

Tax and Legal News

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(Ab)use of the law

For some time now, we've been used to the idea that the wording of the law and its creative application are not enough. Above all, there are the general principles of the abuse of law, with respect to which there is quite extensive Supreme Administrative Court (SAC) case law – we know the basic theoretical principles: the objective test and the subjective test.

Some standard planning techniques of the 1990s and early 2000s are dead and gone. Some, on the other hand, are still (only) hanging on by a thread and specific case law still doesn't suffice for clear conclusions. The SAC recently adjudicated two specific issues quite extensively: the so-called debt push down and the payment of dividends through a holding. It is astonishing that both have been used essentially since the beginning of the new tax system in 1993 and that the first sensible case law is only now emerging. Unlike, for example, crown bonds, where most of the market ended up in court in a historically short time.

In simple terms, debt push down means a situation in which Company A wants to buy Company B. Company A borrows from the bank, buys shares in Company B, and then Company B merges into itself. As a result, Company A holds the entire business of Company B, the profits of which, among other things, can be used to repay the acquisition debt. The tax effect is such that the interest on the acquisition debt is tax deductible (subject to certain conditions), thus reducing the tax base and tax of Company A, including the tax on business of the original Company B.

In some countries, it is completely forbidden - I cannot pay off a debt from a property I borrowed to buy. Some countries allow it, but the tax deductibility of interest is explicitly denied. The legislators simply do not want to reduce the tax base in these situations. We're allowed to and do not have an explicit prohibition on tax deductibility. From the perspective of general tax principles, it probably makes quite a bit of sense. I had to borrow to acquire a business that generates taxable profits.

However, such an environment calls for tax planning. What if I have the money, I don't need to borrow from the bank, and I just create the debt and interest expense artificially with an intra-group loan? And what if I don't even want to buy anything and I can only create an acquisition situation by artificially reselling within the group? Here, intuitively, the interest should probably not be deductible from the point of view of higher justice, though not clearly according to the letter of the law. The tax administrator and, consequently, the courts have already reacted and in 2015 the Supreme Administrative Court issued a landmark decision in the well-known CTP case: a group loan, sale between related entities, interest not deductible because the right was abused. This decision defines what constitutes crossing the

line. We then awaited another avalanche of decisions in less black and white cases to better understand exactly where that line is. But nothing much happened. Only now, after almost nine years, do we have two more decisions: Teleplan and Jihomoravská armaturka.

Teleplan also involved internal sale. Not surprisingly, the tax authorities were tempted to assess this after CTP. But the transaction was preceded by the sale of the entire group to a third party and external financing at the group level. The debt push down into the Czech company was based on the request of the bank that provided the group financing. And the court says the objective test of abuse of rights is met. But the subjective test is not met, because the motivation was not to reduce the tax, but to meet the requirement of a bank that would not otherwise have lent to it. So the law was not abused, the interest is deductible. A small step for the taxpayer, a big step for interpretive practice.

Armaturka made the same argument. Group level acquisition, external financing, etc. It just couldn't find a push down requirement in the bank documentation that would match the implemented structure. The general provisions on restructuring were not sufficient, the right was abused, the interest is not deductible. In terms of optics, it looks like everything is based on some dubious provision in the bank documentation. But that's what the two instances of case law we now have suggest. By the time we have ten, it might come apart somewhere else.

The dividend payment through the holding company is even more obvious. A shareholder, usually an individual, owns a profitable company, and would like to cash out the profits. Normally, he would pay 15% withholding tax. So he'd rather set up an empty holding company. He sells the profitable company to the holding company (which he 100% owns). He's held the profitable company for three years, so the sale is tax-free. The holding company has no funds, so it owes the shareholders. The profitable company pays its profits to the holding company - tax-free, exempt under EU rules. The holding company will use the payment received to repay the debt to the shareholder. Again, no tax, repayment of the liability is not taxable. Net result - the shareholder makes a profit, no tax paid.

Here, the tax administrator was a bit more active and occasionally levied an assessment. Some cases ended up in court, and the tax administrator was mostly supported. However, this July's Supreme Administrative Court decision in the FPPV case turned out the other way around. The SAC overturned the additional assessments. The objective conditions for abuse of law were met - an unforeseen tax advantage was achieved. However, the subjective condition was not met. The taxpayer allegedly did not take steps to evade the tax, but had a number of other good reasons for doing what he did. He wanted to set up a holding to be used for further investment, one of the current partners was getting out and had to be paid out, a new partner came in and the investment through the holding made sense etc. All right. I can't tell from the text of the decision whether it's more of a rebuke to the tax administrator for not dealing with the subjective condition sufficiently and not looking into it enough, or whether it's being made clear that it's really bulletproof in these circumstances.

Either way, the decision has attracted plenty of attention and raised perhaps a little bit of expectation that the tax world will be a little rosier again. You can even find a nice article in the newspaper HN, which gives hope that the Supreme Administrative Court has stood up for entrepreneurs in a matter that tax administrators used to assess by default. The decision is undoubtedly an important one; it shows us where the SAC will not let tax administrators off the hook. We'll have to wait for some light to shine into the remaining gray area of not-so-nice situations. Maybe when we have ten decisions like this, it will be clearer.

The SAC overturned the additional assessments. The objective conditions for abuse of law were met - an unforeseen tax advantage was achieved. However, the subjective condition was not met. The taxpayer allegedly did not take steps to evade the tax, but had a number of other good reasons for doing what he did. He wanted to set up a holding company to use for further investment, one of the current partners was getting out and had to be paid out, a new partner came in and the investment through the holding company made sense etc.

Pillar 2

A dark, semi-transparent background image showing a business meeting. In the foreground, a person's hands are holding a white tablet. Another person's hand is pointing upwards. On a wooden table in the foreground, there is a spiral-bound notebook with a pen and some papers. The background is blurred, showing green foliage.



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Amendment to the Pillar 2 Act

As we have already informed you [here](#), an amendment to the Pillar 2 (Top-up Tax) Act has been submitted.

At the end of August, the amendment was submitted to the Chamber of Deputies as [Document No. 783](#) with minor changes compared to the original government proposal. As the saying goes, the devil is in the details, and this is especially true for Pillar 2. Despite the details and specifics of each group and member entity and jurisdiction, we summarize below the key changes to the proposed amendment that are worth noting. Our summary is not exhaustive, but rather aims to outline only some of the proposed changes.

In the text we use familiar - Pillar 2 - acronyms with explanations below the text itself.

The main good news for all UPEs and IPEs is that the Czech rules have been modified to qualify for Q-DMTT and QDMTT Safe Harbour.

Deadlines/filings

- ▶ **General Information Report (“GIR”)** - will be required within 15 months after the end of the reporting period with an automatic extension to 18 months for the initial period (the deadline cannot be extended) - for more context, go [here](#).
- ▶ Exceptions to the obligation to file a GIR for the IIR/UTPR remain:

- ▶ if the correct GIR is filed by a UPE from a state with which the Czech Republic has an information exchange agreement, or
- ▶ the correct GIR is filed by a designated entity from such state; and
- ▶ the Czech taxpayer notifies the tax administrator by the deadline.
- ▶ GIR for the Czech top-up tax does not necessarily have to be filed by all member entities in the Czech Republic.
- ▶ A submission by one Czech member entity will be sufficient (assuming this will be notified to the top-up tax administrator within the deadline).
- ▶ The exemption from the obligation to file a GIR for the Czech top-up tax should now apply when the obligation to file a GIR for the IIR/UTPR (see above) containing also the necessary information regarding the Czech top-up tax is fulfilled.
- ▶ The above also applies in principle to so-called JVs (joint ventures and JV subsidiaries).

- ▶ **Tax returns** (irrespective of the tax - QDMTT or IIR/UTPR) will be required within the same deadline, namely within 22 months after the end of the reporting period. This deadline may not be extended.
- ▶ A new transitional provision is also proposed that sets the earliest filing deadline for returns/GIRs at 30 June 2026. Given the amended deadlines above, it can be assumed that groups with potentially shorter reporting periods will take advantage of this specific transitional provision.
- ▶ Options for filing a corrective (within the time limit) and supplemental GIR as well as a return should also be introduced.

For most Czech constituent entities, we imagine that the obligation to file a GIR will result in a notice of (qualified) filing in another state. Czech member entities will not be able to avoid making a disclosure.

Use of currency

The current wording of the law with regard to the use of exchange rates and currencies is not straightforward. The amendment should bring a little more certainty and simplification:

- ▶ The calculations themselves should be clearly in the reporting currency. For tax administration, such amount is converted to CZK at the CNB rate for the last day of the reporting period.
- ▶ Conversion to legal values in euro using the average ECB rate for the last month of the preceding reporting period.

Concept of Czech top-up tax (QDMTT)

The existing concept and design of the Czech top-up tax will see many changes, precisely because of the magic "Q" in QDMTT and the QDMTT Safe Harbour. These should already be familiar to fans, readers and connoisseurs of OECD interpretations:

- ▶ There should be a redefinition of the taxpayer: both joint ventures ("JVs") and entities with an element of tax transparency are clearly added.
- ▶ The tax liability for the Czech top-up tax is then incurred separately for each large group. In other words: if a Czech entity is a member of more than one large group, it will not consolidate its obligations and will have separate obligations for each large group to which it belongs.
- ▶ The total domestic top-up tax is determined separately for each "subgroup" in the Czech jurisdiction. Here, the Act refers directly to the OECD rules for separate calculations, specifically (i) MOPE/MOCE, (ii) JVs, (iii) stateless entity, (iv) investment/insurance entity and their aggregate, (v) standard constituent entities.
- ▶ The shares of each entity in the total domestic top-up tax should now be determined within "subgroups", the allocation key remaining derived from the qualifying profit and the effective tax rate of the particular entity. Each of the entities separately pays the part of the top-up tax so determined.

Safe harbours

In Czech law, safe harbours are close to the comprehensive OECD interpretations. The law is being systematically amended with new parameters (which are already familiar to readers of the OECD interpretations). It could be said that as regards safe harbours, the law should be a bit clearer.

Safe harbour for NMCE

- ▶ A new permanent safe harbour is introduced: a rule based on simplified calculations for so-called non-material constituent entities ("NMCEs"). NMCEs are those that are not included in the consolidated financial statements because of their small size/materiality, and such statements must be audited by an auditor.
- ▶ The simplified calculations allow the NMCE primarily to use CbCR accounting data, without having to go through the full Pillar 2 calculation. Note however, the simplified tax included will only be tax payable under the CbCR rules(!).
- ▶ The OECD is expected to expand other areas of a similar safe harbour.

Safe Harbour based on the CbCR Report

- ▶ The entire section of the law dealing with the CbCR Report-based safe harbour – which many of our readers are already familiar with or are beginning to get into – has undergone some fairly significant changes. The proposed changes are intended to reflect OECD interpretations, so the aim is clearly to bring the Czech law into line with OECD rules. Briefly:

- ▶ The law should clearly define the conditions of use: in particular, only for so-called "qualified statements" (with the clear exception of permanent establishments and NMCEs) and the "qualified" CbCR Report (especially with reference to consistent data across a jurisdiction), the CbCR Report without modifications beyond the requirements of this law, exclusion of the effects of selected *hybrid arbitration arrangements*¹.
- ▶ The Act provides for necessary adjustments to CbCR data, such as selected situations relating to PPA (purchase price adjustment) or goodwill.

Other selected "tidbits" worth mentioning

- ▶ If you are tracking transactions between constituent entities made in the period between 30 November 2021 and the entry of Pillar 2, then track both profitable and loss-making transactions. At the same time, you need to review not only the purchase and sale of assets, but also "like-kind transactions" – typically the sale of part of a business.
- ▶ Clear UTPR acceleration rules as early as 2024 when a UPE state uses derogations in accordance with the Directive (i.e. there are no more than 12 UPEs in a given state).
- ▶ The determination of consolidated revenues as an entry criterion for Pillar 2 is clarified – all in line with OECD interpretations.
- ▶ The definition of an investment fund is clarified. The purpose of an investment fund should be to pool assets from at least two investors (as opposed to the original 'large number' of investors).

¹ More on hybrid arbitration arrangements in the next issue of Tax News.

- ▶ POPE (Partially Owned Parent Entity) definition aligns with OECD definition - small word, potentially big change for some - instead of "at least 20% ownership", the test is "more than 20%".
- ▶ The definition of tax benefit is amended in line with OECD interpretations.
- ▶ If an issue is raised in a proceeding before a court or other authority that the implemented top-up tax is disputed (e.g. a conflict with another, superior source of law or due to the existence of a group agreement with a state), the aggregate of qualified top-up taxes in that jurisdiction will be reduced by that amount.
- ▶ There are also many legislative, technical and grammatical clarifications.

The amendment is at the beginning of its legislative journey and some changes may still occur.

Acronyms:

IPE: intermediate parent entity

JV: Joint Ventures

MOPE: minority owned parent entity

MOCE: minority owned constituent entity

NMCE: non-material constituent entity

UPE: ultimate parent entity

QDMTT: qualified domestic minimum top-up tax

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

For most Czech constituent entities, we imagine that the obligation to file a GIR will result in a notification of a (qualified) filing in another state. Czech member entities will not be able to avoid filing a return.

Law and taxes





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The Supreme Court commented on interpreting an agreement on a purchase price amount including any potential VAT

What happened? The defendant investment company, as a prospective seller, entered into a detailed forward contract with the plaintiff, as a prospective buyer, for the purchase of the designated land. The defendant did not know at the time of the conclusion of the future contract whether it would be subject to VAT at the time of the sale (i.e. the conclusion of the purchase contract itself). For this reason, a rider was added to the specific amount of the purchase price stating that “the amount of the purchase price was negotiated including any value added tax that the transfer of the land being sold may be subject to.” However, according to the plaintiff, the circumstances surrounding the conclusion of the future contract showed that it intended to sell the land at a price including VAT.

After the defendant company invited the plaintiff (the buyer) to conclude a purchase contract, a dispute arose between the parties as to the final amount of the purchase price. According to the defendant, in its position as the seller, which was not subject to VAT at the time, this did not affect the price agreement and it considered the agreed purchase price to be final. However, the plaintiff refused to conclude the purchase contract unless the purchase price was reduced by VAT. If he had paid the purchase price in the agreed amount, which did not include VAT, he would not have been able to deduct VAT from that price. The plaintiff thus requested the court to order the defendant company to conclude a purchase contract with him

in accordance with the future contract, but in the wording proposed by him, reflecting the purchase price less VAT, in view of the fact that the seller was not a VAT payer.

Nature of the dispute

The nature of the dispute was thus the meaning of the above-quoted agreement on the purchase price. The Court of First Instance held that the contractual arrangement at issue was sufficiently certain and must

be interpreted as meaning that the amount specified was the maximum amount which the applicant was to pay as the purchase price for the land, whether or not including VAT. The Court of Appeal subsequently agreed with this conclusion. It added that the fact that VAT should be included in the purchase price could not be inferred from the purchase price agreement, nor could it be inferred from any other provision of the future contract or from the purchase contract as an annex thereto.

View of the Supreme Court

However, in its judgment of 23 February 2023, Case No. 23 Cdo 3753/2022-222, the Supreme Court overturned the decisions of the lower courts on the grounds that they had not proceeded in accordance with the statutory rules of interpretation of legal acts refined by doctrine and case law. (e.g. the judgment of the Supreme Court of 31 October 2017, Case No. 29 Cdo 61/2017) and did not sufficiently examine the real will of the parties. In doing so, it stressed, inter alia, that: *“The protection of the good faith of the addressee of the legal act requires (and the first sentence of § 556[1] of the Civil Code expressly so provides) that the court should interpret the legal act only according to the intention of the actor which was or must have been known to the addressee.”*

According to the Supreme Court, the lower courts erred in concluding that the price agreement in the draft purchase contract was completely unambiguous, without, however, following the rules of interpretation laid down by law and further elaborated in the case law of the Supreme Court. In accordance with the conclusions of the case law, the courts should have interpreted the legal act which appears to be unambiguous on the surface, since the conclusion of unambiguity is the result of the interpretation of the legal act. The Court of Appeal thus erred in failing to ascertain the actual intent of the parties; instead, it relied solely on the language of the purchase price agreement at issue.

What is the takeaway from this?

It follows from the decision that the conclusion as to whether or not the agreed purchase price includes VAT must always be made in light of the actual intention of the parties. Only if it cannot be ascertained by such subjective interpretation must the agreement be subjected to objective interpretation, i.e. it must be assessed according to its usual meaning.

Thus, in practice, it is always necessary to examine the circumstances that led to the conclusion of the contract and may have influenced the will of the contracting parties. However, unlike the facts commented on here, the buyer's intention regarding the desired VAT deduction may not be known to the seller, since the tax proceedings are conducted in private and the deduction is only admissible if the conditions laid down by the tax regulations are met. In practice, therefore, it is always advisable to formulate the purchase price agreement in relation to VAT in a sufficiently definite and unambiguous manner so that the true intention of the contracting parties with regard to the amount of the price and the related tax position is captured without any doubt and so that even a possible interpretation of their intention made in accordance with settled case law by the competent court does not allow a different conclusion than the one intended by both parties when concluding the contract.

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

The Supreme Court emphasised that when assessing the agreed amount of the purchase price, it is always necessary to take into account the actual intention of the parties as to whether or not the purchase price includes VAT.

VAT





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Silver Coins and VAT: A Comprehensive Guide for Collectors and Investors

Silver is fast becoming a sought-after investment tool and collector's item, with its price recently surpassing \$32 per ounce. This represents a year-on-year increase of more than one-fourth. Growth is being driven by a combination of factors, including rising industrial demand resulting from the widespread use of silver in electronics and solar technologies. In times of economic uncertainty, silver, like gold, is becoming an attractive haven for investors seeking safe assets.

For the average investor, it is easiest to invest in coins. Will the purchase of coins be subject to VAT? While the taxation of gold coins is very simple (gold coins are exempt from VAT), applying VAT to silver coins is a big adventure. Let's take a look at it together.

(In)validity of coins

Under the VAT Act, money is not considered goods. Even though the term money is not defined by the VAT Act, money must be understood as legal tender of a given state issued in accordance with the applicable legislation of that state. This is logical, as coins circulate rapidly between payers and non-payers as a means of payment and the application of VAT would make it difficult to circulate them.

But how do you know that a given coin is valid? For Czech coins it is relatively easy, as the Czech National Bank informs about each issue of new money through a decree published in the Collection of Laws of the Czech Republic. For coins, the decree specifies the dimensions and weight of the coin, the face value, the silver content, and the description of the reverse and obverse sides. Thus, coins are considered valid if they are issued by the CNB and at the same time it is not stated in the Collection of Laws that they are already withdrawn from circulation. For coins issued abroad (coins issued in the USA, Austria, Australia, New Zealand, for example, are often traded on the Czech market), it is necessary to check the local legislation, as the conditions of validity will differ in each country.

However, "banknotes, stamp cards and coins of Czech or foreign currency sold for collecting purposes at prices higher than their face value or the conversion of their face value into Czech currency according to the exchange rate announced by the Czech National Bank" are considered goods. Therefore, if the price of valid coins is higher than their nominal value, the sale of such coins by a taxpayer in the Czech Republic will be subject to VAT. The taxable amount is the difference between the sale price and the face value. If this difference is zero or negative, the taxable amount is zero.

The face value of Czech coins is easy to ascertain - read it on the reverse side of the coin. For foreign valid coins it is a bit more complicated, the nominal value must be converted into Czech crowns according to the valid exchange rate of the Czech National Bank or the European Central Bank on the date of sale of the coin.

Next, we look at whether silver coins are eligible for the special regime for dealers in second-hand goods, works of art, collectibles and antiques.

Basic or special regime?

The special tax on mark-up regime for dealers in second-hand goods, works of art, collectibles and antiques is regulated in § 90 of the VAT Act and in Annex 4 to this Act. This regime has been introduced to level the tax playing field for traders of goods which are purchased from non-VAT payers and thus traders cannot claim input VAT deductions.

The regime allows traders to tax only the difference between the sale price and the purchase price, i.e. the mark-up is taxed instead of the total sale price. The mechanism is similar to that for the sale of valid coins, however, it is not the face value of the coin that is deducted from the sale price, but

its purchase price. If the difference is zero or negative, the taxable amount and the VAT are set at zero.

Silver coins can theoretically be a work of art, a collector's item, an antique or a second-hand item. So can the special regime be used to save on VAT on purchases? A year ago, the Financial Administration stated on its website² that possible tax evasion consisting in the use of incorrect tax regimes when trading in valid or invalid coins made of precious metals (except gold) has been detected. Let us consider whether coins may fall into one of the four categories of goods for which the special regime may apply.

Works of art

Can silver coins be considered works of art? Theoretically, yes: they are designed by artists, sculptors or designers. For example, the creator of the legendary First Republic five-crown was Otto Gutfreund, our leading cubist sculptor. Under the VAT Act, however, silver coins would have to qualify under Customs Tariff Nomenclature Code 9703 as original sculptures or statues of any material, if made entirely by the artist or as cast sculptures in a limited series of up to eight pieces, produced under the supervision of the artist or his legal representative. Only the artist's initial design, usually made of plaster, would qualify as a work of art, not a series of coins machine struck by the mint.

² [Obchodování platných a neplatných mincí z drahých kovů podléhá DPH a nelze u něj aplikovat zvláštní režim pro použité zboží | Novinky 2023 | Novinky | Finanční správa | Finanční správa \(financnisprava.cz\)](#)

Collectors' items

Coins as collectables must be classified under Customs Tariff Nomenclature Code 9705. This code covers coin collections as well as individual coins of numismatic value. Such coins are characterised by features such as historical significance, limited number of issues, age or other unique characteristics.

This code does not include coins that are produced for commercial purposes, to commemorate, celebrate or illustrate an important event or personality, even if they are produced in limited quantities. Such coins are usually called commemorative coins. They are then classified under Customs Tariff Nomenclature Code 7118, which includes normal valid or invalid coins.

However, such coins may acquire numismatic value due to their age or rarity. A typical example is the brass five-haler with the year 1924, which is one of the rarest Czechoslovak coins in terms of collectability. In its time, the five-haler was the most common First Republic coin. However, only a limited number of 1924 five-halers were minted and this coin is truly rare.

In practice, this means that each silver coin must be individually assessed to determine whether its attributes meet the requirements for collectibles. Newly issued silver commemorative coins will typically not fall into this category and therefore cannot automatically be considered as collectors' items. In its latest judgment, the Supreme Administrative Court³ confirmed that while a coin may have some collector value, what is important is its predominant function at the time of trading.

³ Decision NSS 1 Afs 234/2023 [rozhodnuti-385616 \(nssoud.cz\)](https://rozhodnuti-385616.nssoud.cz)

Antiques

Antiques are classified under Customs Nomenclature Code 9706. These are objects other than works of art or collectors' items, provided they are more than 100 years old. Therefore, if a silver coin does not fall into the previous two categories (it is neither a work of art nor a collector's item) and if it meets the age condition, it qualifies as an antique for the special regime. The only thing that needs to be monitored is the age. This is usually not a problem, the year is always stamped on the obverse side of the coin.

Second-hand goods

If a silver coin cannot be considered a work of art, a collector's item or an antique, we can think about the last category - is it a second-hand item? According to the VAT Act, second-hand goods are tangible movable property that is suitable for further use in an unaltered state or after repair. It must therefore retain its useful function. However, precious metals and precious stones are excluded from this category.

Precious metals and precious stones are automatically excluded from the category of second-hand goods because they are not subject to wear and tear that would depreciate their value. Their value is derived directly from the value of the material from which they are made.

If a precious metal good retains its original function and its value is not determined solely by the amount of precious metal it contains, it can be regarded as second-hand. Take silver cutlery, for example - here one could consider that it is a second-hand good because its primary function is to be

a tool for dining and not just a carrier of silver value. Precious metal coins, however, usually have no such independent function and their value is largely determined by the material from which they are made.

This conclusion was shared by the Supreme Administrative Court in its judgment⁴, which we've already mentioned in relation to collectors' items. The Court stressed that *"the decisive factor in determining whether or not silver coins are second-hand goods will therefore be their function in relation to the preservation of the value of silver"*.

Conclusion

Investing in silver coins is like walking on the slippery terrain of tax regulations, where every step requires attention and caution. From the validity of coins to their age or collectible value to whether they are considered artwork or used goods, every detail can affect how high your investment soars or how low your tax burden falls.

So whether you're a collector looking for your next rare piece or an investor looking for a stable haven for your finances, silver coins remain an attractive option. All you need is the right information and access, and then you can watch your investment grow as brightly and steadily as the price of silver.

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

Investing in silver coins is like walking on the slippery terrain of tax regulations, where every step requires attention and caution. From the validity of coins to their age or collectible value to whether they are considered artwork or used goods, every detail can affect how high your investment soars or how low your tax burden falls.

⁴ Decision NSS 1 Afs 234/2023 [rozhodnuti-385616 \(nssoud.cz\)](https://rozhodnuti-385616.nssoud.cz)

Judicial window

A close-up, high-angle photograph of a wooden gavel resting on a blue book cover. The gavel is positioned diagonally, with its head in the foreground and its handle extending towards the upper right. The book cover has a textured, leather-like appearance. The lighting is dramatic, highlighting the grain of the wood and the texture of the book cover.



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Sale of participation in a holding company and the question of abuse in the subsequent payment of dividends – the view of the Supreme Administrative Court

We bring you the resolution of a very interesting case concerning the issue of the creation of a holding, the payment of dividends and the issue of abuse of law.

Background

- ▶ A holding company was established into which the shares of all partners in Companies 1 and 2 were sold.
- ▶ Subsequently, the holding company decided to distribute the profits of Companies 1 and 2.
- ▶ Subsequently, the liability of the holding company to one of the former (and outgoing) shareholders of Companies 1 and 2 was satisfied out of these distributed profits.
- ▶ The remaining shareholders, who also became shareholders of the holding company, were subsequently partially paid the purchase price of their shares and the new shareholder (CFO of Company 2) was paid an advance on the profit distribution.
- ▶ According to the tax authorities, the above-mentioned conduct was primarily aimed at obtaining a tax advantage in the form of an exemption from income from the holding company's profit share in the subsidiaries and, secondarily, at exempting the former shareholders from income tax on the transfer of their shares in Companies 1 and 2 for consideration, which originated in the aforementioned profit share.
- ▶ Accordingly, the tax administrator assessed withholding tax (for the 2016 tax year) due to the failure to withhold the tax and the failure to remit tax at the rate of 15% on the dividends (by one of the subsidiaries).

Selected arguments of the company

- ▶ There was no abuse of law precisely because of the economic and legal justification for the formation of the holding structure and the related transactions.
- ▶ In the long term, there was a planned exit of one shareholder from Company 1 (25% stake) and Company 2 (52% stake).
- ▶ Another reason was to facilitate the entry of new shareholders. The CFO of Company 2 became a new shareholder.
- ▶ Business expansion is planned in the form of acquisition of other companies or new business opportunities, with the holding structure allowing better financing of individual companies.
- ▶ In view of the lack of available funds and the provisions of the articles of association, it was not possible to pay the profit shares to the individual shareholders and then use these funds to buy out the shareholding of the outgoing shareholder.
- ▶ The reason for the chosen procedure was therefore to pay off the departing partner.
- ▶ The profit share was financed in full by the bank and was not paid in full - the holding company kept part of the money.
- ▶ The gradual payment of the other shareholders' shares ensured that the departing shareholder could leave, the loan could be drawn down, the business risk could be spread and the new shareholder could join without absolute economic paralysis by drawing down a disproportionate loan.

Selected arguments of the tax administrator

- ▶ It did not find the argument concerning the lack of funds to buy out the shares of the departing shareholder to be justified. Companies 1 and 2 had some accumulated profits. Although these profits would not have been sufficient to pay for the business shares, there was the possibility of borrowing the remaining amount, which was eventually done. Nor can the possibility of the remaining shareholders committing themselves to the future payment of the price of the departing shareholder's shares be disregarded.
- ▶ The tax administrator also pointed out that there had been dividends by Company 2 in previous years. This was at a time when the shareholders were already aware of the planned departure of one of them, and it was therefore at their sole discretion whether or not to use these profits to pay the shares of the departing shareholder.
- ▶ In relation to the activities of the holding, the tax administrator stated that the alleged intention to expand the business by acquiring other companies was not proven in any way in the tax proceedings. The tax administrator assessed this intention in terms of the nature of the transactions in 2016, when the holding company was established, concluding that the objective of making acquisitions was not demonstrated at that time. The fact that in the following years the holding found a use in the form of negotiations for future acquisitions, which were not successful, cannot be considered as evidence of the economic justification of the holding structure in 2016.

View of the Regional Court

The Regional Court sided with the tax administrator - a selection of its arguments:

- ▶ The intention of one of the shareholders to sell his shares in no way proves the economic rationality of the establishment of the holding structure and other transactions related to this establishment.
- ▶ Several variants of the solution to the above-mentioned plan have been offered, and the establishment of a holding structure for this purpose appears to the Regional Court to be purely expedient, driven only by the desire to obtain a tax advantage.
- ▶ The Regional Court did not consider it economically rational to establish a holding structure for the purpose of buying out the shares of the departing shareholder, as other, more sensible options were available. First of all, the possibility of dividing the shares among the other shareholders was possible, but it is not true that such a transaction would be administratively demanding.
- ▶ In connection with the acquisition of a business share by a new shareholder in the holding company, it cannot be overlooked that this new shareholder was paid an advance on the payment of profits by the holding company, while the same amount should have been spent by this shareholder to pay for his share in the holding company. He has thus, in effect, paid nothing for his participation in the holding. The will to involve him in the business was thus enormous on the part of others. The Regional Court therefore regards the terms of his entry into the holding company as very favourable and sees no reason why such compatible contractual terms could not have been established even if he had joined Companies 1 and 2 without the holding company being established.

- ▶ The transfer of the shares described above could then be financed in the same way as was done by the holding company for the purchase of the shares of the departing shareholder, i.e. from the proceeds of the retained earnings of Companies 1 and 2, with the remaining purchase price of the shares being financed by a bank loan.
- ▶ It cannot be overlooked that some activity with actual results, which, however, cannot be described as business expansion in the form of acquisitions, has only been carried out by the holding company since 2020. Until then, it has not carried out any economically rational activity in the form of the acquisition of new companies alleged by the applicant. Since 2020, certain activities have been carried out by the holding company, but these were administrative, marginal activities, the actual cooperation with the companies mentioned was always carried out by Companies 1 and 2 and was then purposely presented as an activity carried out by the holding company.
- ▶ The implausibility of the stated purpose is reinforced by the assertion that the nature of the holding was in fact a "pure holding", the purpose of which was merely to hold and manage its own holdings in subsidiaries. According to the Regional Court, that purpose, in light of all the circumstances of the case described above, does not constitute a rational reason for the establishment of the holding structure, but on the contrary, it is indicative of its true purpose, which was to obtain a tax advantage.

View of the Supreme Administrative Court

The Supreme Administrative Court (SAC) disagreed with the assessment of the tax administrator and the Regional Court and sided with the company - a selection of its arguments:

- ▶ According to the SAC, the combination of the transactions in question - i.e. the exempt payment of a dividend and the exempt sale of business shares - defeated the purpose of the tax exemption under § 19(1)(ze) of the ITA. Its purpose is to tax income only at the final recipient. That is not what has happened in the present case. The individual shareholders have therefore in effect obtained money from the holding structure without any tax being paid. Such a result, according to the SAC, is undoubtedly contrary to the purpose and meaning of the quoted provision.
- ▶ However, according to the SAC, the mere fact that the result of the operations carried out is undesirable from the point of view of tax law (i.e. an objective element has been fulfilled) is not sufficient for the conclusion of abuse of law. The tax authorities must also prove the existence of a subjective element, namely that obtaining a tax advantage was the sole, or at least predominant, reason for the taxpayer's conduct. According to the SAC, the tax authorities (and consequently the Regional Court) in this case failed to prove or incorrectly assessed the fulfilment of the subjective criterion of the abuse of rights test.
- ▶ According to the SAC, the fact that the holding company is being built and its activities developed gradually cannot be a reason to conclude that the law was abused when it was established in 2016. Entrepreneurs cannot be required to make their business immediately successful and sophisticated. The SAC is aware that the unified accounting and administrative agenda of the holding structure only started to take real form in 2020 and 2021, which could without further ado be indicative of the holding's long-term inactivity. However, it should be borne in mind the original 'umbrella' nature of the holding company (approaching a pure holding company) and the fact that the single accounting and administrative structure was not the only claimed reason for the establishment of the holding company.
- ▶ Another reason for the establishment of the holding company was to balance the business shares in the subsidiaries and to balance the risks so that the shares in the business companies would correspond to each other. The shareholders thus (also in the future) share equally in the benefits and risks of both companies. According to the SAC, the described solution has a clear economic justification and can justify the establishment of a holding structure. The SAC does not dispute that it is possible to "straighten out" the amount of the shares without setting up a holding structure. However, if an entrepreneur has several interests in establishing a holding company, it is quite logical to prefer to settle the shares within the holding company structure.
- ▶ According to the SAC, it cannot be inferred from the specific transactions used by the company in the payment of profits that its conduct was purposeful or economically unjustified. On the contrary, the company had clearly made an economic and business judgment which resulted in the decision to disburse the profit using the loan. In the situation described above, where the company paying out the profit share had demonstrated the manner and circumstances of financing the payment of the profit share, it was for the tax authorities to prove that the company's conduct was purposive and economically unjustified. In this respect, it was also incumbent on the tax authorities to refute the company's claim that the shareholders (natural persons) did not have sufficient funds to purchase the shareholding and would not have received a bank loan, since banks do not offer such a financial instrument to natural persons.
- ▶ The SAC further stated that it understood the company's argument that the income of the individual partners was properly subject to withholding tax in the past and subsequently. Although past and subsequent honesty is not in itself a basis for finding that there was no abuse of the law in the interim, the facts described in the present case aptly illustrate that the company did not intend merely to obtain a tax advantage when it established the holding company.

- ▶ According to the SAC, the tax authorities could conclude that the alleged acquisition activities of the holding company were purposeful if, for example, the allegations were unreliable and everything indicated that the transactions were carried out only in order to artificially create the impression of acquisition activities. However, according to the SAC, this was not the case. A number of documents (emails, statements, notes) were submitted showing that negotiations on acquisitions had indeed taken place.
- ▶ According to the tax authorities and the Regional Court, the purpose of the planned acquisitions cannot be fulfilled if the transactions in question did not take place. That conclusion is incorrect. The fact that the acquisitions in question were not successfully completed does not necessarily mean that the conduct was purposeful.
- ▶ The tax authorities and the Regional Court were of the opinion that the described actions could have been carried out even at the level of subsidiaries without the establishment of a holding company. This conclusion may be valid in purely general terms. However, according to the Supreme Administrative Court, it also denies the holding company, its shareholders and its subsidiaries the possibility to consider the most appropriate form of business for them. In other words, simply because the acquisitions could be negotiated from the position of the managing directors - the shareholders of the subsidiaries - it cannot be concluded that the holding company was established for a purpose. It is the free decision of each entrepreneur as to what form of activity he chooses. The SAC concluded that in this case the acquisitions were negotiated by the shareholders and managing directors of the holding company. The SAC sees nothing unusual (and certainly not unlawful) in the fact that the holding company entrusted part of the negotiations related to the acquisitions to its subsidiaries.
- ▶ The SAC therefore concluded that the following are in themselves sufficiently significant, logical and consistent with the general characteristics of a holding company: 1. the need for one of the

shareholders to withdraw, the entry of a new shareholder, the settlement of business shares and related aspects, and 2. acquisition activity. All the more so because the reasons alleged are significant in their entirety and thus outweigh the tax purpose, which was certainly a welcome but not the main reason for the conduct. According to the SAC, the transactions pursued a clear and legitimate objective and were economically justified in themselves, even if they were not accompanied by a tax advantage. Moreover, the company, by referring to the general advantages of the holding company, has, according to the SAC, adequately illustrated the overall context of the reasons which led to the establishment of the holding structure.

So it worked out well for the taxpayer this time. However, this case demonstrates that the issue of holding companies is a delicate one and it is always necessary to assess in detail the reasons for the transaction, the manner of execution and the related documentation. We will be happy to assist you with the assessment of your holding structure.

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Another (this time negative) view of the Supreme Administrative Court on the push down of an acquisition credit and the question of abuse of law

We bring you an interesting judgment of the Supreme Administrative Court regarding the push down of an acquisition credit and the issue of abuse of law.

Background

The case at hand concerned the deductibility of interest expense for a Czech company. The interest (or credit) arose in the context of several transactions related to the entry of an unrelated investor into an international manufacturing and trading group. The new investor did not legally enter directly into the Czech company, but into the parent company of the whole group. From the point of view of the Czech credit financing assessment, this was a situation falling into the category referred to as a debt push-down.

- ▶ So what exactly happened? A foreign parent company sold a stake in one of its Czech subsidiaries ("Target") to its other (newly established) Czech subsidiary ("SPV"). The SPV took a loan from the parent company to buy the stake. The interest on the loan taken to buy the subsidiary is generally ineffective for tax purposes.

- ▶ After buying the stake, the Target then inflated the SPV. After the merger, the SPV treated the interest on the loan as tax-effective because the reason for ineffectiveness (the existence of the subsidiary for whose purchase the loan was taken) had disappeared.

View of the tax administrator

- ▶ The tax administrator assessed the transactions leading to the interest on the loan in question as economically unreasonable (they had no independent economic or other rational purpose in its view) and concluded that the company had committed an abuse of law, whereby the unjustified tax advantage was, according to the defendant, interest that reduced the tax base of the company.

- ▶ It pointed out that the "global crisis" argument was general and did not explain the specific steps taken.
- ▶ The tax administrator admitted that in the syndicated loan agreement between the foreign parent company and the foreign bank, the bank in question required the creation of a "partnership structure" (changing the legal form of the Target to a limited partnership and creating two new limited liability companies to serve as its limited partner and general partner). However, the required structure was never created and the company has not shown that the contract with the bank was amended in this respect.
- ▶ The tax administrator stressed that the loan from the parent company to the SPV was not a condition for the bank to refinance the external loan granted for the acquisition. The requirement to change the organisational structure in the Czech Republic and the legal form of the Target had not been fulfilled by 1 January 2009, yet the acquisition of the Target was subsequently carried out, even though the subsequent merger could have taken place without its acquisition. According to the tax administrator, the company did not document the agreement with the bank to simplify the holding structure.

View of the Regional Court

- ▶ The Regional Court stated, among other things, that in its view there was nothing to prevent the merger of the subsidiaries from being carried out directly, i.e. without a sale and the associated loan. It considered the sale and the loan to be artificial and the related interest costs to be tax ineffective on the basis of the prohibition of abuse of law.
- ▶ In this particular case, the Court was not persuaded by the taxpayer's argument that the case had to be considered in the context of the entry of a new investor into the group's foreign parent company and

to take into account the requirements of the financing bank (which provided a loan to the parent company).

View of the SAC

- ▶ Since the transactions were in fact only a "purchase of self" (although formally the company is a different legal entity than the original Target), and the funds "obtained" from the loan were not effectively used for the company's business, the purpose of § 24(1) of the Income Tax Act (ITA) was violated, i.e. taxation on a "net basis" with the possibility of deducting only those expenses (costs) that are related to the taxpayer's business. The SAC agreed with the conclusion that the interest on the loan was not meaningfully linked to the company's economic activity, thus fulfilling the objective element of abuse of law.
- ▶ As regards the company's argument that the loan and the subsequent restructuring resulted from an external acquisition of the German group by a Dutch investor, the SAC found that the company had not documented this fact. The acquisition took place at a different level of the group and the ownership relationship between the foreign parent company and the target (albeit formally in the form of a different legal entity) did not change significantly. At the same time, there was no flow of funds from the German or new Dutch owners to legal entities registered in the Czech Republic. It is not clear how the acquisition of the German companies was related to the series of transactions in the Czech Republic. According to the Supreme Administrative Court, the entry of a new owner into the 'upper echelons' of the group cannot be regarded as the economic reason for the transactions described above.
- ▶ According to the SAC, the transaction in question is not a "normal case" of an acquisition using SPVs and bank financing. This is because it is common for a business share to be acquired by an outsider who, without the transaction, would have no influence over the acquired company and would therefore not be able to assert its interest in the

subsequent merger of the acquired company and the SPV (which is burdened by a loan from the financing bank) in any other way. However, both the SPV and Target were already owned by the foreign companies in question before the restructuring, so there was nothing to prevent the merger from proceeding without the acquisition of Target through the SPV. Moreover, the funds spent by the SPV on the purchase of the stake in target were provided by a related company and not by an external entity (a newly entering investor or bank). Thus, even the typicality of the transactions does not prove their economic justification in the specific case.

- ▶ During the tax audit, the company documented that in the agreement between the foreign parent company and the foreign bank, it was agreed that Target would change its legal form to a limited partnership, with two new Czech limited liability companies owned by German parent companies as its general partner and limited partner. However, this ownership structure was never implemented and the bank's request cannot therefore be regarded as evidence of the economic justification for the changes that were actually made (contrary to the bank's request). The company has not documented that the bank agreed to the simplification of the structure that eventually took place. However, even if the company had established this, the mere consent of the bank granting the loan to the foreign parent company could only show that the transaction did not significantly impair the bank's collectability of its client's receivables, not that it was economically justified for the company.
- ▶ According to the SAC, if the bank actually waived its demand (as the company claims), no restructuring had to take place at all. Once it had taken place, only a merger could have been carried out, without the prior transfer of the business shareholding that led to the loan being secured in order to pay the purchase price.
- ▶ The SAC concluded that the company had not proved its claim that it had achieved positive economic results thanks to the restructuring.

Given that the credit burden was objectively disadvantageous for the company, it is possible that it would have achieved even better results without it. The positive results of the group as a whole (even if they were shown to be linked to the restructuring of the Czech companies) could not demonstrate that the transactions were economically meaningful for the Czech company.

- ▶ As regards the question of the existence of an element of tax advantage and the company's reference to the taxation of the interest in question in Germany, the SAC held that it was clear that the company had paid lower taxes in the Czech Republic as a result of the application of the interest on the loan at issue and had therefore obtained a tax advantage.

So in this case it did not turn out well for the taxpayer. Compared to the Teleplan case, this judgment indicates that the SAC places great emphasis on the form of contractual documentation with the financing bank when "pushing down" an acquisition loan. Attention should therefore be paid to this aspect. We will be happy to assist you with the proper setup of acquisition transactions.

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

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