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Editorial

I would like to share with you our litigation team's accomplishment regarding the interest rate amount on retained excess VAT deductions to be paid to corporations by the financial administration. The tax authority's retention of VAT for a period of two or three months may nowadays be an existential question for many an entrepreneur or business. I sincerely hope that the Supreme Administrative Court's decision will be another piece to the mosaic leading to a more effective examination from the side of the tax authorities, as they should more often employ common sense rather than insist on formalities, as they so often do, especially when VAT evasion has evidently not taken place. For more information on this ground-breaking court decision, please see the article prepared by Jana Fuksová and Filip Morcinek.

Another piece of good news is that after several months of publicity regarding direct and indirect support for entrepreneurs and businesses, support for employees has finally come through in form of the cancellation of the super-gross wage and a return to the taxation of gross wages. Many employees have been affected by the current developments in the economy and business environment, generating lower incomes as a result of the cancellation of bonuses and other variable salary components, the reduction of basic wages, or the compulsory shortening of working hours. The call to cancel the super-gross wage has been discussed repeatedly in the media. I hope that this time, it will finally be implemented. Nonetheless, the deadline of 1 January 2021 is, in my opinion, more than highly ambitious when considering the length of the entire legislative process (realistic only if the change is proposed via an amending proposal as part of one of the amendments that are currently being debated).

I have a feeling that this summer is a bit different. Many people have chosen to spend their vacations in the Czech Republic or in countries from which they can return home by car within one day. During my family's holidays, I experienced a more profound internal freedom and peace of mind. I have been pondering the reason for this and concluded that in places near their home people tend to subconsciously switch from a must-see mode to a more leisurely mode, just going for a swim or a bike ride, spending a night by the campfire barbecuing or just for fun, in short, just doing the simple things we can find all around us but forgot to do because of the lack of time or because we thought they were no longer important... Any thoughts? For instance, when was the last time you swam in the river flowing near your home or stopped at a familiar sight with renewed interest?

May you all have a beautiful summer full of peace and quiet. And to those of you with kids: may they finally get to go to school in September after all the months they had to spend cooped up at home.

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Rules for employing foreigners changed again in July

In step with the epidemiologic situation both in the Czech Republic and worldwide, the Ministry of Health continues to regularly update protective measures regulating the entry of foreign nationals into the Czech Republic. Two new protective measures were published in July, partly amending the approach to crossing borders. The newest protective measure entered into effect on 20 July 2020. What are the most significant changes? How will these affect the employment of foreigners?

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Concerns regarding the reliability of certain foreign Covid-19 tests have led the ministry to cancel the condition under which foreigners were only allowed to enter the CR with a certificate confirming a negative coronavirus test not older than four days. Under the new protective measure, foreigners do not have to be tested abroad but must either undergo a test after they arrive in the CR and deliver the test results to a regional public health office within 72 hours of crossing the Czech border, or quarantine themselves.

Since 15 June 2020, the arrival of foreigners in the CR has been regulated by a traffic light system (Semafor, the ministry's protective measure discussed in this article). It is necessary to distinguish between this Semafor and the Semafor for Czech regions presented by the Minister of Health on 27 July, showing the level of risk of infection in the individual Czech regions and districts. With the publication of the July protective measures, the Semafor rules for arrivals of foreigners in the CR have changed: the list of countries now also includes non-European countries and no longer divides the countries into three categories (colours) according to the risk of infection (red, orange and green) but only into the following two categories:

- **High-risk countries (red)** – Czechs and foreign nationals having spent time in these countries for at least 12 hours in the last 14 days must undergo a coronavirus test on their arrival in the CR. The existing rules remain in application, i.e. foreigners arriving from high-risk countries may only enter the CR if they hold a residence permit (e.g. a long-term visa) or under some of the exceptions permitted by the protective measure.
- **Low-risk countries (green)** – Czechs and foreign nationals arriving in the CR from these countries do not have to undergo a coronavirus test. However, the protective measure of 20 July introduces a special sub-category of countries falling under a stricter regime (currently: Bulgaria, Luxembourg, Sweden, Portugal, Romania, and Thailand). Foreign nationals from these countries may not commence their jobs without submitting a negative coronavirus test to their Czech employers.

A final but crucial change facilitates the entry of third-country citizens who are partners to Czech and EU citizens and have been separated from them due to the coronavirus pandemic. Previous rules only allowed the arrivals of family members where the relationship with the foreign nationals was regarded as unambiguously supportable (primarily, spouses and children). Under the new rules, these foreigners will be allowed to enter the CR if they have at their disposal their partner's affidavit certifying the existence of a mutual relationship and guaranteeing

accommodation and health care.

Subsidies

New COVID programme – Accommodation

The government has approved the Ministry of Local Development's proposal to provide new support to providers of accommodation services. The state will contribute CZK 100 to CZK 300 per every room according to the standard of accommodation over the period of the closure of an accommodation facility due to the government decree. A call to participate in this programme is expected to be announced in August.

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COVID – Accommodation support will be paid to applicants based on the standard of accommodation provided; the maximum aid will amount to CZK 330 per room and night and applies to the most luxurious types of accommodation such as five or four-star hotels, motels and boatels. Camping providers will be entitled to CZK 100. Support is not intended for short-term leases such as Airbnb.

The ministry plans to announce a call for this type of support and provide access to applications during August. First of all, however, it will be necessary to obtain the European Commission's notification currently in progress. As in the case of COVID – Rent, applications will be filed via on-line forms. Administration of support will be the responsibility of the State Fund of Investment Support.

In practice, the seasonality of accommodation services will also be taken into account; for example, if a facility was closed sometime in the last two years, it will not be entitled to this type of support or the support may be proportionately reduced. We will let you know more details once the call is announced.

Interest on retained excess deductions – SAC agrees with KPMG

The Supreme Administrative Court (SAC) issued a breaking decision concerning retained excess VAT deductions, confirming that interest on a tax deduction of 1% + repo rate in effect from 1 January 2015 to 30 June 2017 is in conflict with EU law. The Kordárna interest (based on the well-known Kordárna judgement) equalling the repo rate + 14 percentage points should be applied in its stead.

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Interest on retained excess deductions has seen turbulent developments over the recent years. An explicit regulation of this concept was absent in Czech law until the end of 2014. To rectify this constitutionally unacceptable imperfection, the SAC responded by issuing the Kordárna judgement, according to which taxpayers are entitled to interest of 14% + repo rate from the beginning of the fourth month after the end of the relevant taxable period for the period over which excess deductions were retained. Legislators subsequently responded to this judgement by introducing a new provision to the Tax Procedure Code from 1 January 2015, namely Section 254a, awarding interest on excess deductions at 1% + repo rate, and only from the fifth month after the commencement of a procedure to remove doubt. Interest in the case of tax inspections has not been dealt with at all.

In a case involving a client of KPMG, the financial administration awarded interest of only 1.05%. From the beginning of the case, we objected to the applicability of Section 254a of the Tax Procedure Code in effect from 1 January 2015 to 30 June 2017 for various reasons, one of which was conflict with EU law. However, the Municipal Court in Prague sided with the tax administrator and confirmed the low interest. Consequently, the dispute was brought before the Supreme Administrative Court. The SAC unambiguously arrived at the conclusion that the section in question was in conflict with the EU directive and its interpretation by the Court of Justice of the EU, according to which interest on retained excess deductions must correspond to an interest rate that would have had to be paid on a loan by a taxable person that is not a credit institution. The rate of 1% + repo rate in no way meets this requirement. Moreover, the beginning of the period of applying interest is also at variance with EU law. Since Section 254a of the Tax Procedure Code cannot be applied, the SAC concluded that rules regulating the entitlement to interest on retained excess deductions specified within the Kordárna judgment shall continue to apply, namely the interest rate of 14% + repo rate to be applied from the fourth month after the end of the taxable period.

The significance of the SAC's decision is considerable, since the case is far from unique, as many taxpayers have been drawn into similar disputes. The financial administration has not yet expressed its opinion on the above court decision. Understandably, the decision has made our tax-litigation team very happy, as the SAC has agreed with our arguments.

2019 through the financial administration's eyes

The Report on the Activities of the Czech Financial Administration for 2019 brings very interesting statistical data and information. For example, in 2019, the financial administration completed a total of 30,073 tax inspections and procedures to remove doubt.

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Every year around this time, the financial administration summarises and evaluates its key activities and presents its goals for upcoming years. In 2019, the financial administration regarded as most important the preparation and update of its methodological guidance on income tax and accounting, the update of prescribed forms, amendments to transfer pricing guidelines, the MOJE daně project, nDIS (New Tax Information System), and generally the gradual digitalisation of its activities.

According to the report, the financial administration continued in its fight against tax evasion while using tools such as proving the origin of assets. For personal income tax, it mainly focused on the examination of the accuracy of claiming tax credits and on the taxation of income from sharing economy.

Some statistical figures are also worth mentioning: overall revenues from taxes for 2019 amounted to CZK 907 billion, showing a year-on-year increase of 6.2%. The major revenue item was (yet again) VAT (CZK 431 billion), showing a 4.4% increase compared with 2018, primarily as a result of a higher effectiveness in the collection of taxes due to VAT ledger statements. Nevertheless, the collection of VAT fell behind the originally budgeted sum, which was, according to the report, primarily due to the postponement of the third and fourth wave of the electronic reporting of sales, and the lower effectiveness of tax securing orders as a result of the SAC's decision-making practice and case law. An increase in the collection of corporate income tax is also worth mentioning.

Overall, in 2019, the financial administration carried out 10,408 tax inspections and 19,665 procedures to remove doubt, with tax inspections showing a year-on-year decrease of almost 11%, according to the report caused by the length of inspections already commenced. Total taxes additionally assessed based on tax inspections exceeded CZK 7 billion, showing a year-on-year decrease of almost 30%. The financial administration continued in its targeted inspection activities. The majority of procedures to remove doubt targeted VAT payments, accounting for a share of 64%. The most frequent discrepancies asserted during VAT inspections involved non-standard situations associated with fraud in chain transactions. For income tax, the financial administration continued in its trend of examining transfer pricing, the application of tax deductible items, and the exemption of interest income on one-crown bonds. The financial administration procedures' link with criminal procedures continued: the financial administration delivered a total of 2,000 reports to law enforcement authorities, most often on the grounds of suspicion of committing a crime of tax evasion.

The financial administration reported a total of 12,028 appeals, of which 7,545 were resolved: more than half were dismissed at either the Appellate Financial Directorate or at the individual tax authority levels. The highest number of appeals again concerned VAT. In 2019, administrative courts subsequently reviewed a total of 828 cases,

upholding taxpayers' claims in 278 cases, overall amounting to CZK 5.7 billion. Additionally assessed tax confirmed by the courts totalled CZK 6.1 billion. When looking at the total amount of additionally-assessed tax, it becomes evident that the financial administration again erred mainly in cases where large amounts of tax were additionally assessed.

What is to be expected in years to come? The financial administration's main goal will again be to effectively recover underpaid taxes, especially relating to tax evasion arising from sharing economy, tax reliefs, and proving the origin of assets. During the course of 2020, the financial administration plans to further develop the MOJE daně and nDIS projects and issue methodological guidance associated with an amendment to the Tax Procedure Code, while preparing for the re-implementation of the electronic reporting of sales and the launch of its third and fourth wave, planned to occur on 1 January 2021.

Quick fixes: GFD's information and EC's amended explanatory notes

The Czech amendment to the VAT Act implementing quick fixes is still waiting for its second reading in the Chamber of Deputies. At the end of January, the General Financial Directorate disclosed information confirming the option of invoking the EU directive's direct effect. This means that starting from 1 January 2020, Czech entities may proceed in accordance with the amended EU regulations, even if these have not yet been implemented into Czech law.

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GFD's information

In its information, the GFD points out that if the option of applying the direct effect of the amended directive is exercised, all other related conditions must also be fulfilled. This mainly concerns deliveries of goods from the Czech Republic to another EU member state via call-off stock arrangements. Individual flows of goods (i.e. the transfer of goods to a call-off warehouse and its subsequent domestic sale) must be correctly declared in EC Sales Lists, now containing a new separate sheet specifically designed for this purpose. According to the GFD's information, an updated electronic EC Sales List form should be available on the tax portal (https://www.daneelektronicky.cz/) no later than 20 February 2020. The application of the directive is voluntary, which means that it still will also be possible to proceed in accordance with the wording of the VAT Act currently in effect.

EC's explanatory notes

Explanatory notes published by the European Commission at the end of last year providing certain guidance also for Czech taxpayers have already been discussed here. Today we will focus on another area of the explanatory notes, in particular proving the transport of goods, since proving the physical delivery of goods to another member state is one of the main conditions for entitlement to the exemption of the sale of goods from Czech VAT.

Documents necessary to prove the transport of goods to another member state are newly defined in Article 45a of Council Implementing Regulation No. 282/2011. To prove the transport of goods, it is necessary to be in possession of two or three documents issued by two different parties that are independent from each other and from the vendor and the acquirer. However, in some situations such a requirement is practically unfeasible. How to proceed in such cases?

According to the explanatory notes, if the taxable person does not have the documents required by the regulation in its possession, the exemption from VAT may not be denied to such a taxable entity automatically; it is still possible to prove the exemption from VAT following Article 138 of the directive, i.e. Section 64 of the VAT Act.

The explanatory notes also deal with specific cases, e.g., when suppliers ensure the transport of goods using their own motor vehicles. In such cases, it is admitted that the combination of documents prescribed by Article 45a cannot be obtained. As a result, the conditions set out in the regulation do not apply and the transport of goods must be proven in another manner.

If transport is ensured by the acquirer, the acquirer must furnish the vendor with a written statement of the acceptance of goods by the tenth day of the month following the supply. How to proceed when the acquirer does not provide this statement to the vendor within the set deadline? The EC claims that the ten-day deadline mainly serves to determine the time frame for the statement's delivery and should not penalise the supplier for the failure to provide the statement within the deadline. Therefore, this on its own cannot lead to a denial of the exemption from VAT.

However, the EC's explanatory notes are not legally binding. It will therefore be up to the Czech financial administration to resolve these cases.

EU citizen's temporary residence certificate – lessons learned from COVID-19

The free movement of persons is one of the essential principles for the functioning of European integration, without which we no longer can imagine our work and private lives. Most of us use this freedom just for tourism or short-term work purposes. But many EU citizens stay in the Czech Republic on a long-term basis and the recent closure of borders has made their entry in the CR more complicated.

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The coronavirus crisis has clearly shown that any advantages from the integration of European countries may be neither entirely permanent nor certain. With the closure of internal borders, many citizens of other EU countries got into very complicated situations, irrespective of whether they dwelled in the CR or were just about to arrive here. For several weeks, entry into the CR was restricted to those who were not Czech citizens or did not hold Czech residence permits. This decision made the lives of many EU citizens quite difficult, affecting also their employers who could not know when these persons would be able to resume or commence their jobs. However, these situations could have been prevented had they obtained a certificate of temporary residence.

The Act on the Residence of Foreign Nationals explicitly stipulates a reporting duty for EU citizens whose stay exceeds 30 days. Within thirty days of their arrival, foreigners must visit the Czech Alien Police and report their place of residence (unless the foreigner's address is reported by an accommodation provider). Foreigners are quite often unaware of this duty. However, there is also another option how to meet this duty, with a number of advantages: applying for a certificate of temporary residence, i.e. a document that rather than a residence permit is an official certificate of temporary residence in the CR, issued by the Asylum and Migration Policy Section of the Ministry of Internal Affairs.

Apart from the fulfilment of the reporting duty, the certificate may also significantly help in dealing with certain ordinary life-related matters such as applying for parking permits in blue zones, mortgages and loans, or purchases and registrations of vehicles.

Above all, certificate holders acquire the status of a person with a Czech residence permit. It cannot be excluded that internal borders within the EU will again be closed in the future as a result of negative pandemic developments and only foreigners holding Czech residence permits will be allowed to cross the Czech borders. The certificate of temporary residence that may now seem an unimportant technicality may thus help prevent many unpleasant situations.

End of July brings revolution in posting of workers

A package of significant changes to the posting of workers from abroad entered into effect on 30 July 2020 as part of an amendment to the Labour Code. This package adapts Czech legislation to comply with an amendment to the EU Directive on the Posting of Workers. Changes are primarily aimed to equalise the working conditions of posted and local workers. The amendment may result in a significant increase in expenses for the posting of workers and, simultaneously, a higher administrative burden on employers.

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Under the amendment, for personnel posted to the Czech Republic it is necessary to distinguish between short- and long-term postings. Short-term postings are generally postings shorter than 12 months; long-term postings go beyond 12 months. The short-term posting regime can be extended to up to 18 months but employers must file a written notification of such an extension with a regional labour office and specify why the posting is being extended. All this must be done within 12 months from the moment a posted worker started providing services in the CR.

Before the amendment, the Czech Labour Code regulated the minimum working and payroll conditions to which a worker posted to the CR is entitled. These minimum conditions are currently applicable only to short-term postings, while at the same time, the original list of working conditions that must be provided to posted personnel, such as minimum wage, guaranteed wage or minimum vacation length, has been extended to cover also the provision of statutory extra pay, travel expenses, and acceptable accommodation conditions if provided by the employer.

On the other hand, workers posted long-term must be provided with all working conditions prevalent in the host country, excepting the legal regulation of the origination, change and termination of an employment relationship. Any working conditions under Czech law apply to the posted worker only if these are more advantageous than those under the law of the worker's home country, which is a rule that remains effective for both short-term and long-term postings.

To assess whether a posting is short-term or long-term, posting periods of workers replaced within the performance of the same job at the same place are added together. Under the transitory provisions, a posting commenced before the effective date of the amendment is regarded as a posting commenced on the effective date, i.e. 30 July 2020.

Within the regulation of agency employment, the amendment stipulates the duty of the user, i.e. the employer to whom the worker is temporarily assigned by an agency, to inform the agency sufficiently in advance about its intention to post the worker to another member state while providing services on an international scale (double-posting). Double-posted personnel are also regarded as posted personnel and job agencies remain their employers with all related rights and duties. The amendment also stipulates an exception from these rules applicable to

workers in road transport.

The new rules aim to improve the conditions of posted workers. Nonetheless, relatively many unresolved issues will have to be dealt with by both receiving and posting employers. We therefore recommend adopting a very careful approach to postings and paying proper attention to the preparation of related documentation. The reporting duty towards labour offices should also be adhered to.

To conclude, we also draw attention to changes introduced by the amendment applicable to personnel posted from the CR to other EU countries.

Privacy Shield invalidated; standard contractual clauses remain valid

The Court of Justice of the EU (CJEU) invalidated the Privacy Shield, based on which it was possible to transfer personal data to the USA, and left standard contractual clauses in effect with certain exceptions. The question is whether personal data transfers performed to third countries based on these clauses will prove themselves in practice.

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Maximillian Schrems' previous complaint regarding the processing of his personal data by Facebook resulted in the invalidation of the Safe Harbour concept. His current complaint led to the examination of a subsequent tool based on which personal data were transferred to the USA, i.e. the Privacy Shield programme, and of the validity of personal data transfers on the grounds of standard contractual clauses.

According to the CJEU, the US legislation regulating the access to and use of personal data transferred from the EU to the USA fails to provide adequate protection, which should in principle be equivalent to the protection embodied in EU legislation. The Privacy Shield may therefore no longer be used. The option to use standard contractual clauses for transferring personal data to processors seated in third countries remains (theoretically) in effect. However, as the CJEU pointed out, their use requires the fulfilment of certain duties by the personal data exporters and recipients. These must make sufficiently sure in advance that an adequate level of protection will be adhered to in the relevant country. Moreover, if the recipient is unable to ensure the adherence to standard contractual clauses, they must immediately inform the exporter who must immediately suspend any personal data transfer.

Considering the reservations the CJEU has expressed as regards the handling of personal data by US authorities, the question remains whether standard contractual clauses may actually be used in relation to the USA. For example, the Berlin Commissioner for Data Protection has already made it clear that data controllers should avoid personal data transfers to the USA and prefer entirely European solutions.

To use standard contractual clauses, it is always necessary to thoroughly analyse the law of the state receiving the personal data and to carefully assess each particular case. It can also be expected that their wording will be revised by the European Commission in the future.

Banks not liable to accept deposits?

Significant conceptual changes to the Act on Banks and the Act on Capital Market Undertakings are expected to enter into effect in mid-2021. The regulation of supervision over groups of investment companies (securities brokers) will be transferred to the Act on Capital Market Undertakings and the definition of banks will be extended beyond the current definition.

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The Ministry of Finance has prepared a draft amendment to the Act on Banks and the Act on Capital Market Undertakings, implementing EU regulations regarding the capital markets union aimed at integrating the capital markets of EU member states. The implementation responds to a series of European regulations concerning credit institutions and investment companies.

In connection with changes to EU prudential requirements, the regulation of groups of investment companies including the supervision over such groups will be embodied directly in the Act on Capital Markets Undertakings. The Act on Banks will include only the regulation of supervision over Class 1 investment companies, i.e. large investment companies exceeding the set thresholds. This change is connected with a new definition of banks. The amendment envisions two types of banks: in addition to the banks we know now, a second category of banks will include large investment companies without a licence to accept deposits and provide credits. Under the new regulations banks will have the following defining characteristics only: a banking licence, a legal form of joint stock company, and a registered office in the Czech Republic. The banking licence's content will depend on whether it involves a bank under the legislation currently in effect or a large investment company.

Apart from the above draft amendment, the process of transposing CRR II and CRD into Czech law also involves the submission of a draft Czech National Bank decree amending the Decree on the Performance of the Activities of Banks. Changes will primarily concern the regulation of capital reserves of securities brokers and the management and control system in relation to persons included in a consolidated group: this regulation will be included in EU or industry-specific legislation. The regulatory framework for investment companies responding to IFR and IFD regulations has also been taken into account.

CRR II and CRD V change the regulatory requirements for banks and some other existing rules. Despite the fact that the deadline for adapting to the changes will not expire until the end of this year or in June next year, we recommend starting to assess the impact of new measures now to ensure that your company's transition to modified rules does not cause any major problems.

European Commission's first plans for tax reform within the EU

In mid-July, the European Commission published a first draft of a new tax package aimed to boost the economy and create fair and simple taxation rules within the EU. A more detailed version will be published at the end of 2020, should the OECD's initiatives mainly regarding corporate and digital tax fail to be implemented.

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Recent developments, mostly affected by the coronavirus outbreak, brought the European Union and its member states a number of new challenges, especially in connection with the subsequent downturns of the global and European economies. Tax systems must also cope with the dynamic development of digital technologies, the growing importance of multinational companies, tax evasion, and tax havens.

To respond to all of the above challenges, the European Commission has prepared a vast reform of its taxation policy whose general outlines were presented in mid-July and are part of a fair and simple taxation package. The package is made up of three basic initiatives:

The action plan presents 25 distinct actions to make taxation simpler, fairer and better attuned to the modern economy. These actions will make life easier for honest taxpayers by removing administrative obstacles at every step of the tax proceedings. The implementation of these measures is planned for 2020-2024.

The proposal for the revision of the directive on administrative cooperation in tax matters (DAC 7) focuses on the automatic exchange of information about revenues generated from digital services.

The EC's communication on tax good governance emphasises the promotion of fair taxation and clamping down on unfair tax competition, in the EU and internationally. It also proposes improvements to the EU list of non-cooperative jurisdictions, which deals with non-EU countries that refuse to follow internationally agreed standards.

Both the action plan and the EC's communication primarily stress the need for fairer taxation of digital platforms and other technology companies; simultaneously, they draw attention to the importance of a code of conduct for corporate entities, the reform of the VAT payment system, the fight against tax evasion, fairer taxation of corporate entities including the simplification of administration when paying taxes across the EU, and dealing with the issue of tax havens. The commissionaires also propose a radical reform of the taxation of income of corporate entities within the EU, previously known as the Common Consolidated Corporate Tax Base – CCCTB, on the EU agenda since 2011.

The documents issued do not include any concrete measures within the individual actions; these should be presented by the end of 2020, as the EC currently gives preference to solutions at the OECD level. If consensus is not reached on a global level, the EU will adopt its own legislative solution for corporate and digital taxes. It should also be made clear that unanimous consent of all member states is necessary to approve the EC's tax package, which seems very improbable based on previous experience.

July G20 summit and digital economy taxation

The July G20 summit in Saudi Arabia, a meeting of finance ministers and central banks governors of the world's major developed and emerging economies, brought a certain shift in their effort to set global rules for the taxation of the digital economy. Even though owing to the COVID-19 crisis the final political decision about individual programme pillars has already been postponed until October, the July summit brought a revival of actions the OECD had promised to complete by the end of 2020.

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In our previous article about digital economy taxation we commented on the withdrawal of the USA from debates at the OECD level. According to a report issued after the July summit, however, the US administration seems to have taken a more conciliatory approach and debates regarding Pillar I may be resumed in the second half of 2020. A consensus regarding Pillar II is expected to be reached as promised, i.e. by the end of 2020.

The report provides information on the progress that has been made with respect to individual pillars since the last meeting in January 2020:

Pillar I

The proposal from January 2020 contains 11 basic building blocks (principles) on which Pillar I stands and which should facilitate the effective allocation of taxable income to a country in which such income was generated. The individual principles have been discussed in detail since January and have subsequently been adjusted by the OECD. Nevertheless, a number of questions are yet to be resolved. Most of all, the entire process must be simplified to prevent double taxation.

Pillar II

Similarly as with Pillar I, the finalisation of individual rules before October 2020 has been the most important action relating to Pillar II. It will also be necessary to set Pillar II in a manner to allow its functioning along with the US GILTI and BEAT regimes (US tax laws to avoid tax evasion). Finally, the OECD also plans to reduce expenses that will have to be incurred by individual parties to ensure compliance of their regimes with Pillar II.

The issued report also mentions the positive impacts of both pillars: preliminary analyses show that their implementation would result in a significant increase in world income from the collection of taxes and would improve the allocation of income between the countries by taxing income directly on the markets on which the values were created.

For the OECD, it will be crucial whether the proposed version of individual pillars will be approved at a rescheduled date in October. If this does not happen, it is hard to imagine that the project of setting new global taxation rules will be completed this year.

Case law

CJEU: Services associated with both taxable and exempt supplies may not be partially exempt from VAT

In the BlackRock Investment Management (UK) Ltd (C-231/19) case, the Court of Justice of the EU (CJEU) ruled on whether it is possible to treat a service provided via an IT platform used for both exempt and taxable supplies as a supply exempt from VAT.

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A US company provided services to BlackRock, a British company and a manager of investment funds, via an IT platform, Alladin. These involved a package of services comprising a market analysis, the monitoring of adherence to legal regulations, performance monitoring, risk assessment to make an ideal investment decision, etc. BlackRock used this platform for both the management of collective investment funds, which is exempt from VAT in Great Britain, and for the management of other funds, which is liable to VAT. Services provided via the Alladin platform represented a single supply irrespective of them being used in the management of various investment funds.

BlackRock paid VAT only on a proportionate part of services associated with the management of other investment funds, determined based on their share in the total amount of funds managed. The remaining part was treated as supplies exempt from VAT. However, the tax administrator was of the opinion that all of the services rendered should be taxed, since BlackRock mainly managed other investment funds. A question was referred to the CJEU: whether the services in question represent a single supply from a VAT perspective and, if so, whether it is possible to claim at least a partial exemption.

The CJEU first confirmed that the services at issue can be regarded as one indivisible supply comprising various elements. However, owing to the nature of the provided services, it is not possible to distinguish between principal supplies and ancillary supplies; consequently, this involves a single supply liable to a single VAT treatment. The indivisible supply cannot be split for the purpose of applying an exemption to one part and taxation to the other. The court also rejected the procedure outlined by the tax administrator proposing that the VAT treatment of the services in question should be determined according to the supplies to which the majority of services relates. The VAT treatment depends on the nature of provided services (management of investment funds) and not on their provider or recipient.

As for the option to exempt the entire supply from VAT, the CJEU held that a VAT exemption must be interpreted in a strict manner: to be able to claim the management services for investment funds as supplies exempt from VAT, they must form a separate group regarded as a distinct whole fulfilling the specific functions of the management of collective investment funds. Since the services in question were intended for the management of investment funds of a various nature and could be used for the management of both collective investment funds and other funds, according to the court, they cannot be exempt from VAT.

For the purposes of applying the Czech VAT Act, which does not distinguish between the individual types of investment funds, the judgment is mainly significant as it confirms that it is necessary to apply a single VAT regime on the entire package of services and it is not possible to determine, based on various criteria, a part that is liable to VAT and another one exempt from VAT.

Case law

SAC: Special regulation of period for assessing tax overrides general regulation

The Supreme Administrative Court dealt with the relationship between the general regulation of the period for assessing tax under the Tax Procedure Code and the special regulation of the period under the Income Tax Act in respect of the commencement of a tax inspection for a taxable period for which a tax loss was reported. The heart of the dispute was the question whether when such tax inspection commences a new three-year period under the general regulation stipulated in the Tax Procedure Code begins to run or whether the end of the period for assessing tax is governed by the special regulation stipulated in the Income Tax Act, exceeding the period for assessing tax if a tax loss was reported. The SAC ruled that if a new lapse period begins to run, its duration is governed by the special regulation of Section 38r (2) of the Income Tax Act.

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On 25 November 2015, the tax authority commenced a tax inspection concerning the corporate income tax for the 2013 taxable period for which the concerned entity reported a tax loss. The last taxable period in which the entity could claim the tax loss as a deductible item was 2018, and therefore the period for assessing tax ended on the same date as deadline for assessing tax for 2018, i.e. on 1 April 2022 (according to a special provision of the Income Tax Act). However, the entity subject to the tax inspection referred to the general regulation of the lapse period stipulated in the Tax Procedure Code – three years from the commencement of the tax inspection for the relevant period – and claimed that the deadline for assessing tax had already expired on 25 November 2018. Thus it considered the continuation of the tax inspection after this date an unlawful infringement.

Referring to its earlier rulings, the SAC concluded that the regulation of the lapse period in the Income Tax Act shall be treated as a special regulation to the general regulation of the lapse period in the Tax Procedure Code. The provision in the Income Tax Act includes a special rule for determining the end of the lapse period for assessing tax in the event of tax losses. The fact that a tax inspection has been commenced means that the eight-year lapse period under the Income Tax Act starts to run again from the tax inspection commencement date. In the case in question, the lapse period will thus end on 25 November 2023. The SAC also pointed out that the maximum period for assessing tax is generally limited to ten years, in this case thus ending on 1 April 2024.

With reference to its previous rulings, the SAC emphasised that the special regulation of the lapse period for assessing tax only applies to a particular period, not to all periods for which a tax loss was reported. The purpose of this regulation is to enable the completion of the tax proceedings in relation to the relevant taxable period, not in relation to all periods in which tax losses can be utilised. Any opposite interpretations would actually result in the chaining of tax losses, repeatedly rejected by the SAC.

Case law

Compensation for unrealised service paid upon early contract termination subject to VAT?

The Court of Justice of the EU (CJEU) held that the amount paid by customers upon early terminations of contracts should be considered part of the price for services and thus subject to VAT. The CJEU based its judgment primarily on the recent Serviços de Comunicações e Multimédia SA (C-295/17 MEO) case.

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Vodafone Portugal provided its customers with telecommunication services at preferential prices upon the conclusion of a contract for a predetermined minimum ('tie-in') period. Were those contracts terminated before the end of the tie-in period, customers had to pay an amount stipulated in the contract. In compliance with Portuguese law, this amount was not to exceed the costs incurred by Vodafone for installing the service. Unlike in case C-295/17, the amounts did not equal all payments the customer would have paid over the term of the contract but were lower. Vodafone first declared these amounts as subject to VAT, however, later on, requested a correction as it newly considered these amounts not subject to VAT.

The CJEU held that the consideration for the price paid by the customer is the customer's right to benefit from the fulfilment of the obligations arising to Vodafone from the contract, irrespective of the fact that the customer no longer wishes to or cannot use it. Vodafone enables the customers to use these services and the termination of using these services cannot be made at the expense of the operator. The above amounts retrospectively included in the monthly instalment amounts must be considered as part of the cost of the services Vodafone committed itself to provide to customers. The CJEU further held that, from an economic viewpoint, a predetermined amount received when a contract for the supply of services is terminated early guarantees a minimum consideration for the provided supplies. The amounts paid by customers upon early termination of contracts thus must be subject to VAT. Just as in case C-295/17, the CJEU also found irrelevant that the amount paid by Vodafone's customers did not correspond to the value Vodafone would have obtained if the contract had not been terminated early.

The CJEU ruled that both the consideration for the right to use the services and the services themselves had been determined the moment relevant contracts were entered into. The consideration had thus been determined using clearly specified criteria, according to which both monthly instalments and the manner of calculating the amount for the early termination of the contract were determined, hence any consideration paid by customers was not voluntary or incidental.

Although the amounts paid by customers upon early terminations of contracts did not correspond to the amounts Vodafone would have obtained if contracts had not been terminated early, the CJEU ruled in the same way as in case C-295/17 MEO. These amounts must be considered part of the price and are thus subject to VAT.

CJEU: Member states not obliged to act in concert

Transportation of goods sold to another member state in form of distance selling can be considered effected by the supplier or on its behalf also when the transport agreement with the carrier is concluded by the customer and the supplier plays an important role in concluding the agreement, e.g. by recommending specific carriers.

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The Court of Justice of the European Union (CJEU) decided on the case of the Polish company KrakVet Marek Batko (C-276/18) which supplied products for animals to non-business customers (non-taxable persons) on the Hungarian market. It offered these products through its websites registered on a Hungarian domain, and the goods were shipped from Poland. The customers could opt for a carrier recommended by the supplier, hire another carrier or collect the goods in Poland in person.

In respect of this transaction, KrakVet was not sure of the place of supply, as in the case of distance selling the transport of goods has to be arranged by the supplier or on its behalf. In this particular case, the agreement with the carrier had been concluded by the customer, not by KrakVet. Upon the request of KrakVet, the Polish tax authorities determined Poland to be the place of supply, and therefore the company applied Polish VAT on its supplies of goods to Hungary. In contrast, based on their own investigation, the Hungarian tax authorities concluded that the place of supply in respect of these products was Hungary and assessed additional VAT, including penalties and interest.

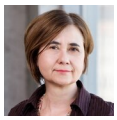
The CJEU pointed out that while a system for the exchange of information between member states is in place, member states do not have to act in concert when using the information from this system. If individual member states assess the same situation differently, a preliminary question shall be referred to the CJEU that will decide which assessment is correct. The member state which applied the wrong VAT treatment must allow for a correction and a refund of the wrongfully collected VAT.

If during transactions customers may choose the manner of transportation themselves and suppliers do not know until the very last moment the customers' choice, it is essential to determine whether the transportation was arranged on behalf of the supplier.

According to the CJEU, it must be assessed whether the supplier played an important role in arranging the transportation, e.g. if a customer selected a carrier recommended by the supplier. If so, transportation should be considered as having been arranged by the supplier or on their behalf, in spite of the contract with the carrier having been concluded by the customer.

News in brief, August 2020

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



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DOMESTIC NEWS IN BRIEF

- The Ministry of Labour and Social Affairs is finalising its preparations for its version of *kurzarbeit*, designed to help companies forced to partly restrict their operations in a crisis. Over a maximum of nine months, the state should provide employees of companies fulfilling the stipulated conditions with 60–80% of their net wage depending on the employee's activity and time spent within the *kurzarbeit* regime. Unlike the one-off support provided within the Antivirus programme, *kurzarbeit* should launch automatically when the Czech economy encounters any crises similar to the current COVID-19 pandemic.

- On 20 July 2020, the government approved the first investment incentives project since the 2019 amendment to relevant legislation. The approved project was submitted by Shimano Czech Republic, a manufacturer of bicycle parts, for the extension of its production in the Moravian-Silesian region. The government granted the requested tax relief incentive as the project is intended to benefit the Karviná region with its high level of unemployment and ongoing structural changes due to the reduction of coal mining.

- In accordance with Decision of the European Commission No. 2020/1101, the deadline for exemptions from customs duties and VAT of imported goods necessary to fight the consequences of the spreading of the new coronavirus COVID-19 was extended until 31 October 2020. Exemptions of imported goods from customs duties and VAT only concern state-owned entities, charitable organisations and rescue units. For this reason, the terms and conditions for exemption from customs and VAT of goods imported from a third country in relation to the SARS-CoV-2 pandemic effective from 7 April 2020 have been updated.

- On 24 July 2020, the European Commission published its draft amendments to the regulation stipulated within the Capital Markets Union (CMU) initiative, responding primarily to the recent COVID-19 pandemic and intending to curtail the adverse consequences of the pandemic. The EC has also published a draft concerning the regulation of benchmarks. The draft regulation concerning benchmarks relates to the end of the applicability of the LIBOR (the London InterBank O⊠ered Rate) benchmark at the end of 2021.

- The financial administration published the results of its financial inspections focusing on public administration. Inspecting 3,332 public administration authorities, it in particular looked at breaches of budgetary discipline, facts indicating the commitment of a crime associated with funds and assets management, adherence to the Public Procurement Act, and compliance with legislation regulating accounting and the record keeping and collection of receivables.

- A review of the capital markets regulation will also change the consequences of insufficient assessments of creditworthiness. Consumer objections will no longer be limited by a deadline of three years after contract conclusion. *Tax and Legal Update* has dealt with this issue in this previous article.

- The law implementing some EU directives governing taxation (primarily reporting of cross-border arrangements within DAC 6 and VAT Quick Fixes) was signed by the president and will come into effect in late August/early September, after its promulgation in the Collection of Laws. The Ministry of Finance has simultaneously been preparing a draft government decree intended to extend the deadline for reporting cross-border arrangements in accordance with extensions on the EU level. The duty to report cross-border arrangements implemented after 25 June 2018 remains unchanged.

FOREIGN NEWS IN BRIEF

- The European Commission initiated a public consultation to revise Council Directive 2003/96/EC restructuring the community framework for the taxation of energy products and electricity. This initiative aims to maximise taxation's role in fulfilling EU climate protection objectives. Aimed to reduce concealed subsidies for fossil fuels and some sectors of economy, the draft includes a revision of tax rates and tax exemptions. The initiative is part of the new sources of funding in the EU plan of economic revival approved by the European Council on 24 July 2020. In addition to changes to energy taxes, new funds should also be generated from fees on plastic packaging, digital tax revenue, or possibly from a tax on financial transactions.

- The European Commission disclosed instructions on changes in customs regimes concerning movement of goods between the EU and the United Kingdom after 31 December 2020.

- The Slovak parliament approved a package of support for entrepreneurs, comprising the cancellation of a special banking tax, an increase in tax deductible fuel expenses (currently only 80% of the total cost of fuels is tax deductible), the introduction of higher criteria for statutory audits, and the implementation of a unified effective date for amendments to tax legislation, making them always come into effect on 1 January of the following year, unless special EU rules or other international treaties stipulate otherwise.

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