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CE Tax&Legal Highlights

February 2020

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Czech Republic

Income Taxes Act Outlook through 2021 – Significant Changes Considered in Individual Taxation

Parliamentary Press No. 572 updating, inter alia, Act no. 586/1992 Coll., on Income Taxes (the "ITA") has not passed the legislation process yet and another amendment for 2021 is already being discussed. According to the statement of the Ministry of Finance of the Czech Republic, the changes under preparation should be based on a long-term plan of the Government of the Czech Republic under which the ITA should be simplified and rid of a large number of exceptions it contains. And frankly speaking, the state budget has to be funded as well. Debates on this topic clearly indicate that the amendment should include mainly changes in individual taxation and some of them are to be fundamental.

Sale of real estate

One of the discussed topics is restriction of tax exemption applied to the sale of real estate that is not the seller's residence. In other words, the restriction would relate to so called investment property the sale of which has been taxed under Section 4 (1) (b) of the ITA to date. The term of possession required to apply the sale exemption should be extended from 5 to 15 years. The time test and other conditions regulating sales of real estate that was the seller's residence (i.e. Section 4 (1) (a) of the ITA) are expected to remain unchanged. In this context, it is interesting to mention a related transitional provision that should stipulate a stricter time test for exemption of property acquired after the effective date of the amendment. Property acquired before the effective date thus would have been treated subject to existing regulations.

Exemption of income generated from bonds issued abroad

Next change possible is the cancellation of interest income exemption for individuals, tax non-residents, generating interest income from bonds issued abroad by taxpayers residing in the Czech Republic (the 'Eurobonds'). Newly, Czech firms in the position of payers could withhold tax to these individuals. We would like to point out in this context that in general, this type of income is subject to the reporting obligation pursuant to Section 38da of the ITA, which will hopefully be less strict in the amendment as promised earlier.

Meal contribution

The amendment should contain the long-awaited and discussed change in the provision of meal contributions by employers. Newly, tax relief should apply to the provision of cash contributions in addition to the existing non-cash allowance (meal vouchers). The cash meal allowance per shift could be exempt for employees in the amount of up to 70% of the upper limit of per diem allowance in case of a business trip of 5-12 hours (which may be about CZK 71 in 2020). Employee cash contributions above this limit would be taxed as employment income. On the part of employers, this should be a tax-deductible expense with no limit.

Cancellation of Financial Investment Exemption

The most fundamental change for investors is the debated cancellation of income tax exemption relating to the sale of securities and income from the sale of shares in business corporations, i.e. for example in a limited liability

company. Income from the sale of shares in a corporation has been exempt after five years of ownership while income from the sale of securities is exempt after three years. According to the latest unofficial information, however, the Ministry of Finance of the Czech Republic has withdrawn this proposal and the amendment will not be proposed.

The question is in what form the amendment will be proposed and, predominantly, with what wording it will be approved. However, we can definitely expect the "shortening era" as the famous Czech author Bohumil Hrabal might have called the plans of the Ministry of Finance of the Czech Republic.

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New Methodical Guidance on Permanent Establishments

General Financial Directorate issued new comprehensive guidance on the taxation of the income generated by tax non-residents from activities performed by means of a permanent establishment. The new guidance represents a relatively extensive and comprehensive summary (28 pages) of an approach to the taxation of a permanent establishment.

In the introduction, the document defines the terms and confirms the approach, which did not present any controversy from the perspective of the Czech practice, i.e. that the creation of an establishment for VAT purposes does not automatically mean the origination of a permanent establishment (note: this principle is also contained in the latest version of the commentary to the OECD Model Tax Convention) and, similarly, creation of a permanent establishment cannot be automatically deduced from a mere registration of a branch without examining further circumstances.

The document further mentions the significance of the OECD commentary as interpretation guidance, with reference to a recent ruling of the Supreme Administrative Court (2 Afs 40/2018 – 58, described in our article Supreme Administrative Court on the (in)dependence and (non)creation of a permanent establishment in May 2019). The General Financial Directorate emphasises therein a dynamic interpretation of the commentary, nevertheless, it concedes (with respect to the opinion expressed by the Supreme Administrative Court) that "if the wording of the given article of the agreement in question differed from the text of the effective OECD

Model Tax Convention, it is necessary to use for the given article the Commentary to the OECD Tax Convention whose wording corresponds to the text of the analysed agreement."

The guidance also deals with the individual concepts of permanent establishment and summarises the information that the General Financial Directorate published as part of its other guidance published in the past. In addition to the previously disclosed information, the document analyses, for example, the calculation of deadlines for the provision of services or determining the tax base, providing the conditions for the creation of a permanent establishment in the Czech Republic have been met.

The second part of the document includes a summary of procedural and administrative duties that have to be met if a permanent establishment is created. It points out the relevant notification duties stated in the Czech Income Taxes Act (Section 38t and the new provision of Section 38da), and also summarises the duties of a permanent establishment as a taxpayer in relation to its employees.

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Poland

Gratuitous performance for companies in serving as management board members without remuneration. Judgment of the Supreme Administrative Court

If a management board member carries out their duties without remuneration, the Company bears the risk of gratuitous performance, as shown in the justification of the judgment issued by the Supreme Administrative Court on 30 October 2019.

This ruling may turn out to be of significance for many market operators, as, in practice, it is often the case that management board members and commercial proxies do not receive remuneration for their service. This is usually due to the fact that either the employment contracts concluded by management board members do not expressly specify the remuneration for their service or, less frequently, the unpaid management board member is a foreigner seconded to Poland, who remains exclusively employed in their original firm and receives from said firm the entirety of their remuneration.

The matter of remunerating management board members for their service has become particularly significant given one of the most recent judgments of the Supreme Administrative Court (NSA) on gratuitous performance in corporate income tax (dated 30 October 2019, case file no. II FSK 3717/17). The case concerned a company in which selected management board members provided their services free of charge while being employed by the parent company. NSA declared that in this situation, the company obtained gratuitous performance of tangible financial importance, as it retained the amount equivalent to the remuneration which, if paid, would have constituted an expense. The Court deemed the amount to be a saved expense, which the company would have had to incur if the compensation had been paid for equivalent services. Importantly, NSA believes that it is so regardless of the fact that, throughout their service, the members were employees of the applicant's parent company holding 100% of its shares.

At the same time, according to NSA, if said members had been shareholders rendering their performance without remuneration, their service would not have constituted gratuitous performance for the benefit of the company.

Corporate income tax

Given the NSA's ruling, there is a risk that tax authorities may start paying more attention to gratuitous performances rendered by the management. As a result, the inspections may devote more focus to whether management board members and commercial proxies receive remuneration for their service. If no remuneration is specified for those seconded by parent companies to serve as management board members or if no separate remuneration is paid to the given company's own management board members for their service, the company bears a risk that it may generate revenues from gratuitous performance.

At the same time, we believe that if no remuneration is paid to a foreign board member pursuant to a relationship governed by Polish law, and if the two companies establish a management fee for the foreigner's provision of their services, revenues from gratuitous performance might very well not be

deemed generated on the part of the Polish company. However, there is a risk that such a fee would not be tax-deductible pursuant to Article 15e of the Corporate Income Tax Act.

Personal income tax
The issue at hand is also important with respect to personal income tax. We are of the opinion that, in light of this issue, one should analyse the management board members' and commercial proxies' involvement structure in terms of the service they provide within the form of their employment. In particular, the companies should examine the applicable contracts concluded with key employees in terms of their function within the firm and their remuneration for service as management board members or commercial proxies.

Furthermore, as a rule, foreigners sitting on management boards of Polish companies under foreign employment contracts are obliged to tax a part of their remuneration within the Polish system in respect of the work they physically perform in Poland. Therefore, the companies may also consider concluding additional local contracts with such board members to simplify their tax settlements and mitigate the risks mentioned above.

Transfer pricing
In analysing the management board members' and commercial proxies' involvement structure, it is also important to consider transfer pricing regulations which may stipulate for the need to introduce an arm's length fee for the services provided, and to prepare transfer pricing documentation. Given the fact that the definition of affiliated companies covers a wide range of entities, transfer pricing requirements may arise in many situations, notwithstanding the case where management board members or commercial proxies are employed in a different group company.

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White list — a chance for more relaxed provisions after the first few weeks of sanctions

Sanctions arising from the improper performance of obligations related to the so-called "white list" have been effective for over a month already. To avoid them, taxpayers have to meticulously verify whether the details concerning the bank accounts of their customers are consistent with the information found in the database of the Ministry of Finance. The white list, which is an electronic list of VAT taxpayers, is designed to facilitate due diligence on the one hand, but on the other hand, it is also an additional administrative burden. Ignoring the related requirements may result in making it impossible for the taxpayer to settle tax-deductible expenses. However, seeing the scale of the problems which have resulted from the new regulations, the Ministry of Finance has decided to slightly relax them. The amendment bill is already being considered by the Sejm of the Republic of Poland.

Sanctions starting this year.

From 1 January 2020 on, paying an invoice for a transaction worth more than PLN 15,000.00 to a bank account not featured in the list maintained by the Head of the National Revenue Administration (KAS) may:

- make it impossible for the taxpayer to classify the payment as tax-deductible expense to the extent in which it was made to an account not featured in the white list;

- lead to joint and several liability for tax arrears of the supplier or service provider with respect to the part of the VAT proportionally due for the supply of goods or provision of services documented by the invoice paid to an account not featured in the white list.

The taxpayer may avoid those sanctions, provided that they properly inform the head of the tax office competent for the issuer about the transfer. They should do so within three days from the transfer order being placed.

The first few weeks have shown that one of the key problems that the taxpayers are facing is generating and archiving complete documentation confirming that the accounts of the respective customers were featured in the list as at the day of making the transfers. The market now features various tools which significantly improve this verification process. In opting for one of them, it is especially worth ensuring that it allows verifying the details provided by customers for mass payments (as some tools only verify one-off transfers). One should also need to know whether the tool automatically records notifications, results, and the time of the verification, and identifies those entities which are not active VAT taxpayers. A wider verification scope also complements other due diligence processes.

Provisions concerning the White List to be revised — what changes should we expect?

The amendment bill drafted by the Ministry of Finance concerns certain fields of application for the current provisions. It envisages that no sanctions should be imposed for payments to an account not featured in the white list if:

- the taxpayer implements the *split payment mechanism* (which currently excludes joint and several liability for the suppliers' or service providers' VAT arrears but does not mitigate the risk that the taxpayer

might not be able to classify the payment as tax-deductible under income tax laws);

- the invoices document intra-Community acquisitions and supplies of goods as well as imports of goods and services settled within the *reverse charge mechanism*;

- payments are made to accounts that are kept by banks or credit unions for their own operations or assignment purposes — if the taxpayer receives information on the status of such an account from the bank, credit union or invoice issuer that provides the details of the account.

Furthermore, the time limit for the notification of a transfer to an account not featured in the VAT taxpayer list is to be extended to **seven days**. Such notifications will also have to be made to a different authority than now — **the head of the tax office competent for the jurisdiction of the transferor**. This should significantly facilitate this process.

Under the bill, **most of the changes will come into force on 1 April 2020.** Fortunately, the bill features favourable transitional provisions. Taxpayers will therefore be able to avoid sanctions and classify payments as tax-deductible for transfers made using the *split payment mechanism* since **1 January 2020.**

Even though the legislative process is not over yet, companies may already consider implementing the split payment mechanism as a way to mitigate the risk of said sanction as an alternative to notifying the relevant authorities.

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New MDR amendment bill — additional reporting obligations. Important changes to come into effect on 1 April 2020

On 5 February 2020, the Council of Ministers presented the Sejm with a bill concerning the amendment of i.a. the Tax Ordinance and the Act on International Tax Information Exchange (parliamentary paper no. 208). It envisages an obligation imposed on the promoters, users, and intermediaries to report all cross-border tax schemes if the first step towards their implementation was made between 26 June 2018 and 31 March 2020 (even if the tax scheme has already been reported).

The new provisions are to come into effect on **1 April 2020.**

Re-reporting cross-border tax schemes / Complementary reporting
The bill stipulates that promoters, users, and intermediaries will be obliged to report all **cross-border** tax schemes if **they made the first step towards their implementation** in the period from **26 June 2018 to 31 March 2020:**

a) **promoters** will have until **31 May 2020 to report the tax schemes;**
b) **users — until 30 July 2020;**
c) **intermediaries — until 31 August 2020.**

For this, they will have to use **a new schema** (XML logical structure), which will be applicable as of 1 April 2020. The template for the schema has not yet been published.

This means that they are obliged to "re-report" the schemes using the new XML schema. Furthermore, the **intermediaries** will also have to engage in retrospective, complementary reporting for those **schemes which they have begun implementing within the period in question.**

The tax scheme numbers assigned up to 1 April 2020 to the respective cross-border tax schemes will become null and void.

In the event that more than one entity is obliged to provide information on the cross-border tax scheme, the implementation of which began between 26 June 2018 and 31 March 2020, and if such information is provided until 31 March 2020, then it is **"the entity which has provided the information in question to the Head of KAS beforehand"** that will be responsible for re-reporting.

Other changes
The bill will also **regulate special powers of attorney to act in MDR-related matters —** with the changes effective, they will also authorise people to act in other matters within this scope, unless the given power of attorney states otherwise. In principle, this is to dispel doubts as to whether separate powers of attorney should be established for each respective instance of MDR reporting. Furthermore, the special powers of attorney to act in MDR-related matters which have been established and have not been revoked before 31 March 2020 will automatically become such powers of attorney as described above.

Other planned changes include:

- the Head of KAS providing the relevant authorities in other EU Member States with information on cross-border tax schemes (within one month from the end of the quarter in which they receive the information in question);
- altering a part of the act concerning specific hallmarks with respect to payments made to tax havens (with the new indent 2 reading: "the recipient of the payment has the place of residence, registered office or management in the territory or in a country applying harmful tax competition, determined on the basis of secondary legislation issued under provisions on [PIT] and [CIT], and on the basis of the EU list of non-cooperative jurisdictions for tax purposes, as adopted by the Council of the European Union);

- providing the Minister of Finance with the right to delegate the performance of MDR-related obligations vested with the Head of KAS to other body within KAS.

As evidenced by the legislative materials, the need to adopt the suggested amendments quickly is largely related to the proceedings instigated by the European Commission against Poland at the end of January with respect to the improper implementation of the DAC6 directive.

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Serbia

Novelties in the international taxation and exchange of information

International taxation and exchange of information

- **On 8 January 2020 FATCA agreemen**t between Serbia and the USA **has come into force**. FATCA Agreement envisages that foreign financial institutions or other financial intermediaries participate in precluding tax evasion of USA citizens or tax residents, by reporting. Competent authority for implementation of this agreement is Administration for prevention of money laundering.
- **As of 1 January 2020 Double Tax Treaty with Israel is applicable.**
- In previous period, a number of countries have ratified the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (Multilateral Convention). More details on how this has affected Serbia Double Tax Treaty network you may find on our web page Tax Alert.
- In November 2019 draft Double Tax Treaty with **Singapore** has been initialed. Signing and ratification is expected in the coming period.
- Serbia has started with negotiations for the conclusion of Double Tax Treaties with **Germany** (which will replace the existing one which has been in force since 1988) and **Japan**.

Reminder

- **Convention on Mutual Administrative Assistance in Tax Matters has come into force for Serbia on 1 December 2019**. Convention will be applicable to exchange of information related to personal income tax and corporate income tax for tax periods starting from 1 January 2020.

What are the novelties of our neighbors?

- **Bosnia and Herzegovina** has signed the Multilateral Convention on 30 October 2019 and filed the provisional list of notifications and reservations. Ratification is expected in the coming period.
- **Bosnia and Herzegovina** has signed the Convention on Mutual Administrative Assistance in Tax Matters in November 2019. Depositing of the ratification document is expected, after which the number of jurisdictions with which B&H may exchange information will be increased.
- **North Macedonia** has signed the Multilateral Convention on 29 January 2020 and filed the provisional list of notifications and reservations. Ratification is expected in the coming period.
- **Montenegro** has signed the Convention on Mutual Administrative Assistance in Tax Matters in 2019, and ratified it in January 2020. Depositing of the ratification document is expected, after which the number of jurisdictions with which Montenegro may exchange information will be increased.

Categories of foreign citizens eligible for temporary residence permit

Serbian government adopted a Decree on the criteria for determining the category of foreign citizens who may be granted a temporary residence permit by the Republic of Serbia, regardless of the grounds for granting the temporary residence on 13 February 2020

Criteria and categories:

The Decree itself does not specify the criteria, however those are defined in the categories of the foreign citizens. There are three categories:

1. Founder of a legal entity in Serbia which performs innovative business activities that is recognized by the registered Science technology park founded by the Republic, autonomous province, City of Belgrade or a local municipality (i.e. startup);

2. Individuals who invest in already registered legal entity in Serbia, or in the business activity by way of investing into tangible and intangible assets (i.e. investor);

3. Individuals who have professional qualifications issued by the competent authorities of the Republic of Serbia (i.e. talent);

In practice, the first category (founders of the legal entity) is currently applicable and temporary residence was obtained on the basis of founding a legal entity or entrepreneurial establishment, however this Decree changes the type of documentation that serves as evidence of the justification of the request

Temporary residence permit duration

Temporary residence permit would be issued for the period of one year for the categories from the points 1 and 3, while for the category from the point 2 temporary residence permit would be issued for the period of 6 months.

If conditions are met, temporary residence permit can be extended for the period of 1 year.

Necessary documentation

The documentation for filing the original request and the request for extension, which is used as evidence to justify the request, is different.

The original documentation proves the intention to fulfill these conditions, while the extension documentation proves that the conditions are fulfilled i.e. that the foreign citizen was staying in accordance with the approved temporary residence permit base.

Work permit

For the above mentioned categories, work permit is acquired in accordance with the Law on Employment of Foreigners.

Decree was published in the Official Gazette no. 13/2020, and will be in force 8 day from the publishing in the Official Gazette.

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Slovakia

Abolition of the Obligation to Sign the Declaration Annually

Since 1 January 2020 the obligation to sign the "Declaration of an Application of a Tax Allowance per Taxpayer and Tax Bonus" form has been abolished, which means that an employee does not have to sign the declaration in 2020, but only reports to the employer any changes that occur during the year.

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Due to Brexit, UK Citizens are Required to Visit the Foreign Police

Due to the Brexit Agreement citizens of the United Kingdom with a registered residence in Slovakia are required to apply for new residence documents in the SR. New documents will be issued based on the automatically granted 5-year permanent residence, or long-term residence, as a result of the UK's exit from the EU. All UK citizens with a registered residence in the SR until 31 December 2020 will be granted this residence from 1 January 2021, but the issue of new residence documents will not be automatic and UK citizens will have to apply for them at the relevant Foreign Police Department.

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