Real estate acquisition tax
The Government approved a proposal to abolish the real estate acquisition tax
Page 03

Tax Code
Expected Tax Code amendment not approved; Government resubmitted a modified version
Page 05

Capital market
Bill amending certain laws pertaining to the capital market
Page 06

International taxation
OECD view on the impact of current emergencies on the application of double tax treaties
Page 07

Transfer pricing
Coronavirus in transfer pricing
Page 08

Transfer pricing
Impact of the current situation on financing within a group
Page 09

Tax losses
Planned institute of tax loss carry back
Page 10

Tax losses
Will the new rules on loss carry-forward already affect tax reporting for Q1 2020?
Page 12

Financing
Moratorium on credits, loans and financial lease
Page 13

Tax administration
The General Financial Directorate issued a methodological guideline on deferring the payment of advances and withholding tax
Page 14

Health insurance
Penalties for late payment of health insurance contributions temporarily suspended
Page 15

VAT
Further remission of VAT on gratuitous performance
Page 16

10 (topics) for 10 (areas)
Deduction to support research and development
Page 17
Editorial

Regular patients

We’ve been in a state of emergency for nearly two months, and we’re focussing maximum attention on the fight against coronavirus. In this fight, however, some less serious diseases are forced to take a back seat. Non-urgent examinations and planned procedures are being postponed. Some people have already tired of the situation and, despite understanding it, might be sad that their (less serious) health issues have been side-lined. In the end, however, one hopes these regular patients will have their turn.

And so it goes with taxes. Not a day passes there isn’t a consideration, draft measure or legal amendment addressing today’s acute virus-induced tax problem – a lack of cash. If you follow our regular Tax Alerts, you know that news has appeared daily since March 13th. The list of measures, postponements, payment deferrals, interest waivers, tax exemptions and deferrals of levies goes on and on. And it covers the entire tax spectrum. Income tax is to be declared and paid later, advances are cancelled. VAT is waived for gratuitous performance. The real estate transfer tax may be abolished. Late payment of insurance premiums is not penalized.

Still, some regular patients who would have their turn in the distant future (if at all) have received a positive news in connection with all these new coronavirus inspired measures. For example, the loss carry back is a concept that has worked in many countries for many years. While it would probably be an impossible thing to enforce in our country under normal circumstances, we might have it now, if only for a few years.

But the patients I’m worried about are the regular ones who’ve been forced onto the side-lines because their cases are not acute. For most taxpayers, 2020 is the first year the ATAD Directive is to be applied. We should be addressing the new restrictions on the eligibility of interest, controlled foreign companies and hybrid mismatches right now.

Similarly, at mid-year taxpayers or their advisers who are not exempt due to confidentiality will start compulsory reporting of some transactions and structures under the MDR (Mandatory Disclosure Regime). Not to mention transfer pricing, which is somehow the perpetual patient in any period.

But not even the most routine patients will be completely side-lined. We’ve all been calmed by the fact we aren’t paying income tax advances and might postpone our return filing (though it will eventually have to be filed). One might think that this year’s tax returns and tax obligations won’t be a major deal since the tax administrator will have to consider the current circumstances. True. But while tax administrators are not about to check tax liabilities now in a mask, they’re likely to do so in a few years with no mask and a hole in the state budget.

The current support for business and those affected is certainly the right thing, but it’s going to cost and we’ll no doubt have to pay for it in the future. And the way to get more money into the state budget is to collect more taxes. From the perspective of two or three years down the road, it will already seem absolutely the right thing for the tax administrator to be strict and narrowly focused on tax collection. Nobody will even remember that these are taxes from the memorable year 2020.

That’s why maybe we shouldn’t forget about standard ‘tax patients’ today and, if we have some time left between cash flow planning, should treat them, too.

For most taxpayers, 2020 is the first year the ATAD Directive is to be applied. We should be addressing restrictions on the eligibility of interest, controlled foreign companies and hybrid mismatches right now. Similarly, at mid-year taxpayers or their advisers who are not exempt due to confidentiality will start compulsory reporting of some transactions and structures within the so-called MDR.
In late March, the Ministry of Finance put forth a surprising proposal to abolish real estate acquisition tax. Together with the abolition of the tax, it proposes the abolition of the tax deduction of interest on loans used to finance housing needs and the extension of the period for the exemption of income from the sale of real estate from the current 5 years to 10 years.

Proposal parameters
Detailed parameters of the actual proposal are unknown as of the preparation of this article as the proposal was approved with amendments that are not currently available. According to current Ministry of Finance information, the parameters are as follows:

- The abolition of real estate acquisition tax is to be applied retroactively to cadastre entries effected as of December 2019 or in other words to cases where the return filing deadline is 31 March 2020 or later.
- The possibility of deducting interest on loans used to finance housing needs is abolished for real estate acquired from 1 January 2022.
- For real estate acquired before 1 January 2021, the current 5-year exemption period will apply to its future sale (a new 10-year period will apply for real estate acquired as of 1 January 2021).

The Ministry of Finance information does not correspond to the available draft proposal of 29 April 2020 prepared for the Government meeting where the new exemption period was supposed to be 15 years while the possibility to deduct interest and application of the current 5-year exemption period for real estate acquired in 2020 was linked to a notification by taxpayer that the real estate tax should not be abolished with respect to the related transaction.

The proposal partly follows on from the general waiver of penalties related to late tax return filing and payment of acquisition tax, when the deadline for filing the return and paying the tax/tax advance falls in the period between 31 March and 31 July 2020.

Impact of the abolition of acquisition tax on individual groups of acquirers
Real estate owners can generally be divided into two groups: 1) natural persons satisfying their housing needs and 2) owners holding real estate as an investment. Under current law, the first purchase of new constructions of family houses (including the land on which they stand) and units in an apartment or family house is exempt from real estate acquisition tax.
From the information available so far, we understand that:

- The main economic impact for people who want to satisfy their housing needs by buying a new house/flat is in fact the impossibility of claiming the related interest costs as a tax base deduction (the acquisition is exempt under current law). In the case of the purchase of a second-hand apartment, real estate acquisition tax will not be applied and the time value of money must be considered when assessing the economic impact. If the proposal is approved in the form indicated by the information of the Ministry of Finance, the preferable action seems to be effecting the loan financed real estate acquisitions in 2020 or 2021 in order to be able to deduct the related interest.

- For investors in (and landlords of) new houses/flats, nothing should change in terms of economic impact (the acquisition remains tax-free and the related costs are claimed as before). However, investors in older houses/flats and other real estate should benefit from abolition of the acquisition tax, while maintaining the current method of deducting costs. In their case, it may be advisable to consider whether to only carry out a potential transaction after the adoption of the law or to do so after the date of abolition of the tax has been definitively confirmed. Individual investors must consider the extension of the exemption deadline for income from the sale of this real estate and the possibility to apply the current 5-year exemption period in case the acquisition is carried out by the end of 2020.

From the point of view of legal entities, the idea of not applying real estate acquisition tax is often one of the reasons why investors undertake to acquire entire companies ("share deal") instead of buying the real estate itself ("asset deal"). If the tax were abolished, this argument would be dropped, and buyers’ interest would likely shift significantly in favour of the asset deal. The reasons for which a seller prefers to sell in the form of a share deal (e.g. time-consuming profit distribution, administrative costs of liquidating the company, preferential tax regime...) should remain; thus, sellers can be expected to be in a more difficult position negotiation-wise than before.

Another impact for legal entities may be the application of an asset deal in situations where, in today’s conditions, a company transformation (demerger/merger) would typically take place. For planned transactions that are normally subject to the tax, such as the sale and in-kind contribution of real estate, postponing them can mean saving this transaction cost.

**Conclusion**

The proposed changes may have a significant impact on the way in which real estate and businesses are sold in the Czech Republic and on investors’ wallets. Given the way in which information on the abolition of real estate acquisition tax is being released to the media, the possibility cannot be ruled out at this stage that only the limitation of the claiming of interest and the extension of the period for exempting income from the sale of real estate will remain in the final proposal. We recommend closely monitoring further developments (about which we'll keep you informed).

If you have any questions about this article, please contact the authors or your usual partner or manager.
The Chamber of Deputies has not passed the major Tax Code amendment we’ve been reporting on in recent months. As expected, deputies rejected the Senate version of the amendment. Subsequently, however, they surprisingly failed to approve even the original text (98 votes of the required 101), which had been approved by the Chamber of Deputies in the third reading in February (by a majority of 104 votes) and forwarded to the Senate.

Shortly after the surprising rejection, the government prepared a modified draft amendment. The current draft amendment is in fact based on the previous wording and only modifies certain points taking into account the comments of the Senate and the opposition. E.g., the following modifications have been incorporated:

- Maintaining the 30-day period for refund of excess input VAT. Compared to the original proposal, however, the minimum amount for the entitlement to an advance payment in respect of the undisputed part of VAT deductions to arise was increased from CZK 10,000 to 50,000.
- Maintaining the tax payment tolerance period but the period will be reduced from 4 working days to 3 calendar days.
- Introducing the option to individually waive the fine for late submission of tax returns.
- Maintaining double interest for the period of enforcement in the execution proceedings of incorrectly determined tax.

In view of the recent discussion of the original draft amendment, the government proposed to the Chamber of Deputies an expedited discussion of the current draft, which could thus be approved in the first reading. The firmly proposed effect of the amendment is from 1 January 2021.

If you have any questions about this article, please contact the authors or your usual partner or manager.
The Ministry of Finance submitted a bill for an inter-ministerial comment procedure in connection with the development of the capital market, which introduces these significant changes to the taxation of personal income:

- Introduction of the so-called “long-term investment account”, which should, thanks to a tax advantage, motivate natural persons to save for old age through investments on the capital market.
- This account should work just like an investment account for individuals (regulated under the Act on Capital Market Undertakings) via which they will be able to invest in selected types of assets (for example, collective investment securities issued by investment funds, bonds issued by the Czech Republic, covered bonds, investment instruments).
- The long-term investment account will then fall within the framework of the Income Tax Act among the newly introduced legislative abbreviation “Old-age Savings Products” with a standardized tax treatment. This will also include state-contributory supplementary pension insurance (the so-called 3rd pillar), supplementary pension savings, pension insurance with a pension insurance institution and private life insurance.
- In the context of old-age savings products, natural persons could deduct a total of CZK 48,000 per year from the tax base for paid contributions (today, a limit of CZK 24,000 for private life insurance and CZK 24,000 for pension products).
- At the same time, employer contributions of up to CZK 50,000 per year would be exempt from income tax.

We will continue to monitor developments in the law for you. If you have any questions about this article, please contact the authors or your usual partner or manager.

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The Ministry of Finance submitted a bill for an inter-ministerial comment procedure in connection with the development of the capital market, which introduces potentially significant changes to the taxation of individuals.
In response to the extraordinary coronavirus measures of individual governments, the OECD has issued a guidance on possible solutions for current situations in applying double tax treaties. The guidance is based on the wording of the OECD Model Treaty, so it is always necessary to consider the text of the relevant bilateral agreement and to assess the given aspects of a particular situation. The full version of the guidance is available here. Below, we summarize the various areas discussed in the guidance.

**Creation of a permanent establishment and place of effective management of companies**

- Performance of the work of employees in a home office in a country other than the state of residence of the employer should not give rise to a foreign permanent establishment.
- Nor should a permanent establishment originate from the activity of a dependent agent who currently concludes binding contracts on behalf of the taxpayer in another country due to the coronavirus situation. A similar logic should be followed in identifying the place of effective management when determining the tax residence of companies in the case of the performance of work by key management personnel.
- On the other hand, the period of interruption of work on a construction site or a construction and assembly project should continue to be included in the total period affecting the creation of a permanent establishment.

**Cross-border workers and state of tax residency of individuals**

- Contributions granted by individual governments to the reimbursement of wages paid to employees should be attributed to the taxation in those countries in which the employment would normally be undertaken.
- In the event that a person, due to the current situation, is temporarily in a foreign country in which during such a period he/she would meet the conditions of tax residence, this discrepancy (exclusion of tax residence in a foreign country) should be resolved by applying the relevant provisions (so-called tie breaker rules) of a specific treaty (e.g. a permanent home, centre of vital interests, nationality, etc.). In the opposite situation in which a person from abroad, where he/she worked and was tax resident, temporarily returned to his/her “home country”, the tie breaker rules should again apply. In this opposite situation, however, due to the stronger link of this person to the “current temporary country” (meaning the original home country), it could be more difficult to draw unambiguous conclusions.

According to unofficial information, the foregoing OECD position is not fully reflected in the provisional view of the Ministry of Finance on a temporary exemption from the creation of a permanent establishment of Czech entities abroad and the related taxation of employee income abroad. We will continue monitoring developments in this area.

If you have any questions about this article, please contact the authors or your usual partner or manager.
We've been witnesses to unprecedented measures. In many sectors, production or sales have been reduced or ceased altogether. Companies and entire multinational groups can be expected to realize lower profits (or losses) in 2020. Subsequently, the question arises as to which group entity should bear these losses.

Specifically in the Czech Republic, a number of companies are only contract manufacturers or limited risk distributors in terms of their functional profile, having a guaranteed small, but stable profit (based on cost plus or resale minus). In good times, the residual profit is taken by someone else in the group, arguing that it bears all the market risks. In bad times – which we may be witnessing now – the group should, on the contrary, bear the loss and allow the limited risk producer or distributor to keep its small but guaranteed profit.

However, from the experience of the crisis of a decade ago, we know that many multinational groups will fight a scenario where a small Czech manufacturer or distributor will be profitable and will pay tax, even though the group generates a loss overall.

But nothing is black and white, and certainly not when it comes to transfer prices. A series of questions will arise. Is the drop in production caused by the outflow of customers? Or rather the impossibility of delivering the product to the customer? Or would the customer want and be able to take product that the manufacturer lacks the manpower to produce? Or are suppliers lacking in raw materials? Finally, it will be important to determine who, according to the transfer pricing documentation, should bear individual functions, who made which decisions and who therefore bears the individual impacts.

We probably can’t rule out that a contract manufacturer operating on guaranteed cost plus will bear the losses, if they are caused by a lack of workers who are quarantined at home.

These questions are likely to arise over time. For now, it is necessary to address the health and basic operation of the business. However, it would be far from a waste of time to think about it and, perhaps, to document who made which decisions and why.

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Many multinational groups are now dealing more than ever with the issue of financing individual companies. If the group has available funds or is able to secure funds (e.g. obtain a bank loan), the easiest way is to provide an intragroup loan, which should bear market interest. The preferred method for determining the market interest rate is the comparable uncontrolled price method. In practice, this is usually based on the credit rating of the borrower and the yield (Yield To Maturity, YTM) of comparable publicly traded instruments, usually bonds.

In the current situation, the very determination of the debtor’s credit rating can be problematic. In many sectors, it will be very difficult to make reliable estimates of future profits (P&L forecasts). Also, the average YTM for bonds traded on the European market has shown considerable volatility over the past month, especially for bonds with a speculative (i.e. BB and worse) credit rating. For example, the average YTM on a 10-year euro bond with a BB credit rating remained stable at around 2.5% at the end of February 2020, reaching almost 6% by the end of March. In the case of worse credit ratings, the differences are even greater. For example, credit rating B increased by more than 8 percentage points during March while, on the contrary, a slight decrease can now be seen. Still, future developments are difficult to predict.

The question is how, on the basis of these data (unreliable financial forecasts, extremely volatile and unpredictable market developments), to make a reasonable comparative analysis at present and to determine the market spread of interest rates on provided intra-group credit.

Whatever way you set the market interest rate now, it will be advisable to reassess and, if necessary, adjust it in the (near) future.

If you have any questions about this article, please contact the authors or your usual partner or manager.

**Transfer pricing**

**Impact of the current situation on financing within a group**

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Tax losses

Planned institute of tax loss carry back

The Ministry of Finance recently published a legislative proposal for the planned institute of tax loss carry back. Below, we summarize selected points:

►►►• It should be possible to deduct the tax loss from the tax base in the taxable periods (or periods for which the tax return is filed) that began in the 2-year period before the start of the period for which the tax loss occurred or in the 6-year period after the end of that period.

►►►• Basically, a taxpayer who, for example, will have a tax loss assessed for the tax period commenced in 2020, may file an additional tax return for the tax period commenced in 2019 and possibly also the tax period commenced in 2018 and deduct this tax loss from the positive tax base. In this case, the taxpayer will have an overpayment from the tax already paid for these periods.

►►►►• Even if the tax loss carry back is applied, it will be necessary to fulfil the conditions set by the so-called substantial change test or test of maintaining the same activity set out in § 38na of the Income Tax Act. In this context, the available explanatory report states that the definition of “change in the composition of persons” is clarified, while it is not entirely clear if the practical interpretation of the term is being shifted. In addressing the comments, representatives of the Ministry of Finance indicate that a change in content is not an objective. Especially given the fact that 2020 will significantly differ from 2018 and 2019 in terms of the economic activity of many companies, we recommend that companies that have changed ownership in this period analyse in advance the possibility of applying losses for historical periods.

►►►• When applying a tax loss carry back, the period for determining the tax (statute of limitations) for the given periods is extended, generally until the end of the statute of limitations for the last tax period for which the tax loss or its part can be claimed (in the case of losses for the calendar year 2020, the last period shall be the calendar year 2026). However, if the taxpayer does not make use of the carry back option, the deadline should not be extended. Since the Financial Administration is currently of the opinion that the extension of the statute of limitations for subsequent losses may be chained, we recommend considering the impact of applying loss carry back in historical periods to the statute of limitations for all periods beginning in 2008 (when the extension of the statute of limitations in connection with the loss was introduced into the law).

►►►• It should not be possible to deduct the tax loss determined after a merger from the tax base of the taxpayer’s legal predecessor in the period preceding that for which the tax loss is determined.

►►►• As regards recipients of investment incentives, the explanatory memorandum states that the application of the tax loss for the previous period is optional for the taxpayer applying the tax credit (contrary to its application in tax periods following the period for which it was determined).

►►►• It should be possible to apply the new regime to a tax loss determined for the tax period ending as of 30 June 2020.

1 https://apps.odek.cz/veklep-detail?pid=ALBSBNGH3FFH
The law includes an exception for accelerating the tax deadline (to earlier assess the loss for the purpose of its carry back). A taxpayer who is legally required to have audited financial statements or whose tax return is filed by a tax adviser may file a tax return for the tax period that ended in the period from 30 June 2020 to 29 June 2021 within 3 months of its expiry (if the tax return is not filed within this period, the standard period pursuant to the Tax Code will apply). This means that for the 2020 tax period, it will be possible to file the tax return within three months and the tax loss will be set at 1 April 2021 and immediately afterwards it will be possible to file an additional tax return for 2019 (or 2018) and apply this loss. In addition, the Ministry of Finance is rumoured to be considering further accelerating the possibility of carry back for the first period of application of this new regime - in the form of an accelerated possibility to claim an estimated loss.

If you have any questions about this article, please contact the authors or your usual partner or manager.

Basically, a taxpayer who, for example, will have a tax loss assessed for the tax period commenced in 2020, may file an additional tax return for the tax period commenced in 2019 and possibly also the tax period commenced in 2018 and deduct this tax loss from the positive tax base.
As described in the previous article, the Ministry of Finance proposed to introduce the possibility of tax loss carry back. Until then, if a for-profit company makes a loss in 2020, it should be able to apply for a tax overpayment for 2018 and 2019 after filing an ordinary tax return for 2020. However, should it not already account for a deferred tax asset today if it is certain that it will report a loss this year? Not yet, according to IFRS and US GAAP rules, because changes in current and deferred tax are accounted for only after the legislation is bindingly adopted.

Given that the ITA amendment could be approved as early as June, it will already be relevant to consider the loss carry-back and a possible deferred tax asset for tax reporting in the second half of 2020.

At the same time, with regard to the expected leaner years, we would like to draw attention to the partially related fact that in tax reporting of the second (but probably already the first) quarter of 2020, it is necessary to assess all recorded deferred tax assets whose realization could be jeopardized in the future, such as expected losses and the resulting lower realizability of these receivables.

If you find this issue to be relevant to you, we will be happy to discuss it in detail.
Financing

Moratorium on credits, loans and financial lease

A law on a moratorium on loans was promulgated in the Collection of Laws on 17 April and entered into force on the same day. The moratorium provides for the postponement of repayments of credits, loans and liabilities from similar financial services, such as a financial lease with a compulsory purchase of the leased object at the end of the lease term (the “loans”), if the debtor so requests.

The moratorium is broad and it should generally apply to all creditors who provided a loan before 26 March 2020 to a consumer or entrepreneur (natural or legal person). The deferral should not apply to liabilities that are more than 30 days overdue, investment instruments (e.g., bonds), credit card liabilities or operating leases.

The debtor shall notify its intention to make use of the deferral of loan repayments for a term of protection that lasts from the first day of the calendar month following the notification (at the earliest from 1 May) to 31 October 2020 (or to 31 July 2020, if the debtor so requests).

The time of fulfilment of the debtor’s monetary debts to the creditor is postponed by the length of the protection period. The creditor is entitled to interest in the maximum amount of the repo rate plus 8 p.p. (i.e. 9% p.a.), if the debtor is a consumer, and in the amount of the agreed rate, if the debtor is an entrepreneur. This interest shall not bear interest. The maturity of this interest is postponed until the end of the loan repayment period for natural persons; for legal entities, the interest is payable at the time agreed. Debtors - natural persons (regardless of whether they have used the protection periods or not) - will not be subject to penalties for late payment until 31 October 2020.

The tax consequences for both creditors and debtors will depend on the accounting treatment of individual items in accordance with IFRS (for banks) and Czech Accounting Standards (for other taxpayers keeping the accounting books in accordance with the Accounting Decree for Entrepreneurs). Typical accounting and tax issues that may arise for both creditors and debtors are as follows:

- accounting and tax assessment of accrued revenues (for creditors) and expenses (for debtors),
- assessment of the (accounting) depreciation plans of leased items of leasing companies keeping the accounting books under the Accounting Decree for Entrepreneurs,
- the impact on the thin capitalization calculation of debtors in the case of a related-party loan,
- the tax impact of (potentially) increased provisioning for creditors after expiry of the protection period,
- in the case of financial leases, e.g., the (additional) application of output VAT by leasing companies or the determination of the value added tax base for leases that are treated as operating leases for the purposes of the VAT Act (but that are considered a financial lease from the perspective of the law governing repayment deferral).

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A law on the moratorium on loans was promulgated in the Collection of Laws on 17 April and entered into force on the same day. The moratorium provides for the postponement of repayments of credits, loans and liabilities from similar financial services, such as a financial lease with a compulsory purchase of the leased object at the end of the lease term, if the debtor so requests.
The General Financial Directorate issued a methodological instruction on deferring the payment of advances and withholding tax.

The General Financial Directorate issued a methodological instruction (here) on deferring payment (or the distribution of tax in instalments) in case of payment of advances on personal income tax from dependent activity and withholding tax from dependent activity and also from selected income of tax non-residents (pursuant to § 22(1)(c), [f] and [g], items [1], [2], [5] and [12] of the Income Tax Act and for interest and other income on loans). Deferrals may be requested in warranted cases in connection with emergency measures relating to COVID-19. This special guidance temporarily modifies previous guidelines, on the basis of which deferrals were not possible in the above cases.

Employers and payers can thus, in warranted cases, request (separately for each month) to defer the payment of advances for the months of February to July 2020 and withholding taxes normally due by 31 March to 31 August 2020. Deferral is possible until 30 September 2020, at the latest.

“The taxpayer should clearly state in the application the reason for the deferral pursuant to §156 (1) of the Tax Code. While it is not necessary to attach extensive annexes to the application, there must be a clear determination of which advances or withholding tax from dependent activity and withholding tax is being requested by the tax entity for deferral and in what amount, for what reason and by what date (or a draft repayment calendar). Given that the amount of the advance or withholding tax from dependent activity is calculated from the income from dependent activity of employees and the amount of withholding tax from selected income, it is essential that the application state both the total amount of advance or

withholding tax from dependent activity and withholding tax as well as the sum/amount requested by the tax entity for deferral.

In the current situation, it may happen that a tax entity has funds in the bank, but requests a deferral on the grounds that fixed costs must be paid (rent for premises, energy, wages of employees, etc.). The tax administrator should consider existing legitimate costs when deciding on the application and, in warranted cases, grant the deferral despite the existence of funds in the bank.”

Standard practice is that the taxpayer is obliged to pay interest on the deferred amount during the deferral period (Czech National Bank repo rate + 7%). However, an application for its waiver can be submitted, but only after payment of the deferred amount; only applications submitted by 31 July 2020 are not subject to the administrative fee (CZK 1,000). The Chamber of Tax Advisers of the Czech Republic is currently discussing with the Ministry of Finance a possible alternative approach to the waiver of interest on the deferred amount in the above cases. We will be happy to discuss the possibility of deferral with you in greater detail and, if necessary, help with the preparation of the application.

If you have any questions about this article, please contact the author or your EY tax team.

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Health insurance

Penalties for late health insurance contributions temporarily suspended

In response to COVID-19, certain changes have been introduced to ease the difficult situation of employers when paying the mandatory health insurance contributions.\(^2\)

The employers are still required to pay contributions to the public health insurance system and submit the monthly payment reports. However, any late payments of health insurance contributions for the period from March to August 2020 will not be penalized until 21 September 2020. Penalties for this period will again be charged from 22 September 2020 onwards.

The relief does not, however, apply to health insurance contributions for February 2020 that were due by 20 March 2020. If these are overdue, the health insurance company will standardly charge a penalty of 0.05 % for each day of the delay for the entire period.

Therefore, the contributions due for the period from March to August 2020 may be remitted until 21 September 2020 without any penalties.

However, employers applying for subsidies within the Antivirus Program for March (and possibly for the following months) should pay health insurance contributions for these months by the statutory deadline. The payment of support is contingent not only on the payment of compensation of wages to employees, but also on the payment of the related social security and health insurance contributions for the given month.

Late contributions payments would also prevent the issuance of a debt-free certificate that the employer may need for other purposes.

For the sake of completeness, we add that even if the Social Security Administration decides to divide the outstanding social security contributions into instalments, non-payment of these contributions will make it impossible to draw support from the Antivirus Program during these months.

However, deferring advances on payroll tax should not have a negative effect on receiving support from the Antivirus Program.

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

Employers applying for support under the Antivirus Program for the month of March (and possibly for the following months) should pay health insurance contributions for these months by the statutory deadline. The payment of support is contingent not only on the payment of compensation of wages to employees, but also on payment of the related social security and health insurance contributions for the given month.
In Financial Bulletin No. 7/2020, the Ministry of Finance has published a decision whereby the Minister of Finance forgives VAT on the gratuitous supply of goods and services to:

►►►►►►►►• essential units of the integrated rescue system,
►►►►►►►►• the Czech Army,
►►►►►►►►►• providers of healthcare services, or
►►►►►►►►►• social services facilities.

Unlike the previous waiver, this decision applies to any goods or services, not just PPE or disinfectants. However, it is limited to gratuitous provision to the above entities. The waiver applies retroactively from 12 March 2020 through the end of the state of emergency.

In addition to the Bulletin itself, GFD information was also published that further specifies the method of reporting such gratuitous performance in the VAT return and other statements. Among other things, the information recommends that VAT payers request confirmation from donation recipients of receipt of the gratuitous performance including the date the performance was rendered.

If you find this issue to be relevant to you, we will be happy to discuss it in detail.
In the penultimate article in the series 10 for 10, we continue with the topic of deductible items and focus on the application of the deduction to support research and development (“R&D”). By using this deductible item, the relevant costs are applied twice – once as a tax deductible expense and the second time as an item deductible from the tax base, in some cases even in the amount of 110% of the original expense (more on this below). As this is a very interesting tax saving, taxpayers, tax advisors and the tax administration often focus on this area and it is therefore worth paying special attention to.

1. The Income Tax Act (“ITA”) allows a taxpayer investing in research and development to deduct 100% of the eligible expenses incurred in a given period from the tax base. If the costs incurred in a given period exceed the costs for the decisive period, the taxpayer may claim a deduction of 110% from such a difference. When calculating the deductible item, it is always important to start from the actual costs for the relevant period, not from the deduction amount applied in the tax return for the previous period. If, in the previous period, expenses in the amount of 110% were also claimed and the taxpayer only used the amount stated in the tax return as a comparative value, then at best that taxpayer would be cheated of part of the deduction, and at worst (for a taxpayer with a promise of an investment incentive), this would violate the condition of maximizing tax deductions and could mean the imposition of a sanction in the amount of the tax rate and a multiple of the unapplied deduction, including interest on arrears.

2. Is it possible to claim a 110% deduction in the first year, even if no R&D costs were incurred at the relevant time? A grammatical interpretation of the ITA supported by the explanatory memorandum leads to the conclusion that even in this situation, 110% of the costs incurred in a given period can be applied within the R&D deduction. However, the General Financial Directorate does not share this view and argues that no research or development was carried out at the relevant time, therefore no costs were incurred at the relevant time, meaning there is no cost to compare with, so a deduction of 100% should be applied. In practice, the procedure largely depends on the bravery of the taxpayer and their relationship to risk; we’re still waiting for a court decision dealing with this issue.

3. Expenditure on R&D project implementation may include (in full or a proportional amount): personnel costs for research and development staff, including travel allowances, depreciation of tangible and intangible movable property or remuneration for financial leasing of movable property used in direct connection with the execution of the project and other operating expenses. The taxpayer is obliged to keep separate records of these costs. The much-discussed question is whether holiday pay can also be included in personnel costs. As you may have read in our January Tax News, this issue was also addressed by the Supreme Administrative Court, which concluded there is no rational reason why these costs should have a different tax regime than worker wages and therefore they represent expenditure incurred in direct connection with project execution.

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2. For the purposes of the R&D deduction, the relevant period is the period that (i) ends on the day preceding the day on which the period begins, and (ii) is as long as that period (§34a of Act No. 586/1992 Coll. on income tax).

4. When applying the R&D deduction, the taxpayer may not include in the expenses, inter alia, expenses for which, even in part, support was provided from public sources (subsidies, grants, investment incentives). As the combination of the deductible item for R&D and the above forms of public support raises a number of relatively insidious tax issues, the topic was also addressed by the Coordination Committee. One controversial point the proposers tried to clarify is the application of tax depreciation of assets at the same time as drawing a tax relief due to investment incentives – they concluded it should be possible to include in the R&D deduction depreciation of machines whose acquisition costs were not included in the part of eligible costs from which the relevant percentage of public support applied a tax relief, even in the year of drawing the investment incentive. Although the GFD has agreed to this conclusion in the past, the conclusions described above are now obsolete. The latest amendment to the Investment Incentives Act clearly states that the date of granting public support is the date of issuing the decision on the promise of such support (not the actual drawing of the tax credit, as inferred by the proposers). By including the depreciation of the equipment in question, one cost would be supported twice, which the ITA does not allow. The tax administrator could therefore challenge such a practice.

5. A taxpayer who has doubts as to whether R&D costs can be included in the deduction may ask the tax administrator for a binding assessment. The request for a binding assessment must, among other things, contain a draft opinion on the decision on the binding assessment. Although tax administrators do not specifically comment in the decision on the binding assessment on whether the taxpayer’s activity meets the characteristics of R&D, the document to some extent reduces the risk of a practical challenge to the application of a deductible item to R&D by the tax administrator. There is interesting Supreme Administrative Court case law on fulfilling the characteristics of R&D and therefore we recommend that every situation be examined in detail in light of the decision-making practice of this court.

6. If the taxpayer does not report a sufficient tax base in the given period to claim the deduction or has achieved a tax loss, the deduction for R&D support may be deducted no later than in the three periods following the period in which the deduction arose. Thus, in contrast to the application of a tax loss, the application of the R&D deduction also considers the periods for which the tax return is filed under § 38ma of the ITA (generally, a tax period shorter than 12 months) – we will deal in more detail with the topic of tax periods and deadlines in the next (last) article in the series 10 for 10. If the taxpayer does not apply the R&D deduction in the given period (does not apply it in the total possible amount), even though there is a sufficient tax base, the deduction (or part of it) cannot be carried over to other periods.

7. Should the taxpayer apply the deduction and subsequently file an additional tax return for a lower tax liability, the unapplied part of the deduction does not expire, but can be carried over to the next period, respecting the three-year period described above (refer to point 6).

8. Section 34 of the Income Tax Act lists several types of items that can be deducted from the tax base – namely the deduction of tax loss, the deduction for support of vocational training and the already mentioned deduction for R&D. However, it does not specify the order in which the individual items deductible from the tax base are to be applied – it is therefore up to the taxpayer (including the recipient of investment incentives) to decide how to apply them (while respecting the deadlines for individual deductions).
9. The amendment effective from April 2019 introduced fundamental changes to the conditions for applying the deduction. Among other things, it introduced the new institute of Notification of the intention to deduct an R&D deduction from the tax base (“Notification”) to the relevant tax administrator prior to project execution. However, the Notification does not remove the obligation to prepare the relevant project documentation. Still, it is sufficient that it be drawn up and approved no later than the deadline for filing ordinary tax return in which the deduction is claimed.

10. Changes to the rules on applying the deduction effective from April 2019 are governed by a transitional provision. As sometimes happens, the transitional provisions of the amendments may not always be entirely clear and comprehensible. The General Financial Directorate has therefore issued information7 stating that, for projects started in a tax period or a period for which the tax return is filed that started before the entry into force of the ITA amendment and did not end by the date of entry into force of the ITA amendment, the taxpayer can choose to apply the old or new regime. However, the new regime may not be advantageous since R&D projects started before the amendment were subject to Notification (see point 9 above), meaning part of the expenditure would not qualify for the deductible item when choosing the new regime for these projects (started before 1 April 2019).

The aim of the 10 for 10 series is to highlight issues we often encounter and that may have (or may have already had) a material impact on the tax position of taxable entities. Given the focus of the article, however, the selected ten points cannot substitute a complete overview of all the issues that we address together in the area of tax adjustments.

If you have any questions about this article, please contact the authors or your usual partner or manager.

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