Rödl & Partner

NEWSLETTER CZECH REPUBLIC

Issue: December 2023

Information on Law, Taxes and Economics in the Czech Republic

www.roedl.cz/en

Czech Law Firm of The Year 2023

Czech Law Firm of the Year 2012–2023

Rödl & Partner

NEWSLETTER CZECH REPUBLIC

Issue: December 2023

Content:

→ Law

Have you checked that your fence is in the right place? Maybe the land's been yours for longer than you think

It sometimes happens that the boundary of a plot is not the same as the boundary recorded in the cadastre. It's quite common and has much to do with the digitisation of cadastral maps. A typical example is relocation, a situation when the owner has occupied a part of a neighbouring plot and has been using it peacefully for a long time. He does not know that this is someone else's land and that he may have inadvertently become the owner of the land.

Martin Švéda
Rödl & Partner Prague

What is acquisition of title by prescription?

A person who reasonably believes that they own the property and that has treated the property as such for a long time may acquire title to the property by prescription. Typically, this happens when a person inherits a garden, whose boundary has not been surveyed by a surveyor and everyone relies on the fence that has surrounded the garden for ages.

Both movable and immovable property can be acquired by prescription, as can a right equivalent to an easement – for example, a right of way over the land of another.

Let's take a closer look at the acquisition of title to immovable property (real estate), as this is probably the most common case in practice.

Proper acquisition of title by prescription

The proper acquisition of title to immovable property by prescription requires that the holder has acted as owner continuously for a period of ten years. Acquisition by prescription may be interrupted if it is not exercised for more than one year. Previous possession by a predecessor in title is included in said period. Acquisition by prescription must be fair and genuine.

Acquisition by prescription is usually ten years

Fair possession means that the holder believes, for compelling reasons, that he is entitled to the right he is exercising – that is, that he believes he is the owner. Genuine possession means that there exists a legal reason that would otherwise be sufficient to create a title. At the same time, fair possession may not be held on the basis of theft, deception or fraud.

Extraordinary acquisition of title by prescription

In some cases, the title deeds are no longer available, such as when the property has been in the family for decades. Doubts may also arise about the validity of previous contracts, or inconsistencies may come to light when the boundaries of the land are surveyed.

For this reason, extraordinary acquisition of title to immovable property (real estate) by prescription has been reintroduced into the Civil Code over a decade ago. It is no longer necessary for the holder to have a legal title. It is sufficient that he does not have a dishonest intention. The law balances this simplification by doubling the retention period for real estate to twenty years.

How to go about it?

If acquisition by prescription is on the table and the owners cannot agree, the court must decide.

Acquisition by prescription can be difficult to prove as many years may have passed. It may then become necessary to produce contemporary photographs or documents, including historic maps, plans or correspondence, and witnesses may be called or archives may be searched for historic official decisions or records.

If you think you may have acquired a title or any other right to property by prescription, don't let it go to waste if you have sufficient evidence.

Contact details for further information

JUDr. Martin Švéda
advokát
(Attorney-at-Law CZ)
Equity Partner
P +420 236 163 740
martin.sveda@roedl.com

→ Taxes

Changes to VAT from January 2024

On 8 November 2023, the Senate approved the government's consolidation package to improve the state budget in the coming years. The package includes a number of changes, including changes to value added tax, which are expected to come into effect as early as 1 January 2024.

Michael Pleva, Monika Páblová
Rödl & Partner Prague

Change to tax rates

The most important change in the amendment to the VAT Act is the abolition of the current first and second reduced tax rates. Instead of the current 15 and 10 per cent, there will be only one reduced rate of 12 per cent. The standard rate of 21 per cent will remain unchanged. This change is also linked to the amendment of the relevant annexes to the VAT Act and the transfer of selected items to the basic tax rate.

Change to tax rates

From 1 January 2024, hairdressing and barbering services, bicycle and clothing repairs, household window cleaning, beverages and draught beer (both as part of a catering service and sold separately), domestic air passenger transport and the services of authors and performers, for example, will be reclassified to the standard rate. Among goods, firewood, cut flowers and imports of works of art, collectors' items and antiques will now be subject to the standard VAT rate. The collection and transport of municipal waste will also be subject to the standard rate. On the other hand, non-regular public passenger transport by land and water (e.g. regular transport of employees of a company) will be moved from the standard to the reduced VAT rate.

Restriction of VAT deduction for cars

Another significant change is the introduction of a maximum amount of VAT deduction for the purchase of an M1 passenger car. Taxpayers will be able to deduct VAT up to a maximum of CZK 420,000, the value of which will include any technical improvements to the property. However, this limit does not apply to taxpayers who purchase M1 cars as goods, i.e. for the purpose of resale. The limit for claiming the deduction will also apply to cars acquired through financial leasing. The limit for claiming the VAT deduction does not apply to operating lease services, but the change in the law itself will have a negative impact on leasing companies as owners and lessors of cars.

Limit on the right to deduct VAT on the purchase of a car

Exemption from VAT on the supply of books

The supply of books, which are subject to the second reduced tax rate under the current regulation, will now be exempt from VAT with a right to deduct the tax. In order to qualify for the exemption, the book must correspond to the verbal description

specified in the VAT Act and be classified in the relevant customs nomenclature code. In addition, the amount of advertising on such goods may not exceed 50 per cent of their content and may not consist exclusively or predominantly of musical sound or audio-visual content. The exemption also applies to electronically supplied services consisting of the supply of books, including audio books, and the lending or rental of books under the Library Act.

Contact details for further information

Ing. Michael Pleva
daňový poradce
(Tax Advisor CZ)
Associate Partner
P +420 236 163 232
michael.pleva@roedl.com

→ Taxes

Top-up taxes in the Czech Republic

On 27 October 2023, the Chamber of Deputies approved the Government's bill on the top-up tax for large multinational groups and large domestic groups (Top-up Tax Act). The bill was sent to the Senate on 6 November 2023, so the deadline for discussion ends 6 December 2023.

Milan Mareš
Rödl & Partner Brno

Being a transposition of Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation of multinational enterprise groups and large domestic groups in the European Union into the Czech legal system, it is expected that the Act will be adopted and promulgated in the Collection of Laws by 30 December 2023. The expected date of entry into force and effect is 31 December 2023.

Why? The tax period to which the rules of the Top-Up Tax Act apply starts on 31 December 2023 at the earliest. If the tax period runs from 1 January to 31 December, the first tax period for top-up tax purposes starts on 1 January 2024.

How will this affect you?

If your company is part of a multinational group of companies or a large national group, the above cited Directive or the Top-Up Tax Act is aimed at you. The first clue as to whether you belong to this group is the group's obligation to regularly report its profit/loss by jurisdiction to the tax authorities, in the Country-By-Country Reporting format. The minimum annual turnover of such a group is €750 million.

Will this tax apply to your company if the corporate tax rate is 19 per cent or 21 per cent from 1 January 2024? Given the adjustments to the tax base under the Income Tax Act and the existence of special deductions and tax credits, the answer is yes.

In fact, OECD and EU countries want to ensure a minimum income tax of 15 per cent for any group structure.

How is the tax calculated for multinational groups?

Unlike the standard income tax, the top-up tax is based on the net profit after tax at the group level. In practice, you will continue to convert the Czech financial statements into the format according to the group accounting regulations (e.g. IFRS, HBII according to HGB, etc.). After the adjustments, the effective tax burden is determined. The effective tax burden is calculated at the level of individual jurisdictions and then for individual companies in a given jurisdiction.

It is therefore advisable to define in existing accounting systems:

- appropriate analytical accounts according to the Czech chart of accounts;
- automatic conversion of financial statements under Czech law into the financial statements under the law of the ultimate entity (consolidating unit).

The top-up tax is the difference between the minimum tax rate (currently 15 per cent) applied to the recalculated tax base and the actual tax paid.

Clearly, this is a top-down tax. But what if the top is a jurisdiction with a low tax burden? Then a second type of top-up tax (hence the top-up tax law) is applied, the so-called Czech top-up tax.

The good news is that the phase-in period for this tax is up to five years. However, in the case of a multinational group, everything generally depends on the jurisdiction of the ultimate parent company. The period may therefore be shorter.

In future editions of the Newsletter, we will bring you more detailed information on the application of the Top-up Tax Act, in particular with regard to investment incentives and research and development costs.

Contact details for further information

Ing. Milan Mareš
daňový poradce
(Tax Advisor CZ)
Associate Partner
P +420 530 300 500
milan.mares@roedl.com

→ Taxes

Consolidation Package: Limit on the exemption of income from the sale of securities

The Consolidation Package will bring significant changes to the taxation of personal income. One of these changes will be the capping of the exemption from personal income tax on income from the transfer of shares in companies and securities.

Martin Zeman
Rödl & Partner Prague

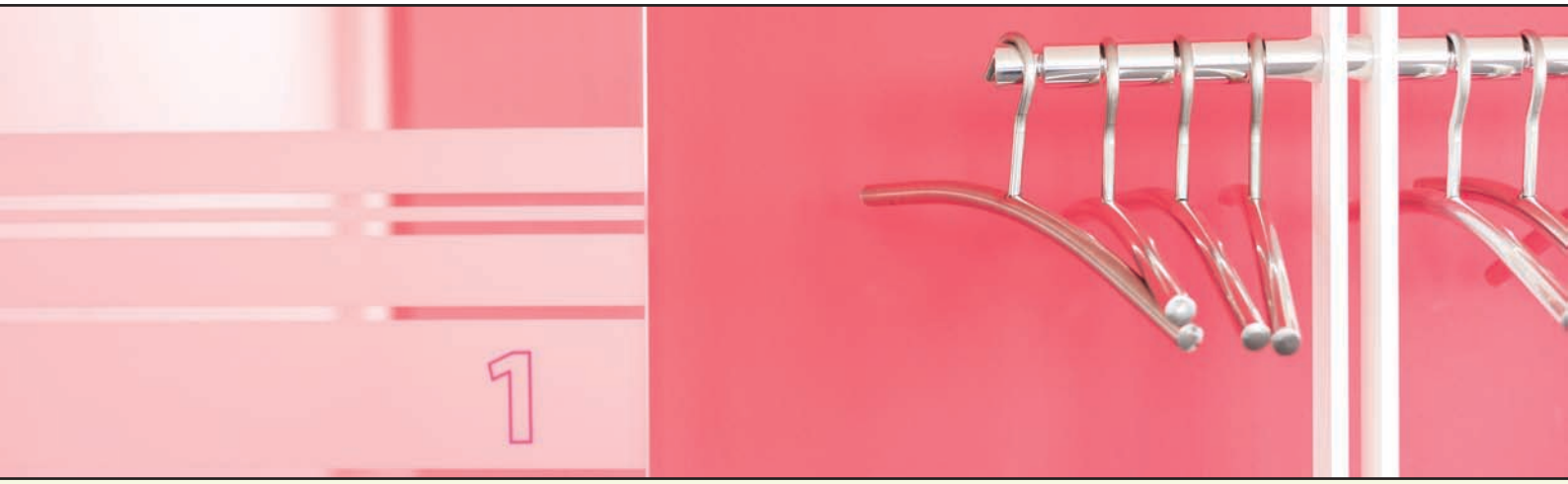
Part of the so-called Consolidation Package, which brings significant changes to tax laws, is the capping of the exemption from personal income tax on income from the transfer of shares in companies and securities. The Package has been approved by the Senate and will hopefully be signed by the President. It will then be published in the Collection of Deeds. In the government's original bill, the change in the sale of securities and shares would have come into force on 1 January 2024. However, as part of the legislative process, the effective date has been delayed by one year and the new exemption limitation will not come into force until 1 January 2025. What exactly do the changes entail?

With effect from 1 January 2025, a limit will be introduced on the exemption of income from the sale of shares in companies and securities that meet the time test for exemption of 5 years or 3 years under Section 4(1)(s) or (w) of the ITA. The cumulative limit of CZK 40 million will apply to income (not profit) earned in the reporting period (calendar year) and the new adjustment will apply to all income realised after 1 January 2025. In connection with this change, the provisions of Section 10(9) of the ITA will also be amended, whereby taxpayers will now be allowed to deduct from income from the sale of a security or share in a company acquired before 1 January 2025 the acquisition value determined in accordance with the law governing the valuation of property as at 31 December 2024, instead of the original historical acquisition price.

In our view, this change will raise a number of interpretation issues in practice. For example, it is not entirely clear how the CZK 40 million limit will be calculated under different purchase price collection variants, where in practice it may occur (as often does occur) that the purchase price is divided into several instalments over several years and the resulting purchase price may be variable and, for example, linked to future economic results. We will continue to monitor developments in this area and keep you informed of the current situation. If you have any questions, please do not hesitate to contact us.

Contact details for further information

Ing. Martin Zeman
daňový poradce
(Tax Advisor CZ)
Manager
P +420 236 163 243
martin.zeman@roedl.com



→ Taxes

Preventive restructuring and its tax implications

Preventive restructuring is a new concept aimed at enabling entrepreneurs in financial difficulties to continue their business, thus avoiding bankruptcy and the need to initiate insolvency proceedings.

Martina Šotníková, Miroslav Holoubek
Rödl & Partner Prague

From a tax point of view, preventive restructuring concerns receivables. On the creditor side, it involves the creation of provisions for receivables and the write-off of receivables. On the debtor side, it is income from debt forgiveness. For both parties, the VAT adjustment on the debt in question is relevant.

Tax adjustments on receivables

The changes in the law related to preventive restructuring have not affected the treatment of tax provisions for receivables. Thus, unlike claims in insolvency proceedings, claims included in preventive restructuring are not governed by special statutory regulations.

Therefore, only the adjustment of the so-called temporary tax provisions can be used to create tax provisions for receivables included in a preventive restructuring.

Write-off of receivables

As a general rule, a receivable can be written off for tax purposes if it is possible to make a provision for tax purposes or if it cannot be made only because the minimum period has not been reached. Section 24(2)(y) of the Income Tax Act has been supplemented by point 7 under the preventive restructuring regime, according to which a claim against a debtor undergoing preventive restructuring may be written off for tax purposes if the claim is directly affected by the restructuring plan and has been extinguished by debt forgiveness under an effective restructuring plan.

As in other cases, in order for a debt to be written off as a tax expense, it must be written off in a timely manner. If the debt is written off in the wrong reporting period, the write-off cannot be claimed as a tax expense.

Cancellation of the debt by the debtor

In the case of a preventive restructuring, no preferential tax treatment has been introduced for the income from the forgiven debt as is the case in insolvency.

If a debt is forgiven in a preventive restructuring, the debtor's tax base must be increased by the amount of the forgiven debt, either through the profit or loss or by virtue of Section 23(3)(a)(12) of the Income Tax Act.

Again, the income from debt forgiveness must be recognised in the correct reporting period.

Adjustment of the VAT base

In amending the VAT Act, the legislator assumed that preventive restructuring is similar in many respects to reorganisation under the Insolvency

Act, and therefore the tax base adjustment regime should be similar.

The main changes are contained in Section 42(2) and (3) of the VAT Act, which allow a taxpayer whose claim has been included in a restructuring plan to make an adjustment to the tax base on the date the restructuring plan comes into effect.

The adjustment of the tax base is then considered to be a separate taxable supply, which is deemed to have taken place on the effective date of the restructuring plan.

Contact details for further information

Ing. Martina Šotníková
daňová poradkyně
(Tax Advisor CZ)
Associate Partner
P +420 236 163 237
martina.sotnikova@roedl.com

Ing. Miroslav Holoubek
daňový poradce
(Tax Advisor CZ)
Senior Associate
P +420 236 163 207
miroslav.holoubek@roedl.com

→ Taxes

Change in the taxation of prizes from promotional contests and draws

The Economic Stimulus Package, effective from 2024, introduces changes to the taxation of prizes from promotional contests and prize draws.

Currently, prizes from promotional contests and prize draws are exempt from income tax if their value does not exceed CZK 10,000. If the value of the prize exceeds CZK 10,000, the prize is subject to withholding tax in full. The organiser must withhold and pay the 15 % tax.

The amendment to the Income Tax Act abolishes the relevant provisions of Section 4, which regulate the limit.

The provisions governing the taxation of prizes from promotional contests and prize draws have been moved to Section 10, which increases the exemption limit from CZK 10,000 to CZK 50,000. As before, this limit will be assessed separately for each prize.

Prizes exceeding CZK 50,000 are subject to a 15% withholding tax, which the organiser is still obliged to withhold and pay.

If your company organises promotional contests and prize draws for customers, be sure to take this change into account.

Contact details for further information

Ing. Martina Šotníková
martina.sotnikova@roedl.com

→ Taxes

Tax implications of private use of a company electric car or plug-in hybrid

The gradual increase in the number of electric cars and plug-in hybrids on domestic roads has led to an increase in the number of these vehicles in company fleets. New types of drive, whether purely electric or a combination of combustion and electric, have practical implications for taxes and wages.

Miroslav Holoubek
Rödl & Partner Prague

The first tax issue to be addressed in the case of plug-in hybrids is to determine whether they are a low-emission vehicle as defined in the Income Tax Act. The answer to this question is crucial for the correct imputation of income in kind for an employee who also uses such a vehicle for private purposes.

A low-emission vehicle is an "...M1, M2 or N1 category vehicle which does not exceed the CO_2 emission limit of 50 g/km and 80 % of the emission limits for air pollutants in real operation as laid down in Annex I to Regulation (EC) No 715/2007 of the European Parliament and of the Council of 20 June 2007 on type-approval of motor vehicles with respect to emissions from light passenger cars and light commercial vehicles (Euro 5 and Euro 6), as amended."

Data on the CO_2 emission limit can be obtained from the large technical certificate. Nonetheless, a certificate of conformity is required to assess the 80 percent of the emission limits. The certificate of conformity provides emission data which are then compared with the relevant limit values.

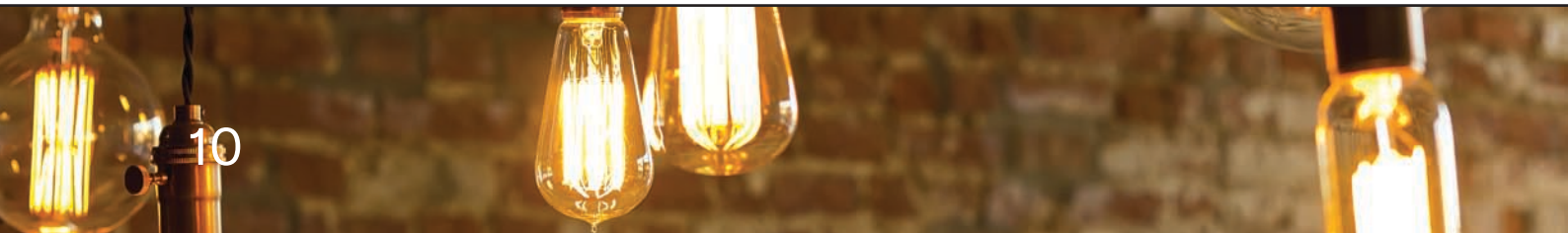
From 1 January 2024, the rules for determining the income in kind, i.e. the percentage of the purchase price of the vehicle to be added for tax purposes to the employee's private use of the company car, will be extended. In 2023, 0.5 per cent of the purchase price (including VAT) was added for the private use of an electric vehicle, which is undoubtedly a low-emission vehicle, but from 2024, only 0.25 per cent of the purchase price (including VAT) will be added, as the electric vehicle will be reclassified as a zero-emission vehicle. Plug-in hybrids, which are low-emission vehicles, will continue to be taxed a 0.5 per cent of the purchase price. For other vehicles, a 1 per cent income in kind continues to apply.

If an employer knows what percentage to allocate to an employee for both a plug-in hybrid and an electric vehicle, it must decide how to allocate the employee's private fuel consumption or how much to pay the employee to compensate for charging the vehicle at home. All of this is complicated by the variety of alternatives that exist in real life. Employees can charge at home using their own PV, i.e. "for free", or they can buy electricity from a distributor, or they can charge the vehicle at commercial chargers or at a company charger. Can you reliably determine and document how much electricity has been charged? How do you determine the consumption of a plug-in hybrid when driving privately? Can it be measured accurately, or can only the ratio of electricity to fossil fuel be determined? The solution to these and other problems must be approached individually, depending on the specifics of using plug-in hybrids and electric vehicles in a given situation.

If you are in doubt about how to set-up a plug-in hybrid or electric vehicle for your employees' private purposes, we are happy to advise you.

Contact details for further information

Ing. Miroslav Holoubek
daňový poradce
(Tax Advisor CZ)
Senior Associate
P +420 236 163 207
miroslav.holoubek@roedl.com



→ Taxes

Supreme Administrative Court assessed tax deductibility of royalties only based on formal attributes of the case, completely ignoring economic aspect

In its assessment, the Supreme Administrative Court (SAC) focused solely on formalities. It wholeheartedly ignored the regulation of contractual relations and the economic logic of the transaction under review.

Martin Koldinský
Rödl & Partner Prague

The SAC issued another ruling on transfer pricing. This time, it concerned a dispute between a taxpayer and the tax authority about the royalties paid and their tax deductibility.

For the sake of completeness, let us start with a very brief summary of the case. In 2014, the taxpayer paid approximately CZK 12 million in royalties to a related party. Subsequently, during the tax audit, the tax authority demanded proof of the substance of the transaction and insisted that the royalty costs incurred must be directly reflected in the taxable income of the taxpayer in the same year in which they were paid.

Although the taxpayer demonstrated the substance of the transaction and its economic rationality, as well as the fact that part of the royalties paid covered the related party's expenses for the development of the products sold, the royalties were fully excluded from taxable expenses by the tax authority as a result of the tax audit. The tax authority's action was subsequently reviewed on appeal by the Appellate Financial Directorate (OFŘ), which upheld the tax authority's action.

The case was referred to the Regional Court. In its ruling on the tax deductibility of the royalties, the Regional Court noted that research and development expenses are often not materially reflected in income in the same tax year, and therefore ruled in favour of the taxpayer and remanded the case back to the Appellate Financial Directorate. However, the Appellate Financial Directorate contested this logical conclusion and appealed. The case was therefore examined by the SAC.

Unfortunately, according to the SAC's judgment, it appears that the SAC decided the case without a more detailed examination and only followed the formalities of the transaction. One of the few findings made by the SAC in its judgment is that the contractual documentation did not show what specific intellectual property was transferred between the related parties. Thus, according to the SAC, the taxpayer did not bear the burden of proof regarding what specific intellectual property was provided in return for the royalties paid.

For the moment, let us leave aside the economic aspect of the case and the details of the functions performed and the risks borne. It is clear that both the tax authorities and the SAC expect each related-party transaction to be supported by meticulously prepared contractual documentation, transfer protocols and a host of other evidence. Unfortunately, if such documentation is not available, the economic rationale of the transaction and its compliance with the arm's length principle may not be examined at all.

In our practice, we frequently witness subpar quality of contractual and other docu-

mentation between related parties compared to standards exercised between independent entities. The reasons are obvious. There is simply an expectation that there will be no disputes within the group about the substance of the transactions or their performance. Unfortunately, however, the SAC's ruling and the tax authority's approach in this case have once again confirmed that Czech administrative authorities like to take a very formalistic approach.

It's also interesting to note that the SAC expressly stated that personal and property links between certain persons may indicate an increased level of risk and that in such cases the administrative authorities should be on the lookout. This only confirms the common perception of transfer pricing as a tax avoidance tool.

We do not recommend underestimating the formalities of the transactions carried out. On the contrary, we recommend very careful preparation of evidence for newly established transactions and detailed review of contractual and other documentation for ongoing or past transactions. The fact that a transaction is between related parties is more likely to be taken into account by the authorities against the parties involved.

Contact details for further information

Ing. Martin Koldinský
soudní znalec
(Court Certified Expert CZ)
Associate Partner
T +420 236 163 750
martin.koldinsky@roedl.com

→ Economics

Are the Czech Accounting Standards coming to an end? Apparently so!

You have probably heard the news. The amendment to the Accounting Act and related ordinances, including the introduction of the so-called functional currency from 1 January 2024 has become a reality. The real news will come in 2025 – and we have a lot to look forward to!

Ladislav Čížek
Rödl & Partner Prague

It is now well known that the consolidation package allows for a so-called functional currency in the form of sterling, the euro or the US dollar. Less well known is the fact that effective from 1 January 2025, Ministry of Finance intends to allow businesses to choose as their functional currency, any currency that is not hyperinflationary.

Another interesting change expected from 1 January 2025 is the abolition of the Czech Accounting Standards. Instead, the Ministry of Finance plans to issue more comprehensive methodologies on specific topics. This has a lot to do with the so-called Coordination Committees of the Chamber of Tax Advisors. The reason for the abolition of the Czech Accounting Standards is convenience – a part of the agenda currently regulated by the Czech Accounting Standards will be included in the new regulations. The other part, which describes the accounting treatment of the balance sheet, will be abolished without replacement.

This may be illustrated by a simple example. Have you ever thought about what the line Provisions relating to operating activities and complex prepaid expenses means in the current Income Statement? After all, the line can be deducted from the Balance Sheet. This is where there should be a significant shift – provisions (e.g. personnel) should be created and reversed against a specific and materially relevant type of expense – for example, in the case of salary bonuses against personnel costs – under the new accounting legislation (probably from 2025). This approach is follows the policy set forth in both IFRS and, for example, the German HGB.

Another example is the recognition of leases under the IFRS 16 in the Czech context. The intention of the Ministry of Finance is that large

and medium-sized companies should report both finance and operating leases in accordance with IFRS 16. Small and micro entities should adopt the concept of recognising an 'asset and liability' for these types of leases, but in a simplified way – without taking into account the time value of money. According to the Ministry of Finance, all of this should be reflected in the tax legislation.

But the news for 2024 and 2025 does not stop there! Are you unsure whether the definition of net turnover will include the sale of unwanted stock to your long-standing customers? Such sales of materials may or may not be included in this absolutely crucial indicator. The new definition of net turnover will apply from 1 January 2024.

Do these changes seem (r)evolutionary to you? Are there too many? Have you forgotten the effective dates? The Rödl & Partner team has been involved from the very beginning. We are familiar with the background, related discussions, direction and trend of the new Czech accounting legislation, we participate in public discussions and comment on individual proposed texts. We are therefore ready to guide you through the transition to the new Czech accounting legislation in the specific conditions of your company.

Contact details for further information

Ing. Ladislav Čížek
Auditor
Manager
P +420 236 163 315
ladislav.cizek@roedl.com

Impressum

NEWSLETTER CZECH REPUBLIC
DECEMBER 2023

Rödl & Partner

Published by:
Rödl & Partner Consulting & Valuation, s.r.o.
Platnéřská 191/2, 110 00 Prague 1
Reg. No. 25724231
Reg. Metropolitan Court in Prague, C 64494

P +420 236 163 111
www.roedl.cz/en

Editorial board:
Jana Švédová | Václav Vlk
Martina Šotníková | Jaroslav Dubský
Ivan Brož

Layout/Typeset by:
Rödl & Partner