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NEWSLETTER CZECH REPUBLIC

Issue: February 2021

Information on Law, Taxes and Economics in the Czech Republic

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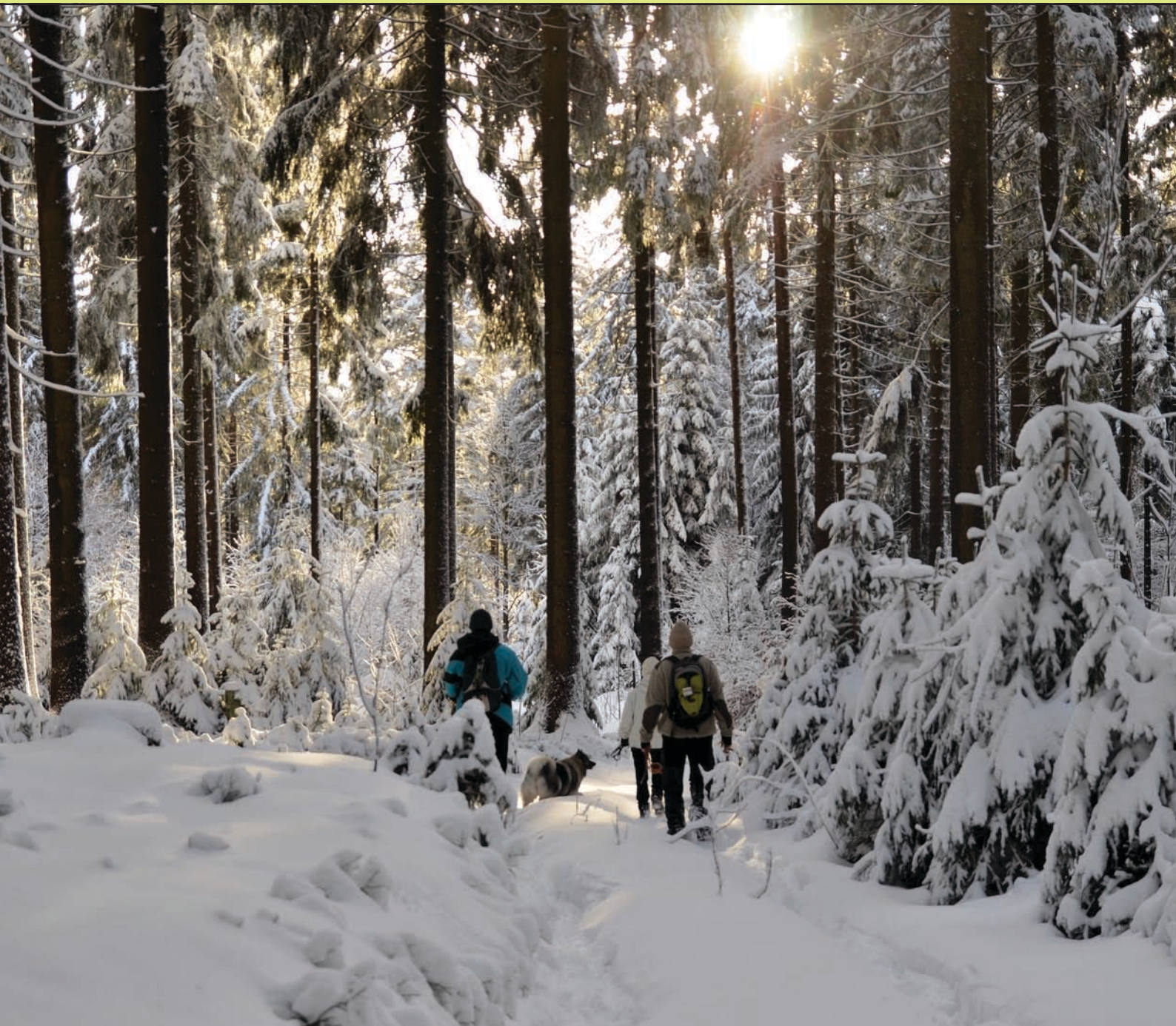

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NEWSLETTER
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Content:

→ Law

Dangers of a digital world

What is a digital world? It is a concept that is difficult to grasp and there exist no general standards or statutory rules that would define it in greater detail. Digital world is often associated with digital market, digital technology, digital transformation, digital age and digital services. But there is much more to it.

Lucie Kianková
Rödl & Partner Prague

Today we seek neither to define the concept of the digital world, nor to delimitate its boundaries. Our aim is to draw your attention to some of the dangers of the digital world that everyone who is prone to be a party to digital evolution should be aware of.

The digital world brings with it many advantages. It provides for new and exciting opportunities, it strengthens and develops competitiveness, it supports the development of a more open society and promotes innovation in fields such as medicine or the environment. Processes and procedures are made more effective and more flexible. Nonetheless, we have noticed an increase in the number of legal disputes associated with the digital world, be that in connection with the Internet or disputes related to the use of digital technology.

We have noticed an increase in the number of disputes concerning the digital world.

We should therefore keep in mind that while there are many advantages, digital development also brings with it many serious disadvantages. An increased level of alertness and precautionary measures are without a doubt suitable tools that allow for a reduced future impact.

The world of digitalisation activates many pitfalls that touch on both natural and legal persons. Unfortunately, not uncommon are serious and intolerable attacks on integrity, particularly as regards honour, dignity, appearance and privacy. Online contexts commonly allow for the unauthorised use of photographs and for the publication of false or distorted information about the person concerned. The reputation and name of legal persons are not safe either. The digital world is an environment that gives rise to domain disputes and lets people share illegal or unauthorised content, both in terms of copyright material and industrial property rights, like trademarks. In the digital world, the providers of information society services (website registrars, operators of community portals or overseers of online photographs) carry serious liability risks that go hand in hand with the illegal content of the data uploaded and the illegal conduct of their users. What must also be kept in mind is that where digital entrepreneurship and e-commerce are concerned, entrepreneurs are constantly in the public eye and their meeting and complying with all statutory rules and regulations should be a matter of course (especially in what concerns consumer

Act in accordance with the principles of prudent management

rights), as should such entrepreneurs taking greater care in their checking up on their contractual partners, because the digital environment is the best place to hide one's true identity.

The examples laid out above do not of course even come close to the tip of the iceberg; so many dangers lurk in the digital world. Ideally, we should thoroughly analyse them with regard to each individual case and a set of circumstances. We do, however, recommend that you always keep the above-described risks in mind and that you always try to steer clear of them. In so doing you will be acting in accordance with the principles of prudent management (the law demands prudent management from the governing bodies of business corporations). So please do not underestimate the risks associated with the digital world and carefully assess their impact on you and your company. Should you be interested, we will gladly discuss the risks involved and suggest measures that will help protect you from them.

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→ Taxes

Remission of real estate tax and road tax accessions

Road tax returns and real estate tax returns may be submitted by 1 April 2021.

Based on the Finance Minister's decision on the remission of tax accessories due to a recent pandemic emergency, which was published on 7 January 2021 in the Financial Newsletter of the Ministry of Finance, fines for late filing of road tax returns and fines for late filing of real estate tax will be waived.

This in essence means that the usual deadline by which these two types of tax return must be filed is prolonged by two months, i.e. it was changed from 1 February 2021 to 1 April 2021. Fines will be waived provided the road tax return or the real estate tax return is filed by the new deadline. In this context, the date by which road tax must be paid is also postponed to 1 April 2021. The date(s) by which real estate tax must be paid remain(s) unchanged.

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→ Taxes

Tax code amendments relating to interest

Among other things, the tax code amendments introduced the following changes in the area of interest:

- The amount of interest was changed. From now on, interest will be based on the Civil Code (for example, default interest will now be the repo rate +8 percentage points, in comparison with the previously used repo +14 percentage points),
- Interest will not be prescribed if the amount of interest would be under CZK 1,000 (previously CZK 200),
- From now on, a notice of the interest prescribed will be sent. One can object against the prescribed interest by filing an objection (the previous procedure was to file an appeal against an assessed payment),
- It is obligatory for governmental authorities to send a notice stating the amount of an underpayment (interest, for example), if the underpayment is one the collection of which is to be enforced for the first time (protection against the consequences of a court-ordered execution upon assets (i.e. a seizure of funds or assets by a court bailiff)),
- Default interest arises on the fourth day after the original payment deadline (previously it was the fifth business day after the payment deadline).

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→ Taxes

VAT on the rental of properties in 2021

On 1 January 2021, the long-anticipated change to Section 56a (3) of the Act on VAT entered into effect. The change restricts the ability of lessors to voluntarily charge VAT on the rental of a property to another VAT-remitting entity when such property is being used for the business activities of such other VAT-remitting entity. At the end of 2020, the General Financial Directorate also issued Information on this issue. The Information addresses the details of the practical application of the new provision.

Klára Sauerová, Johana Cvrčková
Rödl & Partner Prague

Up until the end of last year, a lessor could voluntarily apply VAT on the rental of a property to which a VAT exemption would normally apply. This possibility could be used if the landlord rented the property to another VAT-remitting entity and such other VAT-remitting entity was using the property for its business activities. This had been a welcome possibility, one that was widely used in practice, one that enabled lessors to recover input VAT with regard to costs that they had expended in connection with the rental of the property concerned.

From now on, the ability to charge VAT does not apply to properties designated for long-term residency

As of this year, this possibility has been restricted and it is no longer possible to voluntarily charge VAT on the rental of properties designated for long-term residential use. Specifically, this applies to family houses, residential premises – as defined by the Act on VAT, apartments, structures or parts of buildings where at least 60% of the floor-space is made up of a residential area, and land or a right

The decisive factor is the designated use according to the Land Registry

of superficies (i.e. a right to build on land owned by another party) that includes one of the properties described above.

The Information from the General Financial Directorate states that the decisive factor for determining whether a particular property meets the criteria that preclude the voluntary application of VAT on the rental of such property is the designated use of the property, as recorded in the Land Registry. If a property is recorded in the Land Registry as a family house or a unit designated for use as an apartment, then it is clear that such property is designated for long-term residential use and it is not possible to charge VAT on the rental of the property. However, if the designated use recorded in the Land Registry is, for example, an artist's studio or other non-residential premises, then such property is not one that is designated for long-term residential use and the lessor will be able to decide to voluntarily charge VAT on the rental.

If a property is actually being used for a purpose that differs from the designated use recorded in the Land Registry, for example if a family house is being used as offices, then for the purposes of the aforementioned provision, the designated use recorded in the Land Registry takes precedence. So if a lessor wished to charge VAT on the rental of a family house that is being used as offices, the lessor would have to get a new occupancy permit (use permit) for the changed use and record the new designated use in the Land Registry.

It is also worth mentioning that no interim provisions (i.e. transition period provisions) were enacted in connection with the changes to Section 56a (3) of the Act on VAT. For VAT-remitting entities, this unfortunately means that the new provisions will also apply to contractual relations that arose prior to 1 January 2021. In practice this means that if a VAT-remitting entity acquired a real estate property during the past ten years, or if such entity carried out technical improvements on such property and exercised the right to recover input VAT – a step that was made possible because the entity had voluntarily applied VAT to the rental, such entity will now have to correct the VAT that had been recovered, and will have to return a part of the recovered VAT for every year remaining in the ten year period, this must be done in the VAT return for the last tax period of the year.

If you are impacted by this change, we recommend reviewing whether the correct VAT procedure is being used when billing rent and taking the appropriate steps. Naturally, if you are not entirely certain as to what steps you should be taking, we would be pleased to assist you.

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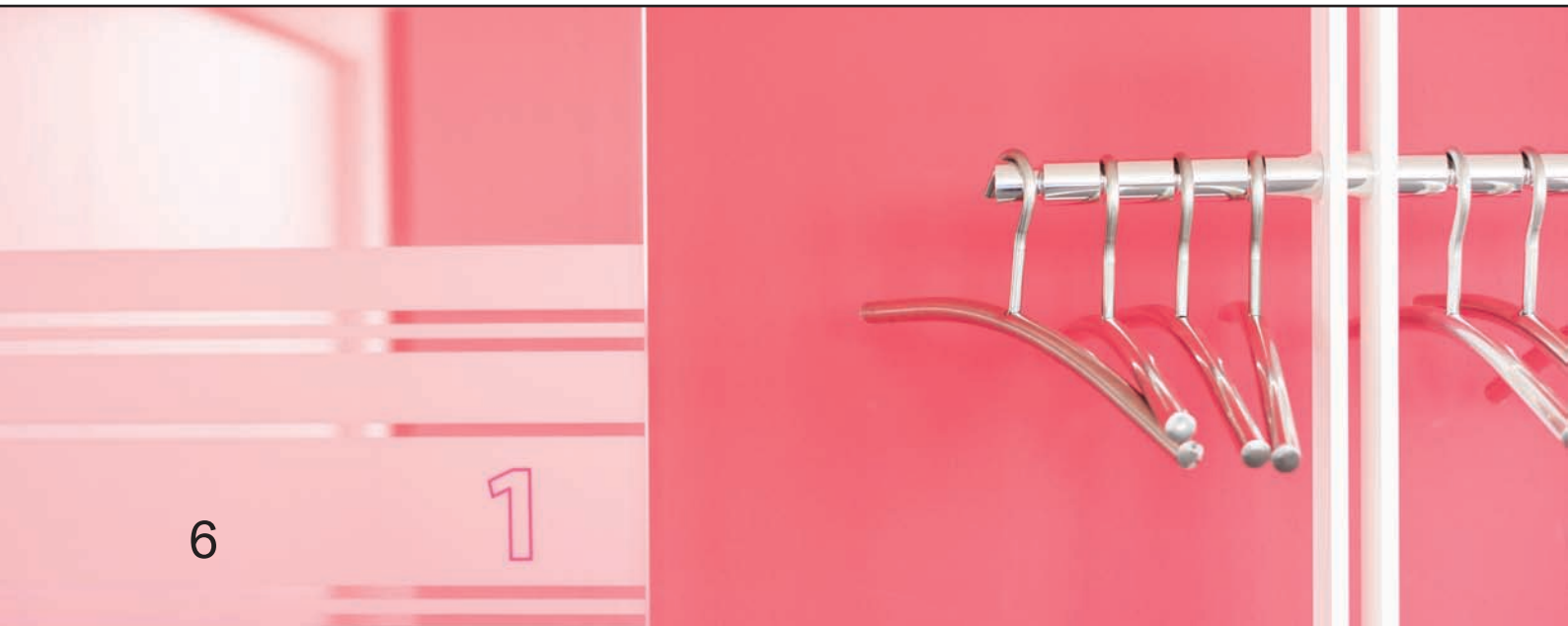

→ Taxes

VAT exemption for COVID-19 vaccines and testing kits

Under a resolution passed by the Finance Minister, any supplies of COVID-19 vaccines and in vitro diagnostic medical devices (testing kits) are to be exempt from VAT.

This VAT relief applies to any and all domestic supplies that were to be taxed in the period from 16 December 2020 to 31 December 2022. The supplied goods are, however, subject to the requirements defined under the relevant European legislation.

The General Financial Directorate has published its report where it presented a practical manual for any VAT duties and requirements.

When supplying goods, the taxpayer must issue a VAT document. In such case, the General Financial Directorate recommends that the invoice should say "the supply is VAT-exempt under the resolution of the Ministry of Finance". As a result, the VAT document does not need to show any tax rate or the tax itself. Those supplies that are to be VAT exempt under this resolution must be specified in the taxpayer's normal business records kept for VAT purposes and they must be shown on Line 26 of its VAT return. There is no need to specify these supplies in the VAT control statement. The recipient cannot recover VAT charged on these supplies as the situation under which the VAT is to be accounted for and paid did not arise.

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→ Taxes

Interest relief for late VAT payments and road tax

The Finance Minister has decided on interest relief for any late VAT payments in the tax period between September 2020 and March 2021 or between Q3 2020 and Q1 2021. In addition, the Finance Minister decided on interest relief for any late payments of the road tax for the tax period 2020. The tax must be paid by 16 August 2021.

In addition, the advance payment of road tax has been waived, i.e. the advance payment that is payable for the tax period 2021 and due by 15 April 2021. This waiver applies to entities whose income predominantly stems from activities that were prohibited or significantly restricted by the measures introduced by the Government in the period between 22 October 2020 to 31 March 2021. In addition, the waiver applies only if the respective tax authority is informed accordingly in a specifically defined manner.

Following this resolution passed by the Ministry of Finance, the period when various administrative fees and charges are waived has been extended. This waiver relates to the period between 1 January 2021 and 16 August 2021.

Moreover, the period when interest on late payments and interest on any deferred payments is waived has also been extended to 16 August 2021. In this case, deferred payments mean any payments deferred in situations when, upon an individual request, an entity was permitted to defer the payment of any tax or to break down the payment into a number of instalments due to the coronavirus pandemic.

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→ Taxes

Demonstrating actual costs associated with holding an ownership interest in a subsidiary

When determining the amount of the actual costs incurred in connection with holding an ownership interest in a subsidiary, the Supreme Administrative Court has ruled that the taxable entity (not the Tax Authority) has a duty to identify and quantify such costs in a trustworthy manner and to provide the relevant supporting documentation.

Jakub Šotník
Rödl & Partner Prague

At its core, the dispute revolved around the issue of whether the taxable entity had properly claimed the actual costs (indirect costs, specifically overhead costs) associated with holding an ownership interest in a subsidiary. For the purpose of determining the amount of such costs, the taxable entity had elected not to use the fixed-percentage cost allowance in the amount of 5% of the income from the profits paid out by the subsidiary and instead quantified the actual costs at just under CZK 400. The Tax Authority did not concur with the manner in which this amount had been determined and argued that the actual costs must have been much higher. The Tax Authority therefore determined the costs on the basis of the fixed-percentage cost allowance, arriving at a cost of CZK 160 thousand. The Tax Authority then assessed additional income tax on the basis of this amount. The Tax Authority had arrived at the foregoing conclusion on the basis of the taxable entity's accounting records, pointing out the cost items that could have been associated with the holding of the ownership interest and that should have consequently been reflected in the calculation of actual costs.

The regional court concurred with the arguments made by the Tax Authority and stated that if a taxable entity decides to claim costs that are lower than the fixed-percentage cost allowance, it is up to the taxable entity to prove such lower costs, it is not up to the Tax Authority. The regional court also rejected the taxable entity's argument that it should be up to the Tax Authority to calculate the actual amount of the costs if the Tax Authority faulted the taxable entity for failing to include certain cost items in the calculation.

The taxable entity filed a cassation complaint against the regional court's decision. In the complaint, the taxable entity stated that the regional curt was inter-mingling two separate issues, the issue of demonstrating costs and the issue of determining the amount of the costs. The taxable entity stated in this regard that taxable entities are only obligated to demonstrate the existence of the costs they incurred. With regard to the determination of the amount of such costs, however, the taxable entity stated that this was merely a mathematical operation and the law does not state what procedure must be used for this purpose. The taxable entity therefore stated that it had borne the burden of proof because the Tax Authority had access to taxable entity's accounting documents and that consequently the only aspect that was being disputed was the calculation of actual overhead costs. If the Tax Authority did not agree with the calculation performed by the taxable entity, the

> According to the Supreme Administrative Court, when calculating actual overhead costs, one needs to create a reasonable algorithm showing the procedure for the calculation of the costs

Tax Authority should have performed its own calculation or asked the taxable entity to modify the calculation.

In its judgement, the Supreme Administrative Court rejected this demand from the taxable entity, as well as the demand to have the Tax Authority repeatedly request the taxable entity to correct the cost calculation, i.e. to repeatedly make such requests until the taxable entity submits a correct calculation that is supported by economic indicators and appropriate evidence. The Supreme Administrative Court emphasized that it is up to the taxable entity to demonstrate the actual amount of the overhead costs concerned, which means that the taxable entity must identify and quantify such costs, and must provide the relevant supporting documentation.

Finally, the Supreme Administrative Court stated that "... due to the nature of the matter concerned, it will not be possible to quantify an absolutely precise value for overhead costs, and it will usually be necessary to create a certain reasonable algorithm for calculating such costs. Such algorithm, however, must reflect all of the costs relating to the ancillary organizational processes that are associated with the holding of the ownership interest in the subsidiary".

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→ Taxes

Meal allowances paid in the Czech Republic and lump sum benefit for meals

On 31 December 2020, the Regulation prepared by the Ministry of Labour and Social Affairs was published in the Collection of Laws. This Regulation introduces caps for 2021 on meal allowances paid in the Czech Republic, the rates for basic compensations for the use of motor vehicles and the average prices for fuel that will be applied primarily when compensation for the use of an employee's private car on business trips is calculated.

As for vehicles, it was for example decided that the basic compensation amounts to CZK 4.40/km and the fuel compensation amounts to CZK 27.80/litre of 95-octane petrol, CZK 27.20/litre of diesel and CZK 5.00/kWh of energy.

As for the meal allowances, a range between CZK 91 and CZK 108 was set for meal allowances for any business trip that takes between 5 and 12 hours.

The maximum value of a meal voucher where 55% of its nominal value may be treated as a tax-deductible expense is derived from the cap for meal allowances in the amount of CZK 108. The value of such meal voucher that may be partially treated as tax-deductible expense would be CZK 137 and the portion that may be deducted from taxes will amount to CZK 75.35. This limit also defines the maximum amount of the lump sum meal allowance of CZK 75.60/shift that is exempt for the income tax on employment income payable by the employee.

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→ Taxes

Recommendations of the OECD for Transfer Pricing in relation to the impacts of the COVID-19 pandemic

Specific economic conditions brought about by the COVID-19 pandemic and consequent government responses have given rise to numerous practical difficulties in applying the arm's length principle (not only) in 2020 and this has led both taxpayers and tax authorities to consider the difficulties in practical application, specifically in terms of how to correctly set transfer pricing methodology. For this reason, the Organisation for Economic Co-operation and Development (the "OECD") issued a report containing recommendations for taxpayers and financial administrations on how to proceed when applying transfer pricing rules in periods sadly affected by the COVID-19 pandemic.

Petr Tomeš
Rödl & Partner Prague

The report by the OECD follows from the basic premise of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the "Guidelines") and focuses on interpreting those principles already contained in the Guidelines in connection with the extraordinary circumstances arising from the COVID-19 pandemic.

The OECD issued the report on 18 December 2020. It is the result of the consensus reached by the financial administrations of 137 OECD / G20 countries involved in the BEPS initiative, the Czech financial administration included. The recommendations focus on four priority topics, specifically: (i) comparability analysis, (ii) losses and allocations of specific costs resulting from the COVID-19 pandemic, (iii) the impact of government assistance programmes and (iv) the impact on Advance Pricing Agreements (the "APA").

The topics are closely linked and the recommendations quite clearly underline a preference for individual solutions to individual cases assessing their specific circumstances. The OECD says no to a simplified view of determining the functional profile of a company (a routine or limited entity, for example) and the therefrom ensuing clear conclusions on bearing risks and incurred loss or even extra costs.

Another feature that runs through the entire report is an analogy with the conduct of independent entities under comparable circumstances, i.e. the creation of a hypothesis on how companies would act under the given circumstances in an arm's-length transaction.

In what regards comparability analysis, there is practically no commonly used historical data that may be deemed comparable to the financial data for 2020, when the COVID-19 pandemic hit. For this reason, the recommendations indicate what alternative data can be used for comparability analysis. These include, for example, changes in costs or revenues at the time of the pandemic, the impact of governmental responses, changes in macroeconomic indicators in given sectors, and deviations of actual financial indicators from those planned.

The report also draws attention to the possibility of taking into account the effects of the pandemic on transfer pricing adjustments in tax returns, should the data necessary for such adjustments be available after the accounts have been closed and provided such a procedure be in accordance with local rules and regulations.

In furtherance to comparability analysis, the report does not allow for any analogy between the current economic crisis and that of 2008/2009 because of the different circumstances in each case.

Following the OECD Guidelines, loss-making companies may be used in the context of the comparability analysis, but only under the condition that those loss-making companies bear risks comparable to those of the tested company and that they meet all the search criteria applied in the benchmarking analysis.

As has already been stated above, each case has to be judged on its own merits. When allocating losses or extraordinary costs among the individual group members in view of the COVID-19 pandemic, it is necessary to consider the distribution of risks and, most importantly, the decision-

making powers to manage such risks. Limited companies may, at first glance, bear certain risks and associated costs, provided they are related to the decision-making powers of local management.

Therefore, the distribution of losses within multinational enterprise groups must always be based on a functional and risk analysis of the companies concerned and there must be sufficient evidence at hand to uphold them before the tax authorities. This should be kept in mind especially now when accounts are being closed for the year 2020 after a COVID-19 stricken year for many a company and when transfer pricing adjustments are being set up.

In conclusion please note that you really need to discuss and describe in perfect detail all the factors that in view of the COVID-19 pandemic have impacted transfer pricing in 2020 (and the upcoming years) in your transfer pricing documentation. Only in this way can you prevent the tax authorities from questioning it.

Our transfer pricing team experts are at your service; they can help you assess the impact the COVID-19 pandemic has had on your transfer pricing and they can help you put together your transfer pricing documentation.

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→ Taxes

Bill to the Income Taxes Act has been published in the collection of laws

On 31 December 2020, the amending bill that had been discussed for a long time was published in the Collection of Laws under Act No. 609/2020 Sb. and it became effective on 1 January 2021. Namely, the Bill introduces the following:

- Super-gross wages have been abolished;
- Basic tax relief per taxpayer has been increased;
- Lump sum benefit for meals has been introduced;
- Extraordinary depreciation has been approved;
- Limit for acquisition costs of tangible assets and technical improvements and betterments has been increased;
- Tax category of intangible assets was cancelled.

As for extraordinary depreciation, the increase in the limit for acquisition costs of tangible assets and technical improvements and betterments and the new rules for intangible assets, a taxpayer may apply this change already in respect of 2020.

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