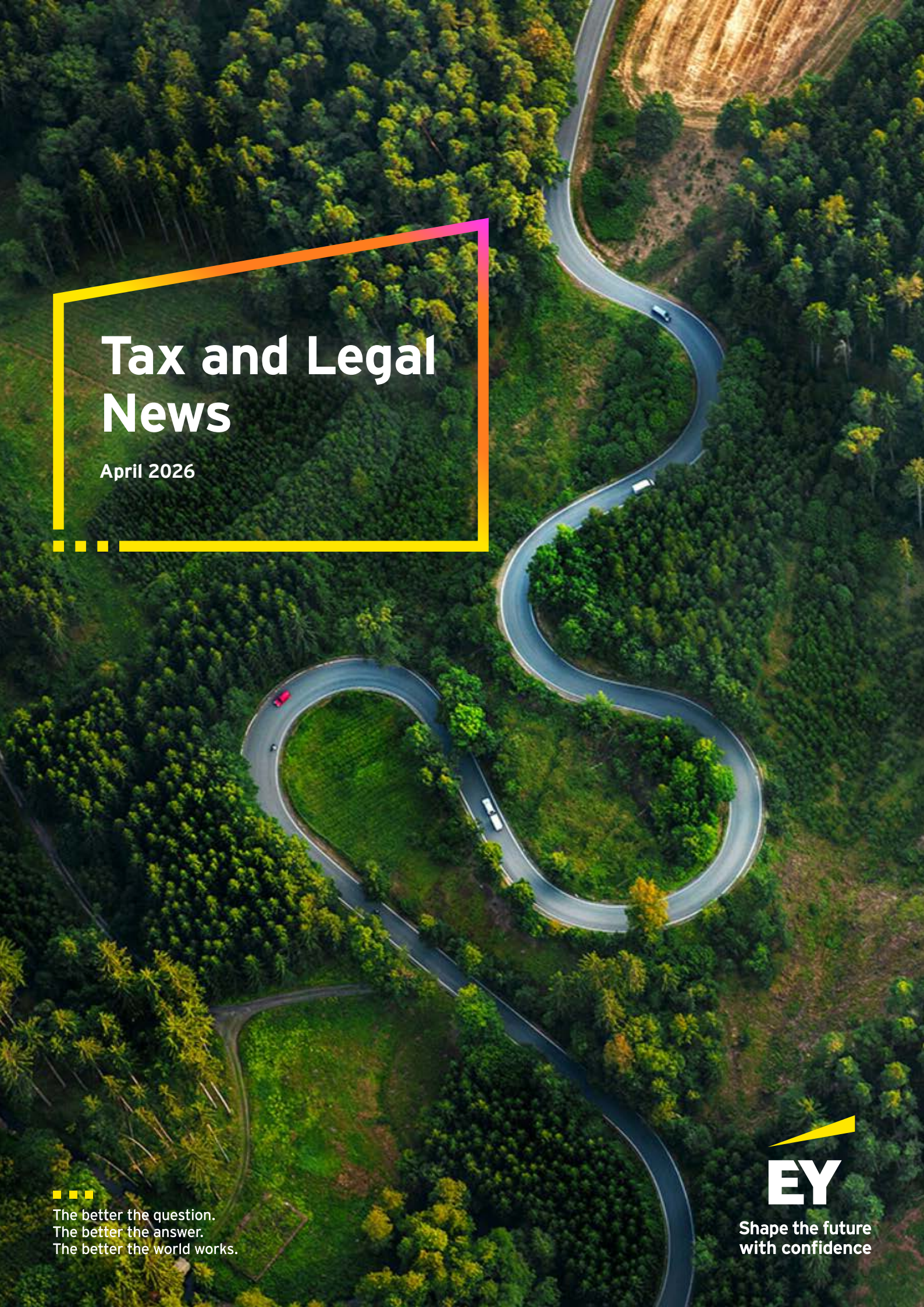

Tax and Legal News

April 2026

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Welcome to the April issue of Tax and Legal News – what's inside?

Editorial – We consider how to deal with uncertainty in the area of taxes.

Pillar 2 – We offer practical insights into fulfilling pillar 2 obligations.

A sad tale of VAT – The Court of Justice of the European Union considered a commercial case that appeared straightforward at first glance: the sale of goods between local traders with delivery to another Member State. The customer ultimately bore the VAT burden twice: first, by paying it to the suppliers without being able to claim a deduction, and second, by having it assessed by the tax authority on the intra-Community acquisition of goods, again without the right to a deduction.

EU Inc. – The European Union is launching a debate on a new EU-wide legal form for companies. As the so-called "28th regime," EU Inc. aims to reduce legal fragmentation, simplify cross-border business operations, and facilitate the growth of innovative companies within the single market.

Hypothetical transaction due to personnel ties – In a recent decision, the Supreme Administrative Court emphasized that the decision-making of senior management with a direct link to the parent company (employment relationship) cannot be viewed solely from the perspective of the company itself; rather, for transfer pricing purposes, it is necessary to assess the structure of the relationships between related parties. In this case, the decision-making role within the company was held by employees seconded from the parent company.

Retroactive application of the exemption for royalties – We present the Court of Justice of the European Union's view on the dispute concerning the interpretation of the conditions for applying the exemption under the Directive on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

The crime of tax evasion – In its ruling on the crime of tax evasion, the Constitutional Court suggests that failing to consult a tax advisor may not be the best strategy.

What else has caught our attention?

- ***Income Tax Return (Public CbCR)*** – The first potential reporting period is the financial period beginning after 22 June 2024.
- ***Tax Plans for the Czech Republic*** – According to press reports, the government is considering keeping the corporate income tax rate at 21% (i.e. it is considering abandoning its plan to reduce it by two percentage points).
- ***Amendments to the Labor Code and a proposed regulation on "platform" work*** – A Labor Code "implementation" amendment has been published, along with a draft Act on Platform Work and amendments to related laws, which includes a change to the definition of dependent work.
- ***Flat-rate travel allowances*** –In a recent judgement, the Supreme Administrative Court confirmed that, in the case of flat-rate travel allowances, the employer is obligated to demonstrate both the reasonableness and rational structure of the chosen flat-rate model, as well as the actual occurrence of business trips to the extent declared.

Welcome to the April issue of Tax and Legal News – what's inside?

- ***Blue Cards*** – Starting 1 May 2026, the minimum wage for Blue Card applicants will increase.
- ***Insurance premiums for the self-employed*** – Lawmakers approved an amendment to the Social Security Contributions Act regarding the non-increase of the assessment base for self-employed individuals.
- ***Methodological questions*** – The General Financial Directorate has begun publishing answers to methodological questions from the public. According to a statement from the GFD's management, methodological questions answered over the past two years will be published gradually.
- ***Single Monthly Employer Report (JHMZ)*** – The Ministry of Labor and Social Affairs has launched a website dedicated to issues related to the Single Monthly Employer Report.
- ***New service on the Czech Social Security Administration (ČSSZ) portal*** – My Account is an online service provided by the ČSSZ ePortal that offers an overview of pension insurance periods recorded with the ČSSZ and allows users to manage their insurance periods.
- ***Change in the tax exemption for gas used in cogeneration units*** – Starting in March 2026, the Customs Administration will change the scope of the tax exemption for gas consumed in combined heat and power generation.

Editorial

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Uncertainty as the norm

Most of us like things to be clear. This is especially true when it comes to taxes, where large sums of money are often at stake (and sometimes even more, if the dispute escalates to a criminal level). Entrepreneurs, tax advisors and the government would therefore logically like to know where they stand. Where exactly the line is drawn, what is still acceptable and what is not. And if not, how much will it cost them.

The Supreme Administrative Court, as the highest court in the administrative justice system, is traditionally expected to finally settle long-standing disputes. Ideally, once and for all. But the reality is quite different. The Supreme Administrative Court is not a factory for certainty, but an institution whose mission is to strengthen confidence in the judiciary—and thereby cultivate society as a whole. To make sense of a world that, for some reason, refuses to organize itself in a meaningful way. At least, that is how its chairman, Karel Šimka, has described its role at various professional forums.

The Supreme Administrative Court has also played a significant role in transforming the tax administration. Today, it operates in a completely different way than it did ten or twenty years ago. It is more professional, analytically stronger and significantly less prone to basic errors. For businesses, this leads to a rather unpleasant conclusion: disputes are rarely won "in court" anymore. What matters is the substance. And above all, the narrative—whether the entire arrangement makes economic sense even without the tax benefit. It is precisely in this area that the case law of the Supreme Administrative Court operates today.

This is particularly evident in cases of abuse of the law. Restructuring, financing, intra-group loans. Formally, everything may be in order, the structure sound and the documentation flawless. But then a simple yet uncomfortable question arises: does any of this make sense on its own? Or is the main goal tax savings, for which a business rationale is being sought after the fact? As soon as the tax aspect begins to take precedence over economic logic itself, red flags start to go up. And no one knows for sure today exactly where the line is that, once crossed, will prompt the court to say, "No, not here.".

Similarly vague boundaries apply to the practice of working as a self-employed contractor (the so-called black system), which, moreover, has increasingly come under scrutiny by the State Labor Inspection Office in recent years. On the one hand, there is the appealing idea of freedom of choice: work however you want, on your own responsibility. On the other hand, there is the state, which needs to collect taxes and insurance premiums and fund the social welfare system. The result is a gray area. A very gray one. The number of customers is counted, economic dependence and the degree of actual compliance are examined—but none of these criteria alone is decisive. It is always

a combination of factors. And so it can easily happen that a structure that held up yesterday may not hold up tomorrow. Not because the law has changed, but because the facts of the case are assessed differently.

Furthermore, improved algorithms and data analysis are playing an increasingly significant role. The selection of tax audits is no longer random, and we must expect it to become increasingly sophisticated. For businesses, this means one thing: relying on the hope that "they won't find out" is not a strategy. The government has a better overview today than ever before—and it will only get better.

Administrative courts are therefore not tasked with eliminating uncertainty. Rather, they must keep it within limits that are still tolerable for the business environment. Decisions must be made in a timely manner and, if possible, consistently. Indeed, it is precisely in the speed of decision-making that we tax advisors have seen a significant shift in recent years: whereas cases used to languish in the courts for several years, today most disputes before the Supreme Administrative Court are decided within a year.

As the president of the Supreme Administrative Court aptly noted in an interview, the role of the judiciary is like maintaining an English lawn. It needs to be watered. Mowed. Over and over again. But it will never be finished.

And therein lies perhaps the most important insight for tax practice. Uncertainty in the tax arena today is neither an exception nor a failure of the system, but rather its normal operating condition. It cannot be completely eliminated—one can only learn to work with it, much like other business risks. Perhaps the following reading will help you in this difficult task....

Formally, everything may be in order: the structure may be sound, and the documentation flawless. But then a simple yet uncomfortable question arises: does the whole thing make sense on its own? Or is the main goal tax savings, for which a business rationale is being retroactively sought? As soon as the tax aspect begins to overshadow economic logic itself, warning lights start flashing.

Pillar 2

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Pillar 2 and Czech tax obligations

The General Financial Directorate (GFD) has circulated an updated draft of the tax return for top-up taxes and the related information return for comment. Below, we highlight 10 key practical insights:

1. A tax return must be filed separately for each of the top-up taxes, i.e. the allocated tax (IIR/UTPR) and the Czech tax (QDMTT).

2. Any notification of compliance with an exemption from the obligation to file an information return must also be filed separately for the information return for Czech top-up tax and the information return for allocated top-up tax.

3. According to the GFD, There is an obligation to file a top-up tax return even if the tax liability is zero.

4. The GFD will not generate an XML form for the information return.

5. If a taxpayer is part of more than one group (for reasons other than being part of a JV group), the taxpayer is required to file a tax return for each group separately.

6. Even if the implementation of DAC9 is not approved in time, there is a provision in § 130(3) of the Top-Up Tax Act under which EU jurisdictions should (in our understanding) be considered qualified for the purposes of the GIR.

7. However, this accommodating approach does not apply to jurisdictions outside the EU. It is unlikely that the Czech Republic will gain timely access to the GIR MCAA, and these jurisdictions should not be considered qualified for the purposes of central filing of the GIR.

8. For example, if a UPE is located outside the EU (but the relevant jurisdiction has acceded to the GIR MCAA) and has subsidiaries within EU countries, it is worth considering filing a central application in an EU jurisdiction that has acceded to the GIR MCAA.

9. In the case of local filing of an information return, the minimum scope of information to be filed in the Czech Republic should likely follow the so-called dissemination approach.

10. For the purposes of the Czech top-up tax, the decision to use transitional simplified jurisdictional reporting during the transitional period may be applied if no top-up tax arises for the relevant reporting period.

We're here to help with anything—feel free to email or call us.

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Intra-Community supplies and acquisitions may be taxed simultaneously in a single country

In its recent judgment in Case T-638/24 ("the Judgment"), the General Court of the Court of Justice of the European Union ("the General Court") considered a straightforward commercial case involving the ordinary sale of goods between local traders. From a VAT perspective, such a transaction should be completely neutral (the buyer should not be liable for VAT). The buyer requested that the seller ship the goods to other Member States. However, because the buyer failed to verify the tax implications of this request in a timely manner, he ended up paying VAT twice.

Factual basis of the dispute

An Austrian company ("the Customer") purchased goods from Austrian suppliers between 2011 and 2015, which the suppliers transported to other Member States at the buyer's request. Since the sellers arranged for transport to other Member States, what was originally a domestic transaction became an intra-Community transaction. From a VAT perspective, this breaks down into two parts. The suppliers made deliveries of goods from Austria to another Member State, and the customer made acquisitions of goods from another Member State (Austria) in the countries where the transport ended, even though the customer was established in the same country as the suppliers (Austria).

Intra-Community supply of goods

Under Article 138 of the VAT Directive, the supply of goods dispatched or transported by the seller or the buyer to another Member State is exempt from VAT. Under the rules in force at the time, it did not matter which VAT identification number the buyer provided to the seller. In the case at hand, the Customer provided suppliers with an Austrian VAT number, and the suppliers subsequently issued invoices with Austrian VAT, believing that they were selling goods in Austria and that this constituted a local supply.

The Austrian tax authority confirmed that the suppliers had incorrectly applied Austrian VAT, as the transactions in question were in fact intra-Community supplies of goods exempt from VAT. Consequently, it prevented the customer from claiming a tax deduction on the purchase of these goods, even though the suppliers were required to declare and pay the incorrectly stated tax on the invoice in accordance with Article 203 of the VAT Directive.

Intra-Community acquisition of goods

Intra-Community acquisitions of goods constitute a taxable transaction, the place of supply of which is the Member State in which the transport of the goods ends. Therefore, the purchaser should register for VAT in those Member States[1]. If this does not occur, Article 41 of the VAT Directive establishes a fallback rule, according to which the place of supply is the Member State that issued the VAT identification number used by the purchaser for this transaction. This rule serves a subsidiary and safeguard function. Its purpose is to prevent situations in which an intra-Community acquisition of goods would not be taxed in any Member State. However, the first rule remains in effect. To encourage the buyer to pay VAT in the country where the transport ends, VAT paid under the second rule is not eligible for deduction[2].

In this case, the Austrian tax authorities considered that the customer had not demonstrated that the goods had been taxed in the country where the transport ended. Since the customer provided its Austrian VAT number to the suppliers, the intra-Community acquisition of goods is subject to taxation in Austria pursuant to Article 41 of the VAT Directive. This created a paradoxical situation in which the acquisition of goods from another Member State was taxed in that same Member State.

The General Court agreed with the Austrian tax authority and held that this rule applies even if the Member State of identification is also the Member State where the transport begins. Article 41 of the VAT Directive thus establishes the standard mechanism for allocating tax jurisdiction among Member States.

Double taxation

The General Court confirmed that Articles 41 and 203 of the VAT Directive pursue different objectives and that their concurrent application is not, in itself, contrary to the VAT Directive or to the fundamental principles of the VAT system. The customer thus bore the VAT twice. He paid it once to the suppliers without being able to claim a deduction, and a second time it was assessed by the tax authority on the intra-Community acquisition of goods, also without the right to deduct VAT.

Double taxation could have been eliminated. The customer could have asked the supplier to issue corrective invoices and refund the VAT paid in error. The customer could also have registered for VAT in the Member States where the transport ended and properly taxed the purchase of the goods there. Subsequently, they could reduce the Austrian VAT charged as a result of using the Austrian VAT ID number.

This is not a case of actual permanent double taxation of the same transaction, but rather the concurrence of two distinct tax mechanisms, which, while they may lead to temporary double taxation, allow the taxpayer to take steps to prevent permanent double taxation retroactively. This is also why another very similar Polish case, C-696/20 Dyrektor Izby Skarbowej w W, was decided differently. The Polish tax authorities, in fact, considered the taxation by the first supplier to be correct and final.

However, proceedings usually drag on, so the deadlines for the supplier to return the unjust enrichment generally expire, and the deadlines for correcting the tax paid also pass in vain. In the end, taxpayers are left with nothing but tears.

1 Unless the simplification for three-party transactions is applied, which allows the buyer (intermediary) in the country of destination not to register for VAT.

2 The loss of the right to deduct VAT was confirmed by the Court of Justice of the European Union in Case C-539/08 Facet.

Would a similar case in the Czech Republic have turned out differently?

The VAT Act defines the acquisition of goods from another Member State in § 16 as *"the acquisition of the right to dispose of goods as owner from the person making the supply of goods, where the goods are dispatched or transported* ***from other Member State*** *to another Member State"*. The term *"other Member State"* is expressly defined in § 3(1)(c) of the VAT Act as *"a Member State other than the domestic territory,"* where "domestic territory" means the territory of the Czech Republic.

From the Czech perspective, for this to be considered an acquisition of goods from another Member State, the transport of the goods would have to actually begin in another Member State, not domestically (in the Czech Republic). From a purely linguistic standpoint, therefore, a similar reassessment would not be possible in the Czech Republic. This is undoubtedly an incorrect implementation of the VAT Directive, which the tax administration should not interpret to the detriment of the taxpayer.

However, in the section on the loss of the right to deduct VAT incorrectly claimed by a supplier, a similar case would have the same outcome.

Would a similar case turn out differently today?

Yes, the outcome would be different, specifically regarding the application of the exemption for the supply of goods to another Member State. In connection with the "Quick Fixes," an additional requirement was introduced for the exemption of supplies of goods to another Member State. The customer must provide a VAT ID number issued by a country other than the country where the transport begins. The supplier may then apply the VAT exemption only if they include this VAT ID number in their summary report.

Since the customer provided its Austrian VAT ID number to the suppliers, the supply of goods to the supplier could not be exempt from VAT today. This supply would be properly taxed in accordance with Austrian law. We therefore believe that the Austrian tax authority would not be entitled to challenge the VAT deduction, as this would not constitute tax incorrectly stated on the invoice within the meaning of Article 203 of the VAT Directive.

Conclusion

For tax practitioners, this serves as further confirmation that formal errors in the identification and invoicing of intra-Community supplies can have significant consequences, even in situations where no actual tax evasion has occurred. We therefore recommend a very careful analysis of your supply chains to prevent similar additional tax assessments. We would be happy to assist you with this.

This is further confirmation that formal errors in the identification and invoicing of intra-Community supplies can have significant consequences, even in situations where no actual tax evasion has occurred.

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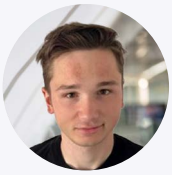

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EU Inc. as a single European company

In recent years, the European Union has been stepping up its efforts to overcome the structural barriers that prevent companies from fully realizing the potential of the single market. One of the key proposals in this area is the European Commission's EU Inc. initiative, which is intended to serve as the basis for the so-called "28th regime" for European companies. This is a concept designed to offer businesses—particularly innovative and fast-growing companies—a voluntary alternative to national legal forms in the form of a uniform, EU-wide legal framework applicable across all Member States.

In practice, the 28th regime is intended to function as a "European layer" above the 27 national legal systems, allowing companies to choose a single harmonized set of rules and then operate within the single market in accordance with those rules, without having to repeatedly adapt to local formalities and differences. The aim is to reduce legal fragmentation, limit the administrative burden and eliminate the legal uncertainty that often accompanies the cross-border growth of companies in the EU today.

From a legislative perspective, it is important to note that EU Inc. is to be established by a regulation, i.e. a directly applicable legal act. Unlike directives, it does not require transposition into national legal systems with various national deviations. This approach is intended to ensure that the new legal form is truly uniform and internationally understandable. At the same time, however, EU Inc. does not replace national legal forms. It is intended to be a parallel option alongside joint-stock companies, limited liability companies and other well-known types of companies. Its appeal lies in the simplicity of the company's entire lifecycle—from formation through financing and internal governance to transfers of ownership or dissolution—and in the ambition to enable companies to grow within the EU with minimal "friction.".

Faster, cheaper, and fully digital setup

One of the most notable features of the proposal is its emphasis on fully digital operations. EU Inc. is designed to enable the incorporation of a company exclusively through electronic means, within a short timeframe (on the order of tens of hours), at very low cost and without the requirement to contribute a minimum amount of share capital. The concept also includes a central European registry and an interconnected digital interface designed to provide a unified overview of key operations and access to basic data on the legal structure and activities of companies.

Ideally, this system is intended to function as a central digital hub where the company's identity and basic corporate data are managed. The practical benefit is to reduce the need to repeatedly submit the same information to different authorities—that is, to move toward a "once-only" principle, whereby the company provides the data once and it is subsequently shared across relevant processes. For companies operating across borders, this could mean a significant reduction in administrative burden.

Modern financing and a more flexible corporate structure

Another area targeted by the proposal is corporate financing and the management of equity interests. The aim is to enable faster and simpler investment transactions, particularly in situations typical of the early and growth stages of a business. It is expected that certain formal requirements will be reduced, particularly those related to physical presence or the mandatory involvement of intermediaries, and that the transfer of shares will be simplified.

The proposal also provides for the use of modern financial instruments and standardized documentation, which are common in the venture capital sector. The aim is to reduce transaction costs and increase the predictability of investment processes when operating in multiple Member States. For both investors and founders, the promise of greater legal clarity and a reduced need to "translate" transactions into different national legal frameworks is particularly important.

Employee stock option plans at the EU level

One of the most interesting aspects of EU Inc. is the area of employee participation. The concept provides for the possibility of participating in a common EU-wide employee stock option system. A key feature is the deferral of taxation until the actual sale of the shares, rather than at the time the option is granted. This addresses the common problem of so-called taxation without actual income, which in some legal systems reduces the attractiveness of stock option programs for employees.

From a practical standpoint, a more uniform and predictable framework for employee stock ownership plans could enhance European companies' ability to compete in attracting and retaining qualified employees. At the same time, this is a factor that investors often consider when assessing the long-term motivation of key personnel within a company. Here, too, however, the final form of the legislation and its compatibility with national tax rules will be decisive.

A second chance and an easier way to wind down operations

The proposal also includes measures aimed at reducing the costs of failure. Innovative entrepreneurship is, by its very nature, associated with experimentation and risk, and a complex and costly process of winding up a business can discourage new attempts. EU Inc. therefore includes mechanisms designed to facilitate a faster winding down of operations and, where appropriate, a fresh start, including simplified insolvency procedures and greater digitization of related processes. For investors, this can mean greater certainty regarding the management of failed projects and more predictable scenarios for the termination of investments.

Cross-border operations without discriminatory requirements

To ensure that the new legal form truly fulfills its purpose, plans also include the elimination of discriminatory national practices. Consideration is being given to defining impermissible requirements, such as the obligation to establish a local branch, appoint a local representative, or use a bank account in a specific country solely for the purpose of obtaining a license or accessing public support. At the same time, the framework is to include sufficient safeguards against abuse that take into account existing protective mechanisms under both EU and national law.

What does all this mean in practice?

EU Inc. is currently a legislative proposal awaiting consideration by the European Parliament and the Council. However, the political direction is clear: the goal is to create a single European legal form that will simplify cross-border business and reduce the costs of growth. From a corporate perspective, the most interesting combination is rapid digitization, a flexible corporate framework and more standardized employee stock option plans. However, a certain degree of caution is still warranted—the success of the 28th regime will depend not only on the text of the regulation, but also on its practical implementation and on whether it succeeds in maintaining true simplicity without creating another layer of complex regulation. That is precisely why it makes sense to keep an eye on the development of EU Inc. right now, as a clear indicator of the future direction of the European business environment.

The European Union is launching a debate on a new EU-wide legal form for companies. As the so-called "28th regime," EU Inc. aims to reduce legal fragmentation, simplify cross-border business operations and facilitate the growth of innovative companies within the single market.

Judicial decisions

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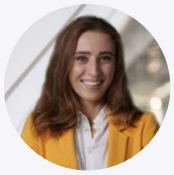

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The Supreme Administrative Court ruled on the existence of a hypothetical transaction resulting from personnel ties

In a recently issued judgment (8 Afs 229/2024), the Supreme Administrative Court ("SAC") addressed the issue of the operational and risk profile of a Czech company, specifically whether the company was entitled to bear a loss from its manufacturing activities in accordance with § 23(7) of the Income Tax Act. The SAC also focused on assessing the existence of so-called fictitious (hypothetical) transactions.

Background

- In 2016–2017, a Czech company ("the Company") was a member of an international group with a Japanese parent company that held an 85% stake in the Company. Employees of the parent company comprised the Company's senior management.
- The Company's main activity was the manufacture of parts and components for the automotive industry.
- The Company supplied its products to its parent company, other affiliated entities and external customers.
- The Company reported a loss from its manufacturing operations for the 2016/2017 period.
- The tax administrator assessed additional corporate income tax on the Company for the 2016–2017 period, as, in his opinion, the Japanese parent company was responsible for this loss and should have compensated the Czech company for it.

View of the tax administrator

- Based on the actual structure of the Company's relationships and operations, the tax administrator concluded that the Company is a manufacturer with limited functions and risks that should generate stable, routine profits rather than losses.

- According to the tax administrator, key functions such as strategic management, planning, negotiations with customers and pricing were performed or directly managed by the parent company through its senior management.
- The tax administrator concluded that the relationship between the Company and its parent company can be classified as a controlled transaction involving complex production carried out by the Company in accordance with § 23(7) of the Income Tax Act. The tax administrator identified a so-called fictitious (hypothetical) transaction between the Company and its parent company.
- In this regard, the tax administrator pointed out that, though the Company sold its products to both related parties and independent parties, all of its production was based on contracts and orders received through negotiations and pursuant to the decision-making authority of the parent company.
- The tax administrator emphasized that, given the Company's operational and risk profile (a manufacturer with limited operations and risks), the parent company should have compensated the Company during the relevant tax period for the difference between the Company's actual profitability and the market-standard profitability of comparable unrelated companies.

Company's statement

- The Company objected that the tax administrator had incorrectly classified it as a manufacturer with limited functions and risks, arguing that it is a so-called licensed manufacturer (i.e. a manufacturer responsible for key functions and bearing key risks, including market and capacity).
- In the Company's view, when determining its operational and risk profile, the tax administrator failed to take into account significant operational and pricing risks and the Company's independent decision-making, as well as the extraordinary circumstances the Company faced during the relevant period, which affected its financial results.
- The Company further argued that the tax administrator had not proven the existence of a fictitious transaction with its parent company, on the basis of which it had assessed additional tax against the Company.
- According to the Company, the tax administrator did not provide evidence or prove that the parent company controlled and effectively managed the Company through persons it had appointed, nor did it prove how the parent company caused the Company to incur a loss, for which it should pay compensation.

What does the regional court have to say?

- The regional court ("RC") upheld the tax administrator's findings and dismissed the Company's complaint.
- The RC agreed with the tax administrator's conclusions regarding the existence of a hypothetical transaction between the Company and its parent company based on the actual operation of the Company's manufacturing activities and confirmed that the parent company performed all strategic and decision-making functions. The Company did not have full control over production and did not participate in negotiating new business deals or in pricing.
- The RC also based its assertion of the existence of a hypothetical transaction on the personnel ties between the Company's senior management and the parent company. The position of president, who was also the Company's managing director, as well as other senior management positions, were held by employees seconded by the parent company, who remained in an employment relationship with it. There was no other person in the Company above these employees who could issue instructions to them or make decisions on behalf of the Company.
- The RC supported the tax administrator's conclusion as to the Company's status as a manufacturer with limited functions and risks, rejected the Company's arguments regarding its involvement in the Company's production operations and furthermore did not agree with the arguments concerning the existence of extraordinary factors that were alleged to have affected its financial results.

Ruling of the SAC

- The SAC overturned the judgment of the RC and remanded the case for further proceedings, in particular because the judgment was not subject to review.
- The SAC concluded that the RC had not adequately addressed the rationale for using the interquartile range and determining the reference period, on the basis of which the Company's profitability was assessed in the context of a hypothetical transaction.
- However, regarding the existence of a hypothetical transaction, the SAC upheld the RC's view that it is not necessary to prove a specific instruction from the parent company, but that the existence of a hypothetical transaction can be inferred from the overall structure of the relationship, particularly the personnel links, the de facto exercise of strategic decision-making or the parent company's control over key risks.
- The SAC noted that the parent company's influence on the Company's production activities is evident, in particular, in the composition of the senior management, which consists of employees seconded by the parent company; apart from the Company's general meeting (85% of whose members are from the parent company), there was no one else who made decisions directly on behalf of the Company.
- The SAC emphasized that decisions made by members of senior management with a direct link to the parent company (employment relationship) cannot be viewed solely from the perspective of the Company as such, but that, for transfer pricing purposes, it is necessary to assess the structure of relationships between related parties. In this case, decision-making authority within the Company was held by employees seconded from the parent company, rather than by the Company's statutory bodies, which were not directly remunerated by the parent company.
- The SAC also agreed with the RC's reasoning regarding the principle of prudent management, stating that evaluating the actions of senior management solely on the basis of this principle would negate the validity of transfer pricing assessments.

Conclusion

In addition to building on a series of previous rulings regarding directives from parent companies (and related compensation), it also responds to the trend in case law regarding non-reviewability, confirming that the court (and the tax administrator) must address the taxpayer's individual arguments and explain in detail why it considers these arguments to be unfounded. A mere reference to "common practice" and the OECD Transfer Pricing Guidelines is insufficient.

In general, we would recommend that Czech subsidiaries of multinational groups that use a similar management structure (where key positions are held by employees seconded by the parent company) pay closer attention to this area, particularly in light of this court ruling.

Let's see if and how the Constitutional Court addresses the objections mentioned above.

The SAC emphasized that decisions made by members of senior management with a direct link to the parent company (employment relationship) cannot be viewed solely from the perspective of the Company as such; rather, for transfer pricing purposes, it is necessary to assess the structure of relationships between related parties. In this case, decision-making authority within the Company was held by employees seconded from the parent company, rather than by the Company's statutory bodies, which were not directly remunerated by the parent company.

Judicial decisions

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Retroactive application of the exemption for royalties – the view of the Court of Justice of the EU

Some time ago, we informed you about a dispute concerning the interpretation of the conditions for applying the exemption under the Directive on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States ("the EU I-R Directive").

A company requested a decision granting an exemption from income tax on royalty payments pursuant to § 38nb of the Income Tax Act (ITA), which implements the exemption under the EU I-R Directive, for the tax periods of the calendar years 2014, 2015, 2016, 2017, and 2018.

View of the tax administrator

- The tax administrator granted it the right to this exemption for the 2017 and 2018 tax periods but denied the request for the other periods. The company had applied for the exemption in June 2019, which, according to the tax administrator, was after the two-year deadline had expired for the years 2014, 2015, and 2016.

View of the Czech courts

- The company challenged the tax administrator's decision in court, but the Municipal Court in Prague dismissed the case. Thus was the dispute referred to the SAC.
- The SAC had doubts regarding the interpretation of the EU I-R Directive and therefore decided to refer the matter to the CJEU for a preliminary ruling.
- The first question referred was whether the EU VAT Directive can be interpreted as allowing the Member State to grant tax exemptions, on the basis of a decision pursuant to Article 1(12), also for the period preceding the date of submission of the certificate and supporting information (or, as the case may be, the date of issuance of the decision itself).

- If this question were answered in the affirmative, the follow-up question would be whether the EU I-R Directive establishes any time limit for filing an application for a decision granting an exemption under Article 1(12) of the EU I-R Directive, or, alternatively, any time limit regarding the period preceding the submission of the application for a decision granting an exemption during which a tax exemption may be granted.

View of the CJEU

According to the CJEU, the EU I-R Directive should be interpreted as meaning that

- a Member State is allowed to grant tax exemptions, on the basis of a decision pursuant to Article 1(12), for the period preceding the date of issuance of that decision or, where applicable, for the period preceding the date on which the certificate and supporting information were submitted to the administrative authority;
- no time limit is specified for the submission of certificates and supporting information that the Member State of origin may reasonably require for the purposes of issuing a decision granting an exemption under Article 1(12) of this Directive, nor does it set a time limit regarding the length of the period preceding their submission for which a tax exemption may be granted. It is therefore for the national legal system to set that time limit on the basis of the principle of procedural autonomy, and it is for the Czech court to verify whether there is a time limit applicable in the given situation under Czech law.
- The case will be referred back to the Czech Supreme Administrative Court, which will determine whether Czech law provides for a time limit on retroactive applications for exemption.

According to the CJEU, the EU I-R Directive must be interpreted as allowing the Member State of origin to grant a tax exemption for the period preceding the date of issuance of that decision, and furthermore, it does not set a deadline for the submission of a certificate that the Member State of origin may reasonably require for the purpose of issuing a decision granting the exemption, nor does it impose a time limit on the length of the period preceding their submission for which tax exemption may be granted.

Judicial decisions

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The Constitutional Court on the crime of tax evasion: failing to consult a tax advisor may not be the best strategy

Tax offenses often exist in a gray area between two worlds: the complex reality of accounting and the strict perspective of criminal law. When a business owner accused of tax evasion defends themselves by claiming it was merely a mistake or a misunderstanding of tax regulations, it may be the small details that determine whether the court classifies such conduct as negligent or intentional. The complainant in the case currently under review found himself in a similar situation. The case involved VAT evasion amounting to millions of crowns. The Constitutional Court ruled in the case that ignorance of tax regulations or their alleged imperfections cannot lead to the conclusion that there was no intentional conduct.

Facts of the case

In a recent ruling, the Constitutional Court considered a constitutional complaint filed by the managing director of a company who had been convicted of value-added tax evasion. The managing director filed a constitutional complaint against the Supreme Court's appellate ruling, in which he argued, among other things, that the lower courts had incorrectly assessed the issue of fault. However, the Constitutional Court did not agree with his arguments and dismissed the complaint as manifestly unfounded.

The essence of the conduct under review was that the managing director failed to report taxable transactions in the form of sales of residential units under construction and the contribution of residential units to the registered capital in the value-added tax returns. According to the lower courts, this resulted in him evading more than 2.7 million crowns in VAT. The District Court in Mělník found him guilty of tax evasion and sentenced him to a suspended prison term. The Regional Court and the Supreme Court subsequently rejected his appeal and petition for review.

One of the main lines of argument that the managing director advanced in proceedings before the general courts concerned a legal error caused by ignorance of tax regulations. The purpose of this argument was to rule out the intentional nature of the managing director's conduct and, consequently, his criminal liability. This is because criminal liability for the offense of tax evasion requires intentional fault.

During the proceedings, the managing director emphasized that he did not understand tax issues himself and had acted in good faith in the transactions based on the recommendations of unspecified individuals whom he regarded as experts (lawyers, tax advisors, accountants, bank employees), describing the situation as one of interpretive uncertainty, particularly given the then-current form of VAT legislation and the lack of an authoritative interpretation. In retrospect, he pointed to his own understanding of the exemption under the "time test," which he erroneously applied to the area of VAT as well, and wrongly concluded that a similar regime should also apply to non-monetary contributions to share capital. At the same time, he argued that the courts had overlooked or underestimated witness testimony supporting the claim that "it did not occur to anyone that the transactions should be subject to VAT," and that therefore intent had not been proven either.

View of the courts

However, according to the Constitutional Court, the general courts correctly rejected this argument. Regarding the objection of lack of knowledge of tax matters, they stated that if the managing director did not understand the tax regulations, nothing prevented him from contacting the relevant tax administrator and requesting an opinion on the matter or at least consulting an expert on tax matters in advance. However, he did not do so of his own volition and apparently intentionally.

In resolving the objection regarding interpretive uncertainties, the general courts pointed out that the taxable transactions not included by the complainant were ordinary transactions subject to VAT, and they assessed the alleged misunderstanding of tax regulations as a self-serving claim, given the failure to consult with professionals or directly with the tax administrator.

The Constitutional Court's decision draws a line between a mere error in a tax matter and conduct relevant under criminal law: in criminal law, intent is not limited solely to situations where the perpetrator expressly "wanted" to evade tax, but may also be inferred if the perpetrator was aware of the risk of an incorrect tax procedure and accepted that risk (typically in the form of indirect intent). In the case at hand, the courts concluded that alleged ignorance of tax rules cannot in itself lead to the conclusion that there was no intent, particularly if the defendant realistically had an opportunity to verify the disputed issues.

Ignorance of the law is no excuse

From a practical standpoint, the conclusions of the ruling can be interpreted as confirming the general principle that "ignorance of the law is no excuse." This principle is reflected here in the assessment of culpability: if the person responsible for tax matters encounters uncertainty or ambiguity, one cannot automatically assume that a subsequent claim of error will automatically rule out intent. On the contrary, the courts attach importance to whether the taxpayer or statutory body utilized available options for expert consultation (internally, with an advisor, or with the tax administrator) and whether they acted prudently in managing tax risk.

If the person responsible for tax matters encounters uncertainty or ambiguity, one cannot simply assume that a subsequent claim of error will automatically rule out intent.

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