Tax and Legal Update

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Editorial

The state continues to focus on transfer pricing: last year, the financial administration carried out 249 inspections, assessing additional corporate tax of almost CZK 1.4 billion. If we add up the results of the inspections since 2014 when the financial administration began to look into the issue more systematically, we reach a figure of CZK 4.5 billion. In view of the state budget deficit, I do not expect the trend of transfer pricing inspections to ease in any way in the coming years but rather the opposite. The area thus certainly deserves our attention.

I am therefore happy that we can continue to pass on our experience to you at our traditional annual conference, and contribute to making sure the additionally assessed amounts are as low as possible. This year's Transfer Pricing Forum was exceptional, with record-breaking online participation, for which I would like to thank you.

For all of us, I hope that the remainder of the summer is pleasant, and that the schoolchildren may return to the school benches in September for a longer time than last year. Real social contact is irreplaceable, and this goes for children as well as for us adults. That is why I firmly believe that after the holidays we will be able to meet in person more often, and that the next Transfer Pricing Forum will again take place physically – of course, streamed in parallel via a platform, especially for those who would otherwise have to travel halfway across the republic to Prague.

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Transfer pricing remains under tax administrators' scrutiny

The financial administration has published information about its tax inspections focusing on transfer prices between related parties. In 2020, tax administrators carried out 249 inspections, assessing additional corporate income tax of CZK 1.4 billion, resulting from increases of taxable income or decreases of tax losses of almost CZK 7.9 billion. Compared with 2019, additionally assessed tax increased almost four times.

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Our recent experience has shown that the state has toughed up its procedures: whereas in the last period, the financial administration mostly only completed inspections commenced before the pandemic, it has become more active recently and initiated an increasing number of new transfer pricing inspections.

Beginning in 2014, the financial administration adopted a more systematic approach to transfer pricing when it introduced, among other things, a new separate appendix to tax returns for disclosing inter-company transactions and began to use information on the volume and nature of these transactions to select corporations about to be subject to a tax inspection. Since then, transfer pricing has been the key target during tax inspections.

Based on information published, in 2014-2020 tax administrators carried out a total of 2,431 tax inspections, in which it increased taxable income or decreased tax losses by a total of CZK 46.9 billion, resulting in additionally assessed tax of more than CZK 4.5 billion. The published table clearly shows that results fluctuate over time, probably depending on the state of completion of individual tax inspection, and that tax additionally assessed has been growing continuously.

Year	Additionally assessed tax (in millions of CZK)	Increase of taxable income including decrease of tax loss (in millions of CZK)
2014	59	504
2015	446	2 823
2016	886	13 286
2017	189	1 264
2018	1 216	18 038
2019	356	3 130
2020	**1 362**	**7 861**
	4 514	**46 906**

Source: MF CR

Considering the state budget's deficit, we cannot expect that the number of inspections focusing on transfer pricing will decrease in the upcoming years; instead, the opposite is more likely. For group entities, it will therefore remain vital to pay proper attention to this issue: set transfer prices in a correct manner and keep proper formal documentation of the pricing method. A proactive approach may also be useful, e.g., it is possible to apply for an advance pricing agreement (APA), i.e. an

assessment of the method in which prices between related parties have been set (GFD Instruction D-32).

APAs represent binding assessments by the tax authorities that are to provide taxpayers with a substantial level of legal certainty on selected transfer pricing methods, usually for three subsequent taxable periods.

New tax credit amounts per second and third child in 2021 taxable period

An amendment to the Income Tax Act, which is part of the amendment to the Act on State Social Aid and introduces a higher annual tax credit per second, third and any subsequent child while simultaneously abolishing the maximum monthly tax bonus limit of CZK 5,025 for the 2021 taxable period, was promulgated in the Collection of Laws on 27 July 2021.

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The tax credit per second child shall increase from an annual CZK 19,404 to CZK 22,320; the tax credit per third and any subsequent children from CZK 24,204 to CZK 27,840, in both cases retroactively for the 2021 taxable period. The tax credit per first child remains unchanged, amounting to CZK 15,204 a year.

In accordance with the amendment's transitory provisions, the new annual tax credit amount per second and third child can only be claimed in personal income tax returns or annual settlements of tax on wages for the 2021 taxable period. This change will not affect the monthly calculation of prepayments of income tax on wages earlier than 1 January 2022. The existing monthly tax credit amounts per second, third and any subsequent children shall be used for the rest of 2021.

The amendment to the Income Tax Act also removes an inconsistency arising from the abolishment of the annual limit for the tax bonus that may be payable to taxpayers if their child credit for the year exceeds their tax liability, put into effect via the tax package effective 1 January 2021, but without making necessary changes to keeping monthly payroll records. **According to transitory provisions, the monthly tax bonus amount limit remains unchanged for the rest of 2021**; subsequently, the final settlement will be made in the annual settlement of tax on wages or in income tax returns for 2021, as the maximum annual tax bonus amount was cancelled via the tax package.

Tips and tricks

Minimising penalties: how to claim a default interest waiver?

The January amendment to the Tax Procedure Code has brought relatively significant changes to default interest, introducing a single default interest rate for both tax administrators and taxpayers of 8% + repo rate. However, taxpayers have tools at their disposal that may further reduce or even eliminate the assessed interest.

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The basis for calculating default interest is the current income tax payable or a refund arising as a result of an unlawful tax deduction. The interest itself arises on the fourth day after the date on which the tax was originally due or the date on which a refund arising from an unlawful tax deduction was to be refunded. Taxpayers may claim a reduction of interest through a detailed review of the tax administrator's calculation, an application for tax deferment, the payment of a tax liability before its substitute due date, or through an application for the waiver of interest, which will be discussed below.

How to apply for a waiver?

According to the Tax Procedure Code, it is possible to apply for a waiver of default interest even if it has already been paid to the tax authority. Applications to waive tax-related charges and interest, through which taxpayers may apply for the waiver of default interest, have no prescribed structure. If the taxpayer applies for a waiver of the amount higher than CZK 3,000, they must pay an administrative fee of CZK 1,000 for each tax to which the application relates. Before filing the application, taxpayers must pay the tax the payment of which was defaulted and resulted in the origination of default interest.

When can default interest not be waived by the tax authority?

Just as for waivers of interest or penalty, the approach to waiving default interest is defined in GFD Instruction D-47, according to which default interest cannot be waived if the taxpayer has seriously violated tax or accounting regulations during the last three years. This may involve, e.g., taxpayers who are unreliable payers, taxpayers who were found guilty by final judgement of having committed some tax crime, or taxpayers who violated their duties in a manner deserving an additional assessment of tax according to whatever information and materials are available.

Violations of duties are assessed at the level of both legal entities and their statutory bodies.

To what extent may the tax authority waive default interest?

When assessing the extent to which default interest may be waived, the tax authority examines the following three criteria: i) justifiable reasons for default, ii) taxpayer's economic and social conditions, iii) frequency of tax duty breaches.

The basis for calculating the specific amount to be waived, ranging from 20% to 100%, is determined based on a percentage assigned to a specific justifiable ground. Relevant justifiable grounds include, e.g., payment of outstanding tax under a different variable symbol, the taxpayer suffering as a result of a natural disaster, or tax payment default of 15 calendar days or less from the date the tax was originally due. The tax authority may also consider other circumstances not specified in the above instruction to be justifiable grounds.

The tax authority subsequently considers whether the severity of the interest charged corresponds with the taxpayer's economic and social background. For legal entities, it evaluates whether any criteria for tax payment deferment have been met, for example, if prompt payment would result in serious damage for the taxpayer or in the cessation of the taxpayer's business activities. If any such reason exists, the percentage determined during the previous phase is increased. Finally, the

tax authority evaluates the frequency of tax administration duty violations. If such specific criteria are met, then default interest amount to be waived is decreased. These involve situations when, e.g., the tax authority reports tax arrears in respect of the taxpayer or when at least two penalties for the late filing of tax assertions were imposed on the taxpayer over the last three years. Continuous and proper fulfilment of one's tax duties thus helps maximise any reductions of default interest.

Subsidies

New programme period: one trillion Czech crowns and simpler procedures for applicants

At the end of June, the Czech Ministry for Regional Development held a conference entitled "Green and Digital Czechia? But What About People…", at which it presented the main goals and investment opportunities encompassed within the EU funds for the following programme period of 2021–2027.

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In the following seven years, the Czech Republic will have one trillion of Czech crowns available in programmes such as OP Technology and Application for Competitiveness (OP TAC), OP Jan Amos Komenský (OP JAK), Integrated Regional Operational Programme (IROP), OP Transport, OP Environment, OP Fair Transformation or Modernisation Fund.

Support will especially target the reduction of CO2 emissions, the circular economy, digitalisation, educational changes and assistance to regions most affected by structural changes (e.g. the discontinuation of coal mining), etc.

Moreover, applicants for support will benefit from several simplifications, e.g., relating to the method of reporting information during their project's implementation or mandatory publicity. Support should also be paid out quicker, as the number of inspections should decrease. The most significant change concerns **the methods of communication between applicants and evaluators**: applicants should get the chance to present their projects at the evaluation committee's meeting and correct their applications for support where correctable criteria are concerned, etc.

The above programmes are planned to be approved and individual calls announced at the end of 2021 or during 2022 at the latest.

Subsidies

Ministry of Industry and Trade presents Czech Hydrogen Strategy

The EU member states have committed to achieving climate neutrality across the EU by 2050. Following this obligation, the Ministry of Industry and Trade presented the Czech Hydrogen Strategy at an international hydrogen conference held on 16 July 2021.

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The Czech Hydrogen Strategy represents an important tool to achieve climate neutrality in the EU, with basic strategic goals involving **reducing greenhouse gas emissions and promoting economic growth**. These goals were used to determine the four pillars of the strategy, which are as follows:

- production of low-carbon hydrogen
- use of low-carbon hydrogen
- transport and storage of hydrogen
- promotion of hydrogen technologies.

To achieve climate neutrality, it is necessary to gradually transform industries and change technologies, since, among other things, the methods currently used to produce hydrogen in the CR release vast amounts of CO_2. The strategy does not only concern transport but also the chemical industry, the energy sector, energy-intensive industries, producers of hydrogen technologies and transport equipment, and the transport, distribution and storage of hydrogen.

The Czech Hydrogen Strategy is divided into three phases: the first focuses on the use of hydrogen under the clean mobility concept; the second, planned from 2026, involves operational industrial testing of the use of hydrogen. The third phase should start in 2031 when it is assumed that hydrogen will already be transported using well-established pipelines, without any need for subsidies. Likewise, it is also expected that the construction and repurposing of hydrogen pipelines will have commenced and that hydrogen will be commercially used in many industries.

To support the development of hydrogen technologies, the ministry is primarily planning to use existing programmes such as The Country for the Future, IPCEI or OP TAC. Other programmes organised by the Technology Agency, the Ministry of the Environment, the State Environmental Fund, the Ministry of Transport and the Ministry for Regional Development shall also be used for this purpose.

The Hydrogen Strategy is currently subject to intra-departmental comments. The final version will be published after its approval by the government.

Kurzarbeit finally given green light after one year

In a draft amendment to the Act on Employment submitted at the end of August last year, the Ministry of Labour and Social Affairs introduced its long-awaited concept for the provision of support during partial unemployment, the kurzarbeit (short-time working) scheme, initially meant to be adopted into the Czech legal system from November 2020. Kurzarbeit was meant to replace the Antivirus programme as early as in autumn last year. Nonetheless, it took almost a year to put the kurzarbeit scheme through.

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An amendment to the Act on Employment, promulgated in the Collection of Laws under no. 248/2021 and introducing the kurzarbeit scheme or a **contribution during partial employment**, has been in effect since 1 July. The contribution is determined by government whenever the Czech economy or some of its sectors are seriously threatened. Reasons for the provision of this type of support include an epidemic outbreak, natural disasters, cyberattacks, or any other extraordinary situations resulting from force majeure events.

Similarly as in the case of Antivirus, employers specified in Section 109(3) of the Labour Code, i.e. the state or institutions receiving contributions from the state budget, may not apply for this type of support. Contributions will also not be provided in respect of employees for whom a working time account was used.

Similarly as with Antivirus, kurzarbeit should support employment in emergency situations when employers have to partly curtail their operations and employees cannot perform work due to an impediment to work on the employer's part. Impediments to work include downtimes or work interruptions caused by adverse weather conditions, other impediments on the employer's part or partial unemployment, and must occur in direct connection with some of the grounds for providing the contribution.

Based on a notification filed with a relevant labour office, employers shall receive a contribution per each employee whose employment lasted at least three months at the date of filing the notification. Notifications shall be filed electronically. The contribution shall amount to up to 80% of expenses per employee (i.e. wages and mandatory charges) if both of the following conditions are met:

- At the time of impediments to work, employees are paid wage compensation equal to at least 80% of their average earnings.
- The employer cannot assign work to employees amounting to a minimum of 20% to a maximum of 80% of their weekly working hours due to the impediments to work. This condition is evaluated on an aggregate basis for all employees.

The monthly contribution amount is limited to a maximum of 1.5 times the average wage in the national economy in the relevant period and is paid out over a maximum period of twelve months.

Similarly as with Antivirus, employers shall submit monthly overviews of employee wage compensation expenses, i.e. monthly statements, electronically to the relevant labour office no later than on the 20th day of the calendar month following the month for which the contribution is to be granted. If the monthly statement is properly filed, the office shall pay out the contribution within eight calendar days of the date the statement was delivered.

The kurzarbeit scheme was finally given the green light. We will just have to wait and see whether it will meet all expectations and contribute to an overall economic benefit.

August brings significant changes to regulation of foreigners' residence in the CR

An amendment to the Act on Residence of Foreign Nationals has undergone a dramatic legislative process. After being vetoed by the senate and subsequently overruled by the deputies, the amendment was signed by the president and promulgated in the Collection of Laws effective 2 August 2021. The amendment changes the rules for issuing certificates and the definition of family members and introduces a widely criticised monopoly for foreign nationals' health insurance.

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The most discussed change arising from the deputies' amending proposal relates to health insurance: foreigners coming to the CR for a period longer than 90 days must conclude a comprehensive commercial insurance contract. The amendment does not allow them to choose their insurance company; instead, for five years, only insurance with VZP, a.s. shall be permitted. The change is controversial with respect to the adherence to economic competition rules but is supposedly vital to avoid unreliable insurance intermediaries and insufficient insurance coverage.

A further novelty is a change in the certificates issued to foreigners, especially third-country ones, as only certificates with biometrics will be issued to them from now on. Holders of older versions will have to have them replaced at the Ministry of Interior's office with local jurisdiction before 3 August 2023. In contrast, certificates issued for EU citizens remain unchanged (including their paper form) save their name, which is to change from EU Citizen's Certificate of Temporary Residence to Registration Certificate. Certificates issued earlier do not have to be changed.

EU citizens will not have to visit the authorities but will nevertheless also be affected by changes introduced by the amendment. They must prepare themselves for a new application fee charged for a registration certificate. Fees will also be imposed for applications for temporary residence, applications to prolong EU citizen's family members' residence cards or certificates of residence permits as well as applications for permanent residence of EU citizens and their family members.

A significant change was made to the age-old definition of EU citizens' family members. According to the amendment, distinction will be made between close (e.g. spouse) and distant family members (e.g. partner). Distant family members will be liable to stricter rules: when applying for a residence permit in the CR, in addition to regular essentials, they will have to support their applications with certificates of the family's aggregate monthly income after the reunion and certificates of travel health insurance providing comprehensive healthcare over the entire period of residence.

The amendment also responds to Brexit and the withdrawal agreement, introducing a special category of UK citizens' family members and imposing the duty to change certificates on Brits. They will have to replace their EU citizens' certificates of temporary residence or permanent residence with new biometric certificates before the end of August of the following year.

Legal

Amendment to Act on Banks

The implementation of CRR II and CRD V has been delayed. The amendment introduces changes to the responsibility of banks, credit unions and securities brokers and new authorisations of the Czech National Bank. Financial institutions must prepare themselves for a zero period between the force and effect of laws.

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In previous issues, we informed you about the Ministry of Finance's bill to implement the EU regulation of prudential requirements affecting mainly the banking sector. The parliament did not manage to pass the amendment within the expected deadline, and after having been referred back to the chamber by the senate, deputies will discuss it again.

Banks were supposed to proceed in accordance with the amendment to the Act on Banks from the end of 2020, or mid-2021. As a result of legislative delays, the amendment is likely to enter into effect on the date it is promulgated in the Collection of Laws. We therefore recommend monitoring legislative process developments closely.

One of the major changes introduced by the amendment is the cancellation of the principle of responsible banks, credit unions and securities brokers. This change relates to the fulfilment of prudential requirements pertaining to financial holding entities on a consolidated basis if the entities are controlling the financial institutions. According to the amendment, financial institutions will no longer bear responsibility for the fulfilment of duties across the entire group. Moreover, certain financial holding entities will fall under the supervisory authority's direct competence.

Another change is the transfer of the regulation of the range of group companies that are part of a consolidated group to the Capital Requirements Regulation ("CRR II"), effective from the end of June 2021;individual national regulations that have so far been in effect no longer apply. It is necessary to pay attention to this duplicity until the amendment to the Act on Banks enters into effect.

Under the amendment, financial institutions will have a new duty to report loans provided to members of statutory bodies, supervisory board, management boards and their related parties.

A new power will be added to the Czech National Bank with respect to auditors. The CNB shall be authorised to request that a bank replace its auditor if this auditor did not fulfil its duty to inform the CNB about certain negative findings during the bank's audit.

If you are uncertain whether you are fully in line with the new legal regulations or the Czech National Bank's requirements, our regulatory specialists will be happy to assist you.

New areas of unqualified trade

With the transposition of new EU rules aiming to prevent the use of financial systems for money laundering or the financing of terrorism into Czech law, new activities were added to 'unqualified trade' under the Trade Licensing Act on 1 January 2021: the provision of services for legal entities and trusts, and the provision of services related to virtual assets.

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The new activities are subject to stricter obligations than other areas within the unqualified trade. If either activity is to be carried out by a corporate entity, a clean criminal record is required for the entity's beneficial owner (as per the act on registration of beneficial owners) and any person who is a member of its statutory body, a representative of a corporate entity in such a body or a person in a position similar to that of a member of the statutory body. This means that in addition to other required enclosures, a list with the names of such persons must be attached when notifying the activity, unless such data can be obtained from a public register or from the register of beneficial owners; for foreign nationals, a certificate verifying their clean criminal record in their homeland is also required.

On 1 July 2021, an amendment to the government decree on the content of individual trades entered into effect, which defines the newly added areas of the activity in more specific terms. **The provision of services for legal entities and trusts includes,** e.g., acting on behalf of a client in the management or operation of a business corporation, and acting on behalf of a client in raising and collecting funds for the purpose of establishing, managing or controlling a business corporation. Also included are acting on behalf of a client in the establishment or management of a trust and services related to the formation of a trust, arranging for the registration of a trust in the register of trusts, facilitating the conclusion of a contract for the setting aside of property by entrusting it to the administration of a trustee, drafting such a contract or mortis causa disposition, setting aside property by entrusting it to the administration of the trustee, or drafting of the trust's statute. In contrast, the activity of notaries, the practice of advocates under the Act on Advocacy, the provision of investment services, the provision of payment services or real estate brokerage do not fall under this area of activity.

Services related to virtual assets include, in particular, the purchase, sale, exchange, safekeeping, management for another, transfer or brokering of the purchase or sale of a virtual asset, the issue of a virtual asset, the lending of a virtual asset other than consumer credit, as well as the provision of financial services relating to the offer or sale of a virtual asset and the provision of other similar services related to a virtual asset. In contrast, neither the actual extraction of a virtual asset nor the confirmation of transactions in a virtual asset fall under this area of activity.

We recommend that trustees and other involved persons make sure they comply with the new obligations by notifying these activities and ensuring the specified persons' clean criminal record to avoid penalties or restrictions of operations.

Alternative solutions to competition issues in Anti-Trust Office's decision- making practice

In the recent case, the Office for the Protection of Competition refrained from initiating sanction proceedings despite the alleged existence of an illegal price-fixing agreement. The office thus indicated its willingness to resolve some matters by means of competition advocacy, i.e. an alternative resolution of competition issues.

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Alternative ways to resolve competition issues

There are two possible procedures to be followed by the office that do not result in sanctions for competitors: the remediation of a competition issue without initiating proceedings, and the imposition of obligations on competitors.

Where the office has not yet initiated administrative proceedings and no public interest exists for their initiation, a competitor may be given the opportunity to undertake measures to quickly remediate the problem and effectively restore competition. If the office then believes that the remedy measures taken have been sufficient, the case may be closed without administrative proceedings. In cases where the harmful effect on competition is low, the office may even stay the case without dealing with it any further.

Where administrative proceedings have already been initiated, the office may impose obligations proposed by the competitors to effectively restore competition. Once the competitors fulfil the obligations, the office may rule to close the administrative proceedings without imposing a penalty.

Alternative solutions in the office's recent decision-making practice

In the recently assessed case, VETCENTRUM Duchek obliged its customers to only sell to end consumers and demanded that they should accept their recommended retail prices. During the investigation by the office, VETCENTRUM Duchek demerged. In the context of the demerger, the business terms and conditions were amended to no longer contain any anti-competitive provisions. Although the agreements were in fact never complied with, VETCENTRUM Duchek's legal successor Rebel Dog proposed to the office that they would explicitly inform their customers that such obligations were invalid and compliance with them would not be enforced or checked in any way. The company then also demonstrated to the office that they had indeed implemented the proposed measures. Since the competitor had only a minor market share, the agreements were not being fulfilled, their compliance was not enforced, and as the potentially harmful situation was remedied prior to the office's intervention, the office considered this case suitable for the use of alternative solutions to competition issues (competition advocacy). The office thus did not initiate administrative proceedings against the competitor and imposed no penalty.

In the past, the Office has used competitive advocacy for example in its investigation of Kaufland regarding listing fees, i.e. fees for the inclusion of goods for sale within Kaufland's network of shops). Once Kaufland undertook certain obligations, the office stayed the administrative proceedings.

The above cases demonstrate that competition issues can also be resolved before the office in alternative ways: without initiating administrative proceedings or by imposing obligations without a penalty. However, it should be borne in mind that competition advocacy is not always applicable and its use is limited, in particular in cases of unlawful mergers. If you have any questions regarding alternative solutions to competition issues or other competition law questions, please do not hesitate to contact our experts from KPMG Legal.

Case law

Tax and IT services for investment funds - exempted from VAT?

The Court of Justice of the European Union (CJEU) yet again dealt with the question of which services provided to collective investment undertakings can be exempted from VAT. In joined cases C58/20 and C59/20, the court outlined the conditions under which individual outsourced services such as tax advisory services or the delivery of a software solution for the management of collective investment funds may be exempt from VAT.

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Under the VAT Directive, services related to the management of collective investment funds may be exempted. Previous case law implied that services provided by a third party may be exempt from VAT if they form a distinct whole, fulfilling the specific and essential functions for the management of those collective investment funds.

In the first case, an Austrian investment management company purchased tax advisory services from subcontractors in the form of statements of taxable income and tax paid for unit holders; the tax advisor used data provided by the management company. The second case involved the purchase of a software solution that calculated risk and performance indicators of a fund, based on the investment company's data.

For both cases, the CJEU further specified that the distinct character condition cannot be interpreted as meaning the outsourcing of the service in its entirety. Although, according to the CJEU's case law so far, exemptions should be interpreted restrictively, in this case, the CJEU rather surprisingly noted that it is important to bear in mind the very purpose of the VAT exemption: to promote the access of small investors to the securities market. The joint management of investments within collective investment funds affords them the possibility of holding, despite a modest investment, a diversified portfolio that protects them against the risks associated with fluctuations of the value of securities and allows them to share the costs of expert management. In the absence of this exemption, unit holders in collective investment undertakings would be taxed more heavily than larger investors who directly invest their funds in securities and do not use fund management services. If a service that is specific to and essential for the management of a collective investment funds were subject to VAT simply because it is not outsourced in its entirety, that would favour management companies which provide that service themselves.

The CJEU concluded that services inherently related to the management of collective investment funds and provided exclusively for the management of such funds may be exempted even if the investment company purchases them from third parties. However, the court did not decide unequivocally whether the specific tax and IT services referred to in the cases in question could be exempted. The final assessment will be up to the national courts which will primarily have to deal with the fulfilment of the second condition: the service’s specificity to and essentiality for collective investment funds. As for tax advisory services, it will be necessary to verify whether the outsourced tax services correspond to the obligations specific to collective investment funds. As for software solutions, the CJEU indicated that the specificity condition might be met, as software was used to make the calculations necessary for the fund’s risk management and performance measurement required by Austrian laws.

Case law

Denying right to deduct VAT before entering bankruptcy compatible with EU directive?

The Court of Justice of the European Union (CJEU) has dealt with the refusal of the right to deduct VAT on taxable transactions carried out by a Romanian company before entering insolvency proceedings.

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A Romanian company registered as a taxable person entered insolvency proceedings following a court order. After the declaration of bankruptcy, a tax inspection was performed at the company. The tax administrator then issued an order to pay additional tax as a result of adjustments to VAT deductions on transactions carried out before the bankruptcy was declared.

The company appealed the order to pay the tax, but the financial administration dismissed the appeal: in its opinion, once the bankruptcy had been declared, the company had ceased to carry out its economic activity. The national court upheld this conclusion, confirming the initiation of insolvency proceedings as a reason to terminate the right to deduct, since any transactions carried out during the proceedings had no economic purpose and served solely to repay debts. The court also considered it irrelevant that the sale of assets within the insolvency proceedings had been subject to VAT. The court based its conclusion on Romanian national laws.

In this context, a prejudicial question was referred to the CJEU, asking whether initiating insolvency proceedings in respect of a taxable person (entailing the liquidation of its assets for the benefit of its creditors) automatically places an obligation on that entity to adjust VAT deductions made in respect of goods and services acquired before it was declared bankrupt. In other words - shall the economic activity of the taxable person be considered terminated on the grounds of a declaration of bankruptcy?

The CJEU concluded that as long as a company continues its economic activities, it competes with other taxable persons carrying out similar transactions. Thus, to maintain the principle of fiscal neutrality, its transactions in terms of VAT should be treated in the same way as those of competing undertakings. The initiation of insolvency proceedings does not prevent the company from carrying out its economic activity. Therefore, it is not possible to automatically deny that company the right to deduct VAT.

Case law

Disposal costs of part of new assets' input price?

With judgment No. 10 Afs 346/2020-43, the Supreme Administrative Court (SAC) has significantly contributed to clarifying when the costs of disposal of assets may be deducted from the tax base directly, and when they constitute investments and shall be included in the input price of new assets.

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The SAC dealt with a cassation complaint filed by the Appellate Financial Directorate (AFD) concerning costs related to the acquisition of new assets. The plaintiff was a company engaged in waste disposal. The heart of the dispute was whether the costs for the demolition of a K1 combustion boiler within the overall reconstruction of a waste incineration plant were related to the acquisition of a new K1 boiler.

As part of an extensive project taking place in 2011 and 2012, the company demolished a K1 combustion boiler. Within the same project, K2 and K3 boilers were demolished and replaced by new boilers that were put into operation in 2011. The K1 boiler remained in operation during the project implementation, to keep the incineration plant running. The subsequent costs of demolishing the K1 boiler were then deducted from the tax base, as an expense. However, based, among other things, on information about the company's future plans as disclosed in its annual reports, the tax administrator concluded that the demolition costs had not been operating expenses but rather related to the next phase of a project – the construction of a new K1 combustion boiler – and should therefore form a part of the entry price of the new K1 boiler.

Foremost, the SAC emphasised the initial necessity to clarify the nature of the demolition costs, i.e. whether they were related to the construction of a new K1 boiler (meaning the acquisition of a new investment). In the AFD's opinion, there was no doubt that the original K1 boiler was demolished to make way for a new one, within a continued investment project. The company, on the other hand, argued that the K1 boiler had been removed for safety and environmental reasons.

Previously, in judgement No. 7 Afs 365/2018-66, the SAC had held that when determining whether costs are related to an acquisition of assets, an unambiguous and direct causal link must exist between the costs incurred and the acquisition of the tangible assets. It is not relevant whether and when the taxpayer formally decided to acquire the assets, but when they actually started to acquire them.

From the evidence available, the SAC deduced that the original K1 boiler had been used during the project implementation to ensure the company's operation until the new boilers K2 and K3 could be put into operation. In the court's opinion, the two new boilers (K2 and K3) then fully replaced the three old boilers in terms of output, therefore the construction of a third boiler was not necessary for the operation of the company.

The SAC therefore concluded that there was no clear direct causal link between the demolition of the K1 combustion boiler and the investment plans for a new K1 combustion boiler; the court thus agreed with the company which claimed the costs as tax-deductible expenses.

The SAC's conclusion thus shows that when assessing whether expenses/costs are to be treated as costs for the acquisition of assets, it is necessary to determine whether there is a clear direct causal link between the expenses/costs in question and the acquisition of the new tangible assets.

News in brief, August 2021

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

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DOMESTIC NEWS IN BRIEF

- The new Building Act and amendments to related laws have been published in the Collection of Laws under No. 283/2021 and No. 284/2021.
- Act No. 269/2021 Coll., on identity cards, became effective on 2 August 2021. In connection with this, several other regulations (no. 270/2021 Coll.) have been amended and a decree implementing the act has been published. This legislation introduces a new type of ID card that will be harder to forge or abuse as it will contain a highly secure contactless chip and biometrics (the holder's facial image and two fingerprints), making it possible to travel without a passport.
- Financial Bulletin No. 30/2021 deals with the payment of VAT under the one-stop-shop regime (OSS) from 1 July 2021.
- Financial Bulletin No. 29/2021 discloses information on the accession of Hungary to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("Multilateral Instrument" or "MLI"). The same information was disclosed in Financial Bulletin No. 28/2021 regarding Croatia.
- Financial Bulletin No. 27/2021 discloses the following:
    - a list of countries exchanging reports under the Act on International Cooperation in Tax Administration (CbCR)
    - a list of contract states applying a common standard for reporting and decisive dates
    - a list for the purposes of meeting reporting duties (i.e. the reporting Czech financial institution informs the reported person who is an individual that they will collect and report information about the reported person before making the first report to the tax administrator).
- The Ministry of Industry and Trade organised a webinar entitled What is Trade like Half a Year after Brexit?
- The chamber of deputies passed an amendment to the Act on Sickness Insurance, extending options to obtain both long-term carer's allowances and carer's allowances. The amendment also modifies paternity leave, extending it to two weeks.
- The chamber of deputies approved a bill on children's day care groups. Care for children from six months until the commencement of their compulsory schooling will be more widely available due to stable and predictable financing. The amount to be paid by parents of children younger than three years shall be a maximum of CZK 4,000 monthly.
- Child benefits have increased by more than one fourth from this July. The range of families entitled to this type of support has also expanded.
- The Ministry of Industry and Trade has prepared an informative pension application (Informativní důchodovou aplikace (IDA)), providing comprehensive and comprehensible information about the number of pension insurance years reported in the system and the expected pension amount.
- The Czech customs administration launched an application for citizens for filing customs declarations for consignments costing less than EUR 150.
- The customs administration released information that temporarily, from 1 July 2021, VAT on the import of consignments costing less than EUR 22 from non-EU countries will not be collected. Further information is disclosed on Celnička.cz or the financial administration's website.
- An amendment to the VAT Act and the Customs Act, introducing new VAT- and customs-related rules for e-commerce (see also the two bullet points above) was referred back by the senate to the chamber of deputies.
- The senate referred back to the chamber of deputies a draft amendment to the Act on Banks (see also our separate article) with a single proposal to amend the Income Tax Act. The senate proposes to renew the exemption of

revenues flowing to Czech non-residents from bonds issued by Czech residents abroad, excepting revenues flowing to related parties, which had been cancelled via the tax package.

FOREIGN NEWS IN BRIEF

- Following an agreement on changes to international taxation reached by the OECD and G20, allowing for the taxation of profits in the market country regardless of physical presence (Pillar 1) and introducing a minimum tax of 15% (Pillar 2), the European Commission issued a factsheet on the recent agreement and implementation plans at the EU level. The method of implementing Pillar 1 in the EU has yet to be decided upon. Pillar 2, primarily aimed to reduce tax competition among the states, will be implemented via a directive setting a minimum global tax of 15% on profits consolidated at the level of controlling companies situated in the EU and establishes the tax non-deductibility of expenses to which the minimum tax was not applied. The pertaining FAQs can be found here.
- The European Commission continues in the consultation process for a legislative proposal aimed at mitigating the debt-to-equity bias in tax. The commission is considering either disallowing the deductibility of interest payments or creating an allowance for equity by enabling the tax deductibility of notional interest for equity.
- The European Commission released a package of reforms aimed at ensuring the EU meets its emission reduction goal of a 55 percent reduction of 1990 emission levels by 2030. There are four key pillars to the reforms, all being phased in over four years:
    - tightening of emission caps when trading with emission rights
    - expanding the sector coverage of emission rights to a broader scope of sectors
    - progressive withdrawal of free permits for emission intensive, trade exposed sectors
    - introduction of a carbon border adjustment mechanism, i.e. carbon tax on imports of certain goods into the EU.