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# NEWSLETTER CZECH REPUBLIC

Issue: March 2021

Information on Law, Taxes and Economics in the Czech Republic

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## Content:

→ Law

# Legal fiction of approval via affirmative binding opinions as per the Building Act

Are you up to building a house or just looking to renovate your flat? You can now get a permit based on the fictitious binding opinions of the authorities concerned.

Alena Tomsová
Rödl & Partner Prague

Act 403/2020 Sb. was published in the Collection of Laws of the Czech Republic on 13 October 2020. It amends the Act on the acceleration of construction projects in transportation, water, and energy infrastructure and electronic communications infrastructure, and certain related laws. The Act came into force on 1 January 2021. Although it may at first glance seem that it is not very important, the opposite is actually true: the amendment changes twenty-five regulations, including those touching on environmental affairs and related matters, and education-related issues. It also changes selected provisions of other laws, including the Code of Administrative Procedure and the Building Act. This article discusses the impacts related to the Code of Administrative Procedure and the Building Act.

The Building Code requires building authorities to handle building procedures in a way that will burden builders as little as possible and, if possible, that will lead to only one decision being delivered per case. Building authorities act in synergy with those authorities who are concerned with protecting public interests (health, safety, economic growth, social fairness, sustainable development, etc.) as per the Building Code and special laws (Water Act, Nature and Landscape Protection Act, Clean Air Act, State Monument Protection Act, Forest Act, Fire Protection Act, Road Traffic Act, Mining Act, Spa Act, Public Health Protection Act and the Energy Management Act). So-called binding opinions issued in accordance with the Code of Administrative Procedure serve the purpose.

## The legal fiction of an accommodating binding opinion

The standard is for a binding opinion relating to proceedings and procedures instigated by the building authority to be issued by the authorities concerned as a basis for the decision-making of building authorities in matters concerning applications for a zoning decision, applications for a building permit and applications for joint authorisation, to name but a few. According to the Building Code, the standard 30-day deadline for the issuance of a binding opinion by the authority concerned can be extended by a further 30 days based on an official note recorded in the applicant's file. The applicant must be informed of the extension of the time-limit. The prerequisite for the extension of the deadline is the reason stated in the Code of Administrative Procedure and the Building Act, i.e. if it presupposes an on-site inspection or if the case is a particularly complex one.

The amendment to the Building Code introduces what is known as the legal fiction of approval via an affirmative binding opinion by affected government bodies (i.e. authorities concerned) to be applied in cases when a binding opinion is not issued by the authority concerned within the prescribed time limit. Such a fictitious binding opinion is deemed accommodating and is not subject to any conditions. If the time-limit for the issuance of a binding opinion is to be extended, the authority concerned must also inform the building authority about this, so that it cannot be inferred from the date on which the application was submitted to the authority concerned and the lapse of the 30-day

deadline that a fictitious binding opinion is being issued and that the building authority can (already) issue an accommodating decision or a permit.

The nature of a fictitious binding opinion in no way differs from your typical binding opinion.

## An application is a must

Applications requesting authorities concerned to issue a binding opinion must be perfect. Should this not be the case, the authority concerned will request the applicant to put their application in order (this information must also be passed onto the building authority) and it will give the applicant ample time to do so and it will instruct the applicant on the consequences involved should the applicant fail to do so. When determining how much time is necessary to put the application in order, the nature of the problem can be taken into consideration. Setting a deadline for putting the application in order does not result in the issuance of a fictitious accommodating binding opinion, because the deadline for its issuance is suspended while the application is being put in order.

If the applicant fails to put the application in order, the authority concerned will not issue an opinion and it will inform the applicant in writing that a binding opinion cannot be issued (again, the building authority will also be informed). Applications for the issuance of a binding opinion can be filed repeatedly.

Only once the application has been put in order does the period for the issuance of a binding opinion start to run. The date on which the original (incomplete or defective) application was filed plays no role in terms of the legal fiction of an accommodating binding opinion. It is not absolutely necessary for the applicant to be informed that the application is now in order and that the authority concerned will continue to process it. What however should be important is the fact that the application is still not completely in order and that the deadline for the issuance of a binding opinion has still not started to run. Should this be the case, the authority concerned should again contact the applicant and require them to put everything in order.

The objective, and dream, of each and every builder is without doubt a permit allowing them to dive right into their building project as soon as possible. Given the fact that when it comes to proceedings conducted by building authorities, these are instigated on the basis of an application filed by the builders themselves and how fast a permit is issued also lies to some extent in the hands of the builders. It would therefore be wise to make sure that the applications are in order before filing them. Because otherwise things will take much longer to get sorted.

If you are a builder-to-be and would like to consult on the matter, we will gladly assist you in your endeavour. Together we can discuss the various issues pertaining to you getting a building permit. We can consult you on the items to be included in your application and we can guide you through and prepare all the necessary legal documents. In fact, we can even represent you in proceedings before government authorities.w

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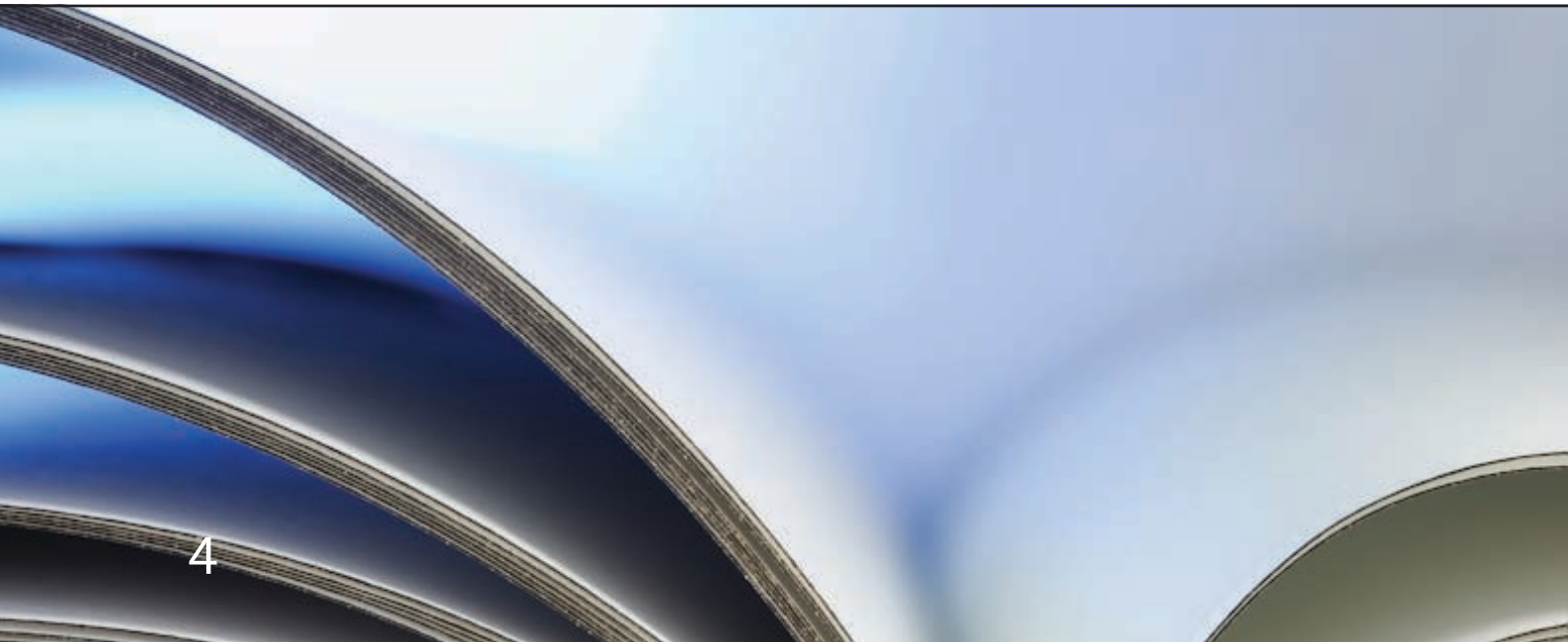

→ Taxes

# What changes does the amending bill to the Act on Income Tax bring to gifts?

In response to the pandemic, Act No. 39/2021 Sb. was published in the Collection of Laws. With effect as of 4 February 2021, the new act amends the Act on Income Tax with regard to gifts.

The amending bill allows taxpayers who are individuals to claim, in the 2020 and 2021 tax years, gifts up to 30% of their taxable amount as a non-taxable part of their taxable income. In subsequent tax years, i.e. starting from 2022 and further, the normal limit of 15% will again apply.

With regard to legal entities, the act enables them to also deduct the same maximum of 30% of their taxable amount from their taxable income, with regard to tax periods ended between 1 March 2020 and 28 February 2022. And just as in the case of individuals, the change is a temporary one. For tax periods ending after 28 February 2022, the standard limit consisting of 10% of the taxable amount will apply.

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→ Taxes

# Personal income tax returns for 2020

It is once again time for the settlement of one's liabilities towards the financial authority by filing a personal income tax return for the 2020 calendar year. In which cases do you have an obligation to file a personal income tax return for 2020, what is the filing deadline and what is new for the 2020 tax year?

Martin Zeman, Karel Kučera
Rödl & Partner Prague

The general rule is that everyone whose annual taxable income that is subject to personal income tax exceeded CZK 15,000 has an obligation to file a tax return. Persons reporting a tax loss also have an obligation to file a tax return.

Employees constitute a special group with regard to taxation. If you are an employee, the only situation in which you are obligated to file a tax return is if in the course of the year you had income from more than one employer concurrently, with the exception of tax-exempt income and income subject to withholding tax. Employees also have an obligation to file a tax return if their income was above the threshold for the solidarity tax ( CZK 1,672,080 in 2020) and if in addition to employment income, they also had other income (income from business activity, income from capital assets, rental income and other income) that exceeded, in aggregate, CZK 6 thousand.

And what are the changes that payers of personal income tax will need to take into account when preparing their tax returns for 2020?

Most of the changes are associated with changes to the average and minimum wage for 2020. In addition to the higher threshold for the solidarity tax (CZK 1,672,080), the tax credit for placement of a child in a pre-school facility has been increased (CZK 14 600), the ceiling under which regular pension payments are exempted

from income tax has been increased (CZK 525,600) and the maximum income level for eligibility for a tax deduction for children provided in the form of a tax bonus has been raised (CZK 87,600).

At the beginning of February 2021, a minor amending bill to the Act on Income Tax was published in the Collection of Laws. The amendments make it possible, solely in respect of the 2020 and 2021 tax years, to deduct from the taxable amount gifts up to a maximum of 30 percent of the taxable amount. Under a new rule, it will be possible to claim a tax loss in respect of 2020 by filing an additional tax return for 2019 and 2018.

A substantial change, one that will already have an impact on tax returns in respect of 2020, consists of a change to the time limit for payment of taxes in respect of 2020. This change was introduced by the amending bill to the Code of Tax Procedure that entered into effect on 1 January 2021, an amending bill aimed at making taxes function on an electronic basis (see the Newsletter for November 2020). With regard to personal income tax returns, the Tax Administration wanted to help taxpayers that elect not to use the standard paper-form tax return and file their tax return electronically. As a favour to such taxpayers, the Tax Administration extended the time limit for electronically-filed tax returns by one month – this year the deadline falls on 3 May 2021. For those submitting standard, paper-form returns, the deadlines remain the same – traditional, paper-form income tax returns must be filed with the tax authority by 1 April 2021 (irrespective of whether they are filed by mail or delivered to the mail room of the tax authority). If a taxpayer uses the services of a tax advisor or attorney to file their income tax return, the filing deadline is 1 July 2021. A new feature is that it will no longer be necessary to deliver the power of attorney for the advisor representing the taxpayer within the standard 3 month time limit for filing a tax return (by 1 April 2021). It will now suffice if the relevant tax return is delivered to the tax authority through the advisor along with an attached power of attorney.

For the sake of completeness, it should be added that tax returns may also be filed electronically. This may be done, for example, via the Financial Administration's tax portal www.daneelektronicky.cz, where you can find, among other things, forms for personal income tax returns. At the end of February 2021, the Ministry of Finance promised to launch the long-anticipated online tax authority office www.mojedane.cz, where it will be possible to file a tax return through the use of a banking identity.

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→ Taxes

# Default interest according to the Code of Tax Procedure

The Supreme Administrative Court has ruled that with regard to default interest calculated pursuant to Section 252 of the Code of Tax Procedure, where such default interest began to run prior to 1 January 2015, the maximum period for which such default interest can be calculated is 5 years. This limit restricting the amount of default interest had been repealed by an amending bill to the Code of Tax Procedure with effect as of 1 January 2015.

Although at first glance it may appear that we are dealing with a court decision the effects of which reach quite far into the past, it should be pointed out that we keep encountering a considerable variety of cases (typically tax audits, court proceedings, reviews) for which this decision will prove useful. And we are certain you will agree that it makes a significant difference whether default interest is limited to a period of 5 years or whether it can be calculated for a longer period of time.

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→ Taxes

# How to sell property as a registered VAT payer?

This question was recently discussed at the last Coordination Committee of the Chamber of Tax Advisory and the General Financial Directorate. Sole traders may sell property not just in the course of their business as taxable persons but also in their capacity of private individuals who sell their personal property as non-taxable persons. In practice, this may become somewhat confusing when it comes to selling one's property in different circumstances. The Coordination Committee has attempted to seek clarity in situations where such ambiguity may arise.

Klára Sauerová, Johana Cvrčková
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The first situation that was brought forward for discussion at the meeting was the case of a registered payer who wished to sell his private property. The property was therefore never recorded in the taxpayer's business assets or used for business purposes and the registered payer never exercised any VAT deductions on the property. This is frequently the case in the sale of a family car that has outlived its usefulness or the sale of an apartment, family house, or any other household furnishings. But the situation may also apply to a sale of municipal property that was not recorded in the town's business assets.

In such circumstances, the registered taxpayer does not act in the capacity of a taxable entity and therefore the sale is not liable to VAT.

But the real life often gets more complicated than that. For example, a registered payer may wish to sell property that he initially purchased in his capacity of a private person, and that was not assigned to his business assets and for which he did not claim any VAT deductions on

The sale of property may be liable to VAT even if the property has been formally assigned to private assets

acquisition, but which he occasionally used in the course of his business. For example, a registered payer may use his private car for a business trip or arrange a business meeting at his family home.

According to the prevailing rulings of the Court of Justice of the European Union (CJEU), that is still a permissible course of action, and not even an infrequent use of private property for business purposes changes the status of the property, the rule being that the registered payer must exhibit his intention to keep the piece of property for his personal use over the entire duration of his ownership and may not claim even a partial deduction of input tax. Insofar as both conditions are satisfied, the sale of such property is not liable to VAT.

The last set of circumstances may combine the features of both of the situations described above, the difference being that the property is ultimately used in a transaction that exhibits all elements of a business endeavor.

A textbook example would be the set of circumstances that led to CJEU's ruling in case C-331/14 Petar Kezič, in which a developer built a shopping center on plots that were partly assigned to his business and partly to his private assets. When he ultimately sold the development project, he assumed that VAT would be charged only on buildings erected on the plots of lands recorded in his business assets. In this case, the CJEU found that even though some of the plots were classified as private assets, the sole trader acted in his business capacity at the time of the transaction, that is as a taxable person, because his use and dispositions with the property indicated that they were principally intended for business purposes. In this case, therefore, the transaction was found to be liable to VAT.

In consideration of the aforesaid, we may draw the general conclusion that a sole trader may exercise a certain degree of discretion in assigning property to his business or private assets. At the same time, care must be taken to assess whether the trader actually uses the property in accordance with its contemplated purpose. If the trader's dispositions with the property clearly exhibit the hallmarks of business use (i.e. the taxpayer takes actives steps to use the property in the normal course of his business), the sale of such property is a taxable transaction even if the property was formally assigned to the sole trader's private assets. The substance of the transaction prevails over the form, which means that each case must be analyzed with a view to its individual circumstances in their overall context.

If you have any questions about potential VAT repercussions in the sale of your property, we will gladly assist you.

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→ Taxes

# VAT on supply of respirators has been waived

The Minister of Finance has issued a decision on an additional waiver of VAT. On the basis of a decision published on 1 February 2021, the Ministry of Finance waived VAT on the delivery of respirators in the case of domestic supply. This applies to supply where the obligation to account for (i.e. to declare) VAT arose during the period from 3 February 2021 to 3 April 2021. If an obligation to account for VAT on a received payment arose prior to the foregoing period, the waiver applies to such tax as well.

The VAT waiver applies to supply of filtration half-masks and respirators designated by the manufacturer for wearer protection at least on a level described as FFP2, KN95 or N95, and to the supply of respirators without an exhalation valve designated for the protection of the wearer and their surroundings. The goods must meet the requirements of the relevant European legislation. The waiver does not apply to full face masks or textile face masks.

When supplying the above-described goods, the VAT-remitting entity has an obligation to issue an official tax invoice without stating the VAT rate or the amount of VAT. The General Financial Directorate recommends stating "VAT waived" on the invoice. If the VAT-remitting entity nevertheless sets forth VAT on the invoice, it has an obligation to account for the VAT (i.e. to declare it). However, according to the Minister of Finance, the recipient of the supply will not be able to recover the VAT paid.

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→ Taxes

# How to deal with the taxation of reimbursements of travel expenses for hired employees?

The Supreme Administrative Court addressed the tax impacts of providing reimbursements of travel expenses for hired employees whose place of residence is abroad.

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In the reviewed case, the taxable entity provided its employees with reimbursements of travel expenses in connection with the hiring of such employees. The taxable entity provided such reimbursements in accordance with its internal policy in which it committed to providing such reimbursements not only to its core employees but also to employees lent to the employer by an employment agency, since the taxable entity was concurrently an employment agency. The reimbursements were reimbursements for the use of the employees' private automobiles for trips to the place of work and back, since these employees in fact resided abroad. The taxable entity took the step of providing such reimbursements due to a shortage of employees in the local labour market and anticipated that the provision of such reimbursements would expand the pool of potential job seekers. The taxable entity did not remit prepayments of the 15% tax on employment income in respect of such reimbursements.

The tax authority cast doubt on the taxable entity's ability to pay the foregoing reimbursements of travel expenses when employees were hired, arguing that such reimbursements did not constitute reimbursements of travel expenses that were being paid out in accordance with the Labour Code. The tax authority also stated that the amounts involved were not tax deductible amounts for the taxable entity – i.e. the employer – and that in the case of the employees receiving them, the reimbursements in fact constituted taxable employment income.

In its judgment, the Supreme Administrative Court first emphasised that the ability to provide reimbursements of travel expenses when employees are hired is not restricted to employers in the non-entrepreneurial sphere, since even an employer in the entrepreneurial sphere may use this practice. It may use this practice provided for in the Labour Code because of the general principle that "everything which is not forbidden, is allowed", it may use the practice on the basis of an explicit statutory authorization.

The Supreme Administrative Court therefore stated that an employer may voluntarily provide hired employees with reimbursements of travel expenses, and that such provision is limited to the same amounts and subject to the same conditions as those that apply when an employee is transferred or temporarily assigned to another employer at another place of work. The time limit for the provision of such reimbursements of travel expenses that is stipulated in the Labour Code also applies to this type of reimbursement of travel expenses.

Reimbursements of travel expenses may be provided to hired employees even if such employees reside abroad

The Supreme Administrative Court further confirmed that such reimbursements of travel expenses represent a tax deductible cost on the employer's side and that it does not represent taxable income on the part of the employees receiving such reimbursements.

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→ Taxes

# Czech Republic signs treaty on elimination of double taxation with San Marino

On 27 January 2021, a treaty on the elimination of double taxation was signed in Rome at the Embassy of San Marino between the Czech Republic and San Marino. The treaty eliminates double taxation with regard to taxes on income and assets and is also aimed at preventing tax evasion and avoidance of tax obligations.

Treaties on the elimination of double taxation have a fundamental impact on the economic and business relations of all open economies. The Czech Republic has already concluded a total of 92 valid treaties with various jurisdictions.

The signing of the treaty with San Marino is the first step, albeit a very important one, for expanding the existing list of double taxation treaties. The treaty will enter into force after both contracting countries have completed their national ratification procedures.

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→ Taxes

# What to watch out for when it comes to transfer prices

Companies performing only routine functions should generally generate only a relatively low, but stable profit. Contrary thereto, companies of strategic importance should generate residual profit, and loss. This is unfortunately not always the case.

Miroslav Kocman, tax expert, interviews his colleagues, Petr Tomeš and Martin Koldinský, who are both experts in transfer pricing.

Miroslav Kocman, Petr Tomeš
and Martin Koldinský
Rödl & Partner Prague

In your experience, how often do local tax authorities show an interest in transfer pricing?

Based on our immediate experience, the number of tax inspections directed at transfer pricing increases by the year. And it's not just about the frequency of the inspections, but also the risk of a lot of additional tax. Statistics published by tax authorities show that tax officials are getting better at their job by the day. One of the reasons why this is the case is definitely the fact that tax inspectors are turning into professionals. But even so, I firmly believe that the main problem lies with the actual taxable persons, who quite gingerly underestimate the significant risks at hand and who fail to have at-the-ready documents supporting the transfer pricing methodology they have adopted.

When you look at the number of inspections carried out and aimed at transfer pricing, to what ex-

tent does the situation in the Czech Republic differ from that in other countries, like Germany, for example?

The situation is more or less the same in terms of the frequency and intensity of inspections. Tax authorities worldwide have been very active in the past decade in checking that pricing is right. But what is significantly different compared to Germany is how the tax authorities communicate with taxpayers. In Germany, tax authorities have been practicing open negotiations for a long time. When a tax inspection is opened, the tax authority clearly states its view on the various areas of inspection and the result is, to a certain extent, a compromise that both parties agree on. Here, in the Czech Republic, we are witness to a much more formalistic approach (submit → we assess → we don't have an opinion right now). Inspections conducted in this way unfortunately tend to prolong the entire process and reduce the legal certainty of taxpayers to a pulp.

Where do you think companies in the Czech Republic make the most mistakes when it comes to transfer pricing? What should they be looking out for?

In my opinion, Czech companies underestimate two areas in particular. The first one is that they don't reflect on ever-changing rules and new requirements ensuing from new recommendations issued by the OECD. To randomly name but a few its things like intra-group financing, intra-group services and the restructuring of relations within the group and the impact on the company's business model. In general, it applies that transfer pricing methodology should be adapted according to where value is created. In practical terms this means that companies performing only routine functions should generate only a relatively low, but stable profit, whereas companies of strategic importance should generate residual profit, and loss. This is unfortunately not always the case. The second underestimated area is that which follows after the determination of the transfer price, that being the obligation to demonstrate that the corporate tax base is determined in line with the arm's-length principle. For this purpose, Czech companies should have at their disposal sufficiently conclusive means that they can submit in the event of a tax inspection and which they can use to demonstrate that their transfer pricing complies with the arm's length principle. In reality, companies quite often only start collecting evidence when the tax authority has already launched a tax inspection, which makes the situation even the more complicated and somewhat compromises the company's position.

What, according to you, most often draws the tax authority's attention to the fact that the company made a mistake in its transfer pricing?

It's usually information aimed at determining the functional profile of the company (emanating from the company's website or annual report, for example), which does not correspond to the company's profitability. Companies often provide information, in good faith, from which the tax authority then infers that the company under scrutiny is a so-called limited or routine company in terms of the scope of its functions, which is significantly controlled by the parent company. Based on transfer pricing theory, such companies should generally generate a relatively low, but stable profit. If, however, the company is loss making, it is just a matter of time before that tax authority will come knocking at its door. Another very sensitive area is when the data in documents already available to the tax authority prior to a tax inspection are inconsistent.

To what extent has the amendment to the Income Tax Act that transposes the ATAD affected transfer pricing?

The amendment to the Income Tax Act that transposes the ATAD has touched on transfer pricing primarily in limiting the applicability of interest costs in relation to the corporate tax base in that exceeding borrowing costs are deductible in terms of the tax base only up to 30 percent of the taxpayer's earnings before interest, tax, depreciation and amortisation (EBITDA), i.e. CZK 80 million. In practice, this rule means tax entities must carefully monitor their financing structure and they must correctly choose between equity and debt. This is another rule that to a certain degree limits tax deductible expenses of financing economic activity and it applies together with already existing thin capitalisation rules. Due to the set limits, this new rule applies to a rather limited number of Czech tax entities.

Would you welcome any further changes to laws regulating transfer pricing that would aid companies in adhering to them and keeping everything straight? If so, what specifically are you looking for?

Companies would very much appreciate clear rules that would lay down how they should demonstrate correct transfer pricing. In other words, legislation governing the mandatory processing of transfer pricing documentation. In the absence of such legislation, companies are unsure how to do this and

such lack of rules does nothing for standard document requirements during tax inspections. Updated methodological guidelines that would reflect the amended OECD guidelines would be enough to help companies keep their documentation accurate and up-to-date.

### What impact will the new OECD guidelines have on transfer pricing (Taxing the Digital Economy Pillars 1 and 2)?

Only time will show what impact the new OECD guidelines will have on taxing the digital economy. The new guidelines as proposed by the OECD are currently in the public comment phase and their final version should be issued in mid-2021, as should the proposal for legislative amendments. So, we are now more or less at the start of the entire process of setting up an international taxation process, despite the fact that attempts to revive the fair taxation of digital economy activity have been one of the OECD's priorities for several years now. The proposed rules provide for a two-pillar principle. The first pillar gives states the right to tax income that has been generated in their territories, without the need for the tax entity that generated the income to be actually physically present. The second pillar sets the minimum level of total taxation to be achieved. Generally I think that the impact of the new rules on transfer pricing will be significant because the new rules will have to be introduced into everyday life. Even though the OECD aims to instigate a system striving for administrative arrangements that are as simple as possible, we may expect increased administrative complexity that will go hand in hand with restructuring relations and the implementation of rules, and of course the necessary documentation. Taking into consideration new strategy guidelines, it may be too early for specific recommendations to be given, because the second pillar may still undergo major changes. I would, however, recommend that all companies engaged in economic activity in any of the digital areas concerned closely monitor the situation and gradually prepare for certain changes to come about. In my opinion, we here in the Czech Republic are going to see cases when the Czech Tax Administration is going to want to tax the income of those foreign entities engaged in an economic activity falling within the definition of "digital" in the Czech Republic.

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