Tax and Legal News

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Building a better working world

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Czech aid to Ukraine

After more than two years of COVID, many people (myself included) were looking forward to the arrival of this spring as the time when life would finally return to its old, quiet ways. It didn't. The events in Ukraine could not leave untouched even those who've been fighting the virus in their own way by pretending it didn't affect them. The current situation painfully and deeply affects every one of us.

From a tax perspective, the topic of solidarity and aid to Ukraine is currently at the top of the list of issues being discussed (even when the time of financial statements, audits and tax calculations is at its height).

The most frequent question remains the possibility of deducting monetary gifts to various Czech and foreign organisations or directly to individuals and the related question of taxation for the gift recipient (including situations where the recipient is an employee or his/her family member). And because the Czech nation is generally very resourceful, it doesn't just stick to these classic forms of aid. We are also dealing with the tax implications of free accommodation, various forms of in-kind donations, organising employee fundraisers or paying wage compensation for volunteer work. What do you think – can the free-of-charge provision of alcoholic beverages (obviously in the context of a martial conflict) be considered a donation fulfilling a humanitarian and charitable purpose, or will this purpose only be fulfilled in the case of drinking water? What about fizzy drinks?

When it comes to creativity, it seems even the legislator didn't want to be left behind. The first draft of the related Income Tax Act amendment has thus seen the light of day in a very unconventional way in the form of transitional provisions. In the end, however, the Finance Minister abandoned this innovative concept and a brand new Bill on tax measures in connection with the armed conflict on the territory of Ukraine caused by the invasion of the Russian Federation (Parliamentary Document No. 173) was circulated to MPs on 9 March 2022. In addition, Questions and Answers regarding this bill were published in a lightning-fast manner on the Financial Administration website (even before discussion of the bill in the Chamber of Deputies began).

The Government's efforts should result in a temporary increase in the limit on the deductibility of donations up to 30% of the tax base and an expansion of the qualified purpose of the donation to support Ukraine's defence efforts. The scope of entities to which donations can be made in 2022 has also been expanded, specifically to the Ukraine State and to natural and legal persons residing or having their registered office in Ukraine. Similarly to the time of COVID, the bill allows the possibility of claiming the relevant expenses for in-kind donations made in 2022 directly in tax deductible expenses (of course, in such a case said expense cannot be claimed again as a tax-deductible item).

However, it is important to note that even after the adoption of the proposed amendment, it will not be possible to deduct from the tax base gifts made across the board to any natural persons, but only to those who meet the conditions regarding their status already defined by law. This includes a relatively narrow range of persons, e.g. those on a disability pension, minor children, persons running medical or school facilities or animal welfare facilities. In the case of gifts to individuals, it may therefore be preferable to use the method of claiming the related expense directly as a tax deductible expense (again, however, only for gifts in kind).

In any case, we acknowledge – with appreciation – that the draft legislation came very quickly. It's just a pity that the government hasn't taken the same constructive approach regarding VAT. Here, the existing legislation applies in full, which means, among other things, that in many cases a taxpayer making an in-kind donation may not be entitled to deduct the related input VAT (more on VAT implications in our next article).

However, many more tax issues exist in relation to the situation in Ukraine. Examples include questions about the accounting and taxation of exchange rate differences or allowances for bad debts, the never-ending area of transfer pricing (which group company should bear incurred losses?) or the VAT implications of exporting goods or services to Ukraine. A number of non-tax issues also need to be addressed – increasing pressure to comply with AML obligations, interpretation of the concept of force majeure (again?), the possibility of sanctions in the event of early termination of contractual relations or failure to comply with a contract, immigration regulations and so on.

Hopefully, by the time you read this editorial, the current conflict will be heading towards some kind of peaceful resolution or the semblance of one. Fingers crossed.

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VAT

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VAT impacts of the war in Ukraine

The war in Ukraine means VAT payers often have to deal with unexpected tax challenges. In this article, we'd like briefly to address a few of these issues.

Aid to Ukraine and refugees

The first heading relates to the various forms of assistance provided by Czech companies.

While the Financial Administration has published its position on selected types of aid (for details in Czech, see HERE), this is limited to (i) the sale of goods domestically to humanitarian or charitable organizations (which then transport the goods themselves to Ukraine), (ii) the provision of material donations, and (iii) financial donations. Thus, it doesn't cover all situations that taxpayers encounter in practice.

In general, the published interpretation is none too benevolent and emphasises the obligations of payers (especially the burden of proof) under the law. For example, for material gifts, it explicitly states that a payer who purchased goods directly with the intention of donating them (i.e. the acquisition was not related to that payer's economic activity) is not entitled to deduct input VAT.

According to available information, there are discussions at the EU level on the possibility of temporarily relaxing VAT rules at least for some selected types of goods (food, toiletries, clothing or medicines), but at the moment it's difficult to predict the outcome.

A very common situation we encounter in practice is the provision of free services to people fleeing the war in Ukraine. The application of VAT varies depending on the specific type of supply. For example, it may be:

- The provision of services entirely free of charge for charitable reasons, i.e. unrelated to the economic activity of the payer. Here, a similarly strict approach as for supplies of goods can be expected.
- The provision of a service free of charge to its recipients, but with a portion of the cost covered by a third party contribution (typically from the state, regions, municipalities or charities). In general, it can be argued that such a payment constitutes a consideration on which output VAT will be deducted and therefore the right to deduct input VAT will remain.
- A less common category may be the provision of services free of charge with the primary purpose of attracting new customers (i.e. as part of an economic activity). In such a case, input VAT claim may be considered (applying the standard rules).

The Financial Administration information also completely omits some forms of delivery of goods. For example, it may be a situation in which the payer delivers goods to Ukraine by their own means or through a carrier and then donates the goods in Ukraine. It is also not uncommon for goods to be delivered for payment to a person who, although not a humanitarian or charitable organisation, subsequently delivers the goods to Ukraine themselves or through other persons.

Disruption of supply chains

In addition to providing assistance, we very often encounter issues related to supply chain disruptions, in particular the reconfiguration of supply chains or dealing with emergency deliveries, which necessitate dealing with downstream tax and customs obligations.

International sanctions

At the same time, companies doing business with Russian and Belarusian customers must closely monitor the impact of international sanctions. These can be broadly divided into export restrictions (from the EU), import restrictions (to the EU) and other prohibited activities. A broad category of banned exports consists of so-called luxury goods, which also include alcohol, clothing and sporting goods. In terms of imports, the trade in iron and steel has mainly been affected, but it can be expected to expand to other areas. When dealing with business partners, it is again important to bear in mind that the ban applies not only to companies on the sanctions list, but also to companies owned or controlled by sanctioned companies.

These sanctions do not necessarily apply only to deliveries to/from Russia or Belarus – they may also apply to deliveries to other countries, if the Czech company is a subcontractor of the customer affected by the sanctions.

We therefore recommend not to underestimate the screening of existing and future business partners. If you're interested, we'll be happy to help you check your portfolio of customers and suppliers. We're able automatically to enrich your data from the list of suppliers or customers with data from public registers or information about the statutory bodies and owners of these entities. We then screen the entire set of these entities for possible appearance on current sanction lists. We'll then support you in connection with the assessment of the identified risks and, if necessary, with follow-up legal services (termination of existing contracts or modification of contract templates for possible future changes, etc.).

If you have any questions, please contact either the authors of the article or your usual EY team.

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Cryptocurrency


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Financial administration information on cryptocurrency

On its website, the Financial Administration published information on the tax assessment of cryptocurrency transactions (for more in Czech, see HERE). Its aim is to familiarize tax entities using cryptocurrency with the tax obligations arising from cryptocurrency operations. Below are selected insights from this information.

VAT

- Bitcoin, or cryptocurrencies, are alternative means of payment for VAT purposes, which are used in a similar way to legal tender.
- If a taxable person carries out cryptocurrency "mining" for their own purposes, this mining is not subject to tax as there is no direct link or contractual relationship between the taxable person and the recipient (however, the situation where the taxable person hires/leases technological equipment for cryptocurrency mining should be treated differently).
- A taxable person who provides a service consisting in the exchange of cryptocurrency into fiat currency and vice-versa for a consideration (e.g. exchange fee, transaction fee) carries out an exchange activity which is exempt from tax without entitlement to a tax deduction. The same tax treatment will apply to the exchange of cryptocurrency for consideration. Exchange activity in the broad sense is not limited to banks, but can also be carried out by any other legal or natural persons, e.g. traders or so-called cryptocurrency exchanges.
- If a taxable person trades in cryptocurrencies (i.e. buys and sells cryptocurrencies) for the purpose of earning regular income, and not just as part of the management of personal assets, that taxable person is carrying out an economic activity. The activity of trading in cryptocurrency for the purpose of generating regular income can be treated similarly to an operation involving money, which is a financial activity and is exempt from tax without deduction.

Corporate income tax

- From an accounting perspective, it is recommended that virtual currencies be accounted for as "one-of-a-kind" inventory.

- Since the Income Tax Act (ITA) does not contain any special regulation for transactions with cryptocurrencies, the correct accounting of the transactions in question is crucial for the purpose of determining the income tax base. The basis for determining the corporate income tax base is therefore based on the profit or loss determined in accordance with Czech accounting regulations.

- Cryptocurrency mining is subject to the same tax treatment as self-production under corporate income tax.

- Buying and selling goods/services for cryptocurrency – this is an exchange and is viewed as a purchase and sale of an item for tax purposes. Income from the exchange of cryptocurrency for another item (or service) is taxed as income from the exchange in the tax year in which the income is earned. Income arising from the exchange of a cryptocurrency for another cryptocurrency is taxed in a similar manner.

- Cash income from the sale of cryptocurrency is taxable as income from the sale of intangible movable property ("one-of-a-kind" inventory). The value of the cryptocurrency as recorded in the books of account will be applied as a tax deductible expense.

- Cryptocurrencies will not be measured at fair value at the balance sheet date.

Personal income tax

- Income from transactions with cryptocurrencies is subject to income tax – it may be either income from self-employment pursuant to § 7, or income from the rental of movable or immovable property paid for with cryptocurrency pursuant to § 9, or other income pursuant to § 10 of the Income Tax Act.

- The decisive factor for the classification of income under the relevant provisions of § 7 or § 10 of the ITA is whether the taxpayer carries out the activity in question with the intention of doing so consistently, for profit, on their own account and responsibility – then the income from this activity is income under § 7 of the ITA. If the taxpayer does not carry out the activity in this way, it is income under § 10(1)(b)(3) of the ITA.

- The income of a taxpayer who holds a trade licence entitling them to carry out this activity is taxed in accordance with § 7(1)(b) of the Income Tax Act (income from a trade business); a taxpayer who does not claim expenses in the actual amount may claim expenses as a percentage of income, namely in the amount of 60% of the income.

- If the taxpayer does not hold the relevant trade licence, even though legally obliged to do so, that taxpayer is considered to be a taxpayer operating a business whose income is taxed in accordance with § 7(1)(c) of the Income Tax Act. If the taxpayer does not claim expenses in the actual amount, they may claim expenses as a percentage of income at the rate of 40% of such income.

- In the case of rental income, it may be either income under § 7(2)(b) of the ITA (in the case of income from the rental of property classified as business property), or income within the meaning of § 9(1)(a) of the ITA, income from the rental of immovable property or flats, or income from the rental of movable property under § 9(1)(b) of the ITA (except for occasional rental under § 10(1)(a) of the ITA).

- The value of the cryptocurrency must be expressed in CZK at the time of the transaction. As cryptocurrencies are not listed in the CNB exchange rate list, a third currency conversion is used.

- There is no taxable income when cryptocurrency is obtained through mining. In the case of individuals who are not an accounting entity, it is an acquisition of an item via own activity and is therefore treated similarly to acquisition of an item via own activity.

- Income earned from the sale of cryptocurrencies may be taxable to individuals as income under § 7 of the Income Tax Act (income from business) if it is earned by the entrepreneur in the course of their business (it is included in their business assets), or as income under § 10 of the Income Tax Act (i.e. other income).

- Buying and selling goods/services for cryptocurrency is considered an exchange of in-kind transactions between two parties – the buyer and the seller. Taxable income is earned by both parties, and on both sides the income is valued according to the law governing the valuation of property. Similarly, income arising from the exchange of a cryptocurrency for another cryptocurrency is taxable.

If you have any questions, please contact either the authors of the article or your usual EY team.

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International taxation

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Danish tax ruling on permanent establishment – sales activities constitute a permanent establishment in Denmark

On 9 February 2022, the Danish Tax Board (DTB) published a tax ruling analysing whether a foreign company's sales activities will create a permanent establishment in Denmark (more HERE).

In this case, a Swiss company hired an employee to be in charge of certain sales activities targeting car dealers in the Scandinavian market. The activities carried out by the employee included:

- New customer acquisition,
- customer database management,
- new product marketing and selected administrative work.

Other important facts include:

- the employee is a Danish national,
- the work the employee does is very limited in the Danish market (and concerns mostly the other Nordic countries),
- the work is carried out from the employee's home, as there is no Swiss company office in Denmark,
- most of the employee's time is spent travelling and visiting car dealers outside Denmark.

The DTB concluded the Swiss company has a permanent establishment in Denmark – selected arguments:

- the activities carried out by the employee are part of the core activities of the Swiss company,
- the employee should perform the main function of developing the Scandinavian market, as this employee was hired to develop sales channels in this market,

- the geographical location of the employee in Denmark – if the employee were not located in Denmark, it would be more difficult to carry out sales activities in the Scandinavian market.

If you have any questions, please contact either the author of the article or your usual EY team.

The Danish Tax Board published a tax ruling that the performance of sales activities by an employee of a foreign company, mainly focused on other markets, creates a permanent establishment in Denmark.

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EU tax plans for 2022

Department for Taxation and Customs of the European Commission published 2022 Management plan (more HERE).

Their main priorities for 2022 include:

- Implementing corporate tax reform/tackling tax abuse within the EU.
- Supporting the EU Green Deal.
- Reforming the Customs Union.
- Protecting the EU's financial interests by tackling fraud.
- Modernizing tax and customs administrations.
- Work on EU Own Resources.

Specific initiatives may include:

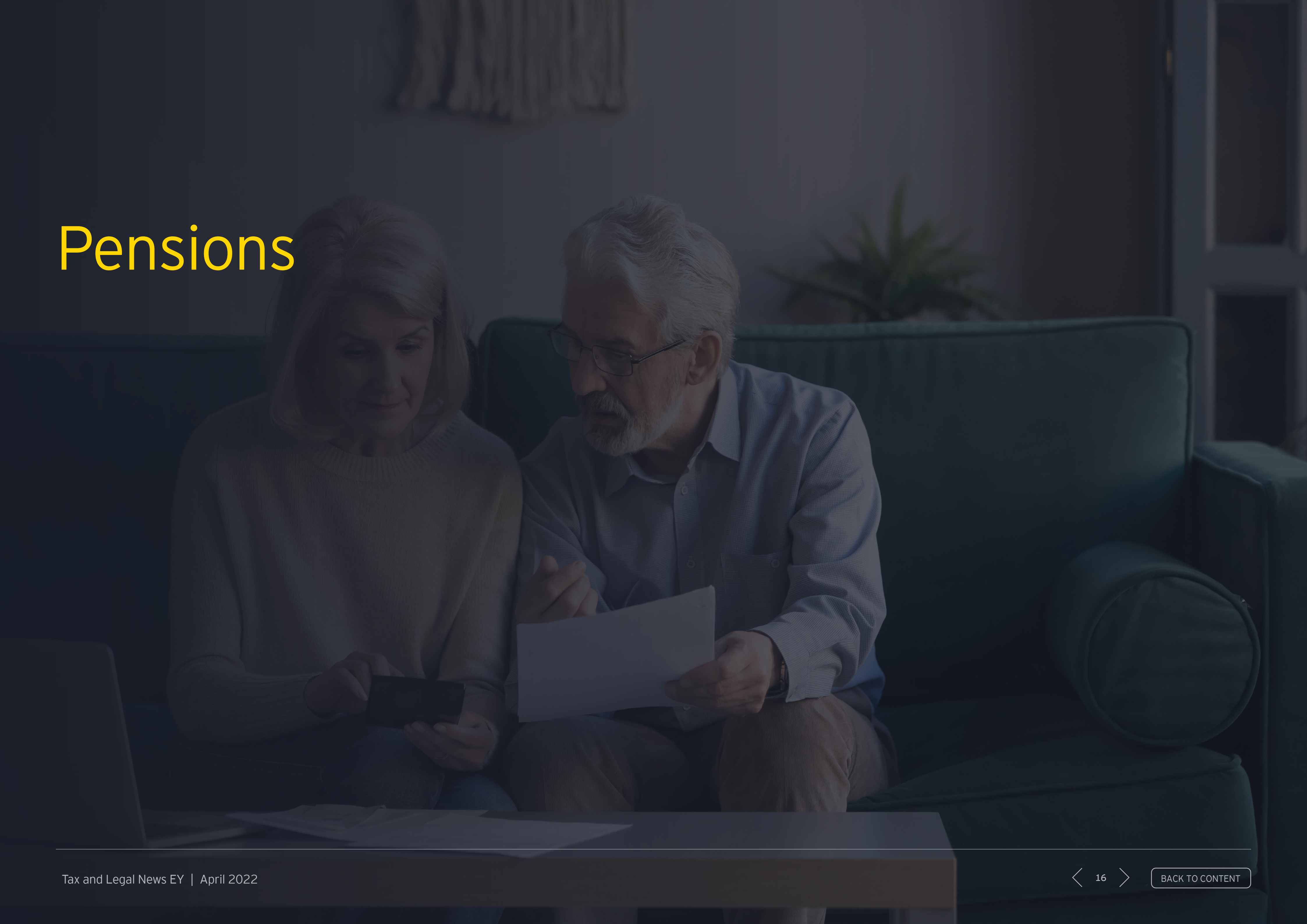
- Push forward with the next critical stages of the OECD two-pillar tax reform.
- Working for the swift adoption of the revised Energy Tax Directive and the Carbon Border Adjustment Mechanism proposals.
- New transparency proposal requiring certain multinationals to publish their effective tax rate.
- Proposal to redress the current debt-bias in corporate taxation by proposing an allowance for equity (DEBRA).
- New EU Withholding Tax Relief Procedure to reduce the risk of double-taxation, lower compliance costs and encourage cross-border investment in the EU.
- Proposal to extend the period of application of the optional reverse charge mechanism.
- New proposal to clarify the criteria for tax residence in order to reduce disputes between taxpayers and administrations and lower the incidences of double taxation.
- Push forward with the UNSHELL proposal.
- Propose new transparency and information exchange measures for crypto-assets and e-currencies (DAC 8).

- Launch an initiative on the VAT Gap in order to determine how to improve VAT compliance and tackle fraud in the modern economy.
- Present the VAT in the Digital Age package to update EU VAT rules and take advantage of the technological solutions that can improve taxpayers' compliance and the fight against VAT fraud.
- Present proposals to improve the impact and effectiveness of the EU black list including coordinated defensive measures.
- A Revision of the Tobacco Directive.
- Proposal to revise the rules for cross-border acquisitions of alcohol and tobacco.
- Fundamental overhaul of the Union Customs Code.

If you have any questions, please contact either the author of the article or your usual EY team.

The main priorities for 2022 include the implementation of the corporate tax reform / the fight against tax abuse in the EU, as well as support for the EU Green Deal.

Pensions



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Bill on a Pan-European Personal Pension Product approved by the Chamber of Deputies

On 2 March 2022, the Chamber of Deputies approved the "Bill on the Pan-European Personal Pension Product and on Amendments to Related Acts" (and later on by the Senate).

At the end of February and the beginning of March 2022, an inter-ministerial comment procedure was also held on the "Draft Decree implementing certain provisions of the Pan-European Personal Pension Product Act and amending the related Decrees on professional competence". The draft decree was submitted by the Czech National Bank, and sets out the details of the application requirements related to the Pan-European Personal Pension Product (PEPP), the information obligations for the PEPP provider and distributor, and the scope of professional knowledge and skills for PEPP distribution.

We already informed you about the draft law on the Pan-European Personal Pension Product and amendments to related laws in Tax and Legal News in March last year. Let's have a quick refresher. The reason for the submission of this draft law is the Czech Republic's obligation to adapt Czech legislation to Regulation (EU) 2019/1238 of the European Parliament and of the Council of 20 June 2019 on the Pan-European Personal Pension Product (PEPP) (the Regulation). The Regulation aims to introduce a long-term financial product and create the foundations for a market for voluntary pension savings managed on a pan-European scale. The Regulation promotes the cross-border provision and portability of the PEPP, which should thus be of particular benefit to EU citizens working in more than one EU Member State.

PEPP should be an alternative for saving for old age in the future. It will be a supplementary personal pension product with voluntary participation and therefore without a link to the pay-as-you-go pension system ("Pillar I"). The PEPP products will be part of "Pillar III" and will be an alternative to state-contributory supplementary pension insurance and supplementary pension savings in the Czech Republic. By its nature, a PEPP can be an insurance product, a deposit or an investment product.

PEPP will be able to be offered by a wide range of financial institutions, such as life insurance companies, banks, investment companies or securities dealers. Uniform rules and supervision will be ensured by the Czech National Bank, which will also decide on the registration of companies for this product. Sellers will be required by law to demonstrate professional competence. PEPP will not be offered by pension companies as their activities do not fall within the harmonised EU sector but are regulated by national regulation.

As regards possible tax support for PEPP, the existing tax support rules for retirement savings products will apply. Therefore, in order to benefit from the tax advantages of the contributions, the PEPP product will have to meet the conditions laid down in the Income Tax Act, i.e. in particular the participation period of at least five years and the withdrawal of funds at the earliest on reaching the age of 60.

If you have any questions on the above topic, please contact the author of the article or your usual consulting team.

PEPP should be an alternative for saving for old age in the future. It will be a supplementary personal pension product with voluntary participation and therefore without a link to the pay-as-you-go pension system (so-called Pillar I). PEPP products will be part of the so-called Pillar III and will be an alternative in the Czech Republic to supplementary pension insurance with a state contribution and supplementary pension savings with a similar tax regime.

Judicial window

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Using evidence from a VAT audit of a business partner

We'd like to draw your attention to a positive Supreme Administrative Court (SAC) ruling (HERE), which allows the application of the findings of a supplier's tax administrator in tax proceedings of the customer.

The customer was engaged in the purchase and sale of construction materials, which were procured from a particular supplier, and the sublease of construction machinery, which were rented from the same supplier – both in the tens of millions of crowns.

The customer's VAT obligations were audited by the Tax Office in Zlín, which stated the customer had not proven actual receipt of the taxable supply. On the other hand, the South Moravian Tax Office, which audited the supplier, came to the opposite conclusion, i.e. that the company was easy to contact and had duly fulfilled its obligations and had no tax arrears.

In the appeal, the customer argued that such difference in the assessments was unlawful. The Appellate Financial Directorate (AFD) refused to comment on these fundamental differences in the conclusions of the two Tax Offices, citing case law according to which findings in one tax proceeding cannot be mechanically transferred to another tax proceeding.

The SAC rejected this approach in view of the prohibition of arbitrariness. It stated that, though the AFD does not automatically have to accept the conclusions of the supplier's Tax Office, if it assesses identical evidence in a completely different way, it must properly justify the reasons for its conclusions, for example, explain what the South Moravian Tax Office has overlooked.

This judgment is very positive, but in practice we recommend using it with caution. The SAC itself suggests that this is a rather exceptional case. For example, according to the previous case law even a binding ruling issued by the supplier's tax authority may not be effectively binding for the tax authorities of its business partners.

If you have any questions on the above topic, please contact the authors of the article or your usual consulting team.

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The Supreme Court commented on the payment of advances on a profit share

The Business Corporations Act ("BCA") allows advances to shareholders for a share of profits during the financial year. The Supreme Court ("SC") has now for the first time comprehensively commented on this issue. In its judgment (27 Cdo 3330/2020), it discusses a number of aspects of profit-sharing advances and answers some of the hitherto controversial questions concerning a corporate decision to pay advances.

Background

In an action filed in October 2018, the suing joint stock company sought payment of an amount exceeding CZK 40 million in respect of an unpaid consideration for the assignment of a claim.

In November 2015, the applicant (as assignor) concluded an agreement with the respondent joint stock company (as assignee) on the assignment of the applicant's claim against the chairman of the respondent's board of directors in the amount of over CZK 40 million. In the agreement, the respondent undertook to pay the appropriate consideration for the assignment of the claim. At the same time, the respondent, as the sole shareholder of the applicant, acting in the capacity of the general meeting, approved the interim financial statements of the applicant for the period from January to September 2015 and subsequently, on the proposal of the board of directors, decided to pay an advance on the profit share for that period in an amount of more than CZK 40 million. (i.e. corresponding to the above-described assigned claim). According to the courts of all instances, the conditions for payment of the advance had been met.

The respondent's claim for payment of the advance on the profit share was subsequently set off by agreement against the applicant's claim for payment of the consideration for the above-described assignment of the claim. The dispute arose when the applicant challenged the validity of the respondent's decision, as the applicant's sole shareholder, to pay an advance on the profit share and thus to set off the aforementioned mutual claims.

The courts of first and second instance (the latter in May 2020) dismissed the action. They found that the payment of the advance on the profit share for the period January to September 2015 was duly decided by the sole shareholder (the respondent) on the basis of a proposal by the board of directors and on the basis of the interim financial statements). The respondent was therefore entitled to a claim against the applicant in respect of the advance on the profit share. The applicant's claim against the respondent in respect of the consideration for the assignment of the claim was therefore extinguished by set-off, the conditions for which were fulfilled.

Legal assessment of the SC

The SC dismissed the applicant's appeal and upheld the lower courts' decisions. The main conclusions of its judgment can be summarised as follows:

- Once the advance has been agreed, if the advance is required by law or if there is another legal reason (creating an obligation to advance – which in this case was the decision of the sole shareholder), the obliged party (debtor) has the obligation to advance (debt) and the entitled party (creditor) has the corresponding right (claim). This claim is in principle eligible for assignment or set-off.

- Unless excluded by the articles of association, the shareholder's right to profit also includes the right to an advance on the profit share [§ 40(2) of the BCA as in force until 31 December 2020; § 35(1) of the BCA as in force from 1 January 2021]. Even in the case of an advance payment, if the conditions provided for by law (or even by the articles of association) arise, the shareholders have the right to receive an advance on the share of profits, representing the shareholder's claim against the company and the company's corresponding obligation to pay the advance.

- It must be decided by the body of the joint stock company within whose jurisdiction the matter falls that the company will pay the shareholders an advance on the profit share. The decision on the distribution of profits falls within the competence of the general meeting [§ 421(2)(h) of the BCA]. In contrast, the law does not expressly entrust the decision on the payment of the advance on the profit share to any of the company's bodies; therefore, in accordance with the provisions of § 163 of the BCA, it belongs to the board of directors (or the management board of a joint stock company with a monistic board structure).

- The decision to advance the company's share of profits (as well as the decision to distribute profits) is not a matter for the company's management. They are therefore not subject to the prohibition on giving instructions concerning the conduct of the business.

- The articles of association may delegate this power to the general meeting. Even then, however, the Board of Directors remains obliged to assess whether the decision to pay the advance is in accordance with the law and can be implemented (and must therefore, in particular, carry out the so-called balance sheet test and the bankruptcy test). However, it is not decisive for the creation of a shareholder's claim for payment of an advance on the profit share whether the company has free funds to pay the advance.

- If the company's general meeting decides to pay an advance on the profit share, though the company's articles of association do not entrust it with this power, it must be assessed in each individual case whether the decision is not merely an instruction by the general meeting for the board of directors to decide on the payment of the advance, or whether it is a decision on a matter falling outside the competence of the general meeting (which is looked upon as if it were not adopted), or whether this decision constitutes a so-called one-off breakthrough to the articles of association (i.e. whether it does not include the shareholders' will to amend the articles of association so as to confer on the general meeting the power to decide on the payment of the advance for this individual case).

- The basic prerequisite for concluding that a resolution of a general meeting constitutes such a one-off breakthrough is its adoption by the majority vote required to amend the articles of association accordingly, and (at the latest) with effect from 1 January 2021, also certification by notarial deed [see § 45(3) and § 416(2) of the BCA, as amended with effect from 1 January 2021].

In accordance with these conclusions, then, if a company wishes to make advances to shareholders (or other persons, e.g. employees, if the articles of association permit such distribution of profits), the company's board of directors decides on this matter, unless the articles of association provide otherwise. For example, the articles of association may oblige the management board to discuss the payment of advances with the supervisory board in advance. The articles of association may also delegate the power to decide on advances to the general meeting.

Even if the articles of association are silent, the general meeting (or the sole shareholder) may decide on the payment of advances on a one-off basis, but such a decision must be adopted by a qualified majority of votes and certified by notarial deed. In view of these costs and the quorum required, it is not very practical for the AGM to decide on this matter. Therefore, if shareholders wish to obtain an advance payment of a profit share, they may, by a simple majority vote, instruct the board of directors to decide on such a payment.

Regardless of which body makes the decision, the conditions laid down by law or the statutes must always be met for the payment of advances. In particular, the company must have sufficient available own funds to distribute profits in accordance with the interim financial statements and must not cause bankruptcy by paying advances. However, available resources are not synonymous with free cash, and the company may supplement the missing cash flow for these purposes with a loan. In such a case, of course, the statutory body of the company would have to assess, with due care and diligence, whether it is economically appropriate to burden the company with the loan taken out for the purpose of paying the advance on the profit share.

If you would like more detailed information, please contact the authors of this article or other members of EY Law or your usual EY team.

The Supreme Court stated that the decision of the competent authority to pay the advance on the profit share creates a claim against the corporation by the shareholder and the corresponding obligation of the corporation to pay the advance. It confirmed that the decision to pay advances falls within the competence of the statutory body of the corporation. However, this is not a decision within the scope of the business management of the corporation and the general meeting may therefore instruct the statutory body on this matter. Under certain conditions, the general meeting may even decide on the payment of advances itself, even if this power of the general meeting is not provided for in the company's articles of association. In any case, the necessary prerequisites for the payment of advances on the profit share must be fulfilled; in particular, the business corporation must have sufficient available resources to distribute the profit according to the interim financial statements and must not cause bankruptcy by paying the advances.

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Tax audit disguised as an on-site investigation

In our tax news we previously informed you about the SAC ruling which addressed what activities of the tax authorities are still an on-site investigation and when it is in fact a tax audit (more HERE). Back then, the Supreme Administrative Court returned the case to the Regional court for further investigation.

Repeated audit is illegal

Recently, the SAC ruled again in the same case (7 Afs 231/2021 - 31) and this time concluded that "the examined procedure of the defendant was a tax audit (focused on the deductible item for research and development) and not an on-site investigation".

At the same time, the SAC added that, given the time gap (approximately 1 year and 3 months) between the original "on-site investigation" and the formal initiation of the tax audit, it could legitimately be concluded that the earlier audit procedure had already been finished. As a result, according to the SAC, the later initiated tax audit was an impermissible repetition and the tax audit was therefore unlawful.

The start of the time limit is crucial

Coincidentally, a few days later the SAC issued another interesting judgment in a similar case (7 Afs 39/2020 - 29). Also in this case, according to the SAC, the "on-site investigation" fulfilled the characteristics of a tax audit.

Since the tax administrator carried out the "on-site investigation" and the subsequent tax audit without significant delay, the SAC considered all the actions as one tax audit. Rather than a meeting on the formal initiation of the tax audit in April 2015, the Tax Court determined that the tax audit had already been started by the email sent by the tax authorities in November 2014 as a part of the "on-site investigation".

Thus, in this case, according to the SAC, there was no unlawful repetition of the tax audit, but an earlier start of the tax assessment period. The three-year time limit thus expired in November 2017 and not in April 2018. The tax administrator issued the additional payment order in March 2018, i.e. unlawfully after the time limit had expired.

Practical impact

It can certainly be argued that the conclusions of the SAC in both cases were based on the individual facts. For the more recent proceedings, the amendments to the Tax Code that have occurred in the interim should also be taken into account.

In general, however, we recommend not to underestimate the procedural aspects of tax proceedings, not only in case of a concurrent on-site investigation and tax audit. Although these are very specific procedural issues, they can often have significant positive consequences for the taxpayer.

If you have any questions about the above topic, please contact the authors of the article or your usual consulting team.

In a recent decision, the SAC concluded that the tax administrator had performed a tax audit (focused on a deductible R&D item) and not a on-site investigation.

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- The Tax Administration is working on updating Directive D22?
- The operator of a tax warehouse is objectively responsible for ensuring that the transport of goods under conditional tax exemption is carried out as declared?
- There is speculation that extraordinary depreciation will be "stretched" to include assets acquired in 2022?
- The Tax Administration has issued updated questions and answers regarding the draft law on tax measures in connection with the armed conflict in Ukraine?