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TAX FRESH

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Dear business partners,

We hope you had a wonderful summer months and gained enough strength for the upcoming part of this year. In this issue of our Newsletter, we center our attention on specific repercussions resulting from the amendment of the Labour Code, the eagerly anticipated communication from the Financial Administration of the Czech Republic regarding the VAT implications of donations, and an explanation of the basic principles of the so-called top-up tax. The legal framework of the latter may present several practical inquiries pertaining to its accurate interpretation and application.

Best regards

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CHANGES IN THE AREA OF AGREEMENTS (DPP) ON JOB COMPLETION AND AGREEMENTS ON WORK PERFORMANCE (DPČ)

On 1 October 2023, an amendment to the Labour Code brought into force new rules for agreements on work performed outside the employment relationship (DPP and DPČ). These rules relate to the implementation of the Directive of the European Parliament and of the Council on transparent and predictable working conditions in the EU. The primary goal of this amendment is to align these agreements more closely with conventional employment relationships, thereby augmenting the rights of employees engaged in such arrangements.

The most significant changes include:

- Holiday entitlement is granted under identical terms as those applicable to the primary employment. A hypothetical workweek of 20 hours will serve as the basis for calculating holiday entitlement. This modification, uniquely, will not become effective until January 1, 2024.
- Employees must be granted time off work in the event of obstacles to work on the part of the employee (e.g. doctor appointment, attendance at the wedding or funeral) and obstacles to work for reasons of general interest (e.g. blood donation), but without compensation, unless otherwise agreed or stipulated by internal regulation.
- Employees will now also be entitled to additional remuneration for working on public holidays, at weekends, at night and in difficult working environments.
- Employees must be granted continuous weekly respite, unbroken daily intermissions, and time for meal breaks and rejuvenation.
- The employer is required to formalize the employee's work schedule in writing or provide notification of any alterations at least 72 hours prior to the commencement of the shift, unless an alternative arrangement is mutually agreed upon between the employer and the employee.
- The employee is entitled to formally request a transition from an agreement-based relationship to an employment relationship, wherein the employer is mandated to furnish a substantiated written reply, concurrently articulating the cause for the termination to the employee.

REIMBURSEMENT OF COSTS ASSOCIATED WITH WORKING FROM HOME ("HOME OFFICE")

The amendment to the Labour Code also introduces a new regulation of reimbursement for costs associated with working from home. This reimbursement is also necessarily related to its new tax regulation in the amendment to the Income Taxes Act.

Concretely, the Labour Code introduces the option to reimburse employees for expenditures incurred in connection with work conducted outside the traditional employer's premises, often referred to as a "home office" setting. Such reimbursement should be explicitly outlined either within an internal policy directive or through a contract executed directly with the employee. The reimbursement of these expenses can be established either based on verified actual costs or as a fixed lump sum amount. Furthermore, it is feasible to mutually consent with the employee to waive reimbursement, provided that this arrangement is documented in writing.

The lump sum is determined by a decree of the Ministry of Labour and Social Affairs, while in the current decree the compensation is set at CZK 4.60 for each hour of work from home. However, the employer is entitled to choose to deviate from this value.

And, it is these deviations that the amendment to the Income Taxes Act (specifically Section 6(7)(e)) is aimed at. Should the lump sum not exceed the amount determined by the decree of the Ministry of Labour and Social Affairs, then this compensation is not subject to income tax (and is therefore not included in the taxable base for compulsory insurance premiums). It therefore has the same regime as, for example, allowances provided on a business trip.

If the employer uses the option to provide a higher amount of compensation, the difference between the amounts will be subject to tax on the work-related income of the particular employee (as well as health insurance and social security contributions).

Should the employer not choose to lump-sum the compensation and compensate the employee for the proven, i.e. actual, costs, then such compensation is not subject to personal income tax (nor is it subject to mandatory insurance contributions).

We would like to remind you that the employer may also provide lump-sum compensation to employees who work under agreement on job activity/work performance (DPP, DPČ), provided that it is stipulated in the relevant agreement.

FUNCTIONAL CURRENCY

The inclusion of functional currency accounting in the upcoming 2024 tax package was introduced in a rather unconventional manner, notably without the customary amendment procedure.

This represents a partial adjustment to the Accounting Act, as the comprehensive revision of the entire Accounting Act has been deferred for a minimum of one more year. Should you opt for this alternative, it is imperative to take into account the necessary preparatory measures within your internal accounting systems. Now, let's look into the practical implications of implementing a functional currency.

At What Point Can I Switch to a Functional Currency?
Businesses have the option to switch to the functional currency starting from January 1, 2024, and they can select from EUR, USD, or GBP currencies for reporting.

If a company primarily engages in business activities denominated in EUR, its sales are tied to EUR-based customers, it secures a bank loan in EUR to support its operations, and it predominantly holds its cash reserves in EUR, then it is probable that EUR is its functional currency, and accordingly, its accounts should be maintained in EUR. The criteria governing the adoption of a functional currency stem from the delineation provided in the IFRS reporting standard IAS 21.

What should you prepare for?
When considering a switch to a functional currency, it is imperative to consider the following aspects:

- Once a company makes the determination to employ a specific functional currency and initiates its use, this selection cannot be altered. The company will have the option to switch to CZK as its functional currency only if CZK attains the status of being the functional currency.

- Transitioning to a functional currency necessitates a modification to the accounting software. Certain software may not inherently support automatic operation in functional currency mode, making it imperative to calculate the time needed for the implementation of the new process.

- Given that this represents a modification in the reporting approach, it is essential to include this information in the subsequent events section of the notes to the final financial statements prior to the adoption of the functional currency.

- During the most recent period preceding the introduction of the functional currency, the conversion should be conducted employing the average exchange rate. The resulting exchange rate difference will be recognized within the company's liabilities under the category of "other profit or loss." This fact should subsequently be described in the notes to the financial statements.

- Presently, in the absence of the aforementioned standard amendment procedure, several unresolved matters persist. From a tax perspective, the most immediate concern revolves around the feasibility of fulfilling tax obligations in the Czech Republic using the selected functional currency. Logically, one would anticipate that such a payment should be feasible for income taxes. Nonetheless, there remains uncertainty as to whether this option will extend to mandatory employee contributions or Value Added Tax (VAT).

- Examples of further inconsistencies in this sub-proposal with other legal norms encompass the retention of limits in CZK under the Accounting Act for classifying accounting units (micro, small, large), as well as the lack of adaptation of most subsidy programs to the functional currency.

TOP-UP TAXES

The Chamber of Deputies of the Parliament of the Czech Republic is in the process of deliberating a bill regarding top-up taxes. This development arises from the enforcement of Council Directive (EU) 2022/2523, which is designed to curtail global tax competition among states. Consequently, the profits generated by companies should be acknowledged and subject to taxation primarily in the locations where the economic activities responsible for their creation take place, namely, where value is generated.

The Czech transposition legislation provides for two top-up taxes, namely the assigned top-up tax (expected to take effect on 31 December 2024) and the Czech top-up tax (expected to take effect on 31 December 2023). Hence, concerning the Czech top-up tax, the initial tax period subject to this tax should commence no earlier than December 31, 2023.

For tax periods aligned with the calendar year, the first tax period would consequently be the year 2024.

The new taxes will be applicable to legal entities. More precisely, these taxes will pertain to entities within large corporate groups, with a global annual turnover exceeding EUR 750 million (the group meets this threshold if this amount is recognised in the consolidated financial statements of the ultimate parent

entity in at least two of the last four reporting periods) and if it does not pay an effective tax rate of at least 15% on profits in the countries in which it participates. The effective tax rate assessment is established at the state level, considering the combined data for all entities within the same group operating within that state.

The Practical Procedure
In practice, Czech top-up taxpayers will initially compute the Czech top-up tax and subsequently evaluate whether there is a assigned top-up tax in other countries that may potentially apply to them. The method for computing the top-up taxes is notably intricate and will place a substantial administrative workload on the impacted taxpayers.

The tax period for the top-up tax, whether it's the assigned top-up tax or the Czech top-up tax, corresponds to the accounting period for which the ultimate parent entity compiles consolidated financial statements.

In relation to the Czech top-up tax, a relatively extensive information sheet will be provided to the tax administrator, which will exclusively be the Specialized Tax Authority. This submission will accompany the tax return and must occur within 10 months following the conclusion of the tax period. The time-frame for submitting the information sheet for assigned top-up tax purposes will be 15 months subsequent to the conclusion of the tax period. However, in the instance of the assigned top-up tax, the deadline for filing the tax return will be extended to 22 months.

As per the current wording of the bill, taxpayers would not be obliged to register for this tax or make advance payments. The top-up tax itself will be considered a tax non-deductible expense when determining the corporate income tax base.

Safe Harbour
Simultaneously, the proposed legislation incorporates the introduction of a transitional safe harbor rule, although with application exclusively to multinational corporate groups. This serves as a provisional exception to the obligation to calculate the top-up tax. In practical terms, this entails a series of three sub-tests, conducted at the jurisdiction level (rather than at the entity level within that jurisdiction). If the criteria of at least one of these tests is met, the top-up taxes will be considered zero, and there will be no need for the calculation of effective tax rate. In this context, it should be noted that a "once out, always out" approach will be introduced. That is, once a transitional safe harbour is not applied for one fiscal year for a jurisdiction, a transitional safe harbour cannot be applied for subsequent years.

To Sum Up the Top-up Tax Matter
We are fully aware, as evident from the preceding text, that the new regulations pose intricate and demanding challenges for the companies impacted. Several additional interpretative matters are currently under consideration. If, upon reviewing the accessible data, you ascertain that you could potentially be subject to the new obligation, we are prepared to provide assistance in preparing the related processes.

INFORMATION OF THE GENERAL FINANCIAL DIRECTORATE ON THE APPLICATION OF VAT ON GRATUITOUS SUPPLY OF GOODS

In current practice, uncertainties have frequently arisen regarding the accurate determination of the tax base for calculating VAT on the gratuitous supply of goods (this essentially refers to the donation of goods), especially in cases where a tax deduction was previously claimed on the acquisition. For this reason, the GFD issued the Information, the aim of which is to unify and define the rules according to which taxpayers should continue to proceed in these cases.

When a taxpayer claims a deduction for purchased goods and later provides (donates) these goods without charge, the tax base should be ascertained based on the purchase price, considering the goods' condition on the date of the taxable transaction. In this context, the tax base is determined by the current residual value of the goods, which equates to the purchase price plus any costs associated with the modernization or improvement of the goods, minus the value attributed to both physical and moral wear and tear. As per the guidance from the GFD, the actual (market) value of the goods at the time of the gratuitous delivery can also be approximated by considering the current condition of the goods. Should the market price surpasses the tax base set during the initial purchase of the goods, the original price remains the basis for determining the tax base.

If the goods are obtained through methods other than direct purchase, such as self-production, the price for determining the tax base for the gratuitous supply of such goods should align with the value of similar goods at the time of the gratuitous supply. For goods that are rare and, as a result, lack a discernible market price, the tax base will be established at the complete cost incurred by the donor in obtaining the goods at the time of the gratuitous supply. This should encompass, if relevant, the expenses associated with their modernization.

A near-zero tax base is also permissible for donated food items that are nearing to an expiry date or a best-before date. This principle can also be extended to situations involving unsellable ready-to-eat food resulting from business closure, food removed from sale due to inadequate packaging, incorrect labeling, or other significant damage. Similarly, other non-food products with a minimum use-by date, including cosmetics, drugstore products, pharmaceuticals, animal feed, flowers, construction chemicals, and other perishable items, can receive a similar treatment.

Conversely, it is not feasible to establish a near-zero tax base for donations of commonly traded goods, such as laptops, mobile phones, or office supplies, even in the context of social, charitable, or humanitarian aid.

The GFD advises that donors should secure evidence that clearly outlines the nature, scope, and timing of the gratuitous supply, including documentation of the present condition of the donated goods to support the tax base determination.

It's important to note that if goods are acquired with the intention of providing them as gratuitous supplies in the future, no deduction should be sought at all.

AND FINALLY, BRIEF MATTER RELATED TO CASE LAW - EXEMPTION OF BENEFITS UNDER SECTION 6(9)(D) OF THE INCOME TAXES ACT

On 16 August 2023, the Supreme Administrative Court, in its judgment 7 Afs 33/2022-41, confirmed the previous administrative practice of the Tax Authority and again emphasised that one of the main conditions for the exemption of employee benefits under Section 9(d) of the Income Tax Act (health, medical treatment, culture, sport, recreation...) is their non-monetary form.

In cases where the employer advances a sum of money to the employee or reimburses a benefit that the employee has purchased himself, the condition for exemption is not met. The requirement for the benefit to be in "non-monetary form" is satisfied only when the employer disburses the benefit to a third party, distinct from the employee or their family member who is the recipient of the benefit.