

# BDO NEWS

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## EDITORIAL



**D**ear readers,  
All of us are worried about the pandemic right now. We are taking a very responsible approach to the crisis, recognising that we cannot interrupt the work we do for you. Our employees have agreed to work from home, are fully equipped and working remotely, available to you through mobile phones, videoconferencing and e-mail. We are doing everything in our power so you can rely on us.

The Ministry of Finance has taken a number of measures to mitigate the impact of the current situation. The main ones include **exemption from fines for late filing of income tax returns until 1 July 2020, exemption from fines for late filing of tax returns and failure to submit a control report caused by demonstrable reasons related to coronavirus, and replacing checks on compliance with the introduction of the 3rd and 4th wave of EET by the tax administrator's advisory activities.** Up-to-date information can be found at our cooperating law firms [Eversheds Sutherland](#), [HAVEL & PARTNERS](#) and [Šmatlák Legal](#).

We are also following other current topics.

The legislative process of changing the Tax Code has already reached the Senate. You can find out what changes await us in one of the articles of this newsletter. While the United Kingdom has not been a member of the EU for more than a month, there are no changes in value added tax or income tax for the transitional period until 31 December 2020.

Currently in the comment procedure is a draft Income Tax Act, which should introduce a flat-rate tax for self-employed persons with effect from 1 January 2021. The amount is set by the Ministry of Finance in the amount of the minimum levy on health insurance, increased minimum levy on social insurance by 15% and taxes of CZK 100. From 1 May 2020 drinking water will be reclassified from 15% to 10% VAT rate. Drinking water means drinking water supplied to customers via a water supply system pursuant to Act No. 274/2001 Coll., on Water Supply and Sewerage Systems for Public Use. This reduction in the VAT rate also applies to hot water produced from drinking water, but does not apply to hot water, which should be noted when invoicing or claiming a VAT deduction. When providing benefit cards to employees, I recommend reading the conclusions of the meeting of the Coordination Committee of the Chamber of Tax Advisors with the General Financial Directorate, where it was concluded that these cards must be considered as a voucher. Their issuance and the related remuneration do not constitute a financial service or a separate taxable supply provided to employers or employees.

Wishing good health to all,

Michal Daňša  
Partner

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## BDO CZECH REPUBLIC

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

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### OBLIGATION TO NOTIFY THE CONCLUSION OF A CONTRACT GIVING RISE TO A PERMANENT ESTABLISHMENT

**T**he obligation to notify the local tax authority of the conclusion of a contract based on which a foreign company can set up a permanent establishment in the Czech Republic is often a neglected obligation. **However, the Income Tax Act requires that it be fulfilled without delay, and the tax administrator may impose a fine in case of a breach of this obligation. The new guideline of the General Financial Directorate, issued at the end of 2019, deals with the setting up of permanent establishments in more detail.**

The guideline states that **the obligation to announce the conclusion of a contract with a foreign enterprise arises regardless of whether the permanent establishment is actually established in the Czech Republic.** An example is a situation where a foreign enterprise provides services to a Czech company in the Czech Republic where a double tax treaty does not give the Czech Republic the right to withhold tax on remuneration in favour of a foreign service provider. If the remuneration for the services provided in the given calendar month exceeds CZK 100,000, the Czech company is obliged to submit a notice identifying the service provider. The fact that the threshold is very low and will ultimately lead to excessive administrative burdens is already apparent from Annex 12 to the tax returns of a number of our clients. Annex 12 shows on a separate line the volume of services purchased from foreign companies within the group. Reporting the income to these related persons via another form sent to the tax administrator every month is a duplicate fulfilment of the same obligation. It remains to be hoped that the provisions in question will soon be amended and that the threshold will be increased significantly. However, the obligation to notify is not a focal point of the guideline. In particular, the guideline aims to harmonise the procedure for taxing the income of non-resident taxpayers on activities carried out through a permanent establishment, mentioning at the outset the need to respect double taxation treaties, which in many cases contain a completely different wording of Article 5 dealing with the definition and the moment of origin of permanent establishments. **The definition of a permanent establishment in a double taxation treaty is always superior to that in a domestic tax regulation.** The definition under domestic law is relevant only in the case of states with which a double taxation treaty is not concluded.

As for the moment of origin of permanent establishments, it is worth recalling that a permanent establishment does not have legal personality and therefore cannot be established. **A permanent establishment is established at the moment the criteria as defined in the double taxation treaty (or in the domestic regulation if such a treaty does not exist) are met.**

In practice, we most often encounter two types of permanent establishments: a brick and mortar permanent establishment and a service permanent establishment.

A brick and mortar permanent establishment is established when a foreign enterprise begins to use its premises in the Czech Republic, such as offices, halls, workshops or market stalls, regardless of the contractual relationship under which these premises are used by the foreign enterprise.

**The establishment of a service permanent establishment requires the fulfilment of a time test, provided that the provision of the activity is not tied to a specific fixed location.** Interpreting the definition of service permanent establishment raises problems in practice, in particular in relation to older double taxation treaties such as the one with Germany. Here, the definition of a service permanent establishment is completely absent and, therefore, with reference to Article 3 of the Treaty, it is proposed to use the definition of the Income Tax Act as a solution.

As an example of a service permanent establishment, the new guideline mentions the provision of management services, where the posted employees of a foreign parent company provide services to the Czech company in training personnel to produce a new product, and the provision of these services exceeds six months. **Remuneration for management services provided by foreign companies in the group is one of the most frequently examined costs within tax audits.** However, while we have been accustomed to the fact that tax administrators focus only on proving the true scope of services provided, there are more and more cases where the conditions of origin of a permanent establishment have been examined. The reason for the change in the tax administrator's approach is often the amount of profit margin applied when determining the remuneration for management services provided. **If the tax administrator is able to prove that the conditions for the establishment of a service permanent establishment have been fulfilled, the Czech Republic is entitled to tax the income derived from the services provided, as well as the wages of posted employees of a foreign company whose length of stay in the Czech Republic gave rise to a permanent service establishment.** Therefore, I recommend paying careful attention to the conclusion of contracts based on which employees providing management-type services are posted to the Czech Republic and, **for a possible review of tax obligations for 2019, have prepared documents showing the actual scope of activities carried out by posted workers in the Czech Republic for the benefit of the Czech company. This is the only way to obtain reasonable assurance as to whether you have an obligation to report the conclusion of a contract.**

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## INCOME TAX RETURN IN TERMS OF TRANSACTIONS BETWEEN RELATED ENTERPRISES

For six years, companies have reported all related-party transactions in the tax return. The Income Tax Act also requires companies to increase their tax base if they cannot sufficiently substantiate the difference between the negotiated price of such a transaction and the price that would be negotiated between unrelated parties under the same or similar terms.

The burden of proof in this case rests with the company, which must be able to argue that it is a normal price under the given conditions. It is therefore not surprising that these transactions are still subject to controls, which are subject to frequent additional tax assessments. In addition, due to incorrectly set prices, companies also misrepresent the accounting information in the published financial statements.

In May 2019, the Financial Administration issued an updated guideline for the taxation of transactions between related enterprises. The purpose of the guideline is to define the principles of transfer pricing for tax purposes. The guideline recommends testing the economic substance of each transaction, its benefit to the entity and the amount of the agreed price, e.g. based on the arm's length principle.

By processing the comparative and benchmark analysis, you get a **market price range** within which prices for comparable products or services typically fluctuate. The core of the analysis is to find external comparable entities, including their profitability indicators. **And the guideline recommends an annual check to see if there have been significant shifts in profitability and to prepare a new benchmark analysis at least every three years.**

Due to the frequency of controls by tax offices that review transactions between related parties, we recommend negotiating prices with related parties at current or usual prices and obtaining evidence, such as a comparative analysis, processed transfer pricing documentation, expert opinions, market analyses or competitive offers indicating that these are indeed current (i.e. market) prices.

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## WHAT CHANGES CAN BE EXPECTED FROM THE AMENDMENT TO THE TAX CODE?

The Chamber of Deputies approved an amendment to the Tax Code that will bring a number of changes to business. Among others, the amendment aims to promote electronic communication with tax authorities by introducing some incentives, including tax overpayments being refunded 15 days earlier when submitting returns electronically or extension of the deadline for filing income tax returns

by one month. The time limit of six months is maintained for entrepreneurs who are subject to an audit or whose returns are handled by a tax advisor.

The positive changes are:

- ▶ extension of the existing tax information box, making it more transparent;
- ▶ reduction of interest on late payments to a level corresponding to the amount set out in the Civil Code (reduction from the current 16% p.a. by six percentage points to 10%);
- ▶ reduction in interest on the amount retained, which corresponds to half of the default interest (reduction from the current 9% p.a. by four percentage points to 5%);
- ▶ increase of interest by one percentage point to 5% as compensation for long-term retention of excessive deduction;
- ▶ increase in the limit for incurring fines and interest on late payments from the current CZK 200 to CZK 1,000.

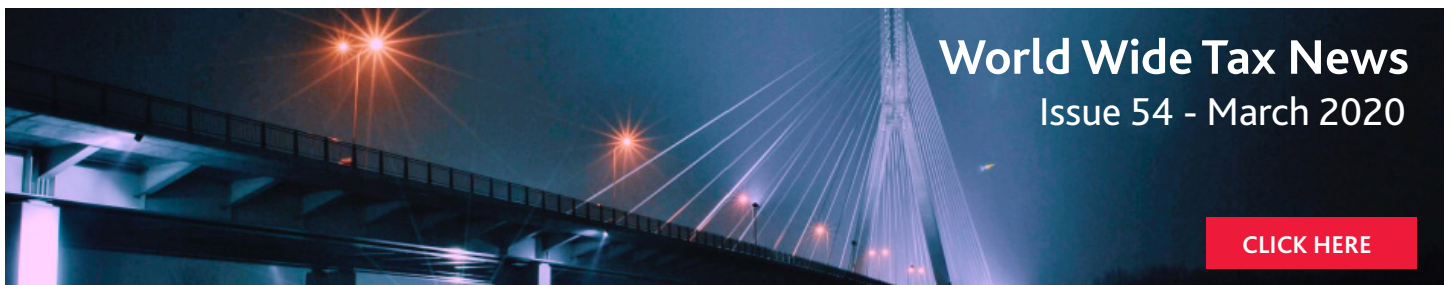
The clearly negative changes are:

- ▶ extension of the deadline for refunding tax overpayments in connection with the introduction of an advance for tax deductions by 15 days;
- ▶ abolishment of the grace period for late payment of four working days, while the grace period of four working days in case of late filing of the tax return remains unchanged;
- ▶ the possibility of the tax administrator to make a visual or audio record of the negotiations without prior notice to the persons participating in them;
- ▶ the possibility, for the avoidance of doubt, to initiate a tax audit, the object and scope of which are not restricted by that purpose;
- ▶ the possibility, subject to certain conditions, to repeat tax audits;
- ▶ the possibility of extending or narrowing the scope of a tax audit during the course of the delivery of a notice of change in the scope of the tax audit.

It is clear from the above that the changes to the Tax Code are not only positive, as the Ministry of Finance seeks to declare in its statements. Interest inequalities continue to exist in the case of errors by state authorities and entrepreneurs, not to mention the negative impact extending the deadline for refunding tax overpayments will have on cash flows. It remains to be seen how the government will apply some of the changes, but I already recommend greater vigilance and attention to protecting your rights.

The amendment to the Tax Code is proposed to take effect on the first day of the second calendar month following its promulgation in the Collection of Laws. This will depend on the course of the legislative process, the amendment having been included in the Senate meeting scheduled for 18 March 2020.

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[CLICK HERE](#)

## BDO HANDBOOK: REACTING TO POTENTIAL BUSINESS CONSEQUENCES OF COVID-19

**W**e have prepared a handbook that will provide you with information necessary to suppress negative influence of the coronavirus crisis on your firm or organization. The handbook provides a comprehensive list of steps to consider in order to circumvent hardships and to ensure the continuity of your business.

[You can access the information here.](#)

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## WEBINAR: HOW TO MAXIMIZE EFFICIENCY WHEN WORKING REMOTELY

**W**e would like to assure you that our goal is to help you and your business pass this difficult time as smoothly and as quickly as possible. As such, we have prepared the first of a series of webinars for you: **How to maximize efficiency when working remotely.** You will:

- ▶ Learn HR best practice for working from home and for managing a team remotely
- ▶ Gain practical advice on how to best communicate, manage your time, manage your workspace, set up necessary work tools and spread positive energy
- ▶ Learn how to remotely use the Teams app (MS Office). The webinar will fully familiarize you with Teams: you will know how to create and edit a team, start a channel, host a video conference, add it to a team's calendar, invite external participants, share your screen and files with others and enable remote access.
- ▶ Find out how to save and edit files on Sharepoint and Onedrive.

The webinar is scheduled for March 31st (Tuesday) at 10AM. You can register for the webinar [here](#).

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