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NEWSLETTER CZECH REPUBLIC

Issue:
May
2024

Information on Law, Taxes and Economics
in the Czech Republic

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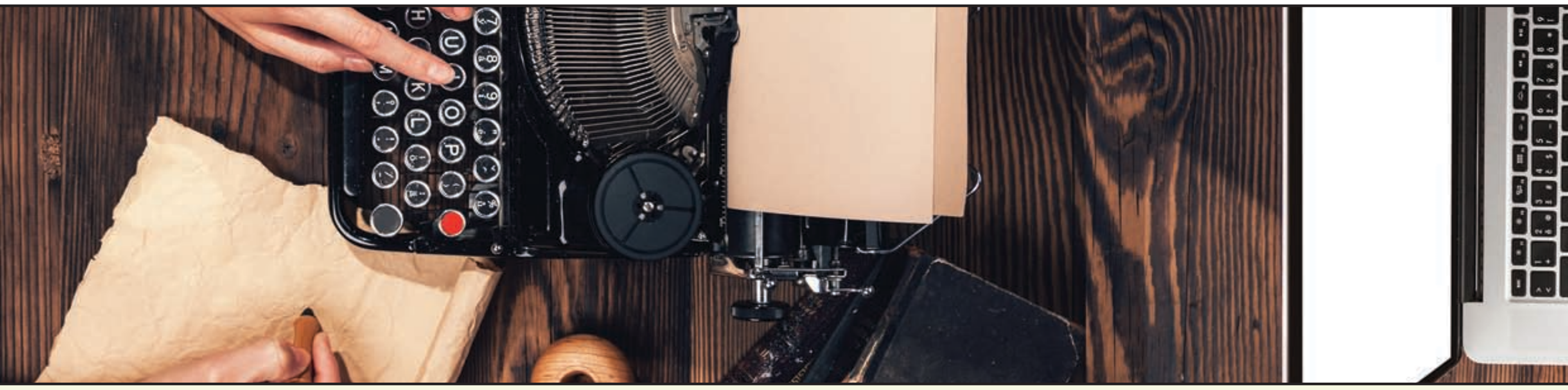
Content:



→ Taxes

Do you have an inventory disposal report? Can we see it?

In its recent ruling, the Supreme Administrative Court addressed the tax deductibility of costs related to the disposal of depreciated inventory in a situation when the taxpayer failed to create a disposal report, despite being required to do so by the Income Taxes Act. In this case, the tax authority and subsequently the Supreme Administrative Court did not dissallow the taxpayer to prove the disposal in other ways. In other words, this means that the absence of a disposal report does not automatically preclude the deductibility of disposal costs.

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In the case under consideration, the taxpayer claimed expenses for the acquisition of cardboard packaging, which had to be disposed of at a waste collection point due to weather-related deterioration. The taxpayer provided a copy of a cash receipt indicating the delivery of 1,340 kg of paper cardboard packaging to the waste collection point, where it was accepted free of charge. Furthermore, the taxpayer proposed questioning an employee of the waste collection point who was supposed to have received the cardboard packaging from the taxpayer.

However, the tax authority had reasonable doubts about the authenticity of the submitted documents. Their findings indicated that the taxpayer did not purchase, sell, or manufacture doors (for which the packaging was intended), and that the goods were not listed in the assets and liabilities overview. The taxpayer asserted that the paper packaging had been purchased with the intention of using it to package the doors before their subsequent sale. However, the tax authority found that the taxpayer had failed to provide any evidence of their business intention to sell doors. Furthermore, the taxpayer did not substantiate the claims regarding the destruction and subsequent disposal of the packaging with the documents provided for by law, such as an inventory list and a disposal report.

In regard to the testimony by the waste collection point employee, she confirmed that she had received "some paper" and that she had issued the cash receipt presented by the taxpayer. However, she could not recall specific details about the material received, its condition, or whether it was indeed from the taxpayer. The witness's memory was understandably vague, given that the witness had been questioned four years after the waste disposal occurred. It is therefore unsurprising that the witness could not recall the appearance or condition of the material received, let alone confirm with certainty that she had received the paper from the taxpayer. Nevertheless, her lack of specific recollection proved detrimental to the taxpayer's case.

Consequently, the taxpayer was in a dire evidentiary need. Without the relevant disposal report specifying the subject of disposal, reasons for disposal, method, timing, and place of disposal, they were unable to sufficiently prove the tax deductibility of the expenses. The Income Taxes Act is clear in stating that the taxpayer must prepare a disposal report to demonstrate disposal. Nevertheless, the tax authority, and subsequently the

Supreme Administrative Court, did not rule out alternative methods of proving inventory disposal. In this case, the tax authority permitted evidence to be provided through witness testimony or records in the vehicle logbook, which demonstrated whether the taxpayer transported the depreciated inventory to the place of disposal, even though ultimately, it is the taxpayer's responsibility to maintain records supporting the facts stated in their tax return.

Based on our experience, we continue to recommend obtaining relevant documentation for any inventory disposal, in particular a disposal report or, where appropriate, a transfer report from the person handling the disposal. However, the good news is that according to the Supreme Administrative Court, a failure to create a disposal report does not automatically exclude the tax deductibility of costs of disposal. Even in such cases, taxpayers can still prove the deductibility of costs resulting from disposal through means other than presenting a disposal report.

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→ Taxes

The Supreme Administrative Court (SAC) has ruled that the reduced tax rate cannot be applied if the role of the beneficial owner of royalties cannot be not proven. Be sure to meet the burden of proof!

In its decision number 6 Afs 56/2023-48, the Supreme Administrative Court addressed, among other things, the definition of the term "beneficial owner" in relation to the application of the withholding tax rate on royalties paid for providing TV broadcast signal by the Czech company YOLT Services s.r.o. to its parent company based in Romania, and its sister companies based in Hungary and Slovakia.

Miroslav Kocman
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The tax authority imposed a corporate income tax levied by withholding at a special tax rate of 15 percent on YOLT Services s.r.o. According to the tax authority, the company was unable to benefit from double taxation treaties and thus apply a lower tax rate. The tax authority justified its decision by referen on the grounds that one of the fundamental conditions for the application of double taxation treaties is the demonstration that the recipient of the royalties is the beneficial owner.

The Income Tax Act defines a beneficial owner as a person who receives payments for their own benefit and not as an agent, representative or principal for another person. However, this definition is so general that it does not provide clear guidance on whether there exists, in fact, a beneficial owner in the particular case under consideration.

In the dispute, the parties sought to rely on other definitions based on Council Directive 2003/49/EC of 3 June 2003, regarding the common system of taxation of interest and royalties, and on the commentary to Article 12 of the OECD Model Double Taxation Convention. The interpretation of the concept of beneficial owner according to those sources is fundamentally consistent. Therefore, the parties presented additional arguments and evidence. One of the arguments presented was that the payment received constituted an economic benefit to the beneficial owner.

In the opinion of the Supreme Administrative Court, the use of a profit margin may not be a necessary and decisive attribute of economic benefit. However, it is essential that the recipient of the royalty has the freedom to decide how to dispose of the payments received. If contractually bound to forward those payments, either in full or proportionally, it cannot be claimed that the payments were received for their own benefit. The Hungarian and the Slovak tax authorities, in response to international requests, confirmed that the royalty payments in question were essentially passed on by the recipient. The Romanian tax authority informed the Czech tax authority that the Romanian taxpayer follows a similar procedure when invoicing services to the Czech entity without adding a profit margin. Consequently, YOLT Services s.r.o. was unable to establish the beneficial owner of the royalties, preventing them from applying the reduced withholding tax rate under double taxation treaties.

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→ Economics

ESRS standards – general information and introduction to ESRS 1

The European Sustainability Reporting Standards, which have been published as a binding Commission Regulation (EU), require large and listed companies to publish regular reports on the social and environmental risks they face and how their activities impact people and the environment. The standards lay down a set of rules and requirements, which specify the scope of the information that must be reported and the process of reporting such information. The duties arising under the Regulation become effective from 1 January 2024. In the Czech Republic, the legislative basis for the ESRS is given by Directive (EU) 2022/2464 on Corporate Sustainability Reporting (CSRD) and the Czech Accounting Act.

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ESRS standards are already available in Czech. However, please note that you should be careful when working with them, as some translations may be inaccurate. When in doubt, please refer to the original wording of the standards. For more information, please see Delegated regulation – EU – 2023/2772 – EN – EUR-Lex (europa.eu).

Categories of ESRS standards reflect topics that they address. Below you may find basic categories:

CROSS-CUTTING STANDARDS

	ESRS 1	General requirements
	ESRS 2	General disclosures

TOPICAL STANDARDS

Environmental standards		
E	ESRS E1	Climate change
	ESRS E2	Pollution
	ESRS E3	Water and marine resources
	ESRS E4	Biodiversity and ecosystems
	ESRS E5	Resource use and circular economy
Social standards		
S	ESRS S1	Own workforce
	ESRS S2	Workers in the value chain
	ESRS S3	Affected communities
	ESRS S4	Consumers
Governance standards		
G	ESRS G1	Business conduct (governance, risk management and internal system of controls)

In Annex II of the Commission Delegated Regulation, you can also find acronyms and glossary of terms: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32023R2772

In total, the Regulation introduces twelve standards. Their wording stretch over about 250 pages and include over 1,000 datapoints, i.e. the data and information that must be disclosed.

But nothing is ever as bad as it seems. Alongside many requirements, the very first standard introduces one of the key principles of ESRS, i.e. the double materiality principle. This can significantly narrow the scope of disclosures. So, let‘s take a closer look at the first ESRS 1 standard.

ESRS 1 – General Requirements

The objective of this Standard (ESRS 1) is to provide an understanding of the architecture of all ESRS's, the drafting conventions and fundamental concepts used, and the general requirements for preparing and presenting sustainability information and reports. This is a core standard that forms the framework for other ESRS standards.
ESRS 1 includes 10 chapters and 7 very practical Appendices. Below we will discuss each chapter in detail.

1. Categories of ESRS Standards, reporting areas and drafting conventions

In general, there are three categories of standards – cross-cutting standards, topical standards and sector-specific standards. The sector-specific standards are still a work-in-progress.

Most of the standards follow the unified structure of disclosure requirements.
- Governance (GOV)
- Strategy, business model (SBM)
- Impact, risk and opportunity management (IRO)
- Metrics and targets (MT)

ESRS 2 Standard includes the minimum disclosure requirements regarding policies (MDR-P), actions (MDR-A), metrics (MDR-M) and targets (MDR-T) regardless of their materiality.

All acronyms used above are derived from the English terminology. Thus, “MDR” means “Minimum Disclosures Requirements”, while “IRO”, i.e. “Impacts, risk and opportunities” is essential for the interpretation of all ESRS standards.

– In ESRS, “impacts” refer to positive and negative sustainability-related impacts that are connected with the undertaking’s business, as identified through an impact materiality assessment. It refers both to actual impacts and to potential future impacts.
– “Risks and opportunities” refer to the financial risks and opportunities related to sustainability, including those that are derived from dependencies on natural, human and social resources, as identified through a financial materiality assessment.

In addition to the disclosure requirements, ESRS also include application requirements. The requirements are governed by Appendix A of each ESRS and are binding.

2. Qualitative characteristics of information

You may not be surprised to hear that the basic qualitative characteristics of information are the relevance and faithful representation. In addition, the standard defines the enhancing qualitative requirements – comparability, verifiability and understandability. These are all specified in detail in Appendix B to ESRS 1.

3. Double materiality as the basis for sustainability disclosures

This part of ESRS 1 defines two main groups of stakeholders:

– Affected stakeholders – individuals or groups whose interests are affected or could be affected – positively or negatively – by the undertaking’s activities and its direct and indirect business relationships across its value chain. Engagement with affected stakeholders is essential for the materiality assessment and the undertaking’s due diligence process.
– Users of sustainability statements who generally coincide with general-purpose financial reporting users, including authorities, social partners, members of academics and others.

The extensive part of ESRS 1 discusses the principle of double materiality. This principle defines the scope of disclosed information other than so-called required disclosures as defined in ESRS 2. We will discuss the area of materiality, due diligence or the value chain more closely in the next issue of our newsletter.

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Impressum

NEWSLETTER CZECH REPUBLIC
MAY 2024

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

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Layout/Typeset by:
Rödl & Partner