. 138/2022 Coll.
- EU member states have passed the EU Data Governance Act intended to improve the conditions for sharing data in the internal market, making it easier and more efficient to share personal and non-personal data within the EU. It will become effective in summer 2023.
- An amendment to the Excise Duty Act has been published in the Collection of Laws under No. 131/2022, temporarily reducing the excise duty on diesel and unleaded petrol by CZK 1.50 per litre, effective from 1 June to 30 September 2022.
- The Act on Tax Measures in Connection with the Armed Con⊠ict in Ukraine caused by the Invasion of the Russian Federation, which extends the tax deductibility of donations made in support of Ukraine, was published in the Collection of Laws under No. 128/2022.
- The president has signed a bill amending Act No. 586/1992 Coll., on Income Tax, Act No. 16/1993 Coll., on Road Tax, and Act No. 201/2012 Coll., on Air Protection, which introduces partial support for electromobility in the form of income tax relief, the partial abolition of road tax, and the abolition of the obligation to add bio-components to fuel.
- A notice of the Ministry of Labour and Social Affairs announcing the amount corresponding to 50% of the average monthly wage for the purposes of life and subsistence minimum and the amount of 50% and 25% of the average monthly wage in the national economy for the purposes of state social support, was published in the Collection of Laws under No. 127/2022 Coll.
- Decree No. 116/2022 Coll., amending Decree No. 511/2021 Coll. modifying the rate of basic compensation for the use of road motor vehicles and meal allowances and determining the average price of fuel for the purpose of providing travel allowances, was published in the Collection of Laws. The decree responds to increased fuel prices on the market.

FOREIGN NEWS

- At its meeting on 5 April 2022, the EU Economic and Financial Affairs Council (ECOFIN) did not discuss the originally tabled proposal for an EU minimum tax directive, harmonising the introduction of a global minimum tax (OECD Pillar 1) across the EU. The proposal is now likely to be discussed at the 17 June 2022 meeting, possibly during the Czech presidency of the EU Council.
- The OECD has put forward for public discussion rules to exclude regulated ☒nancial services from the first pillar framework (allocation of part of the profits from the sale of goods or consumption of services to countries of sale or consumption).
- The OECD has published two additional documents on Pillar 1 for public discussion: the first one concerns the rules for determining Amount A to be taxed in the country of sale; the second one deals with the process of resolving disputes between the country of sale and the country in which profits have so far been reported under the existing rules. More detailed information can be found here.

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