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The coming Windfall

No, this editorial isn't an advertisement for a prequel to a popular TV series. This "windfall" isn't a new show, but "unexpected income" that someone realizes without any effort due to extraordinary external circumstances rather than their own doing.

These external circumstances are currently considered (at least by the National Economic Council of the Government known by the acronym NERV) to be not only the increase in energy prices and energy raw materials caused by energy policy and the military conflict in Eastern Europe, where all energy prices are rising regardless of the cost structure of their producers, but also the rise in interest rates caused by the unbridled printing of money to cover COVID deficits, present and future, caused by war, economic downturn or governments' fiscal irresponsibility.

Those that are "excessively" benefiting from these external impacts, according to the government council, are mainly energy suppliers, which realize high market prices regardless of the source of the energy they produce, and banks, which are able to reflect increased interest rates in their revenues faster than they are passed through to their costs (possibly also refineries and fuel distributors).

According to NERV experts, the least bad solution to the above situation would be the so-called windfall tax that would lead to the transfer of these profits to affected businesses and households, either in the form of direct payments, or at least by not raising other taxes to cover deficits, and that should also have an anti-inflationary benefit.

Far from being a new idea, a similar principle was applied in this country, for example, more than 100 years ago to finance the First World War; it is currently being applied in the UK, has been introduced in Hungary and is being considered by other EU countries.

According to some sources, the Ministry of Finance is already translating expert considerations and recommendations into a draft legal text according to which the tax would apply for calendar years 2023-2025 and would affect the largest groups with businesses exceeding certain criteria and operating in selected industries.

However, the most interesting parameters, such as the specific industries (defined by NACE codes), the size of the selected sales threshold per group or enterprise and especially the tax rate, are not yet known and will probably be the subject of political debate.

The tax base should, according to the available information, be the difference between the current tax base and the average of the adjusted historical tax bases for the period 2015 to 2021 (most likely "indexed" for inflation and probably some small increase).

Both tax bases (i.e. current and historical) should be based on line 220 of the tax return after adjusting for foreign income (i.e. before applying items reducing the tax base). The proposal works with the possibility to transfer, under certain conditions, the amounts of the average historical bases between companies in a group. Advances would be made on the tax (and already in 2023).

Interestingly, the tax could also apply to companies in a group that have nothing to do with the selected industries (presumably electricity, banking and possibly some fuels). The tax could also affect companies that don't necessarily have higher profitability, but that have just grown (i.e. volume vs profitability). The question is whether such a thing would be consistent with the presented objectives of the law and whether there is any simple solution to it.

The entire group, including foreign entities, would presumably be subject to the tax. Their income could then be excluded because "income from foreign sources that is subject to foreign taxation under an international treaty will not be included in the base".

At the moment, therefore, it is essential to monitor the dramatic developments that this mechanism is undergoing and to hope that its eventual impact on the economy will actually be as beneficial as experts predict.

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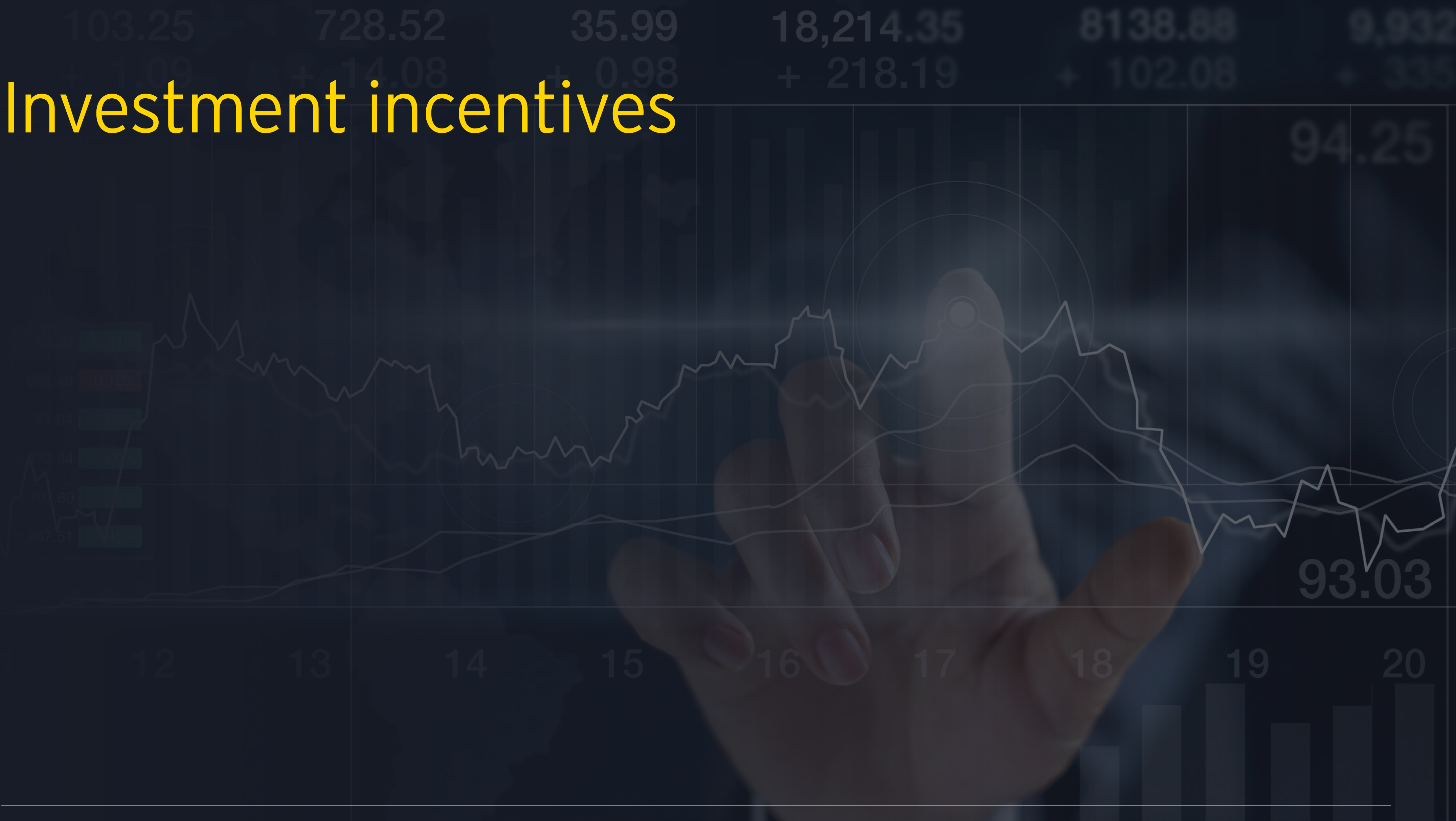
Investment incentives



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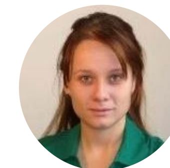

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Draft implementing regulation to the Investment Incentives Act

The Ministry of Industry and Trade has prepared a draft government regulation that follows the forthcoming Investment Incentives Act amendment that we informed you about in early August (more in Czech and English HERE).

Approval of investment incentive applications

We would like to remind you that the aforementioned Investment Incentives Act amendment should abolish the obligation to submit every investment incentive application to the Government for consideration, i.e. the Ministry of Industry and Trade should once again be making the decision. Only applications relating to strategic investments, i.e. investment activities where cash grant is provided for the acquisition of tangible and intangible fixed assets, should continue to be submitted to the Government. In the case of other projects, the decision on the investment incentive will be issued on the basis of an assessment of the conditions and obligations set out in the Investment Incentives Act, other implementing regulations and on the basis of binding opinions of the ministries concerned, as was the case under the original version of the Act until autumn 2019.

The reason for the above-described amendment is the considerable lengthening of the process of deciding on an investment incentive. The investment incentive approval period has been extended from the previous 3 to 5 months to 9 to 12 months.

Moreover, the Investment Incentives Act did not define the criteria on the basis of which the Government should express its opinion on the granting of an investment incentive. Government resolutions have thus often proved to be completely unpredictable and non-transparent for applicants. To illustrate: the Government has rejected a total of 12 out of 29 projects decided so far, while all 29 projects met the prerequisites for fulfilling the conditions set by the Investment Incentives Act and Government Regulation No. 221/2019 Coll. According to a comparison carried out by the CzechInvest agency, applicants were most often rejected on the basis of the company's low interdependence with research and development or for not fulfilling the condition of higher added value, even in state-supported regions, where the fulfilment of this condition is not required according to Government Regulation No. 221/2019 Coll. The second most common reason was that the investment was rejected for being too small, even though all applicants met the minimum level of

investment required by law. This reason is not consistent with efforts to make investment incentives more accessible to SMEs by lowering the minimum qualification requirements. The Government did not take into account whether the investment was located in a state-supported region, but statistics from the CzechInvest agency show that it took into account the high added value and the proportion of unemployed in the region.

Energy savings and transformation

The draft government regulation should contribute to meeting the energy goals of the Czech economy and the energy self-sufficiency of the Czech Republic by more targeted support for the production of technologies and equipment that will contribute to energy savings and energy transformation. Increased support for the production of such technologies and equipment should then be ensured by the following change in the setting of aid conditions:

- Investments focused on these areas will be able to obtain an investment incentive in the form of cash grant for the acquisition of tangible and intangible fixed assets for strategic investment actions without having to reach a value of CZK 2 billion and create 250 new jobs;
- The rate of this cash grant for strategic investment actions would be increased up to 20% of eligible costs in all regions (currently this level of material support is available only in the Karlovy Vary, Ústí nad Labem and Moravian-Silesian regions); this is the maximum possible rate, the specific amount of cash grant will continue to be decided by the Government according to the current possibilities of the state budget and the importance of the investment in meeting the energy objectives of the Czech economy;
- If the investment is approved by the Government as a strategic investment action, it will not have to comply with the higher value added thresholds (see below).

The list of selected products whose production should be newly supported includes heat pumps, photovoltaic systems, solar thermal systems, solar hybrid systems, heat recovery units and solar thermal panels, nuclear reactors and non-irradiated fuel cells, steam generators and condensers, water turbines, water wheels and their controllers, wind turbines, wind-powered generating sets, electrolysers for the production of hydrogen from renewable energy sources, hydrogen fuel cells, meters for the supply or consumption of gases, liquids and electricity, battery storage for electricity from renewable energy sources, insulation materials used as thermal insulation for structures and piping in the construction industry, charging stations for electric vehicles, filling stations for hydrogen electric vehicles, hot water boilers for biomass and electricity for indoor heating, electric cookers, ovens and hobs, power chips, traction batteries for electric vehicles.

Higher added value

The new regulation should also tighten the conditions for obtaining the investment incentive through higher requirements for the added value of supported projects:

- The condition of higher value added would be extended to all regions of the Czech Republic, except for regions with unemployment of at least 7.5% (only the Karviná district currently meets the exception);
- Doubling the requirement to spend on collaboration with a research organisation to 2% of eligible costs;
- Increase in the compulsory share of R&D staff from 2% to 3%.

Certain strategic investment actions should then be exempted from the stricter higher value added limits described above, in particular large-scale investment projects where the high demand for job creation would make it impossible to achieve these limits, or the aforementioned investment projects aimed at increasing the production capacity of

products needed to implement the necessary energy transformation of the Czech Republic.

Effectiveness

The draft regulation is now in the external (inter-ministerial) comment procedure; informal discussions suggest that some of the comments will be directed at the proposed tightening of the higher value added due to concerns arising from uncertainties about future economic developments in relation to the current economic and political situation.

Due to approval deadlines, the new rules are not expected to take effect until 2023, at the earliest.

If you have any questions about the content of the amendment and the related implementing regulation, including their potential practical implications for applicants for investment incentives, please contact the authors of the article or your usual EY team.

The draft government regulation should contribute to the fulfilment of the energy goals of the Czech economy and to the energy self-sufficiency of the Czech Republic by more targeted support for the production of technologies and equipment that will help realise energy savings and energy transformation.

Tax Administration

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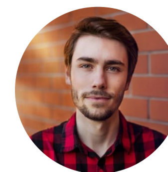

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Information on Czech Tax Administration activities in 2021 – what caught our attention

Every year, the Tax Administration ("TA") publishes a report on its activities, commenting not only on tax collection, but also on control activities, international cooperation in the field of taxation or the exercise of other competences. Below we summarise what caught our attention.

Tax collection

- The total tax collection rose from CZK 850 billion to CZK 866 billion, which is still lower than before 2019, when the collection reached CZK 906 billion. The main impact on collections is a drop of CZK 66 billion in personal income tax collections due to the abolition of the super gross wage.
- VAT collections increased by 8.7%. The largest decrease in VAT collection was recorded in the Hradec Králové Region, which lost significant taxpayers due to local jurisdiction. On the other hand, VAT collections grew significantly in the Moravian-Silesian Region, where foreign entities have local jurisdiction. Due to lower economic activity, these entities claimed lower excessive deductions.
- Total corporate income tax collection increased from CZK 156 billion to CZK 200 billion. The increase in collections is also due to a number of technical effects, such as (i) the partial waiver of advances in 2020 and tax underpayments in regular corporate income tax in 2021, (ii) taxation of insurance companies' technical provisions in corporate income tax for the 2020 tax year (i.e. in 2021).

Control activities

- The number of completed procedures to remove doubts fell again in 2021, this time from 9.6 thousand in 2020 to 7.8 thousand. The likelihood of such a procedure ending with a change in tax liability rose by 3% compared to the previous period and now stands at 83% (it was 75% in 2019).
- Approximately 6,500 tax audits were completed in 2021, similar to the previous year. The TA attributes the low number of tax inspections to the impact of the COVID-19 pandemic, e.g. delays in meetings due to isolation and quarantines or longer waiting times for processing responses in the framework of the international exchange of information. It can be

assumed that once these factors subside, the tax administrator's activity in the control area will increase.

- The most frequent findings were in the area of claiming deductions for fictitious transactions, failure to comply with the obligation to file a tax return, transfer pricing, application of deductible items and exemption of interest income from crown bonds.
- The TA focused on tax losses in corporate income tax in 2021, with a change in tax losses of CZK 1.76 billion, while in 2020 there was a change of only CZK 1.29 billion.

Our TOP 8 from this year's edition
In relation to the institute of notification of exempt income of natural persons, the number of cases in which tax subjects submitted notifications after the deadline but without being invited by the tax administrator (i.e. voluntarily) increased from 223 to 645. These entities were fined a total of CZK 19 million. In 3 cases, individuals filed notifications only after a tax administrator request, for which they were fined a total of CZK 23 million.
The TA actively cooperates with the tax administrations of other countries, inter alia, through requests for the exchange of information. For example, within non-EU countries, this time it focused on the UK, Switzerland, Ukraine, the Russian Federation and the British Virgin Islands.
The OFŘ (Appellate Tax Directorate) is referred to by a certain section of the tax community as the "Confirmation Appellate Directorate" because there is a public perception that it only confirms first instance decisions. But statistically, that's not entirely true – 4,640 appeals were decided in 2021, of which 1,086 were accepted, 567 were partially accepted, 96 were decided against the tax subject (i.e. worsening of the position compared to the decision of the first-instance tax administrator), 2,870 were rejected and 21 stopped.
In 2021, 41 international double taxation cases were resolved. At the same time, taxpayers requested bilateral and local binding assessments in 14 and 39 cases, respectively, of the manner in which the price negotiated between related parties was established or the manner in which the tax base of the permanent establishment was determined.
Under the new reporting obligation (DAC6 MDR), the Czech Republic received a total of 331 records in 2021 and a total of 134 records of cross-border arrangements were sent abroad.
The TA makes specific reference to the handling of cryptocurrencies that are used to conceal an electronic trail or in connection with which no income is declared.
The threshold for committing the offence of tax evasion was increased from CZK 50,000 to CZK 100,000, which has an impact on the number of cases referred to law enforcement authorities.
362 requests for information under the Freedom of Information Act were submitted in 2021, of which 34 were denied. In its replies, the General Financial Directorate stated, for example, that it would work on incorporating the flat-rate scheme into the ADIS information system and on communication with third parties, i.e. with the General Health Insurance Company of the Czech Republic and the Czech Social Security Administration in connection with the flat-rate scheme; approximately CZK 150 million will have been spent by mid-2022.

Cooperation with law enforcement agencies

The TA published several cases arising from cooperation with law enforcement authorities. Below are some of them.

- **Cryptocurrency exchange** – A group of connected persons claimed excessive VAT deductions in relation to unrealised business activities. The structure also included a cryptocurrency exchange. The group enriched itself by at least CZK 30 million.
- **Documents up to CZK 10,000** – At least 36 people engaged in criminal activity by reporting high values in section B3 of the control report, which reports documents worth up to CZK 10,000. Ultimately, these persons were unable to provide any evidence of these amounts. The total damage amounted to CZK 36 million.
- **Fuel imports from Slovakia** – 16 natural persons and 2 legal entities were accused of creating an artificial chain of companies importing fuel from Slovakia. This activity took place as early as 2013, which shows the complexity of the investigation.
- **Fuel imports from Germany and Austria** – A similar case involving Germany and Austria has already been uncovered by investigators. Now, based on new information, they have launched a prosecution against those involved in actually organising the fraud.
- **A fictitious chain of companies** – The Tax Cobra agency accused a total of 22 people of creating an artificial chain of companies for the purpose of VAT evasion. The entire structure was multi-stage, with only the individual intermediate links known, thus concealing the real organiser.
- **Advertising** – An organised group of persons established trading companies and reported high income from advertising activities. In order to reduce their tax liability, they included fictitious invoices in their accounts and claimed the related deduction.

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

The most frequent findings were in the area of claiming deductions for fictitious transactions, failure to comply with the obligation to file a tax return, transfer pricing, application of deductible items and exemption of interest income from crown bonds.

The law

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Cross-border transfer of a registered office to the Czech Republic even from non-EU countries

Recently, we've repeatedly encountered increased demand from clients for services regarding the transfer of a registered office (cross-border conversion) of companies incorporated under foreign law to the Czech Republic. In practice, this usually involves the relocation of foreign holding companies (co-)owned by Czech natural or legal persons to the Czech Republic.

The reasons for relocation vary. In our experience, it's usually a combination of several factors, e.g. loss of anonymity of shareholders due to harmonised legislation on beneficial owners or the requirement to reduce the administrative and financial burden in connection with the administration of foreign companies. Another impetus is the improving stability of the Czech legal environment and the variability provided by the Business Corporations Act effective since 2014.

In respect of companies from EU Member States or the European Economic Area (EEA), the same intention was previously achieved through cross-border mergers involving a Czech entity as the successor company. Unlike the Czech Republic, some Member States did not explicitly regulate the cross-border transfer of a registered office (as opposed to the regulation of cross-border mergers), while the possibility of transferring a registered office and the procedural rules for its implementation had to be derived from the case law of national courts.

Given the financial cost of a cross-border merger, a cross-border transfer of a registered office thus appears to be a suitable alternative with a number of advantages and savings. The transfer of the registered office of a foreign company to the Czech Republic will not result in the dissolution of the company, if it simultaneously changes its legal form to a Czech company and its internal legal relations are governed by Czech law.

Registered office transfer process

The process of cross-border transfer of a registered office to the Czech Republic is primarily governed by the law of the State in which the foreign legal entity has its registered office, including the details of the common terms of the conversion (if required), publication of the intention to transfer, including the notice to creditors, the time limit for approval of the transfer by the shareholders, etc. Compliance with the requirements required by the

law of a Member State for the transfer of a registered office to the Czech Republic is demonstrated by the presentation of a public document issued by an authority of that State (e.g. a notary's certificate).

On the basis of this public deed, the deed of incorporation of the Czech company after the transfer of the registered office and an expert's report certifying that the equity of the foreign company is at least equal to the amount of the share capital stated in the deed of incorporation (if the company changes its legal form to a Czech limited liability company or a joint stock company), the Czech notary will issue a certificate for the registration of the transfer of the registered office in the Commercial Register and, if necessary, make a direct registration of the transfer in the Czech Commercial Register (alternatively, a petition for registration of the transfer of the registered office may be filed with the competent registration court).

The transfer of the registered office to the Czech Republic usually takes effect on the date of registration in the Czech Commercial Register; the deletion from the foreign register is only declarative. In our experience, the process of cross-border transfer of a registered office to the Czech Republic can be completed within 4-5 months (from the start of preparation of corporate documentation to entry in the Commercial Register).

Transfer from a non-EU (EEA) country

The general regulation of the cross-border transfer of the registered office of a legal entity to the Czech Republic is contained in the Czech Civil Code. More detailed rules are regulated in the Act on Transformations of Commercial Companies and Cooperatives. However, it explicitly applies only to cross-border operations with EU or EEA countries.

Thus, according to the prevailing interpretation, no cross-border operation, including cross-border of a registered office, could take place with countries such as Switzerland, the US or the UK (post-Brexit). Although we are aware of isolated cases in the Commercial Register where Czech notaries have registered a cross-border transfer of a registered office from Switzerland to the Czech Republic with reference to the general regulation contained in the Civil Code, the possibility of transferring a registered office from a non-EU (EEA) country to the Czech Republic will be explicitly allowed only on the basis of the amendment to the Act on Transformations that is currently in the legislative process. However, it will remain a prerequisite that the existing legal regime of the foreign company allows the transfer.

In addition to allowing cross-border transfers from non-member states, the purpose of the amendment to the Act on Transformations is also to harmonise the Czech law with the 2019 European Directive on cross-border conversions, mergers and divisions.

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

Recently, an increased number of cross-border transfers of foreign companies' registered offices to the Czech Republic can be observed. In practice, this may be a suitable alternative to the previously preferred cross-border mergers due, inter alia, to the simplified process and lower costs. However, according to the Czech Act on Transformations, so far only transfer of a registered office within the EU or EEA has been possible. Under the forthcoming amendment to the Act, transfer from non-member states, including Switzerland or the UK, for example, will also be possible.

Judicial window

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SAC observations on the conducting of tax proceedings

The Supreme Administrative Court (SAC) has recently issued several judgments addressing practical aspects of the conducting of proceedings by the tax administrator. The cases concerned the importance of informal communication with the taxpayer and the tax administrator's obligation to organise the proceedings in a timely manner.

Informal communications

It is relatively common for taxpayers to encounter communication from the tax administrator via e-mail or telephone in tax proceedings. Although the Tax Code does not explicitly regulate these forms of communication, recent decisions of the SAC confirm that they can't be taken lightly.

In the first case[1], the tax administrator repeatedly tried without success to reach a taxpayer's representative by telephone during a procedure to remove doubts. This procedural passivity of the consultant contributed to the tax administrator's conclusion that the taxpayer failed to bear the burden of proof and led to a tax assessment. As to the tax consultant's objection that she could not be required to discuss client matters over the telephone due to her duty of confidentiality, the Court stated that it *"finds nothing improper or illegal in the tax administrator's telephone communication with the tax consultant and adds that the law does not oblige the tax administrator to communicate with tax subjects exclusively in writing"*.

In the second case[2], the taxpayer did not respond to repeated phone calls and SMS messages from the tax administrator at the end of a tax audit. The Court held that, together with other circumstances, the taxpayer's passivity satisfied the elements of avoidance of the tax audit report. On the basis of this conclusion, the Court also approved the atypical method of delivery of the tax audit report, namely into the taxpayer's own hands by an employee of the tax office directly at the taxpayer's place of work.

1 See the judgment of the Supreme Administrative Court of 19 July 2022, ref. No. 2 Afs 15/2020 - 54.
2 See the judgment of the Supreme Administrative Court of 21 July 2022, ref. No. 9 Afs 349/2019 - 49

The non-standard conduct of both parties stemmed from the approaching end of the tax assessment period, and in this case the Court sided with the tax administrator and did not support the taxpayer's allegedly obstructive conduct. It is not without interest that the situation under review took place around Christmas and the end of the year (between 20 December 2017 and 9 January 2018).

Organising the timing of proceedings

On the other hand, for cases where the taxpayer's conduct is not manifestly obstructive, the SAC confirmed in another decision[3] that the tax administrator is primarily responsible for the proper planning of the proceedings. According to the SAC, the tax office is obliged to organise its activities in such a way that it is able to complete the tax proceedings on time within the time limit for tax assessment, without restricting the procedural rights of the taxpayer.

In a particular case, the Court concluded that if the tax administrator informs the taxpayer of the assessment of the case shortly before the expiration of the tax assessment period and is subsequently "surprised" by the taxpayer's exercise of their right to comment on the assessment or to propose additional evidence, this is a clear error by the tax administrator in the timing of the proceedings, and this must be attributed to the tax administrator, not the taxpayer.

At the same time, the SAC reiterated that the tax administrator, in conducting the proceedings, is obliged to take into account the circumstances that normally and naturally arise for taxpayers and their representatives. Such circumstances, according to the Court, include illness, injury, but also an important business trip or a planned summer vacation.

The Court further stated that in assessing the taxpayer's allegedly obstructive conduct, it must also take into account the tax administrator's own conduct in the proceedings. In this context, the SAC drew attention to the importance of the deadlines set by the internal instruction of the Ministry of Finance[4]. In the present case, the appeal body exceeded the standard time limit for deciding an appeal (6 months) by more than double. For this reason, too, the tax authority was in a time crunch at the end of the proceedings, which, in the standard course of events, cannot be attributed to the taxpayer.

The takeaway

The above cases show that courts generally protect the procedural rights of taxpayers who properly cooperate with the tax administrator in a timely manner. This cooperation can take place even in relatively informal communication. Obstructive behaviour, on the other hand, does not usually bring success in the case.

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

Courts generally protect the procedural rights of taxpayers who properly cooperate with the tax administrator in a timely manner. This cooperation can take place even in relatively informal communication. Obstructive behaviour, on the other hand, does not usually bring success in the case.

3 See the judgment of the Supreme Administrative Court of 27 July 2022, ref. No. 2 Afs 136/2020 - 70

4 See, in particular, Ministry of Finance of the Czech Republic Instruction D--348 on setting tax administration deadlines

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Court of Justice on the application of VAT to a chain transaction not involving fraud

At the beginning of the summer holidays, the Court of Justice of the EU ("CJEU") confirmed in case C-696/20 B against Dyrektor Izby Skarbowej w W. that the application of VAT on chain transactions is still a hot topic. Here, it dealt with possible double taxation in a situation where it was certain that no tax fraud had occurred. Despite the fact that it ruled out double taxation in principle, this case should be given close attention. An error in the correct assessment of a transaction can lead to VAT being charged which is not deductible by any of the traders in the chain.

What happened

The CJEU considered a standard chain transaction. Polish company A supplied goods to Dutch company B, which resold them to company C. Company B was established in the Netherlands but used its Polish VAT number for the purpose of these transactions. The goods were transported by Company A from Poland directly to Company C established in another Member State.

Company B attributed the transport to its supply of goods to Company C and exempted the supply from VAT. At the same time, it claimed a deduction of the Polish VAT applied by Company A.

The tax administrator attributed the transport to the supply of goods between companies A and B. In its view, this supply should have been exempt from Polish VAT as an intra-community supply of goods. The tax administrator therefore rejected the tax deduction claimed by Company B on the purchase of goods from Company A. The loss of the right to deduct VAT was not further disputed in the proceedings.

At the same time, the tax administrator assessed tax on the intra-community acquisition of goods in Poland by Company B on the grounds that it used its Polish VAT number in the transaction. According to the tax administrator, this was a procedure in accordance with Article 41 of the VAT Directive[5]. According to this article, the place of intra-community acquisition of goods is the Member

5 This provision is implemented in the Czech VAT Act in Article 11(2).

State which issued the acquirer with the VAT number (here Poland) used by the acquirer in the transaction, unless the acquirer proves that the acquisition was taxable in the State of completion of the transport. According to settled case law of the CJEU[6], at the same time, it is not possible to claim a deduction for the VAT thus applied[7]. The purpose of this arrangement is to encourage payers to comply properly with their obligations in the Member State of the completion of transport. It is also intended to prevent double taxation on the acquisition of goods from another Member State.

Normally, these two transactions should have been completely neutral from a VAT perspective, not burdened by tax. However, as a result of the incorrect transport allocation, Company B was suddenly liable to pay VAT twice – the first time on a local purchase of goods from a Polish supplier and the second time on an intra-community purchase of the same goods from Poland to another Member State using a Polish VAT number.

What is unusual about this case is that the acquisition of the goods was taxed in the country from which the goods were shipped. At first sight, it would therefore appear that the acquisition of the goods was not from another Member State but from the same Member State, meaning VAT would not be due.

The CJEU should have confirmed whether this procedure complied with the principles of proportionality and neutrality, also in view of the fact that Company C duly paid VAT on intra-community acquisitions of goods in its Member State and Company B was not involved in the fraud.

The outcome

In its ruling, the CJEU concluded that the rule laid down in Article 41 of the VAT Directive can be applied even if the Member State which issued the VAT number to the purchaser is also the Member State of start of the transport of the goods. This is an alternative way of taxing goods actually acquired in another Member State where the transport ends (i.e. in State C). The applicability of this rule is not affected by the fact that Company C declared VAT as if it had itself acquired the goods from another Member State (this tax, according to the Court, relates to a transaction other than the acquisition of the goods by Company B, which is covered by Article 41 of the VAT Directive).

In the end, however, the CJEU concluded that Polish VAT on intra-community acquisitions of goods does not have to be applied. The sale of goods between Companies A and B breaks down into two mirror transactions, an exempt supply of goods to another Member State and a taxable acquisition of goods from another Member State. Since the supply of goods by A was taxed and B is not entitled to deduct that tax (which was not disputed in the proceedings), there is no risk that the transaction in question was not taxed. On the contrary, it would be taxed twice. This would defeat the purpose of Article 41 of the VAT Directive. The application of VAT would not comply with the principles of proportionality and neutrality.

The takeaway

It should be added that the present case dates from the period before the application of the Quick Fixes rules. Today, if Company B provides its VAT number from the state of start of transport for the purchase of goods, the sale will be properly subject to VAT in the state of start of transport, even though it is a supply of goods with transport to another Member State. Subsequently, Company B will probably be able to deduct this VAT (the interpretation of this matter is not yet settled and may still evolve). It is therefore questionable whether the CJEU would rule on the application of VAT under Article 41 of the VAT Directive in the same way.

6 See case C-536/08 Facet-Facet Trading

7 This provision is implemented in the Czech VAT Act in Section 11(2), penultimate sentence

However, this does not change the fact that the Court's new ruling is a call for caution to all those involved in chain transactions. An incorrect assessment of the circumstances of a given case may lead to additional costs in the form of non-deductible VAT.

We will be happy to help you verify the correct application of VAT in the chain transactions you're involved in. If you have any questions on this topic, please contact the authors or your usual EY team.

The Court's new ruling is a call for caution to all those involved in chain transactions. Incorrect assessment of the circumstances of a given case can lead to additional costs in the form of non-deductible VAT.

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Acquisition loan and abuse of law

This time we bring you an interesting decision of the Regional Court in Brno in a case of abuse of law (more in Czech HERE).

The case at hand concerned the deductibility of interest expense for a Czech corporation. The interest arose in the context of several transactions connected (as far as can be inferred from the text of the Court decision) with the entry of an unrelated investor into an international manufacturing and trading group. The new investor did not legally enter directly into the Czech corporation, but into the parent company of the entire concern. From the point of view of the Czech loan financing assessment, this was a situation falling into the category referred to as debt push-down.

In short, the parent company sold a stake in one of its subsidiaries ("target") to another of its (newly established) subsidiaries ("SPV"). The SPV took a loan from the parent company to buy the stake. Interest on a loan taken out to buy a subsidiary is generally non-tax deductible. After buying the stake, the target then merged with the SPV. After the merger, the SPV considered the interest on the loan to be tax deductible because the reason for non-deductibility (the existence of the subsidiary for whose purchase the loan was taken out) had disappeared.

The Regional Court concluded that, in its view, there was nothing to prevent the merger of the subsidiaries from being carried out straightforwardly, i.e. without the sale and the associated loan. It considered the sale and the loan to be artificial and the related interest costs to be non-tax deductible under the prohibition of abuse of law.

In this particular case, the Court was not persuaded by the taxpayer's argument that the case had to be considered in the context of the entry of a new investor into the group's foreign parent company and to take into account the requirements of the financing bank (which provided a loan to the parent company).

The taxpayer lodged an appeal against the judgment. It will be interesting to see how the Supreme Administrative Court comments on the case.

We'll be taking a closer look at this case and other abuse of law rulings in a continuing series of webinars, **Topics in Tax Audits**. The next webinar will take place in the second half of September (more in Czech HERE).

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

From the perspective of the Czech loan financing assessment, this was a situation falling into the category referred to as debt push-down, and the taxpayer has so far been unsuccessful in its defence – we'll see what the Supreme Administrative Court has to say.

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Did you know:

- In view of rising market prices, the rate of meal allowances and the price of gas for the purpose of determining travel allowances have been increased?
- A draft VAT Act amendment introduces a new administrative obligation for payment institutions from 2024?
- The Tax Administration will focus on the correct reporting of imports of goods that were exempt from VAT in other EU countries?
- The General Financial Directorate issued Instruction D-56 regulating the procedure for waiving fines for failure to report exempt income?