Tax and Legal News

December 2025

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Welcome to the Christmas edition of Tax and Legal News – here's what you will find in it

How was it and how will it be? – In our editorial, we traditionally try to take stock and outline the prospects for 2026.

OECD update and home office – The OECD published an update to the OECD Model Tax Convention and Commentary. The most interesting changes concern the issue of establishing a permanent establishment through home office activities. However, the Czech Republic sees things differently.

When does bearing costs (not) constitute the provision of goods or services for VAT purposes? – We provide more detailed considerations, among other things, on the boundary between necessary cooperation and suuply provided in one's own name on the account of another person.

New EU regulations for the digital world – The European Commission has presented a package of measures known as the Digital Omnibus. We summarize the most important aspects of the biggest reorganization of EU digital regulation since the adoption of the GDPR.

Start-up losses and transfer pricing – We have another interesting decision on the subject of "orders" from a parent company and the lack of compensation for "start-up" losses. In our opinion, the Supreme Administrative Court logically rejects a regional court conclusion that was favorable to the taxpayer.

Invoicing of partners and independent contractors – We bring you details of an interesting decision by the Supreme Administrative Court on the boundaries between when company partners perform dependent work and when they provide services to the company as part of self-employment.

What else has caught our attention?

- ***Will there be a new Accounting Act and a related amendment to the Income Tax Act?*** – The outgoing government approved a draft of a new Accounting Act and related implementing amendments. This is potentially the biggest change in accounting and taxation in the last twenty years. The question is how the incoming government will respond to this.
- ***Are we in for a surprise with Pillar 2?*** – The Chamber of Tax Advisors requests a form for the GIR. The Ministry politely refuses and cryptically hints at possible surprises.
- ***What might await us in taxes?*** – On the occasion of our 100th audio alert, we speculated a little about which tax areas might see changes in the coming years.
- ***A change in approach to the nature of income recognition?*** – The Supreme Administrative Court seems to be (finally) abandoning the "principle" that an increase in assets is a condition for the creation of income.
- ***What is the VAT regime for real estate transfers by developers?*** – The Dutch Supreme Court has asked the CJEU for a preliminary ruling on the VAT regime applicable to real estate transfers. The key question is whether the transfer of a newly built property leased by a developer is subject to VAT or whether it can be considered a transfer of a business.
- ***The Directive on Administrative Cooperation in the Field of Taxation (DAC) will be amended?*** – The European Commission is evaluating the functioning of DAC. Pressure can be expected to harmonize interpretations in individual member states and to effectively enforce/sanction or amend DAC6.
- ***Czech adaptation of AI regulation*** – Work is underway on a draft of the first Czech Act on Artificial Intelligence.
- ***A managing director cannot escape responsibility*** – The High Court confirmed that managing directors cannot avoid responsibility by leaving a company at a time of impending bankruptcy instead of resolving the situation.

Editorial

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What awaits us in 2026?

Another year has passed, and once again it's time for my Advent editorial. So, as per tradition, I will take stock and outline the prospects for 2026.

From the perspective of tax changes, election years are usually somewhat inconsequential, with only very cautious, technical, and, above all, non-controversial interventions being made. Alternatively, changes may be popular, but this is difficult in the area of taxation (even less sophisticated voters have already recognized the incompatibility of tax cuts and increased public spending). Or, on the contrary, it may be possible to slip in, or rather discreetly push through, some serious lobbying shrapnel.

The Czech Republic's unique exemption on securities sales, thanks to this inconspicuous amendment, has finally been resurrected, and the 40 million cap will be abolished in 2026.

On the other hand, the sale of cryptocurrencies after three years of ownership is exempted. So far, the limit is 40 million, but who knows how long this limitation will survive? After all, Czech crypto wallets are very well-stocked, and the Czech Republic is often referred to as a bitcoin superpower. The bizarreness of the situation is underscored by the fact that the outgoing government's consolidation package, in its extraordinary zeal to eliminate as many exceptions as possible, has eliminated the exemption of exchange rate differences for individuals. So we will tax speculation on exchange rate movements of traditional fiat currencies, but not adventures in crypto. It will be an adventure for taxpayers and the tax administration to prove that they have held a specific bitcoin for three years without interruption. (And I would like to remind you that the burden of proof lies with the taxpayer.)

Payroll accountants (and programmers of related software) will receive a wonderful gift in the form of a single monthly employer report. It should replace up to 25 different reports to various authorities. Health insurance companies are missing, which is a shame. But otherwise, after two decades, it's a nicely completed project.

The government currently being formed has already published its policy statement. It has committed not to raise any taxes. It even plans to reduce corporate income tax from the current 21% to 19%. It also talks about establishing a single collection point with the aim of merging the collection of taxes, social security, and health insurance. So even health insurance companies will hopefully be integrated.

Multinational companies should be required to submit advance transfer pricing documentation. That would be a really nice gift for Czech tax advisors.

Individuals will enjoy several tax breaks (school fees, discounts for spouses, working students, and higher discounts for individuals with four or more children). There are also promises of tax exemptions for voluntary tips for employees in the restaurant industry, aka America as our role model.

In the world of VAT, as tradition says catering services tax rates are to be modified. And there should be 0% VAT on prescription drugs (and the associated chaos with drugs that can also be bought over the counter). The recently introduced deadline for VAT refunds on unpaid invoices should be reduced to 3 months.

Last year, we waited in vain for accounting reform to appear under the Christmas tree. However, the current government finally managed to approve a draft of the new accounting law and accompanying regulations, including an amendment to the Income Tax Act, last week and send it out into the world. We will see how the new government deals with it. The current plan is to complete the legislative process in 2026, with a legislative recess in 2027 and a full launch in 2028. This is a big deal that we will be discussing throughout the year. We are already looking forward to it.

Finally, let me thank you for your support and cooperation. The entire tax and legal team wishes you all a wonderful holiday season and all the best for the new year!

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International taxation

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Home office and updating the OECD Model Tax Convention

The OECD has published a new updated OECD Model Tax Convention and Commentary.

Perhaps the most interesting changes are those concerning the establishment of a permanent establishment on the basis of activities carried out via a home office.

The Commentary introduces new criteria and circumstances that must be taken into account when assessing whether performing activities from a home office (or other location) leads to the creation of a permanent establishment of a foreign company. Below are some selected observations:

- What kind of place? New passages in the Commentary refer, for example, to a residence or other place such as a second home, vacation rental, friend's or relative's home, etc. We will continue to use the abbreviation "HO".
- Consistency? If the HO is used continuously for a longer period of time to perform activities related to business, this fact, together with other circumstances, may indicate that this place should be considered the place of business of a foreign company.
- Proportion of working time in an HO? The HO would generally not be considered the place of business of the company if the person worked from that location less than 50% of their total working hours for that company during any twelve-month period beginning or ending in a given fiscal year.
- What about at least 50%? If a person works from home for at least 50% of their total working hours, then whether the company has a place of business at that location is determined based on other facts and circumstances discussed below.
- Commercial reasons? An important consideration will be whether there is a commercial reason for the activities within the HO. Generally, this would be the case if the company has a reason for the person to be physically present in the other contracting state for the purpose of carrying out the company's activities, and the use of the HO facilitates the performance of those activities.
- Examples/circumstances of (non-)fulfillment of such commercial reasons:
  - YES – If the HO were not available, the company would use other premises in the country (e.g. a rented office).

- YES – If any of the following situations occur and this situation is enabled/facilitated by the person working from home (e.g. because the situation requires physical interaction in a given country or region):
  - meetings between the person and the company's customers;
  - acquiring a new customer base or identifying business opportunities;
  - identifying new suppliers, managing supplier relationships, or concluding, monitoring, or administering contractual agreements with suppliers;
  - real-time or near real-time interaction with customers or suppliers in different time zones (e.g. provision of call center services, virtual IT support, or healthcare services);
  - access to expertise relevant to business, such as regular meetings with university staff conducting research relevant to the company's business;
  - cooperation with other companies;
  - providing services to customers or clients located in that other state, if those services require the physical presence of employees or other personnel in that other state (e.g. training or repair services performed at the customer's premises);
  - interaction with employees and other personnel of the company or affiliated companies.
- NO – Short occasional visits to the customer's premises or interactions that are insignificant in the context of the overall business relationship with that customer.
- NO – If the company allows the person to work from home solely for the purpose of obtaining or retaining the services of that person.
- NO – If the company allows working from home solely for the purpose of reducing costs (e.g. reducing office space expenses).

Please note the Czech Republic's reservations

However, we understand from the Czech Republic's reservations that it generally disagrees with the application of these new criteria and instead intends to apply the existing general rules and principles.

In the context of discussions with representatives of the Czech Ministry of Finance on this topic, we interpret the Czech Republic's position as follows: provided that (i) the company's business activities are carried out from the given location, (ii) the criterion of sufficient permanence is met, (iii) and the activity is not of an ancillary nature, then the Czech Republic sees no convincing argument for distinguishing between the performance of the activity through HO vs through any other location, such as an office.

The OECD published a new update to the OECD Model Tax Convention and Commentary – including, among other things, regarding home office activities. However, the Czech Republic takes a different view.

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When does bearing costs (not) constitute the provision of goods or services for VAT purposes?

In practice, there are situations where an entrepreneur bears costs in their own name and for their own benefit, but the economic effect of these costs also benefits another person. If the entrepreneur demands remuneration for their actions, this will usually be considered a payment subject to VAT. If no remuneration is involved, the assessment may be more complicated. The Court of Justice of the European Union (CJEU) recently ruled on a case involving gratuitous conduct that benefited another person).

Case C-535/24, Svilosa AD

The Bulgarian company Svilosa AD, operating primarily as a holding company, provided a loan to a non-profit foundation for the purpose of organizing a charity concert to support children suffering from war. The loan amount was provided directly to individuals and companies that were to organize the concert. However, the event did not take place and the funds provided were not repaid. Svilosa therefore engaged the legal services of law firms in the US to recover the amounts owed to the foundation and, secondarily, to itself.

The Bulgarian tax authorities concluded that the legal services were provided for the benefit of the foundation. Although Svilosa paid for the services in its own name, it was the foundation that actually used them. The tax administrator therefore assessed Svilosa's actions as the provision of services free of charge for purposes unrelated to economic activity. From this, it assessed VAT together with interest on late payment.

Missing legal relationship and consideration

The CJEU rejected this conclusion. It stated that in order for an activity to be classified as the provision of a service for consideration, there must be a legal relationship between the provider and the recipient, and there must also be a direct link between the service provided and the consideration received.

In the case of Svilosa, it is undisputed that the company provided the foundation with a loan. On the other hand, Svilosa's actions to recover the amounts it paid out under this loan were not the subject

of any agreement or other legal relationship with the foundation and were not accompanied by any consideration or other form of consideration.

Connection with economic activity

According to the CJEU, Svilosa did not act for private purposes or for purposes unrelated to its economic activity. On the contrary, it took legal action to protect its own economic interests.

According to the CJEU, the costs incurred by Svilosa in order to recover a debt from its debtor in a situation where it acted without the debtor's instruction or authorization do not fall under the concept of the provision of services for consideration. Svilosa therefore did not perform a taxable supply for which it would be required to declare tax.

Questions surrounding the deduction entitlement

An interesting aspect of the Svilosa case is that it carried out holding activities – apparently as a so-called active holding company. It follows from established CJEU case law (e.g., C-60/90, Polysar) that a holding company that only holds shares and does not actively engage in economic activity (a so-called "pure holding company") is not entitled to deduct VAT. On the other hand, a holding company that actively intervenes in the management of its subsidiaries, e.g. by providing them with management and/or other services (a so-called "active holding company") – may claim a VAT deduction, but only to the extent that it is justified (e.g. C-16/00, Cibo Participations).

In addition, legal services were procured in connection with the enforcement of the loan granted. The granting of a loan is generally an activity exempt from VAT without the right to deduction. Logically, the question arises as to whether the costs of enforcing the loan do not constitute a cost directly related to the exempt supply made at the output, for which no deduction is possible.

In the Svilosa judgment, the CJEU did not address the issue of the right to deduction at all, even though it could have been relevant to the case.

A similar fate befell the recent judgment C-465/20, Högkullen. The CJEU similarly neglected the issue of the scope of VAT deduction for holding companies, even though the Advocate General specifically pointed out that full deduction may not be justified in this situation. The CJEU's reluctance to address the scope of deduction may indicate a lack of unanimity among CJEU judges on this issue. All we can do is wait for a preliminary question that the CJEU will have no choice but to address. We will see.

The line between cooperation and service provision

The Svilosa judgment supplements previous CJEU case law on expenditure incurred for the benefit of another person, but within the framework of one's own economic activity.

For example, in case C-475/23, Voestalpine Giesserei Linz GmbH, the company purchased a crane, which it provided free of charge to its subcontractor for the purpose of producing castings for it. The CJEU stated that if the cost incurred is directly related to a taxable supply or the economic activity of the business, it cannot be considered a provision of services for no consideration. However, the CJEU emphasized that the provision of the crane must be limited to what is necessary to ensure the processing of castings on behalf of the company. Such expenditure must be understood as part of the company's business, which does not constitute a separate service provided to another person.

These judgments show that it may not be decisive which other persons benefit from the expenditure incurred. What is decisive is whether the cost pursues the direct business interest of the payer who incurred the cost and at the same time does not go beyond what is necessary for that purpose. Under these conditions, the absorption of costs within the framework of one's own economic interest without recharging them does not lead to the provision of services for purposes unrelated to economic activity.

Conducting business in one's own name on account of another person

The opposite of these rulings is decision C-707/19, Amarasti Land Investment, where the CJEU concluded that acting in one's own name on account of another person entails an obligation to pay tax.

In the dispute in question, the purchaser of the land took the necessary steps at its own expense to survey the land and register the seller in the land register in order to fulfill the seller's legal obligation. The purchaser undertook to perform these acts at its

own expense. Logically, the agreed purchase price of the land did not include consideration for the supply relating to the land register.

Somewhat surprisingly, the CJEU concluded that the purchaser provided services in its own name on behalf of the seller – it acted as a commission agent for the seller's benefit. The commission agent structure creates a legal fiction of two identical supplies provided sequentially – the provision of services by specialized entities to the purchaser and, at the same time, by the purchaser to the seller. The fact that the costs were not recharged by the purchaser to the seller is irrelevant, according to the CJEU.

The line between necessary cooperation and supply provided in one's own name on behalf of another person may not always be clear. The Amarasti case shows that fulfilling a legal obligation on behalf of a contractual counterparty may constitute such conduct. The absence of explicit authorization or power of attorney from the counterparty need not preclude this conclusion.

Conclusion

It follows from CJEU case law that for a taxable transaction to arise, there must be a legal relationship and a mutual exchange of services between the provider and the recipient. The mere fact that a third party may benefit from the transaction is not sufficient. If the payer acts in its own economic interest and not on behalf of or for the account of another entity, this activity cannot be considered a supply of services for VAT purposes. However, in such cases, the provision free of charge must not exceed what is necessary for the purposes of carrying out one's own taxable supplies or economic activities. In order to determine the correct VAT regime, it is always necessary to thoroughly assess all relevant circumstances, especially in borderline cases.

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Digital Omnibus – new changes affecting the GDPR and AI Act

The European Commission has presented a package entitled An Agile Digital Rulebook for the EU, referred to as the Digital Omnibus. This is the biggest reorganization of EU digital regulation since the adoption of the GDPR. The package consists of two separate but interlinked regulations – the first proposal modernizes the EU's digital legislative framework (in particular the GDPR, ePrivacy, Data Act, NIS2, and rules for cloud services), and the second contains targeted changes to the AI Act.

The common goal is to eliminate overlaps between regulations, harmonize key definitions, reduce duplicate procedural obligations and lower the administrative burden on companies without weakening fundamental standards of privacy, security or responsible use of artificial intelligence.

AI Act

The proposal regulates several key obligations for artificial intelligence systems and makes their practical implementation more flexible. It expands the possibilities for using special categories of personal data in the development and testing of AI in order to better identify and eliminate discriminatory manifestations of algorithms, which will enable work with more accurate and representative data sets. At the same time, the obligation to implement binding internal *AI literacy* programs, which were intended to provide comprehensive training for employees on the use of AI systems, is being abolished, as they have proven to be administratively burdensome and ineffective in practice. The proposal also strengthens the possibilities for testing AI in regulatory sandboxes and, in selected cases, allows for controlled testing in real environments, which significantly expands the scope for verifying the quality and safety of systems before they are placed on the market.

New changes in European artificial intelligence regulations give companies more flexibility and time to prepare. Companies that develop or use AI will be able to work with sensitive data when testing models, which will help improve their accuracy and reduce the risk of bias. The removal of mandatory *AI literacy* training means less administration and more room to invest in what really matters—such as AI safety and governance. Enhanced sandbox testing will allow for faster verification of new technologies and timely detection of issues, which is crucial in areas with strict safety or ethical requirements.

Another new feature is the postponement of obligations for high-risk systems. These will only come into effect once the European Commission has prepared the necessary supporting materials, such as uniform standards or methodological guidelines. From that moment on, the deadlines will start to run – six months for some systems and twelve months for the riskiest ones. If the Commission does not issue a decision in time, the deadlines are December 2027 for one group of systems and August 2028 for the other. For companies, this means more time to prepare, faster innovation and less risk of regulatory conflict when implementing AI solutions.

It should be noted that the first draft implementation Act on Artificial Intelligence is already being prepared in the Czech Republic. A more detailed analysis of the new Czech draft can be found in our alert here. Although the Digital Omnibus proposal brings a number of simplifications, the overall agenda remains very challenging for companies, particularly given the convergence of European obligations and upcoming national regulations, which will require careful planning and alignment of internal processes.

GDPR

The proposal significantly revises the definition of personal data and shifts its focus to whether a specific controller is actually able to identify a person. In practice, this approach may broaden the scope of data that will no longer be considered personal, particularly in cases where data is pseudonymized or identification means are only available to third parties. The Digital Omnibus also allows the processing of personal data, including pseudonymized data, for the purposes of AI development and training on the basis of legitimate interest, provided that the controller ensures adequate technical and organizational measures.

Another significant change is the transfer of some rules from ePrivacy to the GDPR, which will mainly affect cookies and online identifiers: in certain situations, it should now be possible to rely on legitimate interest, the validity of user preferences will be extended and the consent management regime will be simplified.

The changes could significantly reduce the administrative and compliance burden for companies that work with large data sets or operate digital services. The new concept of personal data could enable more efficient use of data that has previously been regulated as personal, thereby opening up opportunities for safer anonymization or innovative use. A more relaxed cookie regime reduces dependence on constantly obtaining user consent and can improve the user experience without compromising privacy. For companies developing or training AI, it is essential to be able to rely on legitimate interest. This will enable more stable planning of data projects and reduce the barriers that have prevented work with valuable data sets. Harmonization of security incidents, in turn, brings greater legal certainty and reduces the risk of sanctions caused by different interpretation regimes. Overall, these are changes that enable more innovation while maintaining high standards of data protection.

European wallet

The proposal introduces a new framework for the European Business Wallet, a single digital wallet designed for secure verification of company identities, management of authorizations, and document sharing within the EU. The wallet is intended to build on the eIDAS rules and unify currently fragmented procedures so that companies can electronically prove their identity and legal status across Member States without having to use national or sector-specific systems.

For companies, the wallet can significantly simplify onboarding, cross-border transactions, electronic signing, and proof of authorization in regulated industries. It will enable faster and more secure digital interactions with authorities and business partners across the EU, reduce compliance costs, and eliminate the need to maintain multiple parallel identity systems. For multinational groups, this is a step that can significantly streamline internal processes and the provision of services to clients.

Cybersecurity

The proposal harmonizes the reporting of cyber and security incidents across the GDPR, NIS2, DORA, and other regulations. A single incident will typically meet the definition of an incident under various legal regulations—for example, a personal data breach under GDPR may also constitute a cybersecurity incident under NIS2. It establishes a single point of contact for reporting and standardizes the content and structure of notifications so that companies do not have to comply with different requirements of different regulatory regimes in parallel. At the same time, it regulates selected obligations for digital service and cloud solution providers in order to eliminate existing conflicts between data, security and sectoral standards.

A unified incident reporting regime reduces administrative burdens and limits the risk of errors in crisis situations. Companies will benefit from clearer processes, less duplication and better coordination between security and data teams. For companies with strong online or cloud infrastructure, this means smoother operations, faster incident response and greater legal certainty in meeting regulatory obligations.

The European Commission has presented a new Digital Omnibus package that harmonizes digital regulation, reduces administrative burdens and modernizes rules for data, personal data and AI.

Digital Omnibus schedule

The Digital Omnibus was published in November 2025 and is now entering the standard legislative process. Intensive negotiations between the Commission, the European Parliament and the Council are expected, with Member States' positions already differing significantly. If the proposal is adopted as drafted, the individual changes will be implemented gradually, and their effectiveness will depend on the availability of harmonized technical standards and related implementing documentation. This means that the first parts of the package may come into effect as early as 2027–2028, while the rest will be implemented depending on the readiness of individual areas of digital regulation.

It is therefore essential for companies to continuously monitor legislative developments and assess in advance the impact on processes related to data, cybersecurity and the use of artificial intelligence. Although the Digital Omnibus aims to simplify and harmonize, in practice it may require adjustments to internal guidelines, documentation and governance. Timely planning will therefore be key to a smooth transition to the new regulatory framework.

Case law

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The Supreme Administrative Court ruled on a tax loss caused by an order from a parent company

In a recent ruling, the Supreme Administrative Court ("SAC") addressed the question of whether the costs of launching new production incurred on the basis of instructions from a parent company should be compensated in accordance with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Guidelines") and the provisions of § 23(7) of the Income Tax Act.

Background

- In 2012/2013, a Czech company (the "Company") was a member of an international Japanese group and its main activity was the manufacture of LCD televisions.
- In 2012, its parent company decided that the Company would switch from manufacturing televisions to manufacturing components for the automotive industry.
- This change resulted in high costs for the Company, which led to a tax loss in 2012/2013. The tax administrator did not recognize this loss, arguing that the parent should have compensated the Czech Company for these costs.

View of the tax administrator

- The tax administrator assessed that the Company is a manufacturer with limited functions and risks, which should not bear the costs of starting new production, as it did not have the opportunity to make a decision on this change.
- The tax administrator took the view that even an instruction from the parent company (i.e. a decision to change production) without a formal contract constitutes a transaction between related parties that is subject to the arm's length principle.
- According to the tax administrator, an independent company would not agree to similar conditions (incurring high costs without compensation) and would demand either direct compensation or other guarantees of return on investment.

- The tax administrator therefore reduced the deductible tax loss and imposed additional tax on the Company because the conditions between related parties did not correspond to the conditions between independent entities in accordance with § 23(7) of the Income Tax Act and other relevant regulations.

Opinion of the Company

- The Company argued that the costs of starting production were incurred in accordance with the parent company's decision and that there were no intra-group transactions during the period in question that could be subject to transfer pricing arrangements.
- The Company argued that this was normal business management, not a contractual obligation, and that the costs of starting up production are a normal part of business that can lead to a tax loss.
- The Company emphasized that in future the loss would be offset by profits from product sales and that there was no reason for the parent company to compensate these costs directly.

What does the Regional Court say?

- The Regional Court in Ústí nad Labem ("RC") ruled in favor of the Company and overturned the tax administrator's decision.
- The RC supported the Company's argument that it was not possible to identify a commercial or financial relationship and that this was merely a matter of the Company's normal business management. According to the RC, § 23(7) of the Income Tax Act, which according to the RC applies to contractual obligations and not to business management as such, did not apply to the situation under consideration.
- The RC also agreed that the Company's loss should be compensated from the Company's future sales.

Verdict of the SAC

- The SAC overturned the judgment of the RC and referred the case back for further proceedings.
- The SAC confirmed the tax administrator's conclusions that even an informal instruction from a parent company may constitute a transaction between related parties in accordance with the OECD Guidelines. According to the SAC, the decisive factor is the actual economic relationship and its consequences, not just the legal form.
- The SAC also supported the view that a rationally economically minded independent enterprise would not agree to incur costs without any compensation.
- The SAC was of the opinion that the arm's length principle requires that, in a similar situation, the Company be provided with compensation or other consideration (e.g. guaranteed sales).

What to take away from this?

This ruling confirmed the existing trend in the perception of financial administration. A limited entity that does not have control over risks within the meaning of the OECD Directive should not bear the consequences associated with the materialization of these risks (i.e. it should not bear losses). The SAC's decision also suggests that the consequence of the parent company's order will be more important than the order itself when assessing similar cases.

In practice, it can be expected that tax authorities will increasingly focus on this issue. We would therefore recommend that Czech subsidiaries of multinational groups pay close attention to this area.

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Case law

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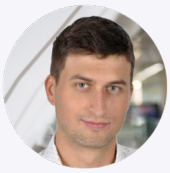

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The Supreme Administrative Court on the assessment of partner income for performing activities for a company

In this article, we will look at the decision of the Supreme Administrative Court ("SAC") in the matter of assessing the activities of partners for a company in the context of taxation of income for services provided by them.

Subject of the dispute

The substantive issue in the dispute was whether the income of natural persons for services provided to a limited liability company in which they are also partners constituted income from self-employment or from dependent activity.

The partners performed project and engineering activities for the company as part of general supplies for investors. The partners considered this income to be income from independent activity pursuant to § 7 of the Income Tax Act, while the tax administrator classified this activity as dependent activity taxable pursuant to § 6(1)(b)(2) of the Income Tax Act. The Regional Court upheld the tax administrator's decision. The company filed a cassation complaint, which the Supreme Administrative Court found to be unfounded.

Company arguments

The company disagreed with the conclusion that the activities of its partners were dependent activities (§ 6 of the Income Tax Act) rather than independent gainful activities (§ 7 of the Income Tax Act). In its argumentation, it relied in particular on the fact that the partners performed services as independent subcontractors of "above-standard services" that did not overlap with the company's normal project activities and for which no authorization from the company was required.

It also pointed out that the partners worked without instructions or supervision, were solely responsible for their work and had a small share in the company (10%). It also claimed that the partners performed similar activities for other entities and that they performed their activities for the company independently and autonomously. If these partners did not perform this activity for the company, it would have to hire an external subcontractor with similar qualifications. The performance of the partners' activities was not subject to the instructions of the company itself and did not involve the fulfillment of the normal role of a partner or dependent work. According to the company, all of this supported the conclusion that the relationship was of a supplier-customer nature, which can be classified as income under § 7.

View of the SAC

The main factor in assessing this issue was examining the very nature of the partner's activity, whether it was of a working for the company nature, i.e. similar in nature to what an employee would do if employed by the company for the purpose of carrying out the company's business (or other) activities. In current legal practice, this is a significant indicator (albeit not binding and not the only one) of whether a partner's income constitutes income from dependent activity pursuant to § 6 or not.

The SAC stated that the activities of the partners were closely linked to the company's business, both economically and substantively, and therefore constituted participation in its actual operation rather than the pursuit of their own business activities. It further concluded that the partners were key to obtaining contracts and that the level of invoicing (99.4% and 78% of the partners' total income for the given tax period) clearly demonstrated a corporate legal relationship. The activities of the partners were closely related, followed on from each other and were in fact identical to the activities of the company. The company therefore incorrectly classified the income paid to the partners as income from dependent activities.

According to the SAC, the tax administrator and the regional court also correctly took into account that the business activities and trade licenses of the partners are identical to the business activities and trade license of the company, i.e. project activities in construction and manufacturing, trade and services. The SAC also found that the partners provided similar services to other entities only to a minimal extent and that the income from the company was their main source of income within their business activities.

In most of its points in this judgment, the SAC quite clearly rejected the company's arguments and ruled in favor of the tax administrator and the regional court. However, it added that in certain situations, the income of partners for the company could be assessed and taxed under § 7:

"On the contrary, the partner's income from the company, which is paid to the partner for something other than the personal performance of the aforementioned activities, in particular for services that the partner would provide to the company under essentially the same conditions even if he were not a partner, shall not be subject to the aforementioned taxation regime. A significant indicator will be whether the partner also provides services to other persons under similar conditions as part of his or her independent gainful activity. It is quite conceivable and often occurs in practice that a natural person is a partner in a certain company and also runs a business as a self-employed person. There is nothing to prevent them from performing activities for the company of which they are a partner on the basis of their corporate legal relationship with the company, and these activities are then taxed in accordance with § 6(1)(b) of the Income Tax Act. At the same time, however, in another dimension of their economic existence, they may also establish a classic supplier-customer relationship with the same company, in which the corporate legal relationship with the company will not play a decisive role. In that case, there is no reason to subject the income from such a relationship to taxation under the above provision. It will always depend on the assessment of the specific situation and on what prevails when all the decisive criteria are taken into account – whether it is a corporate-law relationship or a supplier-customer relationship. If the latter prevails, it is not appropriate to subject the income from it to taxation under § 6(1)(b) of the Income Tax Act."

What to take away from this?

The SAC's decision in this case is not surprising and confirms consistent practice in assessing this issue. In summary, it can be said that the greater the degree of similarity between the services provided by the partners and the company's own activities, the more likely it is that the partner is performing dependent work for the company, which should be taxed under § 6 of the Income Tax Act. On the other hand, the SAC explicitly states that there may be a type of activity performed by a partner for the company that does not meet these criteria, in which case it is appropriate to tax this income under § 7 of the Income Tax Act.

In this regard, according to the SAC, the tax administrator and the regional court also correctly took into account that the business activities and trade licenses of the partners are identical to the business activities and trade license of the company, i.e. project activities in construction and manufacturing, trade and services. The SAC also found that the partners provided similar services to other entities only to a minimal extent and that the income from the company was their main source of income within their business activities.

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