

Richard Bartes

VSB - Technical University of Ostrava

richard.bartes@vsb.cz

ORCID ID: <https://orcid.org/0000-0001-5176-2978>

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Legal Institute of Advance Tax Rulings

Abstract: This paper deals with the legal institute of advance tax rulings in the Czech Tax Code, which comparatively is moderately used by Czech tax entities - both natural persons and legal persons. The main aim of the contribution is to confirm or disprove the hypothesis that the legal institute of advance tax rulings is not just another form of tax consultancy. On the contrary, this legal institute is an independent instrument paid for by the taxpayer and which aims at offering the taxpayer assistance during the process of the tax administration. It can be summarised that the legal institute of advance tax rulings is an instrument for solving problems in the interpretation of tax law because it provides the possibility to request the tax administration to issue a decision stating under obligation how the tax law would be interpreted. The research methods used in the paper are analysis and synthesis, description and comparative methods.

Keywords: tax law, advance tax rulings, tax code

1. Introduction

The advance tax rulings procedure is a special type of tax procedure according to the Czech Tax Code¹. The tax administration is obliged, at the request of a tax entity (taxpayer), to issue a ruling of tax consequences which the taxpayer entity derives from the relevant tax facts, whether presented or anticipated, in cases determined by law.

1 In fact, not only in the Czech republic. The legal institute of advance tax rulings is incorporated into the legal order of almost all EU member countries (with the exception of Croatia, Greece and Latvia). See: European Commission, Commission staff working document: Technical analysis of focus and scope of the legal proposal Accompanying the document Proposal for a Council Directive amending Directive 2011/16/EU as regards exchange of information in the field of taxation. Brussels 2015, is. 60, p. 5.

The aim of the contribution is to explain the practical functioning of the legal institute of advance tax rulings. For this reason, the author applies analysis and synthesis methods, the description method and the comparative method. The author also formulates the possible hypothesis that the legal institute of advance tax rulings is not just another form of tax consultancy.

The scientific question to be answered in the paper, is whether the administrative fee for obtaining an advance tax ruling acts as a barrier to taxpayers wishing to use the service?

The applied literature as the necessary source for addressing the subject is sourced from the Czech Republic. The publication “Finanční a daňové právo” (The Financial and Tax Law) by Mrkývka and Jánošíková could be mentioned. Another applicable source for this subject matter is “Komentář k daňovému řádu” (Commentary on the Tax Code). Also Carlo Romano provides an interesting reflection and reference to the beginning of the advance tax rulings in his publication called “Advance Tax Rulings and Principles of Law: towards a European tax rulings system? In the first chapter of his book, Carlo Romano returns to Roman law and points to the original relationship of the taxpayer and the state. Another foreign publication dealing with the legal institute of advance tax rulings is “Resolving Legal Uncertainty: The Unfulfilled Promise of Advance Tax Rulings” by Yehonatan Givati.

2. The Functioning of the Legal Institute of Advance Tax Rulings

In cases determined by law, the taxpayer is entitled to ask the locally competent tax administration to issue an advance legally binding ruling/decision (i.e. the legal institute of advance tax rulings). The word “binding” means that the decision will be binding upon the tax administration which determines the tax liability not on the taxpayer requesting the ruling². The taxpayer is free to choose whether or not to follow the tax administration’s determination. It should be noted in this respect that the notion “binding” on the part of the taxpayer can be perceived rather as a certain recommendation, statement or as a result of the state’s analysis of the of the specific subject matter that forms the basis of the request. The advance tax ruling is, however, binding over the tax authority which issued the decision and in the case of review in the Administrative Justice, the conditions under which the tax advance ruling was issued and are controlled. It can be said that in the event of judicial proceedings the taxpayer is also in possession of a powerful means of proof. Such evidence can serve as a support to the provisions of the law regulating the legal institute of advance tax rulings. It is also possible to see the context of the general principles of the tax law, such as the predictability of the decision-making process.

2 See: the Section 133 of Act No.280/2009 Coll., Tax Code, as amended.

Conversely, the taxpayer may disagree with the decision of the tax administration and choose to ignore the advance tax ruling and calculate the tax independently or with the assistance of a tax consultant, etc. However, if this route is chosen, the taxpayer is exposed to the potential risk that the tax administration might assess the tax return in an entirely different way.

Notwithstanding, the ruling still fulfils the function of the taxpayer's legal certainty as to how the tax administration will decide. It is also a prerequisite for the decision to be binding at the time of making the advance tax ruling, as the actual status of the case would be the same as the facts on the basis of which the decision of the tax administration was issued.

2.1. Development of the Legal Institute of Advance Tax Rulings Abroad

The general concept of the legal institute of the advance tax rulings has many forms in different countries, and:

- may co-exist side by side;
- may have a different purpose;
- may have different formal or characteristic requirements and features;
- may have a different appellation procedure across different countries.

For instance, Sweden pioneered and introduced the legal institute of advance tax rulings in 1911. The fundamental upswing of the advance tax rulings in the tax law could be found in the last 20 years of the 20th century. The first countries (outside of Sweden) to implement this idea were the United States, the Netherlands and Italy. Overall, this legal institute has begun to expand quickly among OECD countries, and now we can see the inclusion of advance tax rulings in most of their legal orders³.

3. Procedural Aspects of the Advance Tax Rulings

The reasons for introducing the idea of advance tax rulings into the codification of tax law are similar both in the Czech republic and Poland (and elsewhere). In the first instance the institute of the advance tax rulings should serve to resolve the issue of legal certainty. However, legal certainty might be undermined by the following features:

- inconsistency;
- ambiguity;
- frequent changes in legislation;
- uncertainty of interpretation and application of law;
- retroactive effect of tax law.

3 Y. Givati, Resolving Legal Uncertainty: The Unfulfilled Promise of Advance Tax Rulings, "Harvard Law School" 2009, p. 1.

The institute of advance tax ruling serves as an instrument for clarifying the interpretation of tax law. There is an increase in the volume of tax law as well as in its inconsistency. Acts on taxation are massive, ambiguous and frequently changing. Therefore, it may seem that advance tax ruling is a balancing factor in this context. In fact, this legal institute is an instrument to calm an otherwise chaotic and complex system that in many respects fails to make tax law efficient.

In the case of the Czech Republic, individual cases in which the taxpayer can request an advance tax ruling are listed in particular acts⁴. There is no statutory time limit for issuing a ruling after the tax administration has received a request⁵. Similarly, the taxpayer is not subject to a time limit for initiating proceedings in this regard. It might be deduced therefore, that in the case of advance rulings on income tax, the milestone is that point in time when the taxpayer is in possession of all necessary information for filing a faultless request to issue an advance ruling, up until the deadline for filing the tax return.

In general terms it is commonplace to lodge an appeal against a tax decisions, but in the case of advance tax rulings this is not possible. The ruling of the tax administration in such cases is not a decision in the strict sense of the term because it is not possible to appeal against it. According to the commentaries on the Tax Code, this is due to a lack of intervention on the part of the taxpayer, which occurs after the eventual issue of a tax assessment which may be based on an advance tax ruling. After the issue of the tax assessment, the taxpayer can exercise his or her right of appeal and by this means can oppose the advance tax ruling.

The advance tax ruling “procedure” is not a tax procedure in the strict sense of the term. Rather it is a specific type of procedure which contains other elements and whose outcome is a decision, but only in the sense of tax law.

If the tax law the advance ruling is based on has changed, the ruling becomes ineffective. Tax rulings are also ineffective after 3 years from the date on which the decisions come into force. These facts are guarantees of (not only) the taxpayer’s legal certainty.

The result of the advance tax ruling, i.e. a “decision”, is not a decision in the strict sense either. This fact is supported by the judgement⁶ of the Czech Supreme Administrative Court which proclaimed decision as an administrative act which “*establishes, changes, cancels or defines rights and obligations*”. The situations that

4 Act No. 235/2004 Coll., on Value Added Tax, as amended; Act No. 586/1992 Coll., on Income Tax, as amended.

5 In fact, the tax administration is obliged with the principle that “*the tax administrations proceeds without undue delay*” under the Section 7 of the Tax Code. A more precise determination of the time limit is set by directions of the Ministry of Finance.

6 Judgment of the Supreme Administrative Court of 23 August 2011, 5 Afs 37/2011 – 77.

occur after the issue of advance tax rulings do not meet these cited features. Such decision is not binding on its addressee.

In the authors opinion the Czech legislator should also have chosen words other than “ruling” and “decision”. These words can cause useless confusion which is the reason why language interpretation of this legal institute cannot be relied upon.

Since this procedure is not initiated *ex officio* the taxpayers have to bring the request for the initiation of the procedure. Formal requirements for the request are specified in particular acts regulating the cases in which it is possible to apply advance tax ruling. To accord with the Administrative Fees Act, Act No. 634/2004 Coll., the taxpayer is also obliged to pay an administrative fee of 10,000 CZK (equivalent to ca. 380 Euros or ca. 1,666 Polish zloty). In order to initiate proceedings, it is first necessary to pay the fee in full. The same rate is established for all cases of advanced tax rulings, save those relating to VAT which is less expensive.

The question of fees could be dealt with both from the legal and economic point of view, largely because they fulfil several functions. Generally, the (administrative) fee is not the result of calculating the actual costs associated with providing a chargeable (administrative) service. The fee is a given amount fixed by law, or rather a tariff, which realistically is hardly calculable and which in any event is not subject to negotiation between the taxpayer and the tax administration.

The purpose of the administrative fee is the financial contribution of the applicant to cover (or rather to reduce) the general burden of costs of the administrative body and to transfer the costs remitted to the state administration from all of the citizens to a particular individual. Another purpose is a preventive defence against unnecessary submissions to the administrative authorities. The fee does not fulfil a fiscal function but it can be used with effect to regulate the behaviour of the citizenry. More specifically, the amount of the fee is an expression of the fact that the state tries to avoid abuse of this legal instrument by unnecessary requests or even deliberate efforts to overload the bodies of the Financial Administration. If there was no administrative fee it follows that the tax administration would be used instead of a tax consultant. The United States encountered this same situation in the past and thus was forced to restrict advanced tax rulings, set formal requirements and place a charge on all applications⁷.

Elsewhere, in 2014, the Netherlands carried out a “review” of its advance tax rulings. The change resulted in the form of greater transparency and the setting of new conditions for requesting an advance tax ruling⁸. Greece introduced advance tax rulings for first time in 2014 and earlier Lithuania has introduced the procedure in 2012.

7 C. Romano, *Advance Tax Rulings and Principles of Law*, Amsterdam 2002, p. 15-19.

8 Substance rules update in the Netherlands. Taxand.com, Luxembourg 2014, <http://www.taxand.nl/en/news/163> (access: 10.11.2018).

4. Differences Between Advance Tax Rulings and Tax Consultancy

Although it might seem that the advance tax rulings procedure is similar to tax consultancy, it is of course not so. There are several fundamental differences.

First of all, it should be noted that the tax consultant provides tax advice to a client on the basis of a bilateral contract. The tax consultant then advises the client on the most efficient way to arrange their tax affairs, typically by way of a tax plan with options.

Conversely, the advance tax ruling presents to the taxpayer only one course of action albeit without risk of unfavourable consequences. The choice of whether or not to follow the ruling is up to taxpayer. If the ruling is followed the taxpayer is assured that the tax return filed will be both correct (in the eyes of the tax authority) and acceptable.

If the taxpayer chooses not to go along with the ruling, difficulties may arise. On the one hand the taxpayer does not have the possibility to apply for remedy, while on the other, ignoring the decision is not a reasonable approach since it places the taxpayer at risk of being assessed according to the advance tax ruling.

5. Particular Cases for Advance Tax Rulings in the Czech Republic

The Czech taxpayer is entitled to file an application for advance tax rulings but only in relation to the cases referenced in Act No. 235/2004 Coll., on Value Added Tax and in Act No. 586/1992 Coll., on Income Tax. These acts determine the legal requirements of the application to the competent tax administration.

In particular, regarding the Act on Income Tax, a suitable example is a situation where the taxpayer is unsure whether the intervention in property is a technical appreciation under Section 33a of the Act and thus increases the entry value of tangible or intangible assets. In such case, the taxpayer is entitled to file an application to the competent tax administration for a ruling. This application must include the necessary legal requirements in addition to information on the taxpayer and specific information on the assets, as well as the proposal of the decision on the advance tax ruling of the intervention in the assets.

Some other cases of advance tax ruling under the Income Tax Act are as follows:

- advance tax ruling on the ways of allocating expenses (costs) that cannot be attributed only to taxable income (Section 24a);
- advance tax ruling on the proportion of expenses (costs) associated with the operation of a real estate used in part for an activity that results in income from an independent activity or rent and partly for private purposes which can be used as an expense (cost) to achieve, secure and maintain revenue (Section 24b);

- advance tax ruling on research and development expenditure included in the deductions (Section 34e);
- advance tax rulings on the manner in which the price is negotiated between connected persons (Section 38nc);
- advance tax rulings on tax loss (Section 38na).

In relation to the Act on Value Added Tax, a typical situation is that of determining the tax rate for a chargeable event, where The General Directorate of Finance issues an advance ruling on the binding assessment of the determination of the tax rate for the chargeable event (Section 47a). Another case is the object of the advance tax ruling for the application of the reverse charge procedure (Sections 92h and 92i).

For the sake of completeness it can be added that the Czech Registration of Sales Act⁹ also contains a new type of advance tax ruling. The taxpayer can request a ruling on particular sales. Here, the tax administration rules on whether the sale represents a registered sale under the Registration of Sales Act or whether the sale is a random income which is exempt from the Act. Although the nature of the advance tax rulings on registration of sales is the same as the nature of the “classic” advance tax rulings listed above, the administrative fee is much less – 1,000 CZK (the equivalent of ca. 38 euros or ca. 166 Polish zloty).

6. Conclusions

The purpose of the paper was to clarify the legal institute of the advance tax rulings in the Czech republic and to point out the different conceptions of this legal institute in the world. That is why the geneses of the advance tax rulings and a short treatise on development of the advance tax rulings were also mentioned.

In the paper, the functioning and procedural aspects of the legal institute of the advance tax rulings in the Czech republic were presented as well. Due to the high level of the administrative fee for advance tax rulings in the Czech republic, the paper also discusses the reasons for such a high fee. It can be concluded that the specific question set out in the introduction of the paper can be answered positively.

The main aim of the author was to confirm or disprove the hypothesis that the legal institute of advance tax rulings does not constitute another form of tax consultancy. This was achieved mainly by the overall analysis and synthesis, and description of the legal institute of the advance tax rulings according to Czech tax law. As a result, the hypothesis set out in the introduction of the contribution can be confirmed.

9 Act of 16 March 2016, No. 112/2016 Coll., on Registration of sales, as amended.

The legal institute of advance tax rulings is undoubtedly an appropriate procedure for resolving unclear situations regarding the application of tax law. Before the taxpayer files an application, it is of course necessary to assess the admissibility or rather its necessity in any particular case and any possible consequences arising thereof.

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