KPMG

Tax & Legal

Taxes
Subsidies
Tips and tricks
Legal
Case law
In brief

September 2021

Obsah

Editorial

Taxes

New income tax credit

Subsidies

Fifth call under TREND

Ministry of Industry and Trade completes OP TAC preparations

Tips and tricks

Minimising sanctions: other options to reduce default interest

Legal

Changes in carer's allowance and paternity leave

Another step towards digitisation in corporate law

Case law

Lease of real estate via Airbnb considered business activity

SAC stands up for taxpayer over deducting costs of destroyed goods

Intermediation in sale of extended warranties not to be excluded from coefficient calculation

In brief

News in brief, September 2021

Editorial

Over time, we have become more or less used to COVID having done away with the old ways, and we no longer expect city centres full of tourists using Airbnb accommodation. Thus, it feels a bit awkward when the regulation of this activity does not follow current trends. Hence, when the Municipal Court in Prague confirmed last month that renting property through Airbnb platform constitutes a business activity, and therefore income from this activity falls under a separate tax base – income from independent gainful activity, rather than income from leases, this decision came a little too late. Be that as it may, the financial administration will surely be happy about the decision, unlike those providing such accommodation: they will now have to pay social security and health insurance premiums on the income, which was not necessary for income from leases; and the activity may also be subject to VAT.

Companies with many small receivables, as well as debtors from among individuals, may welcome the amendment to the Income Tax Act introducing a new tax relief for taxpayers who are creditors in discontinued enforcement proceedings. The amendment provides for the discontinuation of lengthy enforcement proceedings for small debts of up to CZK 1,500 without interest and penalties. For such discontinued enforcement proceedings, creditors will be entitled to compensation equal to 30% of the debt in form of an income tax credit.

I hope that you had a good rest over the summer and are ready for the new school year, and that we again will be able to meet in person in the upcoming months, without any major restrictions.



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New income tax credit

Recently published in the Collection of Laws, an extensive amendment to the Enforcement Procedure Code and Civil Procedure Code among other things contains an amendment to the Income Tax Act introducing a new income tax credit for taxpayers in the case of discontinued enforcement proceedings. The amendment will enter into effect on 1 January 2022.



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The amendment allows for the discontinuance of excessively long enforcement proceedings concerning low-value receivables. Where enforcement proceedings pertaining to a receivable not exceeding CZK 1,500 excluding interest and penalties continue for more than three years without resulting in the recovery of debt, within the three months of the amendment's effective date, bailiffs should call on the entitled party (usually the creditor) to deposit an advance for expenses for enforcement proceedings. Without such advance deposit, bailiffs will discontinue the proceedings.

If proceedings are discontinued in this manner, creditors shall be entitled to compensation equal to 30% of the receivable being recovered (excl. interest and penalties). However, compensation will not be provided in a monetary form but as an income tax credit for discontinued enforcement proceedings. The credit amount equals the compensation awarded to the creditor by the bailiff upon the discontinuance of proceedings: compensation for the discontinued proceedings equals 30% of the receivable being recovered.

If the taxpayer in the relevant taxable period does not report any tax from which the credit can be deducted (i.e. the taxpayer recognises a tax loss), the credit shall forfeit and the creditor shall not receive any compensation or relief for discontinued proceedings.

Considering the above receivable value limit, it can be expected that this new income tax credit will mainly be used by payers of personal income tax; however, it may also be useful for corporations with a large number of low-value receivables, as further tax savings through this type of credit can be obtained if a greater number of discontinued enforcement proceedings are involved.

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Subsidies

Fifth call under TREND

The Technology Agency of the Czech Republic (TA CR) will probably announce the fifth call to participate in the TREND programme, subprogramme 1 – Technology Leaders, only in December 2021. The original September date has been postponed due to the ongoing preparation of the National Recovery Plan.



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The call will again be aimed at supporting research, experimental development, and innovation. The Technology Leaders sub-programme is specifically intended for projects focusing on the creation of research and development results and their use in the applicants‘ own business activities. Projects should involve manufacturing, digital, and cyber technology areas, such as advanced manufacturing technologies and materials, microelectronics, artificial intelligence or IT security, etc.

Large enterprises will also be able to submit project proposals, either on their own or in cooperation with other participants. **Support will also be available to applicants located in the capital city of Prague**. Maximum aid amount is expected to be up to CZK 40 million per project, aid intensity up to 70% of eligible costs, depending on the size of the project and the nature of the development activity. Operating costs will be supported within eligible costs.

The above parameters are preliminary, as the official parameters for the call have not yet been announced. We will keep you informed about further developments.

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Subsidies

Ministry of Industry and Trade completes OP TAC preparations

According to the Ministry of Industry and Trade, preparations for a new Operational Programme Technology and Application for Competitiveness (OP TAC) for the 2021–2027 programme period have been officially completed. The programme has already been presented by the ministry earlier. OP TAC is to replace the existing OP Enterprise and Innovation for Competitiveness.



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The new programme period was originally planned to begin at the end of this year; however, relevant EU legislation did not come into effect sooner than at the end of June 2021 and, consequently, preparations for OP TAC have just now been completed. First calls to participate in this programme are expected to be announced in March 2022.

Total funds for allocation shall amount to EUR 3.2 billion, i.e. approx. CZK 81.5 billion, and shall be distributed to five priority channels. Most support shall be directed at strengthening the performance of businesses in the area of research, development and innovation, and their digital transformation. The second most supported area shall be a shift towards the low-carbon economy. Support will be provided in form of subsidies or via financial instruments (a repayable type of support) or by a combination of both.

OP TAC mainly aims to mitigate the negative effects of the pandemic and enhance the productivity of local businesses while promoting their shift in global value chains, ultimately resulting in strengthening the Czech economy and increasing the standard of living in the Czech Republic. Support will mainly target small and medium-sized businesses but will also cover large business involved, e.g., in the energy industry and in research and development.

The OP TAC programme paper is currently being examined by the Ministry of Environment. After its approval by the government, it will be submitted to the European Commission for formal review.

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Tips and tricks

Minimising sanctions: other options to reduce default interest

As a sanction associated with an additionally assessed tax, default interest can often be more severe than a penalty. Default interest waiver options, discussed in the previous issue of the Tax and Legal Update, are very limited where tax inspections are involved. However, there are other options available to taxpayers to further reduce, or even eliminate, default interest: applying for the deferment of the tax payment or paying the tax before its substitute due date.



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What is deferment? What are its benefits? How to apply for deferment?

Deferment is the permitted postponement of the tax payment and may take two forms: deferment of the tax payment or the payment of tax in instalments. During the deferment period, no default interest arises, rather interest on the deferred tax amount; the latter amounting to half the default interest. This type of interest accrues over the entire period of deferment. The Tax Procedure Code also allows for retrospective deferments of tax payments, from the original due dates, ultimately resulting in a reduction of the entire default interest. However, retrospective deferments are rather rare in practice; tax administrators most often agree with deferments from the date an application for deferment is filed. It is also possible to apply for a waiver of the interest on the deferred tax amount under similar conditions as in the case of default interest. The mere existence of deferment constitutes grounds for waiving 20% of the interest on the deferred tax amount, provided that other waiver conditions have been met. The ultimate reduction of interest may therefore be even higher.

It is only possible to defer a tax payment in situations specified by law, such as when the prompt payment of tax would severely harm the taxpayer, or if the outstanding tax cannot be collected all at once. Deferment applications have no prescribed form or structure; taxpayers may use the example posted at the financial administration's website as a template. When filing an application, it is essential to state the legal grounds on which the taxpayers ask for deferment and provide all necessary supporting documentation. We also recommend outlining how the taxpayer will pay the tax in the future to prevent the tax authority from coming to the conclusion that the tax will be irrecoverable, which may, in extreme situations, result in a securing order or enforcement proceedings. The submission of an application is liable to an administrative fee of CZK 400.

Early tax payment

Another option to reduce default interest is the payment of an expected additionally assessed tax before its substitute due date. In the case of a tax inspection, any additionally assessed tax is payable within 15 days of the date of a final and conclusive judgment (typically in appeal proceedings). However, default interest starts accruing from the original due date, i.e. the deadline for filing an ordinary tax return. Tax paid early constitutes an overpayment on the person's tax account that is to be used to settle additionally assessed tax. To avoid any potential doubt, we recommend explicitly requesting the use of this overpayment. This early tax payment may

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completely stop the accruing of default interest from the date the tax was paid. If the tax was not additionally assessed by a final and conclusive judgment, the taxpayer may apply for a tax overpayment refund. The money 'saved' in this manner with the tax authority does not bear any interest, and no entitlement to interest arising from the tax administrator's unlawful conduct arises over the time of the early tax payment, even if the additionally assessed tax is subsequently cancelled by the court.

According to the legal regulation effective until the end of 2020, any other tax overpayment should have the same effect as the early payment of tax, irrespective of whether such an overpayment was refunded in the meantime and thus not used to settle any additionally assessed tax. Excess VAT deductions were typical examples. We therefore recommend reviewing in detail the calculation of default interest, especially with respect to tax additionally assessed some time ago, and demand the use of tax overpayments via an appeal.

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Changes in carer's allowance and paternity leave

Ensuring equal opportunities for men and women and work-life balance have long been pressing issues on the European Union's agenda, going hand in hand with the effort to allow fathers to be more involved in raising their children. One of the tools to promote these objectives is Directive (EU) 2019/1158 on work-life balance for parents and carers (the Work-Life Balance Directive), which should be implemented in the Czech Republic by early August next year. Some changes have been already reflected in the amendment to the Sickness Insurance Act, becoming effective from 1 January 2022.



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One of the approved changes is the extension of the period for drawing paternity benefits following the birth of a child. Paternity benefits are mainly available to new fathers who have been covered by sickness insurance for a stipulated period of time and are stated in the child's birth certificate. So far, they could draw a week of paid paternity leave within the first six weeks after the birth of the child; now it'll be two weeks. At the same time, the deadline for drawing the benefits will be extended by the calendar days during which the child was hospitalised for the child's or the mother's health reasons during the first six weeks (for instance, if the child had to be in an incubator), meaning that paternity benefits may also be drawn after the six-week period (from the birth of the child) has expired. Also, paternity leave may be taken by another person (regardless of gender) who has taken a child into care substituting parental care; here, the condition is that the child must not have reached seven years of age at the date of being taken into care. In these instances, only the extension of the paternity leave period applies, not the extension of the deadline for drawing it. The amount of paternity benefits, i.e. 70 % of the daily assessment base per calendar day, remains unchanged.

The amendment also introduces changes in drawing long-term carer's allowances. As before, the allowance shall be available to persons covered by sickness insurance who are caring for a person who has been hospitalised due to a serious health disorder and can be expected to need long-term care for at least 30 calendar days. However, now a four-day instead of a seven-day hospitalisation will be sufficient for the carer to qualify. The application deadline for a decision on the need of long-term care for the purpose of obtaining a carer's allowance has been extended by eight days after the end of the hospitalisation. Furthermore, if care for the terminally ill requiring palliative and long-term care at home is concerned, it will be possible to draw carer's allowances even without prior hospitalisation. Standard carer's allowance will also be available to persons who do not live in the same household with the person being cared for.

The EU Work-Life Balance Directive should also make it easier to balance work and family responsibilities, e.g. by introducing the option of working from home, although employers will have the right to refuse this on reasonable grounds. In other EU countries, the right of parents of children under the age of eight to ask employers for a flexible distribution of working hours or the obligation to divide parental leave between both parents so that each parent has at least two months of parental leave non-transferable to the other parent may be an interesting

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novelty. In the Czech Republic, however, the use of either model is unlikely, as parents can already apply for a different working time arrangements, and both can take parental leave at the same time. Restrictions only apply to parental benefits which can only be paid to one of them. It thus seems that the extension of paternity leave will be the most significant change that the directive will bring to the Czech Republic.

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Another step towards digitisation in corporate law

The Ministry of Justice has prepared a bill to implement into Czech law further changes arising from the EU directive as regards the use of digital tools and processes in corporate law. The related amendment to the Notarial Code has already entered into effect.



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The new legislation aims to transpose Directive (EU) 2019/1151 of the European Parliament and of the Council of 20 June 2019 amending Directive (EU) 2017/1132 as regards the use of digital tools and processes in company law. The directive aims to allow for the formation of companies (at least limited liability companies) fully electronically, and for the use of digital tools throughout a company's further lifecycle, in particular by creating model memoranda of association and making it possible to electronically register data in public registers, file documents in the collections of deeds, or establish branches in other states.

In this context, an amendment to the Notarial Code and the Act on Administrative Fees was published in the Collection of Laws and took effect on 1 January 2021. The amendment to the Notarial Code introduces, among other things, the possibility to prove a person's identity and determine their will as to what content is to be entered in the notarial record without that person's physical presence, by videoconferencing with the simultaneous use of electronic identification means. The amendment will thus in some cases allow for drafting, e.g., a company's memorandum of association without the need to physically appear before a notary. This means that, starting September, it will be possible to form a company fully online.

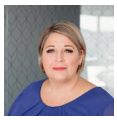
Furthermore, the Ministry of Justice has prepared a bill to amend certain laws in connection with the use of digital tools and processes in company law and the functioning of public registers. The bill incorporates the above outlined objectives of the EU directive in the Trade Licensing Act, the Act on Court Fees, the Corporations Act, and the Act on Public Registers of Legal and Natural Persons and on the Registration of Trusts. The effective date has been proposed for 1 July 2022. For newly formed corporate entities, the bill introduces an option to choose in what phase of the incorporation process they will notify their trade or apply for a licence: before or after filing for registration in the Commercial Register. It will therefore no longer be necessary to wait with the registration in the Commercial Register until a trade licence is obtained.

The bill also redefines the incapacity to exercise the office of a member of business corporation's elected body. So far, integrity as defined under the Trade Licensing Act was taken as a basis for this purpose. Now, there are three reasons for the incapacity to exercise an office: a decision of a Czech or foreign public authority banning the person from exercising an office; reasons related to insolvency; or convictions for selected crimes. The bill also proposes a regulation for the establishment of a non-public register of persons thus excluded from exercising an office of a member of an elected body of a corporation, as foreseen by the European regulation. The register should allow for the exchange of information on persons with an impediment to exercising an office between member states. The bill is only in the early stages of the legislative process, so the proposed wording is still expected to change. However, the basic points outlined above should be maintained, in line with the EU regulation.

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Lease of real estate via Airbnb considered business activity

The Municipal Court in Prague confirmed that the provision of short-term leases via Airbnb meets the criteria of a business activity. Consequently, income from this activity shall be included in a separate tax base as income from an independent activity, rather than income from leases. The decision significantly affects other areas, such as VAT or social security and health insurance, as unlike income from leases, income from independent activity is liable to such insurance premiums.



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The tax authority for the capital of Prague called on an individual to file an income tax return on the grounds that income from a lease contract generated by this taxpayer in the 2017 taxable period should have been included in a separate tax base for the taxation of income from an independent activity. The individual did not agree with the tax authority and included this income in a separate tax base for the taxation of income from leases arguing that the lease at issue only involved the provision of a "bare" lease, without any ancillary services.

The tax authority maintained its position claiming that the substance of accommodation services via Airbnb consists in the provision of short-term accommodation including services such as the provision of soap, towels, bedlinen, etc., which by its nature meets the criteria of an entrepreneurial/business activity. The tax authority further argued that since the individual received payments once every two days on average, the lease could not have been long-term but rather involved the provision of accommodation services even if no ancillary services were rendered. The Municipal Court in Prague sided with the tax authority and dismissed the action on this matter (6 Af 20/2020-28).

The court took into account the nature of entrepreneurial/business activities and the definition of business in the Civil Code and the Trade Licensing Act while also applying available foreign case law under which the short-term nature is a typical feature of leases for business purposes. The court noted that an entrepreneur is a person who independently performs gainful activity, on their own account and responsibility, as a trade or in any similar manner with the intention to do so consistently for profit.

The court also emphasised that the purpose of a lease should be the provision of housing needs. In contrast, accommodation provided via Airbnb does not satisfy anybody's housing needs but only the need for temporary accommodation and, consequently, must be treated as an accommodation service. Other features typical for accommodation services are, e.g., the provision of ancillary services such as cleaning, ensuring regular maintenance or setting price for short periods of time. In the opinion of the court, it is not essential whether the lease is defined as a "bare" lease (i.e. without any ancillary services), but in what manner the activity is carried out. The court therefore concluded that in this case, the individual's income was generated from an activity showing the signs of a business activity and not of a lease.

The court's decision confirmed the tax administrators' existing practice. The decision may certainly be applied to

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similar short-term leases, whether or not offered via other internet portals.

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Case law

SAC stands up for taxpayer over deducting costs of destroyed goods

The Supreme Administrative Court (SAC) upheld a taxpayer's cassation complaint in a dispute over the legitimacy of claiming costs/expenses for destroyed goods. According to the SAC, without informing the appellant the appellate body assessed the issue differently from the tax administrator, concluding, without this being supported by the relevant file, that the taxpayer failed to prove the deductibility of the expenses. The principle of two-instance administrative proceedings was thus breached.



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In the case in question (1 Afs 70/2021 – 40), the taxpayer disposed of inventories after these had been irreversibly damaged (plants worth CZK 3.5 million destroyed by frost). After their disposal, the taxpayer only received CZK 3,000 for sold planters/pots. The tax administrator did not accept the original value of the plants as a tax-deductible expense.

The Appellate Financial Directorate then changed the assessment of the facts of the case, without informing the party to the proceedings. By this, as the SAC emphasised, the principle of two-instance administrative proceedings was breached. The SAC referred to existing case law (e.g. 6 Ads 134/ 2012-47), which emphasises that if in remedying the shortcomings of a first-instance decision, the appellate administrative authority intervenes in the continuity of the administrative proceedings in this way, it may infringe on the participant's rights.

In its decision, the SAC reiterated the conditions that are, under current case-law, seen as necessary for the tax deductibility of costs/expenses:
1. the expenses were actually incurred;
2. the expenses were incurred in connection with the generation of taxable income;
3. the expenses were incurred in the relevant taxable period; and
4. the law stipulates that they are tax-deductible expenses.

In the case in question, the SAC believed that the burden of proof as regards supporting the tax deductibility of the expenses had been carried by the taxpayer. In contrast, the SAC pointed out the unacceptable and purely speculative approach by the tax administrator – and subsequently the Appellate Financial Directorate – where witness statements and certain other circumstances were interpreted selectively against the taxpayer. The SAC further noted that any doubts about the records of goods should lead to asking for further evidence, rather than treating all such expenses as non-deductible.

According to the SAC, the amount of CZK 3.5 million by which the value of the goods being disposed of decreased due to frost damage was a tax-deductible expense. The disposal was carried out properly, as evidenced by witness statements. Inconsistencies in the testimonies are understandable, as five years elapsed since the liquidation, and this does not disprove the facts of the case as presented by the taxpayer.

The SAC concluded by noting that in this type of disputes (where external factors such as weather play an

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important role), tax authorities are obliged to consider the limited scope of information available to the taxpayer. If, after taking evidence, they do not discover any "fundamental facts disproving" the taxpayer's assertions, they cannot categorically exclude the entire expense as tax non-deductible.

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Case law

Intermediation in sale of extended warranties not to be excluded from coefficient calculation

The Court of Justice of the EU (CJEU) denied the full entitlement to VAT deduction to a company providing extended warranties during sales of goods. The sale of extended warranties may not be treated as a financial activity, ruled the court.



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Rádio Popular, a Portuguese company selling household appliances and electronics, offered to its customers an ancillary service involving the sale of extended warranties for purchased goods, and regarded this service a financial activity exempt from VAT. Moreover, they excluded this activity from the calculation of the coefficient used to determine the reduced (proportionate) entitlement to VAT deduction, arguing that this activity was an ancillary financial activity. The company then claimed the full entitlement to the deduction of VAT on all received taxable supplies.

During a tax inspection at the company, the Portuguese tax authority argued that Rádio Popular had been acting as an intermediary of insurance, rather than financial services. Consequently, this type of ancillary services may not be excluded from the calculation of the coefficient to determine the entitlement to VAT deduction in a reduced (proportionate) amount. As a result, the tax authority denied the full entitlement to VAT deduction to the company.

In its judgment (C-695/19), the CJEU first confirmed that Rádio Popular had indeed acted as an intermediary of insurance services. Then the court dealt with the issue whether these services can be excluded from the coefficient calculation as ancillary financial activities, i.e. it examined whether the mediation of insurance services can be regarded as ‘ancillary financial activity’.

The CJEU emphasised that the term ‘financial activity’ must be interpreted strictly, as the exemption of financial activities from VAT constitutes an exception to the general rule that all services are liable to VAT. Consequently, insurance activity may not be regarded as financial activity. Intermediation in the sale of extended warranties thus cannot be excluded from the calculation of the coefficient to determine the proportionate VAT deduction, since this type of activity does not represent an ancillary financial activity.

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News in brief, September 2021

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



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DOMESTIC NEWS IN BRIEF

- The Ministry of Finance has submitted an amendment to the Act on Excise Duties for external comments. The amendment implements an EU directive setting common rules for excise duties within the EU. The amendment has been proposed to enter into effect on 1 November 2022 and 13 February 2023.
- The Ministry of Finance has published the first bill implementing DAC 7, bringing about the automatic exchange of information received from digital platform operators, proposed to be effective 1 January 2023.
- Detailed information on the payment of VAT using a one-stop-shop mechanism from 1 July 2021 and the Ministry of Finance's decision to extend the existing waiver of tax on certain specified taxable supplies relating to respirators from 1 September 2021 to 31 October 2021 have been published in Financial Bulletin No. 30/2021.

FOREIGN NEWS IN BRIEF

- The European Commission has informed that the EU digital levy is on hold until a final agreement on the new international taxation rules at the OECD level is reached, as the agreement will also significantly affect the digital economy sphere.
- The OECD has published a taxation working paper focused on how research and development (R&D) tax incentives influence effective corporate income tax rates. The paper acknowledges that R&D tax incentives are the most common tax policy instrument employed by OECD countries to encourage innovation. For more information, please see the paper here.
- The OECD has released updated transfer pricing country profiles for 20 jurisdictions out of 60. The update includes new information on the transfer pricing treatment of financial transactions and the attribution of profits to permanent establishments. Further updates are expected in 2021 and in the first half of 2022. More information can be found in the country profile database.
- Poland has released details of the tax reform being prepared (the 'Polish Deal'). Proposed key changes inter alia include relaxing the conditions for establishing and operating tax capital groups; introducing a new holding company regime; a suite of innovation-targeted tax reliefs, including incentives for hiring innovative employees, prototype relief covering test production, incentives for making initial public offerings (IPO) or investing in IPOs, robotisation relief, as well as enhanced R&D incentives. Most changes should become effective as early as from 2022.

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