Rödl & Partner

NEWSLETTER CZECH REPUBLIC

Issue: April 2022

Information on Law, Taxes and Economics in the Czech Republic

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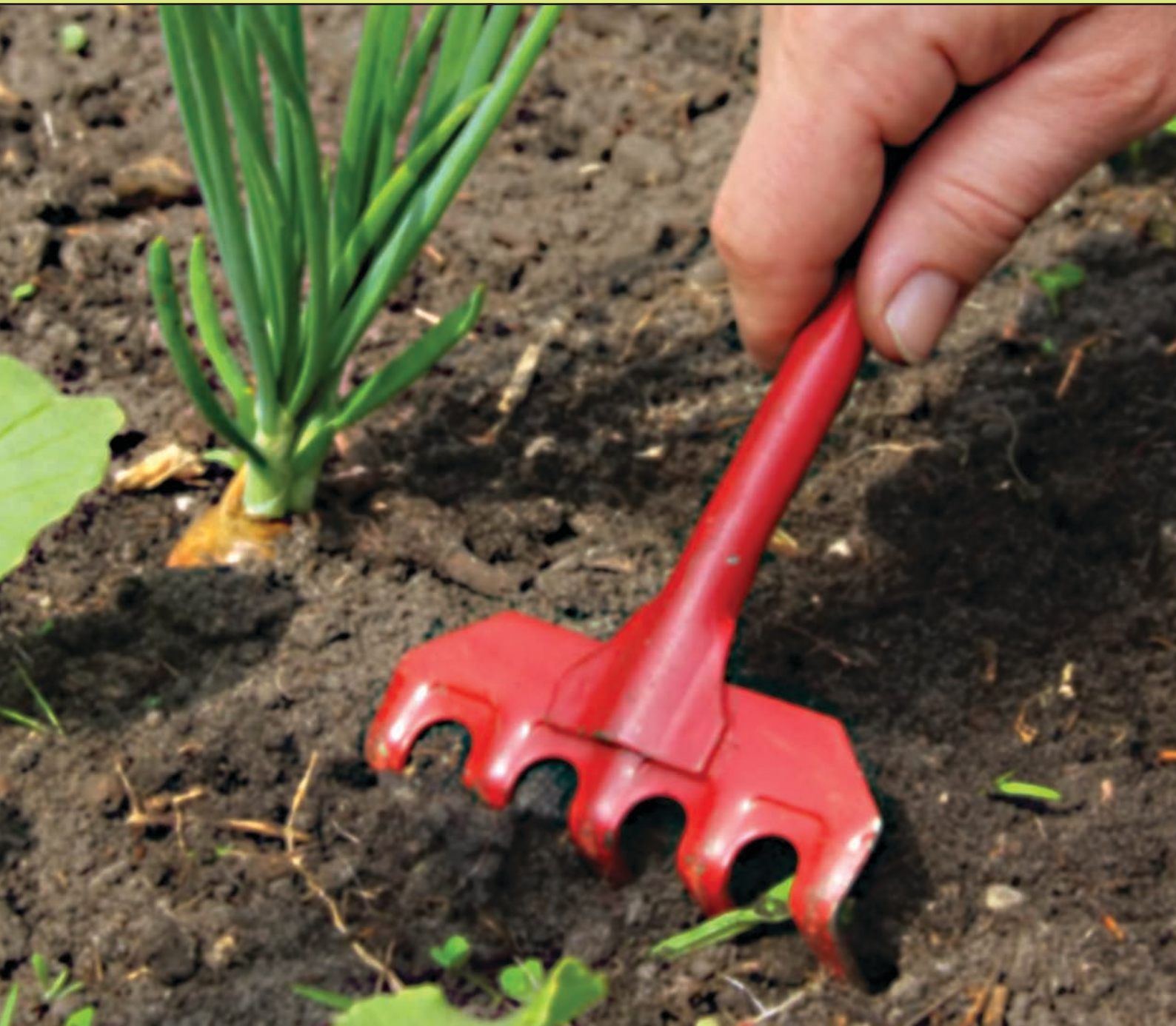

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Content:

→ Law

M&A and the "new" Europe: Sanctions as obstacles to a deal?

Following Russia's attack on the territory of Ukraine, the EU, US, and several other countries imposed a number of sanctions not only on Russian and Belarusian organisations and companies, but also on individuals from both countries.

Hans-Ulrich Theobald
Rödl & Partner Prague

Russia has since imposed a series of counter-sanctions which have made it very difficult to make dispositions with assets located in Russia.

In view of these measures, which are being tightened and extended almost on a daily basis, detailed export controls have become increasing vital. Indeed, sanctions now include a comprehensive ban on the supply of goods, services and funds.

Sanctions may be imposed on certain countries or regions, on the supply of certain goods, on specific measures (such as the closure of airspace) or even on certain persons or groups of persons. It should be noted that sanctions imposed on persons on the sanctions list also include entities in which those persons hold shares (within the constraints of the "ultimate beneficial ownership" concept).

It is therefore extremely important when conducting due diligence to check the ownership structure and business relationships of the target company and the existence and application of an effective internal control system in terms of export. Any violations of sanctions and prohibitions on cooperation with companies listed, for example, on the European FISALIS sanctions list or the US OFAC sanctions list may have a serious impact on the persons concerned (managing directors, and possibly even the owners), the companies involved and their related parties. Such sanctions may also impact potential acquirers.

It should be noted that unlike EU regulations, which have a clearly defined scope of application to all nationals of EU Member States or persons residing, registered in or operating in the EU, the scope of US sanctions is considerably more complex. For example, according to the USA, the link to the USA is already established by invoicing in US dollars. The addressees of the sanctions are not only the parties to the contract, but also persons involved in the performance of the contract, such as carriers, who may even be required to check delivery addresses.

Violations of European sanctions are usually considered an administrative offence or a criminal offence; in addition, the deprivation of economic benefits is commonly assessed. In addition to these consequences, in the case of US sanctions, companies may be subject to the revocation of certain export rights for up to 25 years and may be placed on the Denied Persons List of the Department of Commerce's Bureau of Industry and Security ("BIS"). Thus, these companies temporarily become sanctioned companies.

Therefore, we strongly recommend that the following areas be verified as part of due diligence:

- Has a clear set of responsibilities and competences regarding sanctions (legality control)

been established in the target company with the involvement of the management?
- Are current risk activities and contracts (e.g. the ongoing capital construction project in Russia/ Belarus, financial transactions, deliveries with short lead times, deliveries of inputs, spare parts, etc.) controlled in cooperation with experts?
- Has an internal process for checking compliance with export regulations been established/adapted through questionnaires to trading partners and automated checking of sanctions lists where appropriate?
- Are there regular checks in place to ensure that business partners (legal and natural persons, senior staff, final beneficiaries) and financial institutions involved in transactions are not affected by sanctions?
- Do existing contractual agreements contain appropriate provisions in case one of the parties is or becomes subject to sanctions or embargoes (penalty clauses); has it been agreed that the trading partner will be exempted from guarantees and liability in relation to export control risks (if possible/allowable); MAC, force majeure?

If the review were to find that an internal export control compliance system was not in place or that it was inadequate, consideration would need to be given, based on the risk-based nature of the target company's activities, as to whether exempting the buyer from any risks arising from a potential breach of export control regulations and the relevant sanctions would provide sufficient assurance to the buyer.

Should this not be the case, and if carve outs are not possible, the transaction may not be feasible.

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→ Taxes

VAT tax relief and Ukraine

In the context of the current wave of solidarity towards Ukraine, the tax administration has announced the tax implications regarding VAT on donations.

From the perspective of the VAT Act, a taxpayer may sell goods domestically to a humanitarian or charitable organisation that sends them to a third country, like Ukraine for example, as part of its humanitarian, charitable or educational aid. Such a transaction is then treated as tax exempt and the tax may be deducted. The taxpayer needs to have evidence proving that the conditions for VAT exemption of the export have been met, such as a declaration by the competent organisation that the goods have been or will be exported for specified purposes.

Moreover, the taxpayer may make financial gifts, which are not subject to VAT, and material gifts. If the taxpayer has not purchased the goods for his economic activity, he will not be entitled to claim a deduction and the material gift will not be subject to VAT. If, however, he has purchased the goods for his economic activity, he may provide them to a humanitarian or charitable organisation (see above), to persons other than the humanitarian or charitable organisation or to persons in a third country. In both cases he must apply output tax. The GFD has explicitly rejected the exemption of s. 66 of the VAT Act for exports.

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→ Taxes

Remission of VAT and advance payments of road tax for persons engaged in transport

In response to the significant increase in fuel prices, the Minister of Finance has issued a decision to remit interest on late payment or interest on arrears incurred on VAT in regards to persons whose income is predominantly derived from the transport business.

Accordingly, the tax authorities will not recover any interest for the tax period February-August 2022, or the tax period Q1 2022 or Q2 2022, as the case may be. Naturally, the persons concerned must notify the tax authorities in due time of the fact that the predominant part of their income comes from the transport business.

The waiver of interest on late payment will effectively result in a substitute due date for the road tax on the condition that the VAT to which the interest in question would be linked is paid by 31 October 2022 at the latest. However, this decision does not waive the penalty for late declaration of tax, so VAT returns must still be submitted within the statutory deadlines. At the same time, the Minister of Finance will remit advance payments of road tax to taxpayers for the tax year 2022.

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→ Taxes

Tax changes in response to the war in Ukraine

As mentioned in our Newsletter of March 7, 2022, a special tax law is being drafted in response to the armed conflict in Ukraine. The aim of the proposed revenue changes is to support taxpayers in their charitable activities aimed at helping Ukraine and its people.

Martina Šotníková, Daniel Ďuriš
Rödl & Partner Prague

The new measures concern the following areas:

Maximum value of donations that may be deducted from the tax base in aggregate

The increased limit (30 per cent of the tax base) for deducting donations from the income tax base is extended for the 2022 tax year, or tax years ending between 1 March 2022 and 28 February 2023. The increased limit was originally enacted in connection with the COVID-19 pandemic and only applied to 2020 and 2021.

More recipients

The range of recipients of donations that may be deducted from the taxable income now also includes Ukraine, its territorial administrative units and legal and natural persons having their registered office or domicile in Ukraine. In the past, the scope of beneficiaries was limited to persons

whose domicile or registered office is located in the territory of the Czech Republic, a Member State of the European Union or of the European Economic Area.

Extended purpose of donations

It is now possible to claim a deduction for a donation made for the purpose of supporting Ukraine's defence efforts (for example, the provision of military equipment), which was not possible before.

More non-residents can claim a deduction for donations

Non-residents who may claim a deduction for donations now include residents of Ukraine. The condition for deducting the donation is that the non-resident's taxable income from sources within the Czech Republic makes up at least 90% of their worldwide income. However, this extension only applies to 2022.

A wider range of exempt income

In the tax year 2022, an employee's income in the form of accommodation is exempt from income tax if it is provided by the employer to the employee and a member of the employee's family residing in Ukraine because the employee left Ukraine in connection with the armed conflict. If advance employment tax payments were withheld from such income before the Act came into effect, the difference may be refunded by the taxpayer until the deadline for filing the personal income tax return for that period has passed.

The purpose of supporting the defence efforts of Ukraine is extended to exempt both natural persons and legal entities. This exemption is limited and applies only to 2022.

A wider range of tax deductible costs

Tax-deductible expenses now also include non-cash donations made in 2022 to assist Ukraine (and an extended range of entities) for purposes for which the value of the donation is deductible from the tax base. The reason for this is to simplify administration for taxpayers (for example, the use of a company bus including the driver's salary for the purpose of transporting Ukrainian residents leaving the war zone). If such an expense is claimed, the deduction of this item as a donation from the tax base may not be claimed simultaneously.

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→ Taxes

Travel allowances: Increase in price per kilowatt hour

In response to the increase in energy prices, the Ministry of Labour and Social Affairs has increased the average price per kilowatt hour from CZK 4.10 to CZK 6.00 with effect from 12 March 2022.

Changes in road tax

The Government has decided to scrap road tax for cars, vans and trucks under 12 tonnes in light of the recent increase in fuel prices. Concurrently, the Minister of Finance has decided to waive advance payments of road tax due in 2022.

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→ Taxes

How to (dis)prove the costs incurred in receiving services from the parent company?

The Supreme Administrative Court did not accept the technical assistance agreement, e-mail communication with the parent company, or even copies of the foreign technicians' airline tickets that had been presented as evidence. How, then, can subsidiaries prove that the expenses incurred in receiving services from the parent company were actually incurred at the declared amount?

Jakub Šotník, Michal Gola
Rödl & Partner Prague

The Supreme Administrative Court recently heard the case of a Czech limited liability company that had provided its customers with services consisting in the processing of plastic parts for motor vehicles (in particular, grinding, refurbishing and restoration of parts). The company (a taxable person) did not have staff of its own to render the service and so it entered into a technical assistance agreement with its parent company based abroad. Under the agreement, the parent company sent several of its employees to the Czech Republic to help complete orders for the company's customers. In the present case, the issue was the tax deductibility of the costs incurred in receiving the technical assistance services, or rather the proof of the extent and content of such costs.

The company tried to prove the tax deductibility of the costs incurred primarily through a technical assistance agreement concluded with the parent company, invoices issued, e-mail communication, a list of the staff sent, and copies of the airline tickets and travel documents of the staff sent by the parent company. In attempting to support the tax deductibility of the costs incurred, the company also pointed out that neither it nor any other company in the Czech Republic had any technicians with the necessary technological knowledge to perform the services.

Nevertheless, according to the Supreme Administrative Court, the evidence was not enough to prevent doubt from being cast on the incurrence of the costs in question. In fact, the claims concerning the technical support provided and its scope and content arose neither from the technical assistance agreement nor from the simple list of technicians. Also, the fact that the company did not have technicians with the knowledge to carry out the contract for the company's customer was apparently not sufficient evidence, since the Supreme Administrative Court found that this alone did not suffice in proving the receipt of the services claimed. Moreover, the photocopied passports and airline ticket details of these persons that had been submitted without further evidence do not prove that the technical support was carried out as alleged by the company. The Supreme Administrative Court found that such evidence merely proves that the persons were in the Czech Republic, but not that the costs in question were incurred to the extent declared.

As the above-mentioned evidence clearly fails to prove the tax deductibility of the declared costs, the question then arises what evidence is admissible? It is clear from the reasoning contained in the relevant judgment that the Supreme Administrative Court reached the above conclusions not because it considered the submitted agreement, invoices or staff roster to be ineligible evidence, but because the evidence submitted was of a very general nature and did not give a detailed description of the services performed or the items invoiced. The lack of detailed information in the evidence submitted was thus fatal to the company.

In order to bear the burden of proof, it is therefore appropriate to have proper and detailed records. This may consist, for example, in a detailed definition of the subject-matter of the agreement (specification of specific activities), including a detailed determination of the method of setting the price for the services provided. Detailed records of the services provided, such as attendance records and a summary of the tasks performed, which may subsequently form an annex to individual invoices, may also strengthen the evidence. All this can significantly reduce the risk of an additional tax assessment, including possible penalties. You see the Supreme Administrative Court itself has stated that it is in the interest of the taxpayer to organise its business practices in such a way that it has accurate, complete, conclusive and transparent means of proving its tax claims for the purposes of tax proceedings. In other words, the Supreme Administrative Court reminds us that Fortune Favours the Prepared.

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→ Taxes

The General Financial Directorate has decided on the VAT rate for contact lenses from 1 January 2022

Due to uncertainties regarding the VAT rate on contact lenses from 1 January 2022, the General Financial Directorate has issued information aimed at unifying this procedure.

According to the amended versions of Annex 3 to the Public Health Insurance Act, which deals with the categorisation of medical devices prescribed on the basis of a voucher, and Annex 3 to the VAT Act, which lists the goods subject to the first reduced rate of tax, contact lenses may not be classified under Table 1 of Section C of this Annex. Nonetheless, according to the Common Customs Tariff of the European Union and Annex 3 to the VAT Act, contact lenses may be subject to a reduced VAT rate if they are medical devices under the legislation governing medical devices.

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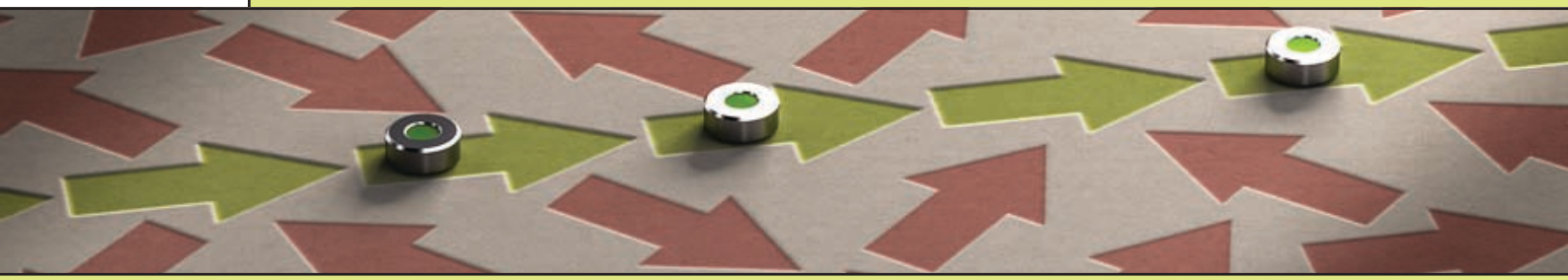

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