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Editorial

The holidays have come and gone and again it's time for our *Tax and Legal Update*, with its first issue in 2020, believed by some to be a magic number. I trust that most of you got the chance to spend Christmas quietly among your dearest and nearest and got to relax and recharge after the year-end rush. I sincerely hope that the new year will be at least as successful for you as the previous one.

Just before Christmas, the Czech president signed the tax rate package, a governmental bill increasing the excise duty on spirits and tobacco products and the tax on lotteries and also changing the taxation of one-crown bonds and insurance provisions. The European Commission released the final version of the explanatory notes on 'quick fixes', which is why we cover them in this issue. We also summarise some changes to be brought by the amendment to the Corporations Act effective January 2021, and the new duties of employers, arising from e-sick notes.

May you start 2020 off on the right foot!

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Tax rate package published in Collection of Laws on New Year's Eve

Just before Christmas, the Chamber of Deputies overruled the Senate and passed the original version of the tax rate package, which was then published on 31 December 2019 under No. 364/2019 and amends certain tax laws in connection with a plan to boost public budget revenues. Effective from January 2020, it increases excise duties, and changes the taxation of one-crown bonds and the method of creating technical provisions by insurance companies.

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In addition to increasing excise duties on spirits and tobacco products, the package will primarily affect insurance companies. From a tax perspective, only technical provisions created under EU Solvency II, and not as has so far been the case under accounting regulations, will be relevant with certain adjustments. Based on comments from the professional public, tax deductible provisions will be reduced by the amounts recoverable from reinsurance contracts and, simultaneously, increased by deferred acquisition costs for insurance contracts. Any impact of the transition to the new rules will be distributed over two taxable periods after the amendment's effective date. Additional taxes will therefore be charged in 2020 and 2021. In its explanatory report, the ministry estimates a one-off increase in public budget revenues of CZK 10.5 billion.

Another important part of the law is the taxation of one-crown bonds, taking the form of a transitory provision applicable to Section 36 (3) of the Income Tax Act, otherwise entirely unaffected by the amendment. In the taxable periods after the amendment, interest income from bonds with a low nominal value issued before 2013 will not be rounded at the level of one security. This in reality has led to the non-taxation of this income. In accordance with the new provision, not interest income, but the final tax per one taxpayer will be rounded. This method of rounding shall apply to all bonds irrespective of their issue date.

The tax rate package also restricts the tax exemption of winnings from gambling only to one million Czech crowns or less. Winnings exceeding one million Czech crowns will be subject to a 15% withholding tax. During the package's second reading, the deputies passed an amending proposal under which gaming payments shall be regarded as related expenses. It will thus no longer be possible for the actual winning to be lower than the tax withheld.

Amendment to VAT Act for 2020: EC explains call-off stock arrangements

At its January session, the deputies' chamber will discuss the amendment to the VAT Act introducing quick fixes in its second reading. Most neighbouring countries managed to implement the quick fixes before 1 January 2020. At the end of December 2019, the European Commission published a final version of the explanatory notes to quick fixes concerning minor and natural losses in consignment (call-off) warehouses not dealt with by the amendment to the VAT Act. The notes, among other things, also comment on the formation of fixed establishments for VAT purposes where consignment warehouses are concerned.

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The Czech Republic failed to implement an amendment to the EU VAT Directive, the so-called quick fixes, on time. Consequently, in the first months of this year, Czech taxpayers may encounter problems arising as a result of the discordance between the Czech Republic and other member states that have already implemented the amended VAT rules. This may also involve problems of a technical nature, e. g., how to correctly declare supplies of goods to consignment warehouses located in other member states in EC Sales Lists. Czech taxpayers may also be taken aback by the new requirements of European suppliers regarding documentation proving the transport of goods to another member state.

The explanatory notes contain several illustrative examples that may also be useful for Czech taxpayers. One of the issues discussed are minor and natural losses in consignment (call-off) warehouses. This problem, which in practice is quite common and which without a certain tolerance limit may automatically result in EU suppliers' registration for VAT, is not addressed by the amendment to the Czech VAT Act. The explanatory notes, referring to the conclusions of the VAT Committee (consisting of the EU member states' representatives), determined a certain tolerance limit for these minor losses, amounting to 5% of the value or quantity of goods in stock, while leaving the final decision on the matter in the competence of the individual member states. This means that losses not exceeding the limit do not have to result in the breach of conditions for applying the simplification for call-off stock arrangements.

The explanatory notes also deal with the formation of fixed establishments for VAT purposes in relation to the existence of consignment warehouses. Whereas the mere registration of a supplier for VAT in the member state in which a warehouse is located does not prevent the application of the simplification under the amendment, the formation of a fixed establishment for VAT purposes is incompatible with such simplification regardless of whether the fixed establishment participates in supplies through the consignment warehouse. A large majority of VAT Committee members agreed that a fixed establishment arises when a warehouse is owned (or leased) and directly operated by the supplier using their own means located in the member state.

Taxes

New environmental challenges for businesses

At the end of 2019, the Ministry of Industry and Trade announced another wave of calls within the Enterprise and Innovation for Competitiveness Operational Programme (OPPIK) focusing on energy savings and the efficient use of energy. The new subsidies have also been designed for large enterprises.

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The new calls under the **Low-Carbon Technology Programme** are divided into the following areas: **Electromobility, Energy Accumulation,** and **Secondary Raw Materials**. Innovative projects implementing energy accumulation technologies, the effective use of secondary raw materials, and the acquisition of various categories of electric cars and charging stations have the biggest chance to receive support. Applications for support can be submitted from 6 January to 28 May 2020. One economic entity may file up to 10 applications for support within each individual activity. The level of aid provided to large enterprises ranges from 20–60% of eligible costs comprising fixed assets. A subsidy may amount to up to CZK 70 million.

The **Energy Savings in Heat Supply Systems Programme** supports the construction and development of existing heat supply systems or the reconstruction of existing systems. Projects may also focus on the installation and modernisation of distribution-technological equipment or gas cogeneration units.

Applications for support can be submitted from 8 January to 14 December 2020. One economic entity may file up to eight applications for support. Large enterprises may receive aid of up to 40% of eligible costs mainly comprising fixed assets. A subsidy may amount to up to CZK 200 million.

The previous year's last call was **Photovoltaic Systems within the Energy Savings Programme**, focusing on the installation of photovoltaic systems for businesses' internal consumption purposes. The programme will accept applications from 13 January to 31 August 2020. The level of aid for large enterprises amounts to 60% of eligible costs mainly comprising the installation of photovoltaic systems and engineering. A subsidy may amount to up to CZK 50 million per project and up to 20 applications may be filed by one economic entity.

We will be happy to provide you with more detailed information on this matter or review whether other programme criteria may suit your company's planned activities.

Double taxation treaty with Korea in effect from January

A new double taxation treaty, which entered into force at the end of 2019, replaces the original document from 1992. Concerning tax withheld at the source, it applies already to income paid or credited at 1 January 2020, hence requiring a very rapid response of withholding tax payers. For other income taxes, the new treaty shall be applied to taxable periods commencing on 1 January 2020 and later. Below we summarise the most important changes.

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Dividends

Dividends are subject to tax at the source of up to 5% of the gross amount of dividends, involving payments to both corporations and individuals. The original treaty also included a 5% limit but it only applied to corporate dividend recipients owning at least 25% of the capital; in other cases, it was a 10% limit.

Interest

The restriction of the taxation of paid interest should certainly be regarded as a positive change. Under the new treaty, interest shall be liable to tax at the source of up to 5% instead of 10% applied previously.

Royalties

The article regulating royalties remains practically without changes. The use of or the right to use copyrights relating to works of art, literature and science remains exempt from tax at the source. A maximum 10% tax continues to apply on patents, trademarks and industrial equipment.

Permanent establishment

The new treaty extends the definition of a services permanent establishment, which arises as a result of the provision of services in the territory of the other state over one or more periods exceeding in aggregate nine months in any twelve-month period. The time test decisive for a permanent establishment – a building site – shall be extended from nine to twelve months.

Proceeds from the alienation of property

A complete novelty is the right to tax at the source proceeds from the sale of securities of or interests in a company resident in the source state if more than 50% of the company's assets consist of real property located in the source state.

Elimination of double taxation

From 2020, when taxing dividends received from a Czech resident, a Korean company may offset not only the withholding tax, but also the Czech tax on profits of the company paying dividends, as long as the Korean company owns at least 25% of the Czech resident's capital or voting rights.

In line with the latest developments in international taxation, the treaty explicitly stipulates a rule according to which the treaty's benefits will not apply if the obtaining of such benefits was one of the main objectives of a transaction or a cross-border arrangement. Hence, we again stress the importance of documentation substantiating the economic purpose of any cross-border arrangement.

GFD information on transfer of heat and cold to 10% VAT rate

In its information effective from 1 January 2020, the General Financial Directorate (GFD) draws attention to the rules of determining the date of supply for the delivery of heat and cold. It provides examples how to technically solve the settlement of advances where tax rates have changed during the settlement period.

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An amendment to the VAT Act effective from 1 April 2019 moves the supply of heat and cold to the second reduced VAT rate (10%), affecting all supplies with the date of supply after 1 January 2020.

The GFD's information draws attention to the correct determination of the date of supply, either as the date a measurement device is read or the date the actual consumption is determined if it cannot be determined otherwise. The GFD has not come up with any revolutionary changes and the rules for the taxation and settlement of advances mentioned in this information shown on a number of examples just demonstrate the current wording of the VAT Act.

The GFD also clarifies that hot water supplies after 1 January 2020 will remain subject to the first reduced VAT rate (15%), since such supplies are considered one delivery, i.e. hot water is mentioned in an appendix to the VAT Act listing goods subject to the first reduced VAT rate.

VAT: Correction of tax base for irrecoverable debts in detail

The amended wording of the VAT Act effective from 1 April 2019 introduced significant changes concerning corrections of the tax base in respect of irrecoverable receivables. The General Financial Directorate (GFD) has now published detailed information about the tax base corrections, clarifying most problematic areas.

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The issue of irrecoverable debts and the related corrections to the tax base is discussed in connection with the original and new provisions of the VAT Act. The information explicitly stipulates that if a creditor's receivable arose before the amendment's effective date, but related insolvency proceedings were commenced after this effective date (i.e. 1 April 2019), it is necessary to proceed in accordance with the new regulation.

The GFD's information draws attention to the fact that the amendment allows for the correction of the tax base for receivables included in the approved reorganisation plan, which was not possible under the original wording of the act.

The information also deals with the reporting of corrections in the creditors' VAT returns and VAT ledger statements. Following the changes in the relevant provisions of the VAT Act, the XML structure of VAT ledger statements changed from 1 October 2019. Field "Corrections in respect of irrecoverable debt" in A.4. should be designated as follows:

- "N" – not a correction for irrecoverable debt
- "A" – a correction pursuant to Section 44 of the VAT Act effective before 31 March 2019
- "P" – a correction pursuant to Section 46 *et seq.* of the VAT Act.

The choice of correction parameters will also be reflected in VAT returns; the completion of returns has also changed accordingly.

The GFD also summarises the conclusions of the Court of Justice of the EU deriving from Judgement C-127/18 A-PACK CZ. The Czech VAT Act stipulates that a correction to a tax base for an irrecoverable receivable may not be made if the debtor is no longer a VAT payer. In the above judgment, the CJEU clearly states that this provision of the Czech act is contrary to the EU VAT Directive. If both the creditor and the debtor were VAT payers at the time a taxable supply was effected, but the debtor ceased to be a VAT payer between the date of this supply and the date conditions for the correction to the tax base for irrecoverable debt were met, the creditor has the right to make a correction.

The information about the correction in respect of irrecoverable receivables is complete and comprehensive; it therefore serves as useful guidance for creditors who consider making such corrections. It contains, among other things, detailed descriptions of various situations such as corrections relating to assigned receivables, restrictions regarding the tax base corrections, suspension of deadlines, additional corrections, cancellation of corrections made, and the determination of correction amounts. It also deals with conditions for making a correction of a VAT

deduction by the debtor.

Legal

Changes brought by the amendment to the Corporations Act - I

The proposed amendment to the Corporations Act, which the deputies will be voting on again in January after it was returned to them by the Senate, is to enter into effect from 1 January 2021 and will bring a relatively high number of changes. We will summarise the most important ones for you in a series of articles, with the first one focusing on proposed changes in the act's initial provisions.

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1. **Contributions into registered capital**

The current legal regulation requires opening a special account with a bank or a savings cooperative to which contributions into the registered capital shall be deposited. This applies even to cases where the registered capital of a limited liability company only amounts to one Czech crown. Under the amendment, it would be possible to make a monetary contribution in another manner as well, for instance with a notary as a contributions' administrator, provided that the registered capital of the limited liability company does not exceed CZK 20 000.

1. ***Rights in rem* to shares/ownership interests in a business corporation to be recorded in the Commercial Register**

Currently, only a prohibition to pledge or transfer a share/ownership interest in a business corporation, if established as a *right in rem,* has to be recorded in the Commercial Register. Under the new regulation, other *rights in rem* to a share/ownership interest in a business corporation (except for those represented by a security) shall be recorded in the Commercial Register as well, for instance a pre-emptive right. This means that these rights will only come to existence once recorded in the Commercial Register.

The amendment stipulates that the establishment and origination of these other *rights in rem* shall be governed by the provisions of the Civil Code regarding the establishment and origination of a pledge to a share/ownership interest in a business corporation. These provisions stipulate that if a share/ownership interest can only be transferred under certain conditions, the same conditions must be met to pledge it. This means that, under the new regulation, if a share can only be transferred under certain conditions, the same conditions must be met to establish another *right in rem* to such a share/ownership interest.

The amendment also allows to stipulate one set of conditions for transferring a share/ownership interest, and different (stricter) ones for pledging it in the memorandum of association or deed of foundation.

1. **Bodies of a business corporation**

Where a corporate entity is a member of an elected body of a corporation, it is currently represented by its statutory body. In extreme situations (e.g. in a chain of companies), it may happen that a corporation is its own representative. Under the new regulation, a corporate entity will have to appoint a concrete individual to represent

it in an elected body of another corporation, and have this representative recorded in the Commercial Register within three months, otherwise the corporate entity's office in the elected body shall terminate. The individual representing the corporate entity shall be subject to the same duties as the corporate entity that is the member of the elected body (for instance the fiduciary duty/due managerial care).

The amendment further specifies conflict of interest rules by, e.g., making it clear that they shall not apply to a corporation's members/partners. The amendment also stipulates the corporation's duty to inform about the conclusion of contracts with controlling or influential entities (not applicable to groups subject to a single management – holdings, or 'concerns' as defined by the Corporations Act). Concluding such agreements may be prohibited by a supreme or supervisory / audit body, if against a corporation's best interest.

1. **Expulsion of a member of a statutory body**

The amendment aims to clarify the rules for the expulsion of a member of a corporation's statutory body. The amendment proposes the time for which a member of a statutory body may be expelled to be stipulated as the maximum period ('up to three years'). On the other hand, the conditions for expulsions shall be stricter: under the existing regulation, there must be a serious and repeated breach of duties (with both these conditions having to be met cumulatively), while under the new regulation just one of the conditions must be met. The breach will be reviewed retrospectively for the last three years prior to the initiation of the expulsion procedure.

1. **Business groups**

The rules regarding the deadlines for filing a report on relations in the Collection of Deeds will be more specific. Under the amendment, reports on relations that form parts of annual reports shall be audited, same as financial statements, and filed in the Collection of Deeds together with the annual reports. In other cases, i.e. where the controlled entity does not prepare an annual report, the report on relations shall be filed in the Collection of Deeds within the deadline for filing the financial statements for the accounting period for which the report on relations has been prepared.

No more paper, e-sick notes are here!

On 1 January 2020, an amendment to the Sickness Insurance Act entered into effect and launched the electronic sick note project. E-sick notes should simplify the exchange of information between sick employees, district social security administrations, physicians, and employers. Changes will mainly concern the process of issuing notes on the temporary incapacity to work ('sick notes') and how employers will be informed about their employees' absences due to illness. The new system will also bring some new duties for employers.

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The amendment introduces the obligatory electronic communication between all parties involved, reducing the number of parts of the decision on the temporary incapacity to work ("sick note") from five to three, of which only one remains in paper form. Other paper sick notes may only be used by physicians and employers on an exceptional basis, solely in the event of an objective technical failure of electronic communication, such as an internet connection failure, power outage, etc. The precise reasons for using the paper forms instead of electronic communication must always be stated on the form.

All notifications by attending physicians regarding sick notes must be made solely in electronic form. The only part of the sicknote to be still issued in paper form shall be the card of the insured person unfit to work (the second part of the sick note), used by employees to prove their illness. The employer shall not be given any part of the sick note, but employees remain obliged to inform their employer of their incapacity to work, for instance by phone or email.

The amendment brings new duties for employers: after 14 days of an employee's incapacity to work, employers shall send to the district social security administration underlying materials for the calculation of sickness insurance benefits, as well as the employee's payment information. Upon the conclusion of the incapacity to work, employers shall notify the district social security administration and provide data necessary for the last payment of insurance benefits.

Employers will also have new remote-access possibilities of obtaining information about their employees' incapacity to work. The first option, offering detailed information about a specific employee's sickness as well as an overview of all incapacitated employees, is to log on the Czech Social Security Administration's ePortal. The portal may be accessed by all employers, even those also using one of the below described other options for obtaining information. Employers may authorise their employees or another individual or legal entity (for instance an external payroll services provider) to use the ePortal services. Employers may also request to be sent automated notifications of their employees' incapacity to work, in a form of data box messages or emails. For notifications via a data box, employers will receive basic information about the employee and their incapacity to work; for email notifications, employers will only receive a message that new information is available to them on the ePortal. The third option is a service offering data on temporary incapacities to work for employers, allowing for the continuous automated download of information about employees' incapacity to work onto payroll or HR software.

For the sake of completeness, please note that all sick notes issued before 31 December 2019 using the old printed forms shall continue in the old regime until concluded. Electronic sick notes will also not concern employees who

have fallen sick abroad, as foreign physicians will, understandably, issue documents on their temporary incapacity to work following the rules of their country. The legal regulation of e-sick notes will not concern other benefits paid from sickness insurance, such as maternity or paternity allowances, care-giver's allowances, etc.

The e-sick note project has come a long way since its original proposal. While the first draft was highly criticised, the final version looks much better. In practice, however, it will not be so much about the quality of the legal regulation, rather than about the technical readiness of all parties involved. Only time will show how e-sick notes will do.

Current pitfalls of hiring employees from third countries

Employers often find it impossible to staff all open positions with domestic job applicants and have no other option than to hire foreigners. While for EU citizens, the formalities needed before they may start work can be arranged within a day, obtaining an employee card, i.e. work and residence permits for third-country nationals, is a long-distance run. While the authorities should approve the application within a maximum of three months, the process is made lengthier by various administrative requirements, depending also on the country from which the foreign worker is to relocate, or, more precisely, the system that the local embassy uses to make appointments for filing applications.

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Under the Foreigners' Residence Act, the decision on the application for an employee card should be issued within 60 days, while in particularly complex cases the deadline may be extended by another 30 days. However, the whole process, from finding a suitable candidate to them starting the job, rarely takes less than four months but instead often drags on for around half a year. The time needed to obtain all necessary residence and work permits in the Czech Republic is one of the longest in the European Union.

Most employers are already aware that to obtain an employee card, they first have to notify the labour office of a job vacancy and pass the job market test, which takes 30 days. They also know that the preparation of all necessary documents, including their super-legalisation and apostilles will take some time. What they often do not realise is that the entire process may be further prolonged by the necessity to get an appointment at the Czech embassy abroad to file the application – the foreign job applicants must make such appointments in advance.

Although all Czech embassies fall under the Ministry of Foreign Affairs, the system of making appointments to file applications is not unified. Approaches differ: some embassies proceed informally – it is enough to phone or write a simple email and an appointment for filing the application is assigned within days. Other embassies have introduced specific procedures for making appointments – the embassy has to be contacted via a specific email address, the message must contain prescribed information about the applicant, and, in most cases, already a copy of the applicant's ID and a document proving the purpose of the stay (for employee cards, typically an employment contract or an agreement on a future contract). While this system is more complicated, if all required conditions are met, an appointment is obtained within weeks.

But there is yet another group of embassies where getting an appointment is extremely difficult or just about impossible. These are embassies with a vast number of applicants, such as the Czech embassies in Vietnam, India or Ukraine. Because of limited capacity, they apply an appointment window system that is only opened several times a year. The appointment to file an application for an employee card has to be applied for at a stipulated time, either by email, by phone or in person, depending on the embassy. This results in overloaded phonelines, endless queues, and the capacity being filled-up immediately after a window is opened. The high number of unsuccessful applicants eager to work in the Czech Republic then attracts fraudsters. At the Czech embassy in Vietnam, their

flagrant abuse of the appointments system is now the subject of a police investigation.

It is crucial not to delay making the appointment for filing the application, while preparing for the procedure to take some time. Before choosing a foreign job applicant, we recommend checking the situation at the respective embassy. If employees are needed urgently, they should be chosen from countries whose Czech embassies operate a more flexible system. The government's new programmes for economic migration may also offer a solution – where both the employer and the job applicant meet the stipulated requirements, participation in the programme (within set quotas) guarantees obtaining an appointment for filing the application, and possibly also shorter approval deadlines.

BankID passed by Chamber of Deputies

At the end of last year, the Chamber of Deputies passed an amendment to the Banking Act, establishing preconditions for the wider use of BankIDs and opening the market for electronic identification services. The amendment has yet to pass through the Senate but is expected to enter into effect as at 1 January 2021.

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Bank identity (BankID) is a tool for the remote verification of a person's identity, supplementing ID cards with electronic chips. Its introduction should by severalfold increase the number of persons able to access free-of-charge online services that require proof of identity.

The aim of the amendment is to facilitate the use of BankID also for verified access to e-Government (the public administration's electronic services) and to widen the possibilities of electronic communication in the private sector.

For banks, the amendment will mean extending the range of services they may offer to their clients once they obtain the respective licence. These include the provision of electronic identification, authentication, and trust services as defined in the eIDAS Regulation. Electronic identification shall take place using the clients' access data to internet banking.

For the private sector, the amendment will widen the possibilities of the digital identification of customers, whether for the purpose of proving their age or identity. The digital customer identification service may be offered to private entities for consideration, either directly by banks, or by identification services providers, i.e. corporate entities in which banks participate with their equity.

Importantly, the amendment to the Banking Act establishes preconditions for banks and branches of foreign banks to access some of the public administration's information systems (e.g. the basic population register, the foreigners' information system, and citizen ID and passport registers). This will also make banks better positioned to prevent the legalisation of proceeds from crime and the financing of terrorism, and to fight identity theft more effectively.

To conclude, please note that the BankID Act is closely linked to the proposed Act on the Right to Digital Services. The latter assumes the creation of a catalogue of services provided by the state administration that may theoretically also be in electronic form. Both the mentioned acts follow the trend of the digitalisation of services, while at the same time making it easier to meet duties arising from AML legislation.

New rules facilitating cross-border corporate mobility within EU

Two amendments to Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 on certain aspects of company law aim to harmonise and modernise EU company law and improve the application of the freedom of establishment. The amendments deal with the use of digital tools and procedures in company law and the rules for cross-border conversions, mergers, and demergers.

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Use of digital tools and procedures in company law

The first amendment shall reduce administrative and financial burdens and promote the use of electronic communication and online tools and procedures in the establishment and management of companies. It will have to be implemented in national legislations by 1 August 2021.

The amendment introduces the option for all EU member states to establish a company or a branch and file documents and particulars in a register exclusively online, using digital tools via the electronic identification system without the need to physically visit any registry offices. It will also be possible to submit documents to registers online, even subsequently during a company's existence. The directive also limits the fees that may be charged for accessing particulars and documents in the registers, by the amount of the administrative costs for such services.

Another positive aspect is the strengthening of cooperation among the registers of individual member states via their interconnection. This means, for example, that a company should have the option to use the documents and particulars it submitted earlier to a register in a domestic state when later registering a branch in another member state. Simultaneously, changes in a domestic register should be electronically exchanged with the register in which the branch is recorded, without the need to again having to submit these documents and particulars.

Rules for cross-border conversions, mergers and demergers

The second proposal currently awaits publication in the EU Official Journal; after the publication, the two-year period for its implementation into national legislations will commence. The amendment takes into account the case law of the Court of Justice of the EU on cross-border mobility. It also responds to the current situation in which more than half of the member states have not yet determined concrete rules facilitating cross-border conversions, substantially obstructing or even preventing their implementation.

The harmonisation of the legal framework should help enhance mobility among member states via cross-border conversions, i.e. without the need to dissolve of a company in one member state, only to establish it again in another one. The amendment introduces harmonised fundamental cross-border conversion rules, focusing on the protection of the rights of creditors, employees, and shareholders/members, and including a special regulation of cross-border mergers and demergers. The amendment also gives the appropriate authorities the right not to permit the registration of a cross-border conversion involving an artificial arrangement designed to obtain

unlawful tax benefits, or excessively restrict the rights of employees, creditors and minority shareholders or members.

The above regulations will be transposed into national legislations in the following years. Hopefully, we can look forward to enjoying more effective communication with registers, the simpler management of companies and their foreign branches, and the easier cross-border mobility of companies within the EU via cross-border conversions.

Another extreme penalty for insufficient personal data protection

1&1 Telecom GmbH, a German mobile service operator, was fined EUR 9.6 million for the failure to implement sufficient technical and organisational measures to protect the personal data of its customers. This is one of the highest penalties ever imposed for the breach of GDPR since its effectiveness. The operator declared its intention to appeal the penalty.

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1&1 Telecom GmbH is one of the largest providers of telecommunication services in Germany. The penalty was imposed as the operator had provided significant amounts of customer account information by phone, based on authentication requiring only a customer's first name, last name and date of birth. The German authorities found the authentication procedure entirely insufficient and asserted that in fact anybody could have easily collected personal data on the operator's customers based on their basic identification data, often commonly available on the internet.

A penalty of up to EUR 20 million or 4% of a company's total annual turnover can be imposed for the violation of GDPR, whichever is higher. Despite the operator having been very transparent, cooperative, and willing to make amends by immediately adding another authentication detail that resulted in significantly better protection of its customers' personal data, the penalty imposed was very high, primarily owing to the operator's high turnover and the severity of the breach, as the personal data of all its customers had been exposed. Similarly, extreme penalties amounting to hundreds of millions of euros for the insufficient protection of personal data may also soon be imposed on the Marriot hotel chain and British Airways.

Both personal data controllers and processors should therefore review to what extent the personal data they process are protected, for example, whether, when providing information to customers, their authentication procedures are sufficient to avoid the provision of personal data to unauthorised persons. To determine the appropriate level of protection may sometimes be quite difficult, as access to services should not be overly complicated and should not require any unreasonable administrative burden. All the more so because GDPR also prescribes that personal data controllers must facilitate the exercise of data subjects' rights, among which is also the right to information about the data being processed. Taking into account the above decision-making practice of the EU's personal data protection offices, we recommend paying increased attention to this matter.

Prudential requirements for dealers in securities

In December 2019, new regulations dealing with prudential requirements for dealers in securities were published in the EU Official Journal, introducing a new categorisation of dealers in securities and rules for the remuneration of their employees, and specifying prudential requirements that will have to be adhered to by dealers in securities from mid-2021. Most dealers in securities will then have to substantially change their risk management systems and assess their internal regulations' compliance with the new legislation.

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The first regulation at issue is a directive on the prudential supervision of investment firms (IFD), which should be transposed into national legislations by 26 June 2021. The second regulation is a regulation on the prudential requirements of investment firms (IFR), which will enter into effect on the same date.

Dealers in securities will be divided into three categories based on their size, systemic importance, and interconnectedness with other companies of the group.

The first category will include large dealers in securities that will remain subject to the CRD IV and CRR regime (or approved CRD V and CRR II). The first category will also include a special category of systemic companies defined as credit institutions under CRR. These dealers in securities will have to obtain a new permit to provide investment services, despite already having a permit under MiFID II.

The second category will include dealers in securities who exceed some of the limits set for the third category. Companies will have to assess the risks of K-factors to determine the relevant capital requirements. K-factors represent various capital requirements regulated by IFR in relation to the risks that dealers in securities represent for customers, markets and for themselves (risk-to-client, risk-to-market and risk-to-firm).

The third category will include small and non-interconnected dealers in securities who do not represent any major risks. Whether a specific company falls into the third category will be determined based on the calculation of K-factors.

Following the new capital requirements, dealers in securities will have to adjust their risk management systems. Changes will involve, among other things, concentration risk and liquidity requirements. IFR and IFD also introduce remuneration principles, in part deriving from the requirements under CRD IV and CRR. One of the main requirements specified in IFD concerns variable components of remuneration, at least one half of which will have to be non-monetary (consisting typically of shares) and deferred over three to five years.

The duties arising from IFD and IFR will start to apply from mid-2021. The ball is now in the Czech legislators' court. However, concerned companies should already start investigating into which category they will fall and what duties they will have to fulfil to accommodate the new rules sufficiently in advance.

Case law

Surprising SAC judgment on taxation of income from sale of securities by individuals

The Supreme Administrative Court (SAC) opined on how individuals should proceed when determining the tax base for the sale of securities in foreign currencies (2 Afs. 4/2019 -38). The court held that the Income Tax Act gives taxpayers the option to choose the manner of determining the exchange rate but not the time of the valuation of the expense/income. So far, the approach generally applied in practice has been that expenses were converted using an annual exchange rate applicable for the year of the sale of securities, rather than the exchange rate applicable for the year of their acquisition.

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A taxpayer purchased securities for US dollars in 2011 and sold part of them in 2012 – within 6 months from their acquisition – also for a price in US dollars. For the purpose of determining the tax base, they converted the income (proceeds) from the sale using the annual exchange rate applicable for 2012; against this income, they deducted the expenses (costs) calculated using the same exchange rate.

The tax administrator disagreed and converted the expenses (costs) of the securities' acquisition using the annual exchange rate for 2011. This resulted in a reduction of the taxpayer's expenses and assessment of additional tax (as the exchange rate was less advantageous for the taxpayer than the one for 2012). The case proceeded to the Supreme Administrative Court, which confirmed the tax administrator's opinion.

The SAC stated that the Income Tax Act gives taxpayers who do not keep accounting books the option to choose from two alternative conversion rates: a fixed exchange rate (set for the year), and a foreign exchange market rate (applied pursuant to the Accounting Act). Had the taxpayer been using the foreign exchange market rate, they would have been applying the rate valid at the time of effecting the 'accounting transaction', i.e. the date securities were purchased. The SAC was convinced that taxpayers must proceed analogously even if they choose to apply the annual conversion rate. This means, that the relevant rate would, logically, be the annual exchange rate set for the period when the securities were purchased. The SAC thus concluded that while the Income Tax Act allows taxpayers to choose the manner of determining the exchange rate, it does not allow them to choose the manner of determining the point in time of the valuation of the expense or income.

Considering the recent strengthening of the Czech crown, this SAC decision may be beneficial for individuals trading in securities.

Case law

SAC: vacation compensation to be included in R&D allowance

In recent judgement 1 Afs 429/2018, the Supreme Administrative Court (SAC) expressed its opinion on a widely discussed question: whether wage compensation paid to employees on vacation may be included in expenses claimed within a research and development allowance. The court concluded that such compensation may indeed be included in the allowance.

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In a tax inspection, a tax administrator refused to accept the inclusion of wage compensation paid to vacationing employees participating in a development project in a research and development (R&D) allowance. The tax administrator thus followed the approach so far generally applied by the financial administration, arguing that wage compensation for vacation does not meet the condition of being directly connected with project solutions: in the financial administration's opinion, employees do not work while on vacation, therefore they do not carry out any research and development activity; the wage compensation paid to them during their vacation therefore does not constitute an employer's expense incurred in direct connection with a R&D project. In this specific case, the regional court sided with the tax administrator.

The issue was brought up by tax advisors at the Coordination Committee of the General Financial Directorate and the Chamber of Tax Advisors. The submitters were of an opposing opinion and the matter was closed without reaching consensus. The Chamber of Tax Advisors' opinion was also supported by other regional courts' decisions – about one of them we informed you in March 2019. Now the issue appeared before the SAC, which unequivocally concluded that that the expenses may be claimed within a R&D allowance.

The SAC considered the financial administration's arguments artificially separating work performance from vacations unconvincing and biased. In the court's opinion, the precondition for claiming the allowance is not that expenses must be incurred directly for the R&D project implementation, but rather in its implementation, meaning in connection with the project solution. Wage compensation for vacation is stipulated by the Labour Code and comprises an obligatory labour expense. The SAC pointed out that employees are entitled to vacation for having worked hours on a research and development project, therefore their wage compensation must be viewed as a remuneration for work, rather than a remuneration for absence from work or for recuperation. In the court's opinion, it is in fact a matter of a payment for work being spread over time.

The SAC also noted that the aim of supporting research and development is to promote the hiring of highly qualified staff and the carrying out of research and development by one's own employees, which naturally involves also the provision of all benefits stipulated by law. The impossibility to claim wage compensation for vacation within a R&D allowance would be contrary to the purpose of R&D support.

The SAC therefore found no reasonable grounds why these expenses should be treated differently than other labour expenses stipulated by law, such as obligatory social security and health insurance premiums, which are standardly included in R&D allowances.

Case law

SC on breach of work duties by bank employee

The Supreme Court (SC) confirmed the validity of an immediate termination of employment of a bank employee working as a cashier. Entirely in line with its previous case law, it confirmed that duty breaches by bank employees must be viewed more strictly. The court mainly based its conclusion on the banking activity's specificity, as it involves a significant element of risk and therefore places high demands on bank employees as regards meeting their work duties and observing internal policies and procedures.

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In the case in question, a bank employee had made 45 cash deposits and withdrawals to and from her own account, accounts she was authorised to handle, and her relatives' ('close persons') accounts, without the consent of her direct supervisor. However, the banks' internal policies and procedures required the direct supervisor's consent for all such activities. Furthermore, the employee several times opened a safe deposit box for which her colleague was responsible, and viewed three of her colleagues in a system allowing the inspection of their accounts and account balances, without appropriate authorisation. When deciding on the rightfulness of the immediate termination of employment by the employer, the SC also took into consideration the employee's overall attitude: throughout the court procedure, she was belittling the entire case, arguing that *"for a bank as an established banking institution with vast options of computer applications, it should be no problem to adopt necessary measures to immediately detect any employee's handling of their or their relatives' accounts".*

In another recent case, the SC also sided with the employer – a bank that had immediately terminated the employment of an employee who, without authorisation, had downloaded 2.2 GB of work-related data on his flash disc. When assessing the intensity of the breach of duties, the court also considered the employer's business activity (the employer was a bank) and the clarity and strictness of the employer's instructions and internal policies regulating the handling of data. The court also reflected on the employee having downloaded the entire content of his mailbox, including sensitive data concerning the credit and other activities of the employer and its clients.

The specific nature of banking activities has already been pointed out by the SC in a judgement dated 2001. The court then emphasised that breaches of duties arising from legal regulations concerning work performed by an employee for an employer that is a bank usually constitute a more severe and serious circumstance than would be the case with other employers. In the court's opinion, the high demands and requirements on bank employees in this respect raise the intensity of breaches to a higher level. For this reason, the exact and strict observance of a bank's internal policies and procedures is also a significant criterion for assessing the intensity of a breach. The court, however, also emphasised that this shall not be the only aspect to consider, as it is only a general assessment of the matter, not considering any other circumstances of the case.

Although higher demands may be placed on bank employees than on those of other entities as regards observance of duties arising from legal regulations concerning their work, bank employers cannot consider their specific

business as the only criterion to assess the intensity of breaches and disregard other criteria entirely. All employers – including bank employers – should assess each case on an individual basis, and consider other criteria defined by case law, such as an employee's personal circumstances, the office they hold, their attitude towards their work duties so far, the timing and circumstances of the breach, the extent of the employee's fault, the manner and intensity of a breach of concrete duties, etc.

Case law

Not keeping track of the other statutory representative? You are jointly liable for any damage they cause!

The Supreme Court (SC) is sending a warning to statutory representatives in limited liability companies: if you do not monitor your colleagues, you are in breach of the fiduciary duty / due managerial care, therefore co-liable for damage that would otherwise not have been incurred (although to a lesser extent).

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In the case in question, the Supreme Court (SC) dealt with the private-law liability for damage caused by embezzlement in a limited liability company. For a rather long period of time, one of its statutory representatives (statutory representative no. 1) had been withdrawing company funds and using them for his own needs. As soon as the other statutory representative (statutory representative no. 2) found out, he lodged a criminal complaint against his colleague.

Yet, in terms of statutory representative no. 2's co-liability for damage, this was already too late. The court concluded that statutory representative no. 2 had breached his fiduciary duty as he did not devote proper attention to the company's governance, factually allowing the embezzlement of its funds. Moreover, he only detected the unauthorised withdrawals from the company's bank account with significant delay (of several years), allowing for the damage grow to nearly CZK 3 million.

Statutory representative no. 2 based his defence on arguments that he was not versed in accounting/book-keeping issues, therefore leaving this area to his colleague. The SC, however, explained that to prevent and detect the embezzlement in time, no special knowledge of booking had been necessary, and it would have sufficed to show a minimal interest in the company's management – suspicious withdrawals of cash could have been detected simply by checking the company's internet banking. The arguments that the misstatements were not even noticed by the company's member who had approved the company's financial statements without any reservations, were not heard either.

The SC concluded that statutory representative no. 2 breached his fiduciary duty as he only exercised his office formally (not taking part in the company's management nor setting up proper controls), and was therefore liable, jointly and severally with statutory representative no. 1, for damage caused by the embezzlement.

The SC's conclusions follow along the lines of the recent judgment of the High Court in Olomouc which held that members of the board of directors of a joint stock company had breached their fiduciary duty by neglecting to check the book-keeping entrusted to one them.

Even where powers and competences are properly divided among individual members of a statutory body (which was not the case here), it does not free the other members of the statutory body (or, if there is no collective body,

other individual statutory bodies) of their duty to adequately supervise the exercise of such delegated powers. For other duties that members of statuary bodies should keep in mind when delegating powers, see our previous article here.

Latest news, January 2020

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

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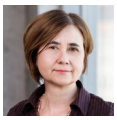

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DOMESTIC NEWS IN BRIEF

- Regulation No. 358/2019 Coll. stipulates basic compensation rates for the use of road motor vehicles and meal allowances for 2020 and slightly reduces the average price of fuel. It also introduces the average price for one kWh of electricity for the purpose of calculating the consumption of fuel by electric cars.
- The General Financial Directorate issued Instruction D-29, regulating the waiver of penalties for the failure to file VAT ledger statements. The new instruction de facto copies existing Instruction D-21 regulating the waiver of charges additional to tax and supplements VAT ledger statement specifics.
- From 1 January 2020, the minimum wage will increase by CZK 1 250, from CZK 13 350 to CZK 14 600. Along with the increase in the minimum wage, affecting approx. 150 000 employees, the guaranteed wage will also grow from a range between CZK 13 350 and 26 700 to CZK 14 600 and CZK 29 200. The guaranteed wage represents the lowest earnings paid according to eight pay-grade levels depending on the required qualification and intensity of work. The guaranteed wage is received by a significantly higher number of employees than the minimum wage.
- The government submitted a large draft amendment to the Labour Code to the Chamber of Deputies. The amendment changes the treatment of vacation; according to the amendment, an employee's weekly working hours will form the basis for assessing vacation, in hours. It also introduces a job-sharing concept, simplifies the delivery of documents to employees, reduces the administrative burden associated with agreements to perform work, and transposes an amendment to the EU Directive on the Posting of Workers.
- A notice of the Ministry of Labour and Social Affairs disclosing the average wage in the national economy for the first to the third quarter of 2019 for the purposes of the Act on Employment was published in the Collection of Laws (under No. 346/2019 Coll.)
- An amendment to certain laws affecting the financial market regulation passed through the third reading in the deputies' chamber. The amendment adapts Czech legislation to Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017, on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC.
- On its website, the Ministry of Finance updated an overview of effective double taxation treaties.
- The Ministry of Finance also submitted to the government for discussion a proposal to negotiate a double taxation treaty between the Czech Republic and San Marino.
- The financial administration draws attention to an amendment to the Real Estate Tax Act changing the conditions for the exemption of land with certain landscape characteristics from tax.

FOREIGN NEWS IN BRIEF

- KPMG has released the KPMG Digital Economy Tax Tracker mobile app - now covering BEPS2.0, digital service taxes, and VAT/GST developments across 63 countries. You can download it free-of-charge from the Apple App Store or Google Play.
- According to a CJEU advocate general, deferring the payment of an undisputed part of an excess deduction until the examination of all taxable supplies is completed is inconsistent with the VAT Directive, as it violates the principle of VAT neutrality.

- ECOFIN adopted a proposal for the taxation of energy products within the EU. The council calls on the European Commission to adopt measures to facilitate the transformation into the climate-neutral EU in compliance with obligations deriving from the Paris Agreement. The existing version of the directive from 2003 must be reviewed and updated.
- The European Commission sent reasoned opinions to the Czech Republic and other countries concerning their failure to complete the transposition of the EU Tax Dispute Resolution Directive (2017/1852) into domestic law. If the relevant member states fail to act within the next two months, the commission may decide to proceed with a case before the CJEU.
- At a meeting of the EU Competitiveness Council, the EU Council of Ministers failed again to reach agreement on the introduction of public country-by-country reporting (CbCR). A majority of 16 countries need to vote in favour of the proposal for it to proceed, but there were only 14 votes in favour of the proposal.
- In December, the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (2016) (MLI) entered into force in respect of Ukraine, Switzerland and Canada. The MLI was also approved by the Moroccan government and the Czech parliament. The MLI was ratified in Costa Rica and will enter into effect three months after the country deposits its instruments of ratification with the OECD. Kenya and Oman signed the MLI, bringing the total number of signatories to 92 jurisdictions.

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