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Recent Developments in International Taxation

Czech Republic

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The developments described below generally cover the period from April 2019 to May 2020.

The most significant development is the upcoming application of the Organisation for Economic Co-operation and Development (OECD) Multilateral Instrument, followed by implementation of the Anti-Tax Avoidance Directive into Czech law.

OECD Multilateral Instrument

On 7 June 2017, the Czech Republic became one of 67 countries to sign the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ('MLI'). MLI implements some of the measures recommended by the OECD Base Erosion and Profit Shifting project, aiming to amend the existing network of bilateral double taxation treaties through a single multilateral convention. For a particular double taxation treaty to be amended by the MLI, both countries party to that treaty have to ratify the MLI and wish that treaty to be amended. On 13 May 2020, the Czech Republic deposited the instrument of ratification with the OECD, listing 52 of its double taxation treaties (out of more than 80) that it wishes to amend though the MLI. The MLI entered into force in relation to the Czech Republic on 1 September 2020.

The Czech Republic decided to adopt MLI at the minimum standard required, and to amend its double taxation treaties to include:

- clarifying the wording of the preamble that the purpose of the treaty is to allow the elimination of double taxation but not through tax evasion or avoidance;
- a principal purpose test to deny treaty benefits in cases of abuse; and
- the application of the mutual agreement procedure to disputes on double taxation.

The explicit principal purpose test in the double taxation treaties will provide the tax authorities with another tool to use. However, there are arguments that the tax authorities can deny treaty benefits in cases of abuse, even if there is no explicit anti-abuse provision in the treaty. It will take some before we will see the practical impact of the MLI.

Anti-Tax Avoidance Directive

The European Union has adopted Council Directive (EU) 2016/1164, setting down rules against tax avoidance practices (the 'Anti-Tax Avoidance Directive' or ATAD). The Czech implementation of the ATAD entered into force on 1 April 2019, generally following the minimum standard required and implementing the following measures:

- limitation on deductibility of interest costs;
- taxation of controlled foreign companies (CFCS);
- exit taxation;
- general anti-abuse rule (GAAR); and
- rules to tackle hybrid mismatches.

Limitation on deductibility of interest costs

Exceeding borrowing costs are deductible up to 30 per cent of earnings before interest, taxes, depreciation, and amortisation (EBITDA), where the definition is based on taxable income and tax-deductible interest costs. The definition of 'interest' for the purposes of this rule is relatively broad and includes all economic costs of financing from both related and unrelated enterprises. The limitation applies to interest costs, less interest revenues, so-called 'exceeding borrowing costs'. The 30 per cent of EBITDA limitation does not apply, if the exceeding borrowing costs do not exceed CZK 80m (approximately €3m). Non-deductible interest costs can be carried forward and deducted up to the above limits in later years. There are various exemptions from this rule, for example, for financial undertakings and standalone entities. Existing thin capitalisation rules on related-party financing remain in force.

CFC rules

The aim of the CFC rules is to prevent taxpayers from shifting income into foreign low-taxed subsidiaries. Under the CFC rules, a corporate taxpayer is subject to tax on undistributed income of a foreign subsidiary, where the subsidiary does not carry out any substantial economic activity and its local tax liability is lower than 50 per cent of the tax liability it would have had under Czech tax laws. The CFC rules should not affect structures for which the level of taxation is comparable at different levels or where controlling companies are subject to lower taxation than controlled companies.

Exit taxation

This rule introduced the taxation of assets in cases of asset relocation without a change in ownership, for example, a Czech tax resident transfers an asset from the Czech Republic to a non-Czech permanent establishment or changes its tax residency. In such situations, assets are deemed, for tax purposes, to have been sold in the original state at their market price.

GAAR

The Czech Tax Code now includes an explicit general anti-abuse rule. However, we expect the practical impact to be minimal because the abuse of law concept has already been applied in Czech tax law in the past based on case law. The application of the abuse of law concept in the Czech Republic is generally in line with case law on abuse of law applied by the Court of Justice of the European Union.

Rules tackling hybrid mismatches

Hybrid mismatches are situations in which various jurisdictions regard a certain instrument or entity differently from others, resulting in a tax advantage. Implemented measures should prevent such a tax advantage arising from double deduction (reduction of tax in several jurisdictions) and deduction without inclusion (reduction of tax in one jurisdiction while not taxable anywhere else).

Reporting of tax-exempt income paid to non-Czech tax residents

Czech-sourced income, which is generally subject to Czech withholding tax but exempt from Czech taxation (eg, due to a double taxation treaty or Czech tax law exemption), payable to non-Czech tax residents is now subject to reporting duty by the Czech payer of the income. Payments under CZK 100,000 per month per single recipient are exempt from this reporting duty. This measure began to apply as of 1 April 2019, and the administration can be quite burdensome for certain taxpayers.

New double taxation treaties

As of 1 January 2020, a new double taxation treaty between the Czech Republic and South Korea replaced an older treaty from 1992. The Czech Republic signed double taxation treaties with Bangladesh, Botswana and Kyrgyzstan in 2019, and with Senegal in 2020.

Draft bill: DAC 6

The Czech Parliament has yet to pass the Czech implementation of Council Directive (EU) 2018/822 of 25 25 May 2018 ('DAC 6'), concerning the reporting obligation of selected cross-border arrangements. The purpose of DAC 6 is the mandatory reporting of cross-border arrangements, which fulfil certain 'hallmarks'. The reporting obligation should generally cover potentially aggressive or abusive cross-border tax-planning arrangements, which were put in place after 25 June 2018. One of the main issues of the draft bill is the scope of arrangements to be reported. The hallmarks and definitions are often quite unclear, which brings a high level of uncertainty regarding whether certain arrangements should be reported or not.

Draft bill: abolition of preferential tax treatment of 'eurobonds'

Bonds issued by Czech tax residents or the Czech state outside the Czech Republic (generally referred to as 'eurobonds') enjoy preferential tax treatment to increase their competitiveness on international capital markets. Currently, eurobonds are not subject to Czech withholding tax, and non-Czech tax residents are fully exempt from Czech taxation on interest arising from eurobonds. The Czech Government has published a draft bill, which among others, abolishes the preferential tax treatment of eurobonds as of 2021. The bill is still subject to discussion. However, if passed as is, the bill could significantly affect the conditions of the bonds issued by Czech companies and complicate their placing on international capital markets.

Draft bill: abolition of real estate acquisition tax

The Czech Government has approved the abolition of real estate acquisition tax amounting to four per cent of the total purchase price for the real estate property. The bill is currently being discussed by the Czech Parliament. Investors usually acquire a Czech real estate property by acquiring the company owning the property (ie, through a share deal). Among others, such a transaction is not subject to real estate acquisition tax. If the bill to abolish real estate acquisition tax were passed, then it would make it more attractive for investors to acquire the Czech real estate property directly (ie, through an asset deal).