Rödl & Partner

NEWSLETTER CZECH REPUBLIC

Issue: June 2024

Information on Law, Taxes and Economics in the Czech Republic

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Rödl & Partner

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Legal news from the digital world

The first half of this year saw significant changes in the digital world, not only in the Czech Republic. What are the most significant updates that should be considered?

Lenka Hanková
Rödl & Partner Prague

Data Services Act

If you provide digital intermediary services, such as data transfer, caching (intermediate data storage during transmission) or hosting, and work with user content (for example, files, videos, photos, comments provided by an internet user), you should know more about the Data Services Act (DSA). It came into full force in February this year. The DSA delineates the circumstances under which a provider may be held liable for infringing user content. It establishes a hierarchy of obligations, with the degree of liability increasing in proportion to the type and scale of the provider's operations. In this context, it is important to note that user content can include product reviews or discussions pertaining to a product or in an online advice section. Consequently, the DSA can also apply to e-shops and regular websites. In addition to this, a new Digital Economy Act is currently being drafted which will also affect the legal conditions for sending commercial communications.

The Digital and Information Agency

The Digital and Information Agency is a recently established government agency that has developed three new services. We have previously informed you about the eDocuments mobile phone application, which enables users to establish their identity digitally. The application was launched in January of this year. It is incumbent on central state authorities, including ministries, to recognise electronic ID cards. From 1 July 2024, other authorities such as the police, cadastral offices, courts, tax offices, labour offices, CSSA, registry offices, trade offices, regional offices and municipalities with extended competence will similarly be obliged to accept electronic ID cards. All remaining authorities and private individuals who are required to verify an individual's identity, such as those obliged under the Anti-Money Laundering Act and pharmacies, are obliged to accept electronic ID cards from 1 January 2025. In April, the Citizen's Portal app was launched, allowing access to a range of state services directly from a mobile phone. The aforementioned portal will shortly include the so-called Register of Representations, which will enable the granting and registration of a power of attorney for acts with the state to be conducted online from 1 July 2024.

Cookies

Anyone who utilises Google and third-party cookies on their websites and employs Google's analytics and marketing services may have observed that Google implemented novel cookie consent and data processing practices in March, in accordance with EU legislation and the cessation of third-party cookies, designated as Consent Mode V2 and the Enhanced Conversion Service. Your marketing consultants will have already configured all requisite elements on your website to ensure optimal functionality of your advertising campaigns and analytics. It is also necessary to modify the wording of the cookie bar and the data processing information for cookies. This is because Google requires consent to be obtained via the cookie bar for the sending of encrypted personal data of the user, such as e-mail or phone number, and for the linking of this data to other data. Furthermore, consent must be obtained to personalise advertisements.

Contact details for further information

Mgr. Lenka Hanková
advokátka
(Attrney-at-Law CZ¨)
Senior Associate
P +420 236 163 720
lenka.hankova@roedl.com

→ Taxes

The latest on taxation between the Czech Republic and Russia: what does the GFD say?

As we informed you earlier, Russia has suspended all material provisions of the Double Taxation Treaty with the Czech Republic as of 8 August 2023. In response, the Czech Republic terminated the application of the Double Taxation Treaty with effect from 29 September 2023. Further details regarding the appropriate course of action for taxpayers engaged in tax transactions with Russia can be found in the recently released Information from the General Financial Directorate on the suspension of the implementation of selected articles of the Double Taxation Treaty (Information).

Kateřina Jordanovová
Rödl & Partner Prague

In the case of income paid to Russia, Czech taxpayers will proceed exclusively according to the Income Taxes Act (ITA) from 29 September 2023. From that moment, taxpayers will be obliged to withhold tax according to the ITA (in practice, most often at the time of payment). Consequently, the income in question will be subject to Czech withholding tax (or tax under the tax reinsurance regime) at the rate stipulated in the ITA, which is typically 15 %. The General Financial Directorate has confirmed in the Information that the penalty withholding tax of 35 % will not be applied. In the case of income from a source in Russia and thus taxed in Russia, the following simplified procedure will be followed. The date of the obligation to withhold tax in Russia is the decisive date. However, the Czech tax authority will also accept the date of the realisation of the income according to the ITA, in particular the moment of recognition of income in the case of accounting entities or the collection of income in the case of non-accounting individuals):

- For income earned prior to 28 September 2023, the issue of double taxation under the ITA will be resolved by crediting the Russian tax, calculated in accordance with the ITA, against the Czech tax liability. Alternatively, for individuals and income from employment, the exclusion method may be applied if the ITA conditions are met.
- For income earned from 29 September 2023 onwards, neither the credit nor the exclusion method can be applied. Instead, the entire Russian tax will be treated as an item reducing the tax base of the Czech taxpayer.
- For income earned between 8 August 2023 and 28 September 2023 (the intermediate period during which Russia, but not the Czech Republic, has ceased to apply the Double Taxation Treaty), the taxpayer may elect to apply either of the above taxing options (bullet 1) or (bullet 2).

A comparable methodology should be employed for Russian permanent establishments, whereby the 2023 revenues and expenses are divided into two periods (from 1 January to 28 September and from 29 September to the end of 2023). Subsequently, the Russian tax is to be apportioned and accounted for in accordance with the aforementioned options.

Furthermore, the Information provides additional details regarding the taxation of one-off or phased income. Should you engage in transactions with Russia and require guidance on the specific tax implications, please do not hesitate to contact us.

Contact details for further information

Mgr. Kateřina Jordanovová, LL.M.
advokátka a daňová poradkyně
(Attorney-at Law CZ
and Tax Advisor CZ)
Senior Associate
P +420 236 163 254
katerina.jordanovova@roedl.com

→ Taxes

Who is affected by the GloBE Rules?

The Supreme Administrative Court has once again refused to allow a clinical trial to Many Czech companies are affected by the GloBE. In the first part of our series on this topic, you will find basic information on the so-called GloBE Rules and the duty to provide information to tax authorities.

Milan Mareš
Rödl & Partner Brno

Act 416/2023 Sb., on equalisation taxes for large multinational enterprises and large domestic groups is a transposition into the Czech legal system 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 Union. It is effective from 31 December 2023.

The explanatory memorandum to the Act assumes, based on data from the 2019 and 2020 Country- by-Country Report, that the application of the Act will affect Ultimate Parent Entities ("UPEs") and approximately 3,200 other Czech entities. The total positive estimate of the income arising under the Income Inclusion Rule ("IIR") and the Undertaxed Profits Rule ("UTPR") is estimated to be in the low tens of millions of Czech korunas per year. In case of the Czech equalisation tax, the positive impact is therefore estimated at around 2 billion Czech korunas.

The additional tax system, which increases the total amount of tax paid on the excess profits of so-called large groups (MNE groups) in any jurisdiction to a minimum rate of 15%, is applied under the so-called GloBE Rules. The GloBE Rules are referred to in S.2 of the above-mentioned Act as the Global Rules against Base Erosion.

Steps to determine the tax

The determination of the equalisation tax can be characterised by the following steps:

- The MNE group determines whether it falls within the scope of the GloBE Rules and identifies the entities comprising it and their tax residency.
- Determination of the qualified gain or loss and the included taxes at the level of each entity.
- Calculation of the partial and overall effective tax rate. In the event that the MNE group is subject to an effective tax rate of less than 15% in any jurisdiction, a mechanism is provided to calculate the equalisation tax in relation to that low-tax jurisdiction, taking into account the imposition of a so-called Qualified Domestic Minimum Top-Up Tax ("QDMTT").
- These equalisation taxes are then imposed on the MNE group under the so-called IIR and UTPR rules.

Clearly, there is a need to separate the group view from the local view, particularly in the first of the above steps. The initial initiative, definition and project management of the implementation of these taxes usually comes from the ultimate parent entity ("UPE").

MNE group in the scope of the GloBE Rules

The primary test is the EUR 750 million consolidated revenue test. The MNE group falls within the scope of the GloBE Rules if the revenue in its consolidated financial statements exceeds EUR 750 million. The test is based on two of the four fiscal years immediately preceding the fiscal year being tested. Special rules address the effect of mergers or divisions on the consolidated turnover test.

The MNE group also identifies the entities and their permanent establishments to which the GloBE Rules apply. In Czech law, these are defined in S.6 Entities. It is important to note that although the GloBE Rules do not apply to so-called excluded entities, the income of these entities is counted towards the EUR 750 million limit.

Duty to provide information to the tax authorities

The Equalisation Tax Act requires the taxpayer (MNE Group or Czech entity) to provide information in the form of a taxpayer's decision. The taxpayer may make a decision on the procedure for determining the equalisation tax in the cases provided for by the Act.

These decisions are differentiated according to their duration as follows:

- One-off decisions;
- Short-term decisions;

– Mid-term decisions;
– Long-term decisions.

The taxpayer must submit these decisions to the tax authority on a fact sheet. If the taxpayer fails to do so, the decision is deemed not to have been taken.

The taxpayer is obliged to submit the Czech equalisation tax fact sheet within the same time limit as the Czech equalisation tax return.

The taxpayer of the allocated equalisation tax is obliged to submit the fact sheet for the allocated equalisation tax no later than 15 months after the end of the tax period. If the tax period is the group's input period, the taxpayer must submit the fact sheet no later than 18 months after the end of the tax period.

In both cases, forms are submitted.

Effective application of the provisions of the Act requires coordination of the various procedures at group level. This requirement applies in particular to the flow of information both within the multinational group or national group and to the tax authorities. The primary responsibility for submitting the fact sheet for both allocated and Czech equalisation tax lies with the member entity itself, i.e. the taxpayer of the allocated or Czech equalisation tax. However, in the case of the allocated equalisation tax, an exception applies if a foreign member enterprise belonging to the same group as the taxpayer submits the information return under certain conditions.

In respect of both taxes, the fact sheet is a basic and comprehensive source of information that should provide the tax authority with a sufficient basis for verifying the correctness of the determination of the Czech and allocated equalisation tax and the subsequent allocation of the allocated equalisation tax on the basis of the rule for the inclusion of profits or the rule for undertaxed profits, while keeping the administrative burden on the taxpayer as low as possible (explanatory memorandum to the Act).

Within the Rödl & Partner Group, we have established groups of experts who will be happy to assist you in more than just the preparation of fact sheets.

Contact details for further information

Ing. Milan Mareš
daňový poradce
(Tax Advisor CZ)
Associate Partner
P +420 530 300 545
milan.mares@roedl.com

→ Economics

Sustainability reports – EU/CR legislative framework

This is a follow-up to the article to last month's issue where we covered the first part of ESRS 1. The Corporate Social Responsibility Directive (CSRD) and the European Sustainability Reporting Board (ESRB) standards significantly expand the amount of information that should be disclosed in Environmental, Social and Governance (ESG) reports. The concept of double materiality has been established for this reason. Its assessment represents the initial and most crucial stage in the preparation of sustainability reports, namely the identification of significant impacts, risks and opportunities to be disclosed in the report. Subsequently, materiality is also pivotal for establishing priorities for the companies concerned and for the entire in-house system for monitoring and evaluating sustainability data.

Radim Botek
Rödl & Partner Prague

The concept of materiality is discussed in depth in Chapter 3, which addresses double materiality as a foundation for sustainability disclosure. Additionally, Appendix A provides a comprehensive list of sustainability topics (and subtopics) to be considered in the materiality assessment.

Example:

ESRS	Topic	Sub-topic	Specific sub-topics
ESRS E3	Water and marine resources	– Water – Marine resources	– Water consumption – Water abstractions – Water discharge – Discharge of water into the oceans – Extraction and use of marine resources
ESRS E4	Consumers and end-users	Impacts related to information for consumers and/or end-users	– Privacy – Freedom of speech – Access to (quality) information

The table shows that certain questions will already be excluded in the initial stage of the significance assessment. For instance, a farm in Central Bohemia that will be drawing water from the Elbe will likely not have to disclose information on ocean water. Conversely, a company operating a chain of retail stores selling cosmetics is likely to find ESRS E3 irrelevant. In contrast, ESRS S4 is likely to be highly relevant for it.

A sustainability issue is deemed significant if it meets the criteria for impact significance or financial significance, or both. The assessment of impact significance and financial significance are interrelated and their interdependence must be considered. However, in most cases, impact assessment will be the primary focus.

The ESRB also assesses significant impacts, risks and opportunities within the enterprise's value chain, based on the nature of its activities, business relationships, regions and other relevant factors. One of the necessary steps is also to assess the dependencies on the availability of natural, human and social resources at an appropriate price and quality.
Let us now consider the two relevance factors in more detail.

Impact significance ("from the inside out")

The significance of a sustainability issue is determined by its impact, whether actual or potential, which is defined as the effect it has on people or the environment, either positive or negative, over any time horizon (short, medium or long term).
Impacts related to environmental, social and governance issues include:

- A company's direct impacts are those resulting from its own activities, including emissions from production, waste production, water consumption, employee commuting and occupational safety;
- A company's indirect impacts are those resulting from its value chain, which includes suppliers and customers. These impacts include those resulting from the extraction of imported raw materials, the transport of products to customers, working conditions and the rights of employees at suppliers;
- The impacts of a company's products and services – for example, the health and safety of users of the company's consumer products, the privacy of end-users;
- The impacts arising from a company's business relationships – for example the impacts of (unethical) marketing practices and the company's external presentation to investors.

The assessment of the significance of negative impacts is based on due diligence (in accordance with UN and OECD principles) and is based on two factors:
- the severity of actual impacts
- the severity and likelihood of potential impacts

Severity takes into account the degree, extent and irreparability of the impact.

Severity takes precedence over likelihood when it comes to potential human rights impacts.

The significance of positive impacts is based on:
- the degree and extent of actual impacts
- the degree, extent and likelihood of potential impacts

Examples of positive impacts include reducing greenhouse gas emissions, improving waste management, promoting sustainable agriculture and improving working conditions.

Financial significance ("from the outside in")

The term financial significance is defined in the context of sustainability reporting as information that could influence the decisions of the primary users of general-purpose financial reporting regarding the provision of resources to the enterprise. This is analogous to the concept of materiality in financial statements.

A sustainability issue is financially significant if it causes, or can reasonably be expected to cause, a material financial impact on the enterprise. This may create risks or opportunities that have or may have a significant effect on the enterprise's development, its financial position, financial performance, cash flows, access to finance or cost of capital.

The potential risks to the enterprise include a lack of or loss of access to critical resources, changes in sustainability legislation, and reputational risks associated with negative environmental or social impacts. Additionally, there is the possibility of increased costs of energy, raw materials, or waste management. Conversely, opportunities may be identified, such as the potential to gain a competitive advantage through the development and marketing of sustainable products and services; to reduce energy and raw material costs through the utilisation of renewable resources; and to enhance reputation and enhance investor and customer confidence.

The assessment of double materiality will undoubtedly prove to be a highly complex, multi-stage process that will encompass a range

of activities, including the identification and engagement of stakeholders, the identification of potential areas of sustainability, the assessment of impacts, risks and opportunities, and the identification of significant sustainability issues. The process will essentially be a kind of funnel, or perhaps a filter, which will ultimately allow the company to focus on the material topics and issues that fall within the CSRD or ESRS framework and will be disclosed in the sustainability report.

To find out more about ESRS 1 and ESRS 2, please refer to our follow-up article.

Contact details for further information

Ing. Radim Botek
Auditor
Associate Partner
T +420 236 163 311
radim.botek@roedl.com

Impressum

NEWSLETTER CZECH REPUBLIC
JUNE 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

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