The amendment to the Income Taxes Act, transposing into the national law the EU Anti-Tax Avoidance Directive (ATAD), has been in effect since 1 April 2019, with the exception of the provisions governing exit tax and hybrid mismatches applicable from 1 January 2020.

The rules governing hybrid mismatches target three key situations:

- double deduction,
- deduction of income without inclusion (in the income tax base in the other state), and
- “imported hybrid mismatch”.

The rules apply to transactions between associated entities. The purpose of the legislation is to prevent situations where one expense is actually deducted in two states, or where two states treat one and the same instrument differently for tax purposes. Other ATAD rules are brief and give rise to interpretation challenges, but the provisions on hybrid mismatches are very succinct and difficult to understand.

Hybrid mismatches may even arise in situations that may not be intuitively presumed, where a Czech company (or a permanent establishment) is classified entirely differently under foreign tax legislation, e.g., where a Czech company is considered a permanent establishment under the US tax legislation. Payments of interest by a Czech company to the American parent company will grammatically constitute a deduction without adequate inclusion of the income in the tax base.

In the event of a double deduction, the deduction is given in the source state, if the other state applies a similar rule (if not, the deduction will not be given in the source country). In the event of a deduction without inclusion, the deduction in the source country is denied and the income is tax exempt in the recipient country (if, however, the source country does not apply a similar rule, the income will be included in the recipient's tax base).

In our articles, we briefly acquainted you with all key parameters of the Czech implementation of the directive laying down rules against tax avoidance practices (ATAD), i.e. the rules limiting the tax deductibility of financial costs, the rules governing transfer of assets without a change of ownership (“exit tax”) and the rules governing taxation of a controlled foreign company (“CFC rules”). Although in most cases, the rules will first apply for the period of 2020, we recommend considering the possible consequences now, as the Czech legislation is rather concise and unclear, interpretation will be difficult and, for the purposes of calculation of the Czech tax liability, the foreign tax treatment of individual items (or entire companies) will have to be known.