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dReport: October 2018

Leaf through the regular overview of tax, legal and accounting news, get up to speed on subsidy and investment incentives developments.

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Tax changes in the taxation of investment funds

In the June issue of dReport, we informed you about the amendment included in the planned change in the taxation of basic investment funds. On 19 July 2018, an act was adopted (with effect from 1 January 2019) which includes a narrowing of the definition of a basic investment fund, and removes from the definition those funds whose shares are admitted to trading only on the European regulated market and do not fulfil the other conditions enumerated by law. These funds will now be subject to the standard corporate rate of 19% and not the current rate of 5%.

As we have reported before, the reason for the change was the Senate's effort to remove from the definition of the basic investment funds the funds that are only registered on a regulated market without actually performing investment activities. Pursuant to the amendment, the benefits of lower taxation can only be drawn by the funds that are active in making investments on financial markets.

The adopted amendment stipulates that the basic investment funds include the funds listed for trading on a European regulated market with no corporate income taxpayer having any investment of 10% or more in the registered capital of the relevant investment fund; in order to meet the condition, investments of related parties that are corporate income taxpayers are considered to be investments of a single taxpayer; the condition is considered to be met even if the permitted investment in the registered capital is exceeded over a period shorter than a half of the taxation period or a period for which a tax return is filed or a period shorter than six months if the taxation period is longer than 12 months and if the fund is not involved in a trade under the conditions stipulated by the Trade Licensing Act.

The above-specified restriction will thus relate to the funds that are only considered to be basic investment funds under the Income Taxes Act due to the fact that they are listed for trading on a European regulated market and at the same time, they are owned within a group or by a limited number of owners, whereby the share of each owner is 10% or more.

The amendment will apply to tax obligations arising after the effective date of the Act, i.e. from 1 January 2019.

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The flat expense charge-off for entrepreneurs will not increase

The Chamber of Deputies rejected an amendment intended to restore the cap on the flat expense charge-off ("paušální výdaje") to the past year's level, i.e. In relation to the annual income of CZK 2 million. As a result, for all income from independent activities, the flat expense charge-off remains only at CZK 1 million per year (income in excess of this amount is taxed on a gross basis). Entrepreneurs and sole traders will need to work out properly whether a more beneficial treatment for them does not involve deducting the actual expenses incurred. Changing the treatment also requires taking into account special obligations related to the change such as additional taxation of receivables, etc.

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Currently on ATAD implementation

The proposed amendment to the Income Taxes Act (included in the government package of tax law amendments), whose primary objective is to implement the EU Anti Tax Avoidance Directive – ATAD from 1 January 2019, is awaiting debate in the Chamber of Deputies in the first reading. A question mark is therefore beginning to appear regarding whether or not the proposed amendment will be able to go through the whole legislative process by the year end.

Given the complexity of the new provisions of the implemented directive (especially the definition and calculation of deductibility of interest and financial expenses arising from loans, CFC rules etc.), the Financial Administration is working to prepare methodology to describe the procedures according to the new provisions and definitions in more detail including illustrations on specific examples. At present it is unclear what form the methodology will have or when the Financial Administration should publish it.

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Amendment to the VAT Act

The technical amendment to the VAT Act, which should substantially revise rules in various areas (voucher taxation, issuance of corrective tax documents, possibility of correcting tax imposed on bad debt etc) has not yet been debated by the Chamber of Deputies. The effect of the amendment will likely be postponed by several weeks (or months).

A similar scenario may also be expected with respect to the amendment to the Electronic Sales Records Act. The amendment should extend the application of the reduced tax rate to other supplies (draught beer, household cleaning services etc).

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Judgments of the Court of Justice of the European Union

In two cases (C-422/17 Scarpa Travel and C-552/17 Alpenchalets Resorts), the Advocate General of the Court of Justice of the European Union (CJEU) defines the taxation of services when the special regime for travel services is applied. The Advocate General infers that advance payments should also be subject to tax (this requirements is not included in the Czech VAT) and, furthermore, substantially extends the definition of travel services (it is debatable how the CJEU will respond to the Advocate General's controversial opinion and how this opinion could affect the interpretation of the Czech VAT Act).

Other interesting interpretations of the Advocate General may be found in case C-502/17 C&D Foods relating to the sale of a share in a subsidiary which was so far only passively held by the parent holding company. The Advocate General indicates that, under specific circumstances, a claim for the VAT deduction may also be considered for received supplied relating to the sale (in particular, advisory services provided to the holding company).

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News round up

BEPS Action 15: Multilateral Instrument

Australia, the Czech Republic, Kazakhstan, Kuwait, Switzerland and Panama approved the multilateral instrument (MLI) in recent days. Namely, in the Czech Republic the Ministry of Finance submitted a draft bill to ratify the MLI to both chambers of parliament on 29 August 2018. The OECD maintains an up-to-date list of signatories to the MLI that also indicates jurisdictions that have ratified the MLI andthe date on which the MLI enters into force for those jurisdictions. The list is available here.

Belgium: Questions and answers to deduction on innovation income

On 26 July 2018, the Belgian tax authorities published frequently asked questions (FAQ) on the application of the innovation income deduction (IID) regime, which replaced the previous patent income deduction. Under the IID regime, qualifying taxpayers may deduct 85% of qualifying net innovation income from the company's taxable base..
The main highlights of the FAQ are: the intellectual property (IP) for which the IID will be applied must be booked as an immaterial fixed asset on the company's balance sheet. R&D expenses that are not directly related to the IP right may not be deducted from the gross innovation income. This includes interest expenses, building costs, as well as any other costs not directly related to the IP.

Implementing of ATAD in Croatia

Croatia's Ministry of Finance has initiated a consultation on several draft tax bills that would, among other things, bring domestic legislation in line with the EU anti-tax-avoidance directive (ATAD), effective 1 January 2019. Proposed new rules for interest expenses incurred on loans granted by both related and unrelated parties would apply in tandem with the existing thin capitalisation rules for interest expenses incurred on loans granted by related parties. The draft measures would also introduce controlled foreign corporation rules covering passive income (including dividends, interest or other income from financial assets, fees for licences or any other intellectual property income, and income from finance leasing) that is taxable in a foreign low-tax jurisdiction. Moreover, another draft bill would extend the 20 percent withholding tax rate levied on remuneration paid for services rendered by non-resident suppliers in non-cooperative jurisdictions (based on the EU list) to interest, dividends, and other similar payments to those persons, provided that there is no tax treaty in force between Croatia and the non-cooperative jurisdiction.

Luxembourg: Access to anti-money laundering information gazette

The bill implementing the EU directive on tax authorities' access to anti-money-laundering information was published on 6 August 2018. The bill, which applies from 10 August 2018, provides amendments to the following laws: the law on administrative cooperation in the field of taxation, the law relating to the Common Reporting Standard (CRS) and the law on country-by-country (CbC) reporting.

Malta updates notional interest deduction guidelines

Malta's revenue commissioner released an updated version of the Notional Interest Deduction (NID) Guidelines on 8 August 2018. The guidelines pertain to the Notional Interest Deduction Rules, 2018, which are effective from fiscal year 2018. For the purpose of calculating the NID, the reference rate must be determined by reference to the risk-free rate published by the Central Bank of Malta for the end of the quarter falling on the same day as the end of the relevant undertaking's accounting period. Further, the NID may be claimed only if it is demonstrated that all shareholders or partners of the undertaking approve the claim for the deduction for the particular tax year.

Poland:New tax measures

Poland's Ministry of Finance released a draft bill proposing preferential tax treatment for income from intellectual property rights and lower corporate tax on small and medium-sized enterprises. The tax measures are expected to take effect on 1 January 2019. The proposed patent box regime would introduce a reduced tax rate of 5 percent for income derived from qualifying IP rights.
The preferential tax regime would cover cases in which a taxpayer conducts research and development activities related to the development, creation, or improvement of a qualifying IP right. The draft measures would also introduce a reduced corporate income tax rate of 9 percent for SMEs with annual turnover of no more than €1.2 million and a notional interest deduction, subject to an annual cap of PLN 250,000. An exit tax would also be implemented in accordance with the EU anti-tax-avoidance directive.

Guernsey and Jersey: New rules for demonstration of economic substance

Guernsey and Jersey are consulting on proposals to apply for accounting periods beginning on or after 1 January 2019, requiring tax resident companies to demonstrate they have sufficient substance. The proposed substance requirements, outlined in detail in the Jersey consultation paper, include several relevant activities that companies operating in the specified fields will need to detail on their tax returns. Those include the amount and type of gross income, type of expenses and assets, details about physical premises, and number of full-time employees. Companies must also demonstrate that they are directed and managed in their tax-resident jurisdiction, and the Jersey consultation provides different ways for companies to do so.

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New framework for resolving international tax disputes

The Ministry of Finance has presented a draft Act on International Cooperation in Tax Dispute Resolution for consultation. It is a new act designed to transpose Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union ("DRM Directive"). It should also be applied to resolve disputes with countries with which the Czech Republic has concluded a Double Taxation Treaty. The principles of the new regulation are therefore **based on existing mechanisms** stipulated by international treaties, and the provisions codify the existing mechanisms, clearly determine the course of the process of international tax dispute resolution, the competencies of individual participants and the deadlines for the intermediate steps.

The new provisions should be applied with respect to **all contracting states**. With respect to the member states of the European Union, certain **additional institutes** will apply, such as the possibility to access tax arbitration (which can, however, also arise from international treaties). In addition, they contain so-called control mechanisms which allow summoning an **advisory body** (composed of representatives of the competent authorities and experts) in certain stages of the proceedings for an independent and unbiased assessment of the dispute. The advisory body can **assess the admissibility of the request as such** (if there is a disagreement between the states as to whether or not the request is admissible) or it can **perform tax arbitration** – material assessment of the question in dispute if the competent authorities do not reach an amicable resolution of the case **within a two-year period.**

Large entities will file requests for the questions in dispute in all of the affected countries, smaller entities and natural persons should be able to use a simplified filing system. The process is expected to result in achieving an agreement, or issuing a decision on the question in dispute that the taxpayer may use during specific proceedings with the tax authority.

The proposed effective date of the new act is 30 June 2019.

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Imposition of sanctions by the Financial Administration

The Financial Administration has recently published information about its activities in 2017 including statistical data concerning specifically tax administration. Based on comparison with the data of previous years, we can observe particularly a trend of increases in sanctioning taxable entities for breaches of their obligations.

The Tax Code regulates a variety of sanction instruments for breaches of obligations of a taxable entity during tax administration. Aside from sanctions for breaches of obligations of a taxable entity of non-monetary nature, a taxable entity can be subject to fines especially for the breach of obligations in the area of filing tax returns and in the area of payment.

In practice, it is no exception that due to the existence of a long-lasting tax audit and appellate proceedings, sanctions can reach almost the same amount as the additionally assessed tax liability. The strictness of the sanctions is exacerbated by the fact that they usually represent a non-tax deductible expense. After the imposition of a sanction, a taxable entity should therefore consider the use of remedies or the possibility of sanction remission, since in recent years it has been possible to obtain at least partial remission of selected sanctions.

Which fines predominate according to the Financial Administration's statistics?

Fine for late tax return

As in previous years, a very frequently imposed sanction pursuant to the Tax Code in 2017 was the fine for late filing of the tax return. This fine was imposed in a total of 273,000 cases, which is 55,000 cases more than in the previous calendar year.

A taxable entity becomes obliged to pay the fine for late tax return if its filing of the tax return is delayed by more than five business days of the end of the period for filing the tax return. The fine is imposed automatically as required by law and the tax administrator has no possibility of administrative reasoning. In this respect, it should be emphasised that this sanction applies even if the taxable entity delays in filing an additional tax return or accounts and reports. The amount of the fine depends on the amount of tax and the period of default. The amount of this fine is set by law as equal to 0.05% of the assessed tax or the assessed tax deduction, or 0.01% of the assessed tax loss for every day following the day of default, but no more than 5%; however, the fine for late tax return simultaneously cannot exceed CZK 300,000. If the taxable entity files a tax return within 30 days of the end of the period for filing the tax return and if the taxable entity was not in default with another tax return in the same calendar year, only half of the amount of the fine is imposed. This fine cannot be remitted in any way.

Penalty

If additional tax is assessed after a tax audit, an additional penalty of 20% of the assessed tax is imposed. If the additionally assessed tax is paid, up to 75% of the penalty may be remitted based on an evaluation of the taxable entity's cooperation.

Default interest

The highest item in the total volume of the recorded additional tax charges imposed for 2017 was default interest imposed in the event of late payment of tax, amounting to CZK 14 billion and it therefore represented 87.2% of the total value of additional tax charges. However, the state budget income from this sanction was higher in previous years (approx. CZK 19 billion in 2016, CZK 17 billion in 2015).

A taxable entity becomes obliged to pay default interest (currently in the amount of 14.5% p.a.) for each day of default starting with the fifth business day following the original due date of the tax, until the day of actual payment.

The taxable entity does not have to be automatically informed by the tax administrator about the tax arrears in any way, even though default interest may arise from just an oversight, e.g. due to the payment of tax with an incorrect variable symbol or forgetting to make prepayments. Every taxable entity should therefore regularly make sure that it has no tax debts, which can be done by filing a request for a confirmation of no outstanding payments or confirmation of the state of the personal tax account, or a request for an extract of facts from the tax file, or online using the tax information box.

Tax that has not been paid on time represents tax arrears, but the performance of this obligation to pay the outstanding amount may still be postponed. One of the possibilities is the permission to defer the payment of tax or to distribute its payment in instalments regulated by Section 156 of the Tax Code; the deferment may be permitted even retroactively. Throughout the permitted deferment, the taxable entity is not obliged to pay default interest but instead a significantly lower interest on the deferred amount (7 % plus REPO p.a.), which can even be partially remitted by the tax administrator in specific cases. In 2017, deferment was granted in 8,210 cases.

Sanctions for breaches of the taxable entity's obligations of a non-monetary nature

A frequently imposed sanction for breaches of the taxable entity's obligations of a non-monetary nature in 2017 were fines for filing a tax return or additional tax return in other ways than electronically even though the taxable entity was obliged to use the electronic method.

Other frequent fines included fines for breaching obligations related to local sales/purchases reporting ('kontrolní hlášení') pursuant to the VAT Act. The highest amount of fines were imposed by tax authorities to VAT payers that did not file the local sales/purchases report even in the substitute period after a call from the tax administrator. In such a case, VAT payers should keep in mind that one transgression per year can be remitted provided that the required conditions are met.

Tax authorities also imposed several fines pursuant to the Accounting Act, e.g. for the failure to disclose the required reports, which are, however, not disclosed by most companies in the Czech Republic according to the statistics. Sanctions were also imposed with respect to the electronic sales records.

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CbC reporting: Amended list of cooperating countries

In Financial Bulletin ("FB") No. 7/2018 of 23 August 2018, the Financial Administration published an amended list of countries exchanging country-by-country reports ("Report") with the Czech Republic. The changes concern Costa Rica, Pakistan, and Bonaire, Sint Eustatius and Saba.

The amendment to the Act on International Cooperation in Tax Administration introduced a new reporting obligation in the Czech Republic as part of the international exchange of information, so-called 'Country by Country Reporting'. This generally obliges each group of enterprises with consolidated global income exceeding EUR 750 million and with local presence to disclose to tax administrations a yearly CbC Report that summarises the financial information on this group. The Report, which is then subject to automatic exchange of information between individual countries, shall be prepared on behalf of the whole group of enterprises by:

- The ultimate parent company; or
- The surrogate parent company (i.e. The Company that was designated by the group to prepare the CbC Report e.g. because the parent company does not have the obligation to prepare it or it is based in a country that is not part of the automatic exchange of CbC Reports – refer to the published list of jurisdictions); or
- The Czech member company if the ultimate parent company or surrogate parent company are based in a non-cooperating country, see above.

On 31 January 2018, the Ministry of Finance of the Czech Republic issued a **list of jurisdictions that have an active exchange of information with the Czech Republic**.

On 27 April 2018, this list was updated for the first time (FB No. 4/2018) and the following countries exchanging CbC Reports for reporting periods beginning on or after 1 January 2016 were added:

- Bermuda;
- Cayman Island; and
- Pakistan.

As part of the second update of 23 August 2018 (FB No. 7/2018), the following countries exchanging CbC Reports for reporting periods beginning on or after 1 January 2016 were added to the list:

- Bonaire, Sint Eustatius and Saba; and
- Costa Rica.

In the case of Pakistan, the activation of information exchange was postponed until reporting periods beginning on or after 1 January 2018.

The complete list of countries is available here.

The published list will continue to be gradually updated depending on the inclusion of additional jurisdictions in the system of CbC Report exchange with the Czech Republic and this information will be once again issued in the Financial Bulletin. In addition to this list, the CbC Report exchange takes place automatically within the European Union.

The first automatic exchange of CbC Reports for reporting periods ending 31 December 2016 took place between these countries in June 2018. This was the first period for which CbC Reports were filed worldwide. In this respect, there was a great deal of discussion about the relationship of the Czech Republic with e.g. Japan, the USA, China and Switzerland, especially regarding the valid periods for which the automatic exchange of information would be activated with these countries. The aforementioned list of cooperating states confirms that Japan and the USA exchange reports already from the taxation period of the FY 2016, so no alternative measures have to be taken with respect to them.

By contrast, China has not joined the automatic information exchange as part of CbC reporting at all so far. If a Czech company has a parent company in China, the group can either designate a surrogate parent company in one of the cooperating countries that is on the list and where the CbC Report for the group will be filed, or the Czech company has to file the CbC Report on its own in its country. This also has to be adequately indicated in the CbC notification.

Thanks to transitional provisions, these obligations are only valid from the taxation period of the FY 2017.

Switzerland will start exchanging CbC Reports from the taxation period of the FY 2018. i.e. The same situation as in the case of China applies for the FY 2017, but for the following periods, the standard situation will apply as for other countries from the amended list, including the USA and Japan.

The exchange of CbC Reports for reporting periods ending no later than 31 December 2017 will follow next in the first half of 2019. If a Czech company is obliged to file the CbC Report at the local Specialised Tax Office, it should do so within 12 months of the end of the taxation period, i.e. for the FY 2017 taxation period by 31 December 2018.

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Tax liabilities – October 2018

October		
Monday, 1	Value added tax	Deadline for submission of application VAT refund from/to other member state to sec. 82 and sec. 82a VAT Act
	Income tax	Payment of special-rate withholding tax for August 2018
Wednesday, 10	Consumption tax	Tax maturity for August 2018 (except the consumption tax on alcohol)
Friday, 12	Intrastat	Submission of statements for intrastat for September 2018, paper form
Tuesday, 16	Road tax	Advance payment of tax for 3rd quarter 2018
	Intrastat	Submission of statements for intrastat for September 2018, electronic form
Monday, 22	Value added tax	Tax return and maturity of the MOSS VAT
	Income tax	Monthly payment of deducted advance payments on personal income tax from employment
Thursday, 25	Lotteries and other similar games	Submission of statement to advanced payment on lotteries and other similar games and payment of advanced payment for 3Q quarter 2018
	Value added tax	Tax return and tax due date for 3Q and September 2018
		EC Sales List for 3Q and September 2018
		VAT control statement for Q3 and September 2018
	Energy taxes	Tax return and tax maturity on gas, solid fuels and electricity for September 2018
	Consumption tax	Tax maturity for August 2018 (only the consumption tax on alcohol)
		Tax return for September 2018
		Tax return for claiming of refund of consumption tax, for example on fuel oil, other petrol (benzine) for September 2018 (if applicable)
Wednesday, 31	Value added tax	Last day of term for submission of application, changes or cancellation of VAT group according to § 95a based on VAT Act with effectiveness of change of group on 1 January 2019
	Income tax	Payment of special-rate withholding tax for September 2018

Tax liabilities – November 2018

November

Friday, 9	Consumption tax	Tax maturity for September 2018 (except the consumption tax on alcohol)
Wednesday, 14	Intrastat	Submission of statements for intrastat for October 2018, paper form
Friday, 16	Intrastat	Submission of statements for intrastat for October 2018, electronic form
Monday, 20	Income tax	Monthly payment of deducted advance payments on personal income tax from employment
Monday, 26	Value added tax	Tax return and tax for October 2018
		EC Sales List for October 2018
		VAT control statement for October 2018
	Energy taxes	Tax return and tax maturity on gas, solid fuels and electricity for October 2018
	Consumption tax	Tax maturity for September 2018 (only the consumption tax on alcohol)
		Tax return for October 2018
		Tax return for claiming of refund of consumption tax, for example on fuel oil, other petrol (benzine) for October 2018 (if applicable)
Friday, 30	Real estate tax	Tax maturity of 2nd tax payment (all tax payers with tax duty above CZK 5,000)
	Income tax	Payment of special-rate withholding tax for October 2018

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Announcement of the Second Public Tender under the THÉTA Programme

On Wednesday, 17 October 2018, the second public tender under the Théta programme will be announced by the Technology Agency of the Czech Republic.

This programme is designed to support applied research, experimental development and innovations and is focused on projects in the energy industry. It will support projects whose objective is the achievement of certain types of deliverables and results such as a patent, prototype or function sample.

The programme is divided into the following three sub-programmes:

1. Research in public interest.
2. Strategic energy technologies.
3. Long-term technological perspectives.

Applicants in this public tender may comprise both enterprises (small, medium-sized and large) and research organisations. The amount of the support per one project may, in the case of enterprises, attain no more than 80% of total eligible costs, depending on the size of the enterprise and the type of the activity supported. Regarding the research organisations, the amount of the support is set at 100% of total eligible costs.

Second Public Tender under the Zéta Programme

On Wednesday, 12 September 2018, the Technology Agency of the Czech Republic announced the second public tender under the Zéta programme. The support from this programme is intended for the projects of cooperation between companies and the academia, through involvement of students.

The necessary presumption of the projects is the achievement of a certain type of a result such as a prototype, function sample, software, industrial or utility design etc. Applicants in this public tender may recruit from among companies and research and knowledge-transfer organisations.

A subsidy applies to the costs such as personal costs, costs of tools and equipment, costs incurred in connection with contractual research, knowledge, patents and advisory services used for the purposes of the project and additional overhead costs incurred immediately in connection with the project.

The maximum amount of the support per one project is CZK 10 million.

Autumn Round of the Acceptance of Applications under the Rural Development Programme

The autumn, already the 7th, round of the acceptance of applications under the Rural Development Programme will take place from 9 October 2018 to 30 October 2018. The managing body is the Ministry of Agriculture of the Czech Republic.

The support will go to projects, eg, in the following areas:

- Educational events.
- Investments in agricultural enterprises.
- Processing of agricultural products and their launching on the market.
- Implementation of preventive measures in forests.
- Post-calamity restoration of forest vegetation.
- Engineering and technology for forest management.

Who can apply for a subsidy?

- According to the type of the supported area, these can be entrepreneurial entities, entities ensuring educational events, entrepreneurs in farming, groups of farmers etc.

What the subsidy applies to:

- According to the type of operation, the subsidy applies, eg, to the costs of procurement of an educational event, technologies for plant and animal production, costs of special mobile machinery for agricultural production, construction and refurbishment of buildings, investment costs leading to the increase and monitoring of the quality of products or relating to the launch of products on the market, costs of machinery and equipment for agricultural products processing, costs of studies.

Amount of the subsidy per one project:

- According to the type of operation: 25% - 85% of costs from which the subsidy is determined.

Acceptance of applications:

- 9 October 2018 – 30 October 2018.

Launching the acceptance of applications for a subsidy under the OP PIK

In late September and during October the acceptance of the applications for a subsidy will be launched in several calls of the Operational Programme Enterprise and Innovations for Competitiveness 2014–2020 whose more detailed description is provided below.

The Innovation Programme

On Wednesday, 26 September 2018, the acceptance of the applications for a subsidy under the programme Innovation (Innovation project) will be launched. This programme focuses on the support of projects implementing new or innovative products, technologies or services in production and on the market. Supportable activities include, eg, product innovation activities such as strengthening the technical and utility values of products, technologies and services and process innovation activities such as the increase of the effectiveness of the process of production or provision of services.

Who can apply for the subsidy?

- Small, medium-sized and large enterprises. However, large enterprises only if the presented project has a positive environmental impact.

What the subsidy applies to:

- Project documentation costs.
- Construction costs.
- Costs of the acquisition of production technologies, machinery and equipment.
- Software and data costs.
- Costs of the rights to use intellectual property.
- Costs of certification of products.
- Marketing innovation costs.

Amount of subsidy per one project:

- CZK 1 million – CZK 40 million.

Level of support per one project:

- Up to 45% of eligible costs for small enterprises.
- Up to 35% of eligible costs for medium-sized enterprises.
- Up to 25% of eligible costs for large enterprises.

Acceptance of applications:

- 26 September 2018 – 27 November 2018.

Applications accepted as part of the call are assessed on an ongoing basis. The project has to be implemented in the Czech Republic, outside the capital of Prague where the actual real place at which the project is realised is decisive. Projects that are realised in districts showing a share of unemployed persons higher than the average share per the Czech Republic receive bonification.

The Potential Programme

On Monday, 1 October 2018, the period for filing applications for a subsidy under the Potential programme that supports projects focused on the construction and development of centres for industrial research, development and innovations starts running. Support is given to the purchase of land, buildings, machinery/equipment and other equipment for the research and development centre.

Who can apply for the subsidy?

- Small, medium-sized and large enterprises. However, large enterprises only if the presented project has a positive environmental impact or the main aim of the project is cooperation of a large enterprise with a small or medium-sized one on a particular research and development project.

What the subsidy applies to:

- Costs of the acquisition of tangible fixed assets necessary for the performance of research and development activities and equipment of the research and development centre such as the purchase of land, machinery and another equipment. However, these have to be depreciable assets (except for land).
  - Costs of the purchase of land only up to 10% of total actual eligible investment costs.
  - Costs of the acquisition of building/new building up to 40% of total eligible investment costs.
- Intangible fixed assets meeting the conditions of the call, up to 50% of total eligible investment costs of the project.
- Costs of obligatory publicity.

Amount of subsidy per one project:
- CZK 2 million – CZK 30 million.

Level of support per one project:
- Up to 50% of eligible costs for all types of enterprises (in terms of size).

Acceptance of applications:
- 1 October 2018 – 15 January 2019.

Applications accepted as part of the call are assessed at once within a round. The project has to be implemented in the Czech Republic, outside the capital of Prague where the actual place at which the project is realised is decisive. Projects that are realised in districts showing a share of unemployed persons higher than the average share per the Czech Republic receive bonification.

The Property Programme

In late October, specifically on 22 October 2018, the period for filing applications for a subsidy under the Property programme that supports projects focused on the reconstruction of technically unsuitable buildings or readjustment of the structures of a brownfield type to the structures intended for doing business starts running.

Who can apply for the subsidy?
- Small and medium-sized enterprises.

What the subsidy applies to:
- Costs of the acquisition of tangible fixed assets such as the reconstruction, modernisation, construction or demolition of buildings, land adjustment, utility networks, roads to buildings etc.
- Other costs related to the building such as project and engineering work or studies and documents that will be included in tangible fixed assets.

Amount of subsidy per one project:
- CZK 1 million – CZK 30 million.

Level of support per one project:
- Up to 45% of eligible costs for small enterprises.
- Up to 35% of eligible costs for medium-sized enterprises.

Acceptance of applications:
- 22 October 2018 – 22 May 2019.

Applications accepted as part of the call are assessed on an ongoing basis. The project has to be implemented in the Czech Republic, outside the capital of Prague where the actual place at which the project is realised is decisive. Projects that are realised in districts showing a share of unemployed persons higher than the average share per the Czech Republic receive bonification.

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

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Equity in the annual financial statements

In today's article, we will focus on equity and selected aspects of its review in the annual financial statements prepared under Czech accounting legislation.

Entities with their reporting periods being calendar years slowly start planning the preparation of their annual financial statements. Preparation of the financial statements includes namely the planning of asset and liability counts, closing operations, such as calculations of deferred or due income tax or a reserve for the tax, recognition of estimated balances and accruals and deferrals, a review of entity classification as part of the reporting entity categorisation rules and other activities.

Is an inventory count of equity necessary?

The Accounting Act does not explicitly require equity to be counted. The reason for "omitting" equity in the list of items that are subject to inventory taking is the fact that the amount of equity results from the difference between assets and liabilities. If assets and liabilities that are subject to inventory taking pursuant to the Act are duly reviewed and any inventory differences are duly accounted for, the value of equity should be reported correctly as far as its amount is concerned.

Fortunately, entities and their management often review equity in terms of its structure rather than being satisfied just with the above indirect review of its amount. The review is based on the entity's key documents, resolutions of the entity's top bodies (the general meeting, the Board of Directors), the company's decisions, records in the Register of Companies, company transformation projects, documents on fair value measurement, donation contracts, etc.

Registered share capital

When reviewing the registered share capital, its increase or decrease, if any, is examined. A record to the Register of Companies is crucial in accounting for the increase or decrease on the account of the share capital. Before the record in the Register of Companies, group account 41 – Changes in share capital is provisionally used.

In verifying the share capital item, attention should be paid to receivables for subscribed capital. Business corporations such as limited liability companies must pay in the subscribed capital within the deadline agreed in the Memorandum of Association, no later than within five years from the establishment of the company or from the assumption of the contribution obligation during the company's existence. In business corporations such as joint-stock companies, the establishment of the company is effective if all founders pay the share premium that may arise and in aggregate, at least 30% of the nominal or net book value of subscribed shares within the period stipulated in the Articles of Association, no later than on the date on which a motion to make a record in the Register of Companies is made. A shareholder is obliged to pay up the issue rate of the shares subscribed by it within the period stipulated in the Articles of Association or in a decision of the general meeting on the increase of the share capital, no later than within one year from the date of the company's formation or from the effective date of the increase in the share capital.

Closing activities should include a review to determine whether the entity creates a reserve or other funds under the Memorandum of Association or the Articles of Association, or based on a decision of the general meeting.

Distribution of profit of a limited liability company

Pursuant to Section 161 of the Business Corporations Act, the amount of profit to be distributed to partners should not exceed the amount of profit of the most-recent completed reporting period increased by retained earnings brought forward and reduced by the loss of prior periods and contributions to the reserve and other funds in line with the Business Corporations Act and the Memorandum of Association.

Pursuant to Section 181 of the Business Corporations Act, the general meeting discusses financial statements no later than six months from the last day of the prior reporting period.

Distribution of profit of a joint-stock company

Pursuant to Section 350 of the Business Corporations Act, a joint-stock company shall not distribute profit or any other internal funds to shareholders if at the date of completion of the most-recent reporting period the company's equity resulting from the regular or extraordinary financial statements or the share capital after the distribution falls below the level of the subscribed share capital increased by the funds that may not be distributed to shareholders pursuant to the Act or the Articles of Association.

Pursuant to Section 403 of the Business Corporations Act, the general meeting will discuss the financial statements no later than within 6 months from the latest date of the previous reporting period.

Reporting profit or loss for the previous reporting period as of the balance sheet date

As of the balance sheet date, Account 431 Profit or loss reported at the end of the previous reporting period in item "A.V. Profit or loss for the current period" should be settled. In the current period, the general meeting should decide on the treatment of the profit or loss generated or incurred, as appropriate, in the prior period. If the general meeting fails to make a decision, the next steps are defined by Czech Accounting Standard No. 018 Capital accounts and long-term liabilities, Section 3.1.11. There should be no balance on this account when the books are closed. If no decision is made on the use of the profit or loss, the balance of this account is credited (in case of profit) or debited (in case of loss) to the relevant account of accounting group 42 – Funds from

profit and transferred profit or loss disclosed in item "A.IV.1. Accumulated profit or accumulated loss brought forward (+/-)".

This provision is practical for reporting entities; however, it may be in conflict with the general meeting's responsibility in connection with the approval of the financial statements and profit distribution or the settlement of loss. This is the last recourse, the natural situation is for the general meeting or the sole owner or shareholder to make the decision during the reporting period. At the same time, an error may occur if a sufficient amount of funds from profit is not created (pursuant to the Articles of Association or Memorandum of Association) to settle the loss or in respect of holding treasury shares.

Bankruptcy

In the end, it should be reviewed that the circumstances specified in Section 182 of the Business Corporations Act did not materialise. According to the provision, a statutory executive is obliged to call a general meeting as soon as he/she learns that the company is at risk of bankruptcy or if the goal pursued by the company is at risk and shall propose to the general meeting to adopt another appropriate measure or liquidate the company in the last resort.

Pursuant to Section 403 of the Business Corporations Act, the Board of Directors will call a general meeting if it learns that the amount of the company's total loss based on the financial statements is so high that if paid from the company's available funds the accumulated loss would amount to half of the share capital, or such a situation may be expected with respect to all circumstances, and shall propose an appropriate measure or the company's liquidation in the last resort.

If the reporting entity reports a deficit on its equity it should be considered whether it is not bankrupt pursuant to the Insolvency Act. If the entity is bankrupt, it should file an insolvency motion.

Conclusion

The above specified shows that although the Accounting Act does not explicitly require equity counting it makes sense, namely for the company's management, to pay attention to the item. Financial statements provide sufficient support to make a detailed analysis.

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Invitation to a Seminar

News in Czech Accounting

Prague, Brno, Ostrava, Pilsen and Hradec Kralove

We would like to invite you to Deloitte's traditional autumn seminar focusing on the possible obstacles in preparing financial statements. The seminar will comprise practical examples and tips in the areas where, as advisors and auditors, we come across the most findings. Furthermore, we will discuss the changes to the Czech Accounting Legislation effective as of 1 January 2018. The programme will also include new tax developments and their impact on companies' financial statements.

The seminar is predominantly intended for accountants, economists and financial managers preparing or involved in the preparation of financial statements under Czech accounting legislation and the related tax and legal regulations, and for all of you who want to learn more about Czech accounting and the most recent tax and legal developments.

The seminar is not intended for the employees of companies engaged in accounting advisory.

Seminars will be held in Czech in November and December in Prague, Brno, Ostrava, Pilsen and Hradec Kralove and will be delivered by our professionals.

Dates

Prague:	14 November 2018 and 11 December 2018
Brno:	27 November 2018
Ostrava:	28 November 2018
Pilsen:	5 December 2017
Hradec Kralove:	28 November 2018

More information on:
www.akce.deloitte.cz

Everything You Wanted to Know about IFRS 15 but Were (Not) Afraid to Ask – Part 4

IFRS 15 *Revenue from Contracts with Customers* became effective on 1 January 2018. As the new standard introduces significant changes in revenue recognition in comparison with the existing regulation, we would like to resume our series of articles focusing on IFRS 15 in greater detail.

Our Accounting News of May 2017 discussed the issues relating to the sequence of revenue steps and the application of the portfolio approach.

In September 2017, the Accounting News elaborated on the requirements of IFRS 15 relating to the identification of contracts with customers.

In our Accounting News of September 2018 we looked into the transition provisions of IFRS 15.

By way of a reminder, please note that detailed articles focusing on IFRS 15 were also published in the Accounting News of July 2014, October 2014 and December 2016.

In this issue we will look into the rather problematic Step 2 of the five-step model because proper identification of the performance obligations in a contract is critical to achieving the core principle in IFRS 15.

Step 2 – Identification of performance obligations

Once an entity has established that it has a contract to which the five-step model can be applied, the next step is to assess whether there are goods or services promised in the contract that represent separate performance obligations. This process is sometimes referred to as 'unbundling'. According to IFRS 15.22, a separate performance obligation can be either:

a. a good or service (or a bundle of goods or services) that is 'distinct'; or

b. a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

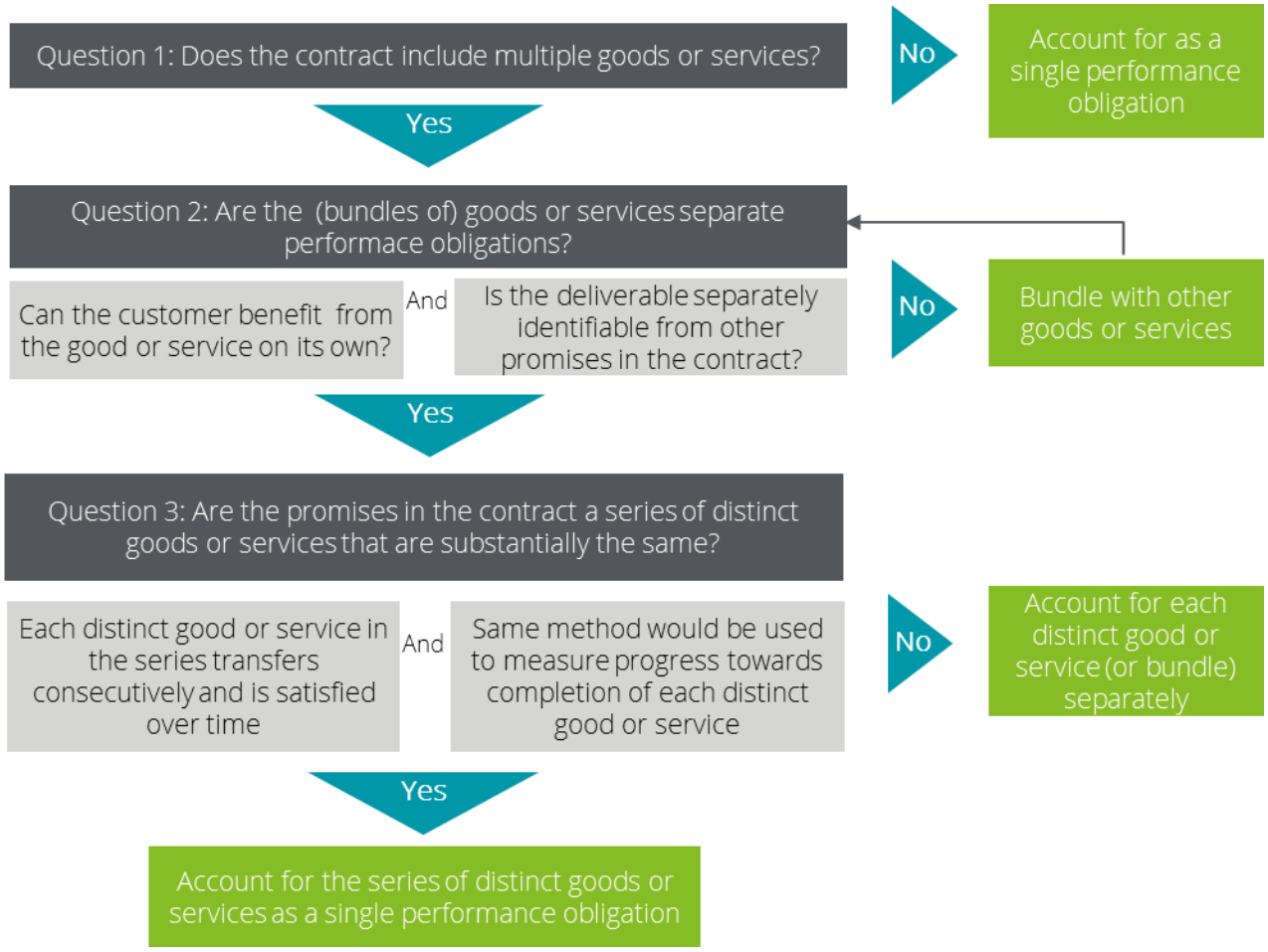
> Note:
> Term 'distinct goods and service' is in detail discussed in sections 26 – 30 of IFRS 15:d
>
> *"A good or service that is promised to a customer is distinct if both of the following criteria are met:*
> *a. the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and*
> *b. the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract)."*

IFRS 15.23 specifies the criteria that must be met for an entity to conclude that a series of distinct goods or services have the same pattern of transfer to the customer - both of the following criteria should be met:

a. "each distinct good or service in the series that the entity promises to transfer to the customer meets the criteria in IFRS 15.35 to be a performance obligation satisfied over time; and

b. in accordance with IFRS 15.39 and 40, the same method would be used to measure the entity's progress towards complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer."

The following diagram sets out the key questions to be assessed by entities to identify whether there are separate performance obligations.



Question 1

Is unbundling optional?

Answer

No. Proper identification of the performance obligations in a contract is a critical aspect of the Standard's core principle, which is to "recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services". Failure to identify and account for the separate performance obligations in a contract could result in the incorrect timing of revenue recognition.

As a practical matter, it may not be necessary to apply the Standard's detailed requirements on unbundling if the amounts recognised and disclosed in the financial statements will be the same irrespective of whether unbundling is applied. For example, when control of two or more goods or two or more services is transferred at exactly the same time, or on the same basis over the same period of time, and if those items do not need to be segregated for disclosure purposes, then it will not be necessary to unbundle each of those concurrently delivered items because the amount and timing of revenue recognised and disclosed under the model would not differ if the items were unbundled. For example, imagine the situation when a company sells during one order and delivery skirt and trousers through its e-shop. Although there are two distinct goods, it is not necessary to unbundle these items because revenue for both items will be recognised at exactly the same time.

Question 2

If an entity concludes that a series of distinct goods or services meet the requirements of IFRS 15.22(b), is it required to treat that series as a single performance obligation or may it choose to regard the distinct goods or services in the series as individual performance obligations?

Answer

An entity that reaches this conclusion is required to account for the series of goods or services as a single performance obligation. IFRS 15.BC113 clarifies the boards' intent to mandate the use of this simplification, which enables the entity providing the same good or service consecutively over a period of time (e.g. A repetitive cleaning service) to account for a single performance obligation instead of each hour of cleaning. IASB states that they "decided to specify that a promise to transfer a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer would be a single performance obligation if two criteria are met".

Question 3

For an entity to determine that the series requirement in IFRS 15.22(b) is met and, specifically, that goods or services have the "same pattern of transfer to the customer", must the goods or services be transferred consecutively?

Answer

No. The series requirement is intended to simplify the application of the revenue model in IFRS 15 and to promote consistency in the identification of performance obligations. Neither of the criteria in IFRS 15.23 refers to the consecutive transfer of goods or services to the customer and, therefore, the applicability of IFRS 15.22(b) does not depend on whether the goods (services) will be delivered (performed) consecutively.

For example, an entity might enter into a contract to provide the same package of cleaning services each consecutive week for 52 weeks. Alternatively, the cleaning contract might envisage that some services are not provided in certain weeks but are provided in other weeks on an overlapping basis whereby cleaning begins before the previous week's work has been completed. Both of the criteria in IFRS 15.23 could be met in each of the cleaning contract examples.

Question 4

For distinct goods or services to be considered substantially the same, and therefore accounted for as a series under IFRS 15.22(b), do the tasks in each increment of service need to be substantially the same?

Answer

No, it is not necessary for the tasks in each increment of service to be substantially the same.

The evaluation of whether distinct goods or services are substantially the same requires significant judgement based on the relevant facts and circumstances of the contract.

An entity should first determine the nature of the promised goods or services to be provided under the contract by evaluating whether the nature of the arrangement is to provide the customer with a specified quantity of distinct goods or services or to stand ready to provide an undefined quantity of goods or services over the duration of the contract period.

If the nature of the promise is the delivery of a specified quantity of a service, then the evaluation should consider whether each service is distinct and substantially the same. If the nature of the entity's promise is the act of standing ready or providing a single service for a period of time (because there is an unspecified quantity to be delivered), the evaluation would focus on whether each time increment is distinct and substantially the same, rather than the underlying activities.

Examples below illustrate different circumstances in which an entity determines that a series of distinct goods or services are substantially the same.

Example 1 - Series of distinct goods or services that are substantially the same – specified quantity of distinct goods or services

Company ALFA provides Customer Z with monthly payroll processing services for one year and concludes that each monthly service (1) is distinct, (2) meets the criteria for recognising revenue over time, and (3) has the same method for measuring progress. In addition, it is concluded that the arrangement is to provide the customer with a specified quantity of distinct goods or services (i.e. 12 distinct instances of monthly payroll processing).

Having determined that it is to provide 12 distinct services, ALFA determines that even though the exact volume of employee payroll data processed may vary each month, the benefit consumed by the customer (i.e. The processing of payroll for that month) is substantially the same for each monthly transaction.

Therefore, ALFA concludes that the monthly payroll services are substantially the same and satisfy the requirements of IFRS 15.22(b) to be accounted for as a single performance obligation.

Example 2 - Series of distinct goods or services that are substantially the same – undefined services over the contract period (hotel management services)

Company BETA provides hotel management services to Customer Y that include hiring and managing employees, procuring goods and services, and advertising and marketing the hotel. On a given day, BETA could clean guest rooms, perform marketing efforts to increase occupancy, and operate the concierge desk.

BETA concludes that the nature of the contract is to provide integrated hotel management services over the term of the contract and not a specific quantity of specified services (i.e. it is not specified that 100 guest rooms must be cleaned per day). The underlying activities in providing the hotel management services can vary significantly from day to day; however, the daily services are activities that are required to satisfy BETA's obligation to provide an integrated hotel management service. Therefore, the integrated service of hotel management transferred to the customer is substantially the same during each period because Customer Y receives substantially the same benefit each period (i.e. there is the same pattern of transfer to the customer).

BETA concludes that each increment of service (i.e. day or week) is distinct, meets the criteria for recognising revenue over time, and has the same method for measuring progress and, therefore, that the hotel management services satisfy the criteria in IFRS 15.22(b) to be accounted for as a single performance obligation.

Example 3 - Series of distinct goods or services that are substantially the same – undefined services over the contract period (IT outsourcing services)

Company DELTA provides information technology (IT) outsourcing services to Customer X for a five-year period. The IT outsourcing services include providing Customer X with server capacity, maintenance of the customer's software portfolio, and access to an IT help desk.

DELTA considers the nature of the promise to Customer X and concludes that it is to provide continuous access to an integrated outsourced IT solution and not to provide a specified quantity of services (e.g. processing 100 transactions per day). The underlying activities in providing IT outsourcing services can vary significantly day to day; however, the daily services are activities performed to fulfil DELTA's integrated IT outsourcing service and are, therefore, substantially the same.

DELTA concludes that, for each period, (1) it is providing an integrated IT outsourcing service; (2) the customer is continuously receiving substantially the same benefit, which is distinct (i.e. there is the same pattern of transfer to the customer); and (3) each increment of time is substantially the same (i.e. The same integrated IT outsourcing solution is provided in each time period).

DELTA concludes that each distinct increment of time meets the criteria for recognising revenue over time and has the same method of measuring progress. Therefore, DELTA concludes that the IT outsourcing services satisfy the criteria in IFRS 15.22(b) to be accounted for as a single performance obligation.

Source: Deloitte's guide to IFRS 15
www.iasplus.com

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IFRS EU Endorsement Process

The European Financial Reporting Advisory Group (EFRAG) updated its report showing the status of endorsement of each IFRS, including standards, interpretations, and amendments, most recently on 12 September 2018.

As of 25 September 2018, the following IASB pronouncements are awaiting European Commission endorsement for use in the EU:

Standards

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

Amendments

- Amendments to IFRS 10 and IAS 28 *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (issued in September 2014)
- Amendments to IAS 19 *Plan Amendment, Curtailment or Settlement* (issued in February 2018)
- Amendments to IAS 28 *Long-term Interests in Associates and Joint Ventures* (issued in October 2017)
- *Annual Improvements to IFRS Standards 2015–2017 Cycle* (issued in December 2017)
- *Amendments to References to the Conceptual Framework in IFRS Standards* (issued in March 2018)

Interpretation

- IFRIC 23 *Uncertainty over Income Tax Treatments* (issued in June 2017)

Click here for the Endorsement Status Report

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Invitation to Autumn Seminars

IFRS News 2018

We would like to invite you to Deloitte's autumn webcast on International Financial Reporting Standards (IFRS).

From the comfort of your office, you will gain a full and lightning-quick overview of new and amended standards. We will give you a short summary of the nature of changes to enable you to identify whether the changes affect your company. You will also learn how much time is left for their potential implementation.

In the webcast, you will have an opportunity to ask questions.

This on-line seminar will not cover in detail the new IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers*, and IFRS 16 *Leases*, which will be the topics of specialised seminars organised in the autumn.

The webcast is predominantly intended for accountants, economists and financial managers working on projects relating to IFRS and for all who want to know more about IFRS.

The webcast will be held in the Czech language and will be delivered by our professionals.

Date

- 16 October 2018 from 10 to 11 a.m.

More information is available at: www.akce.deloitte.cz

IFRS 16 for Advanced Users

We would like to invite you to Deloitte's autumn seminar on International Financial Reporting Standards, this time dedicated to new IFRS 16 *Leases*. IFRS 16 replaces IAS 17 *Leases* and the related interpretations and will be effective for the reporting periods starting on 1 January 2019. The new standard introduces major changes in terms of lessees as operating leases will newly be recognised in the balance sheet.

We will follow up on our seminar *IFRS 16 – the New Leases* Standard, which was held last December and this May. This time, we will place a greater focus on the problematic areas that will require a greater degree of judgement in applying the new standard. More detailed attention will also be given to the different expedients that may be used during the transition to the new standard.

You will learn how to prepare for the implementation of the standard and what new disclosures will need to be made in the notes.

We will be happy to answer any of your questions, for which there will be sufficient time.

The seminar is predominantly intended for accountants, economists and financial managers of projects relating to IFRS and for all who want to know more about IFRS.

The seminar will be held in Prague in the Czech language and will be delivered by our professionals.

Date

- Prague: 6 November 2018

More information is available at: www.akce.deloitte.cz

Most Frequent Errors in Financial Statements Prepared under IFRS

We would like to invite you to Deloitte's autumn seminar on International Financial Reporting Standards (IFRS), this time dedicated to the errors that we most frequently encounter in auditing the annual accounts of our clients and that often recur in the financial statements. We will also focus on missing disclosures in the notes.

In addition, we will provide you with an overview of the standards and interpretations effective for reporting periods starting on or after 1 January 2018. We will address how the implementation of the new standards IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* should be reflected in the financial statements for the year ended 31 December 2018.

We will also present the possible approaches to the transition to IFRS 16 *Leases*, which will become effective on 1 January 2019.

We will be happy to answer any of your questions, for which there will be sufficient time.

The seminar is predominantly intended for accountants, economists and financial managers of projects relating to IFRS and for all who want to know more about IFRS.

The seminar will be held in Prague in the Czech language and will be delivered by our professionals.

Date

- Prague: 21 November 2018

More information is available at: www.akce.deloitte.cz

Deloitte's new publications on US GAAP

We are proud to share with you updates on new publications issued by Deloitte covering various accounting and presentation areas of US GAAP.

As you may have noticed, Deloitte is very active in publishing numerous publications covering various areas of US GAAP. We informed about publications issued in 2017 in our Accounting News of December 2017. During 2018 there have been several new publications published and are now available here.

The series of the Roadmaps publications from 2018 now offers to readers the following topics:

- A Roadmap to Consolidation — Identifying a Controlling Financial Interest (2018);
- A Roadmap to Distinguishing Liabilities From Equity (2018);
- A Roadmap to Initial Public Offerings;
- A Roadmap to Segment Reporting (2018);
- A Roadmap to the Preparation of the Statement of Cash Flows (2018);
- A Roadmap to SEC Reporting Considerations for Business Combinations;
- A Roadmap to Accounting for Environmental Obligations and Asset Retirement Obligations (2018);
- A Roadmap to SEC Reporting Considerations for Equity Method Investees;
- A Roadmap to Applying the New Leasing Standard (2018);
- A Roadmap to Accounting and Financial Reporting for Carve-Out Transactions (2018); and
- A roadmap to accounting for income taxes (2017).

In case you look for any of the topics listed above, you will certainly find our publication useful as it contains references to the codification, various examples as well as an executive summary of individual sections.

While the publications are not intended to supplement the judgements and assumptions made by the company, neither are they intended to supplement consultations of Deloitte's specialists on specific and complex matters, they may certainly support you in your accounting and reporting considerations.

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Blockchain in contractual obligations

The use of blockchain outside of the area of cryptocurrency is being considered more and more often, there is potential for its use for example in contractual obligations. Blockchain can make repeated performance of a large number of items, typically in supply chains, more transparent, secure and thanks to the automation of complex processes even cheaper to operate as a result.

This article is based on the assumption that in private-law contractual obligations, it is best to use the so-called hybrid blockchain, which combines elements of public and private database architecture.

Valid law and the nature of blockchain

At present, most legislations do not contain specific regulation of blockchain and distributed databases. Countries usually perceive blockchain mostly with respect to the banking sector (although there are exceptions[1]). Given the lack of legal regulations, it is necessary to use general provisions and analogical applications of valid law as a starting point.

Blockchain, like software, is a movable intangible asset from the point of view of Czech legislation. Although the core of blockchain is a source code, a computer programme, from a legal perspective it is necessary to also take into account other aspects of blockchain solutions[2], such as the database itself, P2P network or any platform for transactions and smart contracts.

Blockchain in contractual obligations and selected problematic aspects

In the future, blockchain could fully replace the necessity for a so-called trustworthy third party by automating a part of its function and transferring the other part to the transaction participants. However, the enforceability of such obligations comes with a question mark, precisely due to the lack of specific regulation. Hybrid blockchain could be a solution, since it offers the possibility of internal self-regulation while maintaining the transparency of public blockchain.

One of the possible options of setting up a hybrid solution is to create a special (administrator) entity[3] in a private network that would be regulated by an internal code of conduct in terms of functions and obligations, with respect to itself as well as the public part.

The code should reflect especially the primary economic activity of the blockchain, or the blockchain protocol, and it should also regulate the position and authorisation of this special entity. Individual obligations of ordinary participants towards the network as such could then be regulated by the individual master contracts (smart contracts), where the participant's primary contractual partner would be the special entity.

This entity would be responsible for the correctness of verified records (it would initiate the record itself or it would have the power of veto), for the operation of the database and for the performance of the obligation contained in the blockchain, but it would not intervene in the transactions in any way. In the event of an obligation arising from a delict, e.g. entering wrong data or recording an incorrect record, the members of this entity providing joint and several guarantee could seek recourse directly against the originator of the error using smart contracts. It should be pointed out that the managing entity should not perform the function of a trustworthy third party but only a technical and functional supervisor of the individual transactions, in which it does not participate.

In more decentralised blockchains, this entity could be replaced by the code of conduct itself, or the system of smart contracts. With slight exaggeration, this would lead to the creation of a *de facto* "public" private blockchain. In this case, the code would contain a more specific definition of the mutual obligations of the participants, who would conclude them *ad hoc* directly between themselves and provide guarantees to each other.

Conclusion

Although blockchain keeps developing, it is now technically ready for practical use and in many cases it is already being actually implemented, but there still remain many outstanding legal questions. It will be interesting to observe how the expert public will cope with this new challenge and what approach local legislature will take in this respect.

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[1] Certain European countries use blockchain database e.g. for the land registry.
[2] in the case of blockchain, it is necessary to distinguish between the blockchain protocol as a computer programme (or source doe) and the actual data in the database (which are affected differently by additional legal regulation).
[3] in this respect, it is necessary to understand the blockchain administrator as a participant (or group of participants) having broader or different rights compared to ordinary participants.

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