TAXAND

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TAX AUDIT ADVISORY

BMB Newsfilter

 4th quarter 2021

INDEX

PAGE 2
TOP 1: Tax revolution in Slovakia

PAGE 3
TOP 2: Information on tax audits and open data of financial administration

PAGE 4
TOP 3: Amendment to the Accounting Act

PAGE 6
TOP 4: Setting off tax overpayments during a tax deferral

PAGE 7
TOP 5: Impact of increased minimum wage and Kurzarbeit

PAGE 8
TOP 6: European Parliament approved the Public CbCR Directive

TOP 7: Proposed EU Withholding Tax Directive

PAGE 9
TOP 8: Judgement of a Czech court in the case of Airbnb income

PAGE 10
TOP 9: ECJ to review German TPD obligations

TOP 10: New TP guidance on financing structures in Germany

PAGE 11
Useful links

At the end of the year, terms "tax revolution" and "tax reform" were the most used ones in the area of taxes. According to our founding partner and tax advisor Renata Bláhová, who could follow part of the process from close proximity, the tax revolution as presented by the Minister of finance is merely a bold political vision, which first of all needs to be agreed upon by the government. We are certainly pleased that a substantial part of the Smart Tax project, which we have been keeping you informed about since last year (more on this topic in TOP 1), has remained part of the presented vision. All VAT registered entities will be pleased to learn that the e-invoice project is likely to be postponed, although it is an irreversible process. The testing phase is not due to start until 2023, which means the sharp launch will most likely be postponed by a year as well.

Further important domestic news relates to tax audits (TOP2), digitisation of accounting (TOP3) and the year's end revival of the 3A First-Aid-Scheme for companies in lockdown (TOP5).

On the international scene, there have also been some noteworthy developments, including the approval of EU's public CbC reporting (TOP 6), an interesting Prague court ruling on the taxation of Airbnb as a business (TOP 8), and 2 German transfer pricing lawsuits (TOP 9 and 10).

Despite all the turbulence in the society, the BMB team wishes you good health and a peaceful Advent season.

CONTENTS IN BRIEF:

TOP 1: Tax revolution in Slovakia

TOP 2: Information on tax audits and open data of financial administration

TOP 3: Amendment to the Accounting Act

TOP 4: Setting off tax overpayments during a tax deferral

TOP 5: Impact of increased minimum wage and Kurzarbeit

TOP 6: European Parliament approved the Public CbCR Directive

TOP 7: Proposed EU Withholding Tax Directive

TOP 8: Judgement of a Czech court in the case of Airbnb income

TOP 9: ECJ to review German TPD obligations

TOP 10: New TP guidance on financing structures in Germany

INDEX

PAGE 2
TOP 1: Tax revolution in Slovakia

PAGE 3
TOP 2: Information on tax audits and open data of financial administration

PAGE 4
TOP 3: Amendment to the Accounting Act

PAGE 6
TOP 4: Setting off tax overpayments during a tax deferral

PAGE 7
TOP 5: Impact of increased minimum wage and Kurzarbeit

PAGE 8
TOP 6: European Parliament approved the Public CbCR Directive

TOP 7: Proposed EU Withholding Tax Directive

PAGE 9
TOP 8: Judgement of a Czech court in the case of Airbnb income

PAGE 10
TOP 9: ECJ to review German TPD obligations

TOP 10: New TP guidance on financing structures in Germany

PAGE 11
Useful links

TOP 1: TAX REVOLUTION IN SLOVAKIA

As stated above, at this point, the tax revolution presented to the public by the Finance Minister in November is just a bold political vision, consisting of four main parts.

- Family support
- Taxation of employment
- Taxation of companies
- Taxation of self-employed persons

From the perspective of companies, the second and third parts are of importance. We briefly discuss both of them below.

In the **Taxation of employment** section, the old-new vision of simplifying and unifying taxes and social/health insurance contributions, which would be collected in one place, probably through the tax administration, or alternatively through the Social Insurance Agency, was presented in a revolutionary way. Technically and technologically, this is a very difficult challenge that has been revived at regular intervals by each new government for more than 15 years. Until there is a detailed plan, including a legislative proposal, at this point it should only be summarised that it **should lead to a reduction in the overall tax and insurance burden of about 5%:**

- Employees will pay only tax of **19%,**
- Employer will pay (from the gross salary of the employee) social/health insurance contributions of **39%,**
- Employee bonus will be introduced for low-wage earners **(max. €100),**
- Monthly income up to **€357** will not be taxable,
- Social/health insurance bonus for employers will be introduced (from gross salary of the employee, 10% for an employed student and 20% for an employed person with over 70% disability),
- Ban on rising taxes and insurance contributions should be introduced in the Constitution.

How should it be financed:

- Upper limit for insurance contributions will be abolished,
- Abolishment of insurance exceptions (**€300 million),**
- Abolishment of tax exceptions (**€250 million),**
- Savings from the unified collection of taxes and insurance contribution (**€50 million),**
- Increase in legal employment by 2% and dynamic effects (**€300 million).**

INDEX

PAGE 2
TOP 1: Tax revolution in Slovakia

PAGE 3
TOP 2: Information on tax audits and open data of financial administration

PAGE 4
TOP 3: Amendment to the Accounting Act

PAGE 6
TOP 4: Setting off tax overpayments during a tax deferral

PAGE 7
TOP 5: Impact of increased minimum wage and Kurzarbeit

PAGE 8
TOP 6: European Parliament approved the Public CbCR Directive

TOP 7: Proposed EU Withholding Tax Directive

PAGE 9
TOP 8: Judgement of a Czech court in the case of Airbnb income

PAGE 10
TOP 9: ECJ to review German TPD obligations

TOP 10: New TP guidance on financing structures in Germany

PAGE 11
Useful links

The section **Taxation of companies** was briefly introduced by the Finance Minister with a focus on three benefits for businesses:

- Decrease in the **corporate income tax rate from 21% to 19%** and its unification,
- **Super deduction of productive investment assets**, flexibly up to 50% of the tax base,
- **Group taxation of companies** owned by the same entity, which enables setting off losses against profits, paying the tax from a consolidated tax base of the whole group only, and abolishing administrative burden in connection with the transfer pricing documentation.

How should it be financed:

- Increasing the dividend tax from 7% to 9% (€26 million),
- Introduction of e-invoices (€127 million),
- Higher taxes for banks, oligopoly and monopoly (€200 million),
- Anti-fraud-measures and dynamic effects (€160 million).

We are pleased that the reform also includes two important Smart Tax measures (article in Slovak Spectator): super depreciation and group taxation. Given that neither of these measures requires a significant fiscal burden, and, at the same time, both have technically already been partially prepared by the expert section of the Ministry of Finance, we believe that they have a good chance of being approved according to the prepared German model next year with effect from 1 January 2023. Group taxation is already supported by large Slovak businesses (statement of CLUB 500).

We will keep you informed about further revolutionary developments throughout next year with the Christmas wish: May the changes which are particularly welcomed by businesses be approved.

TOP 2: INFORMATION ON TAX AUDITS AND OPEN DATA OF FINANCIAL ADMINISTRATION

In October 2021, the Financial Directorate published Information on the performance of corporate income tax audits. In the introductory part, it defines the objective of the tax audit, the duties of the tax administrator and the taxpayer's burden of proof. The Information lists in detail the documents and data to be submitted by the taxpayer during a tax audit as well as the areas that may be targeted by the tax audit. The Financial Directorate further informs on the procedure for tax audits and specifically discusses the situation when the taxpayer submits the data in electronic form and the tax audit is carried out through the IDEA software.

In November 2021, the financial administration launched the new OpenData portal, where a wide range of tax-related data, charts and statistics are made accessible to the public. There are a total of 144 datasets on the portal.

BMB Newsfilter

INDEX

PAGE 2
TOP 1: Tax revolution in Slovakia

PAGE 3
TOP 2: Information on tax audits and open data of financial administration

PAGE 4
TOP 3: Amendment to the Accounting Act

PAGE 6
TOP 4: Setting off tax overpayments during a tax deferral

PAGE 7
TOP 5: Impact of increased minimum wage and Kurzarbeit

PAGE 8
TOP 6: European Parliament approved the Public CbCR Directive

TOP 7: Proposed EU Withholding Tax Directive

PAGE 9
TOP 8: Judgement of a Czech court in the case of Airbnb income

PAGE 10
TOP 9: ECJ to review German TPD obligations

TOP 10: New TP guidance on financing structures in Germany

PAGE 11
Useful links

Data from the portal is available free of charge and can be downloaded in several formats. The information on the portal is divided into eight categories: Financial administration, Collection of taxes and customs duties, Administration of customs duties, Administration of taxes, Arrears, recovery and enforcement, Tax audit, Information provision and Being healthy is a win. The data will be updated on an ongoing basis and additional datasets as well as data for periods prior to 2015 will be added over time.

TOP 3: AMENDMENT TO THE ACCOUNTING ACT

On 2 November 2021, the Parliament approved the Amendment to the Accounting Act No. 431/2002, which will come into effect on 1 January 2022.

1. *Digitisation of accounting from 1 January 2022*

The Amendment to the Accounting Act responds to the growing trend of electronization of companies and introduces long-awaited provisions on paper and electronic form of accounting records. **The amendment sets out the possible ways of transforming an accounting record into electronic form** and, in addition to the secured conversion, **allows for the use of scanning** to transform an accounting record. This change represents a significant simplification for companies.

The conditions for **transforming an accounting record by scanning** are defined in section 33. The accounting entity is still obliged to ensure the authenticity of the origin, the integrity of the content and the legibility of the accounting record. In addition, when scanning, the accounting entity is obliged to ensure the completeness of the accounting record in the new form, the consistency of the content as well as the integrity of the content.

The accounting entity may ensure the authenticity of the origin of an accounting record and the integrity of its content by having an effective internal control system for accounting records. The exchange of electronic accounting records shall be subject to specific conditions specified by law.

The possibilities are also extended in relation to the signature record, which means, in addition to the handwritten signature, a **qualified electronic signature or a similar demonstrable signature record** that allows the unambiguous demonstrable identification of a person (the signature record may be replaced by the electronic exchange of data).

Another change is that it will not be necessary to keep accounting records exclusively in paper form. **An accounting entity may also keep accounting records electronically,** subject to the conditions specified by law. The company is obliged to define and comply with the manner in which it will keep the documentation. The retention period of 10 years remains unchanged.

INDEX

PAGE 2
TOP 1: Tax revolution in Slovakia

PAGE 3
TOP 2: Information on tax audits and open data of financial administration

PAGE 4
TOP 3: Amendment to the Accounting Act

PAGE 6
TOP 4: Setting off tax overpayments during a tax deferral

PAGE 7
TOP 5: Impact of increased minimum wage and Kurzarbeit

PAGE 8
TOP 6: European Parliament approved the Public CbCR Directive

TOP 7: Proposed EU Withholding Tax Directive

PAGE 9
TOP 8: Judgement of a Czech court in the case of Airbnb income

PAGE 10
TOP 9: ECJ to review German TPD obligations

TOP 10: New TP guidance on financing structures in Germany

PAGE 11
Useful links

2. *Electronic depositing of documents from 1 January 2022*

Another approved change concerns the depositing of documents in the Register of Financial Statements. In order to extend the functionalities of the register and to eliminate errors in non-automated processing of accounting documents, all accounting units will be obliged to **deposit** all accounting documents for the accounting period 2022 or for previous accounting periods **in the Register of Financial Statements** after 1 January 2022 **only in electronic form**.

The Slovak Information Service and accounting units not established for the purpose of business (e.g. a civil association, if it does not have an obligation to be audited or an obligation to submit a tax return, etc.) may continue to deposit documents in paper form.

3. *Public/non-public part of the Register of Financial Statements*

From the beginning of 2022, **the public part of the Register of Financial Statements will be extended to include further legal forms of legal entities**, meaning all legal entities will be included in the public part of the Register. These are mainly land communities, but also non-governmental non-profit organisations such as civic associations, associations of owners of flats and non-residential premises, interest associations of legal entities and others. Thus, **from 1 January 2022, only documents of individuals** (sole traders) and branch offices of foreign persons will remain in the non-public part of the register.

4. *Count of inventory*

Under the current provisions, an entity may take a physical count of its inventory at any time during the accounting period and report the inventory at the balance sheet date by means of increases and decreases.

The amendment **extends the possibility of taking count of inventory to the month following the balance sheet date**, similarly as in the case of other tangible assets.

5. *Company in crisis*

The amendment adds a **section relating to companies "in crisis".** According to the Commercial Code, a company that is in crisis **may not repay money replacing own funds** and its accounts may not include transactions that meet the ban on repayment of money replacing own funds. **If the entity accounts for these facts, it will violate the terms of the Commercial Code and of the Accounting Act**.

INDEX

PAGE 2
TOP 1: Tax revolution in Slovakia

PAGE 3
TOP 2: Information on tax audits and open data of financial administration

PAGE 4
TOP 3: Amendment to the Accounting Act

PAGE 6
TOP 4: Setting off tax overpayments during a tax deferral

PAGE 7
TOP 5: Impact of increased minimum wage and Kurzarbeit

PAGE 8
TOP 6: European Parliament approved the Public CbCR Directive

TOP 7: Proposed EU Withholding Tax Directive

PAGE 9
TOP 8: Judgement of a Czech court in the case of Airbnb income

PAGE 10
TOP 9: ECJ to review German TPD obligations

TOP 10: New TP guidance on financing structures in Germany

PAGE 11
Useful links

6. *Contents of the annual report for non-profit organisations*

The Accounting Act prescribed the content of the annual report for business entities in the first place. Now, **the amendment defines the essentials of the annual report also for non-profit organisations** that are obliged to have their financial statements audited by an auditor due to the 2% income exceeding €35,000 (mostly civic associations, special purpose churches, etc.).

7. *Changes to sanctions*

Lower limits for fines for breaches of the Accounting Act are being set, as they have not been set so far. Fines are also being set for the failure to deposit documents in the register, for breaches in the area of retention of accounting documentation and others.

TOP 4: SETTING OFF TAX OVERPAYMENTS DURING A TAX DEFERRAL

Section 57 of the Tax Procedure Code (Act No. 563/2009 Coll.) enables the taxpayer to file a request with the tax administrator to defer payment of the tax or to allow payment of the tax in instalments, subject to the conditions set by the Financial Directorate. The taxpayer must justify its request and document the reasons, e.g. by an economic analysis demonstrating the negative impact on business activity. This can be particularly helpful to taxpayers in difficult times, e.g. during the current pandemic period. However, in this connection we would like to point out that if the taxpayer is granted the deferral or the payment of the tax in instalments (up to 24 months), an eventual excessive VAT deduction of the taxpayer will be set off against the deferred tax or instalment by the tax administrator. The tax administrator will inform the taxpayer of this fact. The administrator justifies this procedure by referring to section 79(1) and (7) of the Value Added Tax Act (Act No 222/2004 Coll.) in connection with section 55(6) of the Tax Procedure Code.

Example:
Following a tax audit, an additional tax assessment of €200,000 is imposed on the taxpayer and becomes due. The taxpayer files a request for a deferral of 24 months. The tax administrator grants the deferral of 24 months, i.e. the taxpayer is obliged to settle the tax not now, but in 2 years. The deferred tax amounts to €200,000.

Subsequently, an excessive VAT deduction of €50,000 arises to the taxpayer based on a regular VAT return. The tax administrator will not refund the excessive VAT deduction, but it will set off the whole amount of €50,000 against the deferred tax.

BMB Newsfilter

INDEX

PAGE 2
TOP 1: Tax revolution in Slovakia

PAGE 3
TOP 2: Information on tax audits and open data of financial administration

PAGE 4
TOP 3: Amendment to the Accounting Act

PAGE 6
TOP 4: Setting off tax overpayments during a tax deferral

PAGE 7
TOP 5: Impact of increased minimum wage and Kurzarbeit

PAGE 8
TOP 6: European Parliament approved the Public CbCR Directive

TOP 7: Proposed EU Withholding Tax Directive

PAGE 9
TOP 8: Judgement of a Czech court in the case of Airbnb income

PAGE 10
TOP 9: ECJ to review German TPD obligations

TOP 10: New TP guidance on financing structures in Germany

PAGE 11
Useful links

The same procedure will be taken if another excessive deduction arises until the total amount of tax is settled, even though the tax administrator has granted a deferral of 24 months.

To sum up, the taxpayer pays VAT to its supplier when settling an invoice and this VAT will not be refunded by the tax administrator but set off instead.

TOP 5: IMPACT OF INCREASED MINIMUM WAGE AND KURZARBEIT

As of 15 July, the subsistence minimum has risen to €218.06. This increase has an impact on the calculation of e.g. wage tax advances from 1 January 2022.

Please find a summary in the table below:

Type of tax-free allowance /tax bonus	Amount
Personal tax-free allowance	€381.61 /month, €4,579.26 /year
Spouse tax-free allowance	€4,186.75 /year
Tax bonus per child under 6 years	€47.14 /month, €565.68 /year
Tax bonus per child 6-15 years	€43.60 /month, €523.20 /year
Tax bonus per child over 15 years	€23.57 /month, €282.84 /year

In November 2021, the government decided to increase the first-aid contributions again, with effect for the months November and December 2021. Employers will thus be able to draw contributions from the more favourable first-aid-plus scheme. Contributions under measure 3A for temporary Kurzarbeit (short-term work) will increase to 80% of the total labour costs from November 2021, with a maximum amount of €1,100 per employee. However, measure 3B (decrease in sales revenues) remains suspended until December 2021. From 1 January 2022, the scheme was originally supposed to be replaced by the permanent Kurzarbeit system, but as the pandemic situation has worsened again and the first-aid-scheme is more favourable for companies, at the beginning of December the Parliament approved of a change which postpones the launch of the permanent Kurzarbeit by 2 months, i.e. until March 2022.

INDEX

PAGE 2
TOP 1: Tax revolution in Slovakia

PAGE 3
TOP 2: Information on tax audits and open data of financial administration

PAGE 4
TOP 3: Amendment to the Accounting Act

PAGE 6
TOP 4: Setting off tax overpayments during a tax deferral

PAGE 7
TOP 5: Impact of increased minimum wage and Kurzarbeit

PAGE 8
TOP 6: European Parliament approved the Public CbCR Directive

TOP 7: Proposed EU Withholding Tax Directive

PAGE 9
TOP 8: Judgement of a Czech court in the case of Airbnb income

PAGE 10
TOP 9: ECJ to review German TPD obligations

TOP 10: New TP guidance on financing structures in Germany

PAGE 11
Useful links

TOP 6: EUROPEAN PARLIAMENT APPROVED THE PUBLIC CBCR DIRECTIVE

On 11 November, the European Parliament adopted the Directive on public country-by-country reporting. This was the last stage of the approval process, and the directive will enter into force 20 days after its publication in the Official Journal. EU Member States will then have 18 months to transpose the directive into their national legislation, i.e. by mid-2023.

The directive reflects the European Commission's long-standing intention to improve transparency in the corporate tax area. Country-by-country reporting is a tax transparency tool that aims to require sufficient data to identify the country-specific part of a multinational company's activities. The aim is to stop non-transparent practices, such as tax avoidance and aggressive tax planning, which lead to erosion of the taxpayer's tax base and thus to a loss of tax revenue for countries. Currently, multinational companies are required to submit their CbC reports to the tax administration, but do not have to make them public.

The new directive requires multinational companies with a consolidated turnover of more than €750 million to publish specific information, including the number of employees, sales revenues, the amount of profit or loss before tax, the amount of tax paid and deferred, as well as retained earnings. The information must be structured by individual Member States as well as by third countries stated either on the EU blacklist or, for two consecutive years, on the grey list.

The directive also applies to non-EU multinationals doing business in the EU through subsidiaries. Some companies have already published their CbC report on a voluntary basis, others have withdrawn it after publication as the information published was not well received by the public. The publication of the CbC report may therefore also influence the decision-making of multinationals in structuring their business activities so as not to harm their reputation.

In this regard, we would like to inform you that the blacklist (EU list of non-cooperative jurisdictions for tax purposes) as well as the grey list of tax havens were updated in October 2021. The blacklist contains currently only nine countries (American Samoa, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, US Virgin Islands and Vanuatu).

TOP 7: PROPOSED EU WITHHOLDING TAX DIRECTIVE

In September and October 2021, feedback was ongoing on the published proposal for a directive named Withholding taxes - new EU system to avoid double taxation. The feedback is publicly available online, to be followed by a public consultation and adoption by the European Commission in 4th quarter 2022.

INDEX

PAGE 2
TOP 1: Tax revolution in Slovakia

PAGE 3
TOP 2: Information on tax audits and open data of financial administration

PAGE 4
TOP 3: Amendment to the Accounting Act

PAGE 6
TOP 4: Setting off tax overpayments during a tax deferral

PAGE 7
TOP 5: Impact of increased minimum wage and Kurzarbeit

PAGE 8
TOP 6: European Parliament approved the Public CbCR Directive

TOP 7: Proposed EU Withholding Tax Directive

PAGE 9
TOP 8: Judgement of a Czech court in the case of Airbnb income

PAGE 10
TOP 9: ECJ to review German TPD obligations

TOP 10: New TP guidance on financing structures in Germany

PAGE 11
Useful links

In 2020, the European Commission presented a new Action Plan for a Capital Markets Union with 17 recommendations for the Commission and Member States to support the Capital Markets Union, which have been transformed into 16 actions. 17 measures were set out to integrate national capital markets into a true single market, while the measure 10 referred to changes in withholding taxes. Measure 10 aims to reduce tax costs for cross-border investors and prevent tax evasion.

From the point of view of the Capital Markets Union, inefficient withholding tax relief procedures are one of the main barriers that deter people to invest in other Member States, thereby preventing the free movement of capital and capital market integration. It is proposed to introduce a common standardised system for withholding tax relief across the EU. Use should be made of the already existing OECD project on Treaty Relief and Compliance Enhancement (TRACE) as well as EU initiatives such as the Code of Conduct on Withholding Tax. The initiative has a cross-border dimension as it concerns the procedures for relieving from withholding tax of dividend and/or interest payment on investments made in the source country by non-resident investors.

A range of policy options (or a combination of them, if it is deemed appropriate) might include the following:
Option 1: Improving withholding tax refund procedures to make them more efficient
Option 2: Establishment of a fully-fledged common EU relief at source system
Option 3: Enhancing the existing administrative cooperation framework to verify entitlement to double tax convention benefits

TOP 8: JUDGEMENT OF A CZECH COURT IN THE CASE OF AIRBNB INCOME

In August 2021, the Municipal Court in Prague dealt with the issue of the classification of income from short-term rentals via the Airbnb platform. The operator of short-term rentals via Airbnb (an individual) declared and taxed this income as rental income. The tax office reclassified the income as business income and assessed additional tax. The operator argued that it could not be business income as he did not provide any additional services. The Prague court agreed with the tax office that rental income would be the case only if the purpose of providing the flat was to provide for the applicant's housing needs. The provision of accommodation via Airbnb in no way fulfils the statutory purpose of renting a flat, and must therefore be classified as an accommodation service, which falls under business income.

The judgment of the municipal court is in line with the approach of the Slovak tax administration, which also classifies income from Airbnb accommodation as business income and not as rental income.

BMB Newsfilter

INDEX

PAGE 2
TOP 1: Tax revolution in Slovakia

PAGE 3
TOP 2: Information on tax audits and open data of financial administration

PAGE 4
TOP 3: Amendment to the Accounting Act

PAGE 6
TOP 4: Setting off tax overpayments during a tax deferral

PAGE 7
TOP 5: Impact of increased minimum wage and Kurzarbeit

PAGE 8
TOP 6: European Parliament approved the Public CbCR Directive

TOP 7: Proposed EU Withholding Tax Directive

PAGE 9
TOP 8: Judgement of a Czech court in the case of Airbnb income

PAGE 10
TOP 9: ECJ to review German TPD obligations

TOP 10: New TP guidance on financing structures in Germany

PAGE 11
Useful links

TOP 9: ECJ TO REVIEW GERMAN TPD OBLIGATIONS

The European Court of Justice has been asked to review the German transfer pricing documentation requirements and the thereto related sanctions. At issue is the compatibility of national tax rules and the freedom of establishment under Article 49 of the Treaty on the Functioning of the EU.

The case concerns a company based in the Netherlands which provided services to a related German limited partnership. The remuneration for the services is to be based on actual costs and expenses incurred. The German tax authorities carried out a tax audit, focusing in particular on the management fees paid by the German company to the related Dutch entity. The taxpayer was asked to provide transfer pricing documentation and documents relating to cross-border transactions.

Under German tax law, taxpayers who carry out transactions with foreign related companies must keep records of the nature and content of their business transactions with those related parties. This additional obligation only applies to these taxpayers and does not apply to taxpayers who are not group members. The law further provides that penalties apply if a taxpayer fails to comply with these obligations, i.e. fails to submit documentation, submits documentation that is unusable, or fails to submit documentation in a timely manner. In addition, the tax administrator assumes that the taxpayer's domestic taxable income is higher than the amount declared and assesses additional tax.

Following the assessment of such additional tax, the taxpayer filed a lawsuit at the tax court. The national judges held that the legislation led to the correct assessment of tax. However, such provisions - one imposing a documentation obligation on selected taxpayers and the other imposing an additional tax assessment as a penalty - may lead to an infringement of the right to freedom of establishment or of the right to freedom to provide services.

TOP 10: NEW TP GUIDANCE ON FINANCING STRUCTURES IN GERMANY

In July 2021, the German Ministry of Finance (MoF) issued the Administrative Principles regarding Transfer Pricing. This guidance provides that for loans to German borrowing group affiliates the acceptable interest margin for a foreign financing company is limited to the current risk-free market return unless the financing company is "able and authorized" to control the financial investment and bear the corresponding risks.

In October 2021, the German Federal Fiscal Court published a ruling to the Administrative Principles regarding transfer pricing rules for intragroup financing (Ruling I R 4/17).

BMB Newsfilter

INDEX

PAGE 2
TOP 1: Tax revolution in Slovakia

PAGE 3
TOP 2: Information on tax audits and open data of financial administration

PAGE 4
TOP 3: Amendment to the Accounting Act

PAGE 6
TOP 4: Setting off tax overpayments during a tax deferral

PAGE 7
TOP 5: Impact of increased minimum wage and Kurzarbeit

PAGE 8
TOP 6: European Parliament approved the Public CbCR Directive

TOP 7: Proposed EU Withholding Tax Directive

PAGE 9
TOP 8: Judgement of a Czech court in the case of Airbnb income

PAGE 10
TOP 9: ECJ to review German TPD obligations

TOP 10: New TP guidance on financing structures in Germany

PAGE 11
Useful links

The ruling deals with the calculation of the market interest rate for intra-group financing. The court held that the interest rate should be determined on the basis of the economic situation of the debtor, giving preference to the comparable uncontrolled price method rather than the cost-plus method. The decision thus departed substantially from the Administrative Principles of Transfer Pricing presented by the MoF, which considers the risk-free rate as the basis.

The appropriate interest rate should correspond to the rate that would be applied between independent parties and thus be determined on the basis of the debtor's individual rating and any adjustment for group influence (an independent entity would give a better rating with respect to group membership).

USEFUL LINKS

Article on tax revolution (Slovak Spectator) (EN)
Public CbCR Directive (EN)
Proposed EU Withholding Tax Directive (EN)
ECJ to review German transfer pricing obligations (EN)
Ruling of the German Federal Fiscal Court (EN)

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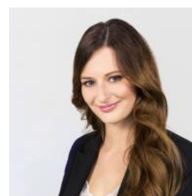
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