

Tax and Legal News

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Actionable? Of course!

For this March editorial, I did not choose to comment on new Czech or European legislation. Rather, I was keen to look at a topic I have been thinking about for some time. I have always enjoyed reading about bizarre lawsuits, i.e. court cases where sometimes even the lawyers themselves are amazed that such a life story can be made the subject of a lawsuit where the plaintiff often succeeds.

The fact that I would somehow be affected by the legal profession may have first occurred to me around 1994 or 1995, when I first saw the great movie Philadelphia with Tom Hanks and Denzel Washington. Although the film's strong story is depicted in many great scenes (especially in the courtroom), what I remember most from is the opening scene in which Denzel Washington is introduced as a great attorney. He discusses his case with a potential client: "So, the whole street is clear except for one small, undeveloped part, this huge hole that is clearly marked and demarcated. And you decide that you have to cross the street at that spot, no other spot. You fall into that hole and now you want to sue the city for negligence, right?" The client responds: "Yes, can we sue them?" The lawyer smiles and says "Yes, of course we can sue them." You may be thinking this is absurd, and only happened to suit the script. But let's take a look at a couple of cases that were actually tried in a courtroom.

Perhaps the most famous case of this kind is the lawsuit brought by a careless McDonald's customer. After the quote from the American film, it will come as no surprise that we are once again looking at

the USA. In 1992, in Albuquerque, New Mexico, 79-year-old Stella Liebeck decided to stop at a McDonald's drive-through to buy a coffee. But when she tried to take the lid off the cup to sweeten her drink, she spilled the hot coffee into her lap. The result? Burns to her thighs and groin that required eight days in the hospital and two years of treatment. Liebeck decided to sue McDonald's because she claimed the coffee was too hot to sell to people. And the result of the lawsuit? The persistent customer ultimately settled for nearly 115 million crowns at today's exchange rate.

This case has become a symbol of the absurdity of some lawsuits and has sparked a debate about corporate liability and product safety. Many have wondered how it is possible for someone to sue for burns caused by their own clumsiness. Probably since then (if not before), US companies in particular have added often absurd warnings to their consumer instructions. A well-known legend is the warning by the manufacturer of a microwave oven that it should not be used to dry wet cats, though as far as I know, this is fiction and no such dispute has been brought to court in the US.

Another example that illustrates how a joke can sometimes have severe consequences is the case of Cathy McGowan in 1999. This American woman decided to call in to a Radio Buxton competition where the prize was a Renault Clio. When Cathy answered correctly, she was excited to drive away in her new car. But... the contest was a joke and the station staff only gave her a small model car. Plus, they reportedly commented that she must be stupid if she thought she was getting a real vehicle. Cathy refused to accept this treatment and took the case to court, which agreed that size really does matter. The station had to pay the woman almost a million crowns - and went bankrupt.

These were historical, well-known cases, so let's see if the issue of bizarre lawsuits has moved on since the 1990s. In 2017, a man asked a woman out on a date to the movies to see Guardians of the Galaxy Part 2. Unfortunately, the woman was apparently more preoccupied with her phone than the film, which offended the man so much that he filed a lawsuit against her. He claimed the woman had broken the rules of movie-going and disrupted his cinematic experience. Eventually, the woman agreed to pay him 17 dollars per ticket, and the man dropped the suit.

When it comes to advertising, who doesn't know the famous corporate slogan "Redbull gives you wings"? In 2016, however, a group of customers decided to take it literally and filed a class action suit against the company for false advertising. They said that after drinking Redbull, they definitely didn't feel like superheroes who could fly. Redbull eventually agreed to an out-of-court settlement, paying out 640,000 dollars.

To take our story beyond the US, we'll use a story from China in 2012, when a man named Jian Feng sued his wife for giving birth to an "incredibly ugly" baby. After a DNA test, it turned out that he was indeed the father, and his wife admitted that she had undergone a number of plastic surgeries. Feng then sued her for misleading him by not disclosing her actual face. His wife had to pay him more than 120,000 dollars.

Marital relationships are, by the way, a fertile area for bizarre lawsuits. A cheated wife, for example, decided to sue her unfaithful husband for €19,621.67 in psychological damages. Her reasoning? The insomnia, headaches and depression that infidelity caused her. However, the court ruled that while marriage is about fidelity, the mental health of the other spouse is not within the court's

competence. On the other hand, compensation for property damage is undoubtedly within the court's power, as recently confirmed by the Massachusetts Supreme Court, which ruled that an engagement ring must be returned to the giver if the wedding does not take place. So, if you, dear readers, are planning an engagement, be sure to be clear about what happens to the ring if things don't go according to plan. Whether you decide to say "yes" or "no," at least you'll avoid a lawsuit, which in this particular case was for 70,000 dollars.

I will be glad if I have managed to entertain you with this excursion into the world of bizarre litigation and take your mind off your everyday worries for a while. And though it is already March, I would like to take this opportunity to wish all our readers a lawsuit-free 2025.

Let's look at a selection of lawsuits where readers are likely to be amazed that such stories and situations can be the subject of litigation.

Pillar 2



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Observations/rules on the practical application of the transitional safe harbour

In this issue, we bring you 15 selected basic simplified observations/rules on the practical application of the transitional safe harbour rules:

1. *Why do it?*: they are simpler than the full rules and may even save a possible top-up tax.
2. *Basic tests*: de minimis test, simplified effective tax rate test, routine profit test.
3. *Period of application*: for the period starting no later than 31 December 2026.
4. *Qualified Country-by-Country Report (CbCR)*: generally based on data from a consolidation package or standalone financial statements + generally consistent accounting standard and source type within a jurisdiction.
5. *Purchase price allocation (PPA)*: in certain circumstances, it is necessary to adjust the data of the PPA effect.
6. *Joint ventures*: may qualify (even if not in CbCR), but must be calculated separately.
7. *Transparent entity*: can effectively qualify by "reallocating" profits to a permanent establishment or to the owner.
8. *Loss-making jurisdiction*: generally meets the routine profit test.
9. *Transition from CbCR safe harbour to full rules*: CbCR safe harbour postpones/extends application of special transitional rules.
10. *Once out, always out*: if I don't meet safe harbour once, I generally won't again next year.
11. *Attention to data adjustments*: only those adjustments to financial data that are specifically required by commentary/guidance.
12. *Special rules for permanent establishments*: e.g. necessary adjustment of head office in situation of loss of permanent establishment + no "reallocation" of tax to permanent establishment from head office.
13. *Hybrid arbitrage arrangement*: may impact, for example, a loan from a foreign related company that utilizes a loss against interest income that it would not otherwise have used.
14. *Consolidation adjustments*: beware of taking into account consolidation adjustments where figures are based on the consolidation reporting package.

15. *Tax accrual*: differences in the tax accrual compared to the final tax may affect the effective tax rate in subsequent years.

If you have any questions, please contact the author of the article or your usual EY team.



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The Supreme Court has addressed service of process on a board member who is on an agreed "leave of absence"

Last summer, the Supreme Court issued a judgment in which it dealt with the context of termination of a member of the Board of Directors of a Czech joint-stock company. The former member of the Board of Directors sought payment of the severance pay agreed under his contract of office from the company.

Background

As a detail, the plaintiff had served in his position at the company since 2012, last being elected to a two-year term in January 2020. His contract of office contained a clause according to which *if the company notifies a member of the Board of Directors not later than two months before the expiry of their term of office that they will not be elected for another term of office, the member of the Board of Directors shall be entitled to a one-off compensation in the amount of six times the basic remuneration for the performance of their duties. In the event that such notification is not made in a due and timely manner and the term of office of the member of the Board of Directors expires, they shall be entitled to a one-time compensation in the amount of eight times the basic remuneration.* However, the contract did not provide for the specific form of delivery of this notice.

The Company sent the aforementioned notice to the Board of Directors member at his work e-mail address on 29 October 2021. The same notice was also delivered to the Board of Directors member in the same manner on 1 November 2021. At the same time, the notice, signed by two other members of the Board of Directors, was also sent to the given Board of Directors member by post.

The Company subsequently paid the outgoing Board of Directors member an agreed severance payment of six times his base salary. However, the board member disputed the timeliness of the service of the notice under the terms of the service agreement and claimed the additional severance payment. He also argued that he was not obliged to actively access his work e-mail account or to perform his duties as Board of Directors chair because he was on 'leave' from 29 October 2021 to 5 November 2021. Thus, the notice agreed above could not have been served on him at that time.

View of the Supreme Court

In deciding the case, the Supreme Court primarily relied on the statutory rule that a legal act is effective against an absent person from the moment the manifestation of intent reaches him or her. This rule has been interpreted and understood by court practice in such a way that it is necessary that the addressed legal act, or the expression of will expressed in it, comes into the sphere of the addressee's disposition. The phrase 'comes into the sphere of disposition' must be understood as meaning the specific possibility for the absent person to become acquainted with the legal proceedings addressed to them. It is not necessary that the addressee actually be acquainted with the content of the act; it is sufficient that they had an objective opportunity to do so.

Legal acts (for which the law does not provide for a special form) can be delivered to the addressee by post, by personal delivery, but also, for example, by 'ordinary' e-mail, though such a form of delivery carries a number of risks (especially in the absence of legal regulation of the quality of delivery in this way). The Supreme Court has clarified, in accordance with the conclusions of the commentary literature, that if a legal act is to reach the addressee's sphere of disposition, it must be obvious that the addressee normally uses the e-mail box, or has invited the sender to use the e-mail address, and it must be undoubted that the e-mail has been lodged in the addressee's e-mail box. Any defects in the delivery in this way would be attributed to the sender, i.e. the sender would have to prove that lodgement in the e-mail box actually took place.

In this case, the company delivered the notice of the non-re-election to the board member's work e-mail account, which, importantly, he routinely used. It was undisputed between the parties that both e-mails were placed in that mailbox on the dates referred to above. Thus, the Supreme Court concluded that the delivery to the work e-mail put the notice in the board member's disposition as early as the end of October. The board member could have been made aware of the notice by simply opening his e-mail inbox.

The Supreme Court did not fail to address the board member's argument regarding the use of "leave." Consistent with settled case law and doctrine, it concluded that taking "leave," however contractually agreed, does not constitute an objective impediment to the board member's ability to check their work e-mail and read the notice

served. The Supreme Court stressed that *a person called to serve as a member of a corporate body is a member of the body for the entire period from the creation of the office until its termination, "24/7", so to speak*. This applies irrespective of any provisions in the performance contract, which in practice are usually based on employment law rules.

What's the takeaway?

Two key lessons for practice follow from the conclusions of this judgment. First, if a person is to perform the function of a member of an elected body of a business corporation (e.g. as an executive officer, member of the Board of Directors or Supervisory Board) with due care, they are obliged to perform it continuously. Thus, unlike employees, they must perform their duties, if necessary, even during an agreed "leave of absence" that may arise from the service contract. As a detail, the decision implies an obligation to check e-mail regularly, in particular for persons serving on elected bodies.

Secondly, the contract of office between a member of an elected body and the company should always precisely, specifically and unambiguously formulate mutual rights and obligations, including the rules of mutual communication and delivery of documents. If, in this case, the contract of office had more precisely formulated the form in which the notice to the director was to be served, the dispute might not have arisen at all.

If you have any questions about serving as a member of a board of directors or other elected body of a business corporation, or if you have any other questions that came to mind while reading this text, please contact the authors of this article or other members of EY Law or your usual EY team.

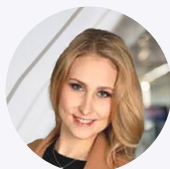
In its decision, the Supreme Court dealt with the moment when the expression of a company's will reaches a member of the Board of Directors and the performance of that board member's function while taking agreed leave.

Tax administration



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How can I increase my chances of getting a penalty waiver?

No mitigating circumstances can be taken into account by the tax authorities when assessing interest and penalties.

Interest on late payment of the tax arises regardless of whether the tax is assessed by the tax administrator, additionally declared by the taxpayer or whether the taxpayer is just late with payment. If the tax is assessed by the tax authority as part of a tax audit, a 20% penalty is typically applied in addition.

Both interest and penalties arise automatically directly from the law. However, in certain circumstances, they can be waived in full or in part.

New General Financial Directorate directive

The General Financial Directorate (GFD) issued updated guidance on the waiving of tax penalties (D-67).

Its content could be described, with a certain amount of simplification, as a tariff. It states, for example, that a "medical excuse" can lead to a 100% waiver. However, interest accrued on the basis of a voluntarily filed supplemental return deserves only 20% relief - in practice, this is probably the most common reason that tax authorities recognize for reducing interest.

However, there are also a number of caveats in the instruction that reduce the possibility of forgiveness. For example, a taxpayer who has submitted demonstrably altered or falsified documents completely loses the chance to have the penalty waived. A person who twice failed to respond in time to the tax administrator's summons during a tax audit reduces his or her chances by 30%.

On the one hand, this is a commendable effort to unify the decision-making of tax authorities in factually similar situations. On the other hand, unfortunately, this system quite often leads to officials making decisions exclusively according to a prescribed template and to a tendency to suppress consideration of individual circumstances, as the following cases illustrate.

Two similar cases, two different outcomes

Recently, the Supreme Administrative Court (SAC) decided two cases which at first glance appear to be quite similar, but whose outcomes fundamentally differ.

In the first case, the SAC sided with the payer who claimed a VAT deduction incorrectly indicated by the supplier on the invoices (it was a cross-border supply that should have been subject to the reverse charge regime). The SAC emphasized that the grounds for waiver asserted by the taxpayer cannot be rejected simply by stating that they are not mentioned in the instruction. It also stated that the purpose of interest on late payment is to compensate for the damage caused by the taxpayer's late or non-payment of his or her tax liability.

In the second judgment, the SAC ruled against the taxpayer, which incorrectly informed its suppliers that it was not subject to the reverse charge (it was a school). After discovering its mistake, it corrected and paid the VAT. It subsequently applied for a waiver of interest on the grounds that the State budget had not been deprived at any point. However, the tax office only waived 20% of the interest on the late payment, as instructed. The Regional Court and the SAC subsequently sided with the tax administrator.

SAC case law unequivocally confirms that the "tariff" specified in the GFD instruction is not final and the tax office is obliged to take into account other circumstances and justifications provided by the taxpayer. Indeed, the instruction itself cautiously allows for such a possibility.

What's the takeaway?

SAC case law unequivocally confirms that the "tariff" specified in the GFD instruction is not final and the tax office is obliged to take into account other circumstances and justifications provided by the taxpayer. Indeed, the instruction itself cautiously allows for such a possibility.

We therefore recommend that when preparing applications for waiver of interest on late payment and penalties, you carefully consider and formulate the facts that are in favour of the taxpayer.

In our experience, good quality argumentation is crucial to the success of an application. Also, the judgments cited above illustrate that even seemingly relatively similar situations can be assessed differently in the final analysis.

If you have any questions about the above topic, please contact the authors of the article or your usual EY team.

Judicial window



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Replacement of capital by debt for partners – view of the Municipal Court

In this issue, we bring you an interesting decision on the tax aspects of debt financing of dividend payments.

Background

- ▶ Due to the global economic crisis, a company (the "Company") did not pay dividends after 2008.
- ▶ However, in 2012 it was decided to pay a dividend.
- ▶ As the Company did not have sufficient financial resources at that time to finance its operational needs, investment plans and dividend payments, it used an issue of crown-denominated bonds (an increase in the bank's line of credit had been refused).
- ▶ The Company approached third parties with a bond subscription offer, which they refused, so the bonds were acquired by the Company's shareholders. Therefore, there was a set-off of the liability from the bond subscription against the claim from the declared dividend.
- ▶ The Company was of the opinion that its actions consisting in the declaration of the dividend, its financing through the issue of bonds and the implementation of related business plans were, in the long term, economically quite rational

actions guided by the objective of satisfying the shareholders' rights to a share of profits while ensuring the further operation and development of the Company.

- ▶ In contrast, the tax administrator didn't like it. According to the tax administrator, the overall sequence of actions of the parties involved and the circumstances surrounding them cannot lead to any other conclusion than that the transactions in question were carried out primarily to burden the Company with the interest costs associated with the bonds issued, thereby obtaining an undue advantage that the Company would not have been able to take advantage of under standard conditions, the predominant purpose of the issuance of the bonds being to obtain a tax advantage.

View of the Municipal Court

- ▶ The Municipal Court in Prague (MC) sided with the Company.

- ▶ To the MC, it seemed plausible that, after it became apparent that third parties were not interested in the bonds but they had already been issued, the shareholders decided to take an alternative course of action. The shareholders effectively agreed to keep the funds in question in the Company in return for interest, thereby ensuring its continued operation and growth.
- ▶ According to the MC, the chosen solution represented a compromise consisting in postponing the payment of dividends, but with the prospect of further profits through interest on the bonds. Moreover, the shareholders' position was strengthened, since instead of a promise of a future dividend they received an enforceable claim on the Company. As a result of this decision, the Company did not have to choose between the implementation of planned projects and the satisfaction of shareholders in the form of a dividend, but could instead realize both of these objectives.
- ▶ In effect, the deferral of dividend payments by the shareholders became basically an additional investment (they gave up dividend payments in favour of the Company, in which they had an interest), and from this point of view the interest on the bonds appears to be tax deductible according to the MC.
- ▶ The actual purpose of bonds in general is to bring into a corporation the funds of outside persons. In this case, given the regulation of joint stock companies, these persons outside the corporation are also to be considered, according to the MC, as shareholders. Although they did not invest new money in the Company, they decided to leave funds in the Company for further investment, which they could legitimately consider as theirs and which they could withdraw from the Company in the form of dividends.
- ▶ In this situation, the MC then concludes that the chosen strategy was a legitimate business practice.

What's the takeaway?

- ▶ Administrative courts have dealt with cases with similar features in the past.
- ▶ Recall, for example, a recent case (a subsidiary using cash-pooling financing from its parent, where the parent's partners decided to reduce the capital so that the parent no longer provided financing to

the subsidiary and this need was covered by bonds subscribed by the partners), where the courts did not demonstrate a willingness to view the individual parties "separately" and saw a somewhat similar situation as primarily artificially inducing the need to find another source of financing.

- ▶ Or the case concerning the push-down of acquisition debt from the upper echelons of a group, where the court hinted at the possibility of an adverse conclusion if the transaction in question had occurred similarly, except that it was financed by debt from a related party.
- ▶ In general terms, we welcome the MC's effort to look at the situation from a new perspective. We believe that a subsequent SAC decision may refine the boundaries at which a sad story breaks into a happy one for taxpayers.

If you have any questions, please contact the author of the article or your usual EY team.

According to the MC, the deferral of dividend payments by the shareholders in effect became another investment (they gave up dividend payments in favour of the Company, in which they had an interest), and from this point of view the interest on the bonds appeared to the Court to be tax deductible.

Judicial window



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Regional Court on the comparability of independent companies

In a recent judgment, the Brno Regional Court (RC) commented on a tax administrator assessment, where the core of the dispute was the question of the correctness of a comparative analysis.

Background

- ▶ A Czech company (the "Company") operated from 1 January 2013 to 31 December 2013 as a Company with a significantly limited functional and risk profile.
- ▶ The Company reported an accounting and tax loss for the period.
- ▶ The tax administrator assessed corporate income tax on the Company and cancelled the tax loss for the period from 1 January 2013 to 31 December 2013.

View of the tax administrator

- ▶ The tax administrator verified the comparative analysis submitted by the Company and assessed that the sample of comparable companies incorrectly included both dependent companies and otherwise non-comparable companies (e.g. operating in a different industry, producing different products, having a different functional and risk profile).

- ▶ In this respect, the tax administrator eliminated six companies and recalculated the arm's length range of the comparable companies' mark-ups on total costs and concluded that the minimum arms length mark-up was 1.54%.
- ▶ As the Company achieved a negative net mark-up on costs of -9.09%, the tax administrator issued an additional tax assessment.

Company view

- ▶ According to the Company, the tax administrator did not sufficiently prove the exclusion of individual companies from the sample of comparable companies (the Company disputed in particular the criterion of the share of intangible assets or the difference in the sector).
- ▶ The Company argued that the tax administrator's actions were contrary to the principle of legitimate expectations, as the companies that were excluded by the tax administrator as incomparable in the audit were, on the contrary, accepted in the binding assessment ruling issued in 2020.

What does the RC think?

The RC upheld the conclusions of the tax administrator and dismissed the Company's claim.

- ▶ Regarding the tax administrator's exclusion of the companies from the analysis, the RC stated that the tax administrator had comprehensively assessed the comparability of each of the excluded companies and, on the contrary, was of the opinion that the Company had only assessed the individual sub-aspects in isolation. The RC focused on eliminating two loss-making companies that were incomparable because they had different functional and risk profiles, operated in different markets, had a higher proportion of intangible assets to total assets and produced a broader portfolio of products. The RC found that the tax administrator had established their incomparability with sufficient reliability.
- ▶ The RC also supported the tax administrator's conclusion that the binding assessment ruling issued for the years 2020-2022 (and subsequently 2023-2025) did not create a legitimate expectation with respect to the historical year 2013, as it related, inter alia, to a different (significantly distant) period.

The subject matter of the dispute was not whether the agreed prices differed from the arm's length prices, but how much they differed and whether the tax administrator established the reference price in accordance with the law. The RC held that the tax administrator had comprehensively assessed the comparability of each of the excluded companies, had demonstrated their incomparability with sufficient reliability, and was of the view that the Company had only assessed each of the sub-aspects in isolation.

What's the takeaway?

From our point of view, it is interesting that the tax administrator went into detail on criteria such as (broad or specialised) sector or diversified product portfolio, which can be largely subjective. In practice, we often see that the tax administrator focuses and emphasises rather "quite obvious" criteria such as independence or a different functional and risk profile. Nonetheless, such an approach is no longer unique - Czech companies should therefore be cautious when preparing comparative analyses and should have thought through their transfer pricing settings, especially with regard to their functional and risk profile.

A cassation complaint has been lodged, so let's see how the Supreme Administrative Court eventually deals with the above.

If you have any questions, please contact the authors of the article or your usual EY team.

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Did you know:

- ▶ The General Financial Directorate has issued methodological guidelines on interest on incorrectly assessed tax? [↗](#)
- ▶ As of 1 January 2025, a VAT Act amendment came into force, which, among other things, introduces the obligation to repay the reclaimed tax deduction on unpaid liabilities? [↗](#)
- ▶ The European Commission has published its new plan to accelerate decarbonization and boost the competitiveness of European industry? [↗](#)
- ▶ There are interpretive uncertainties regarding the newly introduced tax exemption of income from the transfer of crypto-assets? [↗](#)
- ▶ The Senate approved rules to modify the taxation of Employee Stock Ownership Plans (ESOPs)? [↗](#)
- ▶ The Carbon Border Adjustment Mechanism (CBAM) is likely to face major changes? [↗](#)
- ▶ The Government approved the expansion of the "whitelist" to include Taiwan? [↗](#)