Rödl & Partner

NEWSLETTER CZECH REPUBLIC

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Succession and M&A – A business owner's challenge

After the fall of the Iron Curtain and the reopening of the Czech Republic in the 1990's, many companies were founded by business owners who, on account of their age, are now due to hand over their successful businesses to their successor. As the privileged tax treatment of income from the sale of interests in companies by natural persons will undergo considerable changes after 1 January 2025, this issue is gaining additional urgency.

Hans-Ulrich Theobald
Rödl & Partner Prague

There are many challenges to overcome when preparing for company succession: finding a suitable successor (whether within the family, through existing managers or externally), ensuring the financial security of the seller, handling legal aspects and issues of internal and external communication. Emotional factors should not be underestimated either since the sale of a business is usually a matter of transferring someone's life's work.

Many owners of small and medium-sized companies do not have a clear idea of how an orderly handover could take place. The questions regularly asked by investors about the legal, tax and financial status of the target company require thorough preparation by the seller in order to avoid any significant discounts on the purchase price or extensive guarantees and the resulting far-reaching liability. By carrying out due diligence on the seller's part before the actual sales process begins, a seller can recognise and eliminate any existing weaknesses. Due to the current high level of interest rates, the question of whether the investor has secured financing for the transaction from its own funds can also be of fundamental importance.

Finally, the seller may be confronted with the investor's request to remain available at least for a transitional phase in order to ensure the smooth continuation of the company. This can be linked to a staggered payment of the purchase price, which can, however, lead to questions regarding the controllability of the payment criteria by the seller on the one hand and complications regarding the transfer of control to the investor on the other.

It is evident from the above that a succession process can be lengthy. Taking into account the upcoming tax changes, dealing with these issues as soon as possible and seeking professional advice is essential for minimising potential risks and making the most of the opportunity.

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→ Taxes

Building land from the perspective of the VAT Act

Is the supply of undeveloped land registered as land for development in the zoning plan subject to VAT? The Supreme Administrative Court (SAC) recently considered the conditions under which land can be classified as building land for the purposes of the VAT Act. According to the conclusions of the SAC, the zoning plan and the intention of the purchasers are the key factors. On the other hand, it is not necessary that specific administrative steps be taken leading to the intention to construct a specific building on the land.

Michael Pleva, Adéla Gabrielová
Rödl & Partner Prague

The dispute concerned the sale of two plots of land which the seller had exempted from VAT. In the seller's view, no administrative steps had been taken in relation to the land that would lead to the construction of a specific building, and he therefore considered the land sold to be undevelopable. However, the tax authorities took the opposite view, classifying the land as building land and charging output tax to the seller.

Building land

The tax authorities based their assessment on the parties' intentions, the municipality's zoning plan and other circumstances. Among other things, the seller had an expert report prepared prior to the sale and had requested zoning information confirming the developability of the land. Both parties also claimed the related VAT deduction.

The Supreme Administrative Court agreed with both the tax authorities and the Regional Court that the land was a building plot. The key factor in assessing the VAT regime is always the intention of the parties to the contract to supply or acquire the land in question as land for development. Furthermore, the SAC confirmed that a zoning plan can be considered as an administrative act leading to a development and therefore it is not necessary to carry out an administrative act leading to the construction of a specific building.

Zoning plan

In conclusion, the SAC stated that although the concept of building land must be interpreted in the light of the ECJ case law, the classification of land as building land according to an expert report can be a guide for determining the VAT regime. All the above facts led to a confirmation of the seller's intention to supply building land also from a VAT point of view.

In view of the existing case law and the approach of the tax authorities, building land is treated very strictly in terms of the VAT Act. It is therefore advisable to check the VAT treatment of the land prior to the sale.

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→ Taxes

Uncertainty of research as a determining factor in the application of the R&D deductible

The Supreme Administrative Court has once again refused to allow a clinical trial to benefit from the R&D deductible.

Tomáš Jirásek
Rödl & Partner Prague

It has been over five years since the Supreme Administrative Court (SAC) issued a landmark decision in the case of Vestra Clinics s.r.o., in which it rejected a claim for the use of a deductible research and development (R&D) item for a company conducting drug trials on behalf of a pharmaceutical company. The SAC confirmed that clinical drug testing can be classified as an R&D activity. However, in order for related expenses to be deductible, the trial must be carried out by the taxpayer who bears the research risk in the R&D, i.e. the drug developer. If it orders the trial as a service from another company, it cannot claim the deduction and cannot transfer the right to claim the deduction to that supplier.

The SAC took the same line in a recent ruling in the case of the complainant Medical Plus, s.r.o., which also carried out clinical trials of medicines on the basis of precise orders from clients, mainly international pharmaceutical companies. According to tax authorities, such activities do not fulfil the characteristics of research and development under the Research and Development Promotion Act and the complainant did not carry out research and development. In its defence, the complainant tried to argue that the tax authorities did not have the necessary expertise to assess the situation and that it should have had an expert report prepared. However, the Regional Court had already rejected this in the previous proceedings. Nor was it justified in submitting the Frascati Manual, which states that although clinical trials of drugs can be classified as R&D, it is necessary to consider who carries out this R&D in the context of the tax laws.

The Supreme Administrative Court did not want to deviate from its previous case law when it confirmed that the deduction could only be claimed by the sponsor of the study who develops the drug as a new product and whose activity has the required “element of novelty”. The sponsor also bears the entrepreneurial risk that the costs incurred will be wasted if the research fails. The legislator’s aim is to support those taxpayers who bear the risk of losing their money on R&D, to ease their financial situation, to increase the employment of researchers and to give priority to activities with higher added value. The provider of clinical trials does not bear such a risk and the possible failure of a drug does not usually affect its economic results. It simply collects data and carries out tests on the basis of predefined criteria. In the present case, the complainant itself could not explain to the court what research uncertainty it faced. The expert saw the risk on the complainant’s side as the possible discontinuation of the study and thus the end of the financial income. However, according to the SAC, this is not an uncertainty inherent in research activities but a normal business risk.

It can therefore only be concluded that those interested in claiming the R&D deduction must be careful and ask themselves at the outset whether their intention corresponds to the essence of R&D as defined by the Research and Development Promotion Act and the Income Taxes Act. To this end, we would advise engaging an expert in advance to assess whether or not the project contains an element of novelty. It would not be prudent to postpone the preparation of the opinion until the tax audit, when the expert often has no choice but to work in the style of a drowning man grasping at straws.

If you are interested in using a deductible item, please do not hesitate to contact your contact person in the tax department.

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→ Economics

Changes to thresholds and their relation to the change in the definition of net turnover in Czech accounting

Czech accounting legislation now allows accounts to be kept in euros, US dollars and British pounds.

Ladislav Čížek
Rödl & Partner Prague

Due to the significant inflation rate in the EU in 2021 and 2022, the European Commission has issued a directive mandating an increase in the monetary limits for the classification of undertakings, specifically in the value of assets and net turnover. Member States are obliged to increase these limits for 2024. Section 1b of the Accounting Act sets the current thresholds as follows:

In thousands of CZK

Class	Condition	Assets	Net turnover	Employees
Micro	Does not exceed 2 criteria	9,000	18,000	10
Small	Does not exceed 2 criteria	100,000	200,000	50
Medium	Does not exceed 2 criteria	500,000	1,000,000	250
Large	Exceeds 2 criteria	500,000	1,000,000	250

The Explanatory Memorandum to the draft new Accounting Act confirms that these thresholds (limits) are already in line with the aforementioned Directive:

In thousands of CZK

Class	Condition	Assets	Net turnover	Employees
Micro	Does not exceed 2 criteria	11,000	22,000	10
Small	Does not exceed 2 criteria	120,000	240,000	50
Medium	Does not exceed 2 criteria	600,000	1,200,000	250
Large	Exceeds 2 criteria	600,000	1,200,000	250

In 2024, a technical amendment to the Accounting Act is expected to come into force, which will adjust the thresholds to the values mentioned above.

When classifying undertakings for 2024, it is important to note that the definition of net turnover has been narrowed. From 2024 onwards, net turnover will only include revenue on which the undertaking's business model is based. Therefore, revenue from the sale of materials may or may not meet the definition of net turnover in 2024. The same applies, for example, to exchange differences. This will depend on the specific undertaking. The impact on the value of net turnover is undeniable (ceteris paribus), resulting in a reduction. This shift in categorisation thresholds upwards is counterbalanced by the reduction in the real value of this indicator due to the definition of net turnover.

The classification of undertakings is crucial to the content of the financial statements. Smaller undertakings are granted certain concessions. They are not required to prepare a cash flow statement and can disclose less information in the notes to the financial statements. Micro undertaking are also exempt from measuring fair value.

Additionally, it should be noted that the change in the classification of an undertaking is not instantaneous, and the time test needs to be met. It is important to note that net turnover is an item reported in the financial statements that cannot be interfered with simply because of a change in legislation. Thus, the undertaking will evaluate the values previously established and reported in the financial statements against the new thresholds. The net turnover cannot be recalculated under the legislation for the purpose of assessing the established criterion under the time test.

Does this sound like an assessment of dissimilar things? We would be pleased to assist you in classifying your company so that you can be certain of its category and the corresponding obligations or concessions that apply to you.

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→ Economics

Sustainability reports – EU/CR legislative framework

Following on from our previous articles on sustainability, today we bring you Part 1 of our new series on ESG reporting and we will focus on the legislative framework and its essential elements. We will introduce these elements step by step, including the EP Sustainability Reporting Directive transposed into the Accounting Act, as well as ESG standards and Taxonomies.

Radim Botek
Rödl & Partner Prague

It is important to gain a comprehensive understanding of the issue at hand, as sustainability reporting is a complex and increasingly emphasised field. Sustainability reporting is set to become the second pillar of business reporting, alongside financial reporting.

The following regulations are crucial for the preparation, publication and verification of Sustainability Reports:

- The CSRD Directive refers to the Corporate Sustainability Reporting Directive of the European Parliament and of the Council (EU).
- ESRB Standards refer to Regulation (EU) 2023/818 of the European Parliament and of the Council laying down European Sustainability Reporting Standards and amending Directive (EU) 2014/95/EU (European Sustainability Reporting Standards).
- The EU Taxonomy is established by Regulation (EU) 2020/852 of the European Parliament and of the Council establishing a framework to facilitate sustainable investments and amending Regulation (EU) 2019/2088.

In this context, it is important to note that the Directive must be transposed into national legislation, specifically the Accounting Act in the Czech Republic, by 6 July 2024 at the latest. The Regulations, on the other hand, are directly binding for everyone and are no longer subject to any further legislation. This means that the ESRS standards and the EU Taxonomy will not be transposed into the Czech legislation.

The Accounting Act, amended by the Consolidation Package effective from 1 January 2024, already considers partial transposition. Part 8 of the Accounting Act regulates the obligation for public interest entities or large accounting units with more than 500 employees to prepare a Sustainability Report. The extension of entities to other accounting units should be included in the new Accounting Act.

The Accounting Act defines the concept of sustainability for accounting purposes and re-

quires a mandatory sustainability report as part of the annual report, with clearly prescribed content and formalities. The Accounting Act refers directly to the ESRS standards for preparing the Sustainability Report.

Exemptions from producing both individual and consolidated reports are available. Therefore, if the company is included in a consolidated Sustainability Report at the parent company or group level, it is not required to compile a Sustainability Report.

The Accounting Act makes direct references to important EU sustainability regulations, such as the Paris Agreement and the European Climate Legal Framework. These regulations aim to limit global warming to 1.5 ºC and achieve climate neutrality by 2050.

Part 2 will cover the ESRS standards, which are a comprehensive set of ESG reporting requirements.

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