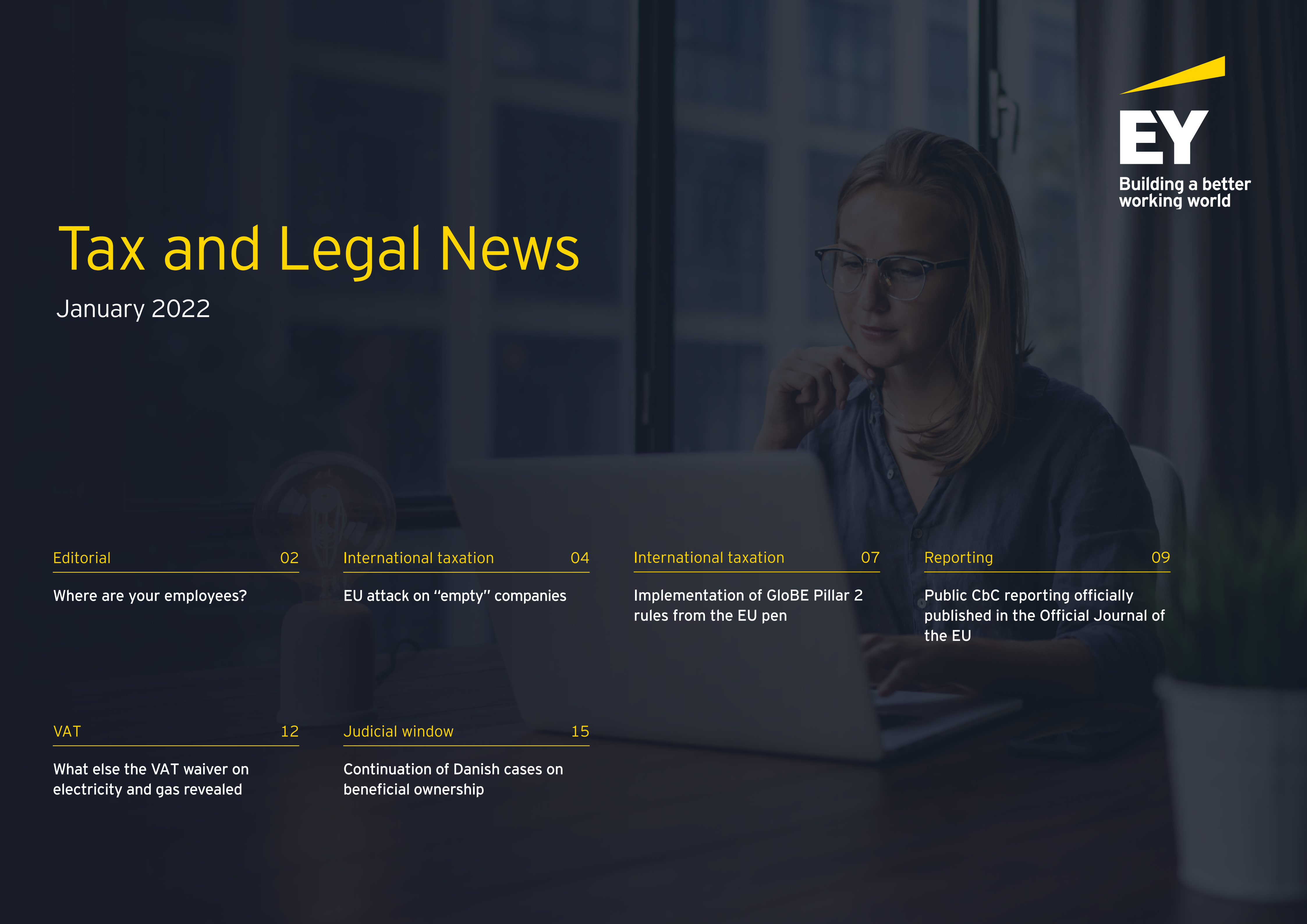

Building a better working world

Tax and Legal News

January 2022

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Where are your employees?

If all your employees are working on site, be it in production or the office, you might as well stop reading – or, if you like, you can read on and see the "joys" you're missing out on. If your people work at least partly from home, read on.

The foreign but apt term "home office" has been around in Czech for a long time, but in the last two years it has entered the vocabulary of employers who, pre-pandemic, considered it to be almost a dirty word. We've all pretty much gotten used to working from home and have learned to work with staff from their home offices. Companies often discuss with us what and how much they should reimburse their employees (it's not much and requires heaps of administration), whether they should tax it (they usually do, especially if they want to pay employees a lump sum) and also what they should reconfigure in their operations to keep their business running as it should (there's a lot).

But there's one area that's virtually shrouded in myth and legend – working from anywhere, which looks very tempting. Why sit at home in the kitchen when you can work somewhere by the sea under an umbrella? Employees often crave such opportunities and employers are understandably wondering how to accommodate them. However, the legislation is unprepared for such a revolutionary (albeit natural in today's circumstances) development and usually offers no specific or simplified rules. Since the beginning of the pandemic, it has become clear that working from anywhere is potentially problematic; the authorities are not very understanding and employers shouldn't turn a blind eye to the associated risks. But anyway, we've heard a thousand and one 'true' stories and have actually seen with our own eyes companies that allow their people to work from the seaside, the mountains or grandma's cottage in Slovakia without any time limit.

Yes, there are companies that make this possible. But they've either done a lot to make it happen, for example, registering for taxes or insurance in selected countries, changing internal regulations and employment contracts to comply with local legislation, or have simply stuck their heads in the sand, claiming "no one will notice". At the same time, a number of countries have already happily declared they're looking forward to taxing new 'beach workers'; some countries are actively looking for established permanent establishments and others are encouraging employers to register for social and health insurance. After all, budget shortfalls exist everywhere.

A number of risks can be significantly reduced, for example, by limiting home office time abroad. But chance is unpredictable. So, you may find yourself investigating a work-related injury to an employee on the other side of the world (according to a recent German judgment, going from bed to computer is a work-related journey and slipping on the stairs from the bedroom is a work-related injury). You may be dealing with the expulsion of your manager who set up a home office on the beach, but forgot he only has a tourist visa. You may already have a permanent establishment and corporate tax liability in a country so popular that statistically you'll always have at least one employee there. And you may unwittingly take the mental health of your payroll accountant to task after the end of the year to recalculate the payroll of an employee who became a tax resident while abroad, meaning you have his Czech tax payments all wrong.

It's good to accommodate employees, and in today's job market you may not have a choice. But it's worth considering whether enthusiastic employees working from anywhere is worth the risks involved. Part of what can help is at least having clear rules and an understanding of what you're at risk of within the boundaries you set abroad and at home. The above-mentioned missing legislative provisions that would simplify everything may, at least when it comes to tax, be partly hidden in the currently discussed international taxation reform, but their completion and implementation are certainly some time away.

Be careful in the New Year, but also healthy and happy.

Since the beginning of the pandemic, it has become clear that working from anywhere is potentially problematic; the authorities are not very understanding and employers should not turn a blind eye to the associated risks.

International taxation

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EU attack on "empty" companies

On 22 December 2021, the European Commission published a long-awaited proposal aimed at preventing misuse of shell entities (se further HERE).

We briefly summarize below our initial impressions:

- The initiative should be implemented via a new directive (and via an amendment of directive for administrative cooperation in the field of taxation).
- The new rules should apply to all entities that are considered tax resident in a Member State.
- The initiative should work with selected indicators.
- If the entity meets the following three indicators, it will be subject to new tax reporting obligations related to economic substance:

    1. High proportion of passive income.[1]
    2. Significant cross-border element (in terms of assets or income).[2]
    3. Its administration is outsourced.[3]

- There should be exceptions from this rule – e.g. for companies which have a security admitted to trading on a regulated market or regulated financial undertakings.[4]

[1] More than 75% of the revenue for the previous two years is "relevant income", i.e. (i) interest and other income from financial assets, (ii) royalties, (iii) dividends and income from the sale of shares, (iv) income from financial leasing, (v) income from immovable property, (vi) income from movable property held for private use with a book value of more than EUR 1m, (vii) income from insurance, banking or other financial activities, (viii) income from services outsourced to related entities. Alternatively, if the book value of immovable property or movable property held for private purposes above EUR 1m represents more than 75% of the value of the total assets (should apply to shares analogously).

[2] Either (i) more than 60% of the book value of assets such as immovable property or movable property for private purposes above EUR 1m was located outside the jurisdiction of the entity in the previous two years or (ii) at least 60% of the relevant income of the entity is earned or paid out via cross-border transactions.

[3] In the preceding two years, the entity outsourced the administration of day-to-day operations and the decision-making on significant functions.

[4] In addition, the exemption applies to (i) a holding company holding shares in operating companies, all of which (including the holding company's shareholders) are tax residents of the same Member State, (ii) a holding company whose shareholders or ultimate parent company are residents of the same Member State, or (iv) an entity with at least 5 full-time employees exclusively engaged in activities that generate relevant income.

- Such entities will be newly obliged to declare in their annual tax return (and substantiate), for each tax year, whether they meet the prescribed indicators of minimum substance - own premises in the given Member State, own active EU bank account or requirements concerning directors/employees[5].
- If the entity fails at least one of the substance indicators, it will be presumed to be an entity without the minimum substance (but with an option to prove otherwise[6]) and may (under certain circumstances) not be able to benefit from double taxation treaties / EU tax directives granted and, in some cases, the relevant income/assets of the entity may be taxed as if it had directly accrued to the entity's shareholder.
- Selected information should be subject to automatic exchange of information between the Member States.
- These new rules are expected to apply from 1 January 2024 (if approved).
- The proposal indicates that there should be a penalty for non-compliance of at least 5% of the entity's turnover.
- The European Commission indicated in its press release that next year it will focus on rules addressing non-EU entities with insufficient substance.

We will continue to monitor this tax initiative.

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

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[5] It is sufficient to meet one of the following two indicators: either (1) one or more of the directors (i) are tax resident in the Member State (or at distance compatible with proper performance of their duties), (ii) are qualified and authorized to make decisions with respect to activities generating relevant income, (iii) regularly, actively and independently use the authority described in the preceding point, (iv) are not employees of an unrelated entity and do not serve as directors of other unrelated entities, or (2) a majority of the employees are tax residents of the entity's state (or at distance consistent with the proper performance of their duties), and such employees are qualified to engage in activities that generate relevant income.

[6] An entity shall be considered to have rebutted the presumption of lack of substance if it demonstrates that it has performed and continuously had control over (and borne the risks of) business activities that generate relevant income (or assets). The entity should also (on application) not be subject to the obligations of the new regime if it can demonstrate that its interposition does not lead to a tax benefit for its owners or the group as a whole.

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Implementation of GloBE Pillar 2 rules from the EU pen

We have kept you informed about discussions at both the OECD and the EU levels concerning the revolutionary changes in global taxation.

As we already informed you, on 1 July a significant step was taken in the process when 130 jurisdictions (including the Czech Republic) issued a joint Statement under the OECD framework, in which they have joined a new two-pillar plan to reform international taxation rules. The Statement indicated an ambition to finalize the detailed technical parameters by October 2021.

On 8 October, 136 jurisdictions (out of the 140 members of the OECD/G20 Inclusive Framework on BEPS) joined the Statement on the two-pillar solution to address the tax challenges arising from the digitalization of the economy (see further HERE). It updates and finalizes the July political agreement to fundamentally reform international tax rules. The expected start of application of the new rules is year 2023.

We brought you an overview of main parameters of this two-pillar approach HERE.

In this context, OECD have just released model rules concerning main aspects of the so called GloBE rules within the Pillar 2 (see further HERE). We brought you our initial impressions HERE.

Just days after the OECD, the European Commission published a proposal for a Directive to implement these new rules within the EU (further HERE).

Simply put - the draft Directive sets forth a system consisting of two interlocked rules - the IIR (Income Inclusion Rule) and the UTPR (Undertaxed Payment Rule) - through which an additional amount of tax - "top-up tax" - should be collected each time that the effective tax rate due on the income of a in scope group in a given jurisdiction is below 15%. In such case, the jurisdiction is considered to be low-tax. Under this system, the parent entity of a group located in a Member State has an obligation to pay an IIR top-up tax calculated according to its allocable share in every entity of the group that is low-taxed (whether such entity is located within or outside the EU). The UTPR should apply in cases where the ultimate parent entity is located outside the EU in a jurisdiction that does not apply a qualifying IIR or where this jurisdiction operates a qualifying IIR but the ultimate parent entity and its resident subsidiaries are low-taxed, by allocating any residual amount of top-up tax to constituent entities of the group located in the EU.

At first reading, we were particularly interested in the following two aspects of the European Commission's proposal:

- The Commission proposes that a Member State may opt to apply a domestic top-up tax to constituent entities located in its territory. This election would allow the top-up tax to be charged and collected in a jurisdiction in which low-level of taxation occurred, instead of collecting all the additional tax at the level of the ultimate parent or other group entities through the UTPR.

- The Member State of a constituent entity applying the IIR, which is usually the jurisdiction of the ultimate parent, would be required to ensure effective taxation at the minimum agreed level not only of foreign subsidiaries, but also of all group entities resident in that Member State.

We will keep monitoring this initiative.

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

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Reporting

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Public CbC reporting officially published in the Official Journal of the EU

We're keeping you up to date on the development of the approval process regarding the introduction of public CbC reporting by selected multinational corporate groups and the main related parameters.

This was formally approved by the Council of the EU at the end of September (more HERE), followed by approval by the European Parliament in November (more HERE) and, on 1 December 2021, the initiative (in the form of an amendment to Directive 2013/34/EU[7]) was published in the Official Journal of the EU (more HERE).

This Directive entered into force on the 20th day following its publication in the Official Journal of the EU (i.e. 21 December 2021). Member States have 18 months to transpose it into national law (i.e. by 22 June 2023).

Reporting will commence no later than the financial year beginning on or after 22 June 2024, and the report should generally be made publicly available within 12 months after the end of the financial year.

So we can expect the first reporting in 2025/2026 (unless some countries decide to require it earlier).

Key reporting parameters

This new obligation should apply to groups with a consolidated turnover exceeding (in two consecutive years) EUR 750 million (and a certain level of presence within the EU).

The exception would be financial groups already reporting under Article 89 of Directive 2013/36/EU.

This report should include (for the given financial year) the following:

- the name of the ultimate parent undertaking, the relevant accounting period, the currency and, where applicable, a list of all subsidiaries consolidated in the financial statements of the ultimate parent undertaking for the relevant accounting period established in the EU or in the tax jurisdictions listed in Annexes I and II of the EU list of non-cooperative tax jurisdictions;

[7] Directive 2013/34/EU on the annual accounts, consolidated accounts and related reports of certain types of undertakings

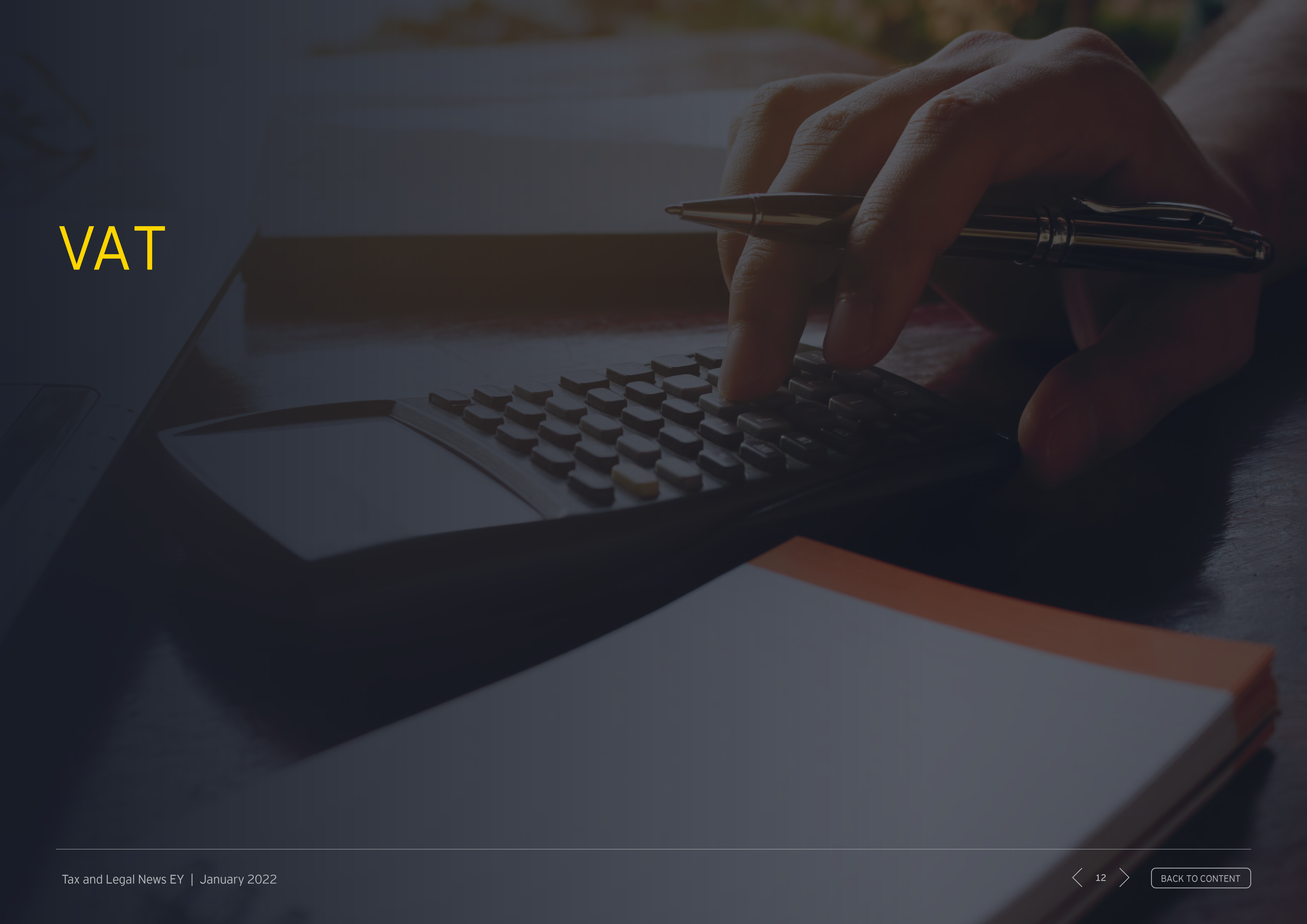
- brief description of activities;
- number of employees;
- revenues;
- profit before tax;
- accrued income tax;
- paid income tax;
- accumulated earnings.

The information should be reported broken down by Member State and, as far as other countries are concerned, also separately for countries listed in Annex I of the EU list of non-cooperative jurisdictions ("blacklist") or those listed for two consecutive years in Annex II of the EU list of non-cooperative jurisdictions ("gray list"). Aggregated data should be provided for the rest of the world.

A five-year "safeguard clause" was agreed, allowing Member States to allow a delay in publication of certain commercially sensitive information over that period; this exception should not apply for information about the "blacklisted" countries.

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

Public CbC reporting will begin no later than for the fiscal year beginning on or after 22 June 2024, and the report should generally be publicly available within 12 months after the end of the fiscal year. Thus, we can expect the first reporting in 2025/2026 (unless some countries decide to require it earlier).



VAT

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What else the VAT waiver on electricity and gas revealed

As of 31 December 2021, the waiver of VAT on the supply of electricity and gas, which applied to advances received or taxable supplies effected in November and December 2021, expired[8]. In this article, we'd like to look back and highlight some unexpected issues that we've discussed with our clients in relation to the VAT waiver.

What does the (average) customer buy?

The VAT exemption applied only to electricity and gas for heat production. One of the relatively frequent ambiguities (especially in rental relationships) was what kind of supply customers were actually buying. In other words, whether the medium invoiced to the customer is a separate supply (supply of electricity, gas, heat, cold, water) or whether it is one component of a more complex supply with a different VAT rate. Both the supplier who has determined the wrong VAT rate and the recipient who wrongly claims a higher tax deduction may have a problem.

An example is a situation where the landlord supplies heat to tenants using a gas boiler. At the time the VAT waiver was in force, tenants approached the landlord with requests for VAT to be waived, as the landlord had long been invoicing for gas supplies and applying 21% VAT. It is clear that in this particular situation the landlord did not supply the tenants with gas (21% VAT or exemption) but with heat (10% VAT). With some exaggeration, this can be compared to a situation where a cleaning company would charge its customers for water consumption (10% VAT) instead of cleaning services (21% VAT).

We have come across many other cases where the waiver of VAT on electricity and gas has revealed a deeper problem in determining the subject matter of the tax. In most cases these were lease relationships where the media were incorrectly charged either as a separate supply or as part of the lease. Although the boundary between these categories may not always be

[8] GFD information on electricity and gas billing in connection with VAT remission (Ref. 70709/21/7100-20116-050822) – here;
ADDENDUM to the INFORMATION of the General Financial Directorate on electricity and gas billing in connection with VAT remission (Ref. 77980/21/7100-20116-050822) – here;
Information of the GFD on the WAIVER of value added tax on the supply of electricity or gas (due to an extraordinary event) of 20 October 2021 – here

clear, some helpful criteria can be found in the case law of the CJEU and the current GFD Information. We also recommend that sufficient attention be paid to the correct formulation in the contract documentation and subsequent invoicing.

When does the obligation to pay VAT arise?

The VAT remission also revealed in many cases incorrect determination of the date of the taxable supply for the supplied media and, with it, the problem on the customer's side of whether they can claim a deduction of the tax that perhaps should have been waived. In its Information, the GFD emphasised that the date of taxable supply for metered media is primarily the date of reading from the metering device. Only if the actual consumption is determined otherwise than by reading from the metering equipment (e.g. calculation of consumption per individual flats or non-residential premises without separate metering equipment), can the date of taxable supply be determined as the date of determination of actual consumption. This GFD interpretation is not entirely new, but it has nonetheless surprised many taxpayers.

In today's digital age, however, even the moment of reading from the measuring device may not be entirely clear, e.g. in plants where consumption is measured continuously and the supplier has the current readings available in an online application at all times.

How to account for partial supplies?

In practice, it is also not entirely uncommon for the landlord and tenant to arrange for electricity or gas supplies in the form of so-called partial supplies (often together with other services such as cleaning, security), i.e. they do not make advance payments during the year, but declare VAT, for example, monthly or quarterly, typically with subsequent annual reconciliation. The GFD does not envisage this option in its Information and works only with the option of advances and their subsequent settlement according to § 37a of the ITA.

However, in the case of the negotiation of partial supplies, it is not entirely clear how any over- or underpayment should be settled; several interpretative options are available. The wording of lease agreements can also be important – we have come across some that combine deposits, partial payments and reconciliation in a very unintelligible way.

Are advances sufficiently exact?

If the customer pays one advance payment for a supply falling under several VAT rates (e.g. electricity and water), the taxable supply is not known with sufficient certainty and such advance payment is not taxable under § 20a(2) of the VAT Act.

The GFD Information introduced some uncertainty into this established interpretation. In it, on the one hand, the GFD treated the remission as a zero-rated VAT, but on the other hand, the Information stated that the advance payment received, which includes other supplies besides gas/electricity (e.g. overhauls of gas boilers), must be split into a commodity-specific part. The question is whether such an approach can be considered a one-off or whether increased attention is needed for indeterminate advances in the future.

If any of the situations described above apply to your company, we would be happy to work with you to consider contractual documentation and practical solutions.

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

The waiver of VAT on electricity and gas has revealed some hidden problems that have spillover effects and need to be addressed even after the waiver ends. We will be happy to assist you with a review of contract documentation and practical solutions.

Judicial window

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Continuation of Danish cases on beneficial ownership

We have received an unofficial translation of the Danish High Court's decision on Danish tax cases concerning the application of withholding tax on interest, decided two years ago by the Court of Justice of the European Union (more HERE). Below is a brief summary of our observations.

Case 1 – Case C 118/16, X Denmark

- Private Equity (PE) funds owned a stake in Luxembourg investment company SICAR, which in turn owned a stake in Swedish company 1, which in turn owned a stake in Swedish company 2, which in turn owned a stake in a Danish company.
- SICAR made a loan to Swedish company 1, which made a contribution to Swedish company 2, which in turn made a loan to the Danish company.
- Thanks to special Swedish rules, Swedish companies 1 and 2 were able to set interest income and costs against each other.
- The Danish tax authorities did not grant double tax treaty or EU interest directive protection for interest payments made by a Danish company and assessed withholding tax on the basis that the companies in the chain were not beneficial owners within the meaning of the Treaty or the Directive, and there was no evidence that the majority of investors in the PE funds qualified for the protection of any other double tax treaty.
- The Danish court rejected the company's appeal, finding, inter alia, that
  - the two Swedish companies were brought into the structure primarily to obtain a tax advantage and neither can be considered the beneficial owner of the interest income within the meaning of the Treaty or the Directive;
  - the PE fund investors cannot be considered beneficial owners, as it was not demonstrated that the interest income of the Luxembourg SICAR was taxed via these investors;

- the Luxembourg SICAR does not qualify for treaty or directive protection because, as a result of the special tax regime, the interest income in question is exempt.

Case 2 – Case C 115/16, N Luxembourg 1

- The PE funds set up Luxembourg company 1, which owned Luxembourg company 2, which in turn owned a stake in a Danish company, and within this structure a loan was made to the Danish company (more or less mirrored between all the companies in the structure).

- The Danish tax authorities did not grant double tax treaty or EU interest directive protection for interest payments made by the Danish company and assessed withholding tax on the basis that the companies in the chain were not beneficial owners (conduits), while PE funds do not qualify for treaty protection.

- It should be noted that initially the funding from the funds was provided directly, however, before the change in tax rules, the Luxembourg companies were inserted into the structure.

- The Danish High Court rejected the company's appeal, stating, inter alia, that the structure had the main objective of achieving a tax advantage – it was therefore abusive and the Luxembourg companies should be regarded as mere conduits, and that it could not be shown that the investors in the funds could be regarded as the beneficial owners.

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

The Danish High Court rejected the company's appeal, stating, inter alia, that the structure had the main objective of achieving a tax advantage – it was therefore abusive and the Luxembourg companies should be regarded as mere conduits, and that it could not be shown that the investors in the funds could be regarded as the beneficial owners.

For further information please contact either your usual partner or manager.

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Did you know:

- The General Financial Directorate issued a directive setting uniform rates for the 2021 tax year pursuant to § 38 of the Income Tax Act?
- The Second Chamber is of the opinion that, in view of the inconsistent case law concerning the conditions of § 23(7)(b)(5) of the Income Tax Act, it cannot rule on the matter itself, and has therefore referred the case to the Extended Chamber?
- The Czech Statistics Office issued a communication with a list of goods that are not intended for simplified reporting in Intrastat?
- The Supreme Administrative Court dismissed a cassation complaint concerning the application of VAT on chain transactions?
- The Ministry of Finance has announced it will not proceed with a further extension of the VAT waiver for filtering respirators and protection class FFP2 respirators?