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Deputy Minister for Taxes and Customs

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Dear Director-General,

First, I would like to thank you for the intensity and speed with which the European Commission has dealt with the Czech Republic's request. As you certainly know, introduction of a generalized reverse charge mechanism is a top priority for the Czech Republic, and it is our concern to introduce this measure as soon as possible. Allow me to forward to you the Czech Republic's comments on the issues you raised in your letter of 22 February 2019 in connection with our request for temporary application of the generalized reverse charge mechanism in the Czech Republic of 16 January 2019, and I am of course ready to answer any further questions that may arise in this context.

As regards the first question concerning information about the envisaged date of commencement of application of the generalized reverse charge mechanism in the Czech Republic under Art. 199c(3)(b) of Council Directive 2006/112/EC, on the common system of value added tax ("VAT Directive"), given the length of the legislative process in the Czech Republic and after accounting for the necessary processes that have to take place before the introduction of the generalized reverse charge mechanism, the closest possible date of introduction appears to be 1 January 2020. That date corresponds to the ideal course of the legislative process in the conditions of the Czech Republic but the legislation in question may as well take effect later. As regards informing the taxable persons concerned, we expect that this process will take place continuously in the context of the ongoing legislative process, and we further envisage at least a one-month period between the legislation entering into force and entering into effect, with the intention being to make the law effective from the first day of the month following the day of its publication. This issue is widely covered by the media in the Czech Republic, and we thus assume that the measures proposed by us under Art. 199c(3)(c) of the VAT Directive implemented during but also after the completion of the legislative process will be fully sufficient, also due to the reason that the introduction of the generalized reverse charge mechanism will not place any heavy demands, financial or technical, on taxpayers.

As regards the second question, related to the institution of a "special method to secure the tax" under section 109a of Act No. 235/2004 Coll., on value-added tax, as amended ("VAT Act"), the Czech Republic has utilized the possibility stipulated in Art. 205 of the VAT Directive – application of the proposed institution of joint and several

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liability – by transposing the said institution into an institution of liability (further conditions of the institution of liability are detailed in paragraph 2 of the request Guarantee by the recipient of taxable supply / sections 109 and 108a of the VAT Act).

The provision in section 109a of the VAT Act (special method to secure the tax, which is in essence a mechanism of split payments) is basically already now intentionally combined with the use of the existing institution of liability (sections 109 and 108a of the VAT Act). On its website, the Financial Administration of the Czech Republic draws the attention of the public to the fact that the recipient of taxable supply in the Czech Republic is in the position of a potential guarantor as a result of the provisions in section 109 of the VAT Act. The risk inherent to the institution of liability, i.e., that the entities concerned could be exposed to "scrutiny" by the tax administrator with respect to possible application of liability, can be eliminated by the institution of special method to secure the tax. A recipient of a taxable supply who pays the VAT to the tax administrator for the taxable supply effected instead of the provider can never find itself, with respect to that supply, in the position of a guarantor under sections 109 or 108a of the VAT Act. For details see par. 3 of Information by the GFD: https://www.financnisprava.cz/assets/cs/prilohy/d-seznam-dani/2017_DPH_Info_k_ruceni2.pdf

The special method to secure the tax according to the section 109a of the VAT Act is a completely voluntary measure, which can be used by the taxable person in case that any kind of goods or services is acquired by it. There are no other additional conditions. The liability of the recipient according to sections 108a and 109 is linked with some conditions and the liability can be applied only when the situation meets those conditions (an unofficial translation of relevant sections of VAT Act is attached).

It is possible to apply both measures separately. The split payment mechanism is intended to be used especially in cases when there is a real risk for the recipient to become liable for the unpaid VAT because some of conditions listed in sections 108 or 109 of the VAT Act occurred or may have occurred. However there is no limitation for the use of the split payment mechanism also in other cases.

The issue is also addressed in judgement of the Supreme Administrative Court of 15 February 2018, ref. No. 5 Afs 78/2017 - 33, www.nssoud.cz. It follows from that judgement that although there is a possibility of application of section 109a of the VAT Act (special method to secure the tax, and payment of the tax by the recipient of the supply instead of the provider of the supply, i.e., elimination of occurrence of the liability), the tax administrator is thus not relieved of the duty of a burden of proof to examine the fulfilment of the knowledge test (the entity knew, should have known and could have known that the tax would deliberately not be paid). Only after the knowledge test is fulfilled (i.e., the premise from section 109(1) of the VAT Act), individual cases (possibilities) of liability under the law can be applied. That is, it cannot be automatically anticipated based on that judgement that failure to use the special method to secure the tax automatically assumes that the recipient of the supply knew, should have known and could have known that the tax would deliberately not be paid.

And conversely, if the institution of special method to secure the tax is not used, the recipient becomes a potential guarantor already under the existing regulation and interpretation for the public.

In practice, however, there are cases where the institution of special method to secure the tax is not used but the institution of liability is not effective for various reasons, e.g., due to the fact that:

– the potential guarantor in the position of recipient of supply who is in the business chain behind a payer of the type Missing Trader not paying output VAT is an entity without assets – payer of the type Buffer, only acting as a "straw men"; a Buffer that stops cooperating with the tax administrator and stops fulfilling its tax obligations is not a person to whom the institution of liability can be effectively applied as the institution of liability in its existing form only applies between two elements in the business chain (supplier-customer relationship) or

– the tax administrator may not have sufficient evidence in the given case that the institution of guarantee can reliably rely on the fulfilment of the "knowledge test" (liability under section 109(1) of the VAT Act), and the burden of proof with respect to "knew, should have known and could have known" lies on the tax administrator.

Liability only comes into play when the debtor fails to pay its debt (or its part) secured by the liability. Primarily, therefore, the tax owed must be recovered from the provider of the supply, and only if the recovery is unsuccessful, liability for the unpaid tax can be applied if the statutory conditions under the VAT Act (sections 109 or 108a) are fulfilled. The time when the application of liability comes into play is therefore much later, only in the payment stage (not in the determination stage – tax assessment).

If the institution of liability applied to domestic supplies exceeding 17,500 EUR always when the special method to secure the tax was not used voluntarily, there would continue to be the aforementioned situation when the institution of liability is not effective. That situation is based on the nature of the measure as such, and cannot be changed in any way.

Furthermore, in the context of such manner of application of the institution of guarantee in relation to the special method to secure the tax (mechanism of split payments), the systems would have to be modified comprehensively so that the payments can be administered if they were used on a larger scale. The original intention of the special method to secure the tax was only to supplement the institution of liability in order to allow reliable payers to exempt themselves from the risk of liability for unpaid tax. The special method to secure the tax is currently used by taxpayers in the order of thousands cases annually. The special method to secure the tax, if it was to be used in combination with liability in the broad sense, would be much more administratively and financially demanding than the introduction of a generalized reverse charge mechanism, both on the side of traders (increased administration in terms of payments, adjustments to IT systems) and on the side of the financial administration (higher demands on the need for investigation (personnel costs), IT systems costs). The numbers of transactions that would have to be treated in this way would be, unlike the current state, in the order of millions annually. While all the measures that would accompany the introduction of the generalized reverse charge mechanism have already been introduced by the Czech Republic, if it wanted to introduce the special method to secure the tax on a large scale, it would have to create the entire demanding system for that measure from scratch.

The special method to secure the tax would at the same time be disadvantageous for the recipients of taxable supply in terms of cash flow as the amount would have to be

paid to the tax administrator before the usual date of invoice maturity in the Czech Republic.

It follows from the above reasons that the introduction of the generalized reverse charge mechanism is, as part of its temporary nature, an undoubtedly more effective and less costly solution than voluntary utilization of the special method to secure the tax (split payments) for domestic supplies exceeding 17,500 EUR per supply.

I believe that this supplementation of our request will be sufficient, and if necessary, I am prepared to further cooperate in this matter.

Yours sincerely

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Attachment: unofficial translation of sections 108a, 109 and 109a of the VAT Act

Section 108a
Liability of authorized recipient
(1) The authorized recipient for whom the obligation to account for and pay excise duty occurred in connection with receipt of selected products from another Member State shall be liable for unpaid VAT from supply of such goods to a third person by a person that acquired such goods from another Member State, unless he proves that he adopted all reasonably expected measures in order to verify that the person that acquired such goods will duly pay the VAT.
(2) The authorized recipient shall be liable for unpaid VAT only to the amount of VAT calculated from the taxable amount corresponding to the usual price including the excise duty.
(3) The tax authority can call the authorized recipient to prove that he adopted all measures pursuant to paragraph 1.
(4) The authorized recipient can use a special method for security of VAT; should the authorized recipient make use of this option, for the purposes of a special method of security of VAT the authorized recipient shall be regarded as
a) a recipient of taxable supply;
b) the person that acquired the goods from another Member State that is subject to excise duty and that supplies such goods to a third person shall be regarded as a supplier of taxable supply.

Section 109
Liability of recipient of taxable supply
(1) A taxable person who receives a taxable supply with a place of supply in the Czech Republic supplied by other taxable person or transfers consideration for such taxable supply (hereinafter referred to as "recipient of taxable supply") shall be liable for the amount of VAT to be paid for such a taxable supply in case that at the time of the execution of the taxable supply or provision of the consideration for such supply he knew or should have known and could have known, that
a) the amount of VAT stated in the tax document will not be deliberately paid,
b) a taxable person who carries out this taxable supply or receives consideration for such supply (hereinafter referred to as "supplier of taxable supply"), shall deliberately make himself unable to pay VAT, or tax evasion or
c) attempt to get tax benefit takes place.
(2) Recipient of taxable supply shall be liable for any tax deficiency resulting from such supply, if the consideration for such supply
a) apparently deviates from regular price without specification of any economic reasons,
b) was paid fully or partly by bank transfer to an account held by a financial service provider out of the Czech Republic
c) was provided fully or partly by bank transfer to another account than the account of the provider of the taxable supply that was published by the tax authority in a way that allows for the remote access and if the consideration for such supply is not higher than twice as much as the amount according to the law regulating limitation of cash payments, should it be exceeded, the payment has to be done by bank transfer or
d) was provided fully or partly by virtual money according to the legislation containing some measures against money laundering.
(3) Recipient of taxable supply shall be liable for the unpaid VAT related to the supply in case that the information that the supplier of a taxable supply is an unreliable VAT payer is published in a manner allowing remote access as of the moment of provision of the supply or provision of consideration for it.
(4) The recipient of a taxable supply that consists in supply of fuels by a distributor of fuels in accordance with the act on fuels shall be liable for unpaid VAT from this supply, if the information that the supplier of taxable supply is registered as a distributor of fuels in accordance with the act on fuels is not published in a manner allowing remote access as of the moment of provision of the supply or provision of consideration for it.

Section 109a
Special methods of provision of VAT
(1) In case a recipient of taxable supply pays VAT for this taxable supply instead of a supplier of such taxable supply, even if he shall not be regarded as liable person, the amount paid shall be used only for settlement of tax of supplier of the taxable supply for this particular taxable supply.
(2) Settlement for supplier of the taxable supply shall be transferred to his tax authority. Together with settlement of tax the recipient of taxable supply shall give information in a way defined by the tax authority about the following

a) identification of supplier of taxable supply,
b) tax, for settlement of which the amount of money is intended,
c) identification of recipient of taxable supply,
d) date of a taxable supply or a date of receiving a consideration by a supplier of taxable person.
(3) In case the payment for a supplier of taxable supply done without a defined date of the taxable supply or the date of consideration receipt, the date of receipt of the payment by the tax authority shall be regarded as the date of the taxable supply.
(4) The amount of VAT paid for a supplier of taxable supply is received and registered on his personal deposit account. On the date of tax payment, this amount shall be transferred to the personal tax account of the supplier of a taxable supply with the date of transfer regarded as the day of payment. In case the payment is done with a delay, the amount shall be transferred to a personal tax account of the supplier of a taxable supply with the date of payment as previously registered for the personal deposit account.
(5) In case the tax for a payment of which the amount is intended, was paid partially or entirely, the amount transferred from the personal deposit account or its part shall be used for tax remittance purposes on personal tax account of the person who carries out the taxable supply.