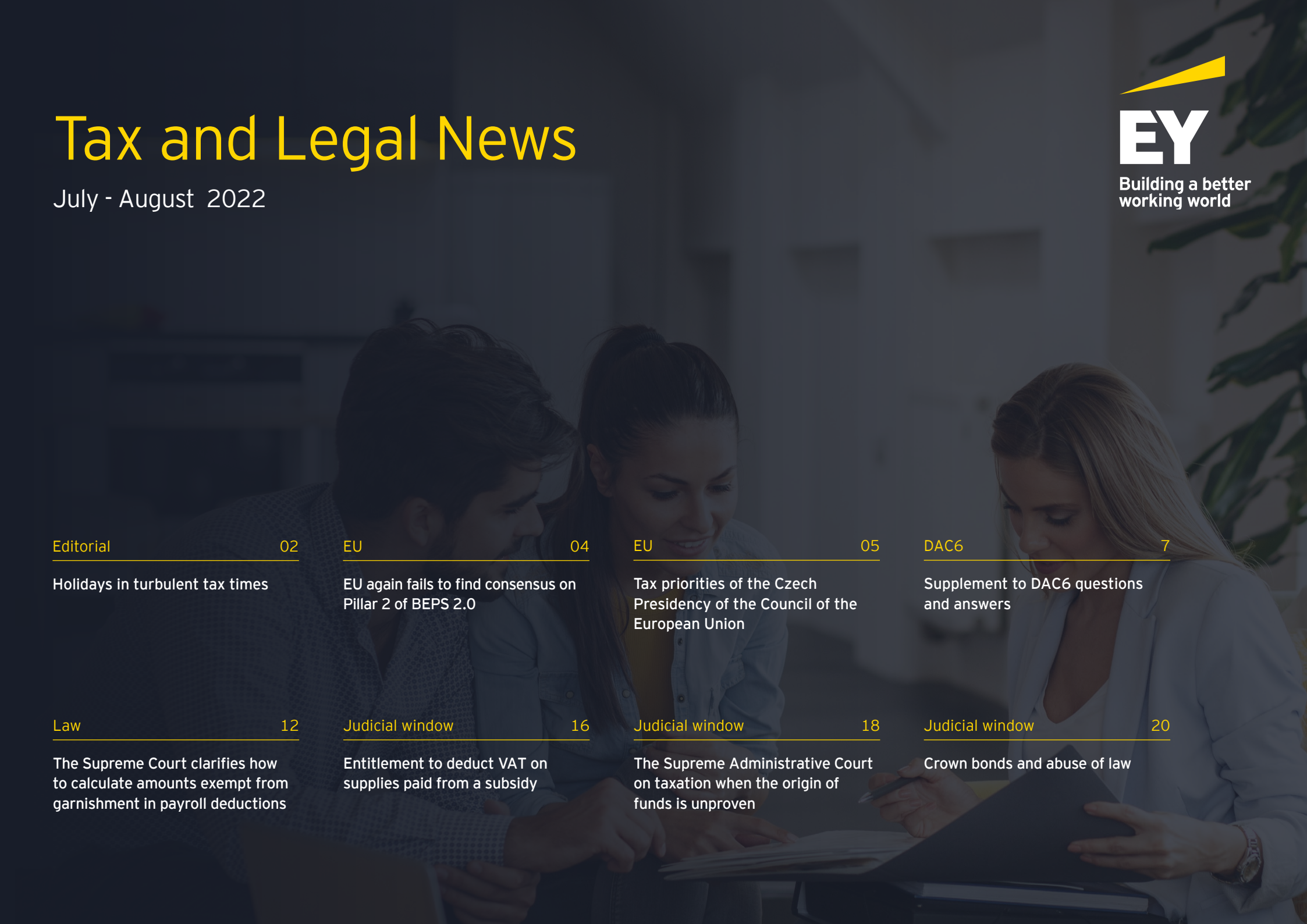
Tax and Legal News

July - August 2022

Building a better working world



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Holidays in turbulent tax times

July is (finally) here, which for many of us (in the northern hemisphere) means summer vacation. I'm looking forward to sun, sea and relaxation and, for a while at least, forbidding myself from thinking about the turbulent changes and trends in the tax world…

and the fact that there are a lot of them on the table at the moment. For example:

- A two-pillar reform of the international tax system, which without exaggeration may represent a global tax revolution that could significantly affect both the way multinational corporations operate as well as national tax policies.
- The ATAD3 or Unshell initiative, which intends to shine a light on companies with an insufficient substance.
- The DEBRA initiative to make equity investment more attractive (as opposed to the currently preferred loan financing).
- The increasingly strict approach of tax administrators (but also the courts) to the concept of beneficial ownership, as evidenced, inter alia, by recent rulings on the issue of sublicenses.
- The increasingly strict approach of tax administrators (but also courts) to the concept of abuse of law, as evidenced, inter alia, by recent judgments concerning various forms of refinancing.
- Greater pressure for transparency; examples include DAC6 (reporting on potentially problematic tax structures), the new DAC7 (reporting on digital platform operators) and the upcoming DAC8 (reporting on crypto-assets).
- The increasingly strict approach of tax administrators (but also courts) to evidence; examples include recent decisions concerning advertising services, financing costs or costs related to the holding of subsidiaries.

Anyway… . I was talking about rest. So for now, I'm going to put these matters aside and get out into the sun.

To all our loyal Tax and Legal News readers: thank you for reading. I wish you a wonderful peaceful holiday season. See you again in September!

Have a wonderful holiday!

EU

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EU again fails to find consensus on Pillar 2 of BEPS 2.0

We keep you informed about the discussions on the revolutionary changes to the international tax system under consideration, both at OECD and EU level.

Simply put, the BEPS 2.0 initiative rests on 2 pillars:

- taxing a larger share of the profits of selected multinational corporations in the countries where they have customers (Pillar 1) and
- the introduction of a global minimum effective tax rate (Pillar 2).

Last time we informed you (HERE) that there are whispers behind the scenes that there could be a breakthrough in the negotiations at the Ecofin meeting on 17 June and EU countries could find a consensus on the proposed EU Directive implementing Pillar 2.

This did not happen.

This time Hungary opposed the proposal.

What could this move mean? One can speculate that the EU will not just abandon this initiative and that it will still be looking to find a solution to implement this initiative. More pressure can be expected to push for a qualified majority voting system instead of unanimity on tax matters, or to push for the so-called enhanced cooperation.

Let us see.

We will continue to monitor this initiative and everything that goes with it.

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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Tax priorities of the Czech Presidency of the Council of the European Union

In connection with the Czech Presidency of the Council of the European Union, the Ministry of Finance (MF) published its priorities in the ECOFIN Council.

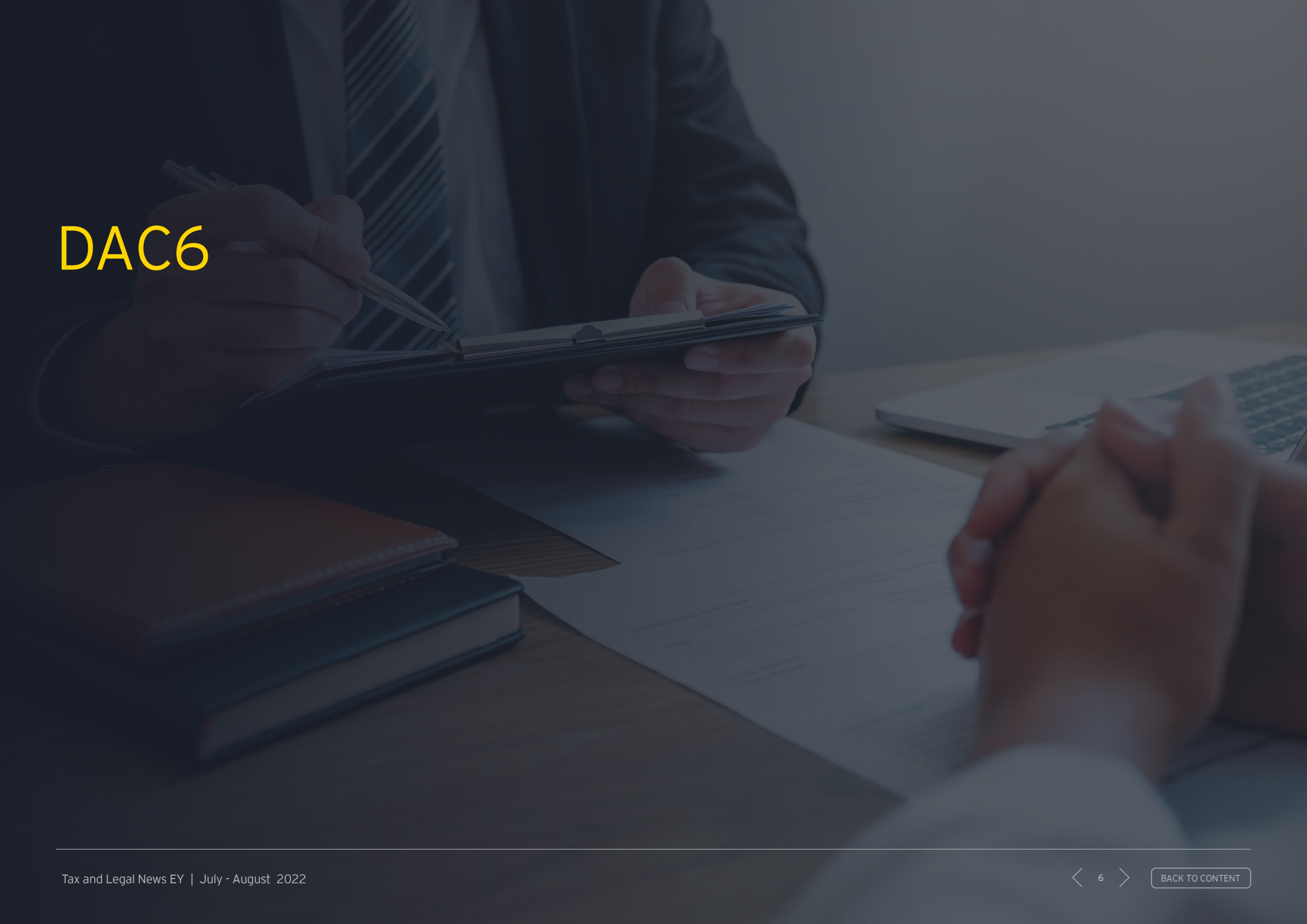
For the area of taxation, the MF will aim in particular at the following (more details HERE):

- simplification of the tax system and reduction of the number of unjustified tax exceptions;
- continuing the preparation of the amendment of the Directive on the taxation of energy products and electricity and adapting it to the current climate targets;
- simplifying and modernising VAT rules to fight tax evasion more effectively;
- discussing the setting up of taxation of the digital economy and the implementation of the OECD global agreement on the taxation of multinational companies in the EU legal framework;
- updating the European list of tax non-cooperative jurisdictions.

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

One of the tax priorities of the Czech Presidency of the Council of the European Union is simplification of the tax system and reduction of the number of unjustified tax exceptions.

DAC6



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Supplement to DAC6 questions and answers

The Directorate General of Finance ("DGF") has just issued a supplement to the Frequently Asked Questions and Answers ("FAQs"), including practical examples, in relation to the reporting requirement for reportable cross-border arrangements ("DAC6"). Below is a selection of what caught our eye.

Basic concurrence and assessment of the main benefit test ("MBT")

For a cross-border arrangement to exist, there must be a concurrence of "the existence of a particular arrangement proposed by someone" and "some tax benefit, or concealment of income or assets or circumvention of the OECD common reporting standard, arising from such arrangement".

If the above-mentioned concurrence ("basic concurrence") does not occur, it is not a cross-border arrangement subject to the reporting obligation. If there is a basic concurrence, the fulfilment of at least one of the hallmarks must be verified (possibly, where necessary, with the application of the MBT).

In view of the fact that the Explanatory Memorandum to Act No. 164/2013 Coll., on International Cooperation in Tax Administration ("DAC6 Act") implementing DAC6 states that the MBT consists in examining whether there is a causal link between a hallmark of the arrangement and the tax advantage that can be expected if the arrangement is applied, the causal link can be examined as follows:

- If a tax advantage results from the arrangement but is not the result of the fulfilment of the hallmark, then there is no longer an assessment of compliance with the MBT and therefore no reporting obligation.
- If the arrangement gives rise to a tax benefit which is the result of the fulfilment of a hallmark, there is no automatic fulfilment of the MBT and it is necessary to assess whether the obtaining of the tax advantage is the main benefit or one of the main benefits of the arrangement.
- The MBT is not fulfilled where the tax advantage does not constitute a tax saving (for example, it may be a simplification of administration or a procedure whereby no reporting obligations other than those set out in the DAC 6 amendment will be required).

Transparent entities

A tax transparent entity is typically considered to be a relevant taxpayer of the arrangement and none of its investors (members/partners) are relevant taxpayers of the arrangement purely by virtue of their position as investors (members/partners) - the reporting obligation is therefore on the tax transparent entity (not its individual investors).[1]

However, this is not the case where the shareholder/partner/investor itself is directly involved in the relevant arrangement and is therefore a relevant taxpayer of the arrangement. In such a case, the shareholder/partner/investor in the arrangement is a party to the contract or transaction that is part of the arrangement. An example of this situation is the transfer of assets between a tax transparent entity and its shareholder/partner. In this case, not only the transparent entity but also its partner is the relevant taxpayer.

Arrangement created within a group - role of intermediary vs relevant taxpayer

In this context, two situations may arise:

1. A cross-border arrangement created within a group by another group entity, but this entity only designed the arrangement for other entities in the group, but does not participate in it itself (i.e., is not a relevant taxpayer of the arrangement). In this case, the entity that created the arrangement shall report it as an intermediary.

2. A cross-border arrangement created within a group by another group entity, except that this entity is itself involved in the arrangement as a relevant taxpayer. In this case, this entity (albeit the one managing or coordinating the implementation of the arrangement), does not report the arrangement as an intermediary, but as a relevant taxpayer of the arrangement.

Provision of tax return preparation or post-implementation services by a tax advisor/attorney or audit of financial accounts by an auditor

In this case, the activity is not an activity of an intermediary if

- the tax adviser/attorney/auditor does not also design, market, organize, make available, manages the implementation, or provide advice in this connection , since the arrangement has already been implemented;

- the activity does not establish a new arrangement or an amendment or addition to an existing arrangement.

Marketable arrangements - what changes to report

New information is reported that a new entity has implemented the arrangement. This new entity may be created as a result of a transformation (division, spin-off or merger). Information is not reported if, for example, there is only a change of name, registered office address or dissolution of the company without a successor company, etc.

Brexit

If a reportable cross-border arrangement has more than one obliged person from more than one EU Member State who have agreed between them that only one of them will file a report in the UK in the period until 31 December 2020, then the obliged persons in the Czech Republic are not obliged to file a report if the report contained the same information. In this case, the obliged persons in the Czech Republic should be able to prove that the report has been filed in the UK - therefore it is advisable to have an arrangement identification number ("A-ID").

1 Partners may be associated entities and therefore should be listed where it is relevant to indicate associated entities.

Which associated persons must be listed in the DAC6 report

There is an obligation to list in the report only those associated persons who are directly affected by the arrangement, not all associated persons, and the listing of associated persons is only relevant for hallmarks that require the arrangement to arise between associated persons.

Definition of associated entities – acting together

The concept of "acting together" within the meaning of section 14b(4) of the DAC6 Act is met, for example, where a cross-border arrangement prescribes that several persons exercise voting rights or other rights arising from the ownership of a share in concert.

Practical examples

Sale of a share in a Czech company between two foreign entities (within the same jurisdiction)

Such a transaction does not in itself meet the definition of a cross-border arrangement. On the other hand, it cannot be excluded that the said sale will be part of a series of arrangements.

Hallmark B.1 - Assumption of tax losses of the dissolving company in a cross-border merger

The Czech parent company is a 100% owner of the foreign subsidiary, both companies carry out similar economic activities and the foreign subsidiary has tax losses from these activities. The Czech parent company decides on a cross-border merger, whereby the foreign subsidiary is dissolved and the tax losses are taken over by the successor company in accordance with Sections 23c and 23d of the Czech Income Tax Act ("ITA"). In such a case, the conditions of hallmark B.1 are not fulfilled. The conditions of the hallmark require a wider range of artificially contrived steps in the arrangement, which the situation described above does not satisfy.

Hallmark B.2 - capitalization of the loan receivable

The capitalization of a loan receivable may be part of a broader process fulfilling hallmark B.2 if, for example, the objective is to achieve lower taxation of dividends compared to the taxation of interest between the companies involved.

Hallmark B.3 - Special tax treatment for foreign investments

Selected jurisdictions offer advantages to foreign direct investments that they seek to attract in this way. For example, this may include lower taxation, more favorable land use rights, administrative support, etc... Hallmark B.3 may be fulfilled if local entrepreneurs bring out part of their capital abroad and then use it, disguised as foreign capital, to invest in their home jurisdiction in order to obtain tax benefits exclusively for foreign investors.

Hallmark C.1.b.i. - almost zero tax rate

An almost zero tax rate is defined as a nominal tax rate of less than 1%.

Hallmark C.2 - depreciation of assets by both permanent establishment and head office

This hallmark is not targeted at these situations as it is a logical consequence of the permanent establishment concept and the principles of international taxation, i.e. depreciation is applied by both the head office and the permanent establishment according to the principles of the given jurisdiction, but at the same time the related income is included in their tax base in both jurisdictions.

Hallmark C.2 - sale of assets from the Czech Republic to another jurisdiction if the income from the sale is taxed and the new owner subsequently starts depreciating the assets again

The hallmark will only be met if depreciation is applied in two jurisdictions simultaneously. The situation described does not fulfil hallmark C.2.

Hallmark C.2 - cross-border leasing where the leased asset is tax-depreciated by both the Czech lessor and the foreign lessee

If there are deductions for the same depreciable assets in more than one jurisdiction, hallmark C.2 is likely to be met.

An example would be a situation where a foreign company owns buildings worldwide through its subsidiaries. As a result of this qualification, the building will be depreciated in both jurisdictions. The Czech subsidiary owns real estate in the Czech Republic and depreciates that real estate for tax purposes. The foreign parent company depreciates it in the same way.

Hallmark D.1.b - a bank, on the basis of a payment order from its customer, transfers funds from its customer's account to an account in a country with which there is no automatic exchange of information on financial accounts

A single instruction to transfer funds cannot be considered as an arrangement. A bank that executes a transfer order at the request of its customer without further knowledge of the arrangement does not constitute an activity of an intermediary of an arrangement.

Hallmark E.1 - provision of an interest-free or low-interest loan to a subsidiary by a foreign shareholder

In the case of an interest-free or low-interest loan between related parties, the exception under Section 23(7) of the ITA is used, which allows for a deviation from the arm's length principle. This type of transaction thus fulfils the definition of a unilateral safe harbor and therefore the fulfilment of hallmark E.1.

Where several similar loans fulfilling the E.1 hallmark are made between the same entities (same lender and borrower), it is sufficient if the arrangement is reported only once.

Similarly, if there is an increase or repayment of the loan, or a change in the interest rate or a change from interest-bearing to non-interest-bearing for loans already reported, there is no need to report the change.

In case the loan is made by the same lender as the previous loans but to a new borrower, in such a case, a fresh report is necessary as it is a new relevant taxpayer of the arrangement.

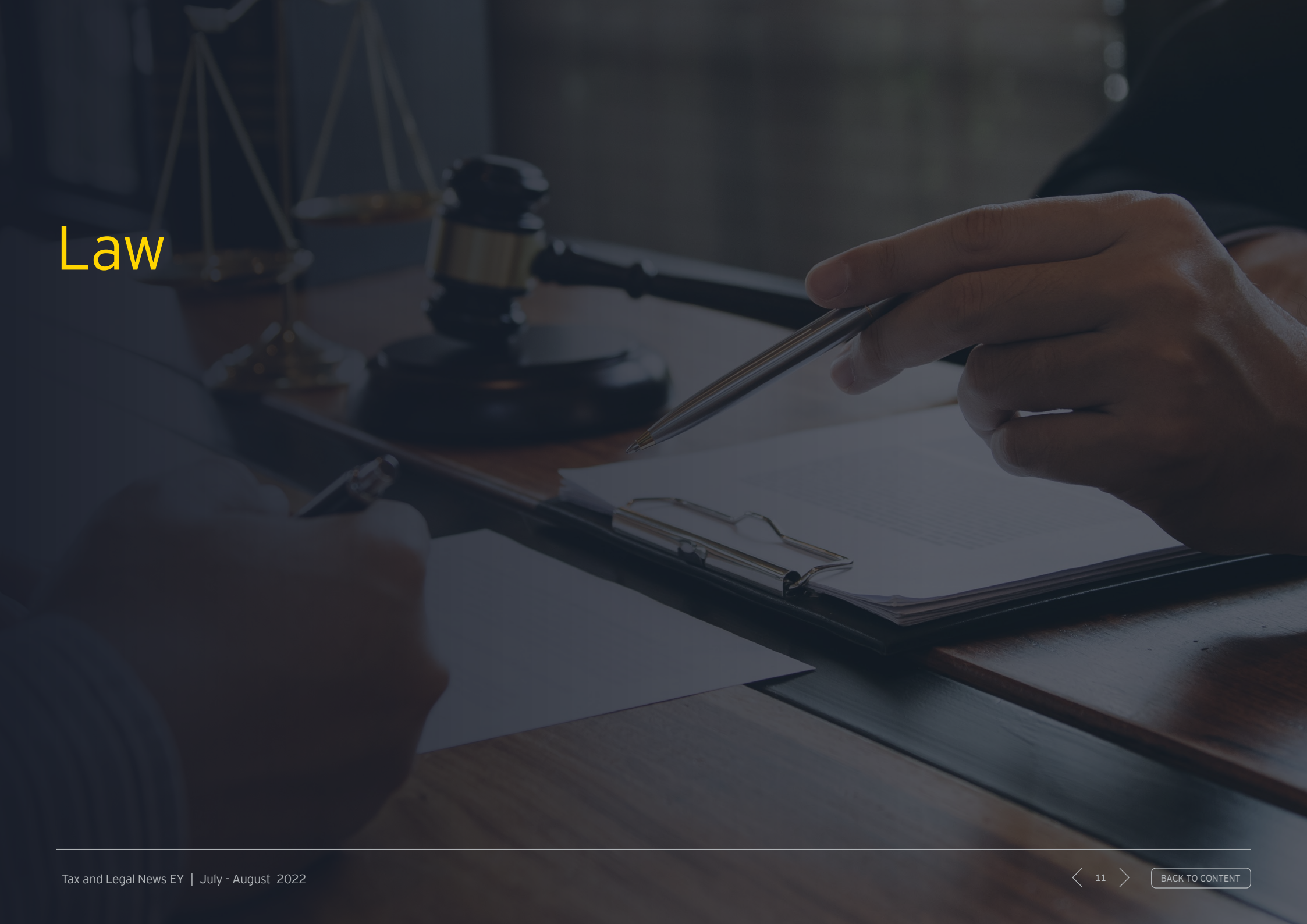
Hallmark E.3 - Calculation of the test

The period of 3 years after the transfer can be understood as a period of 3 x 12 months following the date on which the relevant transfer is made. The projected annual earnings over that period is then the result of the projection for each such period, and a fall below the 50 % threshold for at least one such period should be sufficient to satisfy the condition of hallmark E.3.

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

The Directorate General of Finance has just issued a supplement to the Frequently Asked Questions and Answers, including practical examples, in relation to the reporting requirement for reportable cross-border arrangements (DAC6).

Law



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The Supreme Court clarifies how to calculate amounts exempt from garnishment in payroll deductions

Early this year, an amendment affecting normative housing costs caused many employers' heads to spin, leaving them uncertain as to how to proceed with payroll garnishments of debtor employees and what amount they could correctly garnish. There have been three changes to the legislation affecting the calculation of "amounts exempt from garnishment".

The standard increase in normative housing costs by Government Decree No. 507/2021 Coll., with effect from 1 January 2022, and the increase in the amount of the subsistence minimum by Government Decree No. 75/2022 Coll., with effect from 1 April 2022, didn't cause any difficulties. In addition, however, Act No. 117/1995 Coll., on state social assistance, was amended with effect from 20 January 2022 due to rising energy prices. A new provision, § 26a, was added to the State Social Assistance Act, which specifically provided for an increase in the monthly standard cost of living for 2022. Interpretations have differed as to whether the increased amount of the standard cost under this provision should also be used for the purposes of calculating amounts not subject to wage garnishment.

On 24 February 2022, the Regional Court in České Budějovice issued a measure addressed to insolvency administrators under the jurisdiction of this court, assistant judges and senior court officials of the insolvency department of this court, in which it determined that when calculating insolvency repayment, the amount exempt from garnishment (or the amount of normative housing costs) shall not be increased by the amount referred to in § 26a of the State Social Assistance Act. The Regional Court in Hradec Králové issued the same measure in March.

The Ministry of Justice expressed an opposing view in its methodology for calculating debt relief instalments, where it stated that for the purposes of calculating the amount exempt from garnishment, the increase in normative housing costs under § 26a of the State Social Assistance Act must be taken into account.

Due to these uncertainties, the Supreme Court has begun to address the situation, and in its unifying opinion of 8 June 2022, it successively discusses the various aspects of the situation.

First, it focuses on the State Social Assistance Act amendment that introduced the provision of § 26a. The explanatory memorandum to this amendment states that significantly increased electricity and gas prices have been announced by energy suppliers for 2022. The housing benefit is intended to help families in rental and owner-occupied housing keep 70% of their income after housing costs (65% for Prague). Housing costs are counted up to the maximum amount of the normative housing costs set by law. A government regulation cannot adjust these amounts in response to an increase in energy prices because the power to issue such a regulation contained in § 28 of the State Social Assistance Act does not provide for such a variant. The adoption of the amendment in question was therefore aimed at eliminating this inconsistency between the legal regulation and the factual situation.

The Supreme Court further discusses the above-mentioned measures of the regional courts in České Budějovice and Hradec Králové, referring to the opinion of the Constitutional Court, according to which the court does not have to interpret the applied provisions of the law literally, but must also be guided by the meaning and purpose of the law. The Supreme Court stated that a linguistic, systematic and logical interpretation of the provisions in question could not lead to the conclusions reached by the aforementioned regional courts.

Government Decree No. 507/2021 Coll. set the amount of normative costs for 2022 as stated in § 26 of the State Social Assistance Act. The provision of § 26a(1) of the Act states: *"For the period from 1 January 2022 to 31 December 2022, the amounts of the monthly normative cost of housing set by Government Decree issued under § 28 for the year 2022 shall be increased for the purpose of determining entitlement to housing benefit and the amount thereof (...)."* Therefore, according to the Supreme Court, a linguistic interpretation will undoubtedly lead to the conclusion that the intent of the provision in question is to increase the amounts set for the year 2022 by government regulation in § 26 of the State Social Assistance Act. At the same time, there is no argument within the framework of logical interpretation that would go against the linguistic interpretation. A systematic interpretation also supports the above, as all the provisions under review are found in Title Three of the State Social Assistance Act and relate to the housing allowance, and their temporal scope does not prevent § 26a of the Act from being used to determine the total amount of normative housing costs for 2022.

Moreover, the reference to § 26 of the State Social Assistance Act in footnote 2) of the Government Regulation on amounts exempt from garnishment in a certain sense strengthens the argument that the amounts of the increase in the monthly normative housing costs for 2022 according to § 26a of the Act should be taken into account when determining the amount exempt from garnishment. In its earlier opinions, the Supreme Court has already confirmed that footnotes may be used to interpret a normative text, even though they are not part of it.

For the foregoing reasons, the Supreme Court adopted the following opinion:

"When determining the amount exempt from garnishment of the monthly wages of the obligor (Article 278 of the Code of Civil Procedure), the amount of normative housing costs for 2022 (defined by Government Decree No. 507/2021 Coll.) is increased by the amount specified in § 26a(2) of Act No. 117/1995 Coll. (as amended). This also applies to the determination of the amount exempt from garnishment for the purposes of determining the amount of the debtor's (insolvency) instalment payment in the case of a repayment plan with the monetisation of assets (§ 398[1] and [3] of the Insolvency Act)."

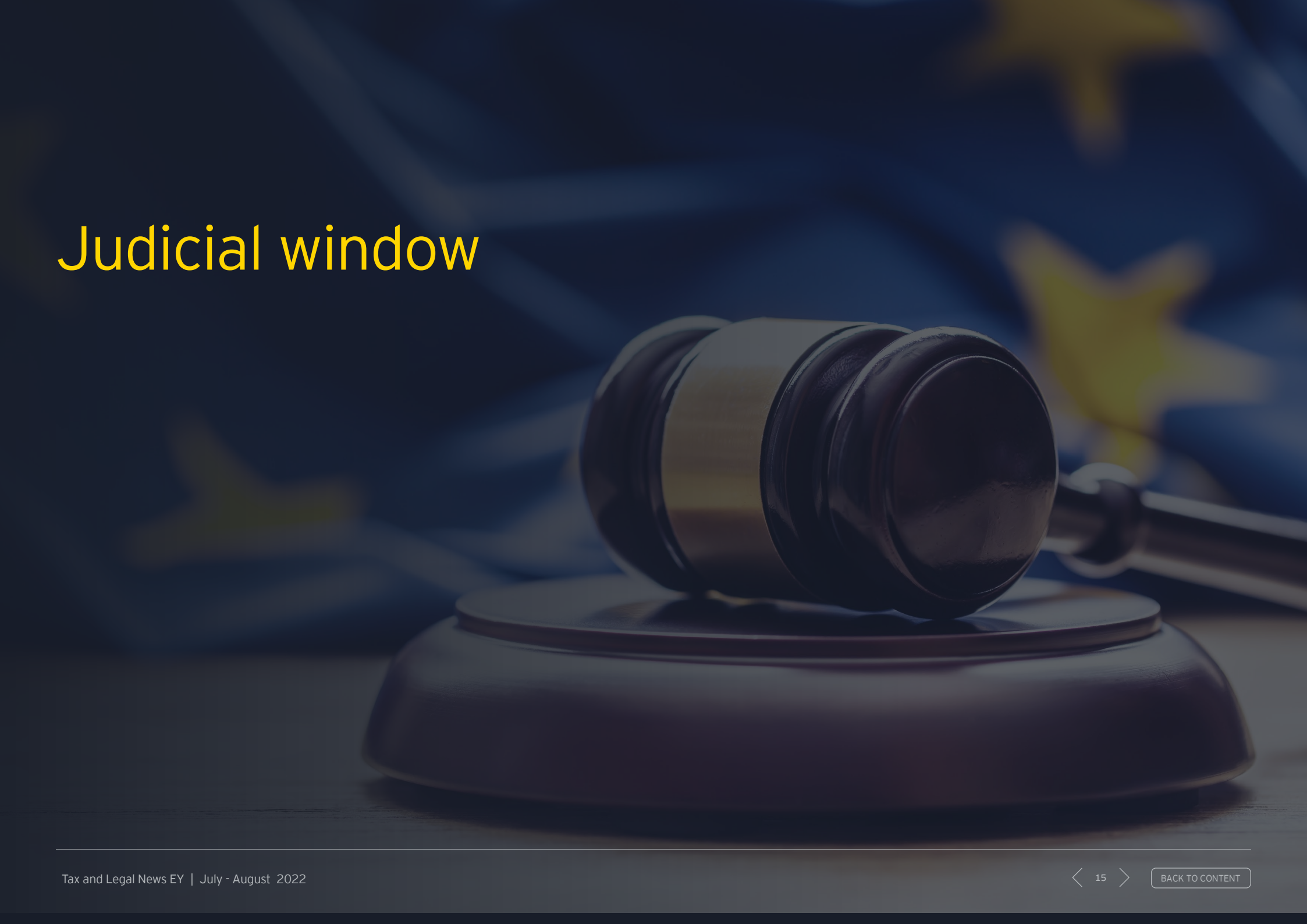
Ultimately, the Supreme Court indirectly considered as correct the procedure set out in the Ministry of Justice's methodology for calculating debt relief instalments, according to which, for the purposes of calculating the amount to be garnished, the increase in the normative housing costs pursuant to § 26a of the State Social Assistance Act must also be taken into account.

If an employer followed the regional courts' measures and, consequently, garnished a higher amount of employee wages than it should have, the employer should correct the practice in the future and deal with the already performed garnishments.

For more detailed information, please contact the authors of the article or other members of EY Law or your usual EY team.

The Supreme Court issued a unifying opinion in the wake of the controversy over the determination of the wage amount exempt from garnishment. Thus, the Supreme Court ultimately indirectly found correct the procedure set out in the Ministry of Justice's methodology for calculating instalments for debt relief according to which, for the purposes of calculating the amount exempt from garnishment, the increase in the normative housing costs under § 26a of the Act on State Social Support must also be taken into account.

Judicial window



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Entitlement to deduct VAT on supplies paid from a subsidy

The Supreme Administrative Court ("SAC") recently published an interesting judgment 6 Afs 97/2020 – 54, which dealt with the question of the right to deduct VAT on inputs paid for by subsidies.

Subsidised program and VAT

The applicant is a registered association whose purpose is to carry out a charitable activity consisting in the development of the use of photovoltaic energy. The association has received subsidies for the training of employees of its member organisations. The basic training program was provided free of charge. In addition, extra services and goods could be purchased for a fee (e.g. lunches, accommodation, training materials). The additional services/ goods were not part of the grant program, were billed separately, and were essentially the only taxable outputs of the association.

Believing the received supplies were clearly related to the provision of free courses, the tax administrator refused to recognise the association's full VAT deduction entitlement. These were very general services referred to as "project administration". The applicant's defence was that it would continue to run the training courses in question on a commercial basis after the end of the grant program, and that it was therefore a preparatory activity for future economic activity.

The SAC reiterated that subsidies should generally be viewed as a source of funding[2], which in itself does not determine the extent of the VAT deduction entitlement. The purpose for which the supply was used must always be assessed. However, in this particular case, according to the SAC, the supplies received were not used for future economic activity, as they were fully consumed for free courses and were no longer usable. The SAC did not consider sufficient the claim that the association had acquired contacts with suppliers and know-how during the subsidised program to provide similar events on a commercial basis in the future. These conclusions of the SAC can be agreed with.

2 Referring to the earlier SAC judgment of 10 October 2013, ref. No. 9 Afs 8/2013 – 42

Questionable reasoning

The other expressed idea is, in our view, at least questionable. The SAC stated[3] that "the case-law of the Supreme Administrative Court and the Court of Justice makes it clear that a subsidy cannot be regarded as consideration, and therefore a transaction the sole purpose of which is to fulfil the purpose of the subsidy is not an economic activity, since it lacks the necessary characteristic of consideration... .".

It is worth pausing on this point. A consideration is an amount that is given in direct connection with performance (by the customer or a third party), including a price subsidy. A "price subsidy"[4] is therefore directly covered by the term "consideration".

However, a price subsidy is only one sub-category of the broader term "subsidy", where the subsidy may enter the tax base[5]. Another common situation is that the provider of the supply receives a "subsidy" that is essentially payment for an ordered service, which the public entity itself consumes. Here we must move away from the name of these payments (subsidy, compensation, operating allowance) and look at their economic substance.

In our view, the SAC's conclusion that a subsidy can never be a consideration is too simplistic and relies essentially on the word "subsidy" alone, which can cover a range of different payments. It should be added that, if the applicant in the judgment described above wished to argue that its subsidy was a consideration, it should also have applied VAT on that consideration because it provided taxable supplies. This was not the case.

In practice, of course, most subsidies are not taxed, and if an organisation decides to add VAT to the price of its services, it often faces resistance from the subsidy provider.

Energy saving tariff – with or without VAT?

There is another topical issue related to subsidies, namely the energy saving tariff for households, which is currently being discussed by the government. Industry and Trade Minister Jozef Sikel tweeted that the State will pay for a discount on a part of consumption (15% - 20%). Depending on the specific conditions, this will either be a price subsidy or a more general third-party consideration, both of which are likely to enter into the tax base of the supplied energy.

In conclusion

The taxation of VAT subsidies and the possibility of claiming a deduction is a very complex issue. If you receive a subsidy and are unsure how to deal with it from a VAT perspective, we will be happy to discuss your specific situation and suggest a suitable solution.

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

The SAC's conclusion that a subsidy can never be consideration is, in our view, overly simplistic and relies essentially on the word "subsidy" alone, which can cover a range of different payments.

3 Paragraph 54 of the judgment
4 Par. 4 section 1) letter a) of VAT Act
5 See paragraph 30 of the judgment in Case C-151/13 Le Rayon d'Or SARL

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The Supreme Administrative Court on taxation when the origin of funds is unproven

In this issue, we introduce an interesting Supreme Administrative Court judgment on the topic of failure to prove the origin of funds.[6]

View of the tax administrator

In 2017, the taxpayer (an individual) was assessed personal income tax for the tax year 2011.

The reason for the tax assessment was that the taxpayer had not declared – in his regular tax return – income he was found on him as cash, which he had transported from the Czech Republic via Germany to Switzerland in 2011, while he told the customs authorities in Germany during a customs inspection that 60% of the transported money belonged to him and the remaining part came from the company where he works as a manager, but whose name he refused to disclose.

As part of the tax audit, the tax administrator examined whether the funds were funds subjected to income tax and concluded that they were the taxpayer's untaxed personal funds.

As the taxpayer did not prove any other origin of these funds in the tax proceedings and did not remove the doubts of the tax administrator, this cash was assessed as other income under § 10 of the Income Tax Act.

View of the municipal court

The municipal court dismissed the taxpayer's claim, disagreeing with the taxpayer's challenge to the very assessment of the money transferred as his income.

According to the court, the tax administrator had proved the doubts about the taxpayer's proper tax return and it was then up to the taxpayer to prove that, as he claimed, the funds were not his. The taxpayer failed to do so and made no effort to clarify the origin of the transported funds.

6 More in Czech here: https://www.nssoud.cz/modalni-obsah/rozhodovaci-cinnost/rozhodnuti-349784?cHash=34688f63db07ec5764d59716c6e261b8

View of the taxpayer

In the subsequent appeal, the taxpayer argued he had proved he could not have had the income in question in 2011, nor could he have otherwise obtained the funds for himself. In his view, this proved beyond doubt that the amount could not have been his income and that he therefore did not have to declare it on his tax return or prove its origin.

In his view, it was unnecessary under these circumstances to insist that he identify the customer (acquaintance, business partner) for whom he was transporting the funds. In fact, if there is no legal reason for him to be in possession of the amount in question in 2011, he cannot prove this circumstance, as it is a negative fact.

On the contrary, if the tax administrator had doubts about the data in the tax return, it was the administrator's obligation to prove this fact. However, this was not done. And if the tax administrator had already considered the amount in question to be taxable income, it should have allowed him to claim a corresponding proportion of his expenses, for example at a percentage rate.

View of the SAC

According to the SAC, it was undisputed that the taxpayer had the amount in cash in 2011. The tax administrator had doubts as to the origin (and taxation) of the transported money on the basis that it was a large amount of money, the taxpayer had not notified the customs authorities of its transport and had refused to disclose to whom the money belonged (his current version also differing from that which he had disclosed to the German customs authorities). In these circumstances, there is no doubt that the burden of proof as to the origin or taxation of the money has shifted to the taxpayer.

However, he consistently denied in his submissions that he was obliged to prove the above facts, he continued to refuse to disclose to whom the money belonged, and the evidence he proposed was wholly insufficient to discharge his burden of proof.

According to the SAC, the taxpayer's claim that he did not have such an amount available in 2011, which he sought to prove with his tax records, tax returns and bank statements, must also be considered unproven. According to the SAC, the fundamental issue in the present case is the origin of the transported money, while there is no doubt that the taxpayer actually possessed this amount. Thus, in these circumstances, even showing that this amount greatly exceeded the taxpayer's total other income would be irrelevant, as it could be significant income that he did not intend to tax.

With regard to the possibility of applying a corresponding part of expenses to the taxable income, the SAC stated that according to § 10(4) of the Income Tax Act, the tax can be reduced only by demonstrably incurred expenses. In view of the fact that the taxpayer did not claim to have incurred any expenses, let alone prove them, the tax administrator cannot be considered to have erred in assessing tax on the taxpayer's entire income.

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

According to the SAC, the fundamental issue in the present case is the origin of the transported money, and there is no doubt that the taxpayer actually possessed the amount. Thus, in these circumstances, even proving that the amount was considerably in excess of the taxpayer's total other income would not be relevant, since it could be a significant income which he did not intend to tax.

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Crown bonds and abuse of law

In this issue, we introduce interesting recent Regional Court in Brno decisions concerning the issue of crown bonds and the question of abuse of law.

Background

As we understand it, the main features of the transaction were as follows:

- In 2010, a company borrowed funds from person A, which it used to build a photovoltaic power plant.
- At the end of 2012, person A assigned her claim on the company to its managing director and the company subsequently issued crown bonds of approximately the same value (with a longer maturity and slightly higher interest rate than the original loan).
- Subsequently, there was a set-off and the result was that the company owed the managing director on the crown bonds and the managing director owed the original creditor A (but with deferred maturity).
- In 2014, the company then borrowed from the bank and subsequently lent to the managing director, who used the funds to repay an obligation to original creditor A.

Non-recognition of interest

The tax administrator (in agreement with the regional court) concluded that there had been an abuse of law and excluded the interest costs on the issued crown bonds from the company's tax base. The issuance of the bonds did not bring the company any funds to finance its business activities and thus lacked economic rationality from the tax administrator's point of view. According to the tax administrator, the sole aim of the interconnected purpose-driven steps of the entire transaction was to obtain an unjustified tax advantage (more in Czech HERE).

Withholding tax

In addition, the tax administrator assessed the company as a withholding agent for the related withholding tax on the interest arising from the bonds paid to the managing director in 2014 and 2015.

According to the tax administrator, the company did not prove the reasonability of issuing the bonds. Although the conditions for obtaining the tax advantage were formally met, the tax administrator believes that these conditions were created artificially by the company in the context of its

normal business activities. The tax administrator considered the main purpose of the bond issue to be the reduction of tax liability by obtaining an unjustified advantage of non-taxation of personal income in the form of interest earned on the bonds. It thus concluded that there had been an abuse of rights and issued payment orders for withholding tax (more in Czech HERE).

The Regional Court agreed with the tax administrator's assessment. As regards the purpose of the Income Tax Act amendment introducing a rounding mechanism for crown bonds, the Regional Court stated as follows: *"...The applicant also disputed the defendant's conclusions that the aim of Act No 188/2011 Coll. was to administratively simplify the calculation of withholding tax. It is true that the explanatory memorandum explicitly linked the reduction in administrative complexity to the exemption from the obligation to file a notification. However, this does not mean that administrative complexity could not also be the reason for introducing the new withholding tax rounding method. According to the court, from the fact that the method of rounding the withholding tax was subsequently changed by the amendment made by Act No 192/2012 Coll., so that interest income from CZK bonds would not escape taxation, it is clear that the aim of Amendment No. 188/2011 Coll. was not to exempt interest income from bonds in the amount of CZK 1, as the applicant claims..."*.

It should be noted that no cassation complaint has been filed against these judgments, so at least for this case the Supreme Administrative Court will not weigh in.

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

The tax administrator not only questioned the tax deductibility of the interest on the crown bonds, but also assessed the related withholding tax on the interest paid on the bonds.

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

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ED None

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Did you know:

- The Czech Confederation of Industry has proposed simplifications in the areas of taxes and insurance premiums?
- The use of the optional reverse charge scheme has been extended until the end of 2026?
- The amendment of the so-called Lex Ukraine regulates, inter alia, the procedure for granting temporary protection and limiting residence applications of Russian and Belarusian citizens?
- The Ministry of Finance has commented on the forthcoming new Accounting Act?
- The Financial Administration has simplified the MY Taxes portal login for foreign individuals?
- Parliament has approved the ratification of the Double Tax Treaty with San Marino?
- The Minister of Finance has revoked the decision to waive VAT on energy?