BDO NEWS

JUNE 2022 - ISSUE 6

WWW.BDO.CZ

EXPERT OPINION - A PARADIGM SHIFT?

MORE ON PAGE 3

FOREIGN CURRENCY ADVANCES DURING THE FINANCIAL YEAR

MORE ON PAGE 3

INCREASE IN TURNOVER THRESHOLD FOR TAXPAYER REGISTRATION

MORE ON PAGE 4

EDITORIAL

Dear Readers,

The long-awaited calming of the situation in society has unfortunately not occurred. The pandemic may have temporarily let up, but the war in Ukraine has changed everything. In previous editions of this newsletter we have discussed, for example, legislative innovations that responded to this state of affairs. In the area of tax, these were mainly adjustments to gratuitous transactions, which, in connection with the provision of various types of aid, had to be specified. Who would have thought before that we would be able to claim gratuitous benefits for military purposes on our tax returns?

Given the global energy crisis, alternative energy sources will need to be further promoted. That is why, among other things, there is another minor change in the Income Tax Act. It has been possible to approve the reclassification of the item of equipment used exclusively to recharge electric vehicles that have an electric or hybrid drive. The reclassification will be from depreciation group 3 to depreciation group 2. The proposed measure will not only apply to newly acquired charging stations but will also be available on a voluntary basis to taxpayers who have already acquired such stations.

In addition, for low-emission vehicles (in particular electric and hybrid vehicles), a reduction in the percentage of the entry price from 1% to 0.5% has been pushed through. For the purposes of the Income Tax Act, this amount is regarded as income of the employee in connection with the free provision of the employer's motor vehicle for business and private purposes.

In one of the following posts, my colleague Lukáš Křístek and I will think about how the new valuation legislation may affect the direction of expert reports.

Our colleagues from BDO's tax and accounting department will explain how to work with and understand new approaches or case law in the area of foreign currency advances. In this area, the conclusions seem to be becoming more firmly established with the help of case law.

The holiday season is approaching. Hopefully, the turbulent developments with their overarching effects will subside and we can all get back to normal.

I wish you all a pleasant summer.

Jiří Jandečka
Partner

CONTENT

BDO CZECH REPUBLIC

- Audit, Tax, Accounting & Payroll Advisory, IT and Valuation
- 500 specialists
- 58 Certified Tax Advisers,
  36 Certified Auditors,
  7 Certified Appraisers,
  8 Attorneys at Law
- 6 offices in the Czech Republic

CONSTITUTIONAL COURT RULES ON INCOME TAXES FOR THE CHAIRMAN OF A JOINT STOCK COMPANY

In a recent judgment, the Constitutional Court confirmed the necessity to tax both income from employment and activities carried out through a mandate agreement for the chairman of the board of directors of a joint stock company .

In the case in question, the previous courts held that the vast majority of the activities performed by the mandatary were typical in nature for the performance of the office of chairman of the board of directors, i.e. the business management of the company, and the remuneration from these activities is then remuneration under Section 6(1)(c) of the Income Tax Act.
For example, the taxpayer was not helped by arguments where, as a principal, he properly taxed the income on his individual tax return. In addition, the taxpayer argued that the Supreme Administrative Court should have preferred the will of the parties to enter into the mandate agreement to the public law rules on taxation.
The Constitutional Court stated it does not matter which legal relationship the taxpayer receives income under that for the qualification of income classified for income tax purposes under Section 6 of the Income Tax Act. For the determination of the public law tax liability, it is not decisive what type of contract is concluded between the parties in the sphere of employment law, commercial law or civil law, i.e. in the sphere of private law, on the activity that is the source of the income to be taxed. The decisive factor is how the content of such a transaction is defined, in this case for the purposes of taxation in public law. Private law rules allow subjects to choose the legal act by which they establish the intended legal relationship, i.e. whether they conclude, for example, a contract for work, a contract for the procurement of goods, a mandate contract, an employment contract, a contract for the performance of work, etc. Public law no longer gives the subjects a choice as to how they tax the income from the legal relationship. It is essential for the tax authorities to determine unambiguously the actual content of the legal relationship that has been entered into.
It is no longer possible to state that this decision has broken through an imaginary wall into joint stock companies, where until now there have been several similar decisions mainly directed at the managing directors and shareholders of limited liability companies. There is no doubt that public limited companies also need to keep a closer eye on how members of their bodies are remunerated and subsequently taxed.

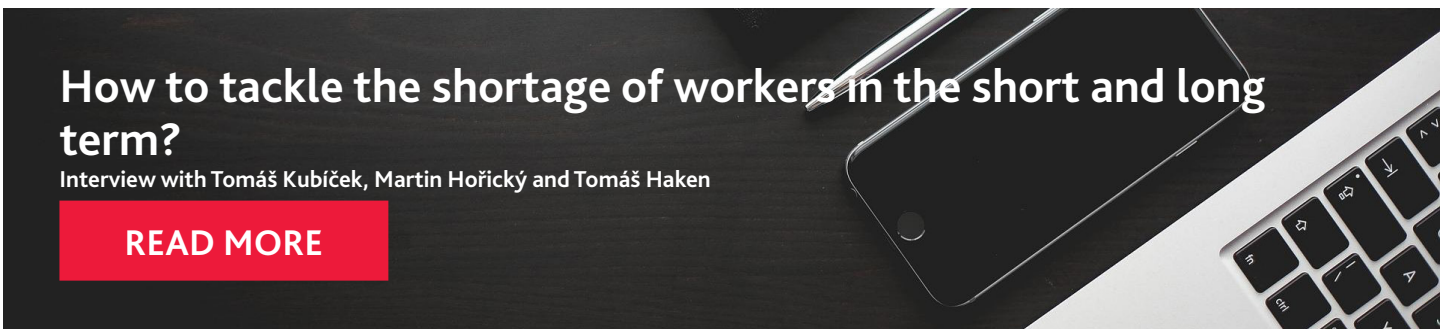
Jiří Jandečka
jiri.jandecka@bdo.cz

DOES YOUR PARENT COMPANY PROVIDE YOU WITH SPECIFIC TECHNICAL SERVICES? DOCUMENTING THEM MAY BE TRICKIER THAN YOU THOUGHT!

In previous articles, we have often discussed the adjustment of costs that a parent company must incur in connection with holding a subsidiary. In a recent judgment of the Supreme Administrative Court, we were interested in a case law that dealt with the opposite.

The subsidiary urgently needed support in the form of technical assistance. The subsidiary itself did not have this knowledge. The parent company was in principle able to provide it with this very specific knowledge.
However, the tax authorities were not convinced that the Korean parent company had sufficiently proved the expenditure on services. The administrator was not satisfied even after being provided with a contract, invoice, list of technicians performing the work and copies of travel documents. According to the tax administrator, the actual scope and content of the services rendered and the purpose of the work could not be deduced from these documents.
The tax administrator's claims were corroborated by the Supreme Administrative Court. It confirmed that it was not entirely clear from the documents submitted what the scope and content of the technical support was. It was not possible to clearly attribute the actual activities to the individual technicians who had travelled from abroad. The taxpayer further sought to produce airline tickets, passports and technical reports. According to the court's statement, it cannot be clearly established that these persons were the ones who were supposed to carry out the activity. Even the taxpayer's suggestion that it would question the personnel who were in charge of keeping records of persons entering the company's premises and who would certainly confirm the regular arrival of these technicians did not help.
It is unlikely that highly specialised Korean technicians came to the Czech Republic just for a spa treatment. However, it is also clear from this case that some tax authorities allow for a similar possibility. The possibility of not defending this very specific technical assistance was apparently not admitted even by the taxpayer. It did not expect such a scrupulous need to prove the details of the technical assistance and, from the logic of the situation, probably did not admit any doubt at all.
Think about how your company can document similar expenses. Consider whether there are other ways in which you can safely demonstrate similar activities. First, I recommend that you read this court decision in detail and take appropriate action depending on the specific situation for similar activities on a larger scale.

Jiří Jandečka
jiri.jandecka@bdo.cz



EXPERT OPINION - A PARADIGM SHIFT?

New expert legislation and successive court interpretations and doctrine are also shifting how experts think about their work. Over the long term, the law and judicial interpretations have sought to make the writing of expert reports more objective. We will review two new institutes that will affect how appraisals are written, and we will also briefly highlight other new developments.

Communication, fee

The law provides for preliminary discussion of the expert assignment between the contracting authority and the expert, including the setting of a deadline. The law further strengthens the expert's independence by the way in which the fee for the expert opinion is negotiated. The fee must be agreed before the commencement of the work and must not be dependent on the outcome. Thus, either a fixed fee or an hourly rate with an agreement on the number of hours is an option.

Uncertain conclusion?

By saying „if the materials or method do not permit the expert to express a definite conclusion, the expert shall state the facts detracting from the accuracy of the conclusion", the Act in one place and the implementing regulation in several places requires the expert to look critically at their work and to state whether the conclusion is certain or merely probable. This is big news. It is not easy to critically evaluate one's own work. It requires a new change in thinking on the part of experts. It is clearly a requirement for objectivity of judgement.

Context (context)

Recently, judges have been looking to expert testimony mainly for context, i.e. to explain the context of the case. They need to understand „what the case is about". They also expect the same from expert reports commissioned by litigants, both in criminal and civil cases. If the judge does not know the context, he or she looks for it in other sources of information. The expert should therefore explain the substance of the case beyond the questions asked, independently and objectively. This is not easy for the expert if they think they must „serve the client", so to speak. Therefore, they are reluctant to disclose information which they think might be prejudicial to the contracting authority. However, the expert is not biased and does not have a relationship with the case or the party. He should therefore write an objective and impartial report. Again, a change in the expert's thinking is required here.

Summary

Experts have yet to fully digest the new expert legislation. In the future, however, we will see a transformation of expert opinions. We therefore recommend that contracting authorities or potential contracting authorities consult an expert before commissioning an expert opinion. They should not be afraid to ask questions at the initial meeting and discuss the substance of the dispute or opinion. They can thus avoid problems later on.

Lukáš Křístek
BDO ZNALEX, lukas.kristek@bdo.cz

FOREIGN CURRENCY ADVANCES DURING THE FINANCIAL YEAR

We have been following the topic of foreign currency advances for you for a long time. Most recently, in April, we highlighted a recent position of the Supreme Administrative Court that has a major impact. The court ruled that of the two approaches being applied, the one used by a minimum of companies is the correct one. In the following lines, we therefore give you an overview of what to look out for in your company during the year. My colleague Jiří Pospíšil follows this article with an analysis of the reporting of advances as of the balance sheet date.

The essence of the two different interpretations of the treatment of foreign currency advances lies in determining when and how exchange rate risk arises and how that risk is accounted for. The usual practice is to book the advance made (and, of course, similarly for advances received) at the current exchange rate and then, on receipt of the invoice, to deduct the advance paid again at the current invoice rate. This often results in an exchange rate expense or income from the difference between the exchange rate used when the advance was made and the exchange rate used when the invoice was settled. However, the Court has currently confirmed the interpretation that there is (with some exceptions) no exchange rate risk associated with the advance paid. Thus, the advance is to be dealt with at the original exchange rate, meaning there is no longer any exchange rate expense or income on account of the settlement of the foreign currency advance.
This interpretation is particularly relevant to the acquisition of assets and inventories but is also generally valid in other areas, such as the acquisition of services or the purchase of energy. The interpretation is also mirrored for advances received. For example, an advance on fixed assets is to be understood as part of the purchase price. Thus, the cost of the asset consists of the advances (valued at the exchange rate at the date of the advances) and the additional payment (valued at the exchange rate at the date of receipt of the invoice).
From the above, it is therefore evident that the issue is far from being limited to that discussed in detail in the article „Foreign currency advances as of the balance sheet date „, but the issue has significant implications for day-to-day operational activities. **We therefore recommend that you analyse the extent to which your company is affected by foreign currency advances and the risks associated with them. In particular, we draw attention to the increased risks for recipients of investment incentives.** We will be happy to assist you with an analysis of the current situation and subsequent solutions.
It is recommended that an analysis of relevance and potential impacts be carried out as soon as possible. In terms of timing, there is no „transitional provision", no „cooling-off period" or the like. The court has merely interpreted the law, the wording of which has long been the same in this area. Among other things, this means that the tax administration can „go back in time" in its audit procedures and use this issue for tax audits of previous years. Fortunately, in view of the statements of the tax administration and our current experience, there are no indications of this so far. **From a practical point of view, we recommend using 2022 for a possible change in accounting methods so that the final balances of foreign currency advances are already reported in full accordance with current case law.** We would be happy to discuss any changes in methodology with you.
Early action is also recommended in terms of technical solutions within the accounting software. It is very likely that your company is using software that cannot effectively handle this new interpretation of valuation and settlement of foreign currency advances automatically.

We would be happy to help you contact your software provider to request a software modification that will allow the application of appropriate automated accounting procedures.
In the following articles we will also deal with the issue of foreign currency advances from the perspective of value added tax.

Lukáš Toman, Michal Daňsa
lukas.toman@bdo.cz, michal.dansa@bdo.cz

FOREIGN CURRENCY ADVANCES AS OF THE BALANCE SHEET DATE

In this article we follow up on our previous report on foreign currency advances during the accounting period. We provide further insight into how accounting and subsequent reporting can help you transition to the new regime for recording advances made or received in foreign currency and how, once the new approach to foreign currency advances is in place, you can also achieve a higher level of compliance with International Financial Reporting Standards (IFRS) in your reporting.

The new approach to foreign currency advances is based on the division of receivables and debts into those whose settlement will require future cash flow (e.g. a deposit) and those whose settlement will be made in kind (e.g. by delivery of products, goods or services). For the former group of receivables and payables (with cash settlement), the obligation to translate such receivables and payables at the current exchange rate as of the balance sheet date continues to apply. The second group of receivables and payables (i.e. without future monetary settlement) are „exempted" from this obligation to translate at the current exchange rate and, therefore, these non-monetary items are not „translated" and are fixed at the exchange rate prevailing when they are settled. **Such a procedure is in line with IFRS**, and therefore its introduction into Czech accounting will bring an advantage to entities that either report themselves under IFRS or that prepare reporting packages for group reporting by foreign parent companies.
For practical application, it is generally recommended that advances received that will be settled in kind (i.e. by delivery of goods, merchandise or services) should be reported under the balance sheet item „Deferred income". Similarly, we recommend recognising advances paid as follows:

- to recognise the advance paid for inventories as part of the item advances made for inventories;
- to record advances paid for fixed assets (intangible and tangible) under advances made for tangible or intangible fixed assets; and
- to recognise the prepayments for services as part of the balance sheet item „Accrued expenses".

This method of reporting can be extremely helpful in implementing the new approach to foreign currency advances, particularly in view of the setup of most accounting software, which typically automatically translates balances in Group 31 and 32 accounts at the balance sheet rate, whereas balances in Group 38 accounts do not. Similarly, it is not common to automatically translate balances in account classes 0 and 1. Before making any changes to the accounting methodology, we recommend that you conduct a thorough analysis of the appropriateness of the changes and the impact of the changes on your company. We will be happy to help you with this analysis.
For the sake of completeness, we add that if completion of the agreed and backed-up delivery is unlikely (e.g. the supplier announces that it is unable to fulfil the order), then the statements should respond appropriately:

- recognise the advance received from the supplier as a liability and translate the item as of the balance sheet date at the balance sheet rate;
- recognise the advance payment made to the customer as a receivable and translate the item as of the balance sheet date at the balance sheet rate.

The reason for this recognition is the nature of such advances as monetary items that carry foreign exchange risk because they are expected to be settled in cash.

Jiří Pospíšil
jiri.pospisil@bdo.cz

INCREASE IN TURNOVER THRESHOLD FOR TAXPAYER REGISTRATION

On Tuesday, 24 May 2022, the Ecofin Council met in Brussels, where one of the topics discussed was the possibility for the Czech Republic to apply an increased threshold for compulsory VAT registration. The Council decision approved the Czech Republic's request last year for the possibility to increase the VAT exemption turnover threshold to EUR 85,000 earlier than from 1 January 2025, as foreseen in the amendment to the European VAT Directive.

„The EU Council has granted our request for an exemption to apply the previously higher threshold for mandatory VAT registration," Finance Minister Zbyněk Stanjura said. „The Czech legislation increasing this annual threshold to CZK 2 million has already passed the inter-ministerial comment procedure and will now be discussed by the government. According to our proposal, the threshold for the use of the flat-rate tax will also increase to twice as much from next year."

The current turnover threshold for mandatory VAT registration is CZK 1 million. The annual threshold is based on the EUR 35,000 negotiated when the Czech Republic joined the EU in 2004 and has remained unchanged for 18 years despite significant price increases. **The Ministry of Finance expects that approximately 105,000 taxpayers will be newly exempted from VAT. Up to 80,000 of them could actually opt**

out of the VAT system.
What will be the practical impact of this measure? For existing taxpayers who fall below the magic threshold of CZK 2 million there will be a „paradise on earth" (in the petitioner's imagination). When the measure comes into force, taxpayers will cancel their registrations in droves and switch to non-taxpayers. Or is the reality different?
In my opinion, registration will be cancelled mainly by payers who are providers of goods and services to end customers. That is, craftsmen, landlords, traders, etc. They should then keep a close eye on whether they exceed the increased threshold again.
The reason for increasing the turnover threshold for compulsory taxpayer registration is to simplify the obligations of taxpayers. Abolition of the obligation to keep VAT records, issue tax documents, submit monthly tax returns, control reports, etc.
This is undoubtedly a laudable reason. But along with these positives come negatives. Once again, a chasm will open between taxpayers and non-taxpayers, between entities that exceed the turnover threshold by CZK 1 and those that are under it by CZK 1. And that crucial CZK 2 difference is very deceptive. In conjunction with the abolition of electronic sales registration, this measure will lead some tax subjects to try to conceal part of their sales in order not to exceed the increased turnover threshold.
Let me put forward my personal opinion. Wouldn't it be easier to remove the limit for compulsory registration altogether? And to set up the VAT system in such a way that every taxpayer is automatically a VAT payer? And at the same consider whether it would not be more practical to simplify the agenda that accompanies VAT. For example, abolish the obligation to process and submit control reports up to a turnover of CZK 1 million. A further simplification could be to use the exemption enshrined in Article 252 of the Directive, which allows Member States to set a tax period for taxpayers of up to one year. Sweden, for example, has negotiated this derogation so that small and medium-sized enterprises that carry out taxable transactions only in Sweden can apply a simplified regime where they file their tax return three months after the end of the annual tax period for direct taxes. Wouldn't it be easier to level the playing field for all taxable persons while at the same time simplifying the obligations that accompany value added tax?
Personally, I'm all for it.

Igor Pantůček
igor.pantucek@bdo.cz

MARK IN YOUR CALENDARS: EVENTS AND SEMINARS

We have prepared a training on sustainable business. In cooperation with Amazon Web Services and Infor, we have prepared a Business Breakfast on current IT trends. You can also look forward to a seminar in cooperation with the General Financial Directorate and BDO Austria on the topic of transfer pricing for companies operating simultaneously on the Czech and Austrian markets.

SEMINAR: SUSTAINABLE BUSINESS, ESG STRATEGY AND GREEN FINANCE

▶ 23 June 2022

Green Deal for Europe, Fit for 55, taxonomy, NFRD, CSRD, SFRD, ESG... Have you heard these terms before but are not sure what they mean? Would you like to know how these new obligations will affect your business? Are you wondering how to make the most of them for your business? Or would you just like to do business responsibly and are considering what approaches to take? Find out where your business stands in terms of sustainability factors with an ESG rating.

Lecturers
- Lucie Johaníková, Partner
- Stanislav Klika, Head of Risk Advisory Services
- Ondřej Veselovský, CRIF - Czech Credit Bureau

BUSINESS BREAKFAST: THE TREND OF ERP MIGRATION TO THE CLOUD

▶ 4 October 2022

In cooperation with Amazon Web Services and Infor, we have prepared a Business Breakfast on current IT trends. Together we will discuss the benefits and pitfalls of putting ERP systems in the cloud. We will present solutions to minimise the risks of cloud solutions, how to address the main concerns of management, and how to ensure the security and agility of the software. We will summarise what factors not to forget when making a decision and what criteria to consider when selecting ERP in the cloud.

Lecturers
- Tomáš Kubíček, Partner
- Tibor Kolejak, Country Leader Amazon Web Services
- David Zeman, Sales Manager SEE Infor

TRANSFER PRICES IN CZECH-AUSTRIAN BUSINESS

▶ 7 October 2022

In cooperation with the General Financial Directorate and BDO Austria, we have prepared a seminar on transfer pricing for companies operating simultaneously on the Czech and Austrian markets. We will draw your attention to the specifics, differences and requirements for the preparation of transfer pricing documentation in the Czech Republic and Austria. Throughout the lecture we will show examples from practice and our current experience from tax audits in both countries. We will discuss together the impact of the pandemic on comparative profitability analysis. At the same time, we will present recommendations on how to proceed with additional transfer pricing adjustments in related-party transactions, and the possibility of reclaiming tax when it is assessed in the other country.

Lecturers
- Lenka Lopatová, Partner BDO
- Vítězslav Kapoun, General Financial Directorate
- Alexandra Dolezel, BDO Austria
- Tomáš Klíma, Partner BDO
- Josef Klíma, Manager BDO

RECORD AND PRESENTATIONS FROM THE SEMINAR "NEW DEVELOPMENTS IN WHISTLEBLOWER PROTECTION: CURRENT RISKS AND OBLIGATIONS FOR COMPANIES AND THE PUBLIC SECTOR"

Stanislav Klika gave a practical introduction to the issue of whistle-blower protection and new obligations for companies and the public sector.

At the seminar, we discussed why public entities must comply with the Directive as of 17 December 2021 and what obligations they have. We showed you how private sector whistleblowers can make a notification to the Ministry of Justice. And we also presented effective solutions to manage these challenges and minimise the regulatory and reputational risks outlined above.

A video recording of the seminar can be found here.

The presentation from the event can be found here.