Rödl & Partner

NEWSLETTER CZECH REPUBLIC

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Rödl & Partner

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→ Law

Practical news on digitisation and copyright

The new year not only saw the entry into force of the button amendment to the Civil Code and the Consumer Protection Act, but also revival of digital and copyright negotiations.

Lenka Hanková, Alice Kubová Bártková
Rödl & Partner Prague

Data boxes mandatory for other persons

As of 1 January 2023, data boxes will be automatically established for all natural persons doing business who have been assigned an ID number. The same applies to all legal entities. Data boxes will allow the delivery of messages not only from public entities (this function cannot be switched off) but also from private entities (the receipt of so-called postal data messages is enabled automatically and it can be deactivated). For both types of messages, the fiction of delivery applies at the moment of logging in or 10 days after delivery of the message to the data box. If you want to send your debtor, for example, a demand for payment, check first whether it can also be delivered to his or her data box.

E-FBL – digitalisation in transport

Freight forwarding companies will also be interested in the new ideas brought forward by FIATA (International Federation of Freight Forwarders Associations). It has introduced the possibility for its members to use paperless bills of lading (FIATA Bill of Lading – eFBL) in a secure digital format based on blockchain technology. We will come back to you with more information soon, as the use of this eFBL has its specifics in the Czech legal system.

Amendment to the copyright act and licences according to the civil code

Have you noticed that when searching for an article from electronic periodicals, Google no longer displays the excerpt, but more or less just the title? This is due to an amendment to the Copyright Act effective from 5 January 2023. Online service providers should now pay a reasonable remuneration to the publishers of periodicals for the use of an article or part of an article.

Furthermore, the amendment specifies the conditions of liability of providers of information society services for online content sharing (platforms such as YouTube, ulož.to) for illegal content uploaded by users. Such platforms must make "best efforts" to obtain a licence from the author and, if they fail to do so, should prevent the publication of infringing content. However, if the author himself alerts the platform, the platform must prevent access to the illegal content or delete the content and try to prevent its re-upload.

Other new statutory licenses are for automated text or data analysis, for the use of works not available on the market, for digital learning or for pastiche. The amendment will also please all those who, as part of their business, make radio or television broadcasts available to a small number of people not for profit (for example, a radio playing

at a hairdresser's), as they will no longer have to pay annoying fees for this soundscape.

Substantial changes have also been made to the royalty arrangements in the Civil Code, which can now only be agreed as a fixed amount in justified cases and taking into account the specificities of individual sectors. An obligation for the licensee to inform the author regularly, at least once a year and to a reasonable extent, about the use of the licence and sub-licence has also been introduced.

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→ Taxes

What does the Financial Administration say about the impact of the energy crisis on transfer prices?

The Financial Administration issued a communication on the impact of the energy crisis on transfer pricing methodology on its website on 20 December 2022.

Petr Tomeš
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Under the spotlight are so-called routine entities with a limited functional and risk profile (which use the cost-plus method to set the prices of their products) and whether these companies have to take into account soaring energy costs (and possibly other inputs) in their full intra-group product prices.

The Financial Administration refers to its Guidance Note on the Covid-19 Pandemic, noting that the same optics should be applied when it comes to the energy crisis.

The Financial Administration is of the view that routine manufacturing companies should take into account, using the cost-plus method, all costs in their cost base from which the price of products is formed after a profit margin is added. This includes rising energy costs in their entirety. Increased energy costs should then be reflected in the profit margin, where its market value can generally be expected to drop, not least because of the energy crisis.

We generally agree with this approach, but in practice the situation will often be more complex. Foreign-owned manufacturing companies have a very diverse range of functions and risks even in terms of energy purchases and the ability to influence the price and other terms of the transaction. If such a manufacturing company decides independently, without the influence of the parent company, on the choice of energy supplier and on the setting of pricing and other terms and conditions of energy purchases, passing on the full amount of the multiple costs to the parent company may not always be the right solution from the perspective of the transfer pricing methodology. Indeed, energy prices and the rate of increase is a factor that the manufacturing company can at least partially influence and should therefore bear some of the associated risks (in other words, the extra costs incurred).

In certain cases, routine manufacturing companies sell their products within the group to companies other than the parent company (or those with more complex decision-making powers). When selling the products of a group routine

distribution company, it is certainly not appropriate to pass on these energy overheads to these group customers, thereby reducing their profitability (unless there is a TP adjustment by the parent company).

In the communication, the Financial Administration mentions that energy overheads in the cost base will be offset by a lower profit margin, which will fall across the market (including independent companies) due to the energy crisis. In practice, however, it will be difficult to find comparable market data that already reflect lower profitability when defending 2022 transfer prices. Data from years before the energy crisis will still be available for a long time. This situation could be resolved to some extent, as in the Covid-19 crisis, by a macroeconomic study of the decline of individual sectors, but it would still make sense to proceed on an individual basis and to examine whether, in relation to the functional and risk profile of the company, the full value of energy multicosts should actually be passed on in intra-group product prices.

We consider the current Communication of the Financial Administration as a successful basis, which will certainly soon be supplemented by a more detailed document describing these practical situations. We will keep you informed of any further developments in future editions of our Newsletter.

If this topic applies to your company and the energy crisis has resulted in a change in the transfer pricing methodology in your group, we will be happy to discuss the potential risks with you and recommend arguments to defend the pricing before the tax authorities.

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→ Taxes

Changes in the service of messages to data boxes effective from 1 January 2023

The Supreme Administrative Court passed judgment last year whereby it changed the legal fiction of delivery of official documents to data boxes. This is good news for private individuals and tax payers in general, as it extends the delivery term for unread messages delivered to a data box.

Petr Koubovský, Ilona Shapoval
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Act No. 300/2008 Sb. On Electronic Legal Acts and Authorised Conversion of Documents lays down the legal fiction of delivery (service) of a data message. According to this legal fiction, an electronic document (data message) sent by a public authority is treated as having been delivered and served on the recipient on the 10th day from the delivery of the document in the recipient's data box irrespective of whether the recipient actually logged into the data box and read the message.

So far, the established practice of local courts applied the rule that "shifted" the delivery date to the next business day only for documents served by a postal service provider. In case of data boxes, users were deemed to have the entire 10-day period to read the message and therefore were not given any additional leeway.

The Supreme Administrative Court's judgment of 26 May 2022 (in case No. j. 4 Afs 264/2018-85) introduces a major change to the prevailing interpretation of s. 17(4) of the said Act. In this case, the court addressed a dispute between a tax office and a company regarding the fine imposed for the late filing of a control statement and the application of the rules related to the fiction of delivery, because the message was delivered on Sunday. In the company's opinion, the

electronic delivery should follow the rule stipulated in the Czech Tax Code according to which the date of service should fall on the next business day. The fourth chamber of the Supreme Administrative Court dissented from the prevailing court rulings on this matter and brought the case before the grand chamber. Having reviewed the matter, the grand chamber decided that effective from 1 January 2023, if a data box user does not open and read the message, the data box message will not be marked as delivered on Saturdays, Sundays and public holidays. The last day of delivery under the legal fiction of delivery will fall on the subsequent business day.

This change in the interpretation of the legal fiction of delivery has important implications for the running of other statutory periods that are binding on tax payers (such as terms of appeal etc.).

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→ Taxes

The Supreme Administrative Court has ruled on the application of tax losses after adjustment of transfer prices

The Supreme Administrative Court issued a decision on the application of a tax loss – as a deductible item from the tax base – a loss which arose following the adjustment of transfer prices in a German tax audit.

Petr Tomeš
Rödl & Partner Prague

As part of a tax audit, the German tax authority questioned a German company's transfer pricing in a transaction with its Czech subsidiary and reduced the German company's costs for purchasing products.

The Czech company subsequently filed a supplementary tax return and reduced the proceeds from the sale of products from the German parent company, and thus the tax base, in order to eliminate the double taxation. The Czech tax authority agreed to this procedure.

A tax loss arose in the supplementary tax return, which the Czech company wanted to claim in one of the subsequent periods. Since under the legislation at the time, it was not possible to claim the new tax loss in a supplementary tax return (this was 2011) unless a higher tax base was reported, the company decided to claim the tax loss by way of a reopening of the procedure. The tax authority disagreed with this approach, as the legal conditions for initiating the reopening procedure were not met. The tax authority also rejected the argument regarding the avoidance of double taxation because the double taxation arising from the German tax audit related to

a different period. The Supreme Administrative Court subsequently upheld the view of the tax authority.

Under the legislation in effect at the present time, which no longer contains this “hard” condition (where claiming a supplementary loss is only possible in cases where the supplementary tax base is higher), it would be possible to claim such a tax loss if the period in question was not already time-barred.

We therefore recommend that our clients pay due attention to such cases in situations involving their associated companies and take the necessary steps to eliminate double taxation. We would be pleased to assist you in examining whether the conditions exist for such secondary transfer pricing adjustments and whether there is the potential to claim tax losses.

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→ Taxes

New instruction of the General Financial Directorate (GFD) on waiving tax appurtenance

The General Financial Directorate has issued Instruction No. GFŘ-D-58, which regulates the procedure of the Financial Administration of the Czech Republic when deciding on waivers of tax appurtenances (i.e. penalties, default interest and interest on amounts to which a grace period applies) under the Code of Tax Procedure. This replaces the original Instruction No GFŘ-D-47. At the outset, it should be said that the instruction does not contain any major innovations.

It newly specifies what constitutes a serious violation of tax or accounting regulations preventing the waiver of the relevant tax appurtenances by, for example, defining the decisive moments in time to be used by the tax authorities for assessing such violations.

The instruction also incorporates the recent case law of the Supreme Administrative Court, which requires the tax administration to additionally assess other circumstances (for example, the nature or intensity of the breach of tax obligations) and thus provides taxpayers with additional arguments they can use in order to potentially obtain a benefit in the form of a waiver of tax penalties (even if only a part of the tax penalty ends up being waived).

Furthermore, the list of justifiable reasons for delay (default) differs slightly. If the taxpayer fulfils any one of these reasons, the tax administration must waive at least part of the tax penalties provided that other conditions are met. At the same time, it does not change the fact that justifiable reasons other than those explicitly mentioned in the instruction must also be considered.

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→ Taxes

The Supreme Administrative Court expressed its opinion on a business model used in the pharmaceutical industry

The Supreme Administrative Court upheld the ability of companies to compensate for low sales prices of regulated drugs through marketing services.

Martin Koldinský
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The Supreme Administrative Court dealt with a case known as ELI LILLY, in which a Czech company (a Czech taxpaying entity) sued the Appellate Financial Directorate and sought to overturn the judgment of the Metropolitan Court in Prague, which had previously upheld the procedure followed by the tax authority. The basis of the dispute was an assessment of whether or not the distribution of medicines and marketing services provided by the taxpayer constituted a single supply for VAT purposes. However, this case also has an overlap with the area of transfer pricing.

From the perspective of transfer pricing, it is interesting that the Supreme Administrative Court, in its judgment of 8 December 2022, found correct the procedure followed by the taxpayer, i.e. the procedure where, in addition to the remuneration for the distribution of pharmaceuticals on the Czech market, which would be a loss-making distribution due to the fact that pharmaceutical prices are regulated, the taxpayer additionally received remuneration for the provision of marketing services. Such remuneration for the provision of marketing services from a related party constituted, in essence, a profitable settlement within the meaning of Section 23(7) of the Income Tax Act and enabled the taxpayer to report a positive profit.

The Supreme Administrative Court stated that the tax base (i.e. taxable income) stemming from the regulated price of medicines on the Czech market cannot include the costs of marketing services, because the price of the medicine would then exceed the regulated selling price. Therefore, the market for the distribution of pharmaceuticals must be treated differently from other sectors that are unregulated and the provision of marketing services must be viewed as a different supply from a VAT perspective, but from a transfer pricing (i.e. income tax) perspective, marketing services must be viewed as an integral part of the distribution of pharmaceuticals on the domestic market. One would not work without the other from a transfer pricing perspective.

In practice, this means that when testing the market normality of the realised profitability of taxable entities operating on the regulated pharmaceutical market, it is therefore necessary to apply a so-called aggregate approach and to consider distribution and marketing activities together. This then of course has an impact on the selection of the entities with which profitability is compared, as it is necessary to work only with comparable companies to determine the arm's length profitability.

We view this judgment of the Supreme Administrative Court as essentially a confirmation of how pricing works between related parties operating in the regulated pharmaceutical industry and as confirmation of the appropriateness of compensating, through other consideration, for the lack of profitability of distributors resulting from the strictly regulated selling prices of pharmaceuticals.

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