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dReport: November 2018

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

Contents

Research and Development Deduction: the Fundamental Ruling

The Regional Court in Hradec Králové ruled in favour of the plaintiff (ENERGO CHOCEŇ, s.r.o.), revoking the contested ruling and referring the matter back to the Appellate Financial Directorate for further proceedings.

The ruling fundamentally clarified the legal term "commencement of the implementation of a research and development project", expressed the impossibility of generalising conclusions for individual taxation periods and, last but not least, expressed the necessity of appointing an expert for selected assessments.

In a dReport article in July, we discussed the upcoming news in respect of the research and development ("R&D") deduction, which should result in decreasing the tax uncertainty and administrative burden for tax payers. The ruling issued by the Regional Court in Hradec Králové (the "Regional Court"), ref. no. 52 Af 18/2016-181, is further good news for payers utilising, or intending to utilise the R&D deduction. The ruling refers to an additional corporate income tax assessment and the related fine for the 2009 and 2010 taxation periods for failing to bear the burden of proof as a consequence of not submitting all business documentation, failing to meet the formal and material requirements of the R&D project and not substantiating the presence of an appreciable element of novelty and the necessity to clarify technical uncertainty.

Highlights of the ruling:

- The payer is not obliged to utilise all costs incurred in relation to R&D. In contrast, they may only deduct costs in respect of which they are able to bear the burden of proof before the tax administrator, taking into account their demonstrability, recording and administrative requirements.
- The Regional Court stated that *"it may be concluded that the **implementation of the R&D project is commenced** upon the **approval of a written R&D project draft** by the authorised person, in which the processor defines the underlying goals, methods and planned costs of the R&D project and other basic details as stipulated by law."*
- Following the approval of the R&D project, the payer must maintain separate accounting records about the R&D project.
- It is solely at the discretion of the payer which activities they will perform prior to the date of approving the R&D project; the costs relating to these activities are automatically non-deductible.
- The Regional Court expressed the impossibility of generalising conclusions for individual taxation periods without demonstrating clear links. This was a response to the generalisation of conclusions whereby the tax administrator inferred from the wording of the internal guideline prepared by the payer that it retrospectively gave rise to the R&D project. It also applied this conclusion to the R&D projects that were, however, related to the period subsequent to the preparation of the guideline.
- In its previous rulings, the Regional Court had already confirmed the above stated necessity of appointing an independent expert, who will themselves assess the sufficiency of the documents submitted and the presence of an appreciable element of novelty and the clarification of technical uncertainty. This is owing to the fact that tax authorities do not have sufficient expertise to be able to assess the appreciable element of novelty, if any, and the clarification of technical uncertainty.
- The Regional Court also addressed the amount of evidence that the payer must submit in order for the appointed expert to be able to prepare the expert opinion for tax authorities. Unless the payer has been demonstrably completely inactive during the tax proceedings, it is fully at the discretion of the expert to assess whether the documents submitted are sufficient for formulating the relevant expert opinion.

Besides the "Fortell", "Abadia" and "Vestra Clinics" rulings, the above stated ruling is the next in line that specifies the not very clear legislative provisions, increases tax certainty for payers and, last but not least, may also be beneficial for assessing contentious issues from the tax administrators' perspective. The full clarification of the as yet not very specific phrase "commencement of R&D activities" hopefully removes the speculations that, during tax audits, R&D activities could be considered to commence, for example, upon the signing of a contract with a customer, receiving an order, or an internal meeting of management regarding the planned activities.

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VAT Act Amendment

As the discussion of the technical amendment to the VAT Act has been postponed, it may be expected that the relevant changes (eg, in respect of tax base corrections, VAT reduction in the event of irrecoverable receivables, taxation of bonuses to statutory executives and members of statutory bodies, differentiation of financial and operating leases or taxation of vouchers for the purchase of goods/services) will come into effect on 1 April 2019 at the earliest. What is more, our information suggests that some of the proposed articles of the amendment are additionally anticipated to be modified in the second reading (eg, the taxation of bonuses to statutory executives and members of statutory bodies should be revisited). Therefore, it is difficult to predict to what extent the VAT Act will be amended.

The amendment should be debated by the Chamber of Deputies in the first reading in late October at the earliest. A similar schedule also applies to the amended Electronic Sales Records Act, based on which the application of a 10% VAT rate to draught beer is proposed.

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Ruling of the CJEU

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 (CoJ) 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 CoJ 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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Announcing the Czech Republic's stance towards the EU's proposals for digital economy taxation

The Ministry of Finance has published on its website a brief summary of the Czech Republic's attitude to the proposals of the European Union concerning the taxation of so-called digital economy (we have discussed this topic in detail here). The Czech Republic opines that any long-term measures in this area need to be addressed at a global level as part of the OECD; therefore, it does not consider the short-term taxation of profits within the EU by introducing an interim (indirect) tax to be a conceptual solution.

Some other countries (including Ireland, Finland etc.) have a similar (i.e. negative) attitude to the presented proposals. We will keep you informed of further developments in this area.

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News round up

Luxembourg: Illegal state aid to McDonald's

Following a four-year investigation, the European Commission concluded on 19 September 2018 that Luxembourg did not provide any impermissible state aid in the McDonald's case. The European Commission that the non-taxation in Luxembourg of certain profits allocated to the US branch was in line with domestic tax law and the Luxembourg-US tax treaty. The commission also found that the Luxembourg tax authorities did not misapply the treaty, and that the tax advantage the Luxembourg entity received—which results from a mismatch between Luxembourg and US tax laws—could not be considered as a distortion of free competition in the single market.

Qualified majority voting for certain tax matters

In January or February 2019, the Commission will propose abandoning the unanimity rule on some tax issues, to improve the efficiency of negotiating tax legislation. The commission is likely to propose QMV on a limited set of tax issues — for example, legislative proposals regarding tax returns. There appear to be two opposing visions for QMV on the commission, the first one is QMV under article 116 of the Treaty on the Functioning of the European Union, which says that when the commission "finds that a difference between the provisions laid down by law, regulation, or administrative action in member states is distorting the conditions of competition in the internal market and that the resultant distortion needs to be eliminated, it shall consult the member states concerned." While according to the second one QMV shall be based on article 48.7 of the Treaty on the European Union (TEU), which says, "Where the Treaty on the Functioning of the European Union provides for the Council to act by unanimity in a given area or case, the European Council may adopt a decision authorizing the Council to act by a qualified majority in that area or in that case."

Germany: Restrictions on dividend distribution

The CJEU found that the trade tax provisions at issue are likely to dissuade resident parent companies from investing their capital in subsidiaries established in non-member states because the deductibility of dividends paid by the subsidiaries in non-member states is subject to stricter conditions than those for dividends paid by resident companies. As such, it constitutes a restriction on the movement of capital between member states and non-member states, which is prohibited by article 63 of the Treaty on the Functioning of the European Union, the Court concluded.

OECD: Tax report for 2018

On 5 September 2018, the OECD published "Tax Policy Reforms 2018: OECD and Selected Partner Economies", Annual report identify major tax policy trends. The report covers the 35 OECD countries, plus Argentina, Indonesia and South Africa. The report highlights that economic stimulus provided by fiscal policy has become more significant. These include for example: the trend toward reducing the corporate income tax rate, with the average rate across the OECD falling from 32.5% in 2000 to 23.9% in 2018 or cuts of personal income tax mainly for low and middle income earners.

Latvia: CFC rules

Currently, there are no CFC rules under the Law. The draft amendments introduce CFC rules, imposing an obligation on taxpayers to pay corporate income tax in Latvia on income shares in a foreign company in which the Latvian taxpayer has significant participation and where the income is derived from non-genuine arrangements that have been put in place for the essential purpose of obtaining a tax advantage. If adopted by the parliament, the amendments will enter into force on 1 January 2019.

Netherlands: Tax package for 2018

The Dutch government's tax plans for 2019 and thereafter, published on 18 September 2018, include implementation of the EU Anti-Tax Avoidance Directive (ATAD 1) – most notably interest deduction limitation and CFC rules, and proposals to gradually reduce the corporate income tax rate and abolish the current dividend withholding tax (WHT) and introduce a WHT on intercompany dividend distributions to low tax jurisdictions and in abusive situations.

Australia: Taxation of digital economy

On 2 October 2018, the Australian government released a Discussion Paper seeking views on options to move towards a "fairer and more sustainable tax system for the digitalised economy." the critical points for discussion in the paper are: whether existing nexus rules for determining which countries have the right to tax foreign residence should be changed, whether the potential tax changes driven by the digitalise economy should be ring fenced to the digitalised economy or apply more widely.

EU: Non-cooperative jurisdictions list

The Council of the European Union announced on 2 October 2018 that Liechtenstein and Peru have been removed from the "grey" list of non-cooperative jurisdictions and Palau from the "black" list. The grey list consists of jurisdictions that do not meet the EU requirements for tax cooperation, but have undertaken to revise their rules. Six jurisdictions remain on the black list: American Samoa, Guam, Namibia, Samoa, Trinidad and Tobago and the US Virgin Islands. These are included on the black list because they either lack transparency or fair taxation or have not agreed to implement the BEPS minimum standards.

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Breakthrough in the Existing Practice? a Company's Management may be Liable for Additionally Assessed Tax

As our experience suggests, the Financial Administration has been exerting significant pressure on tax collection, which is reflected not only in an actual increase in tax proceeds, but also, for example, in the number of tax seizures ordered. However, the Financial Administration sometimes seeks to collect tax in highly unorthodox ways. One such procedure has been reviewed by the Regional Court in Hradec Králové – Pardubice Office (the "Regional Court").

In the case in hand, tax (including accrued interest and fees) was additionally assessed in respect of an entity following a tax audit on the grounds of its failure to prove the VAT deduction entitlement due to not having submitted sufficient evidence demonstrating the performance of construction work. As the company did not pay the additionally assessed tax, it was subsequently unsuccessfully enforced in distraint proceedings. In most cases, the tax administrator would stop short at this point. However, in this case, the tax administrator proceeded to issue a guarantor's call in which it required that the company's statutory executive pay the tax arrears on its behalf. The tax administrator inferred the statutory executive's liability from the following facts.

Consequences of a Failure to Act with Due Managerial Care

According to the tax administrator, the statutory executive erred in that it assumed that it would not be necessary to prove the performance of the construction work in the future. In the tax administrator's view, this error must be necessarily interpreted as a failure to act with due managerial care as the statutory executive was obliged to keep both a copy of the construction log and of the actual documents. As the tax administrator states, this error resulted in the company incurring detriment for which, if it is not settled, the statutory executive is liable and, as a result, he or she may be required to pay the additionally assessed tax.

A Positively Negative Regional Court Ruling

The Regional Court revoked the ruling of the Appellate Financial Directorate; however, this was not on account of the incorrectness of the whole structure of the statutory executive's liability. Instead, the Regional Court directly addressed the conditions under which the above stated liability obligation may originate.

Firstly, the Regional Court stated that additionally assessed tax **cannot** be automatically considered to constitute detriment incurred on account of a failure, if any, to act with due managerial care, the reason being that the amount of tax is determined by law and its payment is mandatory. Nevertheless, according to the Regional Court, interest and fees accrued in respect of the tax – ie, default interest or fees, whose amount is, in some cases, as high as the tax itself – could be considered to constitute such detriment. The Regional Court subsequently reviewed whether the statutory executive failed to act with due managerial care in not having stored the documents. The Regional Court arrived at the conclusion that no legislation stipulates such an obligation and, if the Financial Administration wished to infer a failure to act with due managerial care from this "negligence", it would have to provide a thorough justification thereof. Therefore, the ruling has been revoked for unverifiability.

Tax Audit Implications

The Appellate Financial Directorate has not filed a cassation complaint against the Regional Court's ruling. However, sooner or later, the Supreme Administrative Court is bound to address the issue of whether it is at all possible to infer management's liability for additionally assessed tax. Therefore, as the Regional Court has so far confirmed the theoretical possibility of recovering tax arrears from persons who have violated their obligation to act with due managerial care (ie, namely from all members of statutory bodies), it is possible that, in performing tax audits, the whole Financial Administration will, besides proving the facts resulting in the additional tax assessment, also focus on proving the violation of obligations by the entity's management. Entities, or, to be precise, their elected bodies, should, therefore, consider what obligations may be expected of them by tax administrators in relation to their activities.
The statutory body of an entity which, in relation to its activities, is at heightened risk of involvement (albeit unintentional) in VAT carousel fraud should focus on setting effective and efficient control measures in respect of its business partners.

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The India Project: Simplifying the Procedure for Highly-Qualified Indian Citizens Entering the Czech Market

On 19 September 2018, the Coordination Authority for Border Protection and Migration ruled with immediate effect on expanding the Ukraine Project by India.

The project entitled "Special Procedure Focusing on Highly-Qualified Employees from Ukraine and India" will simplify the steps for up to 500 highly-qualified Indian citizens entering the Czech Republic's market. So far, the project focus has only been on professionals from Ukraine. The annual quota for applications to be made by Ukrainian employees has also been 500. The date on which applications for blue cards or employee cards can be filed by applicants who are Indian citizens participating in the Project is **1** October 2018. The filings can be made with the Czech Republic's Embassy in New Delhi.

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Conceptual changes in provisions regarding vacation time and minimum wage and more than 80 additional proposed changes effective already from 1 July 2019...

...are brought by the draft amendment to the Labour Code presented by the Ministry of Labour and Social Affairs. It is a more modest act compared to the very ambitious but unsuccessful draft from 2016, but it is still worth our attention.

Changes in the regulation of vacation time

The current regulation of vacation time in the Labour Code has been considered unsuitable for a relatively long time. The newly proposed concept should include the right to vacation time expressed in hours; its calculation will depend on the employee's working hours per week. In line with requirements arising from practice, it should be allowed to transfer vacation time exceeding the legally required four weeks to the next year. Changes will also affect the use of vacation time, its reduction in the event of unexcused absence etc.

Flexibility?

Unfortunately, the amendment does not include an explicit regulation of working from home (home office). The Ministry of Labour and Social Affairs responds to the voices calling for the introduction of more modern principles that would bring greater flexibility to our labour market by introducing "job sharing". This would refer to a set-up where two or even more employees share one job position and divide their working time themselves so that they cover the required working hours based on a written agreement between the employer and all the employees sharing the job position.

Delivery

Another problem often encountered in practice has been the discrepancy in the deadlines related to the delivery of labour-law documents. The Labour Code should now be made compliant with the delivery conditions of the Czech Post, i.e. The period for picking up a letter stored at the post office (due to failure to deliver it personally to the employee) will now amount to 15 calendar days (instead of the current 10 business days). Employees will also be required to notify their employer in writing about any change of address where their employer can send documents to them.

Minimum and guaranteed wage

Another proposal concerns the introduction of a fixed mechanism for the valorisation of minimum wage (as well as the lowest levels of guaranteed wage). The objective of the proposal is to set up a valorisation mechanism so that the minimum wage is increased regularly and its amount can be estimated easily and in good time. According to the proposed amendment, minimum wage should amount to 0.548 times the average gross monthly salary in national economy for the calendar year before last (rounded up to the nearest hundred).

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Approaching deadline for an entry of beneficial owners information in the Beneficial Owners Register

An amendment to Act No. 304/2013 Coll., on Public Registers of Legal Entities and Individuals, effective since 1 January 2018, has introduced the Beneficial Owners Register (the "Register") in which all legal entities recorded in the Commercial Register need to record their beneficial owners by no later than on 1 January 2019. Other legal entities recorded in other public registers (including trusts) have to do so by 1 January 2021. What does this duty entail in practice, how complicated is it and what issues may arise?

Who is the beneficial owner?

Under Section 4 (4) of Act No. 253/2008 Coll., on Selected Measures against Money Laundering and Terrorism Financing (the "**AML Act**"), a beneficial owner means an individual who has a factual or legal possibility to exercise a direct or indirect controlling influence in a legal person, trust or other legal arrangement without legal personality status. The beneficial owner always refers to a specific individual (or a group of individuals). The AML Act further specifies the facts that may indicate a beneficial owner. Nevertheless, the existence of such facts does not need to necessarily mean that the given individual is a beneficial owner. It is always necessary to assess whether the individual has the possibility to exercise a controlling influence.

Companies are obliged to identify the beneficial owner and keep up-to-date data for customer due diligence, including the facts constituting the beneficial owner status or other substantiation as to why the individual is considered a beneficial owner.

Beneficial Owners Register

The Register was established on a basis of a requirement of the 4th AML directive for the retention of data on beneficial ownership in a central register ensuring the availability of up-to-data and accurate information on ultimate beneficial owners to state bodies, Financial Intelligence Units (FIUs) and obliged entities when taking customer due diligence measures. As a matter of fact, it may be easy to disguise beneficial owners in complex corporate relations.

The Register is a non-public register. Information on beneficial owners is not provided along with a copy of an entry in a public register, nor is it published. The Register may be accessed by a limited yet relatively large scope of people including, apart from state authorities, representatives of obligated persons which have a duty to identify and verify beneficial owners as defined in the AML Act (this principally involves banks and other financial institutions).

The entire process is certainly not completed with the first entry of beneficial owners in the Register. The data need to be up-to-date and accurate.

What does a failure to enter the beneficial owner in the Register result in?

Sanctions have not yet been defined for a legal entity that does not disclose and enter the information on its beneficial owners in the Register by 1 January 2019. Nevertheless, this may pose an issue when the entity applies for providing financial services as pursuant to the AML Act, financial institutions shall conduct customer due diligence including the beneficial owner identification and verification. When the Register is used for the verification and a discrepancy is identified (or no information is found), this may complicate the provision of a banking product or service.

However, legal entities may encounter other issues in tendering for a public contract or applying for a grant from the EU funds.

Pursuant to Act 134/2016 Coll., on Public Procurement, the public contracting authority should obtain data on the beneficial owner from the Register. Therefore, if this information is missing in the Register or is contrary to other declared data on the beneficial owner, the chances of the legal entity's success in the tender procedure will decrease.

Based on an announcement published on the website of the Ministry of the Industry and Trade, the managing body of the Enterprise and Innovations for Competitiveness Operational Programme included a condition in calls published since June 2018, stating that entities without beneficial owners recorded in the Register as of the date of the grant application will not quality for the grant under the programme.

Is it complicated to make an entry in the Register?

For some legal entities with a simple ownership structure, the identification of their beneficial owner and its entering in the Register will not be a major issue. Nevertheless, in our practice we have encountered companies (not only large ones) with such ownership structures, voting rights arrangements etc. that make it complicated to identify beneficial owners. A seemingly unambiguous term "beneficial owner" has a statutory definition entailing many difficulties. A classic example relates to companies co-owned by foreign legal entities.

Increased attention shall also be paid by companies operating in multiple countries (especially within the EU) in which similar registers and duties may also be in place but the definition of beneficial owners may differ and, consequently, other individuals may be entered in local registers. For example, a beneficial owner in the U.S. refers to a person holding 10% of voting rights, as opposed to 25% in most EU member states.

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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

Tax liabilities – December 2018

December

Monday, 10	Consumption tax	Tax maturity for October 2018 (except the consumption tax on alcohol)
Friday, 14	Intrastat	Submission of statements for intrastat for November 2018, paper form
Monday, 17	Road tax	Advance payment on tax for October and November 2018, possibly the maturity of one advance payment of tax (minimally in amount of 70 % of the annual tax obligation) - in a case of taxpayer, who is an operator of trucks, trailers and semitrailers with maximum allowed weight of 12 tonnes and more, to whom the tax is decreased by 48 % according to § 6 paragraph 10 based on Act on Road Tax
	Income tax	Quarter or half-year tax advance payment
Tuesday, 18	Intrastat	Submission of statements for intrastat for November 2018, electronic form
Thursday, 20	Income tax	Monthly payment of deducted advance payments on personal income tax from employment
Thursday, 27	Value added tax	Tax return and tax for November 2018
		EC Sales List for November 2018
		VAT control statement for November 2018
	Energy taxes	Tax return and tax maturity on gas, solid fuels and electricity for November 2018
	Consumption tax	Tax maturity for October 2018 (only the consumption tax on alcohol)
		Tax return for November 2018
		Tax return for claiming of refund of consumption tax, for example on fuel oil, other petrol (benzine) for November 2018 (if applicable)
Monday, 31	Income tax	Payment of special-rate withholding tax for November 2018

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The Current Schedule of Calls under the Operational Programme Enterprise and Innovations for Competitiveness 2014 - 2020

The table below outlines the current schedule of calls already issued under the Operational Programme "Enterprise and Innovations for Competitiveness 2014 - 2020", including the submission deadlines when applying for support under individual sub-programmes.

Programme name	Programme focus	Call type	Subsidised territory	Recipient type*	Planned period to submit applications for support
Fifth Call under the *Potential* programme	Subsidies for establishing and/or expanding centres for industrial research, development and innovation	In rounds	Czech Republic, outside the capital city of Prague	SME, LE whose business relates to the environment or who cooperate with SME	From 1 Oct 2018 to 3 Jan 2019
Fifth Call under the *Innovation* programme	Subsidies for the purchase of production technology to implement new or innovated products in the production and place them on the market	Ongoing	Czech Republic, outside the capital city of Prague	SME, LE whose business relates to the environment	From 26 Sep 2018 to 27 Nov 2018
Sixth Call under the *Application* programme (both for projects for which the effective cooperation has and has not been established)	Subsidies for industrial research and experimental development	In rounds	Czech Republic, outside the capital city of Prague	SME, LE whose business relates to the environment or who cooperate with SME	From 28 Aug 2018 to 17 Dec 2018
Third Call under the *Property* programme	Subsidies for the modernisation of production premises and renovation of the existing obsolete business infrastructure and premises (such as brownfields)	Ongoing	Czech Republic, outside the capital city of Prague	SME	From 22 Oct 2018 to 22 May 2019
Third Call under the *Energy Savings in Heat Supply Systems* programme	Subsidies for the renovation and expansion of heat supply systems and increasing the CHP (combined heat and power) efficiency	Ongoing	Czech Republic, outside the capital city of Prague	SME, LE	From 11 Jun 2018 to 31 Mar 2019
Fourth Call under the *Energy Savings* programme	Subsidies and activities related to savings in final energy consumption	Ongoing	Czech Republic, outside the capital city of Prague	SME, LE	From 2 Jul 2018 to 29 Apr 2019
Fourth Call under the *Renewable Energy Sources* programme	Subsidies for projects of producing and distributing energy from renewable sources	Ongoing	Czech Republic, outside the capital city of Prague	SME, LE	From 3 Aug 2018 to 29 Mar 2019

Programme name	Programme focus	Call type	Subsidised territory	Recipient type*	Planned period to submit applications for support
Fourth Call under the *ICT and Shared Services – Establishing and Operation of Shared Services Centres* programme	Subsidies for establishing and operating shared services centres	Ongoing	Czech Republic, outside the capital city of Prague	SME, LE	From 28 Aug 2018 to 28 May 2019
Fourth Call under the *ICT and Shared Services – Construction and Modernisation of Data Centres* programme	Subsidies for the modernisation and establishment of data centres	Ongoing	Czech Republic, outside the capital city of Prague	SME, LE	From 31 Aug 2018 to 31 May 2019

In early October, the schedule of calls under the operational programme "Enterprise and Innovations for Competitiveness 2014 - 2020" was updated. Also, the deadline of issuing the call *ICT and Shared Services - Creation of New IS/ICT Solutions* was specified, including the deadline by which the relevant applications shall be submitted. The anticipated time during which the call will be issued is December 2018.

Programme name	Programme focus	Call type	Subsidised territory	Recipient type*	Planned deadline to submit applications for support
Fourth Call under the *ICT and Shared Services - Creation of New IS/ICT solutions* programme	Subsidies for the creation of new IS/ICT solutions	Ongoing	Territory of the Czech Republic, except for the capital city of Prague	SME, LE	From Feb 2019 to Nov 2019

** SME – small to medium-sized enterprises; LE – large enterprises*

Updated Timeline of Calls under the Operational Programme Environment for 2019

In September, the timeline of calls under the *Operational Programme Environment* was updated. As such, next year, support can be drawn under 16 new calls totalling CZK 11.9 billion of obtainable funding. The calls are divided into five priority axes:

- Improving water quality and reducing flood risks
- Improving air quality in human settlements
- Waste management and material flows, environmental burden and risks
- Protection and care for nature and landscape
- Energy savings

In addition to the planned calls, next year also the existing 11 open calls will be in progress. Given this, applicants will be able to submit their applications for support under a total of 27 calls. The applications will be accepted by the State Environmental Fund of the Czech Republic and the Nature Conservation Agency of the Czech Republic.

Announcement of the National Tender "CHIST-ERA III"

On Wednesday, 3 October 2018, the Technology Agency of the Czech Republic announced the public tender entitled CHIST-ERA III. The tender is intended for candidates that succeeded in the joint international call entitled CHIST-ERA III issued in 2017. The tender forms part of the "EPSILON" programme for the support of applied research and experimental development.

Support will be provided to projects that aim to attain at least one of the outputs/goals supported by the EPSILON programme. This includes, for example, industrial designs and utility models, prototypes, software or certified technology.

The candidates that may apply under this tender may be enterprises and research organisations that were evaluated as successful under the joint international call CHIST-ERA III from 2017, whose projects were recommended to receive support and who have received the Decision Letter issued by the CHIST-ERA III syndicate.

The maximum amount of support per project under this public tender is 60% of total eligible costs.

The deadline by which the project drafts can be submitted is 15 November 2018.

Planned Issuance of Call "EuroNanoMed 3"

In accordance with the defined schedule, in November the Technology Agency of the Czech Republic will issue the joint call entitled "EuroNanoMed 3" for 2019 under the "EPSILON" programme that enables support of applied research and experimental development.

The call will be composed of the following three topics:

- Regenerative medicine
- Diagnostics
- Targeted delivery systems

Support will be provided to projects in the area of nanomedicine, specifically in the field of diagnostics and targeted delivery systems.

The anticipated deadline by which the project drafts can be submitted is January 2019.

Open Call Issued by the European Space Agency

The call of the European Space Agency (ESA) for Czech enterprises and organisations entitled "Support of Space-related Activities in the Czech republic" is still open.

The call is designed for Czech companies (including SMEs) and academic and research organizations. Both individual entities and project syndicates may join the programme.

Support will be provided to projects that focus on establishing capacities and enhancing the technology level in technological fields that are relevant for space research. At the same time, the Czech candidates have to be integrated within ESA's supplier structures.

Obtainable support amounts to 90 % of eligible operating costs. The draft projects will be assessed and evaluated both by ESA and the relevant department of the Czech Ministry of Transport.

The current deadline to submit project drafts is 12 December 2018. Please contact us for more details on the call and the relevant technological areas.

Contacts

If these issues relate to your company, we would be happy to provide you with more detailed information.
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Grants CZ

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Other profit or loss from prior years

Since 2013, equity has included the item "Other profit or loss from prior years" (since 2017 as item A.IV.3., since 2018 as A.IV.2.), which is regulated by Section 15a of Regulation No. 500/2002 Sb. In today's article, we will brush up on the purpose for which this line has been introduced and what its appropriate accounting treatment is.

Accounting transactions that are accounted for through other profit or loss from prior years

Reporting entities traditionally report profit or loss for the current period in equity as a difference between income and expenses related on an accruals basis to the reporting period. Accounting for other profit or loss from prior years, as follows from the name of this line, takes place if the reporting entity records income or expense caused by the previous period that was, for some reason, not recognised in the previous period. The Regulation specifies three instances of such use, namely the moment of first-time recognition of deferred tax, correction of errors of prior years (as a result of incorrect recognition or failure to recognise income and expenses in previous reporting periods) and reporting of differences arising from changes in accounting policies. Let's go through each of these situations in greater detail.

A. First-time recognition of deferred tax

When a company recognises deferred tax for the first time, it will certainly use other profit or loss from prior years to recognise the portion of a deferred tax liability or asset related to the pervious reporting period – i.e. caused by circumstances in the previous reporting period(s). It needs to be pointed out here that the first-time recognition of deferred tax is caused by the fact that the company is obliged for the first time to recognise deferred tax, not that the company did not account for deferred tax in previous years due to an error, although correction of errors related to previous reporting periods can ultimately have the same effect on accounting and the financial statements.

The reason for this approach is the origin of deferred tax, which is, in the first year of recognition, based on all temporary differences that have arisen throughout the existence of the reporting entity and continue to exist as of the balance sheet date. Whether it is necessary to recognise a deferred tax liability or deferred tax asset, the part of deferred tax that relates to the previous reporting period cannot affect the profit or loss of the current period and it will be recognised only in the balance sheet – i.e. Dr 426 "Other profit or loss from prior years" / Cr 481 "Deferred tax liability" for a deferred tax liability, or Dr 481 "Deferred tax asset" / Cr 426 "Other profit or loss from prior years" for a deferred tax asset.

The portion of deferred tax that was caused by events of the current period will affect expenses via account 592 and it will be recognised as Dr 592 "Income tax – deferred" / CR 481 "Deferred tax liability" for a deferred tax liability, or Dr 481 "Deferred tax asset" / Cr "Income tax – deferred" for a deferred tax asset.

If the reporting entity interrupted the recognition of deferred tax (e.g. due to expected tax losses, the company decided not to account for a deferred tax asset on the grounds of prudence because it would not be able to recover it in the future) but after a certain time it started recognising the deferred tax asset again, the use of the item Other profit or loss from prior years is not applied and the entire impact of the recommencement of recognition of deferred tax affects the profit or loss of the current period. The reason for this approach is the fact that it is not a policy change or a correction of an error of prior years, but a change of an estimate, which is reflected prospectively. This can apply, for example, to a situation when a reporting entity recognises and reports deferred tax only on a portion of total accumulated tax losses that it anticipates to utilise in the future.

B. Corrections of errors of prior years.

The second case of accounting through other profit or loss from prior years is corrections of errors of prior years that were discovered after the closing of the books for the previous reporting period. The change therefore cannot be reflected in the related period but due to its materiality it has to be corrected. A material error is an error that can significantly impact the perspective and decision-making of an independent user of the financial statements. An professional judgement is necessary to assess materiality and the company's management consults similar situations with the auditor.

Let's have a look at such correction of errors of prior years using an example:

After the closing of the books, an omission is discovered in the form of a failure to recognise a received supplier invoice. This invoice relates to the supply of a service for the closed reporting period and the company's management assessed the invoice amount as material. In the new reporting period, the invoice will be recognised only in the balance sheet as follows: Dr 426 "Other profit or loss from prior years" / Cr 321 "Trade payables", since it should not affect the profit or loss of the current period.

However, it should be mentioned here that when preparing financial statements, it is necessary to adjust the data for the previous reporting period in order to maintain comparability of the information for the current and previous

reporting periods. The information will therefore be included in the financial statements for the previous reporting period as if no error had occurred in the previous period. This means that the supplier invoice will increase the amount of expenses for services at the level of the statements (line A.3. Services) and it will also increase trade payables (line C.II.4. Trade payables). Such an adjustment with an impact on profit or loss naturally indirectly affects the calculation of income tax for the previous reporting period via other tax base, and it requires filing an additional tax return. Simultaneously, the correction of tax liability for the previous reporting period would be taken into account with respect to the corrected error: in accounting records, this would concern accounting between account 426 – Other profit or loss from prior years, and account 341 – Corporate income tax (in our case, it would be a decrease in the total tax liability or the origination of or increase in the total tax asset); in the financial statements, the correction for the previous period would be reflected on the profit and loss account line L.1. Income tax payable, and in the balance sheet on line C.II.2.4.3. in assets, C.II.8.5., or B.2. in liabilities.

If the supplier invoice in our example concerned an immaterial amount, then the invoice would be recognised in the current period on the same expense account on which it would have been recognised in the previous period if the omission had not occurred, i.e. Dr 518 "Services" / Cr 321 "Trade payables".

C. Differences arising from changes in accounting policies

Before the introduction of the item Other profit or loss, reporting entities recognised the impacts of changes in accounting policies as of the first day of the reporting period in extraordinary income expenses, which ultimately affected the profit or loss of the current periods. After 1 January 2013, these cases fall under other profit or loss and the recognition of differences arising from changes in accounting policies, such as a change in the method of inventory valuation, has to be made by a balance sheet entry via account 426. Similarly to the preceding situation regarding the correction of errors of prior years, data for the previous period presented in the financial statements have to be adjusted.

In the event of an increase in the valuation of internally produced inventory due to a change in valuation methods, the change will be reflected as Dr 12* "Internally produced inventory" / 426 "Other profit or loss from prior years". The policy change should always be sufficiently commented on in the notes to the financial statements.

In practice, we can often encounter a thin line between correction of errors of prior years, policy change and change in accounting estimates (a dilemma most commonly arises in the area of estimated useful lives and depreciation of fixed assets). The accounting treatment of the change in accounting estimates is, however, different from the previous two categories. In the case of an estimate, the reporting entity predicts the amount and timing of an accounting event based on the information available at the time. If the circumstances under which the estimate was made change, the reporting entity should change and update the estimate at the moment when it becomes aware of the change, as of the balance sheet date or date of preparation of the financial statements at the latest. This does not affect the matter of disclosing so-called subsequent events or post balance sheet events, which may also concern accounting estimates and which we will address in one of our future articles.

Disclosure requirements

Other profit or loss from prior years is reported via a ledger account in group 42 and for the sake of clarity and later records of balances for the individual periods, it is suitable to divide it into sub-ledger accounts based on the nature of the transactions contained in them. When using the account of other profit or loss, the reporting entity is obliged to comment on this decision in the notes to the financial statements. Specifically, we emphasise the obligation to comment on the fact that incomparable information has been retained; this can concern e.g. situations where the errors relating to prior years or policy changes have been reflected on account 426 – Other profit or loss from prior years, but data for the previous period have not been restated in the financial statements.

What to do next about other profit or loss?

As with profit or loss for the current period, other profit or loss from prior years is also subject to the decision of the reporting entity's highest body about its distribution, whether through transfer to accumulated losses/earnings of prior years or subsequent distribution in the form of profit shares.

Conclusion

Other profit or loss from prior years is not a line that should be used often, but it has an essential position and it is significant especially for compliance with the accruals principle and maintaining comparability of reporting periods.

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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

Applying the expected credit loss model under IFRS 9 to trade receivables

IFRS 9 *Financial Instruments* is effective for annual periods beginning on or after 1 January 2018. Its new impairment requirements will affect almost all entities and not just large financial institutions. Where entities have material trade receivable, contract asset and lease receivable balances care is needed to ensure that an appropriate process is put in place to calculate the expected credit losses.

IFRS 9 introduces a new impairment model based on expected credit losses. This is different from IAS 39 *Financial Instruments: Recognition and Measurement* where an incurred loss model was used.

In accordance with the requirements of **IAS 39**, impairment losses on financial assets measured at amortised cost were only recognised to the extent that there was objective evidence of impairment. In other words, a loss event needed to occur before an impairment loss could be booked.

IFRS 9 introduces a new impairment model based on expected credit losses, resulting in the recognition of a loss allowance before the credit loss is incurred. Under this approach, entities need to consider current conditions and reasonable and supportable forward-looking information that is available without undue cost or effort when estimating expected credit losses. IFRS 9 sets out a 'general approach' to impairment. However, in some cases this 'general approach' is overly complicated and some simplifications were introduced.

'General approach' to impairment

Under the 'general approach', a loss allowance for lifetime expected credit losses is recognised for a financial instrument if there has been a significant increase in credit risk (measured using the lifetime probability of default) since initial recognition of the financial asset. If, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, a loss allowance for 12-month expected credit losses is recognised. In other words, the 'general approach' has two bases on which to measure expected credit losses; 12-month expected credit losses and lifetime expected credit losses.

Lifetime expected credit loss is the expected credit losses that result from all possible default events over the expected life of a financial instrument.

12-month expected credit loss is the portion of the lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

The term **'default'** is not defined in IFRS 9 and an entity will have to establish its own policy for what it considers a default, and apply a definition consistent with that used for internal credit risk management purposes for the relevant financial instrument. IFRS 9 includes a rebuttable presumption that a default does not occur later than when a financial asset is 90 days past due unless an entity has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate.

When it comes to the actual measurement under the 'general approach' an entity should measure expected credit losses of a financial instrument in a way that reflects the principles of measurement set out in IFRS 9. These dictate that the estimate of expected credit losses should reflect:

- an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- the time value of money; and
- reasonable and supportable information about past events, current conditions and forecasts of future economic conditions that is available without undue cost or effort at the reporting date.

Putting the theory into practice, expected credit losses under the 'general approach' can best be described using the following formula: Probability of Default (PD) x Loss given Default (LGD) x Exposure at Default (EAD). For each forward looking scenario an entity will effectively develop an expected credit loss using this formula and probability weigh the outcomes.

'Simplified approach' to impairment

IFRS 9 allows entities to apply a 'simplified approach' for trade receivables, contract assets and lease receivables. The simplified approach allows entities to recognise lifetime expected losses on all these assets without the need to identify significant increases in credit risk. Certain accounting policy choices apply:

- For trade receivables and contract assets that do not contain a significant financing component, it is a **requirement** to recognise a lifetime expected loss allowance (i.e. An entity must always apply the 'simplified approach').
- For other trade receivables, other contract assets, operating lease receivables and finance lease receivables it is an **accounting policy choice** that can be separately applied for each type of asset (but which applies to all assets of a particular type).

A significant financing component exists if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. [IFRS 15:60]

Applying the 'simplified approach' using a provision matrix

When applying the 'simplified approach' to, for example, trade receivables with no significant financing component, a provision matrix can be applied. A provision matrix is nothing more than applying the relevant loss rates to the trade receivable balances outstanding (i.e. A trade receivable aged analysis). Because IFRS 9 does not provide any specific guidance on this issue, we provide a stepped approach to using a provision matrix below.

Step 1 Determine the appropriate groupings of receivables

There is no explicit guidance or specific requirement in IFRS 9 on how to group trade receivables, however, groupings could be based on geographical region, product type, customer rating, collateral or trade credit insurance and type of customer (such as wholesale or retail).

To be able to apply a provision matrix to trade receivables, the population of individual trade receivables should first be aggregated into groups of receivables that share similar credit risk characteristics. When grouping items for the purposes of shared credit characteristics, it is important to understand and identify what most significantly drives each different group's credit risk.

Step 2 Determine the period over which historical loss rates are appropriate

Once the sub-groups are identified, historical loss data need to be collected for each sub-group. There is no specific guidance in IFRS 9 on how far back the historical data should be collected. Judgment is needed to determine the period over which reliable historical data can be obtained that is relevant to the future period over which the trade receivables will be collected. In general, the period should be reasonable – not an unrealistically short or long period of time. In practice, the period could span two to five years.

Step 3 Determine the historical loss rates

Now that sub-groups have been identified and the period over which loss data will be captured has been selected, an entity determines the expected loss rates for each sub-group sub-divided into past-due categories. (i.e. A loss rate for balances that are 0 days past due, a loss rate for 1-30 days past due, a loss rate for 31-60 days past due and so on). To do so, entities should determine the historical loss rates of each group or sub-group by obtaining observable data from the determined period.

IFRS 9 does not provide any specific guidance on how to calculate loss rates and judgement will be required.

Step 4 Consider forward looking macro-economic factors and conclude on appropriate loss rates

The historical loss rates calculated in Step 3 reflect the economic conditions in place during the period to which the historical data relate. While they are a starting point for identifying expected losses they are not necessarily the final loss rates that should be applied to the carrying amount. It should be determined whether the historical loss rates were incurred under economic conditions that are representative of those expected to exist during the exposure period for the portfolio at the balance sheet date.

Step 5 Calculate the expected credit losses

The expected credit loss of each sub-group determined in Step 1 should be calculated by multiplying the current gross receivable balance by the loss rate. For example, the specific adjusted loss rate should be applied to the balance of each age-band for the receivables in each group. Once the expected credit losses of each age-band for the receivables have been calculated, then simply add all the expected credit losses of each age-band for the total expected credit loss of the portfolio. The table below illustrates how the ultimate expected credit loss allowance would be calculated using the loss rates calculated in Step 4.

Determine the expected credit loss	0 days past due	1-30 days past due	31-60 days past due	61-90 days past due	More than 90 days past due	Total
Balances outstanding at reporting date	$875,000	$460,000	$145,000	$117,000	$55,000	
Expected credit loss rate	1.2%	2.4%	6%	10.8%	22.8%	
Expected credit loss allowance	$10,500	$11,040	$8,700	$12,636	$12,540	$55,416

More information about applying the provision matrix approach in practice, including a detailed illustrative example, can be found in the publication issued by Deloitte Global Office which is available here.

Source: a Closer Look — Applying the expected credit loss model to trade receivables using a provision matrix

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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 October 2018.

As of 23 October 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

Webcast took place on 16 October 2018.
Its record is available here.

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

What changes in US GAAP become effective this December?

With the approaching year end most of the companies are already prepared for key US GAAP changes becoming effective soon, for example changes in leasing accounting. There are however more changes upcoming.

You may find useful the below listing of FASB Accounting Standards Updates (ASUs) which are becoming effective on December 15, 2018.

- **ASU 2016-02**, *Leases (Topic 842)* (issued February 25, 2016). This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, for any of the following:
  - Public business entities.
  - Not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market.
  - Employee benefit plans that file financial statements with the SEC.

  For all other entities, the amendments in the ASU are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early application of the amendments in the ASU is permitted for all entities.
- **ASU 2017-06**, *Employee Benefit Plan Master Trust Reporting (a consensus of the Emerging Issues Task Force)* (issued February 27, 2017). The amendments in this ASU are effective for fiscal years beginning after December 15, 2018. Early adoption is permitted.
- **ASU 2017-08**, *Premium Amortization on Purchased Callable Debt Securities* (issued March 30, 2017). For public business entities, the amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, including adoption in an interim period.
- **ASU 2017-11**, *I. Accounting for Certain Financial Instruments With Down Round Features and II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests With a Scope Exception* (issued July 13, 2017). The ASU is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other organizations, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted.
- **ASU 2017-12**, *Targeted Improvements to Accounting for Hedging Activities* (issued August 28, 2017). For public business entities, the ASU's amendments are effective for fiscal years beginning after December 15, 2018, and interim periods therein. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods beginning after December 15, 2020. All entities are permitted to early adopt the ASU in interim periods after its issuance.
- **ASU 2017-15**, *Codification Improvements to Topic 995, U.S. Steamship Entities — Elimination of Topic 995* (issued December 5, 2017). The amendments in this ASU are effective for fiscal years beginning after December 15, 2018. Early adoption is permitted.
- **ASU 2018-02**, *Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income* (issued February 14, 2018). The ASU is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted.
- **ASU 2018-07**, *Improvements to Nonemployee Share-Based Payment Accounting* (issued June 20, 2018). The amendments in the ASU are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, but no earlier than an entity's adoption date of ASC 606.

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Smart contracts as the future of the law of obligations, or pacta sunt servanda in absolute terms?

We have been recently often encountering the term *smart contracts*, especially with reference to the quickly developing blockchain technology. In general, *smart contracts* refer to a technological solution with the objective of independently ensuring the performance of a contractual obligation via a specific technological tool (esp. software).

However, the term *smart contracts* was introduced in theory long before the origin and development of the aforementioned blockchain technologies. Authorship is attributed to the legal theoretician and cryptographer Nick Szabo, who, in his 1997 article (*Smart Contracts: Formalizing and Securing Relationships on Public Networks*) considers common drink vending machines to represent smart contracts, since in his opinion they involve the conclusion of a purchase contract with a seller who is not present at the time but represented by the vending machine. As soon as the purchaser inserts coins in the machine and selects the required goods, they accept the seller's offer and the contract is subsequently performed by the vending machine, which delivers the goods to the purchaser and allows them to acquire the ownership right.

Blockchain and the development of smart contracts

However, the true development of smart contracts did not start until recent years, especially thanks to the development of the technology called *blockchain*, which has brought a crucial commodity to the technological world – data credibility.

So how can we understand smart contracts in the context of today? in general, it can be said that a smart contract is any algorithm that can independently verify, execute, enforce or restrict the performance of contractual rights and obligations. In practice, we can think about purchase or lease contracts, handling of financial derivatives or negotiation and realisation of pledges. However, a warning suggests itself here that the practical use must also be understood in the context of the technological nature of smart contracts. After being approved by both parties, a smart contract (i.e. A mere software code) is uploaded to the blockchain database environment, it is verified and then it waits without a possibility of change for the determined date when the performance of "A" or "B", or even "C" occurs (e.g. cancellation of the obligation, *if-then principle*).

One of the many flaws of smart contracts is the impossibility to subsequently alter the obligation that has been entered into the blockchain environment. Nevertheless, before we focus on the individual pros and cons of smart contracts as such, let's first consider whether this procedure can be regarded as a contractual process in line with valid law.

What does Czech law think about this?

Can smart contracts be considered contracts as such? the Civil Code states that "*in a contract, the parties express their will to establish an obligation between themselves and to be governed by the contents of the contract*" and that "*a contract is concluded as soon as the parties have agreed on its content*". In the case of *smart contracts*, there is no doubt that the algorithm that is supposed to perform the obligation is an expression of the will of the parties and that at the moment of arranging this obligation, it is validated as an obligation in the environment of the blockchain network, i.e. The contract is concluded.

The Civil Code allows everyone to select whichever form they like for their legal acts (unless the agreement or law stipulate otherwise). Another question suggests itself with respect to smart contracts, namely whether legal acts in the form of smart contracts will hold even if the written form is required.

Since all smart contracts, or more precisely their contents, are captured in algorithms written in specific programming languages, expert knowledge is required from the reader to understand them. However, there is no regulation that sets what language has to be used to meet the requirement of written form. We can therefore conclude that an agreed algorithm as such can completely capture the contents of a legal act.

Identification of the agent

Since every user in the blockchain database is a holder of two certification keys – private and public – it is possible to determine the agent, even though it is not possible to identify this person in this way based on usual civil identification data (first name, last name, etc.). This, we should admit, could represent the most problematic part of our assessment and going forward probably also the biggest stumbling block for any efforts to integrate smart contracts in the law. On the other hand, is it necessary in the times of advanced technologies to rigidly insist on the need for identification using conventional data, or is it instead possible to accept a digitalised form of identification features of individual persons, especially in the unique environment that the parties have selected for the "written form"?

Since the private key can be held only by the specific user and the data cannot be changed after being entered in the database, the requirement for signing the written form with an advanced electronic signature is also met, in line with EU legislation and the Act on Trust Services for Electronic Transactions.

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The European Commission Seeking a Solution to the Chemical, Product and Waste Legislation

What is the future of EU waste, chemical and product legislation? the European Commission is seeking an answer to this question, with an opportunity for virtually anybody to share their view.

Public consultation is currently held by the European Commission addressing the interface between chemical, product and waste legislation. **Any interested party is welcome to contribute to this consultation until 29 October 2018 by filling out a questionnaire**. This consultation aims to facilitate the adoption of measures addressing the currently complicated legal interface between chemical, product and waste legislation. The outcomes of the consultation will thus be reflected in future legal regulations and non-legislative initiatives.

The consultation builds upon the EU Action Plan for Circular Economy defining the European Commission's ambitious goal to initiate a transition from the existing linear economy model to circular economy. The application of circular economy principles should facilitate sustainable development in the region, increasing its competitiveness. The conception is inspired by a natural ecosystem in which things are transformed rather than lost. The conception seeks to abandon the current economic mechanism based on the "*take-use-throw*" principle by closing the product lifecycle. The main objective is to minimise the use of primary raw materials and maximise the appreciation and utilisation of all raw materials, products and waste which are already available in the economy. A significant role is played by the initial stage of the product life cycle, i.e. product design with an 80% share in the product's environmental impacts.

Nevertheless, recycling and reuse is often hindered by the chemicals contained in products. Some of them pose a direct threat to humans and the environment. These various types of chemicals occurring in product waste are collectively referred to as *substances of concern*.

The European Commission has identified four main issues hampering the safe use of secondary raw materials recovered from such products, **with the first one being insufficient information on the presence of substances of concern in products and waste**. Product waste often contains substances of concern but waste management operators often have no access to this information as it does not exist or is unavailable to them. The introduction of a compulsory system informing waste management operators of the presence of substances of concern has also been considered.

The second issue relates to the presence of substances of concern that are no longer allowed in new products. This naturally arises from the product lifecycle, hindering the recycling of waste and transformation into new products. This is what we call the issue of "legacy substances" and the European Commission intends to address it by introducing a specific decision-making methodology to support decisions on the recyclability of waste containing substances of concern.

The third issue is that the EU's rules on end-of-waste status are not fully harmonised. The complexity and intricacy of waste streams results in that various materials and waste are traded and used under non-transparent and unclear legal conditions.

The fourth issue involves the missing alignment of hazardous waste and chemicals classification. The hazardous nature of a product may depend on whether or not the product has already turned into waste. This has extensive consequences on the manners of waste management and transition to circular economy. To address this issue, the European Commission has already issued technical guidance on the classification of waste (2018/C 124/01) contributing to waste classification across the European Union.

The European Commission aims to ensure that appropriate information on substances of concern in products is available to all actors in the supply chain and ultimately also becomes available to waste operators. Furthermore, it is necessary to facilitate recycling and intensify the utilisation of secondary raw materials by promoting non-toxic materials cycles, aligning interpretation, introducing end-of-waste status rules and unifying the classification of chemicals and waste across the European Union. A long-term objective involves achieving full compliance between waste and chemical legislation.

In the above-mentioned questionnaire, experts and the general public may comment on the following eight specific challenges based on the issues described:

- No. 1: Defining substances of concern
- No. 2: Tracking substances of concern
- No. 3: Level playing field between secondary and primary material
- No. 4: Level playing field between EU-produced and imported articles
- No. 5: Design for circularity
- No. 6: Improving certainty in the implementation of end-of-waste provisions
- No. 7: Approximating the rules for classification of chemicals and waste
- No. 8: Classifying waste taking into account the form in which it is generated

The European Commission analyses received comments and subsequently issues a summary report based on the experience and observations of interested parties. It is of major importance that a maximum of parties share their views on issues arising from the interface between chemical, product and waste legislation to ensure that this sphere will be regulated on realistic grounds. This is certainly more beneficial and ultimately more practical than law-making detached from reality.

Instruments are available to remove barriers from the EU's transition to circular economy that could mitigate some friction; nevertheless, more observations and information from across the European Union are necessary to develop the best solution to far-reaching issues. Interested parties thus need to get involved in the ongoing consultation and provide the European Commission with their view of future legislation.

The questionnaire is available here.

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