Tax and Legal News

November 2024

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A dignified farewell to the unlimited exemption for the sale of securities

At the end of the year, after about 30 years, the exemption for sales of securities without income limits will end. An individual who sold securities after the 3-year time test was met paid no income tax regardless of whether they sold for a million or a billion. From 1 January 2025, the annual exempt income will be limited to CZK 40 million. It is not for me to judge whether the test limitation is a good or bad decision. But the time test without a cap was unique in the global context.

The exemption limitation applies to newly acquired securities as well as those acquired before 31 December 2024. In an attempt at fairness, or perhaps out of concern for hypothetical retroactivity, the legislature granted security owners the option to apply the market price of the security as of 31 December 2024 to future sales (which are subject to the exemption provisions). This option applies to securities acquired by an individual before 31 December 2024. Any individual holding securities or an interest in a company with a value in excess of CZK 40 million should therefore consider whether they can demonstrate the market price on 31 December 2024.

This is probably easiest for securities traded on a regulated market (stock exchange). It can be a little harder for investment funds, for example, which generally inform investors at least once a year about the value of their securities. But it is questionable whether this will always be the right market price, e.g. in a situation where an investment fund has a redemption obligation but provides funds to the investor within two years, according to the statute.

The most complex will be determining the market price for non-traded securities. Typically, this will be a situation where an individual owns a joint stock company that they have built from scratch. An expert appraisal as of 31 December 2024 is an option. We just need to consider when to prepare the appraisal (in the spring of 2025 or perhaps in three years) and what form it will take (an expert appraisal with a stamp and an entry in the register of expert appraisals or just an expert appraisal without a stamp). Opinions vary in the market, but in general it can be difficult to go back to valuations over x number of years.

The market price as of 31 December 2024, which will be applied against the sale proceeds, is probably fixed, unchangeable and non-transferable. So watch out for conversions and dispositions of equity.

And what will life be like after the test? Individuals are generally taxed on funds received, not income booked. Therefore, even the CZK 40 million limitation is probably calculated on a cash basis. If an individual sells securities (shares in a joint-stock company) for CZK 117 million and the seller pays the purchase price in three annual instalments of CZK 39 million each, the annual CZK 40 million test is probably not exceeded in practical terms. However, the tax administrator may not always like this and in some situations may come up with an abuse of rights argument. And the ensuing litigation is a long slog with an uncertain outcome.

Even after 1 January 2025, the obligation to report exempt income above CZK 5 million per year remains in force.

From the perspective of the Czech tax regime, the above is a significant change. We consider the use of the option to determine the market price as of 31 December 2024 to be significant. The burden of proof is on the taxpayer. For reasons of legal certainty, we can only hope that the new set-up will last for at least another 30 years.

An individual who sold securities after the 3-year time test was met did not pay income tax regardless of whether they sold for CZK 1 million or CZK 1 billion. From 1 January 2025, the annual exempt income will be limited to CZK 40 million.

Accounting

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Substantive outline of the decree in connection with the new Accounting Act

On 1 November 2024, the Ministry of Finance published an updated working version of the new Accounting Act. Along with this version, more detailed theses of decrees were published, supplementing and clarifying individual points of law. Below are selected initial observations.

The big picture

In many cases, the substantive treatment refers to specific International Accounting Standards (IFRS) and the National Accounting Council (NAC).

The changes brought by the updated working version of the new Accounting Act and the related theses of the decrees are significant and, if approved, will have a major impact on accounting practice. The announced effective date is 2026, but it is questionable whether this is a realistic date. This overview is not a comprehensive list of all the changes, but focuses on some key aspects that will affect the accounting practices of most companies. It brings a major shift towards international reporting, but also raises a number of issues.

Different approach to reporting

From a formal point of view, the statements seem to abandon the concept of a standardised structure and the individual lines should now contain references to the details in the notes and an indication that it is a significant item. There will be a simplification of asset reporting, with the gross value of assets and adjustments no longer being shown. The issue of comparables will probably be addressed by the fully implemented National Accounting Council Interpretation I-30. Thus, gross value will not be apparent at a glance for assets, as it is now, and users will be referred only to supplementary information in the notes, which entities will disclose on a materiality basis. A structured form of supplementary information, as we know it for example from the Slovak environment, has not yet been considered in the substantive solution.

The interim financial statements will be implemented in accordance with the existing National Accounting Council Interpretation I-31. There will also be an incorporation of the accounting issue of the opening balance sheet from the Act on Conversions. The incorporation of the opening balance sheet into the Accounting Act can be seen as a logical step, as can the expected clarification of the disclosure of the opening balance sheet.

The theses of the decrees contain detailed offsetting principles and negative definitions of offsetting at the level of statements against offset, credit and discount accounting. The shift to reporting in accordance with international standards is the ability to recognize, on an offsetting basis, new items such as costs and revenues from the sale of fixed assets, interest income and expense, shortages and surpluses, and cost overcharges for entities whose principal activity is the sale of products, goods or services. The expanded offsetting reporting option does not imply offsetting in the accounting for individual entries and in the accounting systems as such, and companies should disclose significant gross values in the supplementary information in the notes. In practice, we see a tendency for offsetting to be reflected in the accounting itself.

The aspect of materiality

The new Accounting Act addresses the general definition of materiality of accounting information. Non-material assets, materials, additional (now technical) improvements and error corrections will be charged directly to the period's expenses. The small asset mix assumes a similar approach to that for accrued expenses. The definition of the materiality threshold and how it is determined is assumed for public sector entities. For the private sector, the methodology is not mentioned. Will it be possible to ensure that materiality thresholds are understandable and applicable to all entities? And how will this information be handled in tax audits?

Valuation at present value

In relation to the measurement of financial statement elements, present value measurement will be new for many entities (particularly medium and large entities). Present value will be used to measure long-term monetary debts, lease debts, long-term receivables and provisions.

Changes in established concepts

The well-established concepts of technical appreciation and valuation allowance are abandoned. They are newly defined as additional appreciation, subsequent depreciation and the thesis of the Decree modifies their presumed definition.

Incorporation of IFRS 16, IAS 16, IAS 38 and more

The substantive solution includes a detailed definition of intangible and tangible assets and leases. For intangible assets, there is a clearly defined link to IAS 38 for intangible assets created from internal and external sources. However, trademarks or customer lists will not be considered as intangible assets created internally. For tangible assets, there will be, among other things, a precise definition of spare parts which, depending on their economic use, will be tangible assets or inventory. The impact of the revaluation of tangible fixed assets to fair value will not be included in available equity. It will gradually become distributable at the same rate as the revalued asset is depreciated.

IFRS 16 will be mandatory for medium and large entities, micro and small entities can opt for voluntary application.

Changes in provisions, estimated items, subsidies and revenue recognition

For provisions, the definition will be refined in terms of the existence of a debt accompanied by uncertainty about the creditor or the maturity of the debt. Debts arising from consideration received shall be deemed certain unless the contrary is proved. There will probably also be a provision for refunds where there is a right of return. This provision will be charged directly against revenue. A new provision for liquidation will be recognised in relation to assets. This will be included in the value of the asset. Provisions in general, including the liquidation provision, are burdened with uncertainty about the related estimates, which will be of interest for the liquidation provision as it enters into the valuation of assets. How will this provision be affected by emerging ESG trends?

Certain receivables and debts of uncertain amount shall be referred to by the common names for receivables and debts, not as estimated items. Accruals will be reported separately within receivables and payables. Untaken leave will be reported as a debt to employees and its current nature as a provision is explicitly excluded.

The section dealing with revenue recognition will deal in more detail with previously unregulated situations where the total consideration is divided into individual revenues with different timing. Consideration is given to the option of accruing according to the fair value of the individual elements or measuring the main part of the performance at fair value and accruing the remaining performance according to the proportion of their fair value. The substantive solution also mentions the implementation of the percentage of completion method for the recognition of revenues and costs in connection with the progressive performance of contracts concluded with customers.

In the case of subsidies, as was evident from the already published theses of the Declarations, the reduction of acquisition costs is excluded and accrual is assumed according to the fulfilment of the conditions of the subsidy (or reduction of the value of subsidized assets for insignificant subsidies).

Derivatives

For derivatives and hedge accounting, a current solution is assumed. In this respect, we therefore do not see a shift towards the current treatment in IFRS.

Other

Other important areas where we expect to see changes include, for example, the (non-)revaluation aspect of conversions, the regime for non-cash capital distributions, the conditions for the voluntary use of IFRS and the parameters of penalties for offences.

Newly introduced principles often involve estimates that are inherently burdened with uncertainty and reliance on the principle of materiality. The statutory audit of financial statements should continue to be limited to medium and large entities and those that prepare consolidated financial statements. It will be interesting to see what other issues arise in relation to the further anticipated clarification, particularly in the context of the link to income tax legislation.

If you are interested in this area, please contact the author of the article or your usual EY team.

The changes brought by the updated working version of the amended Accounting Act and the related theses of the decrees are significant and, if approved, will have a major impact on the accounting practice of entrepreneurs. The announced effective date is 2026, but it is questionable whether this is a realistic date.

Pillar 2

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Another amendment to the so-called DAC Directive – this time concerning Pillar Two

European Commission (EC) published a proposed amendment to the Directive on administrative cooperation in the field of taxation (DAC) – see HERE.

This proposal provides the framework for the operational implementation of Article 44 (Filing obligations) of the Directive on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups (Pillar Two Directive).

The OECD has developed a standard template (GloBE Information Return or GIR – see details HERE) to be used by the entities to fulfil certain Pillar Two filing obligations. It contains the data points to be exchanged and explanatory guidance on its use. This DAC amendment proposal effectively transposes the GIR into EU law by making it the Top-up tax information return envisaged in Article 44 of the Pillar Two Directive.

This DAC amendment proposal also lays down a framework to facilitate the exchange of Top-up tax information return between Member States and, under certain conditions, enable groups to switch from local to central filing (i.e. filing by the UPE or a designated filing entity instead of filing by each constituent entity). This framework includes a "dissemination approach" to ensure that relevant jurisdictions receive the information they need, based on their role with regard to the group, in line with the OECD framework.

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

This draft DAC amendment also sets out a framework to facilitate the exchange of the GloBE Information Return between Member States and allows groups to switch from local to central submission in certain circumstances (i.e. submission by a UPE or designated filing entity instead of by each member entity).

Law and taxes

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The difficult life of senior executives – on the Supreme Court's ruling on tax and insurance payment

We have a very interesting (and a bit scary, as befits November) case on the subject of employee liability. The Supreme Court issued a ruling on 24 September 2024, Case No. 21 Cdo 2057/2023, after which senior employees, corporate lawyers and taxpayers, and employees in other responsible professions will not sleep well.

In short – do you have employees in your company who have authors' contracts in addition to employment contracts? Or do you have parallel work performance agreements or work activity agreements to your employment contracts? Do you have self-employed workers working for your company who could be assessed by the authorities as employees? In addition to regular employees, do you have other workers supplied under work contracts or similar contracts or other potentially illegal employees, including foreigners? Or do you have another practice set up in your company (outside the HR department) where you are not sure whether the tax administrator or other competent authority would not assess it as primarily aimed at reducing the tax or insurance burden or generally circumventing legal obligations?

Then it can be a problem, not only for the company itself, but also for the managers and other professional staff responsible for that area. The company may want to be compensated by them for the damage caused. And employees will not be protected from liability even if the practice in question has passed several inspections by the authorities in the past without missing a beat. Or if they took over the long-established practice of their predecessor.

What happened?

In 1999, the director of the National Theatre introduced a special system of remuneration for artists, after written consultation with the Ministry of Labour and Social Affairs, which was applied until 2013. As a rule, artists were employed on the basis of an employment contract. However, if it was necessary for them to perform additional artistic work beyond their working hours (after a predetermined number of performances per

month), they had, in addition to their employment contracts, authors' contracts under which they were paid remuneration for these additional performances. Remuneration paid on the basis of author's contracts was not taxed by the employer and social security and health insurance contributions were not applied. The actual activities carried out under employment contracts and authors' contracts were identical.

This system of performing artists' remuneration was subjected to direct audit by the Ministry of Culture in 2000 and public administration audit in 2006 and 2010. In 2009, neither the Prague Social Security Administration nor the General Health Insurance Institution found any errors in the audit of the employer's compliance with its insurance obligations. During audits in 2009 and 2012, the State Labour Inspection Office did not find any wrongdoing in the area of artists' remuneration. In 2009, the remuneration system described above was incorporated into the collective agreement.

In 2013, however, the new management of the National Theatre changed its previous approach and concluded that the method of remunerating artists constituted a circumvention of the Labour Code, according to which dependent work may only be performed in an employment relationship, a circumvention of the conditions and limits for overtime work and a violation of the Employment Act. It therefore took corrective action by making additional levies, including interest and penalties.

The additional payments were then assessed by the new management of the National Theatre as damage caused by negligent breach of duty in the negotiation of the collective agreement in 2009 by two employees, i.e. the then General Director of the National Theatre, who signed the collective agreement, and the Director of the Administrative and Legal Section, who helped prepare the agreement. The General Director took up his position in 2007. The Director of the Administrative and Legal Section had worked at the National Theatre as an attorney since 1997 and as Section Director since 2008.

The employees refused to pay the damages – with the quite understandable argumentation that the system of concluding contracts with artistic employees had already been introduced by the previous management, was not in violation of the legislation and, moreover, the regulation of this issue by the collective agreement was not illegal.

The National Theatre therefore filed a lawsuit in 2015, demanding damages of almost CZK 250,000 from the General Director and a little less than CZK 90,000 from the Administrative and Legal Director.

View of the Court of First Instance

The District Court for Prague 9 concluded that all the prerequisites for general liability of employees for damages against their employer had been met. It justified its conclusions as follows. Note that it set a very high standard for employees in positions of responsibility.

- Legal obligation / violation: Performers may not perform identical work for an employer for part of a month under an employment contract and part of a month under an authors' contract, because dependent work may be performed exclusively in an employment relationship. Under an authors' contract, artists would only be able to perform work that is different from that which they performed under an employment contract. The relevant provisions of the collective agreement were therefore contrary to both private law (the Labour Code) and public law (tax, social security and health insurance).

- Breach of duty in the case of the Administrative and Legal Director: Given the workload of the administrative and legal section she managed, it was the Administrative Director's duty to ensure that internal processes – including the procedure for remunerating artists – were in line with current legislation, as she had to keep abreast of the latest developments in legislation and case law. As an experienced lawyer, the Administrative and Legal Director had to be aware of the

legal definition of dependent work and the possible consequences of performing dependent work under a legal title other than employment.

- Breach of duty in the case of the General Director: According to the organizational regulations, the General Director was responsible from his position for ensuring that the processes within the National Theatre were legal and compliant. Ultimately, the responsibility cannot be attributed to the Administrative and Legal Director alone, as the Director had the ultimate responsibility for all internal processes from his position, and collective bargaining involved both.

- Incurrence of damage: As a result of the unlawful method of remuneration, the employer incurred damage as it had to pay the tax administrator the arrears of personal income tax from dependent activity, as well as interest on late payment of the given obligations and penalties for unpaid health insurance. The total amount of the damage was CZK 3.8 million.

- Causation: The Court of First Instance found a causal link between the breach of duty and the damage in the fact that the Administrative and Legal Director did not warn the employer of the illegality of the remuneration system at the time of negotiating the collective agreement or in the subsequent period when the illegal remuneration system was applied, and in the fact that the General Director approved the system.

- Culpability: The two senior employees concerned should and could have known that the scheme was unlawful. However, neither of them took any action against the system and the defective practice during their employment, nor took any legal or factual steps to stop the defective practice and thus prevent the damage from occurring – both of them also caused the continuation of the defective practice.

As there was no intentional fault, the limit of compensation under general liability for damages was four and a half times the average earnings of each employee. The amounts claimed did not exceed that limit.

View of the Court of Appeal

On appeal, the Municipal Court in Prague ruled in favour of the defendant employees. It agreed with the conclusions of the Court of First Instance that the National Theatre had suffered damage, that both directors had breached their duties and that there was a causal link. However, it concluded that there was no fault on the part of the defendant employees. According to the Court of Appeal, they need not and could not have known that they could cause damage to the National Theatre if they transferred the performers' remuneration system to the collective agreement and the employer continued to follow it.

The same system of remuneration for performers was introduced in 1999. The employer then saw the damage as the need to meet additional tax and insurance obligations. It is clear from the reports of the audits carried out between 2000 and 2010 that the auditing authorities found no fault with regard to the levy obligations, even though they were aware of the method of remunerating the employees in question. If the two directors were familiar with the results of these inspections, and if the Ministry of Culture as the founder had been familiar with the remuneration system since 2000 and the Ministry of Labour and Social Affairs had been consulted as well, without any reproach on their part with regard to the levy obligations, then the directors did not have to know, and in fact could not have known, according to the Court of Appeal, that the remuneration system for performers was defective in this respect.

The Court of Appeal reached this conclusion despite the fact that in 2008, employees were alerted to the issue of the use of the Copyright Act in employment contracts in a collective bargaining email. This report, however, did not explicitly warn of the illegality of the contemplated remuneration system; the person in question expressed satisfaction with the version of the collective agreement amendment and merely stated in passing that he did not find any copyright gameplay in the context of a proper employment contract.

The National Theatre subsequently defended itself by appealing.

View of the Supreme Court

The Supreme Court concluded that the appeal of the National Theatre was justified.

According to the Supreme Court, the National Theatre could provide its activities through performers employed either in an employment relationship or under civil law contracts. However, it is not possible for artists to perform the same activity for part of the month under an employment contract and part of the month under a contract under the Copyright Act, because if dependent work is performed, it can only be performed in an employment relationship under the Labour Code.

It is also interesting to note the broadly applicable conclusion of the Supreme Court, set out in the reasoning of the judgment, according to which if an employee cannot, under the Labour Code, perform in another employment relationship or under agreements on work performed outside the employment relationship with the same employer work that is of the same type, he cannot perform the same work of the same type in another relationship based on a civil law contract.

The Supreme Court then analysed the positions of the two employee defendants individually.

The Director of the Administrative and Legal Section was *"obliged by her position to make the correct legal interpretation and to recognize the risk to her employer posed by the combined method of compensating performers. Because she was an expert in the field of law and had worked as a lawyer at the National Theatre for a long time, she was in a position to correctly interpret the law."*

Even though the remuneration practice was long-standing and no misconduct was found by the auditing authorities, the Administrative and Legal Director should and could have (given her personal circumstances) drawn the attention of those who performed legal acts on behalf of the Company, i.e. the General Director. By taking this simple measure, she could have done her part in eliminating the risk to her employer. According to the Supreme Court, the Administrative Director was therefore guilty of wilful negligence.

The General Director was not a legal professional. In assessing fault, it is in his favour that he was not informed of the risk by the person who should have made the correct legal interpretation of the company, i.e. the Administrative and Legal Director. It is also significant that this was a long-standing practice, established by his predecessor as General Director, which was not challenged even in the course of inspections by the public authorities.

On the other hand, according to the Supreme Court, it cannot be overlooked that *"in terms of his personal circumstances, the [General] Director was an experienced executive. He must have been aware of a certain risk simply by virtue of the fact that the combined remuneration system was linked precisely to exceeding the limits of the Labour Code; even as a legal layman, he must have wondered what the meaning of those legal limits would be if they could easily be circumvented by other types of contract."* Indeed, it was proven in the proceedings that such a risk was recognizable even to legal laymen, as evidenced by the above-mentioned email. The Supreme Court therefore concluded that the General Director was also guilty of wilful negligence. However, the degree of fault of the General Director is lower and this must be reflected in the determination of the proportionate part of the damages.

What is the takeaway?

If, in your role as a senior employee, in-house lawyer or tax lawyer, HR manager or other position of responsibility, you see any practice in your company that seems suspicious at first (or second) glance, you must bring it to the attention of your employer. In writing. Consult with attorneys. You must not be swayed by assurances from colleagues or inspection or other bodies, or by the fact that *"this is how it's been done here for 10 years, so it can't be wrong"*. If you don't, a change in the company's management, for example, can be enough to put you "on the hook" for damages. And if you don't pay voluntarily, you can also be sued and pay the costs of the court proceedings - which, for the sake of illustration, the court of first instance calculated at almost CZK 430,000 in the case of the Administrative and Legal Director and at just under CZK 250,000 in the case of the General Director, i.e. in amounts considerably in excess of the amount of the damage itself. The limit of four and a half times the employee's average monthly earnings does not apply to the compensation of costs.

If you have any further questions, please contact the authors of this article or other members of EY Law or your usual EY team.

If, in your role as a senior employee, in-house lawyer or tax lawyer, HR manager or other position of responsibility, you see any practice in your company that seems suspicious at first (or second) glance, you must bring it to the attention of your employer.

VAT

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EU Council approves the "VAT in the Digital Age" (ViDA) package

The package includes three pieces of legislation - a directive, a regulation and an implementing regulation – which introduce several key changes:

Changes as of 2025

- Member States will be able to oblige domestic businesses to issue electronic invoices for domestic supplies of goods and services. They will also be able to lay down the conditions for introducing this obligation.

Changes as of 1 January 2027

- Electronic platforms that facilitate intra-EU supplies of goods to persons established outside the EU will be treated as 'deemed suppliers' in relation to all customers for whom the acquisition of goods from another Member State is not subject to VAT.
- The threshold for supplies of telecommunications, broadcasting and electronic services and for distance supplies of goods of EUR 10 000 applies only to distance sales of goods from the supplier's country of establishment.
- The One Stop Shop regime will be extended to the supply of gas, electricity, heat and cold to final consumers.
- The simplification rules for the transfer of goods under the call-off stock regime will be phased out. Transfers of goods made after 30 June 2028 will no longer be eligible for the warehouse regime. Goods placed in the warehouse regime before that date will be able to remain in the warehouse regime until 30 June 2029, at the latest.

Changes as of 1 July 2028

- The abolition of the warehouse regime will be compensated by the extension of the special One Stop Shop (OSS) regime to the movement of own goods between Member States.
- The One Stop Shop regime will be able to be used not only for distance sales of goods but also for the local supply of goods to consumers (B2C) within a Member State where the business is not established.

- The reverse charge regime is compulsorily applied in situations where the supplier is neither established nor identified for VAT purposes in the Member State where VAT is due, if the customer is already identified for VAT purposes in that State (now the so-called may provision). However, where neither the non-established supplier nor the recipient is registered, Member States will be able to require the recipient of the supply to identify himself for VAT purposes instead of the supplier, whether or not he is established in that Member State.

Changes as of 1 January 2030

- Platforms for sharing short-term accommodation and transport services will be considered as 'deemed suppliers'. They will be responsible for collecting and remitting VAT on behalf of their users unless the providers of these services are VAT registered or account for VAT themselves. Member States will be able to waive these rules in the case of providers qualifying for the small business VAT exemption, provided that this does not distort competition. Member States may further adjust the parameters for applying this exemption. Platforms will be able to collect and remit VAT on behalf of their users as from 1 July 2028, if they voluntarily opt for this practice.

Changes as of 1 July 2030

- Businesses will be required to issue electronic invoices for cross-border business-to-business transactions within the EU. These invoices will have to comply with the European e-invoicing standard, ensuring interoperability between Member States. Data from electronic invoices will be automatically transmitted to tax administrations via a new IT system, which will enable rapid analysis of suspicious activities and increase the control capabilities of tax administrations. For the same reason, the time limit for issuing an invoice will be reduced to 10 days after the taxable transaction has taken place. The summary report (EC Sales Lists) will be abolished.

Changes as of 1 January 2035

- Harmonisation of e-invoicing rules for domestic and intra-EU transactions.

The legislative proposal will now head to the European Parliament for re-approval, as the original text of the European Commission has been modified by compromises agreed at the ECOFIN meeting. The package will then be resubmitted to the Council for approval. Only then will it be published in the Official Journal and enter into force.

For businesses operating in the EU market, it will be crucial to understand the impact of these changes on their business, particularly in the areas of how VAT is applied, invoicing and reporting. For some businesses, the changes may help to reduce the number of VAT registrations in other EU Member States. For others, it may be more beneficial to maintain registrations in other Member States.

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

The EU Council approved the "VAT in the digital age" package on 5 November 2024 (ViDA), which introduces several key changes in the areas of e-invoicing, rules for the transfer of goods under the warehousing regime, the extension of the special scheme for One Stop Shops, the mandatory use of the reverse charge and new rules for platforms providing short-term accommodation and transport services.

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Reduction of the input VAT claimed for outstanding liabilities

In this issue, we look at a brand new obligation introduced by an amendment to the VAT Act, scheduled to take effect from 1 January 2025 (now approved by the Chamber of Deputies and heading to the Senate). This is the correction of a VAT deduction in the case of a receivable that is 6 months overdue. The provision will apply to payers who are in the position of the debtor in the relationship. The introduction of this rule is aimed at preventing the risk of non-payment of VAT to the state budget.

Reason for introduction

Currently, taxpayers are obliged to correct the VAT deduction in the case of bad debts if the taxpayer has learned or could have learned that the facts for correcting the tax base in the case of bad debts have occurred at the supplier according to § 46 of the VAT Act. Simply put, in a situation where they are already insolvent. In such a situation, they usually do not have sufficient funds to pay the tax and the state incurs losses. Therefore, the new obligation should also apply to claims where insolvency is still imminent.

The new regulation is in line with the case law of the CJEU. According to the judgment in Case C-335/19, E., paragraph 42, the correction on the part of the creditor and the debtor does not have to take place at the same time. Member States may require a reduction in the deduction for an overdue receivable where there is already a significant delay in payment before the creditor reduces the output VAT. Thus, before the debtor is so insolvent that the VAT will not be paid to the State.

New rules for reducing the VAT deduction

The subject of the adjustment of the tax deduction is to be those debts, from the debtor's point of view, which will not be paid in full by the end of the sixth month following the month in which the debt became payable. In such a case, the debtor will be obliged to reduce the input tax deduction already claimed in an amount corresponding to the unpaid part of his liability. The debtor must reduce the claim in the tax year in which the last day of the 6th month after the due date falls.

Taxpayers who do not pay their obligations on time will now have to track the due date of individual obligations for VAT purposes as well. Maturity has not yet been dealt with in the records for VAT purposes.

Subsequent increase in the VAT deduction

A new option will be introduced to subsequently increase the VAT deduction again in the event of payment of part or all of the liability.

This upward correction of the deduction is of course an option, not an obligation. It may be made by the taxpayer at the earliest in the tax year in which the reimbursement is made and at the latest by the end of the second year after the end of the tax year in which the reimbursement was made.

The amount of the adjustment shall again be calculated on the consideration provided. It follows that if the debtor pays the liability for the consideration received, which is more than 6 months overdue, gradually, e.g. in instalments, he will in fact only be entitled to the deduction as the instalments are paid.

In the case of quarterly taxpayers, a situation could arise where the conditions for both a reduction and a subsequent re-increase of the VAT deduction are met within the same tax year. In order to avoid situations where two deduction adjustments are made in one tax year with zero resulting impact on the tax liability, the obligation to adjust the deduction in this case does not arise at all.

Reverse Charge

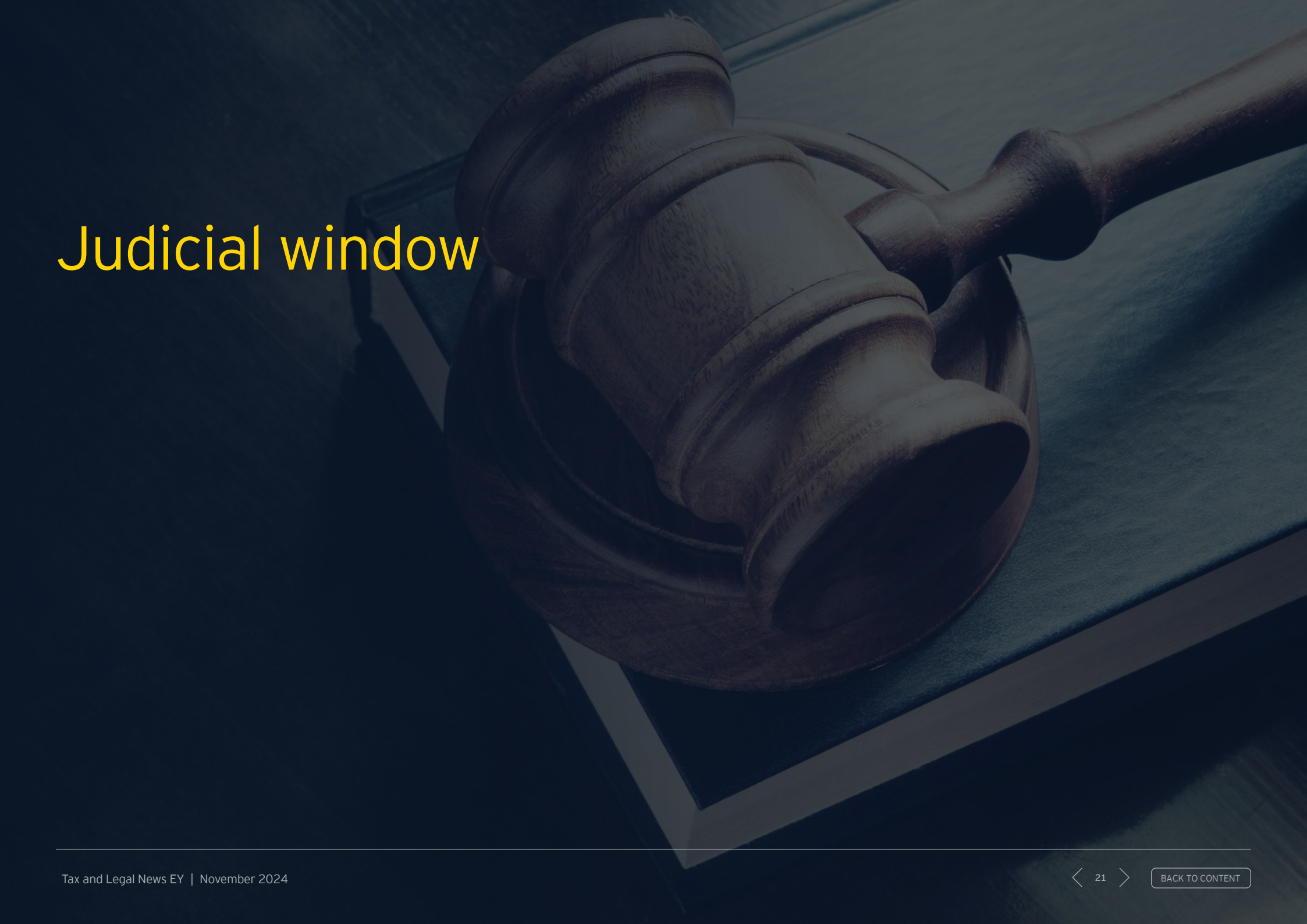
Although the amendment does not explicitly mention it, we believe that if the taxable supply is subject to the reverse charge regime, the provision on correction of the deduction should not apply to it.

When the tax liability is transferred to the customer, the neutrality of VAT is preserved in principle. If there is an accumulation of the output tax and the right to deduct the related input tax for one entity, there is no risk of claiming a VAT deduction without paying the output tax.

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

The subject of the adjustment of the VAT deduction is to be those debts, from the debtor's point of view, which are not fully paid by the end of the sixth month following the month in which the debt became due. In such a case, the debtor will be obliged to reduce the input VAT deduction already claimed in an amount corresponding to the unpaid part of his liability.

Judicial window



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The Supreme Administrative Court on the issue of in-kind employee benefits

In October, the Supreme Administrative Court ("SAC") decided two cases concerning the provision of in-kind employee benefits and the assessment of their (non-)exemption from income tax on the part of employees.

At the outset, it is important to note that both judgments concern tax periods prior to the entry into force of the so-called consolidation package, which introduced into the Income Tax Act (ITA) a limitation on the exemption of in-kind benefits within the meaning of § 6(9)(d) of the ITA. In the years under review, such benefits could be exempted without a limit on the part of the employee, which was widely used by employers.

Although both decisions of the SAC concern the application of the same statutory provision, the background of each case was different. While in the first case, the employer provided employees with cafeteria system points for certain situations (e.g. activity award, quality cup, reward for recruiting a new employee or in life and work anniversary and childbirth situations), in the second case the employer provided employees with points to the cafeteria instead of part of their remuneration for work done.

In both cases, the issue in dispute was whether the benefits in the form of points credited to the cafeteria system constituted income subject to taxation on the part of the employee or whether it was exempt income under § 6(9)(d) of the ITA. The reasoning of the tax administration was practically identical, namely that in these cases the payments constituted income for work done, so-called wages in kind. In its view, such benefits could not be exempted because the provision of § 6(9)(d) of the ITA was intended to exempt from tax only so-called employee benefits, which represent benefits provided in excess of remuneration for work.

The regional courts in the first instance supported the employers' argumentation that the ITA does not distinguish between *wages* and *employee benefits*, but works exclusively with the concept of income. According to the regional courts, if the employer fulfils the conditions for the exemption of such income – in the case of § 6(9)(d) of the ITA, the employer fulfils both the form and the purpose – this is the only condition necessary for the supply to be exempt from tax.

In both situations, the SAC dismissed the cassation complaints of the tax administration and thus upheld the decisions of the regional courts. Interesting passages in the reasoning of the SAC:

- § 6(9)(d) of the ITA does not distinguish whether or not an in-kind benefit is, or should be, considered part of wages under this provision. The legislation is not drafted in this way, as it works with the concept of income, not wages. For this reason, wages (in the sense of the private law, employment law definition) cannot be combined with income from a tax perspective, as they are differently conceived institutions.

- An exception is § 6(9)(a) of the Income Tax Act, emphasised by the Regional Court, which expressly provides that the exemption from tax in the case of in-kind benefits spent on the professional development of employees or their retraining does not apply *"to income accruing to employees in this connection as wages, salary, remuneration or as compensation for loss of income, as well as to other monetary benefits provided to employees in this connection"*. The SAC notes that this provision excludes from tax exemption wages or compensation (monetary or in-kind) received by an employee in connection with his/her professional development and retraining (e.g. training). The Regional Court must therefore be given the benefit of the doubt that if the legislator intended to exclude wages from the exemption from income, it did so explicitly. And in the case of § 6(9)(d) of the Income Tax Act, it did not do so.

- In the case at hand, the applicant made use of the statutory possibility to provide in-kind benefits to employees for precisely defined purposes as exempt benefits. In so far as the statutory conditions were complied with, (...) the applicant cannot be criticised for using the legislation to provide in-kind benefits to its employees, i.e. for the purpose for which they were intended and under the conditions set by the legislature.

What is the takeaway?

With regard to the conclusions of the SAC, it can be stated that the literal interpretation of the ITA played a key role in the cases under review. While in the first case the points credited to the cafeteria system in the given situations rather represented an employee benefit without a direct link to the performance of work, in the second case, according to the facts, there was no dispute that the employer provided employees with points to the cafeteria instead of part of their wages, which in fact resulted in a tax saving on the part of the employees, but also in insurance premiums.

It is worth considering whether, at least in the second case, the Supreme Administrative Court could not assess, in addition to the formal fulfilment of the wording of the law, also the material aspect, where the employer clearly and purposefully achieved a higher net income of its employees from the part of the remuneration for the performance of work that is normally subject to taxation and insurance contributions. In view of the wide-ranging implications of the SAC's decision, it may be appropriate to consider such a view.

Conversely, in the first case, the main message might be that the benefits in question are not in principle related to the performance of the work itself and the allocation of points to the cafeteria and the use of the related exemption as challenged by the tax administration is a perfectly legitimate legal procedure.

The other part of the first case is also interesting, but the SAC did not consider it, because the tax administration's decision was already confirmed by the Regional Court. Here the assessment of the substance itself would be essential.

Finally, we note that it may be rather disappointing for those who like to examine the substantive aspects of individual cases that in two situations with significantly different facts the reasoning of the SAC may be identical without any emphasis on the differences between the cases.

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

The regional courts supported the employers' argumentation, stating that the ITA does not distinguish between wages and employee benefits, but works exclusively with the concept of income. According to the regional courts, if the employer fulfils the conditions for the exemption of such income - in the case of § 6(9)(d) of the ITA, it fulfils both the form and the purpose - this is the only condition necessary for the benefit to be exempt from tax. In both situations, the Supreme Administrative Court dismissed the appeals of the tax administration and thus upheld the decisions of the regional courts.

For further information please contact either your usual partner or manager.

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