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LEGAL TAX AUDIT

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COMPREHENSIVE LEGAL, TAX, ACCOUNTING AND AUDIT SERVICES

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SERVICES RELATING TO IMPORT AND EXPORT OF GOODS

About a year ago our newsletter informed on judgment of the Court of Justice of the European Union in the case C-288/16 "L.Č." IK which dealt with the definition of services relating to import and export of VAT-exempted services. Although the financial administration issued an instruction concerning the application of the judgment in the Czech environment not all ambiguities have been remedied.

A solution was found only recently at the Coordination Committee meeting during which tax advisors and the financial administration reached the following conclusions:

Services relating to export of goods

- As for export of goods, only services provided directly to an exporter can be exempted from the value added tax. In the opinion of the tax administration, such an exporter is the VAT payer claiming the tax exemption for export of goods.

- It must be known to the service provider whether the service recipient claims such an exemption on the basis of information provided by the recipient and/or information stated in the customs declaration.

- If the provider fails to obtain documents sufficient for the grant of the exemption from the recipient and claims the VAT on output in good faith despite the fact that the service is directly tied to export, the tax administrator may question the entitlement of the service recipient to a deduction.

- Service subcontractors cannot claim a VAT exemption for services relating to export.

Services relating to import of goods

- In contrast, for a service relating to import it suffices, if its value under the VAT Act forms a part of the tax base in imports of goods. Therefore, the condition of a direct contractual relationship between the service provider and the importer does not need to be tested and subcontractors can claim the exemption as well.

- If a subcontractor does not possess sufficient information on whether goods will be released to free circulation, it is legitimate for their service to be taxed.

- However, if all information that is relevant for the VAT exemption is known to the service provider but the provider still applies the tax, the service recipient is not entitled to the VAT exemption as such because the case is not regarded as a tax applied under the law.

Compared to the previous years, the VAT issue has become much more complicated especially for shippers. The correct application of the VAT now requires much more intense information exchange between the service provider and recipient and may lead to frequent corrections of tax documents in practise.

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EXECUTIVE BODIES AS VAT PAYERS IN 2019

The discussed amendment of the VAT Act (to enter into effect on 1 January 2019) introduces a possible change in the position of members of corporate bodies in relation to VAT. If the amended VAT Act is adopted as proposed, it is likely that executive directors, members of board of directors and supervisory boards will become VAT payers. If exceeding a turnaround of CZK 1,000,000 in 12 months, they will become obligated to register as VAT payers and pay the VAT on their remuneration.

The current version of the VAT Act excludes persons whose income is taxable as income from dependent activity (Section 6 of the Income Tax Act) from the group of persons being subject to the VAT duty. The proposed wording (if approved) will exclude only "employees or other persons in pursuing an economic activity resulting from employment, performance of an office or other similar relationship". This exemption may not apply to persons who carry out activities primarily on the basis of an agreement on performance of an office under the Companies Act.

Given the ambiguity of the proposed legislation the tax administration is expected to issue a communication in this connection.

Moreover, the mere adoption of the amended law does not mean that executive directors, members of executive bodies (boards of directors) and other affected persons will become obligated to register as VAT payers immediately from the effective date of the amendment. A turnover for the obligatory VAT registration, if applicable, will be calculated only (not earlier than) from the effective date of the amendment.

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VAT ADJUSTMENT FOR RECEIVABLES FROM DEBTORS IN REORGANISATION

The General Financial Directorate has changed its negative opinion on the possibility of adjusting the VAT on receivables against insolvent debtors being the subject of approved reorganisation.

In August 2018 the General Financial Directorate issued an instruction covering this issue, admitting that the tax base and the VAT can be adjusted pursuant to Section 42(1)(b) of the VAT Act, i.e. due to the fact that as a consequence of a reorganisation the amount of consideration for the originally provided taxable supply has changed.

In its instruction the General Financial Directorate specifies conditions for making such an adjustment. The basic prerequisite for the VAT adjustment is that a reorganisation is carried out, among others, by way of restructuring receivables specified in a reorganisation plan. For these receivables a VAT adjustment is made first for the period in which the decision of an insolvency court approving the reorganisation plan entered into legal effect. In accordance with the general rules a VAT adjustment can be made within 3 years from the end of the tax period in which the obligation to declare the tax for the original taxable supply was created.

If during a reorganisation a relevant change occurs in the amount of a receivable to be satisfied (such as cancellation of the reorganisation plan, transformation of the reorganisation into bankruptcy or higher than expected proceeds from receivables), the creditor is obligated to make a new VAT adjustment (i.e. to make an additional VAT payment in the aforementioned cases). Such a new adjustment is to be made again within the original three-year period commencing on the date of the original taxable supply.
In its instruction the General Financial Directorate refers to the case-law of the Court of Justice of European Union and grants the instruction a retroactive effect (i.e. the General Financial Directorate agrees with a VAT adjustment to be made in cases which had occurred before the information was issued).

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ABUSE OF LAW IN THE TAX SYSTEM

The discussed package of tax law amendments includes the incorporation of an express ban on the abuse of law as one of the main principles of the tax administration in the Tax Code. Up to now the concept of abuse of law has been applied only on the basis of case-law.

Abuse of law is a situation in which a taxable person acts precisely in accordance with the law but the prevailing purpose of such a conduct is the gain of a tax or other advantage in contradiction with the sense and purpose of the law. This includes, for example, a situation in which a taxable person intentionally uses a gap in legislation with the objective of tax optimisation despite the fact that they could anticipate that by such a conduct they achieve a result that is not intended by the law.

A typical example of a case in which the tax administrator aimed at examining an abuse of law is the case of CZK bonds issued before the end of 2012. At that time the law provided for an advantageous taxation regime applicable to interest proceeds from bonds with the nominal value of CZK 1. These proceeds were not subject to tax in the case of individuals. High tax-free proceeds in the following years were thus guaranteed to individuals who purchased a greater number of CZK bonds.

A number of companies used this gap in the law and 100 million bonds with the nominal value of CZK 1 were issued before the end of 2012. In a number of cases the bonds were purchased directly by owners of the companies which issued them. The financial administration intensely examined more precise circumstances of these issues. Why? In order to establish whether the bonds were not issued by the companies with the sole objective of tax-free distribution of funds to shareholders and whether law was not abused in this way.

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EXEMPTION FROM THE TAX ON ACQUISITION OF REAL ESTATE

Under Legislative Measure of the Senate no. 340/2013 Sb., on Tax on the Acquisition of Real Estate (the "Legislative Measure"), the first acquisition for consideration of a housing unit in an apartment house is exempted from the real estate acquisition tax. However, housing units are defined not only for apartment houses but also for buildings regarded as a family house for the purposes of a use permit. But unlike in the case of units in apartment houses, the first acquisition for consideration of a housing unit in a family house is not tax-exempted, being subject to the real estate acquisition tax (4%).

The essence of the proposed Legislative Measure lies in the extension of applicability of the exemption from the real estate acquisition tax to the first acquisition for consideration of an ownership title to a housing unit in a family house.

According to the explanatory memorandum on the Legislative Measure, as compared with the previous period, an increased tendency has been seen to define housing units in new family houses. With regard to the fact that also buildings of this type are residential buildings, it seems to be necessary to eliminate the difference between the approach to the tax exemption for apartment buildings and for family houses.

It is proposed that the amended law should enter into effect on the first day of the calendar month following its promulgation.

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