Tax and Legal News

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And how much will you prepay?

The number one international tax topic is the global reform, which once again moved a little closer to reality in October. Even the traditional troublemakers seem ready to cooperate – more on that in the next article. At the moment, however, another tax issue is resonating with the Czech media and in professional chatter, i.e. the VAT waiver on electricity and gas in November and December.

A brief outline of some frequently discussed points:

- The waiver was published on October 20th, effective from November. While jaded Czech VAT payers are used to a lot of things from the past, they were still surprised to only have about a week to implement it (taking the long weekend into account).

- Some entities were also surprised to learn they'd be affected by this change because it applies not just to sales to households, as originally indicated, but also all supplies between VAT payers, likely because it's a tricky business for companies with millions of customers to distinguish with certainty household customers.

- The methodology published just before the effective date seeks to address some unclear items. In particular, there is the fundamental question of what is actually meant by the "supply of gas". According to the General Financial Directorate (GFD), it should be gas intended for heat production or engine propulsion; the method of delivery is not decisive (pipeline, tanker, cylinder, etc.). On the contrary, it excludes the supply of oxygen, helium, technical gases, etc. Even leaving aside the question of whether such a restriction of a grammatically very broad waiver is permissible and why a more precise definition is not directly part of the waiver decision, there are bound to be many borderline cases in practice – isn't lighter gas also intended for the production of heat?

- Irrespective of whether an across-the-board VAT waiver is an appropriate instrument to mitigate the impact of gas and electricity price increases, the stated aim is to provide relief to households that have seen energy prices soar. However, it's clear that in addition to such households, other consumers will also enjoy significant savings – while for some such an impact may be justified (in particular, other households for which energy will gradually become more expensive or health care facilities), one can't help but feel some "stowaways" will be riding along with them.

- On the contrary, the waiver does not apply, for example, to customers who heat with gas indirectly (VAT on heat supply does not change, even if gas is used for its production) or do not make any advance payments or readings in November and December (for example, they've agreed on quarterly advance payments due in October and then only in January).

- Even some members of the government are open about the waiver running counter to EU law, stating that the European Commission cannot in fact intervene anyway, since the measure would expire before formal infringement proceedings could be launched. Nevertheless, the GFD methodology explicitly rejects the right to deduct input VAT for a customer whose supplier would have acted in accordance with EU law, i.e. applied VAT regardless of its waiver.

- The Ministry of Finance formally requested an exemption from EU law and prepared an amendment regulating the 0% VAT rate for next year. Approval is uncertain, however, and even representatives of the likely future government are skeptical of the proposal. It's therefore likely that 21% VAT will again apply from January.

- No surprise, then, that energy consumers without the right to deduct are starting to come up with various creative ways to make the most of the favourable scheme valid until the end of the year. The most commonly discussed method is to pay a large deposit that will cover electricity and gas consumption well into the future. However, this opportunity is not limitless and depends primarily on the contractual terms agreed.

- Suppliers can expect an onslaught of non-standard requests from customers, in particular changes to billing periods, extraordinary readings, etc. However, these may run into limits in the form of administrative options or tax risk management by energy companies. The tax administration's statements already indicate a strict approach and explicitly warn against abuse of the law – the risks involved are primarily borne by suppliers. On the other hand, they may find it interesting to boost their cash flow through higher advance payment collections.

- I won't dare to guess if lines of gas-powered cars will form at gas stations before the end of the year (the waiver also applies to LPG and CNG).

On the contrary, the waiver does not apply, for example, to customers who heat with gas indirectly (VAT on heat supply does not change even if gas is used for its production) or do not pay any advance payments or do readings in November and December (for example, they've agreed on quarterly advance payments due in October and then only in January).

International taxation

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International tax reform – the current situation

Revolutionary changes in international taxation seem to be approaching.

On July 1st, there was a significant shift forward, with 130 countries/jurisdictions[1] (including the Czech Republic) issuing a joint statement under the OECD framework in which they have joined a new two-pillar plan for international tax reform. The statement indicated an ambition to finalise detailed technical parameters by October this year, with a projected start date of 2023 for the new rules.

On October 8th, 136 jurisdictions (out of 140 members of the OECD/G20 BEPS inclusive framework on BEPS[2]) – including the Czech Republic – joined the statement on the two-pillar solution to address tax challenges arising from the digitalisation of the economy (more HERE). It updates and finalises the July political agreement to fundamentally reform international tax rules.

On October 13th, the G20 finance ministers and central bank governors then formally endorsed this final political agreement of October 8th on a two-pillar solution (more HERE). They also called on the OECD/G20 BEPS inclusive framework on BEPS to urgently develop model rules and multilateral instruments so that the new rules come into force globally in 2023.

It seems, then, that we'll see revolutionary changes in international taxation. What should their main parameters look like?

Pillar I – selected parameters:

- Multinational groups (MNEs) with a global turnover of more than EUR 20 billion and a profitability of more than 10% (i.e. profit before tax/revenue) fall within the scope, while the turnover threshold could be lowered to EUR 10 billion in the future.
- Extractives and regulated financial services are excluded.
- For in-scope MNEs, 25% of residual profits (defined as profits in excess of 10% of sales) will be allocated to market jurisdictions with nexus (see next point) using a revenue-based allocation key ("Amount A"). Revenue will be sourced to the end market jurisdictions where the goods or services are used/consumed.

1 For the record, the countries that did not join in July were as follows: Barbados, Estonia, Hungary, Ireland, Kenya, Nigeria, Peru, Saint Vincent and the Grenadines, Sri Lanka.
2 Four countries have not yet joined the statement – Kenya, Nigeria, Pakistan and Sri Lanka. Also of interest – Cyprus is not a member of the OECD/G20 Inclusive Framework for BEPS.

- A new nexus rule will be introduced to allow the allocation of Amount A to a market jurisdiction if the in-scope MNE derives revenues of at least EUR 1 million from that jurisdiction. For smaller jurisdictions with a GDP of less than EUR 40 billion, the nexus will be set at EUR 250,000.
- The relevant measure of profit or loss of the in-scope MNE will be derived from the financial statements with a small number of adjustments. Losses will be carried forward.
- Segmentation will only occur in exceptional circumstances where a segment meets the scope rules (based on the segments disclosed in the financial statements).
- Mechanisms will be put in place to prevent and resolve disputes.
- Application of the arm's-length principle to in-country baseline marketing and distribution activities will be simplified ("Amount B").
- In-scope MNEs should be allowed to manage the process of fulfilling these new obligations through a single entity.
- The Multilateral Convention (MLC) will require all parties to remove all digital services taxes and other similar measures in respect of all companies.[3]
- It is anticipated that the MLC through which Amount A will be implemented will be developed and opened for signature in 2022, with Amount A to commence in 2023.

Pillar II – selected parameters:

- The second pillar comprises:
  - two interlocking domestic rules (together the Global Anti-Base Erosion Rules [GloBE])[4]:
    - the Income Inclusion Rule (IIR), which imposes top-up tax on a parent entity in respect of the low-taxed income of a constituent entity; and
    - the Undertaxed Payment Rule (UTPR), which denies deductions or requires an equivalent adjustment to the extent the low-taxed income of a constituent entity is not subject to tax under the IIR rule, and
  - a treaty based rule – the Subject to Tax Rule (STTR), which allows source jurisdictions to impose limited source taxation on certain related party payments subject to tax below a minimum rate. STTR will be creditable under the GloBE rules.
- The GloBE rules will apply to MNEs that reach the EUR 750 million threshold as determined under the country-by-country reporting (CbCR). Countries may apply the IIR to MNEs headquartered in their country even if they do not meet this threshold.
- GloBE rules will not apply to government entities, international organisations, non-profit organisations, pension funds or investment funds that are an Ultimate Parent Entity (UPE) of a MNE, nor to any holding entities used by such entities.

3 In this context, an agreement has been reached between the US, UK, France, Italy, Austria and Spain on the application of their digital taxes in the context of the expected future implementation of Pillar I of the international tax reform – for more, go to HERE.

4 IF members are not required to adopt the GloBE rules, but if they choose to do so, they will implement them in a way that is consistent with the outcomes established under Pillar 2 and they also accept the application of the GloBE rules by other IF members.

- The GloBE Rules will provide for an exemption from the UTPR for certain MNEs – namely those with tangible assets abroad of up to EUR 50 million and operating in no more than five other jurisdictions, limited to a period of five years after the MNE first becomes subject to the GloBE Rules.

- The GloBE rules will operate by imposing a top-up tax using an effective tax rate test, calculated on a jurisdiction-by-jurisdiction basis, using a common definition of covbered taxes and a tax base derived from financial statements (with agreed adjustments consistent with Pillar 2 tax policy objectives and mechanisms to address timing differences). For existing distribution tax systems, no top-up tax liability will apply if earnings are distributed within 4 years and taxed at or above the minimum required level.

- The minimum tax rate used for IIR and UTPR purposes will be 15%.

- The GloBE rules will provide for a formulaic substance carve-out that will exclude an amount of income equal to 5% of the carrying value of tangible assets and payroll. For a transitional period of 10 years, the excluded amount of income will be 8% of the carrying value of tangible assets and 10% of payroll, decreasing by 0.2 percentage points each year for the first five years and by 0.4 percentage points for tangible assets and 0.8 percentage points for payroll in the last five years. The GloBE rules will also provide a de minimis exemption for those jurisdictions where the MNE has revenues of less than EUR 10 million and profits of less than EUR 1 million.

- The GloBE rules will also provide for an exclusion for international shipping income as defined by the OECD Model Tax Convention.

- Countries that apply nominal corporate tax rates below the STTR minimum rate on interest, royalties and a defined set of other payments should, upon request, implement STTR in their bilateral treaties with developing members of the Inclusive Framework. The right to taxation will be limited to the difference between the minimum rate and the tax rate for the payment in question. The minimum rate for STTR will be 9%.

- The second pillar should be brought into law in 2022 (at least partly through a multilateral instrument) to be effective in 2023, with the UTPR starting in 2024.[5]

If we were to try to summarize our understanding of the above in two simple points:

- selected large highly profitable multinational corporations will tax more profits in jurisdictions where their goods/services are consumed, and

- some sort of sophisticated and modified global CFC rules are to be introduced for selected multinationals, targeting jurisdictions with effective corporate taxation below 15% (with a number of adjustments/exceptions).[6]

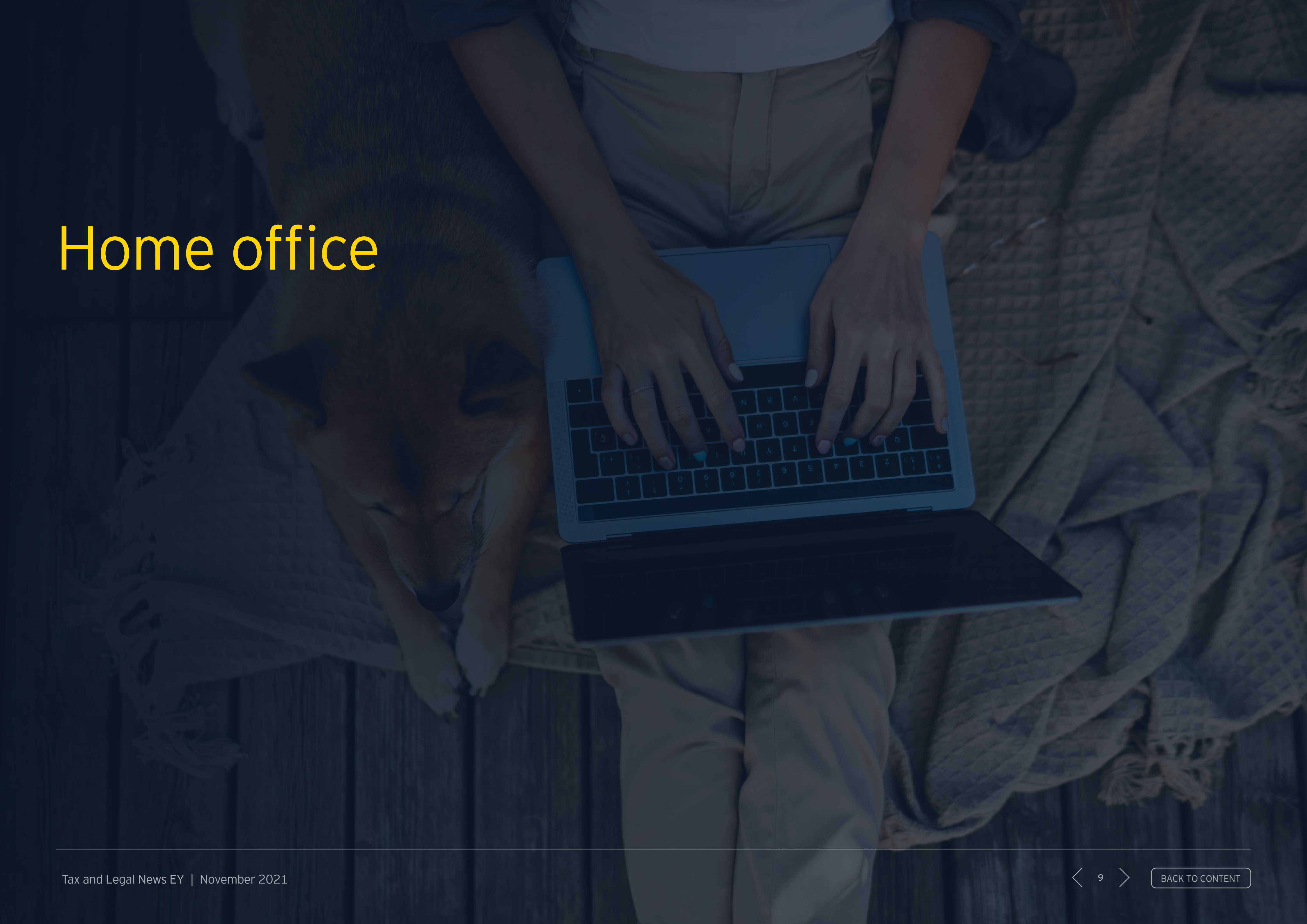
5 It seems, according to available information, that a draft EU directive implementing the Pillar II measures should be published before the end of this year.
6 In this context, the EU Tax Observatory recently published an estimate of the impact of introducing Pillar 2 of the expected international tax system reform. From the data presented, it seems the estimated additional tax revenue for the Czech Republic is minimal. On the contrary, the largest benefit is estimated for the U.S. (for more details, go HERE).

It is clear from the above overview that international taxation is about to undergo a fundamental change. It is also clear that many of the implementation details have yet to be clarified. We'll continue to monitor this area.

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

136 jurisdictions – including the Czech Republic – have joined the statement on a two-pillar solution to reform the international tax system. The ambition is for the new rules to be applied globally in 2023.

Home office



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The issue of "working from home" in Slovakia

Our clients very often deal with the requirements of their employees who want to work, for example, from their home, their parents' home or a cottage abroad. We have therefore prepared a short summary of selected impacts of such work in Slovakia.

A Czech employer that allows its employee to work from home in Slovakia should prepare for significant tax, social and health insurance and labour law implications.

Tax implications for employers

Slovak tax legislation, similarly to the Czech Income Tax Act, recognises the so-called payer of tax. A payer of income tax is a person who is obliged to pay to the tax authority the tax collected or withheld from taxpayers. In the case of employees, this is their employer.

A foreign employer who employs its employees in Slovakia for more than 183 days in any 12-month period will also become a payer of tax in Slovakia. This limit is calculated cumulatively for all potential employees working in Slovakia. Thus, the time limitation on working from abroad that we see for some employers does not necessarily reduce the risk of the employer becoming such a payer in Slovakia.

A Czech company that qualifies as a payer of tax for Slovak tax purposes will then be required to register with the tax office in Slovakia and pay Slovak advance tax on the income of its employees working in Slovakia.

Another significant tax impact may be the creation of a so-called permanent establishment of a Czech employer in Slovakia. Whether or not this happens will depend on the type of activities the employees perform, the length of time they perform the activities and, for example, the premises available to them.

Social security and related contributions

Social security in each EU country is subject to uniform EU legislation. In general, employees are subject to the social security system of only one Member State at a time. For employees who work in more than one Member State at the same time (for example, an employee of a Czech company who will also work from Slovakia), the relevant rules contain additional criteria to determine the Member State to whose scheme the employee should contribute.

Czech employers should be alert in cases where an employee living in Slovakia performs more than 25% of their working time in Slovakia. If they do not arrange for an exemption for the employee (the so-called A1 certificate), the employee will be subject to the Slovak social security and health insurance system. The Czech employer will then be obliged to register in Slovakia and pay the relevant contributions.

Similarly, employers should also arrange for appropriate A1 forms for employees who do not live in Slovakia but carry out work there regularly or on a one-off basis.

In this context, we'd like to remind you that an exception still exists for temporary restrictions on movement due to the coronavirus pandemic. If an employee of a Czech company were to remain working from home in Slovakia due, for example, to border closures in connection with the pandemic, that employee would still be subject to the Czech insurance system. However, its use may already be limited in times of unsealed borders. For more information, see our earlier comments here.

Labour law aspects

To address potential labour law implications, employers should consistently monitor whether employees work for them abroad, or for how long, and properly formalise the work stay.

Even if an employee of a Czech employer has a contract under the Czech Labour Code, they may be subject to certain provisions of the Slovak Labour Code when working in Slovakia.

For example, Slovak employment legislation provides for a regular home office scheme under which the employee is entitled, among other things, to reimbursement of expenses incurred when working from home.

In practice, for example, work-related injuries to employees abroad can also be problematic. Their investigation and subsequent settlement by an insurance company cannot be carried out without sufficient documentation.

Tax implications for employees

From the point of view of the employee's taxation, their tax residency will be decisive. This has an impact not only on the amount and method of taxation of the employee's income itself, but also on the way the employer will manage the employee's monthly payroll. For example, whether it will pay advance tax on the employee's total income or only on part of it.

In Slovakia, a person is considered a Slovak tax resident if they spend more than 183 days in Slovakia during the calendar year, if have a domicile there or have a permanent residence in Slovakia. If the employee is also a tax resident in the Czech Republic, the final assessment of their residency position will be made on the basis of the criteria of the double taxation treaty.

An employee who becomes a Slovak tax resident is obliged to declare and tax their worldwide income in Slovakia, usually through a tax return. Double taxation of income may be avoided via the tax return. Our experience has shown that it is the filing of a tax return in Slovakia by the employee alone or with their Slovak tax advisor outside the control of the Czech employer that can spark the interest of the Slovak tax office.

We have tried to select the most significant impacts that Czech employers may face if their employees work from Slovakia. In determining the individual obligations, employers cannot do without careful monitoring not only of who is working in Slovakia and for how long, but also the nature of their work. We therefore recommend that a system be put in place to provide employers with the necessary information during the year. Subsequent corrections may not be straightforward and may incur penalties from the tax authorities.

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

If a Czech employer allows its employee to work from home in Slovakia, it should prepare for significant tax, social and health insurance and labour law implications.

Data mailboxes

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Changes in the operation of the data mailbox system in communications between private entities

Several amendments to Act No. 300/2008 Coll. on electronic acts and authorised document conversion ("the Act") are about to come into effect, and will fundamentally change the functioning and use of data mailboxes for legal entities as well as for natural persons (both entrepreneurs and non-enterpreneurs). Significant changes in communication between private entities will take place from 1 January 2022 and again from 1 January 2023. Communication with the public administration via data mailboxes will take place as before.

New system for postal data messages

The first of the Act's amendments introduces a new regime for what are known as postal data messages with effect from 1 January 2022. Postal data messages are data messages sent by legal entities or natural persons (both entrepreneurs and non-enterpreneurs) via a data mailbox to the data mailbox of other legal entities or natural persons that are or are not engaged in business. As of 1 January 2022, the receipt of these postal data messages will be automatically activated for all the above-mentioned private entities that have a data mailbox. Today, however, legal entities and natural persons (both entrepreneurs and non-enterpreneurs) must actively authorise the delivery of these messages to the data mailbox in advance. What will remain, however, is the charging for these postal data messages according to the Czech Post price list. The current price of a postal data message (incl. VAT) is CZK 5.

Moreover, after the amendment comes into effect, neither natural persons enterpreneurs nor legal entities will be able to switch off the delivery of postal data messages to their data mailboxes, i.e. legal entities and natural persons entrepreneurs will no longer be able to avoid receiving postal data messages. These will therefore be able to replace other communication channels between businesses and their customers or business partners. Anyone with an active data mailbox will be entitled to send to legal entities and natural persons enterpreneurs via a data mailbox not only enquiries or other routine communications, but also documents with legal effects (e.g. contract termination or withdrawal) relating, for example, to contracts already concluded.

Natural persons non-enterpreneurs, on the other hand, will continue to be entitled to make their data mailbox unavailable for the delivery of postal data messages. They will therefore be able to prevent other data mailbox users from sending any documents or correspondence to their data mailbox. However, they will have to do so proactively by logging into their data mailbox.

Although the aforementioned changes will be effective from 1 January 2022, the transitional provisions of the Act give the Ministry of the Interior, which is responsible for the administration of data mailboxes, another two months to reconfigure the settings of already established data mailboxes in practice. The question is thus how postal data messages will work in practice in the interim period from 1 January 2022 to 1 March 2022.

Fiction of delivery of postal data messages

From 1 January 2022, the fiction of delivery of data messages is also extended to postal data messages. Currently, the delivery of a postal data message requires the authorised person to log in to the data mailbox. A postal data message can therefore wait any length of time for delivery.

Fiction of delivery means that if the authorised person does not log in to the data mailbox within 10 days from the date on which the message was uploaded to the data mailbox, the message shall be deemed to have been delivered on the last day of this period, without the authorised person needing to log in to the data mailbox in any way or without the knowledge of that person about the message. Until now, the fiction of delivery only applied to data messages received from public authorities.

It should be stressed that postal data messages are considered to be private communications. This means that in order for any legal action taken by means of a postal data message to take effect in relation to the addressee, the expression of the will of the acting person must enter the legal sphere of the addressee. Therefore, it is not sufficient if the acting person, where such person is to perform a legal act in respect of the addressee within a certain time limit, merely performs that act by means of a postal data message within that time limit, but it is necessary that the postal data message be deemed to have been delivered to the addressee within that time limit. This will be the case, for example, with a right of claim for defects, as the claim must be made within a certain time limit. It is therefore necessary for the addressee to log in to the data mailbox within that time limit or for the fiction of delivery to occur within that time limit.

It follows from the above that if a sender is planning a legal action and decides to use a data mailbox to do so, they should do so at least 10 days before the (statutory or contractual) deadline for such action. A sender who sends a postal data message later runs the risk that the person with respect to whom the action has been performed will not log in to the data mailbox within 10 days, and therefore the sender of the data message will miss the deadline for performance of legal action, as the postal data message will not have been delivered in time. In order for the sender to be assured that, when performing a legal act by means of a postal data message, this act will be delivered within the specified time limit, it is necessary to act at least ten days in advance. The advantage of a postal data message, on the other hand, is not only that delivery is "certain" and the recipient cannot avoid delivery of the data message in any way, but also that it is easier to prove the content of the data message compared to proving the content by postal or personal delivery.

Documents sent by postal data message

The law directly stipulates that if documents are sent to public authorities via a data mailbox, these documents are automatically deemed to be signed and made in writing by the person from whose data mailbox the documents were sent.

It is our view that this principle should apply similarly to the sending of postal data messages, though the Act does not explicitly mention it. In fact, Section 562 of the Civil Code provides that a legal act made by electronic or other technical means that allows the content of the legal act to be captured and the person acting to be identified shall be deemed to be in writing. We are therefore of the opinion that if a legal regulation or the parties' agreement requires a legal act to be in writing (e.g. in the case of termination of a contract), it is sufficient to attach the text of the legal act to the data message with the fact that it is performed by the person from whose mailbox the data message is sent. In such a case, in our opinion, there should be no doubt as to the content of the legal act or the person acting via data mailbox. We note, however, that courts (in particular, lower courts) showed rather reluctant approach towards legal acts in written form made by electronic means.

Automatic establishment of data mailboxes for natural persons from 1 January 2023

Another major change in relation to data mailboxes will occur with the amendment of the Act effective from 1 January 2023. From this date, data mailboxes will be automatically established for all natural persons enterpreneurs (who do not already have them voluntarily) and data mailboxes will be established for all natural persons who are registered in the basic population register and are fully competent, as soon as this person first uses an electronic identification means issued under a qualified electronic identification system[7] (NIA ID) against one who provides proof of identity under the law governing electronic identification.[8] This means that as of this date, data mailboxes will be automatically set up for natural persons non-enterpreneurs who, for example, use a bank identity (BankID) on condition that they use it vis-à-vis someone who allows proof of identity under the law governing electronic identification. However, natural persons must be notified of this in advance. Once a data mailbox has been set up for natural persons non-enterpreneurs, they may subsequently request that the Ministry of the Interior make the data mailbox set up in this way inaccessible.

If you have any further questions, please contact the authors of this article or other members of EY Law or your usual EY team.

From 1 January 2022, there will be significant changes regarding the sending of what are known as postal data messages via data mailboxes. Legal entities and natural persons enterpreneurs will no longer be able to prohibit the receipt of data messages from other private persons. The fiction of delivery will also be newly applied to postal data messages, if the authorised person does not log in to the data mailbox within 10 days of the delivery of the postal data message to their data mailbox. Last but not least, in 2023, data mailboxes will be automatically activated for natural persons using electronic identification for the first time.

7 Means of electronic identification are listed here.

8 A list of those who allow proof of identity under the law governing electronic identification can be found here.

Judicial window

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Sale of real estate by a natural person – when does VAT apply?

We often get inquiries from individuals who've sold or are planning to sell real estate or who are beginning to invest in real estate. In such a situation, it is essential for the application of VAT whether the seller is acting within the framework of an economic activity (and therefore as a person liable for VAT) or as a private person (in which case VAT is not applicable).

The Court of Justice of the EU (CJEU) has previously commented on this issue, stating[9] that to determine whether an economic activity is involved, it is essential whether the seller takes active steps to sell the property commercially, using means similar to those used by a manufacturer, dealer, etc. The CJEU also indicated certain criteria that should (not) have a major impact on this.

Decision of the SAC

The CJEU interpretation is followed by a recent Supreme Administrative Court (SAC) judgment, which dealt with the situation of a natural person (NP) who, in various forms, acquired adjacent land that was not intended for construction over several years. These lands were subsequently merged and re-partitioned to be suitable for the construction of family homes (their construction and sale was subsequently carried out by another person). Prior to the actual sale, the NP ensured, inter alia, the construction of technical infrastructure and radon measurements, participated in related procedures, and more.

The tax administrator judged these steps as sufficiently active to be considered economic activity; the NP was therefore obliged to pay VAT.

9 Judgment in joint cases C-180/10 Słaby and C-181/10 Kuć.

In the action, the NP argued in particular that its activities were merely the exercise of a property right (management of private property) and in no way constituted an economic activity carried out "independently" as required by the VAT Act.

The Regional Court upheld the tax administrator's conclusions, emphasizing that the NP had carried out deliberate activity aimed at increasing the value of the land and actively preparing it for construction.

The Supreme Administrative Court decision yielded no more substantial arguments (inter alia due to the low quality of the appeal) and the assessed VAT was confirmed.

The judgment also shows that the NP was convicted of criminal tax evasion on the basis of these activities[10].

Practical implications

In practice, we therefore recommend proceeding cautiously with similar investments (not only) in real estate.

For example, it can generally be argued that the length of sales is not in itself determinative of whether a seller is engaged in economic activity. However, it is clear that a carefully thought out "business plan" by an investor can be an aggravating factor.

Any active steps taken by the seller must then be carefully analysed and assessed to see if they give rise to VAT obligations. This may include not only the construction of utilities for land but also other forms of property appreciation (the GFD's interpretations mention, among other things, a change in the zoning plan), but also "merely" a sophisticated approach to the sale of property and its marketing (which the CJEU cites as an example).

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

For investments, especially in real estate, which are at the borderline between private asset management and economic activity, we recommend proceeding very cautiously. Any active steps taken by the investor should be carefully analysed and assessed to ensure they do not give rise to VAT obligations. The construction of utilities for land, changes to the zoning plan and, for example, the approach taken to marketing or other activities of the seller, may be crucial.

10 For the crime of evasion of tax, fee and similar compulsory payment under § 240 of the Criminal Code.

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Development of case law on a claim for "interest on interest" in tax proceedings

We previously wrote[11] about the Supreme Administrative Court ("SAC") case law according to which interest for late payment of interest may be charged in respect of unjustified actions of the tax administrator under § 254 of the Tax Code (as amended before 1 January 2021). The 2017 judgment of the Second Chamber[12] was recently followed by two judgments of the Tenth Chamber[13].

According to the reasoning of the Second Chamber in 2017, these cases do not involve the generally rejected "anatocism" – actual interest on interest – because the later, second interest is effectively calculated on the fixed amount of the previous interest, which is no longer increased. It is thus essentially a new principal (and, by extension, a separate tax), and so not prohibited interest on interest.

Moreover, recent judgments of the Tenth Chamber point to the temporal aspect of the case. They state that it is undoubtedly an unjustified burden on tax proceedings if the tax authorities delay for a significant period of time before awarding statutory interest. The taxpayer affected by that unlawful conduct is therefore entitled to adequate compensation.

Another SAC chamber (the Ninth Chamber) further modified this case law in its current judgment[14], concluding that in the case of late payment of a refundable overpayment (arising, for example, in connection with interest incurred as a result of a lengthy examination of an excessive VAT deduction), the general prohibition on interest from interest is applicable.

In the view of the Ninth Chamber, it is necessary to assess whether or not the original interest arose as a result of unlawful tax administrator conduct.

While interest on unlawful tax administrator conduct is a lump-sum compensation for the damage caused by the unlawful decision, interest on a refundable overpayment is compensation for the damage caused by the

11 See our Tax News of April 2018.
12 Supreme Administrative Court Judgment No. 2 Afs 148/2017 - 40
13 Supreme Administrative Court Judgment No. 10 Afs 382/2020 - 51 and No. 10 Afs 405/2020 - 41
14 Supreme Administrative Court Judgment No. 9 Afs 52/2021 - 42

delay in returning the overpayment. It is, so to speak, the "price of the money" withheld by the tax authorities. It is therefore not interest on an "unlawful act" of the tax administrator, but interest for the period when the amount of the over-deduction claimed is lawfully, but for a considerable period of time, under scrutiny.

In this connection, the Ninth Chamber refers to the regulation of interest in private law relationships. According to the Civil Code, where the claim is one arising from an unlawful act, interest may be claimed from the date on which the claim was brought before the court.[15] The court likens interest on the tax administrator's unauthorized conduct to this institute, which expressly allows interest on interest. In both cases, it is interest from some form of tortious conduct for which the person against whom it was directed is to be compensated. Because of the different nature of interest on a repayable overpayment which is alleged not to have been caused by the unlawful act, interest on such interest is not supported by analogy with the Civil Code, as is the case with interest on an unlawful act.

The above conclusion of the Ninth Chamber can be seen as somewhat inconsistent with the earlier conclusion of the Second Chamber in 2017, which concluded that the basis on which the overpayment arose is irrelevant to the entitlement to interest on the tax overpayment. Therefore, the fact that the overpayment was originally derived from an initial interest does not affect the ability to claim interest on such an overpayment.

Moreover, the conclusion of the Ninth Chamber does not appear to be accepted by the courts without reservation. The Pardubice branch of the Regional Court, for example, issued a judgment in late September[16] in which interest on the interest on a refundable overpayment was awarded with reference to the previous case-law of the Tenth Chamber of the Supreme Administrative Court.

15 § 1806 of Act No. 89/2012 Coll., the Civil Code, as amended
16 Judgment No. 52 Af 43/2021 of the Regional Court in Hradec Králové – Pardubice branch
17 Item 15 of Supreme Administrative Judgment No. 10 Afs 382/2020

It is possible that one of the other chambers of the SAC may also decide to take a different view. In such a case, a review of the entire case by an extended Chamber of the SAC cannot be ruled out.

In this context, we would also like to draw your attention to the change of interest rules in tax proceedings according to the Tax Code amendment effective from 1 January 2021. The amendment introduced, inter alia, a new § 253a, according to which interest on a refundable overpayment does not arise in the case of late repayment of interest paid by the tax administrator, i.e. the prohibition of interest on interest. The previous case law was also based on the fact that the Tax Code did not explicitly exclude interest on unjustified actions of the tax administrator.[17]

We'll keep you informed of any further developments.

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

Another SAC chamber (the Ninth Chamber) further modified the above case law in its current judgment, concluding that in the case of late repayment of a refundable overpayment (arising, for example, in connection with interest incurred as a result of a lengthy examination of an excessive VAT deduction), the general prohibition on interest from interest is applicable.

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

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Did you know:

- The Minister of Finance has decided to waive VAT on electricity and gas supplies in the months of November and December 2021 and on advances received during this period?
- The European Commission has published its work plan for 2022?
- The General Financial Directorate issued information on new developments regarding VAT forms?
- The Supreme Administrative Court commented on the application of § 24(2)(zc) of the Income Tax Act?