Tax&Legal Highlights

Czech Republic

The SAC issued a ground-breaking judgement on the interpretation of tax non-deductible expenses relating to income

Possibility of reassessing the previously applied treatment in connection with Section 24 (2) (zc) of Act No. 586/1992 Coll., on Income Taxes ("ITA") and consequently Section 23 (4) (e) of the ITA

In late July 2017, the Supreme Administrative Court ("SAD") issued a fundamental judgement as part of the watched legal proceedings relating to Section 24 (2) (zc) of the ITA, in the wording effective through the end of 2014, in the context of the write-off of insured loan receivables on the basis of income from insurance proceeds.

The relevant provision generally established the possibility of treating primarily tax non-deductible costs as tax deductible if directly relating income existed in respect of those costs. It was specifically the assessment of the direct relation of the costs in the form of the write-off of an insured receivable and income in the form of insurance proceeds that was subject to the SAD's judgement. The SAD arrived at a conclusion that the existence of a sufficiently intensive and unmediated logical link between taxable income and costs is of key importance for the tax deductibility of costs that are, in themselves, tax non-deductible under the ITA. The SAD acknowledged the

existence of this link in the analysed relation involving the insured loan receivables.

In view of the potential possibility of a relatively wide interpretation of Section 24 (2) (zc) of the ITA, the tax administration has generally approached the provision with a reservation for a number of years, which often also led to a cautious approach of the taxable entities. As a result, the taxable entities often proceeded conservatively in practice, taking into account the restrictive interpretation pursued by the tax administration. Nevertheless, the SAD's judgement triggers the possibility of re-opening historical cases for reassessment and considering the filing of an additional tax return and potentially reducing tax liabilities.

While the judgement applies to the wording of the relevant provision that was in force through the end of 2014, consideration may be given to its possible application in the present in view of the interpretation of the application of the current wording of Section 23 (4) (e) of the ITA which states that income directly relating to tax non-deductible costs is not included in the tax base up to the amount of these tax non-deductible costs and which is often considered, in terms of scope, to be analogous to the provision of Section 24 (2) (zc) in the wording in force through the end of 2014.

Since each case is different, it will likely be necessary to review specific arguments in support of the relation of costs and income on an individual basis. In addition, another judgement of the SAC may be expected in relation to Section 24 (2) (zc) in the wording in force through the end of 2014.

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The Supreme Administrative Court of the Czech Republic Has Ruled on the Amount of the Flat Expense Charge-off for Professional Athletes

On 13 July 2017, the Supreme Administrative Court issued a ruling on the case of the Czech professional footballer David Lafata. The case dealt with the amount of the flat expense charge-off that professional athletes performing their activities based on a trade licence may deduct from their taxable income.

The substance of the dispute was the question as to whether professional athletes engaged in collective sports may perform their activity based on a trade licence and thus charge-off 60% of their fixed flat expenses for tax purposes, or whether such type of activity shall be treated as an independent profession, for which only 40% of flat expenses may be charged off for tax purposes.

The Tax Administration objected that athletes performing collective sports do not perform their activity on a standalone basis and thus do not fully carry the liability, due to which their activity does not comply with the features of trade under the Trade Licensing Act.

However, this interpretation was rejected by the Supreme Administrative Court, which ruled that trade regulations enable athletes to perform their activities based on a trade licence. In addition, in its substantiation the Supreme Administrative Court stated that it is not possible for the Tax Administration to register athletes for VAT purposes performing business activities in line with the Act on Value Added Tax while rejecting to treat athletic activities as trade activities.

Based on its ruling, the Supreme Administrative Court annulled the judgement passed by the Regional Court. As a result, the ruling is generally applicable to all cases of professional athletes engaged in collective sports. Subsequently, the ruling was accepted by the Tax Administration as part of its official comment on the ruling.

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Legislative Amendment to the Act on Country-by-Country Reporting Approved by the Senate

At a recent session of the Senate (dated 16 August 2017), an amendment to the Act on International Cooperation in Tax Administration was approved; implemented in the Czech legal code, this Act is to regulate the so-called country-by-country (CbC) reporting duties. The draft amendment is yet to be signed by the President. The Act will become effective on the day of its publishing in the Collection of Laws

Contrary to general expectations, both the Chamber of Deputies and the Senate managed to consider and approve an amendment to the tax Information exchange act, whereby the so-called country-by-country reporting duty is being implemented to the Czech tax legislation. Filing a CbC Report should be mandatory for multinational groups of entities whose aggregate consolidated income amounts to at least EUR 750 million. The first reported period is the fiscal year 2016.

- Given the delays in the approval process, the deadline for the first compliance with the so-called **notification duty** has been slightly postponed as compared to the originally proposed deadline. The obligation to inform the tax administrator about the ultimate parent entity of a multinational group of companies as well as about the

company which will prepare the CbC Report on behalf of the multinational group of companies is set already for **31 October 2017** in the approved amendment (as compared to 31 January 2018 proposed in the last motion). This concerns all reporting periods ending prior to this deadline.

- The deadline to comply with the so-called **reporting duty**, ie the obligation to prepare a Country-by-Country report on behalf of the whole multinational group and submit it to the tax administrator (with regard to Czech parent and surrogate entities), remains to be, in line with the original amendment, 12 months from the end of the taxation period – ie **31 December 2017** for the 2016 reporting period (as compared to the recently suggested 30 April 2018).

The draft amendment is yet to be signed by the President. The act will become effective on the day of its publishing in the Collection of Laws.

The notification shall be made via databox using a form issued by the Ministry of Finance of the Czech Republic. The format and structure of the databox message and further technical information are to be clarified/announced in more detail by the Czech Tax Authorities after the respective law comes officially in force. Please note that any notifications already submitted to the Czech tax authorities prior to the official law issuance would not be considered.

If you want to learn more, we invite you to watch our *webcast* dealing with this topic.

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Including VAT in the Tax Base for Calculating Real Estate Acquisition Tax

The Supreme Administrative Court ("SAC") has issued a long-awaited ruling in which it took the side of taxable entities by deciding that no value added tax ("VAT") is to be included in the tax base for calculating real estate acquisition tax according to the legal guidance valid until November 2016.

The Financial Administration took the opposite view by claiming that VAT should be reflected in the tax base for real estate acquisition tax calculation purposes. The Financial Administration principally referred to the wording of the explanatory memorandum accompanying Senate Ordinance No. 340/2013 Coll., on Real Estate Acquisition Tax ("**Ordinance"**) which expressly stated that VAT should be included in the tax base. Given the

possibility of dual interpretation of the relevant provisions of the Ordinance that led to differing conclusions, the SAC applied the "in dubio pro mitius" principle, ie in case of multiple interpretations of a legal regulation it is necessary to give precedence to the interpretation that is to the benefit of a private person with a view to protecting constitutional principles. The SAC thus concurred with the view of the taxable entity by concluding that if the legislator had intended to include VAT in the tax base it had failed to do so in the legislation in a clear and non-ambiguous way.

With regard to the actual real estate acquisition tax concept, the SAC stated that the purpose of the tax is to tax financial income generated by the sale of real estate. VAT that was part of the purchase price cannot be treated as part of such income. Including VAT in the real estate acquisition tax base does not coincide with the purpose of this tax since the transferor would not only tax its gain but also the amount which it collected for the state.

In addition, the SAC has found the Financial Administration's approach to be non-consistent with the tax neutrality principle since the fact that a taxable entity is a VAT payer would result in it being charged with a higher real estate acquisition tax than other comparable entities – VAT non-payers. The SAC did not find any justifiable grounds for such a different treatment.

As a result of this SAC ruling, it is possible to file additional real estate acquisition tax returns in circumstances where the tax return was filed in line with the Ordinance valid until November 2016. If the tax returns were filed under the amended wording of the Ordinance, consideration should be given to filing the additional tax returns since it will be necessary to await the relevant court judgement to confirm the final validity of the stated interpretation applied by the SAC.

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