

BDO NEWS

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Dear Readers,
The current issue of our newsletter is, unfortunately, again being published during a state of emergency in the Czech Republic, which was announced on 5 October 2020. In the spring, we experienced this state of emergency for the first time and had no idea what to expect. Several measures introduced in the spring to support the economy are now ending and it is clear that we cannot rely on such massive support this time around. Many companies will feel the serious effects of the crisis in the coming months, and it is difficult to estimate losses because the situation is constantly changing. What is certain is that we are all becoming accustomed to uncertainty and are learning to adapt as the situation unfolds.

All the articles we have prepared for you this month are somehow related to the effects of the coronavirus crisis. I would like to draw your attention to two of them. The first is from our colleagues Dan McGeown (BDO Canada) and Lenka Lopatová, who look

at the influence of COVID-19 on transfer pricing in our country. I think it is no longer necessary to emphasise how tax audits are increasingly focusing on this topic and that the most important additional assessments are related to transfer pricing.

The second article that I highly recommend reading concerns the short-time work ("Kurzarbeit") system in the Czech Republic proposed by the Ministry of Labour and Social Affairs, which Stanislav Štípek compares with the German system. I leave it to you, dear readers, to judge for how the ministerial officials managed this proposal. We only hope it will undergo changes in the Chamber of Deputies so that it will be more flexible and less administratively demanding in practice. I wish you all good health.

Věra Jankovcová
Partner

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BDO CZECH REPUBLIC

- ▶ Audit, Tax, Accounting & Payroll Advisory, IT and Valuation
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- ▶ 35 Certified Tax Advisers, 30 Certified Auditors, 5 Certified Appraisers
- ▶ 6 offices in the Czech Republic

ROUTINE ENTITIES AND PRINCIPALS: ADJUSTING PROFITS

The global coronavirus pandemic affects all aspects of business and can have a significant impact on setting or reassessing transfer prices in your group. In this article, we focus on one of the key issues, namely the adjustment of profits between routine entities and the parent company.

This Insight takes you through immediate short-term actions to consider minimising overall tax payments to increase net cash flow within a multinational enterprise. We discuss how changing target profits for, or adjusting the relevant cost bases of, routine entities may boost cash flows and help companies survive this crisis.

Pre-COVID-19 transfer pricing model

Your company, like so many others, may have adopted a transfer pricing model wherein there is an entrepreneurial, risk-taking entity, being the principal, using routine entities in other tax jurisdictions to perform fairly limited functions while bearing low risks, such as Limited Risk Distributors („LRDs“), Contract R&D Service Providers, Contract Manufacturers or Selling and Marketing Service Providers. For the limited functions performed and limited risks borne by the routine entity, it receives a routine level of profit each year. It is important to note that these routine entities are not „no risk“ but rather „low risk“ entities. It is the principal, on the other hand, that bears most of the economic risks facing the group. For its role within the group, the principal earns all group profits in excess of the routine profits provided to the routine entities.

Unfortunately, to preserve the characterisation of the routine entities, the principal may also bear losses in business and/or economic downturns while still ensuring that the group's routine entities earn their routine profits.

The result is that the group is paying cash taxes in the tax jurisdictions that the routine entities operate within, while incurring tax losses in the principal's tax jurisdiction. While that result is not ideal, this works to preserve the characterisation of the routine entities and principals under the OECD Transfer Pricing Guidelines, and the tax legislation / regulations of those countries that follow the OECD Transfer Pricing Guidelines.

COVID-19's impact on the transfer pricing model

The business and/or economic downturns mentioned above contemplate situations within the realm of normal cycles following the somewhat natural ebb and flow of businesses and economies. COVID-19 is not a normal business or economic event; rather, it is a highly unusual, disruptive world health event that, by its nature, is creating a world economic crisis that eclipses the financial crisis of 2008 and all other recessions and economic crises, other than the Great Depression of the 1930s.

In this article, and using the example above, we are assuming that LRDs are still distributing the group's products, the routine service providers are still providing services, and the principal is still benefitting from those services. If this is not the case, you may want to consult your transfer pricing advisors and legal counsel to determine whether, under existing intercompany legal agreements, the payments being made by the principal to the LRDs and to the routine service providers can be stopped during the relevant period.

Reducing target returns for routine entities

In light of that, what are your alternatives to preserve and manage your Group's cash while preserving the characterisation of the group's

routine entities and the principal? We would suggest the following be considered:

- ▶ Determine whether, under relevant transfer pricing guidance regarding limited risk entities in the particular country, the operating margin for the LRDs can be reduced within the current range, below the range, or even to zero; and/or
- ▶ Determine whether, under relevant transfer pricing guidance regarding limited risk entities in the particular country, the mark-up for the service providers can be reduced within the current range, below the range, or even to zero.

At the end of your group's 2020 fiscal period, evaluate and assess the overall group profit/loss position to determine if year-end adjustments may be required in order to determine if year-end adjustments may be possible to minimise the situations in which a routine entity is paying tax in one country while a principal is incurring losses. The third-party comparables that you used to establish the group's target operating margins and mark-ups will not be available at year-end, so your decisions will have to be made on the best available information at the time of making those year-end adjustments. This might include evaluating comparables' quarterly financial data for Q2 and Q3, anecdotal or industry information on loss sharing in your industry or published governmental information. The hope would be that the arm's length range for 2020 derived from all of this information will reflect the economic impact of COVID-19 across industries and businesses, and would support your final financial results for the 2020 fiscal period.

By taking this action in response to the impact of COVID-19 on your group, you are preserving as much of the group's cash as possible, while maintaining the characterisation of the entities in the group from a transfer pricing perspective.

Analysing the cost base used to determine service fees

Another strategy that is specific to your group's routine service providers is whether there needs to be adjustments made to adjust the cost base used in the determination of the total intercompany service fee, i.e. total costs of providing the service plus an arm's length mark-up, by removing:

- ▶ Costs relating to employees with significant idle time that can be linked to the downturn in the group's business activities due to COVID-19; or
- ▶ Cost relating to idle manufacturing capacity that arose as a direct result of the downturn in the group's business.

If this strategy fits your group's situation, it would be important to try to determine what third-party service providers are doing in their service relationships to deal with the same issues of idle time and idle capacity. Would the recipients be willing to pay for the provider's idle time or idle capacity, and can the service fees be changed under the existing legal agreements between third parties? Third-party evidence should be sought as a means of supporting the decisions made by group management.

By taking this action you will be lowering the overall amount of the intercompany service fees which will allow the principal to retain more cash than it otherwise would.

Next steps

Consider the alternative adjustments to your group's transfer pricing model and whether these changes may be made under your existing intercompany legal agreements. This may require seeking independent legal advice. If considered feasible, then perform financial modelling to determine the benefit to the group in the form of reduced tax

expenditures. Carefully document within the group the decisions made by group management with respect to these alternatives, and preserve that documentation to be ready for any future transfer pricing audit by any of the tax authorities. Ensure that you prepare contemporaneous transfer pricing documentation for 2020 that fully documents the impact of COVID-19 on your industry and your business, and the transfer pricing-related decisions made by management to survive the economic impact of the pandemic. We are also preparing further information on this issue for you in the next issue of our newsletter. At the same time, we invite you to participate in the webinar [CURRENT CHANGES IN TRANSFER PRICING](#), which we will hold in cooperation with a representative of the General Finance Directorate on 26 January 2021.

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NEW REPORTING OBLIGATION FOR CROSS-BORDER ARRANGEMENTS IS COMING (DAC 6)

In the January issue, we informed you that the Chamber of Deputies is discussing an amendment to the Act on International Cooperation in Tax Administration, which implements the so-called European Directive DAC 6 into Czech law. From this obligation, financial administrations in European countries promise to gain a better overview of the use of tax regulations and therefore the possibility of reacting to possible tax evasion.

Originally, the amendment was to be effective by 1 July 2020 at the latest. However, as the Czech Republic and a number of other European countries did not meet the effective date due to the COVID-19 pandemic, the European Union allowed the deadlines for fulfilling the reporting obligation under the DAC 6 Directive to be postponed by up to six months. The Czech government has taken advantage of this opportunity, and after an uncertain summer, it is clear today that we will report for the first time in January next year.

What needs to be reported?

The reporting obligation applies to cross-border arrangements that fulfil at least one characteristic feature listed in the annex to the Act. Let's mark them for better clarity of tax optimisation schemes. The annex lists a number of them, for example, the artificial purchase of a loss-making company to reduce its own tax or the intentional transfer of one income to another type of income, which is taxed at a lower tax rate or completely exempt from tax. For some characteristics, fulfilment alone is not enough to give rise to the reporting obligation; they must also pass the so-called main benefit test, which means that the main benefit or one of the main

benefits of a given tax optimisation scheme must be obtaining a tax advantage.

The reporting obligation is retroactive. Tax optimisation schemes for which the first step was implemented in the period from 25 June 2018 also must be reported.

Who will report?

The so-called „intermediary“ of such an arrangement should be notified, i.e. a consultant, which may be a tax advisor, a lawyer, an auditor or someone else. However, if the consultant is bound by confidentiality, the reporting obligation passes to the client. However, the consultant must inform the client when legal confidentiality applies.

By when will we be obliged to report?

The deadline for reporting varies according to when the arrangement fulfilled the following characteristics:

- ▶ tax optimisation schemes, the first step in the introduction of which was taken in the period from 25 June 2018 to 30 June 2020, must be reported by 28 February 2021;
- ▶ tax optimisation schemes that have been made available for implementation, ready for implementation or for which the first step has been taken by 31 December 2020, must be reported by 30 January 2021;
- ▶ tax optimisation schemes that have been made available for implementation, ready for implementation or for which the first step has been taken by 1 January 2021, must be reported within 30 days of such decisive fact.

How to report?

The report can be submitted electronically. The financial administration promises to publish a report form in the second half of October, so let's hope we will have enough time to become familiar with it.

Therefore, be prepared to meet a new obligation in relation to the tax office. As the deadline for notifying new cross-border arrangements will be only 30 days, it is important that you are able to identify whether you are required to notify. Failure to do so could result in a fine of up to CZK 500,000. If necessary, we are ready to help you with this. DAC 6 is a complex topic and you will need to proceed individually for each transaction, so we have prepared a webinar called „[Exchange of information according to DAC 6 and how to comply with it](#)“ where we will discuss deadlines, the form of reporting and other reporting obligations under DAC 6.

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BDO WEBINARS

We have moved most of our planned events online

[MORE INFORMATION](#)

THE SHORT-TIME WORK SYSTEM (KURZARBEIT) IN THE CZECH REPUBLIC

Following lengthy negotiations, the Czech Government reached an agreement and published a draft law on employment and its amendment, which contains the much-anticipated modification of the short-time work system. According to the ideas of the Ministry of Labour and Social Affairs, the law is to replace the expiring Antivirus Programme, which businesses can draw from for the last time in October. However, the question is whether the change in the law will be adopted by the Chamber of Deputies in such a short time.

While the Antivirus Programme was only a temporary support for employers during the coronavirus crisis, the Short-time Work Act is intended to be a permanent solution. The government was inspired by the German Kurzarbeit law. In my article, I will therefore focus on comparing the two legal regulations. Judge for yourself how it worked and whether the search for Czech originality serves any purpose.

- ▶ The activation of support is determined by the government due to the occurrence of an event such as a natural disaster or epidemic, cyberattack or other emergency situation, which is an intervention of force majeure. The regulation may be limited to part of the country or an economic sector. In Germany, the decision is the responsibility of the local employment office. It can react flexibly, for example, to the situation of a large regional employer, while the government is unlikely to deal with these regional employment shortfalls with its decision.
- ▶ According to the draft amendment to the Act, the employer must inform the employee in advance that there has been an obstacle to work on its part and that the employee will therefore be entitled to support during part-time employment. A priori consent of employees is not required, unlike in the German legislation.
- ▶ The state will contribute to employers for a so-called support period, which is a maximum of 12 months. Here we agree with the German regulation, and at the time of coronavirus this period was extended to 24 months in Germany. The support will be due to the employee for the entire calendar month, unless the employer assigns them work in the range of 20% to 80% of their weekly working hours. The support amounts to a maximum of 70% of the average hourly net earnings, while the ceiling for payment is set in the draft amendment to the Act at one times the national average wage. This is currently slightly over CZK 34,000. This restriction will be a complication for employers when using the short-time employment scheme to maintain a skilled workforce. An employee in Germany receives support amounting to 60% of their lost net salary; for employees caring for children the support is set at 67%, with the support amounting to 80% from the seventh month (calculated from March 2020) and 87% for parents with children. The maximum amount paid in Germany as aid is around EUR 2,900 and corresponds to a salary in excess of EUR 6,900. The specific amount of support then depends on the tax class to which the employee belongs.
- ▶ Employers' contributions to health and social insurance will vary during the period when support is drawn. The employer will pay health insurance from the original unreduced average amount of the employee's gross salary. Social insurance will be paid only from the settled gross wage of the employee increased by the paid partial unemployment benefit, in the month in which the employer receives it at the Labour Office. An employer in Germany must continue to pay health and social insurance both for the employee and its share for the employer. However, the amounts paid will be returned to the employer in a lump sum, limited to the end of 2020.
- ▶ A separate chapter deserving of attention is in the draft

amendment to the law limiting the payment of profit shares and dividends. The draft amendment requires the employer to declare that within 24 months of submitting the notification it will not pay its shareholders extraordinary profit shares, distribute equity and provide them with other extraordinary benefits, including early repayment of loans. It is a question of what extraordinary profit shares means according to the draft amendment to the law. Is it possible to start from the distribution of profit for the previous year or from any average pay-out for the last three or five years? What if the company did not make a profit last year? Will the payment of profit in the current year be considered extraordinary? Another question is the time for which profits cannot be distributed. The state will pay the support for a maximum of 12 months, so why is the employer limited to 24 months when paying profit shares? Restrictions on the payment of dividends during the period when Kurzarbeit is drawn in Germany do not apply. However, it was subject to political discussion as to whether the state should not regulate the payment of dividends in any way, as is the case in France or Denmark.

The amendment to the Employment Act will certainly be the subject of a heated debate in the Chamber of Deputies, and I assume that the final wording of the amendment to the Act will change. We will inform you about the final form on our website or in other issues of our newsletter.

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ABOLITION OF REAL ESTATE ACQUISITION TAX IN 2020 AND NEW EXEMPTION TESTS FOR THE SALE OF REAL ESTATE TO NATURAL PERSONS FROM 1 JANUARY 2021

With effect from 26 September 2020, the real estate acquisition tax was abolished in the Czech Republic. This tax was applied to the acquisition of immovable property for a consideration, such as the purchase of land, the allocation of real estate to a trust fund or the acquisition of the right to build. Acquisitions of real estate registered in the Land Register after this date are therefore no longer subject to real estate acquisition tax.

According to the transitional provisions, the abolition of real estate tax also applies to the acquisition of real estate registered in the Land Register between 1 December 2019 and 25 September 2020. The date of registration in the Land Register is therefore decisive (and not, for example, the date of signature of the purchase agreement).

In the case of real estate not registered in the Land Register, the decisive factor is the acquisition of ownership.

Taxpayers affected by the abolition of the tax have no obligations towards the financial administration. Therefore, they do not have to file a tax return or pay tax. However, if they have already paid the tax, they have the option of applying to the relevant tax office for a refund of the overpayment.

There is no automatic refund of paid property tax without applying. In connection with the abolition of the acquisition tax, an amendment to the Income Tax Act was approved concerning the exemption test for the sale of real estate to natural persons, from five to ten years. This change only applies to real estate acquired from 1 January 2021. For real estate acquired before this date, the original five-year time test applies. Another amendment to the Income Tax Act adopted in connection with the abolition of real estate acquisition tax is the reduction

of the maximum amount of interest on mortgages which taxpayers can deduct from the personal income tax base, from CZK 300,000 to CZK 150,000 per calendar year.

The government is preparing another amendment to the tax laws, expected to take effect on 1 January 2021. It is proposed, for example, to introduce a meal voucher lump sum (a cash allowance for employees' meals). The government also announced the possibility of abolishing the super-gross wage (a method of calculating income tax). The tax package is currently being discussed in the Chamber of Deputies. We will inform you again about the changes it will bring in upcoming issues of this newsletter.

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HOW TO EFFECTIVELY DEFEND AGAINST PHISHING?

With the transition to digital communication and more frequent work from home, the number of cyberattacks on companies is increasing. Recently, the number of so-called phishing attacks has increased at an unprecedented rate.

All fake e-mails are a form of social engineering designed to solicit information from users. Technically, an attack using social engineering can be considered an attack that requires human interaction to obtain information about or compromise the victim. An attacker can impersonate IT support staff, a new employee, a service provider, and so on.

The goal of phishing may not only be to obtain data, but also to support further attacks. Of course, the attackers also use current events from around the world and try to adapt to them. Favourites include natural disasters (droughts, floods), epidemics (many phishing e-mails or sites have appeared in connection with COVID-19), elections, holidays or data update requests.

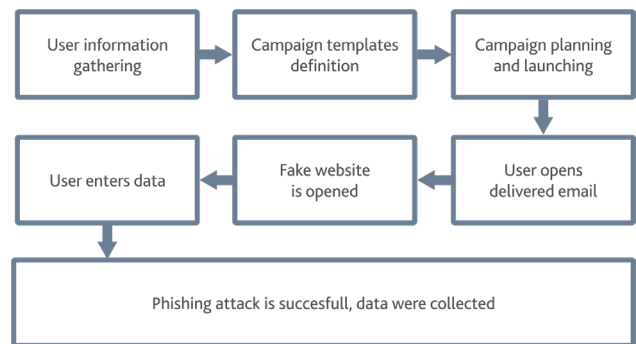
How to identify an attack?

- ▶ **Suspicious sender's address** - Check the sender's address carefully, as the address may look legitimate at first glance. However, it may be in a non-standard format (characters are missing, bad formatting, etc.).
- ▶ **Generated greetings or signatures** - Generic greetings or signatures should also alert you. Examples include "Dear Sir/Madam" or "Dear Customer".
- ▶ **Spurious hyperlinks or pages** - This can be very well identified by placing the mouse cursor on the link and see which address it is pointing to. But it is important to be careful at this point. Addresses can be very similar to the correct addresses.
- ▶ **Grammatical accuracy and appearance of the e-mail message** - If the e-mail message contains incorrect grammar or unusual formatting, it is most likely a forged message.
- ▶ **Suspicious attachments** - Examples are unexpected attachments, calls for urgent download from a website, requests for urgent payment of an order you are not aware of, etc.

How best to defend yourself?

In general, from the point of view of cybersecurity the most important defences are analysis followed by training (and subsequent regular training) of users. There are solutions that allow you to send simulated attacks in the form of fake e-mails to targeted recipients. Subsequently,

over time we will evaluate the reaction of users and propose measures. The simulated submission itself is also a form of training users how a targeted campaign against a given company can look like. The process of the entire anti-phishing defence is as follows:



The entire campaign is implemented in several stages. First, the range of target recipients is defined and then they are targeted with the various campaigns. Each user will receive a fake e-mail according to a template that mimics e-mail messages from Microsoft or Google. Its purpose is to evoke in the user a sense of urgency to open an e-mail and enter data.

The next stage is the final evaluation of the information obtained and a proposal for further steps for the company. All data is processed completely anonymously and with respect for all users.

Due to the increasing number of attacks on companies worldwide as well as in our country, I strongly recommend focusing on cybersecurity in your company. Above all, the proverbial „prevention is always cheaper than a cure“ applies here.

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MARK IN YOUR CALENDARS: EVENTS AND WEBINARS

Your health and safety is important to us, so we decided to move the planned seminars online in the form of webinars.

You do not need any special computer equipment to participate in the webinar. You can also connect via a tablet or mobile phone. After registering and paying the participation fee, you will receive a link to the page where the webinar will take place.

If you have already registered for a seminar, we will contact you directly to make the change.

WEBINAR: THIRD-PARTY VERIFICATION - SOC2 TYPE 1, TYPE 2

We will introduce you to the new requirements for compliance with regulations of technology suppliers to the USA. We will focus on the areas that SOC2 verifies, the inspection process and the planned changes applicable from January 2021.

- ▶ 5. 11. 2020

SEMINAR: NEW ACT ON EXPERTS – IMPACT ON PROFESSIONS

At the seminar, we will tell you about the long-awaited law on experts. You will get information about how the expert activity will be anchored

in the system of law, the position of the expert in the legal process, how their position and that of expert institutes will change in general and what to expect from these changes.

▶ 19. 11. 2020

WEBINAR: WAGE NEWS IN 2021 AND THE NEW LABOUR CODE

We will talk about the most important changes in payroll accounting in 2020, planned changes and news for 2021, as well as upcoming changes in the field of labour law, taxes, health insurance and social security, payroll deductions and other changes in the area of wages. In addition to the already approved legislative innovations, we will also discuss proposals in the legislative process and the most important Czech and European court decisions.

▶ 19. 11. 2020

WEBINAR: A MAJOR AMENDMENT TO THE BUSINESS CORPORATIONS ACT

In this webinar we will introduce you to the most important changes and the main impacts that the biggest amendment of the Business Corporations Act since 2014 will bring. We will focus on a basic overview of the changes and adjustments in the general part of the law, such as the adjustment of profits. We will discuss specific changes in the operation of limited liability companies regarding the amount of share capital, powers of the general meeting, decision-making, termination of participation in the company and more. You will also learn about the most important legal regulations of a joint-stock company, such as the articles of association, the functioning of the general meeting, the prohibition of competition, etc.

▶ 26. 11. 2020

WEBINAR: EXPERIENCE WITH 2020 TAXES AND NEWS FOR 2021

Like every year, we have again prepared a seminar for you which aims to explain all the main amended provisions for 2021 concerning income tax and value added tax. We will also touch upon the most important changes in connection with the filing of tax returns for 2020. You will also learn about news in the area of financial statements and we will talk about changes planned in 2021.

▶ 27. 11. 2020

▶ 2. 12. 2020

WEBINAR: EXCHANGE OF INFORMATION ACCORDING TO DAC6

We have prepared a webinar where we will introduce you to the changes associated with the notification obligation valid in the Czech Republic since 2021. We will discuss news and the necessary deadlines, the form of reporting and other obligations of intermediaries associated with notification. You will also learn what the possible sanctions are for not reporting correctly.

▶ 3. 12. 2020

SEMINAR: FINANCIAL STATEMENTS FOR 2020 AND NEWS FOR 2021

This year, we have prepared another in our traditional series of seminars for you. It aims to explain all the changes that 2020 brought to us in accounting and to point out the steps you need to take when closing out the business year. We will also talk about the changes planned for accounting and related tax regulations in 2021.

▶ 14. 12. 2020 – PRAGUE

WEBINAR: CURRENT CHANGES IN TRANSFER PRICING

In cooperation with the General Financial Directorate we have prepared a webinar where we will discuss the main factors and recommended changes in the contractual documentation you need to consider in the area of transfer pricing. In the context of the economic changes related to the COVID-19 pandemic, with companies in all tax jurisdictions facing its effects, large multinational groups can be expected to report consolidated losses. This is an exceptional situation, but even so, it can be expected that the financial administration will check whether Czech routine producers covered all costs and generated the usual market profit. Given that because of local government measures routine producers may not be able to cover all fixed costs, let alone generate profit, it will be especially important to analyse the reasons that led to such an outcome.

▶ 26. 1. 2021