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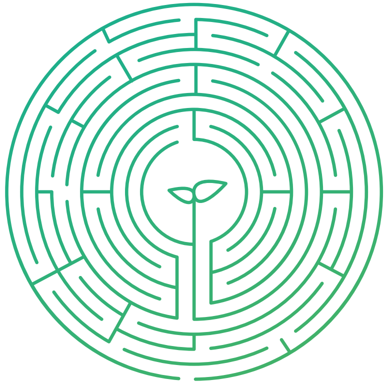
Accounting news
Czech Accounting,
IFRS and US GAAP

Tax news
Direct, indirect
and other taxation

Legal news
Newly proposed
legislative changes



Grants & Incentives news
News from Grants
and incentives area

dReport
Deloitte Czech Republic

March 2018

Deloitte.

Accounting News
Deloitte Czech Republic

March 2018

Amendment to Regulation No. 501/2002 Coll., for Banks and Other Financial Institutions, from 1 January 2018

On 15 December 2017, an amendment to the implementing regulation to the Accounting Act for banks and other financial institutions was published in the Collection of Laws under number 442/2017 Coll.

Main reasons for the amendment

The main reasons for the amendment to Regulation No. 501/2002 Coll., for reporting entities that are banks or other financial institutions (hereinafter the "Regulation Amendment"), were as follows:

- Effectiveness of the new International Financial Reporting Standard adopted for use in the EU – *IFRS 9 Financial Instruments*, which replaces IAS 39 *Financial Instruments: Recognition and Measurement* from 1 January 2018;
- Incorporation of changes brought by Act No. 257/2016 Coll., on Consumer Lending, as amended; and
- Changes of a legislative and technical nature.

Primary changes in the Regulation

The primary changes brought by the Regulation Amendment include:

1. **Presentation, measurement and disclosure of financial instruments**
   A new Section 4a was added, introducing the obligation for reporting entities "to present, measure and disclose information on financial instruments in the notes to the financial statements in line with the international accounting standards adjusted by directly applicable regulations of the European Union on the application of international accounting standards".
   A financial instrument means a financial instrument as per international accounting standards. This therefore means that from 1 January 2018 reporting entities have to present, measure and disclose information on financial instruments in line with the following International Financial Reporting Standard (IFRS):

- **IFRS 9 *Financial Instruments***
  The standard sets out requirements for recognition, measurement, impairment and derecognition of financial assets and financial liabilities and general hedge accounting.
- **IAS 32 *Financial Instruments: Presentation***
  The standard sets out the principles of classification and presentation of financial instruments as debt or equity instruments and for offsetting financial assets and liabilities.
- **IFRS 7 *Financial Instruments: Disclosures***
  The standard defines requirements for disclosures that will enable users of financial statements to evaluate the significance of financial instruments for the reporting entity and to discover the nature and extent of risks arising from financial instruments and the way in which the reporting entity manages these risks.

Accounting news – March 2018

In Financial Bulletin No. 10/2017 of 22 December 2017, the Ministry of Finance issued a communication concerning this extensive change of accounting methods in the area of financial instruments. **The communication of the Ministry of Finance states**: "The reference to IFRS for the purposes of presentation, measurement and disclosure of financial instruments in the notes to the financial statements will ensure that the affected reporting entities will have access to principles and policies for reporting more complicated transactions."

The Communication of the Ministry of Finance also provides a more comprehensible explanation of the transitional guidance included in Article II, paragraph 2 of the Regulation, which provides certain reporting entities with a **three-year transitional period** to ensure a problem-free transition to the new accounting methods and requirements concerning financial standards. The reporting entities which will have to follow IFRS in the area of financial instruments only from 1 January 2021 are:

a. **Securities traders**, organisational branches of a foreign securities trader pursuant to the Act on Capital Market Trading;
b. **Investment companies and investment funds** or branches of a foreign entity that is authorised to manage investment funds or foreign investment funds pursuant to the Act on the Activities of Investment Companies and Investment Funds; and
c. **Pension companies**, participants funds or transformed funds pursuant to the Act on Supplementary Pension Savings.

In line with the communication of the Ministry of Finance the above reporting entities will use Czech Accounting Standards for Financial Institutions as amended as of 1 January 2018.

Reporting entities that cannot use the transitional period in the area of financial instruments (i.e. banks, savings and loan cooperatives, financial holding groups, electronic money institutions and payments institutions) will not use Czech Accounting Standards for Financial Institutions effective as of 1 January 2018 in the area of financial instruments, but instead the directly applicable regulations of the European Union on the application of international accounting standards in line with Section 4a of the Regulation.

Accounting news – March 2018

A number of changes to the Regulation also follow from the fact that IFRS 9 categorises financial assets differently from the previous standard IAS 39. Financial assets are now classified as measured at amortised cost, at fair value through equity and at fair value through profit or loss.

2. Cash flow statement

Section 3 of the Regulation adds the obligation to prepare the cash flow statement, which already follows from Section 18 (2) of the Accounting Act. Pursuant to the Act, this obligation applies only to medium-sized and large reporting entities, but it does not concern public interest entities (banks, savings and loan cooperatives, insurance companies, pension companies and health insurance companies).

Entities are newly required to prepare the cash flow statement with an adequate application of Regulation No. 500/2002 Coll., for Businesses.

3. Cancellation of extraordinary income and expenses

The profit and loss account items 'Extraordinary income' and 'Extraordinary expenses' have been cancelled.

The Regulation Amendment also fine--tunes certain other provisions in a legislative and technical respect, which will not lead to any significant changes in practice.

The Regulation Amendment came into force on 1 January 2018 and it will apply for reporting periods beginning on or after 1 January 2018.

The full text of Regulation No. 501/2002 Coll. can be found here.

Amendment to Czech Accounting Standards

Following the Regulation Amendment, on 22 December 2017 the Financial Bulletin published **changes to Czech Accounting Standards** for reporting entities maintaining accounting records under Regulation No. 501/2002 Coll., effective from 1 January 2018.

The main change is that form 1 January 2018 CAS Nos. 108 Securities and 110 Derivatives will not be used by banks, savings and loan cooperatives, securities traders, financial holding groups, electronic money institutions and payments institutions.

The full text of the changes in Czech Accounting Standards for Banks and Other Financial Institutions can be found here.

Czech Accounting

- Amendment to Regulation No. 501/2002 Coll., for Banks and Other Financial Institutions, from 1 January 2018
- Amendment to Regulation No. 502/2002 Coll., for Insurance Companies, from 1 January 2018

IFRS

- The IASB issued amendments to IAS 19 regarding plan amendments, curtailments, and settlements
- Annual Improvements to IFRSs (cycle 2014-2016) endorsed for use in the EU
- IFRS EU Endorsement Process

US GAAP

- The FASB clarifies the application of the new leasing standard to land easements

How we can help you

The amendment to Regulation No. 501/2002 Coll., for Banks and Other Financial Institutions, and the newly introduced obligation to follow IFRS in the area of financial instruments will entail an extensive and difficult change for many reporting entities.

In this respect Deloitte can offer you:

- English-language publications at www.iasplus.com;
- Consultations with Deloitte experts concerning the specific impacts of IFRS 9 on your reporting entity;
- dReport articles addressing this topic;
- Assistance during the implementation of the requirements set by this new standard; and
- Seminars on IFRS 9 *Financial instruments*.

If you would like to find out more about our advisory services, please contact David Jurčík (djurcik@deloitteCE.com).

Amendment to Regulation No. 502/2002 Coll., for Insurance Companies, from 1 January 2018

On 15 December 2017, an amendment to the implementing regulation to the Accounting Act for insurance companies was published in the Collection of Laws under number 443/2017 Coll.

The main reasons for the amendment to Regulation No. 502/2002 Coll., for reporting entities that are insurance companies (hereinafter the “Regulation Amendment”), were as follows:

- Effectiveness of the new International Financial Reporting Standard adopted for use in the EU – IFRS 9 *Financial Instruments*, which replaces IAS 39 *Financial Instruments: Recognition and Measurement* from 1 January 2018;
- Terminology adjustments related to the amendment to Act No. 277/2009 Coll., on Insurance, as amended; and
- Changes of a legislative and technical nature in response to changes in other legal regulations.

We believe that the most important change from the perspective of insurance companies is the inclusion of a new paragraph 6 in Section 3, which stipulates that for the purposes of presentation, measurement and disclosure of information in the notes to the financial statements regarding securities, equity investments and derivatives and transactions with them, a reporting entity should apply the provisions of Regulation No. 501/2002 Coll., for Banks and Other Financial Institutions, as amended as of **31 December 2017**. This is because the amendment to the Regulation for Banks as of 1 January 2018 eliminates the previous provisions and refers to IFRS 9 *Financial Instruments* for the presentation of financial instruments, their measurement and disclosure. The maintenance of the current approach to securities, equity investments and derivatives will mean a significant simplification for insurance companies as they will not have to transition to IFRS 9 in the area of financial instruments.

The Regulation Amendment came into force on 1 January 2018 and it will apply for reporting periods beginning on or after 1 January 2018.

The full text of Regulation No. 502/2002 Coll. can be found here.

Following the Regulation Amendment, on 22 December 2017 the Financial Bulletin published **changes to Czech Accounting Standards** for reporting entities maintaining accounting records under Regulation No. 502/2002 Coll., effective from 1 January 2018.

The full text of changes in Czech Accounting Standards for Insurance Companies can be found here.

The IASB issued amendments to IAS 19 regarding plan amendments, curtailments, and settlements

On 7 February 2018, the International Accounting Standards Board (IASB) published 'Plan Amendment, Curtailment or Settlement (Amendments to IAS 19)' thus finalising one of two issues relating to IAS 19 submitted to the IFRS Interpre--tations Committee and exposed together in June 2015.

Background

In June 2015, the IASB published ED/2015/5 *Remeasurement on a Plan Amendment, Curtailment or Settlement/Availability of a Refund from a Defined Benefit Plan (Proposed amendments to IAS 19 and IFRIC 14)* combining two issues submitted separately to the IFRS Interpretations Committee into a single package of narrow--scope amendments to IAS 19 *Employee Benefits and IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction.*

However, in April 2017 the IASB decided to pursue the amendments to IAS 19 and in September 2017 it confirmed it would do so despite putting off the amendments to IFRIC 14. Although exposed together, the IAS 19 amendments are unrelated to the IFRIC 14 amendments.

Changes

IAS 19 *Employee Benefits* specifies how a company accounts for a defined benefit plan. When a change to a plan–an amendment, curtailment or settlement–takes place, IAS 19 requires a company to remeasure its net defined benefit liability or asset.

Plan Amendment, Curtailment or Settlement (Amendments to IAS 19) specifies how companies determine pension expenses when changes to a defined benefit pension plan occur.

The amendments require a company to use the updated assumptions from this remeasurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. Until now, IAS 19 did not specify how to determine these expenses for the period after the change to the plan. By requiring the use of updated assumptions, the amendments are expected to provide useful information to users of financial statements.

Effective date and transition requirements

An entity applies the amendments to plan amendments, curtailments or settlements occurring on or after the beginning of the first annual reporting period that begins on or after **1 January 2019**. Early application is permitted but must be disclosed.

Source: www.iasplus.com

Annual Improvements to IFRSs (cycle 2014–2016) endorsed for use in the EU

On 8 February 2018, the European Commission endorsed the Annual Improvements (cycle 2014 – 2016) for use in the EU.

The Annual Improvements include amendments to three IFRSs, which have been summarised below.

Standard	Subject of amendment	Details
IFRS 1 *First-time Adoption of IFRSs*	Deletion of short-term exemptions for first-time adopters	The amendments delete certain short-term exemptions in IFRS 1 because the reporting period to which the exemptions applied have already passed. As such, these exemptions are no longer applicable.
IFRS 12 *Disclosure of Interests in Other Entities*	Clarification of the scope of the standard	Clarified the scope of the standard by specifying that the disclosure requirements in the standard, except for those in paragraphs B10–B16, apply to an entity's interests listed in paragraph 5 that are classified as held for sale, as held for distribution or as discontinued operations in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations.*
IAS 28 *Investments in Associates and Joint Ventures*	Measuring an associate or joint venture at fair value	The amendments clarify that the option for a venture capital organisation and other similar entities to measure investments in associates and joint ventures at FVTPL is available separately for each associate or joint venture, and that election should be made at initial recognition of the associate or joint venture. In respect of the option for an entity that is not an investment entity (IE) to retain the fair value measurement applied by its associates and joint ventures that are IEs when applying the equity method, the amendments make a similar clarification that this choice is available for each IE associate or IE joint venture. The amendments apply retrospectively with earlier application permitted.

Amendments to IFRS 12 are effective for annual periods beginning on or after **1 January 2017**.
Amendments to IFRS 1 and IAS 28 are effective for annual periods beginning on or after **1 January 2018**.

Accounting news – March 2018

IFRS EU Endorsement Process

The European Financial Reporting Advisory Group (EFRAG) updated its report showing the status of endorsement of each IFRS, including standards, interpretations, and amendments, most recently on 8 February 2018.

As of 20 February 2018, the following IASB pronouncements are awaiting European Commission endorsement for use in the EU:

Standards

- IFRS 14 *Regulatory Deferral Accounts* (issued in January 2014) – the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard
- IFRS 17 *Insurance contracts* (issued in May 2017)

Amendments

- Amendments to IFRS 2 *Classification and Measurement of Share-based Payment Transactions* (issued in June 2016)
- Amendments to IFRS 9 *Prepayment Features with Negative Compensation* (issued in October 2017)
- Amendments to IFRS 10 and IAS 28 *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (issued in September 2014)
- Amendments to IAS 19 *Plan Amendment, Curtailment or Settlement* (issued in February 2018)
- Amendments to IAS 28 *Long-term Interests in Associates and Joint Ventures* (issued in October 2017)
- Amendments to IAS 40 *Transfers of Investment Property* (issued in December 2016)
- *Annual Improvements to IFRS Standards 2015–2017 Cycle (issued in December 2017)*

Interpretation

- IFRIC 22 *Foreign Currency Transactions and Advance Consideration* (issued in December 2016)
- IFRIC 23 *Uncertainty over Income Tax Treatments* (issued in June 2017)

Click here for the Endorsement Status Report.

The FASB clarifies the application of the new leasing standard to land easements

On 25 January 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2018-01, "Land Easement Practical Expedient for Transition to Topic 842" that clarifies the application of the new leases guidance to land easements and eases adoption efforts for some land easements.

Background

On 25 February 2016, the FASB issued Accounting Standards Update No. 201602, Leases (Topic 842), to increase transparency and comparability among organisations by recognising lease assets and lease liabilities on the balance sheet and disclosing key information about leasing transactions.

In connection with the FASB's transition support efforts, a number of stakeholders inquired about the application of the new lease requirements in Topic 842 to land easements.

Land easements (also commonly referred to as rights of way) represent the right to use, access, or cross another entity's land for a specified purpose. Land easements are used by utility and telecommunications companies, for example, when they need to take a small strip of land–or easement–to bury wires. Not all companies have historically accounted for them as leases.

Stakeholders pointed out that the requirement to evaluate all old and existing land easements–sometimes numbering in the tens of thousands–to determine if they meet the definition of a lease under the new standard could be very costly. They also noted there would be limited benefit to applying this requirement, as many of their land easements would not meet the definition of a lease–or, even if they met that definition, many of their easements are prepaid and, therefore, already are recognised on the balance sheet.

Scope of the ASU

The amendments in this ASU affect entities with land easements that exist or expired before an entity's adoption of Topic 842, provided that the entity does not account for those land easements as leases under Topic 840.

Main provisions of the ASU

- The amendments in this ASU permit an entity to elect an optional transition practical expedient not to evaluate under Topic 842 land easements that exist or expired before the entity's adoption of Topic 842 and that were not previously

Accounting news – March 2018

accounted for as leases under Topic 840. An entity that elects this practical expedient should apply the practical expedient consistently to all of its existing or expired land easements that were not previously accounted for as leases under Topic 840.

- Once an entity adopts Topic 842, it should apply that Topic prospectively to all new (or modified) land easements to determine whether the arrangement should be accounted for as a lease.
- An entity that does not elect this practical expedient should evaluate all existing or expired land easements in connection with the adoption of the new lease requirements in Topic 842 to assess whether they meet the definition of a lease. An entity should continue to apply its current accounting policy for accounting for land easements that existed before the entity's adoption of Topic 842. For example, if an entity currently accounts for certain land easements as leases under Topic 840, it should continue to account for those land easements as leases before its adoption of Topic 842.
- This ASU also amends Example 10 of Subtopic 350-30, Intangibles–Goodwill and Other–General Intangibles Other Than Goodwill.

Effective dates

The amendments in this ASU affect the amendments in Update 2016-02, which are not yet effective but may be early adopted, and Example 10 of Subtopic 35030. The effective date and transition requirements for the amendments are the same as the effective date and transition requirements in Update 2016-02. An entity that early adopted Topic 842 should apply the amendments in this Update upon issuance.

The new ASU is available here.

Sources: www.iasplus.com
www.FASB.org

Accounting news – March 2018

Contact

Should you have any questions regarding the matters outlined in this publication, please reach out to your contact person from Deloitte's Audit function, Deloitte's technical desk at CZ_TechnicalDesk@deloittece.com or one of the following specialists:

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Tax news

Deloitte Czech Republic

March 2018

The Proposed Amendment to the ITA Brings Changes for Both Legal Entities and Individuals

The Ministry of Finance has released a proposed amendment to the Income Taxes Act (the "ITA") for consultation, through which the new anti-tax avoidance principles arising from the ATAD Directive (Council Directive EU 2016/1164 of 12 July 2017) should be implemented, including the abolition of the "super-gross salary" and the "solidarity tax surcharge", while, at the same time, increasing the personal income tax rate.

In addition to the changes for legal entities and individuals described below, all payers should be subject to the new anti-abuse rule (or general anti-abuse rule), currently only inferred by the judicature in certain cases. According to the amendment, the Tax Code should specifically provide for the procedure in situations where the main, or one of the main, aims of the transaction is to generate a tax or another benefit in breach of the letter and spirit of the law. We will analyse this topic in more detail in next issues of dReport.

I. Changes for Legal Entities

Over the last year, we gradually informed you of the rather substantial changes that are expected to be implemented in the ITA for legal entities by the end of 2018. The new taxation principles primarily affecting large companies with cross-border operations are based on the ATAD. The Directive stipulates five anti-tax avoidance measures: the interest limitation rule, exit taxation, general anti-abuse rule, controlled foreign company rules, and hybrid mismatches. The ATAD implementation deadline is 31 December 2018; therefore, the proposed amendment to the Income Taxes Act must become effective on 1 January 2019, at the latest (except for the exit taxation and hybrid mismatches rules, in respect of which the implementation period is extended until the end of 2019, or 2021 for 'reverse hybrid mismatches').

Limitation of the Deductibility of Borrowing Costs

The new rules limiting the tax deductibility of financial expenses as stipulated by the Directive should generally affect **all companies (except for financial businesses and other than group entities)** and all loans, ie including group loans as well as loans from banks and other entities.

What procedure will be applied to calculation under the new rules? According to the proposed amendment, the payer will firstly determine non-tax deductible financial expenses arising from the general rules (costs related to the holding of an interest in a subsidiary, costs of financial instruments in respect of which the interest is based on the debtor's profit, and costs in excess of the thin capitalisation limit). In the next step, the payer will determine excessive borrowing costs (hereinafter "EBC" for the sake of simplification), which, to put it simply, represent the difference by which borrowing costs (arising from all loans – ie from group loans as well as loans from third parties) exceed interest income. The difference will be subsequently compared to the de minimis value. The Directive makes it possible to set the exemption threshold (the tax deductibility of total annual EBC) in the maximum amount of EUR 3 million, with the proposed amendment retaining the threshold (or, to be precise, retranslating it to CZK 80 million). Therefore, if the payer meets the EBC threshold, they will not need to deal with anything else. Otherwise, they will have to calculate the tax deductibility limit from EBC, which is determined as 30% of the 'tax EBITDA' value (which is, in essence, based on the difference between taxable income and tax-deductible expenses to which the applied tax depreciation charges and EBC are added). EBC will be tax-deductible up to the 30% threshold, and any excess amount will represent a non-tax deductible expense in the given taxation period. However, it will be possible to record the amount and carry it over to the subsequent taxation periods as a tax-deductible item.

Please note that the EBC calculation method applies a definition of financial expenses other than the one that is customary in the existing practice: for example, it also includes the values of capitalised costs in balance sheet items or interest on finance leases.

Controlled Foreign Company (CFC) Rule

The ITA amendment proposal implements the rule by using a fiction according to which the performances of a controlled foreign company giving rise to taxable income are regarded as if they had been generated by the controlling entity in the Czech Republic, provided the controlled foreign company i) does not perform significant economic activities (using staff, equipment, assets and premises); and ii) is subject to a foreign tax liability that is lower than half of the tax liability to which it would be subject in the Czech Republic.

Controlled foreign companies are entities in whose capital a Czech entity holds a direct or indirect interest of more than 50%.

Exit Taxation

The substance of the measure is the taxation of the market value of the payer's assets in relocating the assets abroad without changing the ownership structure in the country from which it was relocated (a de-facto fictitious "profit from sale" without any sale). The payer may utilise the net book value of the assets as a tax-deductible expense in respect of the "fictitious income" determined based on the market value of the relocated assets. The proposed amendment introduces (taking into account the relevant provisions of the ATAD) the deferral of tax, or apportionment of the tax payment to instalments, which should comply with the Tax Code.

Hybrid Mismatches

Hybrid mismatches occur in situations where double non-taxation applies as for example expenses are deducted twice in different countries, or income is not taxed, or a combination of both. The aim is to prevent these mismatches: "non--taxation" occurring as a result of hybrid mismatches is preferentially addressed by applying the primary defensive rule (ie, for example, by not allowing a tax deduction if the income is tax-exempt in the other country). If the rule is not enforced, the other country should apply the secondary defensive rule (to tax the relevant income in the given case).

II. Changes for Individuals

With effect from 1 January 2019, the proposal should abolish the super-gross salary, or the inclusion of insurance premiums paid by the employer in the tax base of individuals' income from dependent activities. Employees' tax bases should newly only consist of their gross income. The proposal will additionally abolish the solidarity tax surcharge, which complicated the calculation of tax in respect of persons with higher income.

However, the tax rate will increase. Instead of the existing 15% rate, two rates will be introduced: 19% for income of up to CZK 1.5 million a year, and 24% for income in excess of the threshold.

Employees with lower income will, in effect, see a 1.1% decrease in taxation (19% as opposed to the existing 20.1% effective tax rate), with higher taxation applicable to persons with rental income and persons with other income (these were only subject to a 15% tax rate following the deduction of expenses).

Entrepreneurs and other entities with income from independent activities will be compensated for the increased tax rate by the possibility to deduct three quarters of the social security and health insurance contributions made on top of standard expenses (actual or flat-rate expense charge-offs). In theory, their taxation should remain substantially unchanged thanks to the deduction; however, tax calculation and related administration will become more complicated for them. We will discuss this topic in more detail on our regular webcast.

The amendment may be expected to be modified both during consultation and during the subsequent debate in Parliament. We will keep you informed about further developments.

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A Change in the Treatment of Tax Exemption of Income from Royalty and Interest Payments?

In late January, an important ruling of the Supreme Administrative Court (SAC) was issued under Ref. No. 3 Afs 250/2016. The ruling is related to tax exemption of income from royalty payments and interest on a debt financing instrument.

The common system of taxation applicable to interest and royalty payments made between associated companies of different Member States has been introduced by the European Union by way of Council Directive 2003/49/EC (Directive). The Czech Republic implemented this system into its national tax legislation by way of the provision under Section 38 (nb) of Act 586/1992 Coll., on Income Taxes (ITA).

The subject of the assessed case was a negative ruling passed by the Tax Administrator in terms of acknowledging the tax exemption of income from interest on a debt financial instrument for 2011 and 2012 based on an application filed by the taxable entity in July 2013. According to the Tax Authority, and as later confirmed by the Appellate Financial Directorate, the application for tax exemption could not be approved due to the fact that it was filed too late. In terms of the late filing, the authorities stated that a critical precondition to utilise a tax exemption is to obtain a resolution of a constitutive nature. In other words, this means that tax exemptions may be utilised no sooner than after the issuance of the relevant tax exemption resolution, ie not backwards.

In its appeal, the taxable entity principally referred to the Directive as such, which stipulates that if the taxable entity's company withholds tax at source in a case in which tax exemption should be used, an **entitlement arises for the taxable entity to seek the refund of the tax withheld in this way, within a period of at least two years from the date on which the interest and royalty payments were made (if the tax exemption preconditions have been de facto met)**. Given that in the Czech Republic, tax exemptions depend on the issuance of a resolution under Section 38 (nb) of the ITA, the two-year period for refunding withheld taxes may be connected with the point at which the application for tax exemption was filed.

The SAC upheld this opinion of the taxable entity and stated that the importance of decisions on tax exemption lies in the authoritative confirmation of matters based on which the entitlement to tax exemption originates and the fulfilment of which is required in order to achieve the exemption of interest from withholding tax.

Do not hesitate to contact us if the new ruling of the SAC affects you directly. We will be happy to discuss with you in detail the ruling and the alternatives of its application in your case.

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A New Form of the TP Attachment to the Corporate Income Tax Return

Since 2014, taxable entities that meet specific criteria have been obliged to fill in an appendix to the corporate income tax return related to intercompany transactions. Also due to this measure, transfer prices have attracted the attention of the tax administration more significantly. The taxable entity is supposed to fill it in, if it meets at least one of the following criteria: the entity owns assets of at least CZK 40 million; the entity generates turnover exceeding CZK 80 million; the entity's average recalculated headcount equals 50 and, simultaneously, the entity performed a transaction with a related entity abroad, incurred a loss or was granted a promise for investment incentives and, simultaneously, performed a transaction with a related party. In short, these are the preconditions indicating that the taxable entity is obliged to inform the tax administration on its intercompany transactions in detail.

In 2018, the tax administration has issued a new form of the attachment that is to be filled in already for the 2017 reporting period. The attachment has been extended to include additional lines, specifically in Table B where, for the first time, the costs and income from rents will be filled in (Line 4), and in Table C, where the taxable entity will newly indicate whether it provided or received any financial or bank guarantees.

The obligation to file the transfer pricing attachment will newly apply to financial institutions It is still valid that the attachment is not to be filled in by the permanent establishment of tax non-residents.
All details necessary for the preparation of the attachment to the tax return are described in the instructions provided for the filling of Item 12, Part I of the corporate income tax return.

For more information on intercompany transactions, do not hesitate to contact our transfer pricing team.

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New Transfer Pricing Reporting Duty for Financial Institutions

Financial institutions are newly requested to file the transfer pricing appendix to the corporate income tax return already for FY 2017.

So far an exception from the obligation to file the Appendix to the tax return applied, among others, to the following types of companies:

- Banks;
- Savings and credit associations;
- Insurance and reinsurance companies;
- Investment fund administrators including investment funds administered by them, if the funds lack legal personality;
- Investment funds, investment fund depositories, and major investment fund sponsors; and
- Pension companies including all funds administered by them, including transformed funds through which pension companies provide additional pension insurance.

Starting from FY 2017 the exception for the above mentioned financial institutions will not apply, if meeting the general criteria (please see the previous article for the details).

The Appendix includes an overview of the intercompany transactions performed with respect to sale and purchase of assets, mutually-provided intercompany services and other intangible supplies, financial transactions and overview of payables/receivables. Contrarily to other entities, certain exceptions apply to financial institutions, such as not having to complete several specific items such as the sales and purchases of material, products and goods (Line 4 in Table A), the use of cash-pooling (Line 6 in in Table C) and short-term payables and receivables (Lines 3,4 in Table D).

The latest Appendix version for FY 2017 including the completion instructions is available under the following link: http://www.financnisprava.cz/assets/tiskopisy/5404-E_4.pdf?201801051300

As the practice over the years during which the Taxation Authority has been using the Appendix to the tax return has shown, the information gained on intercompany transactions has become an integral part of the process in selecting entities for tax audits focused on transfer pricing issues. As expected, the Taxation Authority performs a risk analysis of companies based on the data received. In combination with publicly-available sources and information from prior tax proceedings, the analysis helps the Taxation Authority to gain initial insight into a company's position within a group, and thus to define more particularly the areas of closer scrutiny. Since 2014, we have seen a series of "waves" of initiated tax proceedings, both in the form of local inspections and tax audits, the subject of which was principally transfer pricing. As such, it can be anticipated that now this wave will also concern financial institutions, which are centrally administered by the Specialised Tax Office.

In addition, we noted that starting from 2018, the Taxation Authority plans to complement the information gained from local resources by data gained through the international exchange of information, specifically from Country-by-Country Reports. As such, in addition to information on particular Czech companies' activities, Country-by-Country reports provide an overview of how multinational groups of companies work as a whole from the global perspective. Among other things, these reports highlight the locations in which groups operate, what particular activities are performed in individual countries, where major profits are generated, what the group actual taxation is in individual countries, and the like. In this way, for the first time the Czech Taxation Authority will be able to assess information on particular taxable entities, which was only unilateral so far, in the context of the whole multinational group's operations. The degree to which the Taxation Authorities succeed in combining the data resources and what particular impact this will have on taxable entities will show in the coming years.

For more information on intercompany transactions, do not hesitate to contact our Transfer Pricing Team.

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Upcoming Amendment to the VAT Act

The Czech Ministry of Finance has presented the first proposed amendment to the VAT Act, which should (barring exceptions) become effective on 1 January 2019. The amendment is set to fully revise the rules for correcting the tax base or the possibility of decreasing VAT in respect of irrecoverable receivables. It introduces special treatment for taxing vouchers for the purchase of goods/services, thereby transposing the relevant EU Directive. Additional transposition of EU rules includes the implementation of new processes for services provided electronically to non--taxable entities. The changes should also specifically affect the financial sector (a new definition of finance leases, application of exemptions to independent groups of entities) and the real estate industry (inclusion of certain work on the property in the compulsory/voluntary adjustment of tax deductions, impossibility of imposing tax on premises rented for housing purposes). Furthermore, the changes with general implications include a stricter approach to issuing tax documents and their delivery.

At present, comments on the amendment to the VAT Act made by experts as well as non-specialists are being processed. The Czech Ministry of Finance should subsequently address these and submit the amendment for the subsequent legislative process.

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Supreme Administrative Court Ruling on the Rejection of a Tax Deduction Claim

In its recent ruling 5 Afs 60/2017, the Supreme Administrative Court addressed the possibility of rejecting a tax deduction claim made by a payer in a situation where the supplier declared the relevant tax, yet the subcontractor failed to pay VAT at the very beginning of the entire business chain. The ruling has been recently referred to by the media as ground-breaking as, in certain cases, it benefits the fact that the tax administrator is generally unable to reject the tax deduction at all if VAT was not paid by an indirect, rather than direct, business partner. This would, indeed, be a revolutionary assertion. Nevertheless, the Court has not stated any such thing: it merely rejected the tax administrator's assertions that the payer was demonstrably aware of the failure to pay tax, or should have and could have been aware of it. The other sub--comments made by the court in relation to individual "errors" on the part of the payer are quite apt, yet in no way innovative: they merely uncover the fact that the tax administrator's actions were entirely mistaken and rash and do not in any way advance the view on the issue of proving participation in tax fraud. Nevertheless, we **consider this ruling to be of great use and it will surely be a convenient means of protecting tax payers' rights**.

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Further EET Developments

Following its ruling of 12 December 2017, the Constitutional Court revoked the implementation of the electronic sales records ('EET') in the two remaining phases which were to affect the vast majority of sales of services (e.g. freelancers, agriculture) and the sales generated by craftsmen and producers. In addition, the court cancelled the EET obligation in respect of sales set out in Section 5 b) of the EET Act, i.e. a taxpayer's sales that are realised by way of a cash-free transfer of money which is ordered to take place by the payer through the recipient who is the taxpayer charged with recording the sales. The reason for this cancellation relates to the fact that those payments leave an electronic trace both with the bank and operator of the payment cards system and the trader, and hence recording the sales under the EET Act serves no useful purpose. In practical terms, this means that starting from 1 March 2018, it will not be required to record sales made in a way other than in cash, check, bill of exchange and similar forms. The taxpayer is not obliged to record sales received subsequent to 28 February 2018, for example, by payment cards or through payPal, PayU, etc. However, as confirmed by the Ministry of Finance, taxpayers may record the sales voluntarily. It also applies that after 28 February 2018, the receipt no longer needs to indicate the taxpayer's tax ID (or the tax ID of the authorising taxpayer) if the taxpayer is an individual/physical person. This information will continue to be sent as part of the data message of the recorded sales.

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The Tax Administration Released a List of Countries to Exchange CbC Reports with the Czech Republic

In Financial Bulletin No. 2/2018 of 31 January 2018, the Czech Tax Administration released a list of countries that will be exchanging Country-by--Country Reports (the "CbCR") with the Czech Republic. The announced list will gradually be updated following other jurisdictions joining the CbCR exchange system with the Czech Republic; this update will also be published in the Financial Bulletin.

With the Amendment to the Act on International Cooperation in Tax Administration, a new reporting obligation as part of the international exchange of information, so called Country-by-Country Reporting, was introduced in the Czech Republic. This obliges groups of companies with consolidated global income exceeding EUR 750 million to present to the respective tax administration the CbCR on an annual basis, summarising financial information on the group. The obligation to prepare the CbCR, which is subsequently subject to an automatic exchange of information between the individual countries, for the entire group of companies applies to:

- **The ultimate parent company**; or
- **A surrogate parent entity** (ie an entity that was assigned to prepare the CbCR by the group eg because the ultimate parent company is not obliged to prepare the CbCR in its country or the country is not included in the CbCR automatic exchange – refer to the list of jurisdictions published); or
- **A Czech member company** in case the ultimate parent company or the surrogate parent entity have their seat in a country mentioned above.

On 31 January 2018, the Czech Ministry of Finance published a long-awaited **list of jurisdictions with which the automatic exchange of information is active for the Czech Republic.** The list is available at http://www.mfcr.cz/cs/legislativa/mezinarodni-spoluprace-v-oblasti-dani/umluva-o-vzajemne-spravni-spolupraci--mca/mnohostranna-dohoda-cbcr. Except for the countries on this list, the exchange of the CbCR automatically takes place in the European Union. The first automatic exchange of the CbCRs between these countries will take place in June 2018.

In most cases, Czech companies obliged to comply with Country-by-Country Reporting have already had to notify to the Czech Tax Administration on who will be filing the CbCR for the group for the reporting period beginning after 1 January 2016. Given that the Czech Tax Administration has not published the list of countries included in the automatic exchange of information until now, Czech companies may have **indicated incorrect** data in the CbC notification. Should a company find out that a respective country is not included in the newly published list and this change affects the facts stated in the already filed CbC notification, the change of data is to be reported in a **notification of a change**. The notification of a change is again to be filed to the Specialised Taxation Office electronically via the EPO tax portal on a specific form and in the form's letterhead, the option **"Change of data"** is to be ticked.

In case eg a Czech entity has already notified that the CbCR will be filed by the ultimate parent company with its seat in a country which is not listed under the jurisdictions obliged to exchange the CbCR (for reporting periods beginning on 1 January 2016 and later), **amended data** are to be disclosed in the notification of a change, ie:

- In case the CbCR for the group will be filed by a **surrogate parent entity** from the published list of countries exchanging the CbCRs, the Czech entity is to provide its data and the respective taxation period for which the CbCR will be filed for the first time.
- In case no surrogate entity was established, the **Czech entity is to be stated** as the entity **obliged to prepare the CbCR** for the group. Based on transitional guidance, in this case, the first reporting period to be reported is a reporting period beginning on 1 January 2017 or later.

n case the country where the ultimate parent company filing the CbCR (or the surrogate entity) is seated shows up on an updated list of jurisdictions complying with the CbCR automatic exchange, it will again be possible to file a notification of a change and present these facts.

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Amendment to the Double Tax Treaty with Chile

In its Financial Bulletin, the Ministry of Finance has issued Information on the Practical Application of Article 11 of the Double Tax Treaty between the Czech Republic and the Republic of Chile ("DTT").

Article 11 (7) of the DTT between the Czech Republic and the Republic of Chile contains what is referred to as the 'most--favoured-nation clause'. Therefore, if one of the contracting parties subsequently concludes a double tax treaty with a different state under more favourable terms, the relevant advantages will also apply to the former treaty. Following the conclusion of the DTT between Chile and Japan, which contains more favourable provisions on interest payments, these will also apply to the interest paid among Czech and Chilean residents provided all the conditions stipulated are met.

Therefore, from 1 January 2017 onwards, for the purposes of Article 11 (2) of the DTT between the Czech Republic and the Republic of Chile, a 4% rate, instead of the original 5% rate, will apply if all the conditions stipulated are met (eg in respect of payments to banks, insurance companies etc). If interest had already been taxed in 2017 in the source country in breach of the above stated rules, the beneficial owner of interest is entitled to seek a refund of the tax paid so that the tax liability in the source country of income complies with the above stated rules.

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News round-up BEPS

New members for BEPS inclusive framework

The Bahamas, Mongolia and Zambia have joined the inclusive framework for the global implementation of the BEPS project, bringing the number of participating jurisdictions to 111. The whole list of participating jurisdictions is available here.

Action 13: Transfer Pricing Documentation and Country-by-Country Reporting

Finland – On 19 December 2017, the Ministry of Finance announced that the government had approved a notice under the OECD Automatic Exchange of Information Agreement (2014) (MCAA) that Finland is willing to exchange country-by-country (CbC) reports with other willing jurisdictions for earlier tax periods than set out under the MCAA.

Hong Kong – The government of Hong Kong has released the text of a bill that would amend the Inland Revenue Ordinance to codify the arm's-length principle and comply with the minimum standards for participation in the base erosion and profit-shifting project's inclusive framework. Under the "fundamental rule" proposed by the bill, profit or loss of an enterprise or permanent establishment will be adjusted if related-party transactions result in a tax advantage and their price or terms differ from what would have been agreed to by unrelated parties. Although Hong Kong currently has no domestic legislation adopting the arm's-length principle or transfer pricing methods, Hong Kong's bilateral treaties and the Inland Revenue Department's administrative guidance follow OECD standards, the legislative council brief says.

China – On 19 December 2017, the State Administration of Taxation (SAT) issued a public notice clarifying CbC reporting related issues. According to the notice, Articles 7 and 8 of Public Notice 42 on Filing Related Party Transactions and Administration of Contemporaneous Transfer Pricing Documentation do not apply to CbC reporting for 2016. Under Article 7 of Public Notice 42, the Chinese tax authority may, on the basis of treaties, agreements or arrangements, exchange CbC reports with other jurisdictions, whereas Article 8 requires certain categories of multinational enterprises that do not meet the CbC reporting threshold to submit CbC reports if they have not submitted CbC reports to any tax jurisdiction, or submitted CbC reports to a tax jurisdiction with which China does not have an exchange of information mechanism, or the other jurisdiction has never exchanged the CbC report with China despite the existence of an exchange of information mechanism.

Portugal – Order No. 383-A/2017 approves form 55, the official financial and fiscal CBC reporting form, which must be submitted electronically, preferably in the XML format, within 12 months after the end of each concerned fiscal year. However, for fiscal year 2016, this deadline is extended for another 2 months (i.e. until 28 February 2018).

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In Brief

EU list of non-cooperative jurisdictions
The Council of the European Union has published the conclusions on the EU list of non-cooperative jurisdictions. The report details the reasons why jurisdictions are included in the list and the commitments made to address the issues identified. The full text of the conclusion is available here.

EU releases tax policy roadmap
The Bulgarian Presidency of the EU Council has published its tax policy roadmap setting out the council's planned short- and medium-term work on direct and indirect tax issues. The roadmap is available here.

Finland proposes changes to interest deduction limitation rules
On 19 January 2018, the Finnish government published a draft proposal that would revise the domestic rules governing the deductibility of interest expense. The proposed amendments are based on the EU anti-tax avoidance directive and would substantially broaden the scope of the interest deduction limitation rules and further limit the deductibility of interest expense. If approved, the rules would be applicable for financial years ending on or after 1 January 2019.

French parliament adopts the finance bills for 2017 and 2018
On 21 December 2017, the French parliament adopted the second amended finance bill for 2017 and the finance bill for 2018. These finance laws–the first of President Macron–are intended to reduce the tax burden on companies and individuals, further the government's objective to orientate savings towards helping the financing of companies and ensure that provisions of the French tax code are in line with EU law. Measures also are included to attract companies leaving London following Brexit.

China announces WHT deferral on reinvested profits
On 21 December 2017, the Ministry of Finance (MoF), the State Administration of Taxation (SAT), the National Development and Reform Committee and the Ministry of Commerce (MOFCOM) jointly issued a circular (Cai Shui [2017] No. 88) temporarily exempting from withholding tax dividends and profits distributed to foreign investors and re-invested in China. The exemption is applicable to dividends distributed on or after 1 January 2017; the withholding tax already paid on the distribution of dividends on or after 1 January 2017 may be refunded.

Italian 2018 budget law includes new regime for taxation of digital services

Italy's budget law for 2018, which was published in the official gazette on 29 December 2017 and generally applies as from 1 January 2018, makes a number of significant changes to the country's tax rules. Among other provisions that affect corporations, the new law introduces an equalisation tax on digital/web-based services; revises the definition of permanent establishment (PE); amends the rules for interest and depreciation deductions; and provides for a substitute tax on income from qualifying participations. A new 3% equalisation tax will be withheld from payments for "digital services" made by Italian companies to resident and non-resident providers as from 1 January 2019. The equalisation tax will apply to services provided over the internet or electronic networks and that are characterised by a high degree of automation and minimal human intervention. The tax will apply only to business-to--business transactions.

Japanese 2018 tax reform proposal

On 14 December 2017, proposals for the 2018 tax reform were approved. Under this tax reform, among other changes, tax credits and incentives will be expanded for companies which increase wages or capital investment, and the definition of a permanent establishment (PE) will be expanded to align Japanese tax law with the definition under the OECD's Base Erosion and Profit Shifting project.

OECD launches International Compliance Assurance Programme pilot

The OECD announced on 24 January 2018 that the pilot International Compliance Assurance Program (ICAP) for the multilateral risk assessment of large multinational enterprise groups was launched on 23 January in Washington DC. The voluntary program will use country-by-country reports, master files and local files and other information to facilitate open and cooperative multilateral engagements between multinationals and tax administrations, with a view to providing early tax certainty and assurance. The ICAP has been developed under the framework of the OECD Forum on Tax Administration (FTA) Large Business and International Program, sponsored by the Canada Revenue Agency (CRA). The objective is a more efficient use of resources both for multinational groups and for tax administrations and, in the longer term, fewer cases entering into mutual agreement procedures (MAP). Australia, Canada, Italy, Japan, Netherlands, Spain, the UK and the US are in the pilot.

Poland enacts major corporate tax reform

The reforms generally apply from 1 January 2018 and introduce a new limitation on the deduction of debt financing costs, restrict the deductibility of certain payments made to related parties and tax havens, create a separate capital gain "basket" of income and revise the controlled foreign company rules, among other changes.

Taiwan proposes rules for taxing digital sales by foreign companies

Sales by a foreign enterprise from some categories of digital services will be subject to Taiwanese corporate income tax based on a presumed profit margin and domestic contribution share, effective 1 May 2018, according to the rules proposed by Taiwan's Ministry of Finance. Under the proposed rules, payments to foreign enterprises with no fixed place of business in Taiwan would be subject to a gross withholding tax unless the enterprise applies to the National Taxation Bureau (NTB) for examination and approval of its net profit under the rules for determining expenses and profit.

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Two Interesting Court Rulings on Interest arising from Tax Proceedings

On one day in December 2017, the Supreme Administrative Court issued two very interesting rulings related to interest arising from tax proceedings.

Under the first ruling, the Court acknowledged the origination of interest on interest by stating that in the event of delays in imposing interest arising from the Tax Administrator's unjustified action an entitlement to (additional) interest arises to taxable entities. Such interest shall be calculated from the amount of interest, which has been charged with delay.

With regard to the relevant circumstances, an entitlement to interest arises for taxable entities either from unjustified steps taken by the Tax Administrator, or from a delay in refunding refundable excessive tax payments. Therefore, it is material whether the delayed imposition of interest results in a "non-refundable" excessive tax payment (which will be offset by the Tax Administrator against the taxable entity's tax arrears), or in a refundable excessive tax payment (which is paid to the taxable entity).

The second ruling follows immediately up on the ground-breaking ruling from 2014, in which the Supreme Administrative Court approved VAT payers' entitlement to interest on excessive tax deductions arising from the fact that prior to refunding the excessive tax deduction the Tax Administrator spent an unreasonably long time reviewing it ("the ruling in the Kordárna case").

Under this ruling, the Supreme Administrative Court scrutinised the question of whether a separate application was to be filed for refunding the excessive tax payment, which originated from the imposition of interest in line with the ruling in the Kordárna case /ie interest on a delayed refund of a refundable excessive tax payment/, or whether the Tax Authority should both impose and refund the excessive tax payment automatically (ie ex offo).

The Court concluded that on one hand, the interest should have been imposed automatically ex offo, however, on the other hand, the tax payer had to apply for the reimbursement of the thus-originated excessive tax payment separately. Moreover, the Court highlighted that in events in which the interest was imposed no sooner than pursuant to the steps made by the tax payer (who had to spend a great amount of time claiming it), it shall on no account be anticipated that by those steps the tax payer sought solely the imposition of interest without its payment.

Therefore, it may be summed up from the ruling that tax payers that generate an entitlement to interest due to the fact that an excessive tax payment was with-held from them, under conditions equal to those applicable in the Kordárna case, shall explicitly apply with the relevant Taxation Authority for the refund of such interest (unless the tax payer has already done so). On the other hand, interest imposed in line with the wording of the Tax Code effective from 1 January 2015, should be refunded without any prior applications together with the excessive tax deduction to which the interest is related. However, it shall be noted that applications must be filed for refunds of excessive tax deductions, which were additionally assessed based on additional tax returns or based on tax audits. We will discuss this topic in more detail on our regular webcast.

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The Czech Republic wants to amend the rules for posting employees in the EU

The EU Posting Workers Directive shall be amended, claims the Czech government. Currently, it complicates the life for many employers that post their employees abroad: the employers have to register at the authorities of the respective states, they have to provide the employees with numerous documents (e.g., A1 certificates, copies of employment contracts etc.). In addition, the rules for minimum wage and other labour law obligations need to be obeyed. The Directive is now subject to revision, as part of which the Czech government asks, among others, for excluding international transit. However, employers from other industries may expect the tightening of the rules, requested especially by West European countries. We will keep you informed about any updates.

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Tax liabilities – March 2018

Thursday, 1	Income tax	• Submission of income tax from employment settlement for taxable period 2017
Monday, 12	Consumption tax	• Tax maturity for January 2018 (except the consumption tax on alcohol)
Wednesday, 14	Intrastat	• The Intrastat statement for February 2018, paper version
Thursday, 15	Income tax	• Quarterly advance payment on tax
Friday, 16	Intrastat	• The Intrastat statement for February 2018, electronic version
Tuesday, 20	Income tax	• Monthly payment of deducted advance payments on personal income tax from employment • E-submission of income tax from employment settlement for taxable period 2017
Monday, 26	Value added tax	• Tax return and tax for February 2018 • EC Sales List for February 2018 • VAT control statement for February 2018
	Consumption tax	• Tax return for February 2018 • Tax return for claiming of refund of consumption tax for example on fuel oil and other petrol (benzine) for February 2018 (if applicable)
	Energy taxes	• Tax return and tax maturity on gas, solid fuels and electricity for February 2018
Tuesday, 27	Consumption tax	• Tax maturity for January 2018 (only the consumption tax on alcohol)

Tax liabilities – April 2018

Tuesday, 3	Income tax	• Submission of special-rate withholding tax settlement for February 2018 • Submission of special-rate withholding tax form settlement for tax year 2017 • Submission of tax return and payment of tax for 2017, if the taxpayer wasn´t required an audit and fills the tax return himself/herself
Monday, 9	Consumption tax	• Tax maturity for February 2018 (except the consumption tax on alcohol)
Monday, 16	Road tax	• Advance payment of tax for 1st quarter 2018
	Intrastat	• The Intrastat statement for March 2018, paper version
Wednesday, 18	Intrastat	• The Intrastat statement for March 2018, electronic version
Friday, 20	Value added tax	• Tax return and maturity of the MOSS VAT
	Income tax	• Monthly payment of deducted advance payments on personal income tax from employment
Tuesday, 24	Consumption tax	• Tax maturity for February 2018 (only the consumption tax on alcohol)
Wednesday, 25	Lotteries and other similar games	• Submission of statement for advanced payment on deduction from lotteries and other similar games and payment of advanced for 1. quarter 2018
	Value added tax	• Tax return and tax for Q1 and March 2018 • EC Sales List, Q1 and March 2018 • VAT control statement for 1Q and March 2018
	Energy taxes	• Tax return and tax maturity on gas, solid fuels and electricity for March 2018
	Consumption tax	• Tax return for March 2018 • Tax return for claiming of refund of consumption tax for example on fuel oil and other petrol (benzine) for March 2018 (if applicable)
Monday, 30	Income tax	• Submission of special-rate withholding tax settlement for March 2018

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Legal news
Deloitte Czech Republic

March 2018

Options to transfer the registered office from non-EU countries

A cross-border transfer of the registered office as stipulated in the Czech Transformation Act has recently experienced a mild but noticeable development. The key limit of the Transformation Act is the fact that it only relates to cross-border transformations with the EU (or EEA) states. Under this Act, no cross-border transformation has been possible to date with countries such as Switzerland, the USA or Russia and will not be possible with Great Britain after its exit from the EU. However, general guidance on the cross-border transfer of the registered office of any legal entity under the current Civil Code might be an interesting solution.

The transfer of the registered office as stipulated in Czech Act no. 125/2008 Coll., on transformations of commercial companies and cooperatives, as amended (the "Transformation Act")[1] has recently experienced a mild but noticeable development resulting from the case-law of the Court of Justice of the European Union[2]. Application of the Transformation Act is limited as it only relates to cross-border transformations with the states (corporations from the states) of the European Union or the European Economic Area.

No transformations are thus possible with a number of jurisdictions that are economically significant, such as Switzerland, the USA or Russia and, very likely, Great Britain after its exit from the European Union at the end of March 2019.

This basic limitation of the Transformation Act could be overcome thanks to the changes introduced into Czech law by the Civil Code effective since 1 January 2014[3] (the "**Civil Code**"). The Civil Code contains a general provision regulating the cross-border transfer of the registered office of any legal entity that may also be used to transfer the registered office of a legal entity (a commercial corporation) between the Czech Republic and any country outside of the EU (EEA).

An option for the cross-border transfer of the registered office with non-EU countries under the Civil Code

The existence of the guidance stipulated in Section 138 et seq. of the Civil Code seems to provide legal entities from third countries with an opportunity to transfer their registered offices to the Czech Republic (and vice versa) without this opportunity being included in an international treaty as

1 Specifically, Section 384a et seq. of the Transformation Act.
2 Refer namely to the case of Cartesio, C-210/06 CARTESIO Oktató és Szolgáltató bt.
3 Act no. 89/2012 Coll., the Civil Code, as amended.

was the case with the previous wording of the Commercial Code.

The provision is general, applicable to all legal entities and as such it relates to all commercial corporations unless a special legal regulation contains a specific provision. The special regulation is the above-mentioned Transformation Act that explicitly provides for transformations of (Czech) commercial corporations but its applicability to cross-border transformations is limited to other EU (EEA)[4] member states only. For legal entities (and namely commercial corporations from an economic point of view) from third countries, there is no provision in any other legal regulation. It thus may be inferred that these legal entities may transfer their registered offices pursuant to the Civil Code.

This approach is confirmed by the statement of reasons underlying the new Civil Code which reads as follows in this respect: "*in the globalised world, cross-border changes in registered offices of legal entities and establishing and transferring their branches cannot be prevented. For this reason it is proposed to stipulate transfer of a legal entity's registered office from abroad to this country and vice versa and define as of which date the registered office's transfer is effective. However, the absolute freedom is hindered by legal provisions prohibiting legal entities from violating public order*".[5]

Are we going to transfer registered offices of companies instead of making cross-border mergers with Great Britain after Brexit?

It should be admitted that in practice we hesitate to transfer companies from (or to) third countries. There is some logic in this approach because there is undisputable legal and tax unclarity in this respect, making companies use other legal instruments for cross-border transfers of assets and activities.[6] The potential of cross-border transfers of registered offices with respect to countries with which it has not been possible so far is undoubtedly great as this relates to countries with which no transformations could be made at all, such as the above-mentioned Switzerland, the USA, Ukraine or Russia. No less interesting is the application of this legal regulation

4 Refer to Section 3 in connection with Section 59b of the Transformation Act.

5 Statement of reasons for Act no. 89/2012 Coll., the Civil Code. ANAG Publishing House, p. 69

6 Eg. standard direct transfers of assets and establishing new companies or branches. It should be pointed out that such procedures have their limits and various practical disadvantages, including taxation.

to Great Britain with respect to the forthcoming date of its exit from the European Union as of 29 March 2019.

Companies willing to transfer the centres of their businesses to the EU or vice versa in respect of Brexit should ideally start addressing the situation now. The processes of cross-border mergers and registered office transfers may take several months to complete and effective from Great Britain's exit from the EU, British companies are likely to lose all legal advantages of EU harmonisation (predominantly, they will lose the option to make cross-border mergers that have been relatively popular today).

If they miss the deadline, the general transfer of the registered office under the Civil Code may become a solution to the legally complicated situation. Application of this provision might not only be limited to transfers of companies between Great Britain and the Czech Republic. Theoretically, the Czech Republic could be a "gateway" or an "interchange station" through which British (but also American, Swiss, Russian, Chinese and other) companies could enter the EU to subsequently place their registered offices to the final country, using the harmonised mechanisms of cross-border mergers or (intra-European) transfers of registered offices.

Limits of cross-border transfers of registered offices under the Civil Code

The Civil Code defines several limits for the relocation of registered offices: a legal entity may not be transferred if it is not permitted by the other country's law or if it violates public order. The registered office of a prohibited legal entity pursuant to Section 145 of the Civil Code may not be transferred to the Czech Republic.

In order to transfer its registered office to the Czech Republic, a foreign legal entity must provide a resolution on the selected form of the Czech legal entity and founders' legal procedure as part of its petition to be recorded in the Czech public register. Internal relations and the liability of members (partners) and members of bodies for debts incurred after the transfer of the registered office are subject to Czech law. Accordingly, a Czech legal entity may transfer its registered office abroad if permitted by law of the receiving state. Under Section 140 of the Civil Code, a Czech legal entity is obliged to publish its intention to relocate its registered office over a period of at least three months (as opposed to the Transformations Act stipulating a two-month period in Section 384k).

The question is what the "intention" should include. As opposed to the Transformation Act, the Civil Code does not provide for the project of registered office transfer, does not require an expert opinion, does not contain any specific rules for accounting documents, etc. The question is whether the incomplete information contained in the Civil Code should be supported by other rules, eg whether the provisions of the Transformation Act should be applied analogically (although the interpretation above does not indicate so).

Similarly to the Transformation Act, creditors of a legal entity are authorised to require sufficient security when the recovery of their debts is impaired and if no agreement is achieved the issue will be decided by court. As opposed to the Transformation Act, Section 140 (2) of the Civil Court stipulates that if a legal entity fails to provide security under the court's decision, members of the statutory body (except for those who prove that they undertook sufficient efforts to meet the resolution) are liable for unsecured debts.

Considerations with respect to cross-border registered office transfers should include the tax regime that includes several obstacles at the moment

Czech Act no. 586/1992 Coll., on income taxes, as amended (the "Income Taxes Act") only provides guidance on indirect (tax-neutral) mechanisms of cross-border mobility of companies within the EU (EEA), ie the cross-border transfer of the registered office of a European Company (SE) or European Cooperative Society (SCE) and the cross-border merger.

There is no information in the Act (or in the EU Directive[7] the principles of which the Income Taxes Act has adopted) on the cross-border transfer of the registered office of a company with a legal form different from an SE or SCE or the cross-border transfer of a registered office from/outside of the EU (EEA).

However, the broader guidance of the Transformation Act as amended based on the above-mentioned EU judicature (referring to the fundamental freedom of establishment within the EU) allows for cross-border transfers of registered offices of companies that have a legal form other than SE or SCE within the EU (EEA) and the Income Taxes Act should be applied in this situation analogically to SE or SCE.

7 EU Directive 2009/133/ES on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States, as amended.

On the contrary, outside of the theoretical framework of the Civil Code, there is no legal standard or case law addressing (tax) aspects of registered office transfers from/outside of the EU (EEA) today. In this situation, migrating companies may be exposed, for example, to the risk of potential additional taxation on exit (so called 'exit tax' to be introduced in the Czech Republic in 2019) of companies transferring their registered offices outside of the Czech Republic, the problem of determination of the tax base of assets of the company transferring its registered office to the Czech Republic, unclear procedural obligations (such as the need for the tax office's approval of a company transfer), etc.

It is possible that the predictability of the tax regime will have a critical impact on the practical applicability of the cross-border transfer of registered office under the Civil Code. At present, the issue is rather confusing as there is no explicit guidance. Without the appropriate amendments to tax regulations, the current situation may be discouraging for a number of companies considering transfers of their registered offices, namely in a context in which "time-tested" methods of relocation, such as sales, may be used to achieve a similar objective.

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Options to transfer the registered office from non-EU countries

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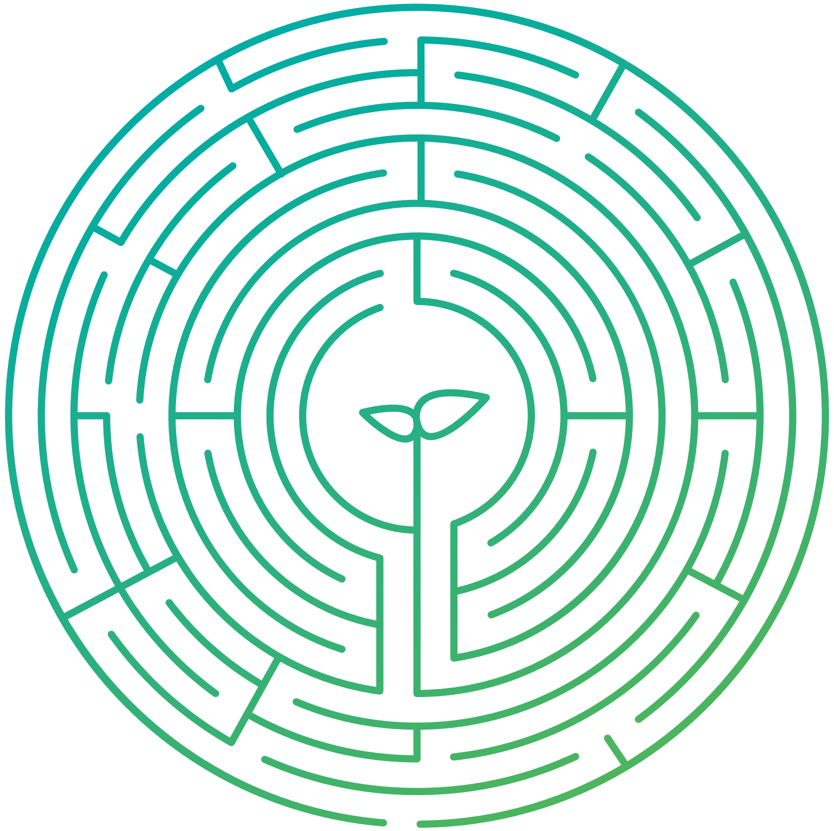

Grants & Incentives news

Deloitte Czech Republic

March 2018

Updated Schedule of Calls within the Enterprise and Innovation for Competitiveness Operational Programme for 2018

The Ministry of Industry and Trade published the updated Schedule of Calls within the Enterprise and Innovation for Competitiveness Operational Programme for 2018. The updates of the schedule published in December 2017 include postponing indefinitely the publication of calls with the original publication date in January in order to review the calls in the context of the Ministry's new priorities. The anticipated deadlines for publishing the selected calls are listed below:

Programme name	Programme focus	Type of call	Supported territory	Types of recipients*	Anticipated publication date	Planned date of receiving application for support
Call IV: ICT and shared services	Creating new IS/ICT solutions	Rounds	Czech Republic, outside the capital of Prague	SME, LE	2/2018	from 2/2018 to 6/2018
Call III: Energy savings in heat supply systems	Reconstruction and development of heat supply systems, increasing the CHP efficiency	On-going	Czech Republic, outside the capital of Prague	SME, LE	4/2018	from 4/2018 to 10/2018
Call IV: Energy savings	Activities relating to final energy consumption savings	On-going	Czech Republic, outside the capital of Prague	SME, LE	6/2018	from 7/2018 to 12/2018
Call IV: Application	R & D activities with outputs including prototypes, industrial designs and utility models, software etc.	Rounds	Czech Republic, outside the capital of Prague	SME	6/2018	from 6/2018 to 9/2018
Call V: Innovation	Purchasing production technology to launch new or innovated products into production and on the market	Rounds	Czech Republic, outside the capital of Prague	SME	6/2018	from 6/2018 to 10/2018

*SME – small and medium-sized enterprises, LE – large entities.

Publishing the 4th Tender within the EPSILON Programme

On 28 February 2018, the Technology Agency of the Czech Republic will publish the 4th tender within the Programme for the support of applied research and experimental development (the "EPSILON Programme").

The programme aims to support projects the results of which have a high potential for prompt application in new products, production processes and services. The programme can only support industrial applications using new technologies and new materials in the energy, environment and transport sectors for which at least one of the following outcomes may be reasonably expected: patents, prototypes, functional sample, pilot plant, verified technology, software, industrial design/utility model, and certified methodologies/practices/specialised maps with expert content. Tenderers include enterprises, research organisations and individuals engaged in business activity. The maximum amount support per project is 60% of total eligible expenses whereby the average expected support from the state budget is CZK 10 million per project.

Updating the Supplier Selection Rules

At the beginning of January, the Supplier Selection Rules were updated with effect from 15 January 2018.

The most significant changes include adjusting the procedure in line with the Supplier Selection Rules and the Act on Public Procurement with regard to a change in the financial limits for public tenders and concessions. Furthermore, conditions for sub-suppliers have been specified, including the cancellation of the original Section 42 restricting the signing of a contract with a participant involved in publishing the respective tender procedure.

Updated Schedule of Calls within the Enterprise and Innovation for Competitiveness Operational Programme for 2018

Publishing the 4th Tender within the EPSILON Programme

Updating the Supplier Selection Rules

Contacts

If these issues relate to your company, we would be happy to provide you with more detailed information. Feel free to contact us at any time.

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