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The accelerating train of international taxation

I'm surprised at the speed of the global implementation of some tax rules. I mean, it's faster than I ever thought – a sentence I never thought I'd hear myself say.

I've always taken the G8, G20, OECD and EU proposals with a grain of salt, never really believing the current generation would see major change in their professional lives. I've been reassured by the major project to unify the rules for calculating the income tax base (the so-called CCCTB), which the European Commission first promised to propose by the end of 2008. We're about to celebrate our 20th anniversary and implementation is not imminent. And that's just a legislation for the EU without complex discussions with the US, Asia, etc..

Then BEPS (Base Erosion and Profit Shifting) arrived and something broke. When the first action plan was published in 2013, I found it unlikely that items like interest deductibility limitations, CFCs and hybrid mismatches would be quickly implemented into domestic legislation. But in 2016, the EU issued ATAD (the Anti-Tax Avoidance Directive) and all Member States implemented it in 2019. The BEPS action point to amend all double tax treaties looked like something out of a fairy tale. There are reportedly over 3,000 such bilateral treaties, the work for half a century. But then came the multilateral instrument (MLI), which would essentially amend all the treaties at one go. By 2016, more than 100 countries had joined and by 2019 it was in effect. In 2013, we started DAC 1 with a basic information exchange and last year we approved DAC 8 for the reporting of crypto assets.

BEPS 2.0 further increases the pace with two pillars. In 2021, more than 140 countries joined pillar two – a minimum corporate taxation of 15%. There are massively complicated rules on how to calculate that 15% and who in a group should actually pay (so there'd be no escape through the few countries that hadn't joined). And in 2024, we have 30 countries that have implemented it, including the Czech Republic.

What comes next and how fast? I would guess we start with the rich (however defined). In his low-key speech at the recent G20 ministerial meeting in Sao Paolo, Professor Gabriel Zucman's said wealthy individuals should systemically pay a progressive tax. Most tax systems are nominally set up that way. However, the reality captured in the Global Tax Evasion Report 2024 shows that while this is true for most taxpayers, it suddenly breaks down for the truly wealthy, whose effective taxation is regressive. The higher the income, the lower the rate. The reason, according to the professor, is obvious. They have enough resources and motivation to create structures to minimize the tax burden.

The professor therefore proposes an analogy to pillar two for individuals. Let's set a minimum tax that an individual must pay. According to the professor, it's obvious that really wealthy individuals will have most of their assets in corporate structures and therefore most of their income will not be realized for individuals but within these corporate structures. That's why we don't set the minimum tax as a percentage of income (we wouldn't collect anything), but as a percentage of assets. Illustratively, he states 2%. When I think of some of the people in the Forbes 500, paying 2% of the value of your assets every year as an individual is suddenly a pretty big number.

According to the professor, it's obvious that really wealthy individuals will have most of their assets in corporate structures and therefore most of their income will not be realized for individuals but within these corporate structures. That's why we don't set the minimum tax as a percentage of income (we wouldn't collect anything), but as a percentage of assets. Illustratively, he states 2%.

Arguments that these people will not have the liquidity to make such tax payments are rejected because, according to the professor, it is their own fault for hiding their income in corporate structures to avoid taxes. The estimated financial benefit of such taxation of billionaires is USD 250 billion annually. But the biggest benefit is said to be restoring public confidence in the fairness of the system.

How fast? Consider a few lines above how the speed of implementation grows exponentially and maybe we can guess – a few years (literally)? Pure speculation.

Pillar 2

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Pillar 2 and the 750-million condition

One of the conditions for a group to fall under the Pillar 2 rules is a consolidated revenue of at least EUR 750 million in at least 2 of the 4 periods preceding the tested period.

So all I have to do is look at the consolidated financial statements of the group for the years 2020-2023 and if the consolidated revenues are below EUR 750 million in at least three of them, I'm safe for 2024??

Not necessarily.

We have (among other things) special rules for situations where a group (or entity) buys another group (or another selected entity). Simply put, if the acquisition in question satisfies the conditions of this special rule, then I must retrospectively add the revenues of both groups (or the group and the entity[ies]) to assess the minimum revenue condition, and I can satisfy the minimum revenue condition even if the consolidated revenues of none of the relevant financial statements for the preceding years are in themselves more than EUR 750 million.

Let's demonstrate with an example. In December 2023, Group A bought (all of) Group B. The consolidated annual revenue of each group for the last few years is around EUR 400 million (per group). As the acquisition will fall under the special "aggregation" rule, the consolidated returns of both groups must be added retroactively for the application of the minimum revenue rule, and Group A (now including Group B) will therefore fall under the Pillar 2 rules in 2024.

This is a simple example. In practice, there may be more complicated scenarios in which applying the special rules will not be entirely straightforward. We would be happy to help you with this assessment.

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

Note the special rule on "retrospective" aggregation when assessing whether the minimum revenue condition for the application of Pillar 2 rules is (or is not) met.

VAT

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Application of VAT on various forms of recharges

One of the principles of VAT is neutrality. In the chain of economic transactions between the primary producer and the final consumer, the tax should (in an ideal VAT world) be levied, on a continuous basis, on the difference between the selling and buying prices for goods and services. Neutrality is undermined mainly by exceptions to the basic rules, application of exemptions for selected types of goods and services, different VAT rates, involvement of non-payers in the chain, complicated rules. Taxpayers must comply with the rules and therefore interpret them correctly.

In this article, we consider the erosion (the diversity, if you like) of VAT application rules in situations that are often referred to in practice as "recharges", but in fact involve a wide range of different types of transactions.

The common denominator is that the entrepreneur bears the costs, which are then passed on to another entity. However, such cost shifting does not automatically mean the same treatment for VAT purposes.

1) Recharges outside the scope of VAT

HQ/Branch

The recharging of certain cost items may not be subject to VAT. A typical representative of these situations is the recharging of costs between a HQ and an establishment. Legally, the establishment is not an entity distinct from the HQ; therefore, any recharges are internal only and have no impact on the VAT liability (see e.g. CJEU C-210/04 FCE Bank). Exceptions are situations where the HQ and the branch are established in different Member States, with one of them being part of a VAT group (see e.g. SDEU C-7/13 Skandia, C-165/17 C-812/19 Danske Bank).

Payment on behalf and on the account of another party

Amounts received by the entrepreneur from the recipient of the supply to cover expenses paid by the entrepreneur on behalf and on the account of the recipient of the supply are not subject to VAT, provided the entrepreneur doesn't charge a surcharge and doesn't claim a tax deduction (off-balance sheet accounting is typical). Examples include fees or expenses paid against the background of various legal transactions or services provided to recipients. We recommend to approach the 2008

MoF Information on § 36/11 (now § 36/13) of the VAT Act with great caution. These conclusions seem to be outdated in today's optics and proving legitimate expectations on the basis of administrative practice may be difficult (see e.g. later Information of the Ministry of Finance on the application of VAT to insurance activities, conclusions of the CJEU in case C-605/20 Suzlon or the Supreme Administrative Court 2 Afs 345/2016-34). Last but not least, the absence of a written mandate from the recipient and the related proof of authorisation is a major challenge for spending on behalf and on the account of the recipient.

Reimbursement of a share of costs according to the law

In practice, situations arise in which an entrepreneur requests reimbursement of costs incurred in connection with the implementation of obligations imposed by law. An example is the Energy Act and the obligation to pay a share of eligible costs to the energy system operator in connection with hooking up a customer to the system or securing a transfer. According to the MoF Information of 2005, this is not a payment for taxable transactions (unlike the payment of the costs of establishing a connection or unauthorised energy consumption). This topic was also addressed in a paper presented to the Coordination Committee (442/17.12.14), which confirmed this practice. Another example is the recharging of wage costs in the case of temporary assignment of an employee under the Labour Code (see the 2004 MoF information on the application of the VAT Act to the provision of labour, later moderated by the conclusions of the Coordination Committee on Paper No. 358/22.02.12). However, CJEU judgments show the opposite trend of VAT being applied (see e.g. CJEU C-94/19 San Domenico).

2) Independently provided supplies

On the other hand, the transferred costs may be in the nature of an independently provided supply, which is generally subject to VAT. It is typical for an independently provided supply to be carried out by the entrepreneur in his own name, on his own account and responsibility and bearing the associated economic risk. The VAT treatment then depends on the nature of the goods or services concerned.

The CJEU considered such a service to be the provision of warranty repairs by the buyer on its own behalf and for its own account, which it subsequently recharged (without a margin) to the supplier of the defective goods, in a situation in which the seller had not fulfilled its contractual obligation to provide repairs (see C-605/20 Suzlon).

It is also worth noting the development of unit owners' associations (UOA), which until recently were not considered by the Czech tax administration to be taxable persons when recharging costs to unit owners. The approach has been "disrupted" by a CJEU judgment (C-449/19 WEG) on the basis of which UOAs can apply for VAT registration and possibly achieve cost reductions (among other ways, through the supply of heat at a reduced rate instead of charging gas, electricity, coal at the standard rate).

3) Third-party payment

A specific case for independently provided supplies is situations in which the recipient of the supply is different from the person who pays the cost – the concept of so-called third party payment. The third party to whom the cost is recharged is not entitled to a deduction. The invoice received is not a tax document for that person.

This may include, for example, gifts provided under loyalty schemes (e.g. C-53/09 and C-55/09 Loyalty Management UK and Baxi Group), but also situations in which various subsidies or grants are used for the supply of goods or services (e.g. fruit for schools, see SAC 5 Afs 5/2021-29) or compensation for loss-making supplies made on the basis of instructions from a parent company. In connection with the VAT Act amendment currently in a comment procedure, in the coming years we will probably see a revision of the Czech concept of the price subsidy.

Situations in which a payment constitutes a donation must be distinguished from those cases.

4) Fictive supplies – commission agent

One specific situation is the provision of supplies on one's own behalf on someone else's account – in practice often associated with a commission structure (though other similar types of contracts may also be involved). From the point of view of VAT, there is a legal fiction of two separate supplies – the provision of supplies from the principal to the commission agent and from the commission agent to a third party (or vice versa). Some uncertainty remains regarding the number of supplies (2 or 2+1), or the possibility of applying the same VAT regime to both supplies (e.g. in situations in which the application of the exemption is conditional on the possession of a licence or the existence of a specific status of the supplier of the supply, etc.). In practice, this rule can be quite impractical, particularly in situations where the commission agent receives or provides a large number of transactions that it must "mirror" with the principal at the same time.

Relatively surprisingly, the CJEU (C-707/18 Amarasti Land Investment) considered acting in one's own name on someone else's behalf even in a situation where the purchaser of the land has carried out, at its own expense, the steps necessary to survey the land and register it with the Land Registry (in order to fulfil the seller's legal obligation). This conclusion was not precluded by the fact that no consideration was specifically agreed between the parties. Finding the boundary between incurring one's own costs in the context of necessary cooperation and the establishment of a transaction on behalf of the counterparty (and hence the provision of a supply) may not always be entirely intuitive.

A very recent development is the sale of fuel via fuel cards. Following the CJEU judgment (C-235/18 Vega International), the VAT Committee stated in its Working Paper No. 1046 that the concept of two separate supplies will be fulfilled if the card issuer acts in its own name on behalf of the fuel supplier or cardholder. Paper No. 617/28.02.24 submitted to the Coordination Committee, which develops this idea, has not yet been concluded.

5) Supplies incidental to the main supply

The situation is somewhat more complicated if the cost is recharged in connection with another supply. The law generally provides that certain types of incidental expenses are included in the tax base of the main supply as part of it, e.g. packaging, transport, insurance, commissions (see § 36/3 of the VAT Act). In the words of the CJEU, ancillary costs do not constitute an end in themselves for the customer. For certain types of costs, such a criterion may be difficult to interpret.

Disputes may arise, for example, over the cost of services or goods charged in addition to rent (e.g. water supply, heating, building maintenance, cleaning of common areas, security). The landlord usually secures costs from suppliers on its own behalf and then recharges them to the tenant. The CJEU has concluded that such costs may, under certain conditions, constitute ancillary supplies to the lease and thus follow the same VAT regime (see C-392/11 Field Fisher Waterhouse, C-42/14 Wojskowa Agencja). The Czech case before the CJEU is a dispute concerning recharging for cleaning (see C-572/07 RLRE Tellmer Property), in which the CJEU concluded that it was a separate, severable supply from the lease. A similar conclusion was reached by the CJEU in the case of recharging the insurance of a leased item without any increase (see C-224/11 BGZ Leasing), even with the retention of the VAT exemption.

The CJEU (C-276/18 KrakVet) considered a case of a cross-border sale of goods over the internet, where the buyer could choose a carrier recommended by the supplier, hire his own carrier or collect the goods in person. The separation of the transport service from the supply of goods had an impact on the qualification of the supply (mail order sale of goods

with the place of supply in the country of termination of transport vs. supply of goods in the country of commencement of transport), which ultimately led to lower taxation. The CJEU defined the parameters to be examined for the qualification of the transport as an independent separable supply.

6) Transactions of another nature

Another type of recharging is when the entrepreneur recharges his customer for the purchased goods, but his role in the transaction is limited or has a different character.

A typical example is the recharging of costs incurred by the payer (e.g. accommodation or transport costs) in order to provide another service (e.g. installation of a machine). This is not an ancillary supply in the true sense of the word because it is not accepted by the customer. They are consumed by the supplier himself and the amounts recharged form the taxable amount of the other service.

Examples include leaseback contracts, where the leasing company does not economically acquire the right to dispose of the goods as owner, rather its role is limited to financing (see e.g. CJEU C-201/18 Mydibel SA). A similar situation also arises in the specific case of fuel cards (see CJEU C-185/01 Auto Lease Holland, or the aforementioned Vega International case).

In practice, we might also encounter situations in which an entrepreneur recharges a customer for a co-ownership interest in property while actually providing a service to the customer (e.g. sale of a co-ownership interest in a means of transport where the counterparty effectively uses only transport services).

7) Special regime

No less importantly, special regimes cannot be overlooked.

Specific rules apply to the provision of travel services. This may involve the resale of a combination of tourism services (or goods) or the recharging of a single accommodation or passenger transport service. VAT is applied only on the surcharge, there is no right to deduct (see § 89 of the VAT Act). This situation can be encountered when recharging the costs of participation in a marketing event.

A special regime also applies to dealers in second-hand goods (see § 90 of the VAT Act).

The provision of services by independent groups of persons to their own members who pay the costs according to their share (so-called cost-sharing) is exempt from VAT without the right to deduction (§ 61[g] of the VAT Act). However, the practical applicability for entrepreneurs is limited. The concept has been discussed in more detail in contributions to the Coordination Committee (249/29.10.08, No 309/08.09.10, 523/20.06.18) or the CJEU (C-274/15 Commission v. Luxembourg, C-326/15 DNB Bank).

Conclusion

The list of examples is only demonstrative. When recharging expenses, you may encounter various situations whose practical classification may not be clear under a particular tax regime. Applying VAT will depend on the facts and the nature of the expense being recharged. The above summary may help to improve your understanding of the issue. However, dogmatically questioning the role of intermediaries in transactions (and the concept of recharging, in general) may undermine the very principle of the tax – as a general consumption tax, VAT applies at every stage of the production and distribution chain.

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

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Digital Services Regulation AKA new rules for the online environment

On 17 February 2024, Regulation (EU) 2022/2065 of the European Parliament and of the Council of 19 October 2022 on the single market for digital services, and amending Directive 2000/31/EC (the Digital Services Regulation) ("DSR"), which applies to intermediary services, came into force.

It supplements other legislation already in force, which the EU has adopted as part of its work to regulate the digital environment. The Regulation introduces extensive new obligations for operators of online intermediary services established or located in the EU. The scope and content of the obligations vary according to the nature and social impact of the service provided. The main objectives of the Regulation are to create a safe, predictable and trustworthy online environment.

The Regulation introduced several categories of obligations, some are common to all service intermediaries and others apply only to selected groups and subsets of service intermediaries. The DSR mainly affects three types of intermediary service providers, namely (i) intermediary service providers (e.g. hosting services), (ii) online platforms and (iii) online marketplaces. While micro or small enterprises are exempted from some of the obligations, entities with an extremely large reach, i.e. very large online platforms and very large internet search engines, have additional obligations beyond the basic obligations for other providers (e.g. risk assessments, audits, etc.). Some of these obligations are described below, but this is not a comprehensive list of all obligations under the DSR.

Combating and moderating illegal and harmful content

The first broad category of obligations common to intermediary service providers is the obligation to ensure a safe digital environment, both through mandatory cooperation with the competent authorities and through the obligation to set up mechanisms to detect and combat illegal or harmful content.

In general terms, the Regulation does not hold providers liable for illegal content stored or distributed through their service. However, the exemption from liability ends when they become aware of illegal activity or illegal

content. At such time, they are required to take prompt action to eliminate or render such content inaccessible[1]. In this respect, attention must be drawn to the fact that intermediary service providers are not themselves obliged to search for illegal content.

However, intermediary service providers have an obligation to cooperate with the competent national judicial and administrative authorities in dealing with illegal content that has been stored or disseminated through their service and to comply with orders to remove it or to provide information about the users who have stored or disseminated the illegal content through their service.

In addition, in order to strengthen the security of the digital space and to combat illegal content that is stored or distributed through the online environment, providers of hosting services are obliged to establish procedures for reporting and taking action against illegal content. An expression of this obligation is the obligation to set up an accessible and user-friendly reporting system for users to report content they consider illegal. Following this, service providers are obliged to take measures to investigate the reported content and, where appropriate, remove it.

The obligation to moderate illegal content or content in breach of contractual terms is linked to the obligation of providers to take decisions to remove or make it unavailable or to suspend or terminate the accounts of certain recipients of the service or otherwise prevent the provision of the service.

Operators of online platforms are also obliged to establish an internal system for handling complaints against their decisions. Under the Regulation, service recipients may turn to an out-of-court body to resolve any disputes arising from these decisions. The decision of this body is binding on the operators of online platforms.

Facilitating communication and the accessibility of intermediary service providers

All intermediary service providers also have an obligation to make communication easier and more user-friendly for service recipients as well as for Member State authorities, the Commission and the Board[2]. To this end, they are, for example, obliged to identify single points of contact and keep information about them easily accessible and up-to-date. They are also obliged to ensure that a means of communication is available for communication with service recipients that is not limited to automated machines. Providers who offer their services within the EU but do not have an establishment here are now obliged to appoint a legal representative for this purpose.

1 This liability applies to all providers of intermediary services with the exception of the provision of direct transmission services, i.e. services consisting in the transmission of information provided by the service recipient over a communications network or in the provision of access to a communications network.

2 The European Digital Service Board in accordance with Article 61 of the DSR, i.e. an independent advisory group of digital service coordinators for the supervision of service providers.

Business Terms and Conditions

The new regulation will also affect the form and content of contractual terms and conditions. Intermediaries are obliged to include information on restrictions on the use of services, on content moderation and on rules for dealing with complaints in the terms and conditions. Their comprehensible form is emphasised – the contractual terms and conditions must be clear and easy to understand. Particular emphasis is placed on the wording of the terms and conditions in the case of services that are targeted at or predominantly used by minors. For these cases, an additional specific requirement is that the information conveyed be expressed in a way that is comprehensible to minors.

Particular attention should be paid in this respect by operators of very large online platforms and very large search engines, which are required to publish their contractual terms and conditions in the official languages of all the countries in which they provide their services, as well as to provide a concise and easily accessible summary of them.

Transparency

One of the DSR's objectives is also to achieve a more transparent digital environment. This objective is embodied in two main obligations, namely the obligation for platform operators to publish information about their activities and the obligation of transparency in advertising and recommendation systems.

All intermediary service providers are obliged to publish information about their activities at least once a year. This includes information on content moderation, but in particular categorised information on the number of orders received from Member State authorities, the number of notifications of illegal content, the action taken on them, the number of complaints, etc. This obligation does not apply to micro and small enterprises. Additional information obligations are imposed on online platform providers, which are also required to publish information on out-of-court dispute resolution and the number of suspensions of services.

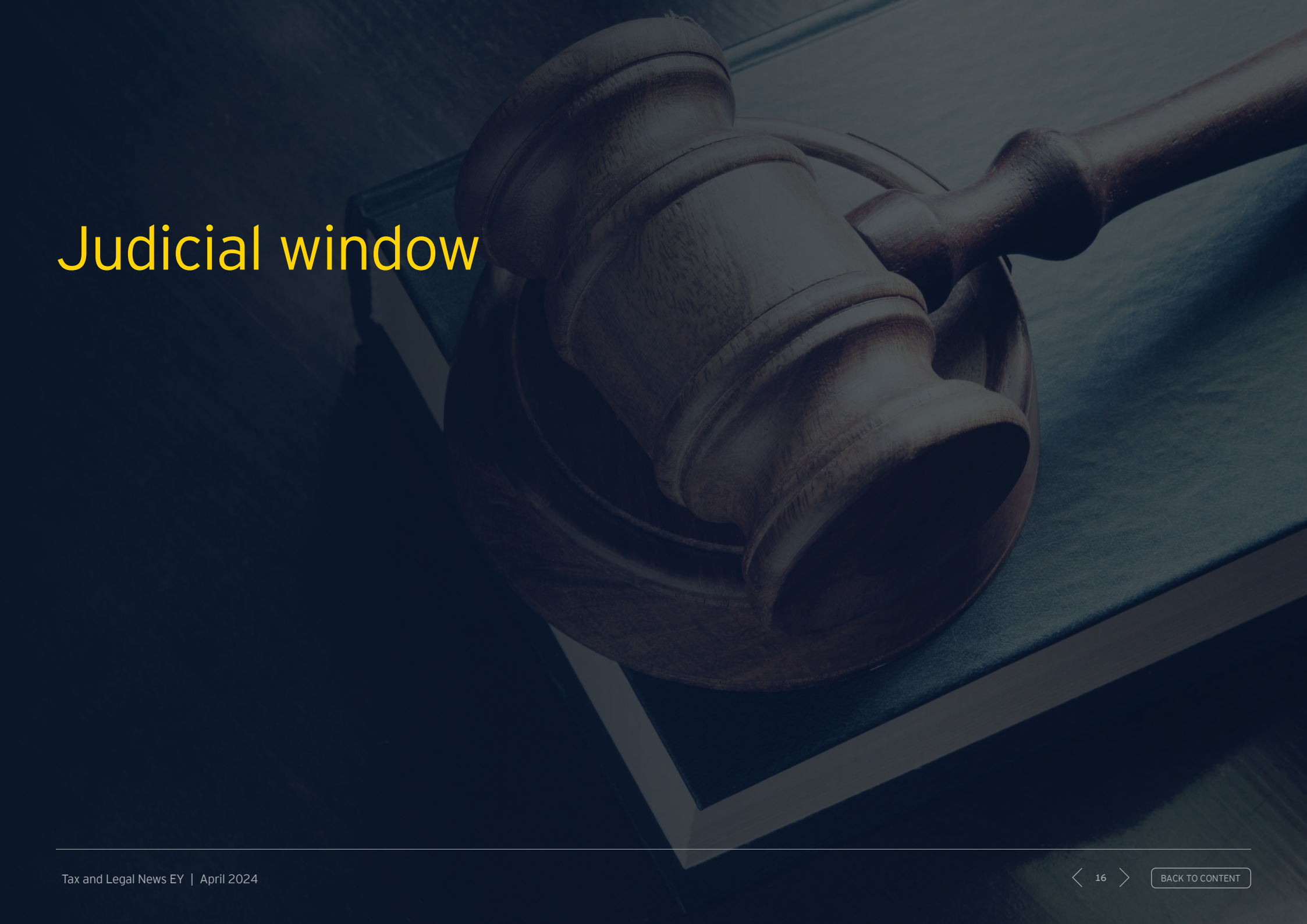
The extended transparency obligation will also apply in the area of advertising messages. Operators of online platforms will be obliged to ensure that, for each individual advertisement, it is possible to identify the fact that it is an advertisement, on whose behalf it is presented, who pays for the placement of the advertisement, etc. At the same time, it is essential to highlight the prohibition on any advertising messages being targeted at users on the basis of profiling based on information such as their political views, religion, racial or ethnic origin or sexual orientation. Enhanced protection is provided to minors.

Providers of online platforms that allow consumers to contract with traders remotely, or marketplaces, have an obligation (with the exceptions of micro and small businesses) to ensure that traders offering products and services through the platform are only allowed to use the platform after sufficient identifying information has been obtained from them (the trader's contact information, a copy of the trader's identity document or other electronic identification, details of the trader's payment account, whether the trader is registered in a public register, including self-certification that the goods and services offered comply with Union law). Platform operators are obliged to ensure that the information obtained is complete, reliable and up-to-date.

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

The obligation to moderate illegal content or content in breach of contractual terms and conditions is linked to the obligation of providers to take decisions to remove or make unavailable content or to suspend or terminate the accounts of certain service recipients \ or otherwise prevent the provision of the service.

Judicial window



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The Extended Chamber of the Supreme Administrative Court on so-called essential costs

The Extended Chamber of the Supreme Administrative Court (SAC) recently rejected an interpretation according to which the tax administrator would always have to recognise at least the minimum part of expenses objectively necessary to achieve taxable income in the event of the taxpayer's failure to prove the expense.

This decision should overcome the contradiction in the case law of the individual SAC chambers. However, it seems not all the open questions have been answered by the Extended Chamber. We take a closer look at this issue in our article.

Essential costs – a general view

As a general rule, costs incurred in generating, assuring and maintaining taxable income are deducted for the purpose of determining the corporate income tax base in the amount proven by the taxpayer and in the amount provided for by the Income Tax Act and special regulations.[3] The law therefore establishes the presumption that it is the taxpayer who bears the burden of proof with respect to the facts decisive for the application of tax costs. If the taxpayer does not bear the burden, the tax administrator will exclude the costs as not tax deductible and increase the tax base by them.

However, situations may arise in which the taxpayer fails to bear the burden of proof regarding the tax deductibility of certain costs (or a group of costs), but it becomes apparent in tax proceedings that the taxpayer objectively had to incur some costs of a similar nature to realise the related tax income. If the tax administrator excludes these costs of the taxpayer en bloc, it may conflict with the tax administration's declared objective of correctly identifying and assessing taxes and ensuring their payment.[4]

3 § 24(1) of the Income Tax Act.
4 § 1(2) of the Tax Code.

Two partially contradictory principles thus stand in opposition to each other:

a) As such, the tax constitutes an interference with a constitutionally guaranteed property right and should be set according to the law and in the correct amount (not the maximum); and

b) The Income Tax Act provides for tax deductibility of costs only in the amount proven by the taxpayer.

A certain intersection of the two approaches is the recognition of the part of costs objectively minimally necessary to generate, assure and maintain the proven taxable income, i.e. 'essential costs'. In such a case, however, the tax is no longer determined on the basis of evidence, but in an alternative way using aids.

The SAC has dealt with essential costs on a regular basis in recent times. However, the case law has not been uniform, especially with regard to the fulfilment of the conditions for the transition from evidence to a tax determination using aids. Over time, the various chambers have taken one of two approaches:

a) When excluding one of the essential costs (or group of costs), the tax administrator should proceed to determine the tax according to the aids even if only a marginal part of the accounting (a specific cost) is questioned.[5] This approach emphasises setting the tax at the correct level.

b) In the case of the exclusion of essential costs, the tax administrator switches to the determination of tax according to aids only if the general conditions for switching to such a determination are met, i.e. in particular if a substantial part of the accounting is called into question.[6] This approach is based on the primacy of evidence as the main means of determining tax and the taxpayer's obligation to prove tax deductible costs.

The case at hand

In this context, the Eighth Chamber of the Supreme Administrative Court (SAC) dealt with a case in which the tax administrator excluded the costs of auxiliary construction work as tax-deductible during a corporate income tax audit because the taxpayer did not prove it had received the work from the declared suppliers, and did not prove its scope or price. The excluded costs represented 6.75% and 1.62% of the taxpayer's total costs in the audited tax years.

However, the actual execution of the work, including the impossibility of its execution by its own employees, was not questioned by the tax administrator. The taxpayer therefore requested that the tax administrator determine and recognise as tax-effective at least such minimum costs as had to be objectively incurred in order to obtain taxable income (the above-mentioned essential costs).

The tax administrator rejected this procedure because, in its estimation, the prerequisites for switching to the alternative method of tax assessment, i.e. according to aids, were not met. It would have done so if a substantial part of the taxpayer's accounts had been called into question and it had not been possible to determine the tax by means of evidence.

5 See e.g. the Supreme Administrative Court judgment of 28 February 2018, ref. No. 2 Afs 238/2017 – 35.

6 The approach of the Fourth (4 Afs 381/2019), Eighth (8 Afs 2016/2018) and Ninth Chambers (9 Afs 320/2019) of the SAC.

Consideration of the case by the Extended Chamber

In view of the inconsistency of the existing case-law, the Eighth Chamber referred the case to the Extended Chamber for consideration.

In its decision,[7] the Extended Chamber essentially struck a balance between the loose recognition of essential costs and the requirement to prove costs, while respecting the objective of tax administration, i.e. to determine the correct amount of tax.

The Extended Chamber concluded that *"if the tax entity fails to prove circumstances indicating the tax deductibility of a specific expense (group of expenses) pursuant to § 24 (1) of the Income Tax Act, the tax administrator is not obliged to switch from proving to determining the tax according to aids and to determine the relevant part of the expenses objectively at least necessary for the acquisition of the existing service or goods."*

At the same time, however, the Court acknowledged that it is not a necessary condition for the transition to the determination of tax according to the aids that a substantial part of the accounting records be called into question. According to the Extended Chamber *"there may be factual situations where, even if a marginal part of the accounts is disputed, it will not be possible, e.g. in view of the volume of the disputed contract in relation to the volume of other contracts in the relevant tax year, to determine the tax correctly enough on the basis of the evidence."* However, the fulfilment of the conditions will still have to be examined according to the circumstances of each case; the court did not set more specific limits.

At the same time, the Extended Chamber commented on the taxpayer's ability to prove costs if the conditions for switching to aids are not met. It stated that *"if the taxpayer proves that the expense (cost) claimed by the taxpayer actually occurred (had to be actually incurred), even if under different circumstances (including a different amount) than stated on the document, it can be recognised as a tax-effective expense, if other legal conditions are met. However, it must be remembered that this is an extreme situation where the standard statutory method of claiming the expense has not been followed by the taxpayer. If the taxpayer wants to eliminate the consequences of its error, it must also prove the incurrence of an essential cost."*

The Extended Chamber therefore emphasised the importance of evidence as the primary means of determining tax. At the same time, it emphasised the taxpayer's burden of proof as to the facts necessary for the correct assessment of the tax. The line of case-law according to which the tax administrator should proceed to the assessment of tax according to aids, even in the case of disputed individual facts, was thus superseded by the decision of the Extended Chamber.

Conclusion

In its decision, the Extended Chamber of the SAC emphasized that the primary method of determining tax is evidence. Although the possibility of recognising essential costs is not generally excluded, a mere reference to the objective necessity of their incurrence is, according to the Extended Chamber, insufficient. However, the threshold for the tax administrator to switch to the determination of tax according to aids is still open and must be examined on a case-by-case basis.

7 Resolution of the Extended Chamber of 13 February 2024, Ref. No. 8 Afs 296/2020 – 133.

Finally, it should be emphasised that the recognition of essential costs is only allowed for income tax. In the case of value added tax, it is always necessary to prove that the statutory conditions have been met for all supplies in order for the deduction to be recognised[8].

If you are interested in this area, please contact the authors of the article or your usual EY team.

The Extended Chamber emphasised the importance of evidence as the primary means of determining tax. At the same time, it emphasised the taxpayer's burden of proof as to the facts necessary for the correct assessment of the tax. The line of case-law according to which the tax authorities should proceed to the assessment of tax according to aids, even if the individual facts were disputed, was thus superseded by the decision of the Extended Chamber.

8 Supreme Administrative Court judgment of 9 October 2023, Ref. No. 5 Afs 91/2022-48.

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The Supreme Administrative Court on the question of the applicability of the exemption of income from a sale

In this issue, we bring you an interesting decision concerning the exemption of the sale of real estate by an individual.

Background

An individual (natural person – NP) sold a cottage, failed to claim the exemption on the amount corresponding to the purchase price and claimed the related technical improvement costs (these related costs were higher than the proceeds from the sale).

The tax administrator excludes from income the amount corresponding to the purchase price and at the same time excludes from expenses the amount spent on the technical improvement of the property in question, arguing that the conditions for the exemption of income from the sale have been met and such income should not be included in the tax return (and the related costs cannot be claimed).

The NP defended itself by arguing that the exemption is optional, further arguing that it actually used the property for business (notwithstanding that it had not accounted for it).

View of the courts

The NP did not succeed with this argument before the tax administrator or the regional court.

The case went to the Supreme Administrative Court (SAC), which also sided with the tax administrator.

As regards the exemption under § 4(1)(b) of the Income Tax Act (ITA), according to the SAC, it is not left to the will of the taxpayer whether or not to use this exemption (if the conditions are met). In the opinion of the SAC, the construction of the provision in question does not give the taxpayer the possibility to (dis)use the exemption, but such income is always exempt from tax if the conditions provided for by law are met.

As regards the objection of using the property for business purposes, the SAC stated that the NP did not prove that the formal condition (keeping tax records in relation to the cottage) had been fulfilled and at the same time the documents and statements submitted by the NP did not prove that it had actually used the cottage for business purposes during the relevant period (it only documented that it had rented the cottage three times during 2015, for a maximum of one week in May, July and August). According to the SAC, the provided documents do not suggest the feature of consistency had been met; there is no evidence of the provision of accommodation services, active marketing of the property, etc. According to the SAC, it appears from the documented evidence that the NP rather achieved occasional rental income in the context of managing its own property.

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

As regards the exemption under § 4(1)(b) of the Income Tax Act (ITA), according to the SAC, it is not left to the will of the taxpayer whether or not to use this exemption (if the conditions are met).

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ED None

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Did you know that:

- a draft amendment to the Act on International Cooperation in Tax Administration was published, which should implement DAC8 into Czech legislation?
- as of 2024, two new instruments limiting the taxation of unrealised exchange rate differences have been added?
- an updated EY VAT Guide was published?
- the CJEU has improved the chance of recovering VAT on bad debts?
- EY has prepared a guide to payroll taxation and employer obligations in more than 90 countries?