KempHoogstad
Tax Advice & Solutions

Tax News October 2017

Dear clients,

This summer and autumn did not bring any changes to tax law but it does not mean there are no news in the tax field. We are sending a review of news that can affect your business or your taxes.

We would be happy to discuss the new aspects with you.

The KempHoogstad Team

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Aspects of guaranteeing for unpaid VAT

It is obvious that the financial administration makes much efforts to increase the collection of taxes with the help of existing instruments for tax collection of both existing or potential tax arrears. Part of the motivation is to use instruments for preventing tax avoidance, including extending the possibilities of the guarantee mechanism.

Recently, we have experienced considerably more frequent requests for payments of tax arrears in a relatively short period after the respective taxes were due together with warnings of a potential seizure. Besides the mentioned methods, an often discussed issue is the use of guaranteeing orders. A guaranteeing order is used by the tax administrator for ensuring the collection of taxes which are not due or even assessed yet, but there is a well-founded risk that the tax entity will not be able or willing to pay the tax and thus it may be very difficult to collect the taxes. For example, the tax entity can receive a guaranteeing order during a tax control if the tax administrator anticipates an additional tax assessment or in a situation where the tax entity does not expect such an order at all. Such a situation could be when the tax entity receives a tax supply, subject to VAT, and becomes a guarantor for the given supply.

The issue of guaranteeing for unpaid VAT is one of the areas that tax entities should not underestimate because it can trigger a number of risks. We summarise below the situations and circumstances where guaranteeing for unpaid VAT can occur.

The first category of cases where the receiver of taxable supply guarantees for unpaid VAT concerns situations that a tax payer can identify and control in a specific manner:

(i) the payment for the supply was evidently different from the usual price for no economic reason;

(ii) the payment was provided to a foreign bank account;

(However, there is a judgement saying that such guaranteeing arising for such a reason is in contradiction with EU law.)

(iii) the payment was provided to an account other than the one recorded in the public registry of VAT payers and the total amount of the payment was above CZK 540,000;

(iv) the payment was partially or completely provided in virtual currency;

(v) the provider of the supply is an unreliable payer recorded in the public registry; and

(vi) the subject of the supply was the delivery of fuel by a fuel distributor who is not recorded in a respective registry of fuel distributors.

The second category of cases where the receiver of taxable supply guarantees for unpaid VAT concerns cases based on the assumption that, at the moment of realising the given supply, the receiver of the supply knew or should or could have known that:

(i) the tax will not be paid; or

(ii) the supplier will be or was intentionally in a situation where it could not pay, or

(iii) the tax will be evaded or a tax bonus will be extracted.

The second category of situations relating to the guaranteeing process is quite a risky area for the tax entities because proving that the tax entity "knew, or should, or could have known", or "did not know and could not have known" can be really difficult and thus the tax administration can sufficiently recovery the taxes from the tax entity – the receiver of the supply – because of guaranteeing by law. Basically, it is not enough to check whether the payment for the supply goes abroad or to an account not recorded in the registry or to an unreliable payer. It is appropriate to set other rules for investigating the reliability of the supplier with respect to the above-mentioned risks.
With respect to this, we can use as a partial guideline the information released by the financial administration in July 2017 relating to revealed tax frauds in the provision of the labour force (more information here, in Czech only). The information provides, among other things, a list of certain circumstances that according to the financial administration can suggest under certain conditions the "riskiness" of the supplier:

(i) The business partner was established recently, has no relevant business history or recommendations or experience, and is unknown in the given field. They have no web pages or they are only partially functional or the web pages do not inform about business activities. The available information on the financial situation of the business partner (available from public sources) show that the given subject can jeopardise VAT payment.

(ii) The business partner is managed and administrated by persons with no or minimal knowledge and experience in the given field, or persons with their background abroad (usually in European countries with a lower level of labour prices, for example, Ukraine, Bulgaria, Romania, etc.), or is managed by persons other than statutory representatives or persons authorised for acting or management.

(iii) The business partner often makes changes to data recorded in the Commercial Registry, including changes to the executive body, supervisory body and partners (for example, the only partner and executive body is a foreign person).

(iv) The subject of business recorded in the Commercial Registry does not match the actual activities of the business partner or is described very generally and broadly, the business partner does not have a relevant licence or certificate for the given field of activity.

(v) The address of the business partner's seat is in an office house (office buildings), it is not apparent if the seat is real or if it is virtual or if it is a seat in a family or residential house. Business deals are made outside the business partner's seat, for example in public premises.

(vi) The business partner is out of reach for a long period, for example, only on a foreign phone number (even if they have a seat in the Czech Republic), or the communication is problematic as such.

(vii) The business partner does not require sufficient contract provision, the contents of a contract is vague and differs from other contracts common in the given area, or it does not contain standard provisions.

(viii) The business partner offers supplies for a considerably lower price than usual, or offers other not-standard advantageous business conditions. The payment conditions are unusual, for example, payments abroad or to an unregistered account, to an account held by another person, or payments in cash.

Of course, the financial administration admits that evaluation of the facts contributing to guaranteeing according to the VAT Act depends always on the specific circumstances of the given business activity and it states that the list of the stated non-standard situations is only an example.
We recommend investigating the business partner, especially for deals that are not random and insignificant from the value point of view, and keeping proper documentation on such an investigation which can be very useful when proving to the tax administration what the tax entity "knew or should or could have known". It is necessary to realise that investigating the "reliability" of business partners should be realised not only when the cooperation with the new business partner starts, but it should be continuous, because lowering the rate of "reliability" of the business partner can happen all the time (for example, because the business activity or the executive body changes).
In conclusion, if the tax entity evaluates a prepared transaction as being risky in a certain manner, there is always a way under law to pay the respective VAT for the supplier directly to the tax administrator and thus reduce the risk of guaranteeing. Using this method, i.e. paying VAT by the recipient of the supply instead of the supplier directly to the account of the respective tax administrator, requires a certain procedure. In such a case, it is necessary to include this procedure in the contract with the supplier.

Case law

We would like to inform you about two interesting judgements released lately – a judgement of the Supreme Administration Court related to including VAT in the tax base for the purposes of the real estate transfer tax and an ESD judgement related to exemption from VAT with respect to chain deliveries within the EU.

VAT and real estate transfer tax base

Since 2014, the method actually used in real life is the following: if the tax base for the real estate transfer tax is the agreed price, it is understood that it is the agreed price inclusive of VAT. This method is based on the official interpretation of the financial administration which is grounded in the wording of the explanatory memorandum to the legislative measure adjusting the real estate transfer tax since 2014. The explanatory memorandum states that the agreed price means the total price inclusive of VAT.
Recently, the Supreme Administrative Court has been deciding on a case where the tax payer as the seller (subject to the real estate transfer tax) had to submit the tax return and the tax payer determined the tax base as the agreed

price exclusive of VAT. The financial authority did not accept the method and assessed the tax from the agreed price inclusive of VAT. The financial authority's steps, subsequently confirmed by a Regional Court, were supported by the above-mentioned explanatory memorandum. However, the Supreme Administrative Court accepted the view and arguments of the tax payer and decided that in the given case VAT should not be included in the tax base for the purposes of the real estate transfer tax.

The Supreme Administrative Court gave the following reason for the decision (among other things): the adjustment of the tax base stated in the legislative measure differs slightly in the wording from the original legislative adjustment in the Real Estate Transfer Tax Act, but factually it does not constitute a change compared to the former determination of the tax base before 2014 when there were other judgements confirming that the tax base is the price without VAT. A mere pronouncement of the lawmaker's intention in the explanatory memorandum to the legislative measure without any further explanation that the agreed price means the total price inclusive of VAT cannot be considered a change explicitly embedded in the respective regulation.

Another argument of the Supreme Administrative Court is a contradiction to the tax neutrality principle where the unacceptable thing is that a VAT payer should be subject to a higher real estate transfer tax than other comparable subjects who are not VAT payers.

Based on the above-mentioned information, sellers who paid the real estate transfer tax from the tax base determined from the agreed price inclusive of VAT during the period from 2014 to 31 October 2016, should consider submitting a supplementary tax return. Applying the above-stated conclusions to transfers carried out after the amendment of the legislative measure effective from 1 November 2016 should be carefully analysed, because the judgement dealt with a case that was governed by the wording of the legislative measure before the amendment.

Classification of supply transports within the EU and VAT exemption

In the recent case no. C-386/16 Toridas, the Court of Justice again describes in detail the rules for claiming VAT exemptions for the intra-Community supply of goods. The court confirms that, if three entities are engaged in trading and one of the entities transports the goods from one EU member state to another then the realised transport must be classified for only one of the two supplies. This fact has a key impact on the possible application of VAT exemption to the supply of goods by the first (or the second) entity in the trade chain, or on the possible use of the simplified procedure for three-party trading which is applicable in the country where the goods were delivered. This confirms that, for example, in the case of two successive sales under the Incoterms EXW conditions the first supply cannot be exempt.

Traders who sell goods on an international scale should pay attention to the rules for the correct classification of transport in a chain supply of goods. Besides the above-mentioned Incoterms rules, it is necessary to follow any other contract provisions relating to where exactly the transferring of risks and rights (related to the possibility to de facto handle the goods) happens. Each trader should acquire at least some information from the receiver where it transfers the risks and rights to its customers, especially with respect to trading goods in the parity Incoterms EXW/FCA and if

the supply can be exempt. It should be noted that if this happens in the same country, the first delivery cannot be exempt.

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