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In brief

News in brief, July 2023

Editorial

We tried to prepare the July issue of Daňovky so that you can get it in your mailbox before you set up the out-of-office reply. Although our newsletter is not classic beach reading, I believe that we have managed to put together an interesting holiday issue full of important information.

It seems that we will finally get to see a simplification of the rules of remote work from abroad. This month, a framework agreement entered in effect, allowing employees to work from home from abroad to a greater extent without their employer having to register and pay insurance premiums abroad, i.e., in the state of the employees' residence. The business world has been calling for such a simplification for years, and I am glad that our efforts were not in vain.

Since June, conditions in rail transport also changed. If on summer journeys your train is delayed, you may want to know about your rights to compensation and rerouting.

And if you're planning to travel to the UK, pay attention, as the rules of entry are changing. Although the post-Brexit withdrawal agreement allowed Czechs to travel visa-free, Britain now intends to tighten the conditions of entry and is introducing electronic travel authorisations. From 2024, these will be necessary for short stays of up to six months even if you travel only as a tourist.

Here's wishing you'll get to enjoy the summer months to the fullest, and spend them by the water, in nature, or with a book in your hand.



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Taxes

What will the consolidation package entail? Updates and clarifications

The governing coalition has introduced several legislative changes with which it intends to increase state budget revenues. Below, we aim to update and clarify information on the imminent regulations resulting from the material approved by the government on 28 June 2023.

A complete summary of the impending changes in corporate income tax, indirect taxes and real estate tax can be found here. Upcoming changes in personal income tax can be viewed here.

Corporate income tax: Limitation of tax deductibility of selected costs

- The tax deductibility of expenditures on employee benefits provided as non-monetary benefits become conditional on the right to the benefit being stated in the collective or employment agreement or in the employer's internal regulations. The amendment is intended to explicitly state that expenses for benefits provided to family members of employees are also tax deductible.

Abolition of exemptions (of non-cash benefits and several others)

- Abolition of the exemption of the state contribution to building savings.
- Abolition of the separate exemption for foreign exchange gains on money exchanges. Taxpayers will now be able to apply an exemption on these foreign exchange gains up to the general limit for the exemption of other income (in aggregate up to CZK 50,000).

Reduction of non-cash income for employee vehicles

- The amount of an employee's monthly non-cash income when using a vehicle for private and business purposes will be 0.25% of the purchase price for emission-free vehicles.

Donations to Ukraine

- The amendment extends the validity of the measures related to the armed conflict in Ukraine and introduced by Act No. 128/2022 Coll. to the tax period of 2023. Thus, e.g., the 30% limits on gifts provided in connection with the armed conflict in Ukraine and exempt temporary accommodation provided by the employer will remain in force. According to an explanatory memorandum, the taxpaying employer will have to reimburse the taxpaying employee in the form of a correction of the individual affected months of the payroll register in accordance with Section 38i of the Income Tax Act. At the same time, this correction will also result in the reimbursement of social security and health insurance premiums, if paid.

Real estate tax

- The amendment also includes a comprehensive modification of the coefficients by which municipalities can

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influence the proceeds from this tax and several other partial changes, e.g., in the definition of individual immovable property for tax purposes and the scope and exemption of land and buildings, which can significantly affect tax liabilities.

Value added tax

- The possibility of deducting VAT on passenger cars will be limited to CZK 420,000, which corresponds to a tax base of CZK 2 million, not only for the purchase of such a car, but also including any subsequent technical assessment. The Ministry of Finance plans to further consult the European Commission on this change.

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Can lessees claim deduction of import VAT?

The VAT Committee again considered the possibility for lessees to deduct import VAT if the lessee is also the person liable to pay import VAT. It reiterated that to exercise the right to deduct, it is necessary for the taxable person to have incurred the related costs to carry out their business activity and at the same time included those costs in the price of the output supply.



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At its 98th meeting, the committee dealt with the import of an aircraft where the importer of the goods was also the lessee. The question was whether the two conditions for exercising the right to deduct, i.e., the incurrence of the related costs to carry out the business activity, and their inclusion in the price of the output supply, had been met. The committee ruled that this was not the case as usually, the total cost of the goods themselves is borne by the owner of an aircraft and not by the lessee who will only bear the expenses charged by the owner for the lease as such.

This view seems to be in line with the committee's earlier conclusions and the judgment of the Court of Justice of the EU (CJEU) in Case C-621/19 Weindel Logistik Service, in which an EU company imported goods for repair into the EU. In this case, the court denied the importing company the right to deduct import VAT, as it did not own the imported goods and at the same time did not include the costs associated with the repair of the goods in the price of the output supply.

The committee thus essentially concurred with the CJEU's opinion and its own previous conclusions, see Document No. 762 for more details on the leasing of aircraft. Considering the committee's current discussions, the conditions for exercising the right to deduct import VAT should be respected. Therefore, to exercise the related right to deduct import VAT on the import of goods, the lessee of the goods must prove a link with their business activity and, at the same time, include the costs of importation in the price of their output supplies.

However, the committee is aware of the different approaches taken by member states. Therefore, also in the light of the previous case law of the CJEU that allows the right to deduct import VAT by a non-owner, it has invited delegates to present their views on this matter.

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Simplifying rules for payment of insurance premiums for cross-border workers at home offices

To avoid discrimination against cross-border workers, the European Commission has introduced a framework agreement that allows working from home (teleworking) from abroad to a larger extent without employers having to register and pay insurance premiums abroad, i.e., in their employees' state of residence. The Czech Republic was one of the first member states to sign the agreement.



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As the place of the physical performance of work is often the decisive criterion for determining the applicable social security legislation, teleworking (working from home) from abroad can lead to a change in one's social security jurisdiction. This has an impact not only on employees but also on their employers. Under the basic coordination rules for employees working in several member states, the extent to which they work from their place of residence is decisive: if they carry out at least 25% of their activities (in terms of working hours or remuneration) in their country of residence, they are subject to the social security system of their country of residence.

The framework agreement increases this limit to up to 49.9% of the working hours and provides for a simplified exemption procedure whereby requests for exemptions will be approved automatically without the consent of the other member state if prescribed conditions are met.

The framework agreement will apply as early as 1 July 2023 when the no-impact policy introduced in connection with the COVID-19 pandemic expires. At the same time, this new framework agreement will replace the bilateral agreements concluded between the Czech Republic and Austria/Germany, discussed in the April issue of *Tax and Legal Update*.

To qualify for an exemption under the framework agreement, the following conditions will have to be met:

- the employee carries out telework (usually from home) in the country of residence different from the member state in which the employer has its registered office
- the type of work carried out from home and using information technology is the same as if it were carried out at the employer's registered office
- the work of the employee is not carried out in any member state other than that of their residence and that of the employer's registered office
- the employee works more than 50% of their working hours in the country of their employer's registered office (while spending no more than 49.9% of working hours in the country of their residence)
- the employee has an employer (one or more) in only one member state

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- the employee and the employer jointly apply for a special exemption under the framework agreement
- both the country of residence and the country of the employer's registered office have signed the framework agreement.

On the closing date of this issue of *Tax and Legal Update*, the framework agreement had been signed by the following states:

- Belgium
- Czech Republic
- Finland
- Liechtenstein
- Luxembourg
- Germany
- Netherlands
- Norway
- Portugal
- Austria
- Slovakia
- Switzerland.

A complete and regularly updated list of states that have acceded to the framework agreement can be found on the website of the Belgian Social Administration, the depository of the signed agreements.

As member states may accede to the agreement subsequently (i.e., after 1 July 2023), we recommend that you always check the current list of member states when dealing with a specific case.

The framework agreement does not apply to manual work or self-employed persons.

The framework agreement will not be applicable in situations where the employee performs manual labour, works in several member states (or third countries outside the EU/EEA), is self-employed, or works from a branch of their employer or business partner/client in the country of residence. In such situations, an individual exemption may be requested under Article 16(1) of Regulation (EC), the granting of which is subject to approval by the institutions of the states concerned.

An exemption under the framework agreement may be requested for up to three subsequent years, even repeatedly. Retroactivity will only be possible under certain conditions. The application is submitted in the state where the employee wants to be insured (i.e., in the state of the employer's registered office).

If no request for exemption is filed, the employee's applicable social security legislation will be determined in accordance with the EU basic coordination rules. However, employees working in two or more countries (including cross-border teleworking) should not forget their notification obligation to the social security institution in their country of residence. Also, the tax implications for both employee and employer in the employee's country of residence where the activity is carried out should not be neglected.

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Subsidies

Capping energy prices: what not to forget in July

Another deadline for the evaluation and submission of reports on the assessment of excess financial benefits for the entire half of 2023 for large enterprises is approaching. The report for the January to June period must be submitted by 31 July 2023. At the same time, large enterprises not exceeding the maximum aid limit and wishing to remain in the capped energy price regime have to submit new declarations to their energy suppliers for each commodity by the same date. And another amendment to the decree regulating the price energy capping regime has been in effect since 30 June.



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In the last issue of our *Tax and Legal Update*, we summarised our experience with the AIS MIT system and simultaneously provided some practical tips for the upcoming evaluation of financial benefits and the submission of the reports for the first half of 2023. According to information from the Ministry of Industry and Trade, the obligation to submit the report applies to all large enterprises that consumed electricity or gas at capped prices in the period from 1 January 2023 regardless of whether they remained in the energy price capping regime in the following quarters.

In practice, this means that even if a large enterprise purchased electricity or gas at capped prices only in the first and not in the second or subsequent quarter, it still has to assess the financial benefit and submit the report to the ministry also for the second and third quarters and then submit a report for the whole year 2023 at year-end. According to the ministry, this is because the amount of the obtained financial benefit and of the maximum (permissible) financial benefit may change over time even if the large enterprise no longer consumes energy at capped prices, e.g., because of a change in the exchange rate or the amount of eligible energy supply costs (change in the average price of electricity/gas consumed in 2023).

At the same time, large enterprises not exceeding the maximum aid limit and wanting to remain in the price energy capping regime must submit new declarations to their energy suppliers for each commodity by 31 July 2023, all this in addition to submitting their reports to the ministry.

Moreover, on 30 June 2023, another amendment to the government decree was published in the Collection of Laws, which, e.g., further specifies the calculation of EBITDA, the method of deducting other subsidies received in 2022 and 2023 from the maximum permissible financial benefit, and the deadlines for adjusting facts or data in the report.

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We will continue to monitor developments regarding capped prices and available interpretations. We will be happy to provide you with support in assessing your financial benefits or completing the assessment report should you be interested.

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Tips and tricks

What you can learn by inspecting your tax file

The financial administration knows more about you than you think. For each taxpayer, the tax administrator keeps a file in which various documents are kept. Below, we summarise what you can find in your tax file and how to access it.



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Unlike court files which are only kept for individual court proceedings, a tax file is kept for every taxpayer. This way, tax administrators collect information about the taxpayers: taxpayer submissions, tax administrator decisions, protocols, and official records. But that's not all – there may also be audio or video recordings in the file.

The file is structured by individual tax proceedings, namely taxable periods. Furthermore, it is divided into parts relating to the recovery of taxes, other obligations, or fines. One part of the file, however, remains hidden: the part relating to any search activities. There, the tax administrator keeps documents that can be used as evidence – and, logically, does not want to show their cards to the taxpayer before it has to.

Taxpayers have the right to inspect the file. As for the search part, however, they may only do so in justified cases, when necessary for the further course of proceedings, and if it does not jeopardise the objective of tax administration or the interest of another taxpayer or other persons. But even if the tax authority does not allow the taxpayers to inspect the concrete documents kept in that part of the file, it must still allow them to see a list of the documents kept in each part of the file. The taxpayer thus may inspect the list of the documents that the tax administrator wants to use against them. And, according to the Supreme Administrative Court's case law, the list must clearly indicate what the concrete documents are so that the taxpayer can see whether these documents can be used as evidence. This means that the tax administrator has to show their cards a little bit, and the taxpayers can thus defend themselves in a more informed manner.

May a taxpayer come to see their file even without making an appointment with the relevant tax administrator? The law is clear here: if the tax administrator has office hours, they are obliged to allow the inspection of the file within those hours. The officer in charge of the file not being present at the office is not an obstacle to inspecting the file – another officer may step in. The tax administrator thus cannot dictate the conditions under which the file can be inspected. And if their office hours do not suit you? The tax administrator is obliged to allow access to the file even outside office hours. However, it is good practice to make an appointment – to ensure that the inspection of the file will run more smoothly and efficiently.

It may also be that taxpayers are too busy to travel to the tax administrator's office, especially if they can't be sure that inspecting the file will be of any use to them. There is a solution for such cases: the taxpayer may request a copy of or an extract from the list of documents in the file to find out what documents the tax administrator keeps about them and whether it is worthwhile inspecting the file. The taxpayer may also request the documents

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from the file to be sent to them via their data box. The first-time provision of the documents is free of charge, any subsequent sending is subject to a fee. Inspecting the file in person is always free of charge.

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Ministry of Labour and Social Affairs refrains from changing 'Svarc system' definition

The Ministry of Labour and Social Affairs wanted to fundamentally change the definition of illegal work, to facilitate its prosecution: the long-term character of the relationship would no longer be decisive for assessing it as illegal. However, following pressure from the Legislative Council of the Government as well as the public, the ministry has deleted the changed definition from the proposed amendment to the law.



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The current Employment Act defines illegal employment as dependent work that is performed by an individual (natural person) outside an employment relationship or outside of agreement to perform work or to complete a job. According to the Labour Code, dependent work is work that is performed:

- within a relationship in which the employer is superior and the employee is subordinate
- in the employer's name
- according to the employer's instructions, and
- personally, by the employee for the employer.

Another defining feature of dependent work was deduced by the courts – to conclude that employment is illegal, it is also necessary to prove that the relationship has a long-term character. However, proving long-term character has been rather difficult for the State Labour Inspection Office in practice. The ministry therefore wanted to make its evidentiary position easier, by changing the law.

Nevertheless, the Legislative Council of the Government, an advisory body to the government in the matters of adopting new laws, disagreed with the proposal. In its opinion on the proposed amendment, it stated that the change would unreasonably extend the definition of the 'Svarc system' to activities that are not dependent work and there is no legitimate reason to prohibit or restrict them. The new definition of illegal work would also be erroneous, as the requirement of a long-term character of the relationship can be deduced from the defining feature of the employer's superiority and the employee's subordination.

The legislative council also criticised the aim of the change – that is, to make life easier for the labour inspectorate: the council aptly pointed out that the inspection authorities' lack of evidence could not be resolved by changing the rules. Following this opinion, the Ministry of Labour and Social Affairs has decided to keep the definition of illegal work, i.e., the 'Svarc system', in its current wording.

Despite the above-described developments, the State Labour Inspection Office intends to continue to strictly punish illegal work. Collaboration with workers using a sole trader status ('IČO') is still a common standard in

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many fields. We recommend thoroughly assessing any problematic relationships and modifying the contractual documentation as well as the conditions of practical cooperation to minimise the risk that the relationship would be assessed as the ‘Svarc system’. Employers may face a fine of up to CZK 10 million for violating the ban on illegal employment.

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Fundamental changes in rail passenger rights

On 7 June 2023, the revised EU regulation on rail passenger rights and obligations entered into effect. The new rules will affect everyone, especially passengers with disabilities, and passengers transferring to another route or transporting bicycles.



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A significant change is the obligation for carriers and railway infrastructure managers to also provide real-time information on connections and delays to ticket vendors and travel agencies. Passengers will thus be better informed about the current situation on the railways even if they did not buy their ticket directly from the carrier.

Right to compensation and re-routing

Carriers that meet the definition of a sole railway undertaking are now obliged to issue a direct transport document (i.e., a through ticket). This will allow greater protection for passengers in the event of delay or missed connections, making it easier for them to exercise their right to compensation. The amount of compensation then depends on the length of the train delay and amounts to:

- 25% of the ticket price for a delay of between 60 and 119 minutes
- 50% of the ticket price for a delay of more than 120 minutes.

For the avoidance of doubt, the regulation now directly mentions that passengers are not entitled to compensation in the event of extraordinary circumstances not related to the railway operation that the railway undertaking could not have prevented and could not have averted. Examples include extreme weather conditions, pandemics, or terrorist attacks. On the other hand, a strike by the carrier's employees is not such an extraordinary circumstance.

The revised regulation also includes the right to self-rerouting. Passengers whose journey is disrupted by delays or cancellations must be offered a solution to that situation by the carrier. If the passenger is not informed within 100 minutes of the disruption, they have the right to do their own rerouting. This means that they can buy a ticket from another rail or bus carrier and the original carrier must then reimburse them for the costs incurred.

Support for passengers with disabilities

The regulation also strengthens the protection of passengers with disabilities and gives them the right to assistance when boarding and disembarking from a train, the possibility to buy a ticket directly on the train, and the right to compensation for loss of or damage to assistive equipment (e.g., wheelchair, walker). A passenger with disabilities must request assistance at least 24 hours before they need assistance. This period has been shortened from the original 48 hours. At the same time, the staff of the carrier or railway station must be properly trained so that they can meet the needs of people with disabilities.

To promote the use of alternative means of transport, the regulation makes it mandatory to provide a minimum of four bicycle places on each new or upgraded train. Individual member states can then increase the number of such places.

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Rail carriers should prepare for changes as soon as possible, not only in terms of adapting contractual documentation and sharing information with vendors and other persons but also in terms of providing training to their staff.

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Changes in conditions for holding an office in a corporation

An amendment to the Corporations Act came into effect on 1 July, introducing partial changes to the conditions for exercising an office as members of statutory bodies of corporations. The law now contains a closed list of obstacles to holding such office and establishes a register of excluded (disqualified) persons.



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Under current legislation, a member of an elected body (such as a statutory representative or a member of the board of directors or the supervisory board) must have full legal capacity and integrity and be free from any impediment to carrying out a trade under the Trade Licensing Act. As of 1 July, the Corporations Act contains its own regulation partially narrowing and specifying the conditions contained in the Trade Licensing Act.

Under the new Corporations Act, apart from legal incapacity, the only obstacles to holding an office as a member of an elected body under are:

- a final and conclusive conviction for crimes defined in an exhaustive list that most often occur in connection with business activities (e.g., embezzlement, fraud, money laundering, damage to creditors, etc.)
- bankruptcy declared on the property of a member of an elected body
- a ban on holding an office as a member of an elected body imposed by a Czech or foreign public authority (court or administrative body)
- a ban on performing activities related to the activities of a corporation imposed by a Czech or foreign public authority.

The Ministry of Justice shall also keep a register of persons excluded from holding an office as a member of an elected body of a corporation. Courts and notaries will be obliged to verify the eligibility of selected persons against this register as part of the registration procedure. Although the register will be non-public, anyone will be able to file a request in a prescribed form to the ministry for an extract of the data kept about them in the register.

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AI under control: European Parliament moves landmark regulation to trialogue

In mid-June, the European Parliament (EP) voted on its comments on the proposal for a regulation on artificial intelligence (AI), kick-starting trialogue negotiations. This brings the EU one step closer to adopting the world's first ever comprehensive AI regulation.



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The regulation particularly aims to ensure security and increase transparency in the use of this rapidly developing technology. Companies wishing to supply AI systems to the EU market or use them in their operations will have to reckon with several new obligations in the future, depending on the category of the AI system.

The regulation divides AI into four categories according to the level of risk it poses (risk-based approach): unacceptable, high, limited, and minimal. The use of AI falling into the 'unacceptable' category (e.g., social scoring) will be prohibited in the EU. Most obligations will affect high-risk AI systems. This category includes many AI systems used in critical infrastructure, education, and recruitment.

The EP plans to negotiate the amending proposals with the Commission and the Council in a trialogue, discussing, e.g., the final definition of AI itself and the criteria for determining high-risk systems. In response to a hot topic of recent months – ChatGPT and similar tools – the EP also proposes that certain obligations should also apply specifically to generative AI systems. The level of sanctions will also be discussed. The EP proposes to raise the maximum fine for non-compliance with the rules set out in the regulation to EUR 40 million, and up to seven percent of a company's total global annual turnover if a corporation violates the rules.

Negotiations in the trialogue could end this year. We could then see the final text of the AI regulation at the beginning of 2024.

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Legal

New block exemptions for R&D and specialisation agreements in force since July

The European Commission has adopted revised horizontal block exemption regulations for research and development (R&D) and specialisation agreements, including related interpretation guidelines. The aim is not only to remove some ambiguities but also to extend the applicability of these safe harbours.



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The Treaty on the Functioning of the EU (TFEU) prohibits the conclusion of agreements between undertakings which could affect trade between member states and could have the effect of preventing, restricting or distorting competition in the internal market. One of the exemptions from this prohibition is the block exemption for research and development (R&D) and specialisation agreements.

In particular, the new horizontal block exemption regulations for research and development (R&D) and specialisation agreements, which replace their predecessors from 2011, aim to increase the clarity of the current rules to reflect the latest decision-making practice so that companies can better assess whether their agreements could enjoy the safe harbour benefits. At the same time, the regulations bring other significant changes which:

- clarify the method of calculating the relevant market share (e.g., where sales figures for the previous calendar year are not representative, data for the three previous calendar years should be used)
- simplify the standstill period during which safe harbour benefits can be used even if the contracting parties' respective market shares rise above the relevant market share threshold
- extend the possibility of applying the block exemption to more types of specialisation agreements
- provide for a 'soft safe harbour' for sustainability standardisation agreements that meet specified conditions
- lay down detailed rules on information exchange agreements, sustainability agreements, marketing agreements (including consortia in procurement procedures), mobile telecommunications infrastructure sharing agreements or joint ventures
- offer practical recommendations to companies to prevent infringements of competition rules (e.g., use of clean teams in the exchange of information)
- extend the power of the Commission and national competition authorities to withdraw the block exemption in individual cases (e.g., where the agreement would significantly restrict competition in innovation).

The regulations entered into effect on 1 July 2023. Although agreements meeting the conditions of the existing regulations will be able to use the existing exemptions and the new regulations will apply to them only from 1 July 2025, we recommend that you reflect these new rules as soon as possible in your contractual documentation, internal regulations, and compliance programmes.

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Heated flavoured tobacco not available from October

The European Union and the Czech Republic are following the global trend to reduce the consumption of tabaco in their population. From 23 October 2023, it will no longer be possible to sell flavoured heated tobacco products, so very popular among smokers. What other changes did the amendment to the Act on the Protection of Public Health and related laws bring?



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In recent years, sales of heated tobacco products have increased in EU member states. To protect the health of young people in particular, certain exemptions concerning flavoured heated tobacco have been abolished. Czech legislation responded by establishing a ban on placing flavoured heated tobacco products on the market.

However, **the amendment does not stipulate any transitional period** during which entrepreneurs could sell their stocks of flavoured heated tobacco products: from 23 October 2023, these products will not be allowed to be sold, without any exemptions. Entrepreneurs will have no choice but to try to get rid of the stock earlier through various discount events. The supply of flavoured smoke will therefore be considerably reduced, as flavoured cigarettes or roll-your-own tobacco with characteristic flavours can already no longer be purchased. However, flavoured e-cigarette refills are still available.

In addition, on manufacturers, importers, sellers and distributors of heated unflavoured tobacco products, the amendment imposes similar labelling obligations as for roll-your-own or waterpipe tobacco, including the obligation to label their goods with a health warning about the risk of smoking.

The amendment to the Act on the Protection of Public Health also abolishes the obligation of persons working in the food industry to have a food hygiene permit. According to the legislators, this involved unnecessary bureaucracy, especially as this permit was sometimes issued by a general practitioner without a proper examination of the worker and its validity was not limited. Food industry workers will no longer need food hygiene permit from 1 July 2023.

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Ambitious customs legislation amendment coming soon

The most ambitious amendment to customs legislation since 1968 is heading to the MEPs. Prepared by the European Commission, it aims for EU customs to make full use of electronic data, and to significantly simplify customs procedures.



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The reform relies on the digital transformation of the economy to shorten lengthy customs procedures and replace traditional statements with ‘smarter’ ones. At the same time, the customs administration will get new tools and means to properly assess and stop imports that pose a real risk to the EU, its citizens, and the economy.

The reform responds to the current pressures under which EU customs operates, including a huge increase in trade volumes, especially in e-commerce, a fast-growing number of consignments’ properties that must be checked at the border, and shifting geopolitical realities and crises. It will make the customs framework fit for a greener, more digital era and contribute to a safer and more competitive single market. The reform simplifies and rationalises customs reporting requirements for traders and should reduce the time needed to complete import processes, namely thanks to a single customs interface facilitating data re-use. For e-commerce and large companies, the systems are to be made available already in 2028, for other entities in 2032.

The amendment to customs legislation contains the following objectives:

- Central authority – An EU Customs Authority will be established to oversee the EU Customs Data Hub. The Data Hub will use a new customs system with real-time data. Over time, it will replace the existing customs IT infrastructure of EU member states, saving up to two billion euros a year in operating costs.

- Partnership with businesses – in the reformed EU customs union, traders will be able to log information on their products and supply chains through a single online environment in the EU Customs Data Hub. Thanks to machine learning, artificial intelligence, and human intervention, customs authorities will have an overview of supply chains and movement of goods across Europe. Under the new regime, it is also envisaged that trusted traders could release goods into circulation in the EU without any active customs intervention.

- Smarter customs checks – the proposed new system will give customs authorities a bird's-eye view of the supply chains and production processes. Sharing real-time data between member states will allow for faster and more effective responses to potential risks. Artificial intelligence will be used to analyse the data and to predict potential problems, which will allow EU customs authorities to focus their resources on stopping dangerous or illegal goods, and on ensuring compliance with EU law.

- More modern approaches to e-commerce – the amendment introduces the responsibility of online platforms for compliance with customs obligations. The platforms will make customs and VAT payments on purchases, ensuring transparency for consumers and reducing hidden charges. The current exemptions for

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goods up to €150 will be abolished to avoid fraud. The reform also simplifies customs duty calculation for the most common low-value goods bought from outside the EU, which will be beneficial for the platforms as well as for the customs authorities.

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UK to require travel authorisation for EU citizens

Following Brexit in 2021, the United Kingdom became a third country and no longer benefits from the free movement of persons and services within the European Union. So far, the withdrawal agreement has allowed visa-free travel for Czech citizens travelling to the island country for non-gainful purposes. Now, however, the UK intends to tighten the conditions for entry, aiming to strengthen the protection of the UK's borders and to have a better overview of potential security threats.



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From 2024, the UK plans to require an electronic travel authorisation (ETA) from all visitors to the country. The ETA will be mandatory for citizens of all states with whom the UK previously negotiated a visa-free regime. It will be required for short-term stays in the territory (up to six months) for the purpose of tourism, business, study or medical treatment. It will also be necessary for transit through the territory (e.g., by air) even if no border check takes place during the transit. The obligation will not apply to holders of British residence or work permits. By and large, the ETA will be similar to the American ESTA travel authorisation required of EU residents flying to the US for tourism or passing through their territory.

The decision on granting an ETA may take upwards of three working days.

The ETA will have to be applied for before travel and will be subject to a £10 fee. The whole process will not be a mere formality, as it may take up to three working days to decide whether to grant a travel authorisation, or even longer if the British authorities conclude that they need to carry out further checks into the applicant's residence history. Once issued, the ETA will be valid for two years, during which the holder will be able to enter the UK repeatedly.

Foreigners will be able to apply for the travel authorisation via the official UK government website or via a mobile application. The certificate of granting an ETA will be issued in electronic form and will be linked to the applicant's travel document which the applicant must use to enter the country. It is also possible to apply for an ETA by proxy. Please note that even minor children must have their own travel authorisations.

For EU citizens, the obligation should apply from the end of next year. For citizens of other visa-free countries such as some Middle East countries, it will be mandatory from February 2024 already.

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Case law

SAC: Social events for clients not tax deductible

A company organised a meeting with clients to celebrate the anniversary of its foundation, with an accompanying programme titled "20 years – client event – social gathering – the priority is to relax, enjoy and try interesting activities". The Supreme Administrative Court was asked to assess whether the costs of the event were advertising and promotion, thus tax deductible, or whether they were tax non-deductible entertainment expenses.



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In a case recently dealt with by the SAC (10 Afs 113/2021), a company included in its taxable base the costs of arranging an evening gathering with clients. Following an extensive tax inspection, the tax administrator concluded that the event had the character of entertainment rather than of advertising and promotion and treated the costs as tax non-deductible. The SAC further did not accept expenses for replacing lights or royalties/licence fees for a trademark as tax deductible.

Entertainment *vs.* advertising expenses

In the company's opinion, the expenses were tax-deductible advertising expenses. During the social evening, some social activities for clients were taking place, including a music band for listening and dancing and a magician's show. But there was also a training, a presentation of the company's results, and the introduction of a new logo. According to the company, the event was organised to strengthen the position of the brand and the company's name on the market to fight its competitors, and to promote the company's products. Numerous informal meetings with clients took place during the event. The company among other things also paid for its clients' accommodations.

The SAC first commented on entertainment and advertising expenses in general. According to the SAC, the list of entertainment expenses in the Income Tax Act is only demonstrative (not exhaustive) and provides guidance for defining the content of the term. These are supplies of a certain type intended for direct consumption by, or a gift to, a specific person. On the other hand, advertising involves the process of finding new customers, in the SAC's opinion. The SAC, like the tax administrator, assessed the event as a presentation: the video recording of the event suggests that it was a social event intended for direct consumption by business partners, and not a promotion of specific products or services.

Construction work

In the same judgment, the SAC also dealt with the tax deductibility of other expenses. Among other things, whether the replacement of lights in a warehouse was a repair (a one-off cost) or a technical improvement (to be depreciated gradually). The judgment reminds us how important it is for the taxpayer to be able to prove the extent of the work carried out and the state before and after the work. In the case at hand, the company failed to prove the condition of the warehouses before the work was initiated, therefore the court excluded the costs from the tax

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base.

Royalties paid

The SAC also commented on the tax deductibility of royalties paid for the use of trademarks. At the heart of the dispute was whether a company was using two trademarks – the old and the new, or only one of them. Tax administrator's doubts were triggered by partial transactions in the trademarks, subsequently produced amendments to contracts, and other circumstances. In the end, the court agreed with the tax administrator and the regional court and did not accept the royalties as a tax-deductible expense. This part of the judgment reminds us how crucial it is to have high-quality documentation and a comprehensive and stable (not changing over time) explanation of various transactions and their circumstances.

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Case law

Transfer pricing perspective on business model changes

The Supreme Administrative Court (SAC) examined whether the tax administrator had correctly set the reference price of services provided between related parties following a change in the business model, and sided with the taxpayer.



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The taxpayer had initially acted as a subcontractor, providing the processing of raw material for its fellow subsidiary to be further used for the production of an automotive part. For this 'toll manufacturing' the taxpayer charged a fixed rate per minute of work. During the taxable period, the production was fully moved to the Czech Republic, and the business model changed: the taxpayer now assumed the role of a fellow subsidiary and became an independent manufacturer of the entire automotive part and its final supplier to customers.

In a tax inspection, the tax administrator assessed the price of services provided by the taxpayer in the original 'toll manufacturing' model. The tax administrator concluded that the provider was below cost and assessed additional income tax; the price was set by reference to the price of the complete supply in the new business model while the tax administrator attempted to make relevant price adjustment.

The regional court vacated the tax administrator's decision, stating that the tax administrator had not proceeded correctly in determining the reference price. The tax administrator filed a cassation complaint against the decision.

The SAC first dealt with the correct determination of the reference price, explaining that it is crucial to take as a basis primarily existing uncontrolled transactions that are, at least in their essence, comparable to the controlled transaction. The SAC stated that despite the tax authority's best efforts to clean the transaction comprising the sale of goods (after the change in the business model), the transaction could not be considered essentially comparable to the (original) controlled transaction comprising the provision of subcontracted services. The tax authority was in effect comparing the incomparable, as they did not consider the difference between the status of the taxpayer as a subcontractor merely working for the fellow subsidiary, and as an independent producer bearing all the risks associated with production.

Furthermore, the SAC stated that the tax administrator had wrongly chosen only one independent transaction rather identifying a range of reference prices in similar subcontracting transactions.

The SAC thus ruled consistently with its previous case law. Therefore, please note that any argumentation to substantiate transfer prices should be supported by the documentation of the business model, including an analysis of functions and risks in the context of the adopted transfer pricing methodology.

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SAC sides with labour inspectorate on simpler checks of illegal outsourcing

Disguised employment mediation, i.e., the renting of labour without a labour agency licence, is the most frequent labour-law offence of recent times. It is relatively new, and both parties involved – the 'pseudo' agency and the customer using the labour – face fines of up to CZK 10 million. The labour inspectorate has been focusing intensively on detecting and penalising the offence. In its recent judgment, the Supreme Administrative Court dealt with what facts the labour inspectorate must prove in an inspection. The result is very unfavourable for business practice.



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In the case in question, the inspectorate found the company being inspected (a provider of workers) guilty of committing the offence of disguised employment mediation, as it had in fact rented labour to another company (the customer) without having appropriate authorisation. Officially, the company concluded a contract for work with the customer, with the aim to conceal the actual practice – the renting of labour. Under the contract, the employees of the company being inspected performed the work of assistant controllers in manufacturing of electronic components at the customer's workplace. The customer supplied the workers with work clothes, assigned, managed, and supervised their work, and kept their attendance records. The company being inspected defended itself against the penalty in court.

The regional court sided with the company – it concluded that the labour inspectorate had insufficiently verified the facts of the case, therefore it was not possible to conclude that an offence had been committed. The court pointed out that the renting of labour means assigning one business's own workers to another business to carry out work. The business to which a worker is assigned should thus assign work to them, organise, direct, and supervise their work, instruct them, create favourable working conditions for them, and ensure their occupational health and safety. In this context, the court assessed the findings of the labour inspectorate as insufficient, as they could also be interpreted as manifestations of legal cooperation under a contract for work.

It is not the labour inspectorate's duty to examine every single fact in an inspection in detail.

The labour inspectorate was not happy with this outcome and filed a cassation complaint with the Supreme Administrative Court (SAC). The SAC disagreed with the regional court's conclusions. The SAC stated that the decisive element for assessing whether there is a disguised employment mediation is the factual meaning and content of the relationship between the employees of the supplier (the potential 'pseudo' agency) and the customer. The labour inspectorate had investigated the facts of the case as to the actual performance of the work: i.e., who had directed, assigned, and supervised the work, and had further supported its conclusions by the vagueness of the formally concluded contracts for work and the very general description of the work in the order. The SAC also took into account the fact that the fee of the company being inspected was set at CZK 250 per hour of work of an employee of the company being inspected. Considering the content of the file, the evidence presented,

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and the rationale of the original decision, the SAC concluded that the defendant company's activity, by its nature, was in fact not creation of work (under a contract for work) but renting of labour.

The SAC also referred to its previous case law according to which it is not the labour inspectorate's duty to examine in detail every single fact during an inspection, but it is essential that the facts ascertained in their entirety indicate that an offence had been committed, which was fulfilled in this case.

The SAC's conclusions, while forthcoming to the labour inspectorate, are very unfavourable for business practice, as the line between legal outsourcing and illegal, disguised employment mediation is very thin. Neither legislation nor case law provides clear guidance, and high fines can be imposed for incorrect setups. We can only recommend consulting all outsourcing contracts with an experienced consultant.

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Case law

CJEU on adjustments of VAT deductions for written off goods

The Court of Justice of the European Union (CJEU) ruled on adjusting input VAT deductions for written off goods no longer usable due to wear and tear, defects, and obsolescence. The taxpayer defended not adjusting the VAT deduction for written off goods that had objectively lost their usefulness.



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Between 2014 and 2017, a Bulgarian telecommunications company sold selected written-off fixed assets as waste, destroyed them, or disposed of them. Accordingly, the company had adjusted the VAT deduction. However, in 2019 they applied for a refund of the adjustments made on the ground that Bulgarian law was in that regard incompatible with the VAT Directive. The tax administrator rejected the application while the court threw out the subsequent legal action. The company, therefore, filed a cassation complaint, and the Court of Appeals referred the question to the CJEU.

Article 185 of the VAT Directive generally states that no VAT adjustment shall be made in respect of transactions remaining totally or partially unpaid. Also, no VAT adjustment shall be made for the destruction, loss or theft of property duly proved or confirmed. However, member states may require adjustments in respect of unpaid or partially unpaid transactions, and in respect of theft.

The Bulgarian court referred to the CJEU the question of whether writing off goods was a change in the factors used to determine the amount of input VAT deducted if the goods were subsequently sold. The court's answer was that the sale of goods constituted a taxable supply linked to the right to deduct. The fact that it was a sale of waste outside the normal economic activity was irrelevant.

Additional questions were referred to the CJEU as to whether the duly proved destruction or disposal of goods written off was a change in the factors used to determine the amount of the deducted input VAT. Here, as well, the CJEU ruled in the affirmative, although the change does not give rise to the obligation to correct the deduction if the destruction is duly proved and justified.

The destruction or loss of goods necessarily entails the disappearance of any possibility of using them in the context of taxable transactions. Logically, loss cannot be the result of a deliberate action on the part of their owner, whereas that cannot be ruled out in the case of destruction. The destruction of assets decided upon because of the objective loss of their usefulness in the taxable person’s usual economic activities thus meets the conditions of Article 185.

Finally, the Bulgarian court referred to the CJEU the question whether Article 185 of the VAT Directive precludes national legislation that requires the VAT deduction to be adjusted when goods are written off. It is clear from the

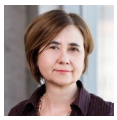
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conclusions on the previous questions that such national provisions are incompatible with Article 185. Furthermore, the destruction of goods is not one of the cases in which Article 185 allows member states to require the adjustment of deductions.

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News in brief, July 2023

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



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DOMESTIC NEWS

- The following regulations were published in the Collection of Laws:
  - Regulation No. 191/2023 Coll., amending Regulation No. 467/2022 Coll., amending the rate of basic compensation for the use of road motor vehicles and meal allowances, and determining the average price of fuel for the purposes of providing travel expenses for 2023.
  - Communication No. 192/2023 Coll. of the Ministry of Labour and Social Affairs, announcing an amount equal to 50% of the average monthly wage in the national economy for the purposes of the living and subsistence minimum and an amount equal to 50% and 25% of the average monthly wage in the national economy for the purposes of state social support.
  - Act No. 173/2023 Coll., amending Act No. 325/1999 Coll., on asylum and Act No. 326/1999 Coll., on the residence of foreign nationals in the Czech Republic.
  - Act No. 171/2023 Coll., on the protection of whistleblowers, and Act No. 172/2023 Coll., amending certain acts in connection with the adoption of the Act on the Protection of Whistleblowers.
- The Ministry of Finance published an updated list of effective double taxation treaties.
- The government approved an amendment to laws in connection with the development of the financial market and the provisions of support for old age, with effect from 1 January 2024. The amendment proposes modifications to Pension Pillar III to increase the attractiveness of saving for old age and introduces a new state-supported method of saving for retirement, the 'long-term investment product'.
- The financial administration draws attention to the postponement of the effectiveness of the amendment to the VAT Act relating to immovable property to 1 January 2024.
- The financial administration also issued information on windfall tax prepayments and on DAC 7:
  - Information for windfall tax prepayment payers
  - XSD structure for creating XML reports on reportable sellers under DAC7.
- The government approved an amendment allowing the establishment of energy associations and the sharing of the produced electricity.
- The Ministry of Industry and Trade published the results of assessing the administrative burden on entrepreneurs for 2022, carried out in cooperation with the relevant ministries and other state administration authorities using the Database of Information Obligations, an online tool. The report informs about the implemented system steps and measures to reduce the burden on entrepreneurs, about digital projects within the ministry's competence and about working groups dealing with the business environment. An overview of current and upcoming measures can also be found on the www.stopbyrokracii.cz website.
- Within the DigiCompetence project, the Ministry of Labour and Social Affairs has created a new scenario of the self-evaluation tool EVALDO – Home Office to test the level of digital competencies that are needed to perform work from home. More information can be found HERE.
- In June, the government approved an amendment to the law focusing on organisational changes in the Czech Social Security Administration (ČSSZ). Individual district administrations will now be administratively replaced by territorial social security administrations with contact points in each district so

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that they remain as close to clients as possible. This will provide more flexibility with more agendas and make work easier to organise and move. More information can be found HERE.
- The chamber of deputies approved an amendment to the Labour Code (e.g., changes to agreements for work outside employment, teleworking) including an amendment to the Income Tax Act regarding the tax treatment of compensation for remote work.
- In its second reading, the chamber of deputies discussed an amendment to the Act on Excise Duties, which increases excise duty by CZK 1.50 per litre. The third reading originally scheduled for 29 June 2023 has not yet started.

FOREIGN NEWS

- At the June ECOFIN meeting, ministers debated the Commission's proposal for a VAT in the Digital Age package, with proposed effect from 2024 (in particular, the issue of reporting standards and e-invoicing). The proposal will be discussed further and the adoption of the regulation with the originally proposed effective date is unlikely.
- The Swedish EU Presidency Report indicates that progress has been made on several issues of the draft UNSHELL directive, such as applicability, substantive criteria, tax implications, tax residence certificates, and reporting deadlines. However, further discussions will be needed to find a compromise solution to some outstanding issues.
- The European Commission has released for consultation a proposal for a directive on a uniform system of application of withholding tax (FASTER). The proposal is intended to introduce faster procedures for applying withholding taxes, in particular on distribution of profits and interest on publicly traded shares and bonds. The main tools are to be the introduction of a single digital tax residence certificate and a central register of financial intermediaries acting between investors and withholding tax payers (issuers of securities). The directive is proposed to take effect on 1 January 2027.
- The European Commission has launched a consultation on a draft implementing regulation setting out the rules for the application of the Carbon Border Adjustment Mechanism (CBAM) during its transitional phase (1 October 2023 to 31 December 2025). During this period, importers of goods falling within the scope of the CBAM will only be required to comply with reporting obligations, without making any payments. The proposal outlines the methodology to be used during the transitional period to calculate embedded emissions released during the production process of CBAM goods. In the first years, the companies concerned could choose between three reporting methods. From 1 January 2025, the new EU methodology would be the only reporting methodology.

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