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CE Tax&Legal Highlights

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Czech Republic

A New Transfer Pricing Guidance and the Czech Translation of the OECD Guidelines

The General Financial Directorate (the "GFD") issued new Guidance D-34 on the application of international standards to the taxation of related party transactions. This guidance replaces existing Guidance D-332. Together with the new guidance, the Czech translation of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2017 Edition) was published in the Financial Bulletin of the Ministry of Finance no. 5/2019.

The purpose of Guidance D-34 is to ensure that a uniform approach to determining a tax base impacted by related party transactions is applied by both the Tax Administration of the Czech Republic and taxable entities. As opposed to the previous guidance, the update provides more detailed information on, for example, the following topics:

- Actual actions of the parties versus contractual arrangements;
- A functional and risk analysis, including typology of functional profiles, discussion on the key role of industry value drivers, the issue of legal versus economic ownership of intangible assets, or explanation of the difference between a function and an activity;
- Recommendations on how to prepare a benchmarking analysis, including a list of the most frequent quantitative criteria, or recommendations on the approach to updating the analysis; and
- Overview of the methods to identify transfer prices, including comments on their practical application.

What situations may occur or practical considerations

The new guidance also contains some of the GFD's own considerations which are, in our experience, often applied by tax administrators in conducting tax audits. Such considerations relate to, for example, the possible existence of related party transactions that are not explicitly referred to in contractual arrangements and accounted for but do exist in reality. This may involve a so-called "order of the parent company", which refers to a control of an independent transaction by a related party, such as when a parent company orders a subsidiary to execute a sale of goods to external customers for a lower than an arm's length price (and substantiate it by claiming that the transaction will generate a certain benefit for the group as a whole).

If the transaction constitutes a sale of goods to related parties, the tax administrator will try to arrive at a conclusion in the tax audit, by applying Section 23 (7) of the Income Taxes Act, on the difference between the referential price calculated by it and the identified price and subsequently adjust (increase) the entity's tax base by the identified difference.

However, if the sale of goods involves external entities, the situation will be seemingly more difficult for the tax administrator as it is an independent transaction (it is impossible to directly apply the approach under Section 23 (7) of the Income Taxes Act). Nevertheless, in such a case, the tax administrator can use the institute of the parent's company order as disclosed above and attribute the difference between the referential price and the identified price to that transaction. The tax administrator will subsequently conclude that the price in that transaction (in the form of a compensation to the subsidiary) shall be determined in an amount corresponding to the identified difference, increasing the entity's tax base as appropriate.

The above-specified example of the Tax Administrator's approach as well as the issuance of new Guidance D-34 as such demonstrate that the Czech Tax Administration closely monitors the international developments in the area of transfer pricing and does not hesitate to apply a highly sophisticated approach to its audit activities.

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Investment Incentives Will Have New Rules

On 7 June 2019, the Chamber of Deputies approved the government proposal of an amendment to the Act on Investment Incentives, Bulletin of the Chamber of Deputies no. 298 of 8 October 2018. The amendment can be expected to come into force approximately in September 2019. The approved amendment will represent the basic framework of conditions for awarding investment incentives. Most of the general conditions for granting investment incentives will be flexibly regulated by a governmental decree based on the economic situation and the needs of the labour market.

Following the amendment to the Act on Investment Incentives, support will be directed primarily to projects with higher added value, which should be ensured in particular by the condition of a higher ratio of employees with higher salaries and university education, by cooperation with universities and research organisations, or investments in research and development projects. These conditions should not apply to projects realised in the "supported regions" with higher unemployment.

Government approval will be needed

An important new aspect of the system of awarding investment incentives is the condition of the government's approval of all the applications with respect to the benefit brought to the region by the investment. A positive change concerns the cancellation of the condition of creating job openings for investments in manufacturing, and the halving of the limits of general conditions for small and medium-sized enterprises. Technological centres and centres for strategic services will attract more intensive support in the form of cash support of job openings in all regions or by decreasing the limits for new job openings for strategic investments.

Investment plans submitted before the effective date will be subject to the existing conditions for obtaining an investment incentive.

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Poland

Authorities' restrictive approach to tax exemptions in the Polish Investment Zone. Change in the interpretation of the law affecting entrepreneurs operating based on a decision to provide support.

Over recent months, the Director of the National Revenue Information System has issued a number of specific tax rulings which confirm that all income coming from activities specified in a decision to provide support and carried out in the area indicated therein may be exempted from tax (up to the state aid ceiling). However, recent rulings show that tax authorities have changed their approach to the detriment of entrepreneurs.

In its rulings (dated 22 May 2019, Ref. No. 0111-KDIB1-3.4010.113.2019.1.APO and dated 21 May 2019, Ref. No. 0114-KDIP2-3.4010.55.2019.2.MS) the Director of the National Revenue Information System stated that the taxpayer's argumentation that all income coming from activities covered by the decision to provide support is exempted from tax is correct, however, it is against the objective of the Strategy for Sustainable Development, namely to support the growth of private investment by introducing a new mechanism to encourage new investment in Poland, as well as the constitutional equality of rights of taxpayers, and therefore it is not correct.

There have already been two such rulings which may suggest that these are not isolated cases and that the stance of the Director of the National Revenue Information System has changed. **In practice, such change may considerably impede the possibility of claiming the tax credit under the decision to provide support** (offered in the so-called Polish Investment Zone).

It should be noted though that such approach of the tax authorities is against the rule set out in the same law saying that if more than one permit or decision to provide support was given, the aid should be accounted for chronologically. In practice, the obligation to account for the aid chronologically would prevent an investor from using further decisions to provide support that they have secured (i.e. the investor would have to pay tax on the income earned on subsequent projects included in decisions to provide support, until the ceiling set out in the first decision has been reached).

Such ruling is also inconsistent with the new provisions of the tax law which explicitly require a divestiture and taxation of income, if operations are conducted outside a Special Economic Zone (SEZ) or the area specified in the decision to provide support.

Previous change in the stance of tax authorities

The above change in the way the laws are interpreted is not the only indication of inconsistency on the part of tax authorities. The stance on the possibility to sum the state aid ceilings available under several SEZ permits and to account for them chronologically has also changed over the years.

Until 2015 the tax authorities were like-minded and confirmed that tax payers may sum up their taxable income based on several SEZ permits.

This approach then changed and the authorities issued a number of rulings stating that the taxable income has to be calculated separately for each investment project / permit.

However, there have recently been several favourable rulings and judgments of administrative courts which confirmed that joint records may be kept and used as the basis for calculating CIT-exempt income earned on operations carried out in a special economic zone under several permits.

Since the opinions presented by the authorities, both with regard to the activities carried out based on SEZ permits and now based on decisions to provide support, have been changing rapidly, there is a risk that the recent unfavourable specific tax rulings regarding the operations carried out under decisions to provide support may lead to another change in the so far favourable stance maintained by the tax authorities that the state aid ceilings may be combined based on several SEZ permits (and that the state aid may be accounted for chronologically).

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The government adopts a bill to amend the VAT Act scrapping the obligation to submit a VAT return and turning it into JPK_VDEK

The plans of the Ministry of Finance to change VAT regulations are ambitious and may prove challenging for the taxpayers. The new reporting requirements will necessitate a review of the existing processes and procedures and will also pose a technological challenge. One may expect more amendments to VAT returns — the current bill, which scraps VAT returns, requires that the taxpayer correct errors within 14 days of their discovery. The new law is intended to come into force on 1 January 2020 for large enterprises (hiring over 250 employees and with a turnover in excess of EUR 50 million) and in July 2020 it will become binding for all other taxpayers. On Thursday (6 June 2019) the government adopted a bill to amend the VAT Act scrapping VAT returns and introducing new JPK_VDEK.

The uncertainty which continues to surround the change (e.g. lack of necessary technology) makes it difficult to outline a clear plan on how to adapt to the new law. The results of our latest tax survey conducted during a webcast only confirm the sense of uncertainty and confusion.

A large majority of participants stated that they would have problems with classifying their operations to relevant Product Group Codes (if the list of available groups is not changed). The respondents were also concerned

about an onerous obligation to review bank accounts due to the planned introduction of the so-called "whitelist". At the same time, over 20 percent of the participants stated that the new list of taxpayers is a useful means of verifying counterparties.

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Old fiscal markings valid only for the next six months

What are the obligations of entities trading in goods required to carry a fiscal mark?

1 January 2019 saw the entry of new fiscal markings applied to tobacco and alcohol products which significantly reduces the possibility of using the existing fiscal markings.

What is it all about?

The Ordinance of the Minister of Finance of 29 May 2018 amending the ordinance on the designation of excise goods with fiscal marking (Journal of Laws of 2018, item 1178) sets out that as of 1 January 2019 tobacco and alcohol products have to carry new fiscal markings. The new fiscal markings contain a 2D bar code with information about the series and year the fiscal marking was made. The 2D bar code is intended to simplify verification of the legality of products and the authenticity of the fiscal marks — once scanned, the bar code will provide all information about the fiscal mark under review. Fiscal markings on tobacco products, which so far had the size of 45x22 mm, are now 32x16 mm.

What does it imply?

Although entities obliged to mark excise goods (mainly excise warehousekeepers) may no longer attach old fiscal markings, the excise duty act provides that goods which already carry an old fiscal mark may be traded until 31 December 2019. After that date, holders of such excise goods intended for sale and carrying inappropriate fiscal markings will have to buy special validating fiscal marks and attach them to the goods.

This means that all entities selling such goods are obliged to verify whether the markings are appropriate. The excise duty act provides that special validating fiscal marks are required e.g. in situations (other than duty suspension arrangements) when excise goods intended to be resold carry inappropriate fiscal marks.

Special regulations apply to tobacco products which may carry old fiscal markings until 20 May 2019, provided that the year of production on the markings is 2019. Goods carrying such markings may be offered for sale until the end of this year. The sale of tobacco products carrying old fiscal markings with the production year of 2018 was allowed until 28 February 2019.

It seems that, if excise goods carrying old fiscal markings are subject to the duty suspension arrangement, new fiscal markings, not necessarily the special validating markings, will be allowed. This was confirmed in a specific tax ruling of the Director of of the National Revenue Information System (0111-KDIB3-3.4013.42.2019.2.WR) issued on 26 April 2019.

What next?

Special attention should be given to goods carrying fiscal markings and intended for resale. Goods carrying old fiscal marking may be sold until the end of the year with no need for special validating markings. Special attention should be given to tobacco products carrying both old and new fiscal markings which may be sold with no need for special validating markings, provided the year on the marking is 2019.

We recommend that you review your stock of excise goods carrying fiscal markings to determine:

• whether the markings are appropriate, and

• the level of stock of products carrying fiscal marks valid until the end of 2019, i.e. whether special validating markings should be attached or whether other measures should be taken to avoid the need of making the products legal ,if they are subject to the duty suspension arrangement.

The spirits industry applied for an extension of the validity of their fiscal markings, however, so far the Ministry of Finance has not published any draft ordinance that would extend this period.

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Withholding tax. Explanations regarding the new withholding tax rules

On 19 June 2019 the Ministry of Finance published the long-awaited explanations regarding the new withholding tax rules, i.e. the rules of collecting a lump-sum tax on cross-border payments of interest, royalty payments, dividends and payments for purchases of

intangible services. Please note that these are draft explanations open for comments until 30 June.

Withholding tax — gist of the explanations

Though the explanations are rather general, even a cursory examination is sufficient to notice the restrictive approach of the Ministry of Finance to the interpretation of the new regulations. Polish entities will be obliged to fulfil a number of new, additional requirements to verify international counterparties (both those related and non-related) in terms of the permissibility of exemptions or lower withholding tax rates, specifically, when it comes to considering the counterparties as actual recipients of the payment in Poland. To a large extent the explanations discuss the due diligence on the part of Polish payers and provide general examples of conduct.

It seems that even greater obligations are placed on the managers of Polish entities making cross-border payments in excess of PLN 2 million a year (in practice, the management boards of Polish companies making cross-border payments). In the explanations, the Ministry of Finance explicitly specifies that by making the statement referred to in Article 26.7a of the CIT Act and Article 41.15 of the PIT ACT — exempting from the withholding tax or lowering its rate — the payer guarantees that the tax has been accounted for correctly and assumes all consequences of such a statement.

The explanations are sure to become the topic of an intense discussion.

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New requirements for bond issues as of 1 July 2019

The beginning of the second half of the year will see the entry into force of the majority of regulations under the Act of 9 November 2018 amending certain acts in connection with the strengthening of the supervision over the financial market and protection of investors in this market (Journal of Laws of 2018, item 2243). The amendment will trigger significant changes in the structure of bond issues, which will become subject to severe sanctions, and impose disclosure obligations on the issuers who have issued debt in recent years.

The most important changes taking effect on 1 July 2019 are that bonds will no longer be issued as certificates and that all issued bonds will need to be registered in the depository for securities (maintained by the Central Securities Depository of Poland) or a company which has been delegated to perform such function). Until now the registration duty applied only to the bonds issued via a public offering, whereas the records of private placements were kept by the bank acting as the bondholder. The above change will increase the costs of issues, because a fee will have to be paid for the registration of each series of issued securities. What is more, a sudden increase in the number of entities obliged to register bonds may also extend the period needed to process the applications by the Depository.

The registration data thus collected will enable the Depository to make important information publicly available, i.e. the information on outstanding bonds issued by individual entities, on the amount of their liabilities arising from these securities, as well as the information allowing to determine the scope and timeliness of performance of the obligations.

To ensure greater security of bond issues and to streamline the process of bond registration with the Depository or with a different authorised entity, the amendment requires that the issuer enters into an agreement with the issue agent before the private placement. **The issue agent will be obliged, among other things, to verify the legal requirements of issuing and offering bonds, as well as to support the issuer in the process of registering securities in the depository. Only investment firms authorised to maintain securities accounts (e.g. brokerage houses) or custodian banks will be allowed to perform that function.**

The regulations provide for **a fine of up to PLN 2,000,000 for failure to provide or for improper provision of information about the bonds or the issuer in the securities' registration procedure where such data are important for the assessment of the admissibility of the registration**. Furthermore, a fine may be imposed on both the management board members and the attorneys acting on behalf of the issuer or the issue agent.

The above rules will apply to bond issues carried out after 1 July 2019. **Earlier securities not redeemed by that date will be subject to the existing provisions, however, issuers will be bound by an additional disclosure obligation — by 31 March 2020 they will have to provide the Depository with information on the bond issues conducted so far, specifically the number of securities, their interest rates and the dates of fulfilling obligations arising therefrom, as at 31 December 2019. A failure to provide such information will also be subject to a fine of up to PLN 2,000,000.**

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Serbia

International taxation and exchange of information

I On 13 June 2019, Serbia has signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters

The Convention enables jurisdictions to engage in a wide range of mutual assistance in tax matters: exchange of information on request, spontaneous exchange, automatic exchange, tax examinations abroad, simultaneous tax examinations and assistance in tax collection, all in line with the level of obligations taken over by a particular state.

This Convention should be ratified in the following period, when more information on obligations of Serbia are expected.

II Serbia has signed the FATCA Agreement with United States of America on 10 April 2019

FATCA Agreement envisages that foreign financial institutions or other financial intermediaries participate in precluding tax evasion of USA citizens or tax residents, by reporting on USA citizens and tax residents that keep their financial assets in non-US financial institutions and foreign bank accounts.

The Agreement has still not been ratified by Serbia.

III During April 2019 a first round of negotiations was held in Hong Kong for the conclusion of double tax treaty between Serbia and Hong Kong.

MLI Developments

Malta, Ireland and Finland have deposited their instruments of ratification to the OECD.

The provisions of Multilateral Convention have effect on the Serbia – Malta Double Tax Treaty, as follows:

- In Serbia and Malta, for taxes withheld at source on amounts paid or credited to non-residents, where the event giving rise to such taxes occurs on or after 1 January 2020;
- With respect to all other taxes levied by Serbia, for taxes levied with respect to taxable periods beginning on or after 1 October 2019; and
- With respect to all other taxes levied by Malta, for taxes levied with respect to taxable periods beginning on or after 1 January 2020.
- The provisions of Multilateral Convention have effect on the Serbia – Ireland Double Tax Treaty, as follows:
- In Serbia and Ireland, for taxes withheld at source on amounts paid or credited to non-residents, where the event giving rise to such taxes occurs on or after 1 January 2020;
- With respect to all other taxes levied by Serbia or Ireland, for taxes levied with respect to taxable periods beginning on or after 1 November 2019;
- The provisions of Multilateral Convention have effect on the Serbia – Finland Double Tax Treaty, as follows:
- In Serbia and Finland, for taxes withheld at source on amounts paid or credited to non-residents, where the event giving rise to such taxes occurs on or after 1 January 2020;

- With respect to all other taxes levied by Serbia, for taxes levied with respect to taxable periods beginning on or after 1 December 2019; and
- With respect to all other taxes levied by Finland, for taxes levied with respect to taxable periods beginning on or after 1 January 2020.

Other: It is expected that the Multilateral Convention will come into force for the following states with which Serbia has concluded double tax treaty:

1. Luxembourg – 1 August 2019
2. The Netherlands – 1 July 2019
3. Georgia – 1 July 2019
4. United Arab Emirates – 1 September 2019.

Guidance for mutual agreement procedure related to international double taxation treaties

Serbian Ministry of Finance has recently published a Guidance on the use of the mutual agreement procedure under the double tax treaties, which is an important step in establishing and developing international tax practice in Serbia.

The text of the Guidance may be found on the following link: https://www.mfin.gov.rs/UserFiles/File/dokumenti/2019/Objasnjenje%20o%20Postupku%20zajednickog%20dogovaranja%20Final.pdf. (Please note that the Guidance is only available in Serbian language).

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Slovakia

Draft Changes to the Income Tax Act

The Ministry of Finance of the Slovak Republic (the "MF SR") presented a draft amendment to the Income Tax Act, which primarily introduces changes in the following areas:

R&D expenses – an increased deduction of R&D expenses from the original 100% to 150% for the 2019 taxation period and to 200% for subsequent taxation periods.

Receivables – conditions for the tax deductibility of the creation of provisions, write-off or assignment of receivables, and the time when the receivables become time-barred, will not be assessed as at the date they are written off, assigned or the date of creation of a provision, but as at the last day of the taxation period in which they occurred. In this regard, a receivable is not considered time-barred if it was not time-barred for at least one calendar day of the relevant taxation period.

Expenses subject to the obligation of payment – contractual penalties, late payment fees and default interest are to be considered tax deductible after a period in which they were assessed as tax non-deductible only after payment. It is also proposed to include flat-rate compensation for costs related to exercising a claim from a debtor and severance payments for beneficiaries in the amended Article 17 (19) (g) as tax deductible expenses after payment, which would expand this group of tax expenses. For fees and commissions for mediation, taxable persons will no longer have to monitor their deductibility limitations as the previous limitation of 20% of a mediated transaction is cancelled. In this group of expenses, it is also proposed to extend the definition of consulting services to include corporate governance and business management consulting services according to codes of Statistical Classification of Products by Activity: 70.1 and 70.22.1.

Micro-taxable persons – it is proposed to introduce a new category of a "micro-taxable person". A micro-taxable person will be a taxable person, a natural person, who generates income from business activities and other self-employed activities, where the amount of such income does not exceed the amount set for the purposes of VAT registration for a taxation period (currently EUR 49 790). A micro-taxable person will also be a legal entity whose income for the relevant taxation period is capped at EUR 49 790 inclusive (related parties cannot be considered micro-taxable persons). The amendment proposes various tax reliefs for this taxable person group.

Tax losses – it is proposed to extend the period for carrying forward tax losses to five years, and it will be possible to carry them forward for up to 50% in the first year. Special rules for carrying forward tax losses were proposed for micro-taxable persons.

In-kind benefits – other changes relate to employees, eg with regards to exemption of their in-kind benefits. Due to the reduction of the administrative burden, these benefits are exempt up to EUR 500 if they represent tax non-deductible expenses for the employer. These in-kind benefits include teambuilding events and corporate parties, and the amount of exemption of such benefits for an employee is the total for all employers for the taxation period.

The full wording of the draft amendment to the Act can be found here:

https://www.slov-lex.sk/legislativne-procesy/SK/LP/2019/329

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New VAT Rules

In connection with an amendment to the VAT Directive of December 2018, the Ministry of Finance of the Slovak Republic submitted a draft amendment to the VAT Act for interdepartmental comments. It will become effective on 1 January 2020 after its approval. The draft act is intended to simplify and harmonise rules in selected areas of EU cross-border trade. Proposed changes to the VAT Act include:

- Facilitation of call-off-stock;
- Harmonised rules for chain stores;
- Changes to the conditions for exemption of the supply of goods to another Member State;
- Supplementation to tax exemptions for transactions with crude oil and mineral oils.

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