

BDO NEWS

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EDITORIAL



Dear Readers,
The October newsletter was prepared at a time when many of you were thinking about which political party to vote for in the next election. So you may have missed the Czech National Bank's rather dramatic decision to raise key interest rates by 0.75% at the beginning of the first week of October. CNB Governor Jiří Rusnok justified it by seeking to stave off the threat of rapidly rising year-on-year inflation.

Our first article also addresses the issue of interest rates, specifically for loans granted between interconnected companies in multinational groups. The change in the CNB rates is one of the economic circumstances that can affect a group's business and financial strategy. The purpose of this article is to provide you with new information issued by the General Financial Directorate in response to the current OECD guidelines on transfer pricing in financial transactions.

Most of us have got used to the idea that VAT is something that never stays the same. The pandemic has taught us to shop from home and has contributed significantly to the development of distance selling (e-commerce). Since October, we have had new VAT rules for this area directly in Czech law.

Recently, we have seen an increased interest in equity investments in the market. In some cases, financial assistance is used to secure the necessary financing. Read our article on this subject to find out what financial assistance is and what conditions need to be met for it to be provided fairly.

I hope that our electoral votes will contribute to a balanced, functioning and economically successful society that protects basic human values and the individual's right to his or her own opinion more than it protects consumerism.

Lenka Lopatová
Partner

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BDO CZECH REPUBLIC

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

INFORMATION FROM THE DIRECTORATE-GENERAL FOR FINANCE ON TRANSFER PRICING GUIDELINES FOR FINANCIAL TRANSACTIONS

On 4 August 2021, the Directorate-General for Finance issued a document briefing on the content of the Transfer Pricing Guidelines for Financial Transactions, which were published on the OECD website already in spring 2020 („OECD Guidelines for Financial Transactions“). A translation of the Guidelines into Czech is attached to the Information.

We consider the information issued during the summer holiday season to be important, as it confirms the previously published **intention of the Tax Administration to focus attention on the true nature of financial transactions and the conditions under which these transactions are carried out.**

Prioritising the substance of the transaction over the formal contractual arrangement is an approach that the Tax Administration has generally long applied to any other group transaction in transfer pricing tax audits, but in the case of financial transactions, until recently the OECD Transfer Pricing Guidelines did not contain any specific recommendations that both taxpayers and tax administrations could follow in setting and controlling the prices of financial transactions and that would help prevent disputes in this area.

The OECD Guidelines on Financial Transactions define several absolutely essential categories of financial transactions. **These are intra-group lending, cash-pools, hedging and financial guarantees,** addressing in detail for each of them the circumstances under which the price was determined.

A very common example of an intra-group financial transaction is an intra-group loan. It can be assumed that an independent lender would first check the borrower's risk of insolvency before providing funds. There are currently several commercial database offerings on the market containing tools that can determine a „rating“ using a mathematical model and data from published financial statements. The borrower's rating is one of several comparability criteria that should be considered when determining the market-based intra-group interest rate. **Note that the borrower's rating may be significantly affected by the ability of local management to exercise control and management functions related to the use of the funds provided if control and management of the local company's activities has been taken over by a controlling person.**

The interest rate on an intra-group loan should ideally be within the range of interest rates on loans to independent borrowers on comparable terms. The term comparable terms includes, for example, the maturity of the loan, subordination, collateral, the amount advanced, etc. To find data on comparable interest rates for loans granted to independent borrowers under the above-mentioned

comparable circumstances (the so-called CUP method), it is usually necessary to use a paid-for commercial database containing the necessary data. In addition to the CUP method, the General Financial Directorate information allows for the possibility of using methods based on financing costs or economic modelling methods. The services of a **valuation firm** may be used here. **The principle of balancing the costs incurred in documenting the transaction against its significance should be respected in the preparation of transfer pricing documentation.**

As regards the course of tax audits focused on financial transactions, in practice, one can encounter an approach where the Tax Administration scrutinises in detail the circumstances of financial transactions formally based on a contractual relationship bearing the defining characteristics of a loan, the contractual terms of which regarding the maturity or the amount and frequency of repayments are not actually fulfilled and for which the risk of the debtor's insolvency is not checked. Consequently, the possibility of early repayment of the loan could be exercised when the indicators that are normally checked in the case of a loan granted between unrelated parties are not met.

In the case of foreign tax administrations, it is not an exception when, based on a tax audit, a part of interest related to a loan granted by a Czech parent company to a foreign subsidiary is reclassified as a hidden dividend payment and tax is subsequently assessed on the unrecognised interest costs. In such cases, the question arises as to how and whether it is possible to achieve such a solution where the reclassification of interest is accepted by the Czech Tax Administration to avoid double taxation of the amount that was already taxable income on the Czech side. Recall that as of 15 September 2020, the Act on International Cooperation in the Resolution of Tax Disputes in the European Union has entered into force, which should harmonise the procedure of both tax administrations in resolving such cases.

Financial transactions are a separate category of related-party transactions where the context in which the transaction takes place is important. Our experience in tax audits to date suggests that to properly define the category to which the financial transaction under review actually belongs and to demonstrate the actual risks associated with the transaction on the part of the lender or guarantor, it is necessary to describe and explain the basic principles of the financial strategy of the group as a whole. **The group's financial strategy should be described in the section of the transfer pricing documentation referred to as the MASTERFILE.**

Lenka Lopatová
lenka.lopatova@bdo.cz

TRANSFER PRICING IN CZECH-GERMAN BUSINESS

Seminar in cooperation with BDO Germany, 5 November 2021 - Pilsen

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RULES FOR E-COMMERCE CAN BE FOUND IN THE CZECH VAT ACT FROM OCTOBER

An amendment to the Value Added Tax Act came into force on 1 October. It sets the rules for taxation of distance sales of goods (e-commerce), which have been in force in the European Union since 1 July, and therefore many entities took advantage of the direct effect of the Directive and started to follow the EU provisions three months earlier than they were legislatively regulated in the Czech VAT Act. In addition to the new rules for distance selling of goods, which we wrote about in detail in our [May newsletter](#), and the abolition of the VAT exemption for purchases of goods from non-EU countries whose value did not exceed EUR 22, the amendment brought several other changes.

In response to the case law of the Court of Justice, the condition that the debtor must still be a taxpayer for the creditor to be able to adjust the tax base of a bad debt is abolished. This entails an entirely new provision in Section 79e, which the debtor must bear in mind when cancelling their VAT registration. Their new obligation is to repay the deduction they have claimed on the supplies received which remained unpaid at the date of cancellation. If they then pay part or all of the debt to the creditor in the following three years, they can reclaim VAT on the paid part of the debt by filing an additional tax return.

In other particulars, the amendment clearly defines the period for which the deduction can be claimed in the claim for refund. The rule is set in such a way that **persons registered in another EU Member State can claim a VAT refund in the Czech Republic for the year in which the transaction took place or in which the tax document was issued.** The later date is decisive. If the transaction took place on 31 December 2020, but the document was not issued until 5 January 2021, the refund can be claimed only for 2021.

A marginal but relatively common and sometimes emotionally charged issue is the question of rounding. This has so far applies only to cash payments for the practical reason that the Czech currency no longer has heller coins, i.e. when buying one croissant priced at CZK 1.90, only a cash payment of CZK 2 is possible. However, as many invoices intended for non-cash payment contained a rounding of the amount to be paid to whole crowns, the amendment introduced the same rounding rule for non-cash payments. **Therefore, as of 1 October, the amount of the rounding-off is not included in the tax base for both cash and non-cash payments.**

Petr Vondráš
petr.vondras@bdo.cz

PART-TIME ALLOWANCE - „KURZARBEIT“

In September 2020, the first proposal was submitted by the Ministry of Labour and Social Affairs, kicking off a rather complicated legislative process to introduce support during periods of partial unemployment, known as „Kurzarbeit“. The final proposal was not passed by the Senate until June 2021, signed by the President and implemented in the Czech legal system

by the amendment to the Employment Act No. 435/2004 Coll. effective from 1 July 2021.

This amendment introduces the „part-time work allowance“ („PWA“), which is regulated by the new provisions of Sections 120a - 120f of the Employment Act. These provisions determine the conditions for activating this allowance, its amount, the range of beneficiaries or the details of its use. The previous legal regulation of the partial unemployment allowance (Section 115 of the Employment Act as amended on 30 June 2021) proved to be cumbersome and inadequate in terms of the amount of the allowance for situations such as the coronavirus crisis. Under the previous legislation, each individual application by a particular employer was subject to prior government approval. At the time of the coronavirus crisis, around 57,000 employers applied for support and it was not possible to deal with each application individually at the government level. A further limitation was the amount of the initial grant, which was set at 20% of the employee's average earnings, with an upper limit of 0.125 times the average wage in the national economy. This currently amounts to CZK 4,784, which would hardly motivate an employer threatened by economic losses to keep employees employed even when they do not have work for them and at the same time have to pay them wage compensation.

Therefore, new legislation was adopted for the PWA, based on the experience with the Antivirus programme, which was widely used by companies during the crisis. The provision of the new part-time allowance effective from 1 July 2021 is always subject to a government decision. The latter, after discussion in the Council of Economic and Social Agreement, will issue a regulation activating the provision of the PWA in cases where the Czech economy or a sector thereof is seriously threatened for economic reasons, due to a natural event, epidemic, cyberattack or other event of force majeure. A government regulation may limit the provision of the allowance during the period of part-time work to a part of the territory of the Czech Republic or to a sector of the economy. It may also be limited to a certain range of employers by setting binding employer indicators.

Further parameters and conditions of the revised part-time allowance are set out below:

Duration of the allowance

The allowance can be granted for a maximum of 12 months. For the first time, the duration of the allowance is set at a maximum of six months, and thereafter it may be extended for a maximum of three months at a time, up to a maximum of 12 months.

Amount of allowance

The allowance will be provided up to 80% of the employee's costs (the employee's wage compensation under Section 120c(1)(a) and the social security and public health insurance premiums calculated on this part of the wage compensation, which the employer is obliged to pay).

The maximum amount of the allowance is limited to 1.5 times the average monthly wage in the national economy in the reference period (first to third quarter of the calendar year preceding the calendar year in which the employer's statement was submitted). For the year 2021, the maximum allowance would be CZK 51,916 per month per employee in the case of activation of the PWA.

Conditions under which the allowance is granted

If employees were unable to work in a given month because of any

of the employer's work-related impediments, provided that such impediments occurred in direct connection with any of the grounds based on which the government decree applying the PWA was issued, the employer is entitled to the PWA for the entire month, provided that

- the employer pays workers wage compensation equal to at least 80% of their average earnings; and
- it does not assign work to employees of at least 20% and no more than 80% of their weekly working time. This condition must be assessed cumulatively for all employees.

At the same time, the allowance can only be claimed for employees who have been employed at least three months on the date of the employer's notification.

Who cannot benefit from the allowance

Employers listed in Section 109(3) of the Labour Code, i.e. contributory organisations, state funds or the state, will not be able to apply for the allowance. The allowance is intended mainly for employers in the private sector. However, there is still a restriction if the employer uses a working time account. No allowance is payable for the period when the employee's working time account is used

Application for the allowance

The employer must apply for the allowance by means of a written notification submitted electronically to the relevant branch of the Labour Office (according to the employer's registered office in the case of a legal entity and according to the employer's residence in the case of a natural person). Before submitting the notification, the employer must inform the employee in writing of the obstacle to work on the employer's side.

Each month, employers will then electronically submit a summary of their workers' compensation costs, known as a statement of account. The deadline for submitting the statement is the 20th day of the month following the month for which the allowance is provided. Within eight days of receipt of a complete and proper statement, the Labour Office will transfer the PWA to the employer's account.

Unlike the Antivirus programme, the award is not contingent on the employer having already paid compensation for a given month, and employees can apply for the PWA in advance. However, to file a claim, it is necessary to already have the previous month's payroll data and then the Labour Office has eight days to pay the allowance. In practice, many companies will not receive the PWA until after the payroll deadline

Although the part-time allowance is often referred to as „Kurzarbeit“ recalling its inspiration by German legislation, the Czech and German solutions are not identical. In addition to how the state reimburses the costs or the amount of the allowance, how the allowance is activated also differs. Regardless, both are designed to protect jobs, enable employers to retain skilled workers and deal with economic losses beyond the control of the companies themselves. But it will only be

possible to assess the practical functioning of the part-time allowance when it is activated. Only time will tell whether this institution will be widely used, for example, in the event of a regional emergency or a crisis in a particular sector, and whether it will become a flexible tool for combating the crisis.

Jana Heranová

jana.heranova@bdo.cz

FINANCIAL ASSISTANCE IN CONNECTION WITH ACQUISITIONS

After the cooling in 2020, the acquisition market is experiencing a boom and growth is expected in the future. In connection with the acquisition of mainly real estate projects, the Business Corporations Act regulates an institute called financial assistance. Even before the acquisition process begins, the existence of financial assistance must be taken into account and the structure of the transaction must be adapted accordingly.

Definition of financial assistance

The legal regulation of financial assistance in Czech law is based on the European Directive regulating certain issues of company law and is regulated in the Business Corporations Act.

Financial assistance is defined as a situation where the target company provides a certain advance, loan, credit or security to the buyer for the purpose of acquiring a share in the company. The essence of financial assistance is that the buyer enters into a contractual relationship with the shareholders of the target company whose shares it wishes to acquire. The target company then provides either direct funds or some form of security for the transaction.

In practice, cases of financial assistance are usually limited to the provision of collateral. The issue of financial assistance is particularly relevant in the case of acquisitions of real estate companies.

An illustrative example is a transaction in which the buyer acquires a share in a company whose only significant asset is a certain piece of real estate. Normally, such transactions are financed through bank loans.

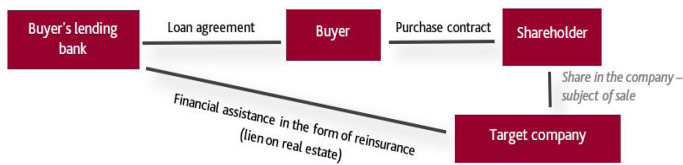
A prerequisite for a bank loan is the creation of a lien on the property. The buyer must therefore ensure, in cooperation with the target company, that the latter concludes a lien agreement with the bank and registers the lien in the Land Register. The establishment of a lien in such a case constitutes financial assistance, which is subject to a number of formal legal rules.

WHISTLEBLOWING

New obligation for companies to set up an internal channel for reporting unlawful conduct

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The above can be illustrated in the case of real estate acquisitions by the following diagram:



General conditions for providing financial assistance

The provision of financial assistance was completely prohibited by the previous legislation. The current legislation does not prohibit financial assistance but makes it subject to a number of rules.

As a general rule, a company must not cause itself to become insolvent or overindebted by providing financial assistance.

The rules governing financial assistance are different for limited liability companies and joint-stock companies.

Financial assistance – specifics of a limited liability company

A limited liability company may provide financial assistance if the managing director of the company executes a written report specifying the terms of the assistance and the risks and benefits to the company.

A further condition is that the financial assistance is provided on fair terms (in particular, a market rate of interest, an amount of collateral commensurate with the amount lent, etc.).

The granting of the financial assistance will be decided by the shareholders at a general meeting.

Financial assistance – specifics of a joint-stock company

The financial assistance regime in the case of a joint-stock company is more robust and complex compared to the rules for a limited liability company.

The conditions for granting financial assistance are as follows:

- a) Financial assistance is provided on fair terms (i.e. the same rule applies here as in the case of a limited liability company);
- b) The statutory body will investigate the financial capacity of the person to whom the assistance is provided;
- c) The statutory body will prepare a written report stating:
 - a. the factual justification for the financial assistance;
 - b. the conditions under which the assistance is provided;
 - c. the reasons why the financial assistance is in the company's interest;
 - d. conclusions on the financial capacity of the person to whom the assistance is provided;
- d) The provision of financial assistance must not cause the reduction of equity capital below the subscribed share capital increased by funds that cannot be distributed to shareholders under this Act or the company's articles of association;
- e) The company must establish a special reserve fund in the amount of the financial assistance provided.

The granting of financial assistance is decided by the general meeting of the company in the same way as in the case of a limited liability company.

Financial assistance is problematic in the case of a joint-stock company, primarily because the company is obliged to create a special reserve fund in the amount of the financial assistance provided, which significantly limits its practical use. Few companies have sufficient liquidity of their own to create such a fund. This is particularly true if the company's only significant asset is a piece of real estate.

Another method of acquisition without financial assistance

The financial assistance itself represents a potential complication of the acquisition transaction, with associated time and organisational costs. In the case of joint-stock companies, the rules on financial assistance are so strict that they make it virtually impossible for many companies to use it.

A similar result can be achieved by means of a transaction in the form of an asset deal – a direct purchase of real estate, purchase of a commercial enterprise or part thereof.

Particularly in the case of a joint-stock company, it is then advisable to consider the possibility of changing the legal form to a limited liability company or using one of the more complex acquisition schemes.

Practical recommendations

Financial assistance has formal rules that must be followed. It is advisable to keep them in mind before structuring the transaction itself and to check whether the characteristics of financial assistance are materially fulfilled in the course of the acquisition. Whether financial assistance is provided in an acquisition depends on the underlying timing of the acquisition, the manner in which it is carried out and the potential tax consequences.

Aleš Malach, Kateřina Moravcová

ales.malach@bdolegal.cz, katerina.moravcova@bdolegal.cz

MARK IN YOUR CALENDARS: EVENTS AND SEMINARS

We invite you to BDO's autumn training courses. We are preparing for you traditional courses on new developments in the field of tax, payroll and accounting, but also seminars on new topics such as the Whistleblower Protection Act or transfer pricing issues. The training sessions are held in person across the Czech Republic, but we also bring you the opportunity to watch them by video.

SEMINAR: TRANSFER PRICING IN CZECH-GERMAN BUSINESS

▶ 5 November 2021 - Pilsen

In cooperation with BDO Germany, we have prepared a seminar for you on the issue of transfer pricing for companies operating simultaneously in the Czech and German markets. We will draw your attention to the specifics, differences and requirements for the preparation of documentation on transfer pricing in the Czech Republic and Germany. Throughout the lecture we will show examples from practice and discuss our current experience of tax audits in both countries. We will talk about the effects of the pandemic on the comparative analysis of profitability. At the same time, we will present to you the

recommendations of the procedure for additional adjustments to transfer prices for related-party transactions and the possibility of a tax refund when assessing it in another country.

Lecturers

- Lenka Lopatová, Partner
- Arwed Crüger, Partner
- Věra Jankovcová, Guest of Honour
- Nikola Jandečková, Senior Consultant

SEMINAR: NEW WHISTLEBLOWER PROTECTION LAW: HOW TO PREPARE FOR IT?

- ▶ 11 November 2021 - Prague

The year 2021 sees the introduction of a new Whistleblower Protection Act. Under the Act, companies with 25 or more employees and contracting authorities will have to establish procedures for receiving and processing reports, train employees and ensure that whistleblowers' personal data is protected by the end of March 2022. We cordially invite you to the BDO seminar, where we will present a brief and practical overview of what the obligations are, how to meet them and not drown in paperwork and regulations. We will provide you with practical knowledge about the impact on businesses and the benefits of introducing effective reporting channels.

Lecturer

- Stanislav Klika, Head of Advisory Services

SEMINAR: NEWS IN WAGES IN 2022, WORK FROM HOME AND EMPLOYMENT OF FOREIGNER

- ▶ 23 November 2021 - Pilsen
- ▶ 24 November 2021 - Domažlice
- ▶ 26 November 2021 - Brno
- ▶ 29 November 2021 - České Budějovice
- ▶ 30 November 2021 - Prague

As in previous years, we have prepared a seminar for you this year summarising the basic salary and personnel changes that will affect both you personally and your company. At the seminar we will discuss the most important changes in payroll accounting for 2021 and upcoming news for 2022. We will talk about what changes await us in the field of labour law, personal income taxes, health insurance and social security premiums, changes in deductions from wages and specifics of employment of foreigners.

Lecturers

- Veronika Sovová, Manager
- Monika Lodrová, Manager, Head of Personal Income Tax
- Michaela Tydlačková, Senior Consultant

SEMINAR: EXPERIENCE WITH 2021 TAXES AND NEWS FOR 2022

- ▶ 23 November 2021 - Brno
- ▶ 30 November 2021 - Pilsen
- ▶ 1 December 2021 - Domažlice
- ▶ 2 December 2021 - Prague

- ▶ 3 December 2021 - Tábor
- ▶ 6 December 2021 - České Budějovice

Like we do every year, we have prepared a tax seminar for you, the aim of which is to provide an explanation of all the main amended provisions for 2022 concerning income tax and value added tax. We will also draw your attention to the most important changes in connection with the filing of tax returns for 2021. In addition, you will learn about this year's news in the area of financial statements, and we will tell you about the planned changes for 2022.

Lecturers

- Zenon Folwarczny, Partner, Head of Tax
- Tomáš Klíma, Partner
- Igor Pantůček, Partner, Head of VAT
- Ivan Kovář, Partner
- Martin Tuček, Partner
- Petr Vondraš, Manager
- Petr Linx, Manager
- Michaela Srpová, Manager
- Jan Tuček, Manager

SEMINAR: FINANCIAL STATEMENTS FOR 2021 AND NEWS FOR 2022

- ▶ 7 December 2021 – Prague
- ▶ 14 December 2021 – Brno

We have prepared a traditional seminar for you, the aim of which is to provide you with an explanation of all the novelties that the year 2021 brought to us in accounting and to remind you of the steps that need to be implemented within the year end work of business entities. We will also introduce you to the planned changes in accounting and related tax regulations for 2022.

Lecturer

- Jiří Pospíšil, Manager, Accounting Methodologist

More events in cooperation with partners can be found on our [website](#).