

Czech Republic publishes final bill amending *Act on International Cooperation in Tax Administration* to implement Mandatory Disclosure Rules

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Executive summary

The Czech bill amending the *Act on International Cooperation in Tax Administration* implementing the European Union (EU) Directive on the mandatory disclosure and exchange of cross-border tax arrangements (referred to as DAC6 or the Directive) was published, on 14 August 2020, in the Czech Collection of Laws.

The final Czech Mandatory Disclosure Rules (MDR) legislation is effective from 29 August 2020.

Also, on 7 September 2020 the Czech Government approved a six-month deferral to the initial MDR reporting (deferral regulation) which was officially published on 10 September 2020. The deferral regulation generally follows the Council amendment to the EU Directive 2011/16 allowing Member States an option to defer for up to six months the time limits for the filing and exchange of information on cross-border arrangements under DAC6.¹

The final Czech MDR legislation is broadly aligned to the requirements of the Directive.

Detailed discussion

Background

The Council of the EU Directive 2018/822 of 25 May 2018 amending Directive 2011/16/EU regarding the mandatory automatic exchange of information in the field of taxation (the Directive or DAC6), entered into force on 25 June 2018.²

The Directive requires intermediaries (including EU-based tax consultants, banks and lawyers) and in some situations, taxpayers, to report certain cross-border arrangements (reportable arrangements) to the relevant EU member state tax authority. This disclosure regime applies to all taxes except value added tax (VAT), customs duties, excise duties and compulsory social security contributions.³ Cross-border arrangements will be reportable if they contain certain features (known as hallmarks). The hallmarks cover a broad range of structures and transactions. For more background, see EY Global Tax Alert, [Council of the EU reaches an agreement on new mandatory transparency rules for intermediaries and taxpayers](#), dated 14 March 2018.

EU Member States were obliged to adopt and publish national laws required to comply with the Directive by 31 December 2019.

The key differences between the final Czech legislation and the Directive are summarized below. This Alert also highlights notable clarifications provided by the Explanatory Memorandum which accompanied the draft Czech legislation.

Scope of taxes covered

The scope of taxes covered under the Czech final legislation is fully aligned with the Directive and applies to all taxes except VAT, customs duties, excise duties and compulsory social security contributions.

Reportable arrangements

Under the Directive, an arrangement is reportable if:

- ▶ The arrangement meets the definition of a cross-border arrangement; and
- ▶ The arrangement meets at least one of the hallmarks A-E specified in Annex IV of the Directive.

Under DAC6, cross-border arrangements are defined as arrangements concerning more than one Member State or a Member State and a third country. The hallmarks can be

distinguished as hallmarks which are subject to the main benefit test (MBT), and those which by themselves trigger a reporting obligation without being subject to the MBT. The overall definition of reportable arrangements included in the final Czech legislation aligns with the DAC6 definition.

As regards the term “arrangement” – which is not further defined in the Czech law – the Explanatory Memorandum states that it may be defined as follows: a reportable cross-border arrangement is deliberately designed or deliberately communicated describable and sufficiently concrete instruction to act in a certain way consisting of one or several steps – fulfilling at least one hallmark and having a cross-border impact – which is at least in broad aspects communicated (regardless of whether provided for a consideration or for free).

Hallmarks A-E of the Directive

Most elements of the hallmarks included in DAC6 are not expressly defined. The Explanatory Memorandum to the Czech final legislation provides some clarification (although it is overall rather limited) on some of these elements.

- ▶ **Hallmark A.1** – This hallmark aims to capture arrangements where the participant in the arrangement undertakes to comply with a condition of confidentiality which may require them not to disclose how the arrangement could secure a tax advantage. The Explanatory Memorandum indicates that if an arrangement makes it possible to obtain a tax advantage, regardless of whether it is publicly known or not, then the MBT should likely not be met in relation to hallmark A1 even if a condition of confidentiality exists.
- ▶ **Hallmark A.3** – This hallmark aims to capture arrangements that has substantially standardized documentation and/or structure and is available to more than one relevant taxpayer without a need to be substantially customized for implementation. The Explanatory Memorandum indicates that this hallmark, to a great extent overlaps with marketable arrangements.
- ▶ **Hallmark B.1** – This hallmark aims to capture arrangements where the participant uses contrived steps to acquire a loss-making company, discontinues the main activity and then uses the losses to reduce its tax liability. The Explanatory Memorandum provides an example of an arrangement where the goal is to purchase, at a low cost, intangible property held by various companies. Where a

low-valued company is purchased at a low price (e.g., due to actual or expected losses), the respective intangibles will be transferred to the acquirer and the target's activities subsequently discontinued. Although involving contrived steps, the arrangement is not focused on obtaining a tax benefit (i.e., access to the losses) and thus, the MBT should not be met.

- **Hallmark D.1** - This hallmark aims to capture arrangements which may have the effect of circumventing legislation concerning the automatic exchange of information on financial accounts. The Explanatory Memorandum refers to the fact that a bank may be an intermediary if it knowingly participates in steps aimed at circumventing the Organisation for Economic Co-operation and Development Common Reporting Standard (CRS). If - on the other hand - the bank only allows opening a bank account without having knowledge that the bank account is to be used within such a CRS circumventing arrangement - then the bank should not be considered an intermediary in such a case.
- **Hallmark E.2** - This hallmark aims to capture arrangements involving the transfer of (rights to) hard to value intangibles. The Explanatory Memorandum mentions financial instruments such as derivatives in connection with this hallmark - there is no further explanation provided as to the significance of this reference (financial instruments are not normally considered part of hard to value intangible assets).

Main benefit test

In accordance with DAC6, the MBT will be satisfied if it can be established that the main benefit or one of the main benefits which, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement, is the obtaining of a tax advantage.

According to the Explanatory Memorandum, the "essence" of the MBT is an analysis as to whether there is causal link between a hallmark and a tax benefit that may be expected if an arrangement is implemented. If an arrangement leads to a tax benefit particularly because a hallmark is met (and should the hallmark not be met, the tax benefit would not be achieved) - then the MBT is met. If, however, an arrangement leads to a tax benefit regardless of whether a hallmark is met - then the MBT is not met as it is not the particular hallmark that leads to the tax benefit.

Intermediaries

Under the Directive, intermediaries with EU nexus have the primary obligation to report arrangements to the tax authority. The Directive gives Member States the option to exempt intermediaries from the obligation to report where the reporting obligation would breach legal professional privilege (LPP). If there are no intermediaries which can report, the obligation will shift to the taxpayers.

The LPP exemption is also included in the final Czech MDR legislation and certain advisers are exempt from the disclosure obligation due to professional duty of confidentiality. Professional confidentiality is the obligation to maintain confidentiality pursuant to the *Czech Act on Tax Advisory*, the *Czech Act on Advocacy*, the *Czech Act on Notaries*, the *Czech Act on Auditors*, or the laws of another EU Member State to the extent applicable to an exchange of information on reportable cross-border arrangements.

- Under the final Czech legislation, the reporting entity is primarily an intermediary of a reportable cross-border arrangement which is aware of, possesses or controls the arrangement.
- However, the obligation to report will shift to the relevant taxpayer of a reportable cross-border arrangement where:
 - The taxpayer was informed that the respective intermediary is bound by the professional duty of confidentiality with regard to the arrangement; this does not apply if another intermediary, not bound by professional duty of confidentiality, is involved. In this case the intermediary that is exempt due to LPP is obliged to inform the other intermediaries (known to him) and the relevant taxpayer about this fact (i.e., that it is exempt due to LPP); or
 - If the given arrangement has no intermediaries.
 - DAC6 defines two categories of intermediaries: promoters and service providers. The final Czech legislation defines intermediaries by reference to the same two categories.
- According to the Explanatory Memorandum, where an arrangement was prepared in-house, by the user itself, the entity should not be regarded as an intermediary. However, if an arrangement was prepared within a group by another of its member entities, then this other member entity is the intermediary in respect of those entities to which the arrangement was subsequently provided. The Explanatory Memorandum also states that an employee working for a company while designing, promoting or implementing cross-border arrangement is not an intermediary.

Reporting deadlines

Under DAC6, for intermediaries (and relevant taxpayers), the trigger events for reporting under the Directive (from 1 July 2020) are when the reportable arrangement is “made available for implementation”; or when the reportable arrangement is “ready for implementation”; or when “the first step of implementation has been made.” The same trigger events apply in the final Czech MDR legislation.

Under the Directive, reporting starts from 1 July 2020 and exchanges between jurisdictions from 31 October 2020. However, reports will retroactively cover arrangements where the first step is implemented between 25 June 2018 and 1 July 2020.

The Czech reporting deadlines fully align with DAC6.

Deferral of DAC6 reporting deadlines

On 7 September 2020 the Czech Government approved a six-month deferral to the initial MDR reporting (deferral regulation) which was officially published on 10 September 2020. The deferral regulation generally follows the Council amendment to the EU Directive 2011/16 allowing Member States an option to defer for up to six months the time limits for the filing and exchange of information on cross-border arrangements under DAC6. In practice, the new reporting deadlines under the Czech MDR legislation are as follows:

- ▶ Information on a reportable cross-border arrangement where the first step of implementation was done between 25 June 2018 and 30 June 2020 must be submitted by 28 February 2021.

- ▶ Information on a reportable cross-border arrangement where the first step of implementation was done between 1 July 2020 and 28 August 2020 (i.e., the day preceding effectiveness of Czech MDR law) must be submitted by 30 January 2021.
- ▶ Where the cross-border arrangement is made available for implementation or is ready for implementation, or where the first step in its implementation has been made (or assistance provided) between 29 August 2020 and 31 December 2020, information must be submitted by 30 January 2021.

Penalties

The Czech Tax Administrator may impose a fine on intermediaries and/or relevant taxpayers for failure to meet the relevant MDR obligation - such as the reporting obligation or informing another intermediary/relevant taxpayer on exemption due to LPP or the obligation to keep related documents (generally for 10 years) - of up to CZK500,000 (up to approx. €20,000).

Next steps

Determining if there is a reportable cross-border arrangement raises complex technical and procedural issues for taxpayers and intermediaries. Taxpayers and intermediaries who have operations in Czech Republic should review their policies and strategies for logging and reporting tax arrangements so that they are fully prepared for meeting their obligations.

Endnotes

1. See EY Global Tax Alert, [Council of the EU adopts amendments for deferral of MDR filing deadlines](#), dated 24 June 2020.
2. For background on MDR, see EY Global Tax Alert, [EU publishes Directive on new mandatory transparency rules for intermediaries and taxpayers](#), dated 5 June 2018.
3. DAC6 sets out a minimum standard. Member States can take further measures; for example, (i) introduce reporting obligations for purely domestic arrangements; (ii) extend the scope of taxes covered; (iii) bring forward the start date for reporting.

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EYG no. 006434-20Gbl

1508-1600216 NY
ED None

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