Tax and Legal News

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Have a nice summer

We would like to wish you, as every year at this time, a peaceful summer and a nice holiday. Many of us have been hectically finishing up our tax returns, whether corporate or personal, and sorting out the final touches before we leave. While we don't want to add any more complicated considerations to the list, we have a tireless legislator who refuses to rest over the summer.

On 28 June, the Government approved the consolidation package and sent it to the Chamber of Deputies. The desire to meet the budget is evident and most of the proposed changes are therefore political rather than technical. There is probably no point in contemplating whether a 2% increase in the tax rate is systemically and methodologically correct; we just need to collect more, so we raise the tax. And, probably understandably and rightly, there's not much discussion about it.

It is interesting to see, however, in a slightly exaggerated way, what resistance and pressures some of the other proposed changes have generated. The removal of the employee benefits exemption has undoubtedly garnered the most attention – or perhaps just the most publicity. The debate over whether ‘exempt and non-deductible (for employers)’ or ‘taxable and deductible’ has incited a great deal of passion. Whatever the outcome, it isn’t likely to have a material impact on the state budget in the end. But, the fight for workers' rights is clearly popular and certainly laudable. So let's see how it plays out.

The abolition of the exemption for the sale of securities has the opposite effect. It's not talked about much. It's probably not popular to oppose repeal. This is the umpteenth attempt to repeal or restrict the exemption. Previous attempts have not been very successful. This time the proposal is a little more elaborate. It repeals the exemption only for sales over 40 million. And it interestingly addresses potential retroactivity. On future sales of shares acquired before the proposed change in the law, I will be able to deduct the market value as of 31 December 2023. Simple, clear. The burden of proof is on the taxpayer to prove market value. i.e. when I sell in say 2028 I will prove what the market value was 5 years ago. If I start establishing that market value in 2028, my evidentiary position may not be the strongest. One may consider preparing a valuation for a possible future sale now in 2023. The evidentiary strength is probably generally better. Moreover, if the valuation is prepared by an expert with a round stamp, it will not be easily contradicted by a tax administrator. But what if the future shows that today's valuation assumptions deviate significantly from future realities and the price was more favourable to the taxpayer?

Might someone think to throw the valuation in the trash and prepare a new one? But if it was made historically by an expert, it should be in the expert's journal, and therefore cannot be denied to exist, right? Can the tax administrator access it? So the consideration of whether to deal with the valuation now or in the future, and with or without an expert, is not entirely trivial – and different taxpayers may reach different conclusions in different situations.

I think that's enough for now. More thoughts in September, after a well-deserved vacation.

Have a nice summer.

More thoughts in September, after a well-deserved vacation. Have a nice summer.

EU

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EU published draft Directive on Faster and Safer Relief of Excess Withholding Taxes (FASTER)

The European Commission (EC) published a legislative proposal for a Directive setting forth rules aimed at making certain withholding tax procedures in the European Union (EU) more efficient and secure.

The proposal includes the following main building blocks:

- A common accelerated EU digital tax residence certificate to be issued by the investor's residence state.
- A choice for Member States between "relief at source" procedure and a "quick refund" system or a combination of both - procedure that is compulsory for dividends from publicly traded shares and optional for interest payments on publicly traded bonds (with some exceptions such as dividends from shares acquired very shortly prior to the ex-dividend date).
- The establishment of a national register of certified financial intermediaries (registration will be mandatory for "large financial institutions") and an introduction of a common reporting (and verification) obligations on certified financial intermediaries in the chain.

The Commission proposes that the rules (if approved) come into effect as of 1 January 2027.

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

The European Commission has published a legislative proposal for a directive setting out rules aimed at streamlining and securing selected withholding tax procedures in the EU.

Pillar 2

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Czech implementation of Pillar 2 – safe harbours

Several weeks ago, a draft Czech implementation of the Pillar 2 rules was published ("Act on TuT").

Below we provide you with selected observations on selected aspects of the safe harbours within the meaning of Article 32 of the EU Directive on ensuring a global minimum level of taxation for MNE and large-scale domestic groups – as currently proposed in the draft implementation law (§§ 83–88 and 135–137 of the Act on TuT).

- The draft law deals with both permanent (in our understanding) and transitional safe harbours (SH).
- SH is an optional (to some extent) simplifying jurisdictional exception where, if the conditions are met, the top-up tax (TuT) for a given jurisdiction and period is generally treated as zero (generally without the need to make more complex calculations under the full TuT regime).
- Types of permanent SH:
  - Routine profits test (substance-based income exclusion covers simplified profits),
  - De minimis test (average of simplified revenues / profits is less than EUR 10 million / EUR 1 million),
  - Simplified ETR test (simplified ETR is at least 15 %).
- What is meant by simplified qualifying revenues/profits/covered taxes will be added to the draft law once a substantive solution is adopted at OECD level. The rules for permanent SH may yet to shift significantly.
- Transitional SH are only relevant for the transitional period, i.e. the tax year starting no later than 1 January 2027 (and ending no later than 30 June 2028).
- The types of transitional SH are similar to the permanent ones listed above, generally based on country-by-country report (CbCR) or financial statements (FS) data:
  - Routine profits test (substance-based income exclusion covers pre-tax profits as per CbCR),
  - De minimis test (revenue / profit before tax under CbCR is less than EUR 10 million / EUR 1 million),
  - Simplified ETR test (simplified ETR, i.e. adjusted income tax expense according to financial statements / profit before tax according to CbCR, is at least 15 % or 16 % or 17 % - gradually increasing ETR).
- Generally, if the transitional SH is not applied one year, then it cannot be applied the next year in that jurisdiction.

- Special modifications/limitations apply e.g. for joint ventures, transparent ultimate parent entities, investment entities etc.

The above SH are not the only simplifying exceptions - we will bring you some more next time.

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

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VAT

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ViDA!

Some time ago, the European Commission published a proposal for an amendment to the VAT Directive, the so-called “ViDA“ (VAT in the Digital Age), to modernise the VAT system within the EU, with the aim of the detailed changes to the current legislation coming into force gradually between 2024 and 2028.

The purpose of the proposal is to increase the resilience of the VAT system to tax fraud, to reduce the VAT gap (uncollected VAT) and generally to better adapt the VAT system to the current digitalisation and new business models.

In this article, we give you some background information on this proposed VAT Directive amendment and look in more detail at the changes planned for 2024.

At the time of writing, the ViDA proposal is being discussed at the ECOFIN level[1]. Some Member States have already expressed their doubts about the feasibility of such rapid changes in practice and the costs for businesses. The next ECOFIN meeting is scheduled for October 2023, so a possible postponement is being discussed.

Timetable of changes

Although the planned timetable for changes to the VAT Directive should be taken with a grain of salt, significant delays cannot be relied upon and companies should therefore start preparing for the individual changes.

1 Council of EU Finance Ministers

2023

- Public discussion and proposal modification

2024

- Introduction of the obligation to accept electronic invoices – recipient consent is not required
- New definition of "structured electronic invoice" – automated and electronically processed
- At 31 December 2024 – end of the call-off stock regime

2025

- Standardised VAT registration (expanded One-Stop-Shop)
- Movement of own goods – reporting in OSS
- Accommodation and ridesharing platforms will be considered as a deemed supplier of these services and will apply VAT on them
- Mandatory reverse-charge on local delivery of goods by a non-established person

2028

- Digital Reporting Requirements (DRR) – mandatory reporting of B2B transactions in the EU within 2 days of supply
- Exemption of supplies to the EU will not be possible if they are not reported in the DRR
- Cancellation of summary statements
- Invoicing within 2 days of supply
- Termination of summary invoices
- New mandatory invoice elements

Selected changes (maybe) as of 2024

Structured electronic invoice

The current definition of an electronic invoice[2] will be replaced by a new definition for which just any electronic format will no longer suffice; rather, a structured format will be required to enable automatic and electronic processing of the tax document (without human intervention). A tax document sent in "regular" pdf format as an attachment to an email will no longer meet this definition.

The explanatory memorandum to the Directive amendment states that the electronic invoice for VAT purposes will be brought into line with the concept in the already existing Directive 2014/55/EU, on electronic invoicing in public procurement. This Directive and the EU Commission's implementing Decision set out so-called "European formats" for electronic invoices. This new definition is planned to be mandatory for Member States from 1 January 2024.

2 Existing Article 217 "For the purposes of this Directive, 'electronic invoice' means an invoice which contains the information required by this Directive and which has been issued and received in any electronic format." Proposed Article 217 "For the purposes of this Directive, an 'electronic invoice' means an invoice containing the information required by this Directive and which has been issued, transmitted and received in a structured electronic format allowing for automated and electronic processing."

E-invoicing

Issuing electronic invoices

From 2024, Member States will be able to make it compulsory to issue electronic invoices (in the above formats). Member States do not have to use it yet. At this point in time, it is difficult to predict how individual countries will approach this option. The next big change should come as of 2028, when mandatory e-invoicing (in the formats listed above) should be introduced as a default rule and Member States have the option to maintain paper invoicing for certain cases.

Receiving electronic invoices

Currently, if a supplier wants to issue electronic invoices, it must obtain the customer's consent. The VAT Directive does not currently allow Member States to oblige customers to accept invoices in electronic form (except for public contracts) without requesting a specific exemption, as for example Italy has already done and Germany is now planning to do.

This rule prevents Member States from introducing some forms of electronic reporting of transactions and generally slows down the development of digital taxation. For this reason, the Directive amendment removes the requirement for the mandatory consent of the recipient of an electronic invoice from 2024.

Call-off stock (warehouse regime)

Another proposal is to abolish the current simplification for the call-off stock regime by 31 December 2024. This change is linked to the extension of the One-Stop-Shop (OSS) scheme from 2025, which will allow the reporting of the transfer of own goods under the EU VAT single registration. The existing simplification will thus lose its purpose. At the same time, a mandatory reverse-charge on local delivery of goods by a non-established person is to be introduced from 2025. The abolition of call-off stock should therefore not lead to a cash-flow disadvantage in such a situation.

However, goods shipped before that date will still be eligible for the simplified call-off stock scheme until 31 December 2025.

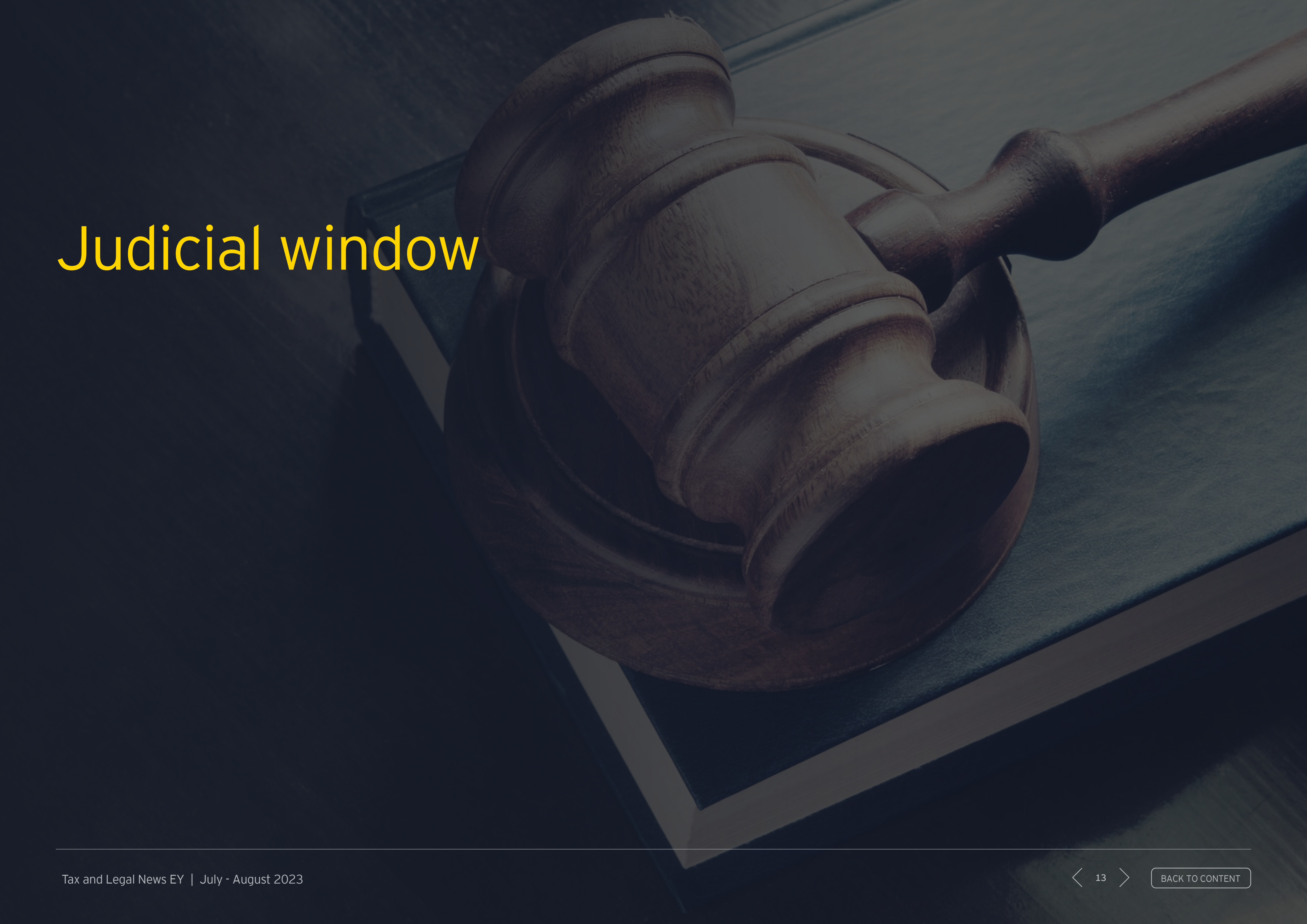
Next steps

We will keep you updated on the development of the ViDA proposal and other changes it contains in future editions of Tax and Legal News.

In conclusion, at this stage, companies should internally verify their ability to accept and process structured electronic invoices in the format described above and, if their systems are not yet able to do so, start preparing for such a change.

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

Although the planned timetable for changes to the VAT Directive should be taken with a grain of salt, significant delays cannot be relied upon and companies should therefore start preparing for the individual changes.



Judicial window

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The Supreme Administrative Court on proving the origin of income

In this issue, we present an interesting Supreme Administrative Court (SAC) judgment on proving the origin of income.

Background:

- The tax administrator found that during 2015, the taxpayer – a natural person – personally deposited cash in the amount of CZK 11,900,000 into the bank account of company X, in which he was a statutory representative and partner.
- After analysing the movements in the bank accounts and taking into account the income received by the taxpayer in 2014 and 2015 from company X as its statutory representative, the tax administrator had doubts as to whether the taxpayer's income in 2015 corresponded to an increase in his assets, consumption or other expenditure, identifying a difference of more than CZK 11 million over the known income.
- The tax administrator concluded that the taxpayer had not borne the burden of proof as to the origin of the assets, as he failed to prove that the identified difference in income and expenses was related to the alleged provision of a loan in the amount of CZK 100 million, which the taxpayer was supposed to have received in cash from Mr. XY in Spain in 2012.
- The Regional Court sided with the tax administrator.

View of the SAC

The SAC also sided with the tax administrator – its selected findings:

- The rules contained in § 38x et seq. of the Income Tax Act (ITA) effective as of 1 December 2016 can also be applied to the taxable period before its effectiveness if the notice pursuant to § 38x(1) ITA relates to assets, consumption or other expenditure acquired or made by the taxpayer in the taxable period for which the limitation period for tax assessment has not yet expired.
- If a taxpayer claims to have made an expenditure from income for which the limitation period has already expired, the taxpayer must logically explain and, at a minimum, certify to the tax authorities that the expenditure arises from income acquired during the preceding period.

- After a longer period of time, the tax administrator cannot require the taxpayer to submit evidence of such quality as, for example, for a period for which the three-year limitation period has not yet expired. However, the burden of proof cannot be limited to the taxpayer's assertion that his income was earned in a period in which the objective limitation period has expired.

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

If a taxpayer claims, in response to a request for proof of income, that it has made expenditures from income for which the statute of limitations has expired, the taxpayer must logically explain and, at a minimum, certify to the tax administrator that the expenditures were made from income acquired during the preceding period.

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Interesting Regional Court ruling on the deductibility of royalties

We briefly present an interesting Regional Court in Hradec Králové judgment regarding the tax deductibility of royalties paid to a foreign parent company (the case concerned the year 2014).

Background

From 1 January 2014, the overall R&D set-up within a Group changed, with intellectual property becoming centralised in Switzerland at the Group's management company, which had assumed all strategic R&D functions and risks.

Until the end of 2013, the Czech company carried out the development activities on its own, at its own expense, responsibility and risk, but at the same time it was the owner of the developed intellectual property. After the introduction of the new model, these activities were carried out under the authority, responsibility and at the expense of the Swiss company.

In 2014, the Czech company incurred development costs, which were subsequently passed on to the Swiss company, as part of the accounting for the remuneration for the provision of contract research and development, which was determined using the cost plus method. On the other hand, it had to pay royalties for the use of the new intellectual property belonging to the Swiss company, the royalty being set at a percentage of the Czech company's sales.

View of the tax administrator

The tax administrator questioned the tax deductibility of the royalties paid by the Czech company for 2014. The tax administrator argued, among other things, that the royalty could only be paid on sales substantially affected by the licensed intellectual property. In other words, it did not make sense to the tax administrator for the Czech company to pay the royalty as a percentage of sales when it was (from its perspective) obvious that the new intellectual property for which the royalty was paid could not be reflected in the Czech company's sales in the year in question at all.

View of the Regional Court

The court sided with the taxpayer. The court found, inter alia, that the change in the group's R&D set-up made sense to it overall and that the tax authorities interpreted the tax deductibility test – or the requirement of a factual and temporal link between the expenditure and the income – too narrowly.

The Court considered it logical that research and development expenditure is often not, to a significant extent, reflected in income in the same tax year. For example, the development of a new machine may take several years before it results in a product that can be sold (and thus generate a profit) – this time-lag cannot in itself, according to the Court, be an obstacle to the tax deductibility of the relevant costs in the tax year in which the taxpayer incurred them.

A cassation complaint has been filed, so let's see what the Supreme Administrative Court has to say.

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

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The Supreme Court on the consequences of breach of the contractual limitation of assignment of receivables

In a recent judgment, the Czech Supreme Court dealt in detail with the legal effects and related consequences of an assignment of a claim made in violation of a contractual prohibition or restriction agreed between the debtor and the creditor. According to the judgment, an assignment made in breach of such a prohibition is ineffective against the debtor until the debtor consents to it, while the assignment agreement remains valid. This is a fundamental question with regard to the legal certainty of the persons concerned and the possible practical consequences, which has not yet been clearly answered in the context of the new Civil Code.

Context

Although the legislation in force has never explicitly defined the consequences of a breach of the contractual prohibition on assignment of receivables, under the previous legislation, i.e. the "old" Civil Code, there was a relatively uniform view on the consequences of a breach of an agreement between the debtor and the creditor to limit or prohibit the assignment of receivables.

The case law and commentary literature have unanimously concluded that an assignment agreement concluded in violation of the provisions of § 525 of Act No. 40/1964 Coll., the Civil Code, is, with exceptions, absolutely invalid with reference to the provisions of § 39 of the said Act. At the same time, assuming that the assignment agreement was subject to the now abolished Commercial Code, it was possible to consider relative nullity under certain conditions. In such a case, the debtor was bound by the conduct of the assignor and the assignee, unless it actively invoked the invalidity of the assignment.

However, after the adoption of Act No. 89/2012 Coll., the Civil Code ("CC"), uncertainty again prevailed in relation to this issue. The new legislation also does not explicitly regulate the consequences of a breach of a contractual agreement between the debtor and the creditor concerning the limitation or prohibition of assignment of a receivable, and the professional community has not agreed on its unambiguous interpretation. The answer was provided by the Supreme Court in the above-quoted judgment, when it concluded that an assignment of a receivable made in violation of a contractual prohibition or restriction agreed between the debtor and the creditor is ineffective against the debtor until the debtor consents to it, provided that the assignment agreement concluded between the assignee (i.e. the intended assignee of the claim) and the assignor (the original owner of the claim) remains valid. In practice, the Supreme Court's conclusion will mean that the debtor in such a case will not be obliged to perform its debt to the assignor and will be able to "get rid" of its debt by performing it against the assignor as its original creditor.

Facts and reasoning of the Supreme Court

In the present proceedings, the plaintiff sought to determine the validity of the assignment of the certificated bonds, the transferability of which was limited under the terms of issue of the issuer (i.e. the company that issued the bonds). The company's bonds could be validly transferred only with the company's prior written consent, provided that if consent was not given within 15 days of the date of receipt of the request for consent, the company was obliged to redeem the bonds.

Being aware of this restriction on transferability, the assignee and the assignor entered into an assignment agreement in respect of the bonds in question, in which the assignor also undertook to apply to the company (which was the debtor in this case) for consent to the assignment immediately after signing the agreement. The assignor did so, and at the same time as the agreement was signed, the bonds were duly endorsed and delivered to the assignee. However, the company did not grant its consent to the transfer of the bonds within the time limit set, or did not respond to the assignor's written request for such consent.

A year later, insolvency proceedings were opened against the company, in which the assignee, in the position of a creditor, filed its claim against the company on account of the alleged ownership of the bonds. However, the company denied the claim as to its authenticity and amount, precisely on the grounds that it had not given its consent to the assignment of the bonds in question, with the result that the assignee did not have active standing to assert the claim.

In its judgment of 27 April 2023, Case No. 27 ICdo 30/2022, the Supreme Court first stated that in the case of bonds, it is essentially the creditor's right against the debtor to certain performance in the sense of a claim under the provisions of § 1721 of the CC. Noting the previous inconsistency of the legal consequences of the outlined issue, where absolute and relative nullity, as well as relative ineffectiveness or creation of a liability relationship between the assignor and the debtor was assumed, the Supreme Court proceeded to the analysis of the individual legal consequences of violation of the contractual prohibition of assignment of receivables. However, it is necessary to stress that this assessment does not take into account cases in which it is desirable to protect the good faith of an assignee who did not know about the contractual limitation of the possibility of assignment. Therefore, the conclusions of the decision of the Supreme Court described above apply only to situations where the assignee had demonstrable knowledge of the prohibition on assignment agreed between the debtor and the assignor.

The purpose of the provision of § 1881 (1) of the CC limiting the possibilities of assignment of a receivable, if so agreed, is to protect the interests of the debtor. This thesis must then be reflected in the consideration of the consequences of a breach of such a restrictive arrangement by the assignor.

According to the Supreme Court, in light of the above thesis, the variant under which a valid and effective assignment of the receivable would occur in such a case, with the simultaneous establishment of a liability relationship between the assignor and the debtor (i.e. the debtor would be able to claim compensation from the assignor for damages caused by the violation of the prohibition of assignment without the debtor's consent) cannot stand. In such a case, even if the assignee was aware of the existence of the restrictive covenant, the protection of the debtor would outweigh the protection of the assignor acting in breach of the contractual arrangement.

The debtor's protection would not be complete even if the breach of the contractual prohibition of assignment of receivables would result in the absolute invalidity of the assignment agreement, as the established case law and doctrine applicable under the previous legal regulation had suggested. Absolute nullity would at the same time prevent the debtor from accepting the assignment of the receivable, even if made in breach of a valid agreement, since in the case of absolute nullity, unlike relative nullity, the legal act affected by the nullity is irrevocably null and void.

Conclusions implying the relative invalidity of the assignor's breach of the contractual arrangement also cannot stand in the context of the interest of the debtor's protection. The latter would be bound by any excessiveness of the assignor's conduct if it did not object to the invalidity of the assignment itself. Such an interpretation would shift the responsibility for the validity and effects of the assignment to the debtor, who would have to react actively and invoke the invalidity of the legal act on the basis of which the claim was assigned.

Therefore, the Supreme Court considers the solution consisting in the relative ineffectiveness of an assignment of a receivable made in violation of a prohibition or restriction agreed by the debtor with the creditor, of which the assignee was aware, to be appropriate and sufficiently taking into account the interests of the debtor. The assignment will thus remain ineffective against the debtor until the debtor consents to it, for example even by implication. This option undoubtedly takes into account not only the interest in a sufficient level of protection for the debtor but also the sustainability of the trade in receivables. The contractual relationship between the assignee and the assignor, even if arising from a substantively ineffective contract, remains valid.

In conclusion, an assignment of a receivable made in violation of a prohibition or restriction previously agreed between the debtor and the creditor, of which the assignee was aware, remains (temporarily) ineffective against the debtor until the debtor's consent is given, while the assignment agreement remains valid.

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.

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Did you know:

- In a recent judgment, the Supreme Administrative Court confirmed that foreign legal entities established in the EU may register a free trade without the need to establish a branch in the Czech Republic?
- A New EU Framework Agreement expands the options for expatriate workers to remain in the existing social security system?
- The amendment to the Act on the Residence of Foreigners will mean changes as of 1 July 2023, especially to so-called blue cards?
- The Government has approved amendments to long-term investment product laws?
- The SAC has issued an opinion on the boundary between deductible promotion and non-deductible representation?
- The consolidation package has been updated?
- The European Commission has published a draft implementing regulation to the already approved regulation introducing a CBAM from 1 October 2023?