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Editorial

Mid-June, an amendment to the Investment Incentives Act passed through the third reading in the Chamber of Deputies and is soon to be debated by the Senate. It substantially changes the manner of awarding investment incentives: Apart from a generally stricter approval process, a number of other changes has been proposed, such as projects being approved exclusively by the government, or a 'higher added value' criterion. This brings an unpleasant uncertainty for investors and disrupts already established procedures, which is bound to dramatically decrease the number of supported projects.

And there are other crucial laws currently in the legislative pipeline: the Act on Electronic Reporting of Sales is going to the Senate, and the Chamber of Deputies is to discuss another bill aiming to boost the state budget – the so called 'rate package', which, apart from increasing rates in particular of excise duties, also changes the tax treatment of insurers' technical provisions. Another bill waiting to be debated is the amendment implementing the EU directive on VAT and on administrative cooperation in the field of taxation (commonly referred to as DAC 6), which introduces a reporting duty for cross-border transactions. An amendment to the Tax Procedure Code also entered the legislative process, as well as a widely discussed Digital Tax Bill which has already earned itself the nickname of 'the digital constitution'.

It so seems that this summer will indeed be rich in legislative changes. Let us see what the deputies will manage to discuss before the parliament is out for vacations from mid-July through August.

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Watch out for tax inspections! Companies drawing investment incentives surprised by transfer pricing issues

Apart from loss-making companies, tax administrators now systematically target transfer pricing in profit-making companies that draw investment incentives.

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The scenario is always the same: the tax administrators announce a routine inspection of corporate income tax focusing on compliance with the conditions for drawing investment incentives. Among other things, questions are asked about related-party transactions. However, their real focus is on something else than in cases of companies not drawing investment incentives in form of tax relief. It so happens that the Income Tax Act contains a specific condition for the drawing of this type of investment incentive, namely that the taxpayer's base for calculating the relief must not be increased by business transactions with parties related through capital or personnel in a manner not compliant with common economic principles.

Should the tax authority identify and prove (often using evidence provided by the taxpayers themselves) a breach of this condition, taxpayers are sanctioned for their excessive profitability. Sanctions are imposed depending on when the unlawful increase in the base was proved, and may come in two forms: either the investment incentives are withdrawn completely, in which case the taxpayer must file additional tax returns for all periods when the incentives had been drawn, or the tax administrator assesses additional income tax on the detected excessive profitability.

In our experience, inspections of this type may take place any time while incentives are being drawn. And, what we found rather startling, the tax authority may see a problem even at companies where previous inspections focusing on investment incentives did not find any fault as regards transfer pricing. This means that not even having the methodology reviewed by the tax authority gives the taxpayer any certainty that the same conclusions will again be drawn in a later inspection. We therefore recommend not underestimating even seemingly routine tax inspections.

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New Instruction D-34 and translation of TP Guidelines

The financial administration is unifying procedures to determine tax bases affected by transactions between associated enterprises, both domestic and cross-border.

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In Financial Bulletin 5/2019, the General Financial Directorate (GFD) published long-awaited Instruction D-34. It replaces existing Instruction D-332 on applying international standards in the taxation of transactions between associated enterprises. At the same time, a Czech translation of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations of July 2017 was published.

The new instruction deals with the following issues, among others:

- The arm's length principle and its regulation in Czech laws comparative analyses (benchmarking) and factors determining comparability recommendations how to proceed with comparative analyses description of methods to determine transfer prices and their use in practice.

- The opening part of the instruction deals with transfer pricing in general, mainly its codification, referring to the revised OECD Guidelines of 2017. The instruction also mentions the BEPS Action Plan published in 2015 by the OECD as a basis for analyses.

- The basis for the application of the arm's length principles is the comparison of conditions in a related-party transaction to those in an unrelated (independent) transaction. According to the tax authorities, any business relationship between associated enterprises, including a parent company's instruction resulting in a taxpayer's loss, shall be considered a related-party transaction.

Special attention is paid to the value chain and to risk and functional analyses. A relevant analysis should determine the profile of the enterprise under review, and subsequently the distribution of profits depending on where in the chain of enterprises the value is created.

The instruction contains more detailed recommendations on preparing comparative analyses (benchmarks), including a recommended updating interval: a new analysis should be prepared every three years, while a review of the independence and profitability of selected unrelated enterprises should be carried out on an annual basis. As per common practice, multiple-year data, usually for 3 to 5 years, should be used to determine market ranges. The full wording of Instruction D-34 is available here.

KPMG can prepare full-scope transfer pricing documentation that meets all the above recommendations. If you are not sure whether your present documentation complies with Instruction D-34 or if you wish to have an entirely new transfer pricing documentation prepared, we will be happy to help.

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VAT treatment of members of societies finally clarified?

In its May and June sessions, the Coordination Committee commented on the tax treatment of members of societies (former associations) without legal personality. A presentation from the side of the tax advisors dealt with the VAT treatment when determining a member's final share in a society's profit; consensus was not reached on the issue. Another issue was the correct identification of the scope of supply for various ways of invoicing by societies; here, the GFD eventually agreed to the conclusions of the paper submitters.

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Effective 1 July 2017, special provisions of the VAT Act concerning societies were cancelled. Before the amendment, supplies effected between members of societies were not considered for VAT purposes. Under the new regulation, however, each member of a society shall follow the generally applicable provisions of the VAT Act on an individual basis. The transition period during which members of societies that existed before the amendment could still apply the old regulation expired at the end of December 2018.

Originally, the tax advisors' paper aimed to confirm the VAT treatment of another common situation when the society's members' share in the society's joint activity is determined based on variable criteria, which means, for instance, that their final share in profit only becomes known at the end of a calendar year. The tax advisors' opinion was that the subsequent adjustment to reflect the final share in profit was an adjustment to the tax base under Section 42, while such adjustments are generally covered by regular VAT returns. However, the GFD and the tax advisors did not agree on this issue, meaning that taxpayers will remain uncertain as to how to proceed in such situations.

Nevertheless, consensus was reached on the other issue covered by the paper: the specification of supplies provided by individual members from a VAT perspective. In practice, it is often one member who acts vis-à-vis third parties, acting in their own name and for their own account (as regards their share in the joint activity), and in their own name and for the other members' account (as regards the other members' share in the joint activity). Such a situation is just one of the possibilities of acting in the society's joint affairs, as the GFD noted in their information on the application of VAT to a society's members valid from 1 July 2017.

The GFD thus confirmed that in the case in question, the scope of supply shall remain unchanged, meaning that the same supply shall be given in the tax documents (invoices) issued to third parties by the one society's member issuing the invoice as well as in the tax documents then issued between the society's members. Similarly, an identical supply should also be provided in tax documents in situations where individual members act vis-à-vis a customer in their own name and for their own account. To illustrate: if the contracted supply is construction work, all society's members should issue invoices for construction work, while the rules stipulated by the VAT Act shall apply to the individual supplies on a case by case basis (for instance: when assessing the limits for a local reverse charge for supplies between members, their share in the joint activity should be considered).

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Are you ready for changes in the VAT ledger statement?

With the recent amendment to the VAT Act, the revised Instruction on Completing the VAT Ledger Statement entered into effect on 1 April 2019. Its most significant changes concern corrections to the tax base for irrecoverable debt. What to watch out for when stating these corrections in the VAT ledger statements?

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First, please note that new Section 46 of the VAT Act shall be applied if all facts relevant for the correction occurred after the effective date of the amended act, i.e. after 1 April 2019.

In the present XML structure of the VAT ledger statement valid until 30 September 2019, the creditor/debtor shall check the corrections in respect of irrecoverable debt field in the VAT ledger statement line in the respective section (A4/B2); this field has been pre-set as blank. Then, they have to specify whether it is a correction to a tax base under Section 44 of the VAT Act in its wording before 31 March 2019, or a correction under Section 46 of the VAT Act as amended after 1 April 2019. The tax administrator will only know which correction this is from the information stated in the respective line: for corrections under Section 44, only the amount of tax shall be corrected; for corrections under Section 46, the amounts in the tax field and the tax base have to be corrected.

The XML structure of the VAT ledger statement is to change further from 1 October 2019. The corrections in respect of irrecoverable debt field will contain the following values, depending on the corrections made:

- N – not a correction for irrecoverable debt,
- P – a correction at the creditor's under Section 46 et seq. or at the debtor's under Section 74a of the VAT Act,
- A – a correction under Section 44 of the VAT Act in the wording before 31 March 2019.

If the creditor/debtor enters P in this field, then the amounts of the correction to the tax base and the correction to the related tax shall be stated in the VAT ledger statement line. If they enter A, only the amount of the tax correction shall be stated; the tax correction field shall in this case remain inaccessible. We recommend reviewing your system's readiness for these changes.

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Rate package to tax one-crown bonds

The government has passed a so called rate package aiming to boost public budget revenues. Some points were added to the finance ministry's original bill, in particular the taxation of one-crown bonds. The proposed taxation of insurers' technical provisions changed as well. The increases in tax rates on gambling, spirits, cigarettes and tobacco remained as originally proposed.

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The proposed amendment to some tax laws aiming to increase revenues of public budgets, referred to as a rate package, was submitted to the deputies' chamber in June. The bill we wrote about in the May issue of Tax and Legal Update is expected to enter into effect on 1 January 2020; this effective date is conditional upon the completion of the legislative process by the end of the year.

Unlike the original wording, the bill now also stipulates the taxation of one-crown bonds in a transitional provision applicable to Section 36 (3) of the Income Tax Act (which, however, remains unchanged by the proposed amendment). In the taxation periods following the amendment's effective date, interest income from bonds with a low nominal value issued before 2013 would no longer be rounded (down) for each individual security; this treatment in effect meant not taxing this income at all. Under the amendment, the generally applied rounding whereby the tax base (i.e. the interest income) is not rounded, and only the final tax is rounded, for each taxpayer, would apply to all bonds, regardless of the date of issue.

The proposed amendment to the Reserves Act has also undergone changes in the commenting procedure: it still applies that only the technical provisions under the EU Solvency II Directive, with certain adjustments, will be tax-deductible, not the technical provisions under accounting standards. The ministry has also partly responded to comments raised by the professional public and proposes to reduce the amount of tax-deductible provisions by amounts recoverable under reinsurance agreements, while increasing them by the balance of deferred acquisition costs of insurance contracts. Unlike the original wording, which proposed the one-off taxation of the difference between the technical provisions under the accounting standards and the adjusted technical provisions under Solvency II, the governmental wording now proposes to spread the impact of the change over two taxation periods following the amendment's effective date. Any additional taxation would thus take place in 2020 and 2021. In its explanatory report, the ministry also updated the estimated one-off increase in public budget revenues from CZK 3.8 billion to CZK 10.5 billion.

The government also proposes a limited tax exemption of winnings from gambling/betting, to amounts not exceeding CZK 100,000. Winnings above this amount would be subject to a 15% withholding tax. As the proposed taxation does not allow to deduct the amount of the wager from the tax base, situations may occur in gambling/betting where the actual winning would be lower than the tax withheld.

The rate package is yet to be discussed by parliament; we thus have to wait and see what the concrete tax

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regulation of individual areas will be like.

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GFD admits a looser interpretation of transitional provisions on R&D allowance

The General Financial Directorate (GFD) published information on the application of transitional provisions of the tax package that entered into effect on 1 April 2019. It mainly concerns research and development allowances and regulates the application of transitional provisions to development projects. The described approach nevertheless differs from recommendations that firms are currently applying.

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According to the most frequent interpretation, the new rules shall apply to projects initiated after the amendment's effective date, i.e. after 1 April 2019, while their application is optional for projects initiated from 1 January 2019 to the end of March 2019. Projects initiated before this time should be governed by the original rules, i.e. the wording before the amendment.

The GFD's information, however, admits a more benevolent interpretation of the transitional provisions: it allows to choose the applicable rules for all projects initiated in the taxable period or a period for which a tax return is filed that commenced before the tax package's effective date and did not end by the effective date. This means the beginning and the end of the taxable period in which the development project was initiated is of key importance.

To recap, for taxpayers, the new rules have also brought a duty to notify tax administrators of the intention to claim the research and development allowance for a project even before initiating it. At the same time, the preparation and approval of the project documentation may be postponed until the deadline for filing the tax return for the period when the taxpayer first claims the allowance for the project.

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Class action lawsuits are coming to the Czech Republic. Retail better get ready!

A separate bill drafted by the justice ministry is to introduce the class action to Czech law, allowing holders (or purported holders) of identical or similar claims to assert these in court jointly, in single proceedings. This could mainly affect retail businesses offering or selling goods and services to a wide range of customers, for instance in banking, consumer production, or the automotive sector. The bill has now been released for comments.

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To some extent, Czech laws already allow for jointly asserting one's claims in court, for instance in consumer disputes. In civil proceedings, this can be done through intervention in proceedings. Yet, current regulation is rather fragmentary and does not provide an efficient tool to assert collective claims. In practice, missing legal regulations are often substituted with various contractual arrangements, such as commission agent arrangements or the assignment of receivables.

The bill in its present wording provides for the possibility of collective proceedings for all private-law disputes. Czech class actions should allow for both opt-out-based and opt-in-based proceedings. The original wording of the bill preferred opt-out proceedings, where all holders of identical or similar claims would be parties to the proceedings by operation of law without having to take any active part in the proceedings (or even being aware of it being pending).

The funds recovered would be deposited by the defendant in the account of the court, which would then satisfy the individual participants' claims. The remaining amount not collected would be forfeited to the state. This is inspired by the US system of damage compensation, which accentuates its punitive nature. Such a concept of damages, however, does not have a tradition in the Czech legal environment, which is why it was not favoured by the professional public. In response to the criticism, the justice ministry has reconsidered its approach. Now, opt-in proceedings where claim holders actively register (opt-in) are the preferred type; this corresponds better to Czech law.

By drafting the bill, Czech legislators preceded their EU colleagues, as the Directive on Representative Actions is only just being discussed in the European Parliament. As much as legislators declare in the explanatory report the proposed regulation's compliance with the directive, it differs in many aspects. Unlike the Czech regulation, the directive exclusively targets consumer disputes, and explicitly forbids class actions to be financed by the defendant's competitors. It is therefore likely that once the directive is adopted, Czech legislators may have to amend their class action law accordingly.

Class actions are an entirely new tool to facilitate asserting even smaller claims that are not presently worth

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pursuing in court on an individual basis. Retail businesses in particular should monitor the legislative development and get ready for the new rules. Class actions are bound to expose some businesses to even more consumer claims and, in their final effect, may lead to greater emphasis on the quality of products and services and compliance with legal standards.

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Revolution in AML to affect all legal entities

With the implementation deadline for the fifth AML Directive approaching, preparations of legislative proposals transposing it into Czech laws are underway, including, among others, an amendment to the Czech AML Act (No. 253/2008 Coll. – Act on Certain Measures against Legalisation of Proceeds from Crime and Terrorism Financing). What new duties does the directive impose on obliged entities and other companies?

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The first novelty to affect all legal entities is the introduction of sanctions for the failure to report beneficial owners. The sanctions have to be effective, proportionate, and dissuasive. While until now, it was theoretically possible to only apply general provisions of the Act on Administrative Offences, the new rules will be more concrete. Furthermore, the register of beneficial owners will be accessible to the public.

The main changes will concern financial institutions: they will have to implement measures to prevent accepting payments by anonymous prepaid cards issued in third countries not complying with requirements equivalent to those for prepaid cards issued in the EU. A transaction limit will be set for them, and member states may also ban cards from third countries altogether.

Another area of concern are virtual currencies. A change in their definition is being prepared. Providers of exchange services between virtual currencies and fiat currencies, and custodian wallet providers will have to be registered.

Financial institutions will face considerably stricter sanctions. For serious, repeated or continuous offences, fines of up to CZK 130,000,000 or a ban to undertake the activity may be imposed. Sanctions would cover a wide range of offences: from failure to report a suspicious transaction to absent group strategies or not postponing a customer's order.

A new obstacle to carrying out the trade/activity of accounting advisors, book-keeping and keeping of tax records is to be introduced: a legal entity will not be allowed to undertake these activities if its beneficial owner has been sentenced, by a final and conclusive judgement, for a crime in connection with carrying out the activity. A similar measure shall also apply to beneficial owners of companies active in legal, audit or tax advisory services, while the beneficial owner will be required to have no criminal record at all.

At present, it is hard to predict the concrete changes which the amendment to the AML Act and related laws will bring. Yet, from the wording of the fifth AML Directive and the legislative proposals published so far, it seems that the rules will tighten further. The changes will concern financial institutions, but will affect other entrepreneurs, too.

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Amendment to Asset Valuation Act to define market value

Draft amendment to the Asset Valuation Act submitted by the government to parliament aims to introduce a definition of market value as an alternative valuation method into Czech law. If passed, the new law should enter into effect on 1 January 2021.

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The Asset Valuation Act mainly regulates valuation methods to determine a tax base (whether for property tax, income tax, VAT or fees). Its purpose is to set general criteria and principles to help prevent tax evasion. The act is generally used to determine prices of assets for purposes other than sale (such as court-ordered settlement and distribution of the joint property of spouses, or decisions by financial institutions to grant mortgage loans). The price determined under the act is also used to assess economy of purchases and sales of property by the state.

Under the current wording of the Asset Valuation Act, the basis for valuation is mainly an asset's common price, which is determined by comparing (negotiated) purchase prices of comparable things. The amendment widens the valuation options, introducing the market value as an alternative valuation method. According to the amendment, this method should mainly be used in situations where purchase prices of comparable things are not available to determine the common price, either because of the unique nature of the thing being valued, or because the thing has not yet been traded at the given time and place. Market value shall be the estimated amount for which a property should most probably exchange on the date of valuation between a willing buyer and a willing seller in a business transaction in a free market after proper marketing.

Another change will concern undeveloped construction plots of land where a separate legal regulation stipulates the maximum admissible built-on area. Under the current wording of the law, only the part of the land corresponding to the built-on area limit is to be considered a construction plot for valuation purposes. Under the proposed amendment, the whole plot of land would be considered a construction plot: the explanatory report states that these plots of land should be valued as one functional unit, because prices of construction plots are also negotiated for the whole plot of land without differentiating as to their development possibilities.

Following the new Civil Code, the amendment also includes specifications as regards the right of superficies or easements: it proposes that for the purposes of determining the price of real property encumbered by an easement or another right in rem established by operation of law (such as protective or safety zones) these should be valued as real property's defects. For this purpose, the term of a property owner's loss is introduced, which shall be determined as the loss of the owner's benefits from the assets resulting from them being encumbered by these rights.

The amendment will also affect the Consumer Credit Act. It gives providers of consumer credits for housing purposes a choice of valuation methods to apply to the collateral: they may choose between the usual price and the market value. The reason for this is that at times of rapid fluctuations in price levels, a usual price may not always correspond to actual market conditions, as it is calculated based on prices negotiated in the past. In the time of growing real estate prices, consumers are likely to welcome the change.

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Renewable energy sources for all Europeans

The last of the eight legislative acts constituting the Winter Energy Package was published in the European Union's Official Journal in June. Submitted by the European Commission in November 2016, the changes to EU energy legislation aiming to enhance energy efficiency, reduce carbon intensity, shift the focus towards consumers, and build the energy sector upon renewable sources have thus been completed.

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The support of electricity from renewable energy sources will primarily be regulated by Directive No. 2018/2001, repealing current main Directive No. 2009/28/EC. The new directive is part of the EU's plan to become a leader in renewable energy sources, setting a target proportion of 32% for renewable energy sources in the EU's total gross energy consumption by 2030. Taking into account the performance to date, the Commission may decide to further increase the proportion in 2023. The individual member states should participate in this plan by setting their own goals within their integrated national energy and climate plans.

To achieve the set goals, the member states will be allowed to continue to apply the support regimes in compliance with the principles of openness, transparency, compatibility, non-discrimination and cost efficiency. An amendment to the Act on Renewable Energy Sources currently in preparation introduces the provision of operating support for new production plants in form of auctions, which should be consistent with all criteria set by the directive. The member states may also decide to what extent they will potentially support electricity generated from renewable sources in another member state. If they decide to do so, they will have the right to require physical proof of the import of such electricity, and to limit the support only to the producers of the member states with which they have a direct network connection. Under certain conditions, the member states may limit the provision of financial support to certain technologies.

In contrast with Directive No. 2009/28/EC, the new directive does not generally guarantee the producers of electricity from renewable energy sources the right to a preferential connection to a distribution network. On the other hand, however, the directive aims to substantially simplify and shorten the administrative procedure to obtain a permit for the construction, modernisation and operation of plants for generating electricity from renewable resources. With certain exceptions, the permit-granting process may not exceed two years, and only one year where smaller production plants are concerned. Producers will be able to obtain all necessary permits and approvals via a single administrative contact point. For renewables self-consumers, i.e. producers who use electricity from renewable sources for their own consumption or sell it without doing it as part of their principal business activity, with an installed capacity of 10.8 kW or less, the connection to a distribution network will be possible through a simple notification procedure to the appropriate distribution network operator. The member states may then decide to apply the simple notification procedure also to production plants with an installed capacity higher than 10.8 kW but less than 50 kW if network stability, reliability and safety is not threatened.

The Czech Republic must transpose the majority of the directive's provisions by 30 June 2021. The above-

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mentioned amendment to the Act on Renewable Energy Sources, introducing an auction in which the winning electricity producers obtain financial support, is yet to be submitted to the government. In addition, the deputies' chamber is currently discussing an amendment to the Energy Act prepared in response to the European Commission's criticism of the existing regulation. The Czech Republic now finds itself in a situation when it has to amend the regulations that have been incorrectly transposed and must prepare for the implementation of new directives and regulations. The energy sector will therefore change dramatically in the upcoming years.

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EU introduces parental leave for both partners and ten-day paternity leave

The rate of employment for women in the EU is by 11.6% lower than that of men and, moreover, a third of all EU women work only part-time. Differences in employment are much more profound for parents and other persons with care responsibilities. Consequently, in mid-June, the EU Council approved a directive on work-life balance for parents and care-givers, aiming to address women's underrepresentation in the labour market and to provide for a better balance of work and family lives. It is now up to the member states to implement the content of the directive into their national legislations within three years.

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The directive introduces paternity leave: fathers or equivalent second parents will be able to take ten working days of paternity leave around the time of the birth of a child, and will be compensated at least at the level of sick pay. The member states may allow the taking of paternity leave also before childbirth. The paternity leave of seven calendar days has already been in force in the Czech Republic, compensated at a level exceeding sick pay. To meet the directive's requirements, our legislators will only have to extend the paternity leave to ten working days, i.e. double the current entitlement.

For parental leave, the directive aims to balance the taking of parental leave by both fathers and mothers; in the future, each parent should have the individual right to parental leave of at least four months, of which at least two months may not be transferred to the partner. In practice, this means that each parent should stay at home with their child for at least two months. The non-transferrable part of the parental leave should be paid; however, the minimum amount of pay has not been determined. Working parents should also be allowed to apply to take parental leave in a flexible manner, i.e. on a part-time basis, which is another obligation imposed on member states by the directive. However, employers may refuse to satisfy such requests. Czech regulations already allow for the alternation of partners on parental leave and for full parental leave to be taken only by one parent.

The novelty is a care-givers' leave of five working days a year for workers providing personal care or support to a family member. The directive also stipulates the right to time off from work for force majeure reasons in urgent family matters. The amount of compensation is left to be decided by the member states; these may also opt for not providing any such allowance. In our legal environment, the new concepts remind us of impediments to work as a result of home nursing or provision of long-term care. The directive also stipulates the right of all working parents of children up to the age of eight to flexible working arrangements, including flexibility in the place of work. Similarly as in the case of taking parental leave in a flexible manner, working parents will be entitled to apply for such working arrangements, while the final decision will be made by the employer. The Czech Labour Code currently allows for applying for shorter working hours or another suitable adjustment of working hours by parents of children up to the age of fifteen.

We have to wait and see whether the directive will really help enhance the gender balance in the labour market and improve work-life balances. It will largely depend on what approach is adopted by individual member states. The

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majority of tools introduced by the directive have already been in force in a certain form in the Czech Republic. The major challenge for Czech lawmakers will be the requirement to enable the drawing of time off in a flexible manner, such as by alternating leave and work. This could really result in a greater involvement of men in care responsibilities.

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Case law

General meeting's consent to transfer or pledge part of a business establishment

The Supreme Court sided with a formal and material approach to the 'part of a business establishment' term, specifying when the general meeting's consent is required to transfer or pledge a significant part of a business establishment.

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Under the presently valid Corporations Act, general meeting's consent is required for a transfer or a pledge of a business establishment or such a part thereof that would mean a significant change to the existing structure of the business establishment or a significant change to the company's scope of business or activity. Because of the absence of the legal definition of a part of a business establishment, this provision causes serious interpretation difficulties: it can be construed materially, i.e. as a significant part of assets, or formally and materially, i.e. as an independent organisational unit at the same time meeting the condition of significance/materiality for the existing structure of the business establishment or the scope of the company's business or activity. The correct interpretation of the part of a business establishment term is important namely because if the general meeting's consent is not obtained in cases where such consent is required by law, this may render the legal act invalid (void).

In its judgement no. 27 Cdo 2645/2018, the Supreme Court supported the formal and material concept: a part of a business establishment shall mean an independent organisational unit (a branch) of a business enterprise with a certain degree of significance/materiality for the company. The Supreme Court thus confirmed the conclusion previously formulated by the High Court in Prague, as noted in past November's Tax and Legal Update. Both interpretations differ from the majority opinion in professional literature, where the concept is understood materially, i.e. as a significant/material portion of assets.

The extensive interpretation of the concept, i.e. the material approach, gives more control and protection to members/shareholders, yet to the detriment of legal certainty and security of company dealings. Without a detailed analysis often requiring considerable efforts and funds, it may be virtually impossible for third parties to determine whether the transfer of a certain part of assets is subject to the general meeting's consent. In its judgement, the Supreme Court stated that based on grammatical and logical interpretations the meaning of the term has to be construed more narrowly: the general meeting's consent shall thus be required for a transfer of a branch of a business establishment (i.e. a part of a business establishment that demonstrates economic and functional independence) that at the same time meets the condition of significance/materiality in terms of the business establishment's structure or the company's scope of business or activity.

Using this interpretation, it may also be concluded that if one of a company's many branches is being transferred with all of them having the identical scope of business and turnover, the general meeting's consent shall not be required, as the materiality condition will not be met. Other transfers or pledges of significant components of a business establishment (such as machinery or buildings) are decided on by the company's statutory body, within business management.

The Supreme Court also noted that had the legislators intended to subject all significant transactions involving the

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company's assets to the general meeting's consent, they would have done so explicitly, for instance using the part of assets term. In this respect, please note that an amendment to the Corporations Act that aims to resolve this interpretation uncertainty by replacing the part of a business establishment wording with a part of assets and liabilities is presently being discussed in the Chamber of Deputies. This may mean a shift back to the material concept. Preparing any transactions involving company's business establishment will therefore continue to require increased prudence in the future as well.

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Parliament passes extensive amendment to Foreign Nationals' Residence Act

The amendment underwent significant changes in the course of the legislative process. The approved wording includes the government's authorisation to set economic migration quotas and to activate extraordinary work visas. The amendment will also affect employee cards. The bill is now on its way to the president and once signed, it will enter into effect (with some exceptions) on the 15th day after its promulgation in the Collection of Laws.

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The new rules mainly intend to make life easier for foreign students and research workers. Under the amendment, after finishing their studies or research, foreign students and research workers may apply for a residence permit in the Czech Republic for up to nine months to find employment or start a business. Holders of residence permits for the purpose of research or study issued by another EU member state may stay in our country for up to one year without a visa.

The government's authorisation to set economic migration quotas remained in the wording of the amendment, which means that the government may regulate the number of applications for residence permits collected during the year by Czech Republic's representative offices/ embassies abroad, taking into account the workers' country of origin, the state of particular sectors of the Czech economy, or the type of work performed. At the same time, present migration projects and special regimes will be unified and combined into three economic migration programmes. The government will also be authorised to activate the issuance of so-called extraordinary work visas, which, in the event of labour shortages, will make it possible for selected categories of workers from stipulated countries to obtain a work visa for up to one year through fast-track proceedings.

The foreign nationals' duty to attend one-day adaptation/integration courses within one year from being issued a residence permit remained in the amendment, with minor modifications, and shall apply from 2021.

Provisions concerning employee cards were added to the wording by an amending proposal. In the future, when collecting their residence permit, employees will have to submit their employer's confirmation that they actually have started work. Changes in employment, employers or positions will no longer require the consent of the Czech Ministry of the Interior; instead, it will suffice to notify the ministry of the change at least 30 days in advance. In reality, this change is merely cosmetic, as applicants will still have to wait for the ministry's confirmation that the conditions for making the change have been met. The amendment also limits the possibility of changing an employer – this will only be possible after six months from issuing the employee card, while for cards issued under a special migration programme, changes are permitted only after the end of the cards validity. The possibility to switch from an employer to an employment agency will also be limited.

Other novelties are the possibilities to fast-track the termination of foreigners' residence permits in the Czech Republic and to speed-up expatriation procedures in the event of security threats. Decisions to terminate foreigners' residence permits on the grounds of public order or security may in the future not be appealed in

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administrative proceedings – only their judicial review will be possible, while the court will have to decide within 90 days. After the amendment's effective date, to cancel a residence permit it will suffice that the person has been sentenced to unconditional imprisonment or for three intentionally committed crimes.

Another amending proposal introduces significant changes to the Employment Act. For instance, information and record-keeping duties vis-à-vis labour offices as regards workers posted abroad should remain with their foreign employer, not the Czech entity to which they have been posted.

The amendment has come a long way from its original wording proposed by the government. The result is a package of rather extensive changes in immigration law. We just have to wait and see how the new legal regulation will work in practice, in particular whether the quotas and extraordinary work visas will satisfy Czech employers' needs.

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Latest News, July 2019

Last month's tax and legal news in a few sentences.

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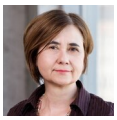

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HOME NEWS IN BRIEF

- On Monday 1 July 2019, an amendment to the Labour Code entered into effect abolishing, yet again, the waiting period (karenční doba), i.e. the first three days of a temporary inability to work for which no compensation was paid. Under the amendment's transitional provisions, the old rules will apply to temporary inability to work that originated before July 2019, meaning that employees who became unable to work on 28 June 2019 will still not be entitled to compensation for the first three days of sickness. The amendment was originally planned to enter into effect together with an amendment to the Sickness Insurance Act introducing e-sick notes, which aims to give employers better control over whether their employees on sick leave observe the prescribed regime. However, the effective date of this amendment has been postponed to 2020.
- The government has submitted for comments a draft government decree stipulating the maximum number of applications for visas for stays beyond 90 days for the purpose of conducting business, applications for long-term residence permits for the purpose of investing, and applications for employee cards that can be filed at Czech Republic's representative offices abroad.
- The Chamber of Deputies passed an amendment to the Act on Local Fees responding to the dynamic development of the sharing economy and setting a level playing field for short-term accommodation market. The amendment introduces a fee to replace existing fees for spa or recreational stays and accommodation capacity fees. The new fee will apply to short-term stays provided for consideration regardless of location and purpose; it will considerably extend the range of facilities that are subject to local fees.
- The Chamber of Deputies passed an amendment to the Act on Electronic Reporting of Sale as proposed by the government. The originally expected date of launching the last stages of ERS, i.e. 1 July 2019, has already elapsed, and 1 January 2020 is not realistic either. If the Senate returns the bill to the Chamber with proposed changes, or if, as expected, they vote it down altogether, the deputies will have to vote on the draft amendment again. The amendment is thus likely to be promulgated in the Collection of Laws in the autumn, and the last waves of ERS are to be launched (and some taxable supplies reclassified to the 10% tax rate) six months after the law has become valid.
- On 27 June 2019, the financial administration provided access to the electronic filing of notifications on income flowing abroad under Section 38da of the Income Tax Act, replacing the taxpayers' notification of income tax withheld. Taxpayers have the duty to notify tax administrators of income from sources in the Czech Republic paid to tax non-residents from 1 April 2019, while the new duty also applies to cases where the income is tax exempt or is not subject to tax on the grounds of double tax treaties.

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WORLD NEWS IN BRIEF

- The European Commission has published the draft Council Implementing Decision authorising the Czech Republic to apply a general reverse charge mechanism. The proposal is to be debated by the Council, and unanimous consent is required to pass it. It is not yet clear at which council session the proposal will be debated. The Czech Republic has applied for authorisation to apply a general reverse charge regime from 1 January 2020 to 30 June 2022 to transactions in excess of EUR 17,500 (approximately CZK 450,000).
- The European Commission has been requested to clarify certain issues of electric car charging, including, for instance, whether it should be treated as a provision of services or as a supply of goods (electricity). Electric car charging is also dealt with in light of the conclusions formulated in the CJEU's Auto Lease Holland and VEGA International judgements, dealing with the purchasing of goods using fuel cards.
- India has become the 28th country to deposit with the depositary (the OECD) its ratification documents for the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). It will thus become valid for India on 1 October 2019. From this date, India shall apply the adopted measures in its tax treaties vis-à-vis the 22 countries that have also been applying MLI. On the Czech part, the ratification of MLI is still waiting to be approved by the Chamber of Deputies. An interactive database containing changes to individual double taxation treaties arising from MLI, including those not yet ratified or in effect, is available on the OECD website.
- The Court of Justice of the EU issued two judgements clarifying the rules for deducting losses by non-resident subsidiaries and entities owned by them (C-607/17 Memira Holding, and C-608/17 Holmen AB).
- The Bulgarian parliament discussed in the first reading the introduction of compulsory transfer pricing documentation (local and mater file); the deadline for submitting the documentation to the tax administrator should be March of the following year. Failure to meet the duty will be penalised.
- The Polish government submitted to parliament a draft amendment to the VAT Act. The existing VAT return format is to be replaced by a single audit file format. At the same time, the requirements for records kept for VAT purposes will be limited. If passed, the amendment is to enter into effect on 1 January 2020.
- The Slovak government has approved an amendment to the Income Tax Act. Among other things, it implements the rules of taxation of hybrid mismatches with third countries (ATAD 2) and introduces new tax incentives for the automotive industry. The amendment is to enter into effect on 1 January 2020.
- The Slovak government has approved a bill to implement Council Directive (EU) 2018/822 of 25 May 2018 (DAC 6), as regards the mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements. The bill is based on the directive and stipulates sanctions of up to EUR 30,000 for duty breaches. Its expected effective date is 1 July 2020.

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