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dReport: November 2019

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Expansion of exemption from real estate acquisition tax effective

On 1st November, a new legal provision amendment took effect that will allow exempting from real estate acquisition tax also the first acquisition of an apartment unit in a detached house against payment, not just in an apartment building.

At present, exemption from real estate acquisition tax applies to the first acquisition against payment of ownership title to the construction of a detached house, to a plot of land or the right to construction including the construction of a detached house, and to a unit including an apartment and a garage, cellar or storeroom used together, which are found in an apartment building.

However, there are an increasing number of cases where apartment units are delimited in detached houses as well. This occurs for various reasons, for example, because certain areas allow only the construction of detached houses. The first acquisition of such an apartment unit against payment is currently not exempt from real estate acquisition tax.

Financial administration vs. taxpayers

Although certain tax administrators have admitted the exemption from tax even for apartment units in detached houses in the past, the Financial Administration[1] objected against such treatment and emphasised that the legislative objective was indeed to exempt only apartment units in apartment buildings, whether to prevent the construction of "horizontal panel buildings" or due to stricter regulation of apartment buildings. However, taxpayers disagreed with this interpretation as they perceived this exemption as a motivational element for the acquisition of a new apartment regardless of whether it was found in a detached house or an apartment building.

Deputies agreed with taxpayers

The Chamber of Deputies has granted the requests of taxpayers who pointed out the discrepancy in the exemption from real estate acquisition tax in the case of a new apartment unit in a detached house, and it approved an amendment to Senate Ordinance No. 340/2013 Coll., on Real Estate Acquisition Tax, within the terms of Act No. 254/2016 Coll. The amendment will also allow the exemption of the first acquisition of an apartment unit in a detached house against payment.

The amendment came into force on 1st November 2019. The exemption will apply only to apartment units in detached houses acquired on and after 1st November 2019.

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Are Tax Liabilities Transferred to the Successor Company in the Event of a Demerger?

While in the case of demerger by split-up, i.e. demerger where the demerged company ceases to exist, it is clear that the tax liabilities are transferred to the successor companies, it is less clear to what extent the tax liabilities are transferred in the case of demerger by spin-off, i.e. in cases where the demerged company does not cease to exist as a result of the transformation.

Transformation by demerger involves the transfer of the demerged company's net assets to one or more successor companies. The demerged company then may or may not cease to exist as a result of the demerger.

The method and extent of transfer of tax rights and liabilities related to the transferred net assets are generally regulated by the Tax Code. Section 240 of the Tax Code states that if a legal entity ceases to exist with a legal successor, its tax liability is transferred to the legal successor. Until the end of 2013, this provision additionally stated that if a legal entity ceased to exist as a result of a demerger without a clear indication to what extent the tax liability would be transferred to its legal successors, legal succession concerning tax liabilities would be determined by the tax administrator.

The transfer of the tax liability was therefore more closely defined only in cases where the demerged company ceased

to exist as a result of the demerger. Then it was up to the participating companies, or the tax administrator, to specify the distribution of these liabilities in sufficient detail directly in the transformation project (the extent of transfer of tax liabilities is an obligatory component of the demerger project). In practice, it meant that the participating companies could determine what tax rights and liabilities would be transferred to the successor companies.

On the other hand, in the case of a demerger by spin-off, that is transformation without the dissolution of the demerged company, the method of transfer of tax liabilities was unclear. The Supreme Administrative Court even reached a conclusion in one of its rulings that in the event of a spin-off performed while this legal regulation was in effect, the transfer of the tax liability would be possible only if the demerged company ceased to exist. In the event of spin-off where the demerged company did not cease to exist, all the tax rights and liabilities remained with the original taxpayer.

Situation after the amendment to the Tax Code in 2014

The Tax Code was amended in 2014. The definition of the transfer of the tax liability in the case of demerger by split-up was transferred to Section 240b of the Tax Code and subsequently expanded to include all cases of transformations of legal entities by demerger (not just cases where the demerged company ceases to exist). The Supreme Administrative Court confirmed the transfer of the tax liability from the non-dissolving demerged company to the successor company in the case of demerger by spin-off based on this provision. However, this ruling was issued under specific conditions. It concerned an existing tax liability (albeit one which was conditionally exempt as of the date of the legal effect of the transformation) tied to the contribution of an investment in a company pursuant to legal regulations on exemption from property transfer tax in the event of contribution in kind in a company as effective at that time.

It is therefore questionable whether the transfer of the tax liability in the event of transformation by demerger can be generalised to all cases of spin-off, and whether it is possible in line with Section 240b of the Tax Code to adjust the extent of the transfer of the tax liability from the non-dissolving demerged company to the successor companies in the transformation project at will. This consideration is crucial not just in terms of the liabilities existing as of the effective date of the spin-off due to the "cross-liability" of the companies participating in the transformation for the debts transferred as a result of the spin-off, but also due to the potential transfer of latent tax liabilities as of the effective date of the transformation.

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Pension Agreement between the Czech Republic and Belarus

The Czech Republic and Belarus concluded a pension agreement. It became effective on 1 October 2019 together with the Administrative Arrangement for the Use of the Agreement and was published in the Collection of International Treaties of the Czech Republic, specifically under No. 47/2019 and No. 48/2019 of Collection of International Treaties.

The aim of the agreement is to ensure employed and self-employed persons are subject to the legislation of the state in which their employment or self-employment is performed. The agreement prevents double payment of pension contributions for the same job and at the same time it prevents being excluded from the pension scheme completely. a special rule applies to assigned employees and it is also possible to negotiate exceptions.

The agreement applies to all persons who are (or were) subject to the legislation of one or both contracting states, regardless of their nationality. The agreement only covers pension (old-age pension, disability pension, widow's/widower's pension, and orphan's pension) and it also provides for pension insurance contribution payments.

The agreement does not apply to sickness benefits, work injury and occupational disease benefits, unemployment benefits or health insurance. These cases need to be addressed in accordance with the legislations of both states individually.

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Gambling Taxation revised by the Chamber of Deputies of the Czech Republic

Parliamentary Press No. 509 – the government bill on amendments to certain tax acts in connection with increasing public budget revenue, which also amends Act No. 586/1992 Coll., on Income Taxes, as amended ("Income Taxes Act") – was passed through a third reading in the Chamber of Deputies of the Czech Republic. On 8 November 2019, it was submitted to the Senate of the Czech Republic for further debate. Therefore, the changes that this parliamentary press proposes may pass and become effective on the expected date, i.e. 1 January 2020.

As we have mentioned in the previous articles, this amendment proposes changes mainly related to:

- Restrictions on the exemption of gambling winnings for individuals;
- Taxation of interest income arising from bonds issued before 1 January 2013;
- Methodology of creation and tax deductibility of technical provisions in insurance business; and
- The definition of a parent company – apart from municipalities and voluntary unions of municipalities, other public corporations such as regions and the state, or better the Czech Republic, are proposed to be considered as parent companies.

Over 50 amendments were proposed to the debated parliamentary press. In relation to income tax, however, only amendments related to the taxation of gambling winnings were passed. The original proposal suggested that gambling winnings (including the receipt lottery) over CZK 100,000 should be subject to a withholding tax. However, the text submitted to the Senate was adjusted in the following way:

Gambling was divided into the following income categories:

- Lotteries and raffles;
- Fixed-odds betting and totalisator games;
- Technical games;
- Live games with the exception of live game tournament;
- Live game tournaments and small scale tournaments; and
- Other than the above stated types of gambling.

The winnings from lotteries, raffles and the receipt lottery will be subject to a withholding tax, with the tax base being the gross amount of winnings not reduced by any expenses. Single winning under CZK 1 million will be exempted from the tax. Taxpayers will also be allowed to include the income from lotteries and raffles being subject to the withholding tax in their income tax return and apply the withheld tax in a similar way as a tax advance payment, if such an approach is favourable to them.

The income from other above stated types of gambling will be taxed in the income tax return of the taxpayer as other income, i.e. it will not be taxed by the game organiser (payer of the tax) through a withholding tax. However, the tax base will be calculated as the difference between the total winnings in the given type of income (see the income categories above) and the total stakes (bet amounts) within the same type of income. If the difference between total winnings and total stakes from all gambling activities in the respective type of income for the whole taxable period does not exceed CZK 1 million, the income from the respective types of gambling will be exempt from the tax. It will not be possible to apply other expenses than the stakes for calculating the tax base.

For the sake of completeness, we would like to add that Parliamentary Press No. 572 – the government bill on amendments to certain acts in connection with the implementation of the EU tax regulations and with the prevention of double taxation – is supposed to affect the Income Taxes Act as well. However, it is still being discussed by the Chamber of Deputies, with the first reading not yet finished. Therefore, it is very likely that the amendments proposed by this parliamentary press will not have completed the legislation process by the end of this year and they will be implemented later than 1 January 2020.

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The Supreme Administrative Court ruled on the moment on which an investment is initiated

The Supreme Administrative Court of the Czech Republic issued judgment No. 7 Afs 365/2018-62, which deals with the moment from which an entity is to capitalize the costs of acquisition into the value of the tangible and intangible assets. In terms of allocation of certain costs to the acquisition value of assets, the court held that it was not essential when the tax entity had formally approved the investment to be made but when it had objectively begun to invest even though it was not quite certain at that time that the investment would be completed successfully.

The Supreme Administrative Court thus upheld the interpretation of the National Accounting Council No. I-5 (Determination of the date at which the costs related to the acquisition of tangible fixed assets start to be capitalized), which states that the crucial moment is when the accounting unit actually rather than formally decides to acquire a new investment to address the relevant issue. In the present situation, no qualitative change was found in the company's procedure, i.e. expenses of the same nature were incurred to make the investment both before and after the formal decision of the board of directors in the relevant matter.

According to the court, the company's formal decision would only be relevant to the cost classification for accounting purposes if the commencement date of capitalisation of the costs included in the decision preceded the actual commencement of the investment or if the decision resulted in a qualitative change in the taxpayer's procedure to the extent that it would only start to incur the costs relating to the acquisition of assets from that date.

The above-mentioned judgment also very marginally and indirectly touches the interpretation of Section 25(5)(a) of Act No. 563/1991 Coll., on Accounting, as amended, namely the connection between the costs incurred and the acquisition of assets. The Court admits that accounting regulations do not define such a connection in any way. Therefore, it recommends examining the link between the given cost and the acquired asset, irrespective of whether or not (or when) the tax entity has formally decided on the acquisition of assets. In this case, it is again referred to the procedure and to a non-exhaustive list of costs that may represent regular operating costs as stated in the interpretation of the National Accounting Council No. I-5.

We see the attractiveness of the judgement in that the Supreme Administrative Court confirmed some of the conclusions of the interpretation of the National Accounting Council No. I-5 and that it accepted the argument arising from that document by which it considered it to be a relevant source in a certain sense.

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News round up

VAT Act Amendment

The VAT Act amendment, which should become effective on 1 January 2020, will definitely not be passed and published in the Collection of Laws by the end of 2019. That is because the Chamber of Deputies will discuss the amendment for the first time at the end of November 2019 at the earliest, even though the amendment was supposed to implement the EU Directive on new rules for the intra-Community trade of goods. However, we believe that the absence of new rules should not cause any trouble; VAT payers can use the direct effect of the EU Directive.

VAT Rounding – the General Financial Directorate Informs

In advice issued in the middle of October, the General Financial Directorate informed about the new VAT rounding rules applicable from 1 October 2019. In the case of VAT rounding for wire transactions, the GFD interpretation was quite surprising, as it contradicted the wording of the VAT Act. However, it cannot be expected in practice that the GFD interpretation would not be accepted.

No Change to VAT Payer Registration Limit in Sight

The European Commission, which has an interest in unifying the system rules for taxable persons not yet registered for VAT purposes, has not yet reached an agreement about the limit that should be set for a compulsory registration for VAT purposes. Moreover, the effect of the potential change was postponed to 2025, and therefore we cannot expect any changes to this topic in the next few years.

CJEU's judgments

The opinion of the Advocate-General of the Court of Justice of the European Union in Case C-488/18 Golfclub Schloss Igling implies that member states have the authority to selectively define, which sport services and the performance closely related to them can be exempt from VAT without a right to claim VAT deduction. As of now, the Czech VAT Act contains only one criteria for the exemption – the requirement of the non-profit nature of the provider.

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What will 2020 bring in the area of VAT? Quick fixes already in January and a VAT decrease for selected supplies in May

One of the main topics of the traditional autumn seminar on value added tax, which is organised every year by Deloitte, were the new rules in the area of VAT, jointly referred to as "quick fixes". Their primary purpose is to unify certain rules for cross-border transactions with goods within the European Union. What do they bring, specifically? How can preparations be made for them?

New legislative rules in the area of VAT, quick fixes, will come into effect on 1 January 2020. They are a set of transitional measures that will be applicable until a final VAT system is established within the EU. However, when I read through the quick fixes, and I have been reading them for half a year, I feel that they are rather ambiguous and could be understood to mean anything. Therefore, we keep waiting to see how these rules will actually be interpreted.

1. Tax exemption with respect to the supply of goods to another EU member state

The first quick fix states that when supplying goods to another member state, the customer will now have to communicate their VAT ID to the supplier, otherwise it will not be possible to exempt the supply of these goods from VAT. At present, the VAT Act stipulates that an intra-community supply of goods is exempt from tax if it is supplied to a person registered for income tax in another member state, which you can check by verifying their VAT ID. "What changes is that now you will need to have proof that the customer has actively communicated the VAT ID to you and in addition, there will be a deadline when the customer has to do so. The question is how to determine this deadline. AND there is no clear answer to that, because there are several interpretations," said Tomáš Brandejs.

A relatively comprehensive view is offered by the financial administration, which says that the last date for obtaining the customer's VAT ID is the 15th day of the month following the month when the supply of goods to another member state occurred, which is actually the last date by which the supply has to be reported.

At the same time, to obtain VAT exemption it will be necessary to include a record of the supply in the EC sales list. If the record contains incorrect information, for example a typo, such flaws can be remedied with a proper justification to the satisfaction of the relevant bodies.

Deloitte's point of view: Companies will have to create a system for obtaining VAT IDs from their customers and store evidence of the date when the VAT ID has been communicated to them – meaning communicated actively. It is therefore not enough to discover the VAT ID yourself on the internet. Ask your existing customers to send you their VAT IDs as well, even if you have been doing business with them for years.

2. Methods of demonstrating the transport of goods to another member state

Another change concerns the demonstration of transportation to another member state. The supplier holding evidence of such transportation will transfer the burden of proof to the tax administrator, and the tax administrator will be the one to have to demonstrate that the transportation did not take place.

At first glance, this second "fix" seems positive for the supplier. At second glance, however, some complications start taking shape. The rule governing the obligation to demonstrate transportation is called "2 or 1+1". What does that mean? the supplier has to provide two pieces of evidence. Two groups of evidence are set and the supplier can choose to provide both pieces of evidence from the first group, or one piece from the first and one from the second group of documents.

First group: Documents concerning transportation – signed CMR waybill, bill of lading, invoice for air transportation, invoice from the transportation provider

Second group: Other documents – transportation insurance policy, bank confirmation of payment for the transportation, official confirmation of completion of transportation in the destination state (e.g. from a notary public), confirmation form the storage provider of receipt in the warehouse in the destination state

What is the problem? That these pieces of evidence cannot be prepared by the supplier or the customer and each of these two pieces of evidence have to be prepared by a different person that must be independent of the supplier and the customer. These conditions can be met if transportation is arranged by the supplier – the first piece of evidence could be the CMR sheet signed by the carrier, the second a bank confirmation of payment for the transportation. However, what if the transportation is arranged by the customer? In such a situation, you essentially have only the CMR sheet.

Deloitte's point of view: Under such conditions, try to secure a set of some other documents prepared by you or the customer to have a sufficient number of them, so that you could tell the tax administrator that while you do not meet the conditions of the regulation, you have not just two pieces of evidence but instead as many as four, for example.

In addition, remember that you will need a written confirmation of transportation from the customer by the 10th day of the following month.

3. Transport assignment

The third quick fix focuses on so-called chain transactions, the subject of which is the supply of the same goods between several business partners. In general, the new rule provides that the shipment is automatically assigned to the first supply, i.e. The transaction between a supplier and an intermediary, and thus potentially exempt from VAT. The second supply will then be taxed. However, in the case that the intermediary provides the supplier with his VAT ID assigned to him for VAT purposes in the country of commencement of shipment, the shipment will be assigned to the second supply.

Deloitte's point of view: In this context, however, we will encounter a new phenomenon. As the fact that the intermediary provides the supplier with the VAT ID from the country of his tax residence does not necessarily mean that the intra-Community supply made by the supplier must be exempt from tax. Can the supplier trust the intermediary that he will actually deliver the goods? He may, but naturally, it will not be enough for the tax administrator. Therefore, given the above-mentioned regulation on the means of evidence of the transport of goods, suppliers will tend to tax the first supply.

4. Call-off stocks

The amendment introduces a modification of the rules for call-off stocks and simplification in the case of call-off stocks where the supplier moves his own goods from another member state. A customer who takes goods from such a call-off stock will self-assess his VAT not at the time of entry into stock, but at the time of release from stock, i.e. when the customer actually acquires the right to dispose of the goods as their owner. The law will also explicitly anticipate that the customer may change.

However, the new rule also brings new obligations:

- The goods must not be stored in the call-off stock (i.e. in the customer's state) for more than 12 months. On the 366th day, the conditions are breached and the supplier will have to report the relocation of goods to the given member state.
- Goods should not be stolen, lost or destroyed (including technological losses) - in these cases, the goods will be reported in a traditional way, not in the above-mentioned

simplified regime. Thus, in case of theft, the supplier will have to report that he had moved the goods to the Czech Republic, for example, and that the goods had been stolen there.
- New code for supplies to another member state for the EC Sales List.

More news in the area of VAT

Transfer of selected services and products to the reduced 10% VAT rate from 1 May 2020

- Catering services including serving soft drinks or draught (keg) beer
- Books, e-books and audiobooks, including lending
- Tap water and water / sewage
- Repair of footwear, leather products, clothing and textile products, bicycles
- Hairdressing and barber services
- Home care for children, elderly, sick and disabled citizens
- Window cleaning and cleaning services in homes

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Tax package introducing changes in consumption and gambling taxes passed by the Chamber of Deputies

On 6 November 2019, the Chamber of Deputies passed a bill amending selected tax legislation in relation to increasing the public budget income. The amendments concern, inter alia, consumption and gambling taxes. The bill will now be considered by the Senate.

Consumption taxes – significant changes in tax rates

A significant change relates to an increase in alcohol tax rates. The alcohol tax rate in respect of alcohol contained in products under nomenclature code 2207 (such as products containing more than 80% of alcohol or alcohol products used as fuel), nomenclature code 2208 (such as whiskey, vodka, gin) and in other cases will newly be CZK 32,250 / hl of ethanol. Furthermore, the alcohol tax rate will increase to CZK 16,200 / hl of ethanol in respect of alcohol in fruit distilled liquor arising from growers' distillation in amounts of up to 30 litres of ethanol per grower in a single production period. Changes in tax rates are summarised in the table below.

Products	Original rate	Amended rate
Alcohol in products listed under nomenclature codes 2207, 2208 and in other cases	CZK 28,500 / hl of ethanol	CZK 32,250 / hl of ethanol
Alcohol in fruit distilled liquor arising from growers' distillation in amounts of up to 30 litres of ethanol per grower in a single production period	CZK 14,300 / hl of ethanol	CZK 16,200 / hl of ethanol

Another increase in tax rates will relate to tax on tobacco products when the percentage portion for cigarettes newly increases to 30%. The fixed portion of the tax rate will newly amount to CZK 1.61 / piece for cigarettes, CZK 1.88 / piece for cigars and cigarillos and CZK 2,460 / kg for smoking tobacco. Furthermore, the minimum tax rate for cigarettes should also increase to the aggregate minimum amount of CZK 2.9 / piece. In respect of heated tobacco products, the tax rate should increase to CZK 2.46 / piece. Changes in tax rates are summarised in the table below.

	Original rate – percentage portion	Amended rate – percentage portion	Original rate – fixed portion	Amended rate – fixed portion	Original rate – minimum	Amended rate – minimum
Cigarettes	27%	30%	CZK 1.46 / piece	CZK 1.61 / piece	CZK 2.63 / piece	CZK 2.9 / piece
Cigars, cigarillos			CZK 1.71 / piece	CZK 1.88 / piece		
Smoking tobacco			CZK 2,236 / kg	CZK 2,460 / kg		

The passage of this act may result in an obligation to change tax collateralisation arising for tax warehouse operators or authorised recipients in respect of recurrent receipts of selected product. Therefore, it is necessary to calculate an increase in tax collateralisation, if any.

Interestingly, the limit for beer produced by an individual in facilities for home production of beer will increase as well; newly, if the amount of beer produced in this manner does not exceed 2,000 litres on a calendar year and the beer is not sold by the producer, the producer will not be considered a taxpayer.

Gambling tax – change in tax rate

The tax package also includes a change in tax rate in respect of a partial tax base for lottery tax that should newly amount to 35%, rather than 23%. The original wording of the act intended to increase gambling tax rates also for other partial tax bases; however, several amendments have been made to the bill, ruling out other increases in tax rates from the bill.

Further development

At present, the bill will be considered by the Senate. The Senate may pass, reject or return it with amendments to the Chamber of Deputies. If the bill is rejected or amended by the Senate, the Chamber of Deputies will once again take a vote on the bill. Nevertheless, the wording of the act is anticipated to take effect from 1 January 2020.

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International Taxes in Brief

US guidance on tax treatment of virtual currency

On 9 October 2019, the US Internal Revenue Service (IRS) issued a ruling and FAQs providing guidance for taxpayers holding virtual currency as a capital asset. The IRS guidance addresses many areas associated with virtual currency transactions, including tax accounting, valuation, reporting, charitable contributions and the tax implications of "hard forks" and airdrops. In Notice 2014-21, the IRS stated that virtual currency is treated as property for federal income tax purposes and provided examples that illustrate how general income tax principles would apply to transactions using virtual currency. The recently issued FAQs provide several additional examples that continue to emphasize that longstanding federal income tax principles applicable to property will apply to virtual currency in the same manner, notably with respect to: determining gain or loss on sale of virtual currency, determining gain or losses on exchanges of virtual currency (e.g. for services or other property), determining basis on the purchase of virtual currency, as well as the treatment of the receipt of virtual currency as remuneration for services or wages.

Belgian draft bill on transitional regimes for Brexit

On 18 October 2019, the Belgian Council of Ministers adopted a draft bill on various transitional regimes with respect to Brexit. The transitional regimes include for example maintenance of benefits related to supplementary pension, long-term saving and pension saving contracts concluded in or before December 2019; withholding tax exemptions for remuneration paid to researchers completing R&D projects with universities; exemption for capital gains realized before 31 December by private investment companies established in the United Kingdom and the tonnage tax regime.

CJEU AG in cross-period loss relief case

On 17 October 2019, an Advocate General of the Court of Justice of the European Union (CJEU) delivered her opinion in Case C-405 /18, which concerns the interpretation of freedom of establishment under Article 49 TFEU, read in conjunction with Article 54 TFEU. The question that arises in the case is whether the freedom of establishment permits a taxpayer, when relocating a company's place of management, to claim in the host State a tax loss incurred in previous years in another Member State. The case is set in the context of an action brought by a Czech company which is claiming a loss before the Czech tax authorities. The company sustained that loss previously in the Netherlands. It was no longer able to take the loss into account there due to the transfer of its place of effective management to the Czech Republic, and thus in the absence of economic activity in the Netherlands. The AG concluded that the simple transfer of the place of a company's management from one Member State to another Member State falls within the scope of freedom of establishment under Article 49 TFEU. The exclusion of cross-period loss relief in the case of a cross-border transfer of the place of management does constitute a restriction of freedom of establishment. However, it is justified by the preservation of the balanced allocation of the power to impose taxes between Member States.

CJEU upholds Belgian notional interest deduction

On 17 October 2019, the Court of Justice of the European Union (CJEU) issued a decision upholding the Belgian allowance for corporate equity (notional interest deduction, NID). The CJEU concluded that the measure does not lead to disadvantageous treatment of Belgian companies with foreign permanent establishments (PEs), even though different calculation methods apply to calculate the NID for such companies and companies that operate purely domestically. In the case at hand, the Belgian Court of First Instance in Antwerp requested a preliminary ruling from the CJEU on the method of calculating the NID, which is different for Belgian companies with a PE in another EU member state and Belgian companies that operate purely domestically. Where the profits of a foreign PE are exempt in Belgium under a relevant tax treaty, the net value of the PE's assets is initially taken into account when calculating the NID granted to the Belgian company. The NID is subsequently reduced by the lesser of (i) the part of the deduction for risk capital that relates to the PE and (ii) the positive result generated by the PE. In contrast, this deduction does not apply where a company operates solely in Belgium. The referring court asked whether this difference in treatment violates the freedom of establishment principle in article 49 of the Treaty on the Functioning of the European Union.

CJEU AG opinion on freedom of establishment

The Advocate-General (AG) concluded that articles 49 and 52 of the Treaty on the Functioning of the EU must be interpreted as precluding legislation of a member state which excludes from the exemption from withholding taxes, in a general way on the basis of a territorial criterion, dividends paid by subsidiary companies incorporated in the given member state to their parent companies incorporated in Gibraltar.

EU updates list of non-cooperative jurisdictions

On 10 October 2019, the European Council announced that it had removed the Marshall Islands and the United Arab Emirates from annex I of the EU list of non-cooperative tax jurisdictions (black list); and Albania, Costa Rica, Mauritius, Serbia and Switzerland from annex II (grey list). As a result,

nine jurisdictions remain on the list of non-cooperative jurisdictions: American Samoa, Belize, Fiji, Guam, Oman, Samoa, Trinidad and Tobago, the US Virgin Islands and Vanuatu. The Council reiterated that it would continue to regularly review and update the list in 2019, but has requested that updates are limited to a maximum of two per year as from 2020. The actual list of non-cooperative jurisdictions is available here.

Definition of substance requirements

Number of states have recently introduced new rules for substance requirements based on which the nexus taxation is derived. Among these states is Curaçao where the Ministry of Finance issued a decree providing guidance on the term "substance" within the meaning of article 1C, sub 2 of the Corporate Income Tax Code on 12 September 2019. The decree is effective as per 13 September 2013. Substance requirements are derived for example from the place of seat of management or the residency of board members. Amended rules for the recognition of economic substance were also introduced by the British Virgin Islands (BVI) on 9 October 2019. The substance rules introduced by BVI refers to BVI companies and limited partnerships with legal personality (LPs) that are engaged in "relevant activities," unless they are considered non-resident for the purposes of the Economic Substance Act. Due to political commitments given to the EU Code of Conduct Group in December 2018, also Guernsey and Jersey have recently introduced a mandatory disclosure regimes (MDR) with respect to economic substance information. The MDR introduced in Jersey on 23 September 2019 would require Jersey "intermediaries" to report to the Jersey tax authorities if they become aware of Common Reporting Standard avoidance arrangements or passive offshore vehicles that are held through opaque structures. The implemented MDR in Jersey follows the OECD version of MDR, rather than the EU version of MDR (known as DAC 6), where there is a much broader list of reportable arrangements. The new legislation shall be enacted by 31 December 2019. The newly MDR proposed by Guernsey shall be also introduced into law by 31 December 2019. The proposed MDR rules would require Guernsey promoters of tax avoidance arrangements and service providers to disclose information on the arrangement or structure to the Guernsey Revenue Service.

Limited validity of tax rulings issued before 1 January 2015 in Luxembourg

Luxembourg's 2020 draft budget law presented by the Finance Minister to the Chamber of Deputies on 14 October 2019 includes a new provision regarding the validity period of advance tax decisions issued by the tax authorities before 1 January 2015. Currently, advance tax decision requests receiving a favourable response from the tax authorities after 1 January 2015 are valid for five years, subject to certain conditions. Decisions issued before 1 January 2015 are generally valid indefinitely provided the decision complies with the legislation in force. The 2020 draft budget law would introduce a new provision under which these decisions would be applicable only until the end of fiscal year 2019. Taxpayers affected by the proposed change that wish to receive an advance decision covering tax years after 2019 would have to file a new application.

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News on the Taxation of Digital Economy

On 9 October 2019, as part of the ongoing work of the G20/OECD Inclusive Framework on Base Erosion and Profit Shifting ("Inclusive Framework"), the OECD released a public consultation document containing a Secretariat Proposal for a "Unified Approach" under Pillar One.

Scope

The scope of the new rules will cover highly digital business models but also goes further, focusing on consumer-facing businesses. More work will be done on scope and possible exclusions or carve-outs. Size limitations, such as the EUR 750 million revenue threshold used for country-by-country reporting requirements, will be considered. The document sets out that extractive industries are assumed to be out of scope.

New nexus approach

The new rules will create a nexus for in-scope businesses that is not dependent on physical presence, but instead on sustained and significant involvement in the economy of a market, largely based on sales. It is possible that the new nexus could have thresholds, including country-specific sales thresholds calibrated to ensure countries with smaller economies are included. This measure would be designed as a new self-standing treaty provision (in addition to the existing permanent establishment and business profits articles).

New profit allocation rules

The new profit allocation rules shall be applicable to taxpayers within the scope, irrespective of whether they have in-country marketing or distribution present (permanent establishment

or separate subsidiary) or sell via unrelated distributors. The new approach shall increase tax certainty for taxpayers and tax administration and shall be based on Three Tier Allocation Mechanisms, i.e.:

- Amount a – a share of deemed residual profit allocated to market jurisdiction using a formulaic approach;
- Amount B – a fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdiction, and
- Amount C – binding and effective dispute prevention and resolution mechanisms relating to all elements of the proposal, including any additional profit where in-country functions exceed the baseline activity compensated under Amount B.

Next steps

Comments to the consultation documents were welcomed until 12 November 2019. The public consultation will be held on 21 and 22 November 2019 in Paris. The OECD continues its work in respect of the global anti-base erosion proposal (Pillar Two) of the program of work. A consultation document is expected to be released also in November 2019, followed by a separate public consultation meeting in Paris in December 2019. The OECD hopes that political agreement on the architecture of both the new nexus and profit allocation rules and the global anti-base erosion rule can be reached by June 2020.

Individual national efforts for the taxation of digital services

Irrespective of the OECD's ambitious goal to introduce the world-wide rules for the taxation of digital services, many states continue with the introduction or implementation of their national rules. In the recent days, some progress in the implementation process has been achieved in France. The French tax authorities published guidelines for consultation clarifying aspects of the digital services tax on 16 October 2019. Comments are requested by 29 November 2019. The guidelines clarify reporting and accounting obligations, recovery, control and litigation and a tax consolidation system within a group of companies. In addition, Russia considers new ways to tax digital companies according to recently released budget guidelines for 2020-2022. Foreign entities providing electronic services in Russia are already required to register with Russian tax authorities and collect and remit VAT on those services. The Russian government considered draft legislation on the issue as early as 2016, when the MOF reportedly said that the legislation was meant to implement action 1 of the OECD's base erosion and profit-shifting project. The budget document especially calls for the "creation of a system of legal regulation of the digital economy, including the creation of a legislative framework for the formation of a single digital environment" in order to introduce more digital technology to the economy. Other countries which are currently seeking the introduction of rules for the taxation of digital economy are Malaysia and Indonesia.

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Tax liabilities – December 2019

December		
Monday, 2	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 2019
Tuesday, 10	Excise tax	Tax maturity for October 2019 (excluding excise tax on alcohol)
Friday, 13	Intrastat	Submission of statements for intrastat for November 2019, paper form
Monday, 16	Road tax	Advance payment on tax for October and November 2019, 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, 17	Intrastat	Submission of statements for intrastat for November 2019, electronic form
Friday, 20	Income tax	Monthly payment of deducted advance payments on personal income tax from employment
Friday, 27	Value added tax	Tax return and tax for November 2019
		EC Sales List for November 2019
		VAT control statement for November 2019
	Energy taxes	Tax return and tax maturity on gas, solid fuels and electricity for November 2019
	Excise tax	Tax maturity for October 2019 (only the excise tax on alcohol)
		Tax return for November 2019
		Tax return for claiming of refund of excise tax, for example on fuel oil, other petrol (benzine) for November 2019 (if applicable)
Tuesday, 31	Income tax	Payment of special-rate withholding tax for November 2019

Tax liabilities – January 2020

January

Thursday, 9	Excise tax	Tax maturity for November 2019 (excluding excise tax on alcohol)
Monday, 20	Value added tax	Tax return and tax maturity to MOSS
Tuesday, 21	Income tax	Monthly deduction of the sum of deducted advance payments for personal income tax from dependent activity
Friday, 24	Excise tax	Tax maturity for November 2019 (only excise tax on alcohol)
Monday, 27	Gambling tax	Tax return and tax maturity for 4th quarter of 2019
	Value added tax	Tax return and tax for 4th quarter and for December 2019
		Summary report for 4th quarter and for December 2019
		Control report for 4th quarter and for December 2019
	Energy taxes	Tax return and tax maturity on gas, solid fuels and electricity for December 2019
	Excise tax	Tax return for December 2019
		Tax return for claiming of refund of excise tax for example on fuel oil and other petrol (benzine) for December 2019 (if applicable)
Friday, 31	Biofuels	Reporting according to Section 19 (8) Act no. 201/2012 Coll.
	Road tax	Tax return and tax for 2019
	Real-estate tax	Tax return (completely) or partial tax return for 2019
	Income tax	Withholding tax payment based on special tax rate for December 2019

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Second Call for Proposals in the TREND Programme in Preparation

On 4 December, the Technology Agency of the Czech Republic is planning to announce a second call for proposals in the TREND programme, in particular sub-programme 2 – Newcomers, focusing on the support of industrial research and experimental development. The objective of the TREND programme is to support projects focusing on implementing the results of industrial research and experimental development in practice and on the support of penetration of new markets. The main aim of sub-programme 2 is to support research and development ("R&D") activities of enterprises in cooperation with research organisations, especially those applicants, who do not carry out R&D activities on a regular basis. The programme is organised under the aegis of the Ministry of Industry and Trade of the Czech Republic, but the subsidiser is the Technology Agency of the Czech Republic.

The applicants can be businesses and research organisations. The submitted projects need to have the aim of achieving a result of some kind, such as a prototype, a functioning sample, software, a design or utility model etc. The subsidy applies to staff costs, subcontracting costs, scholarships and other direct costs.

The maximum aid intensity under this call for proposals is up to 80% of total eligible costs for a single project, based on the type of research activity and type of applicant.
The maximum aid amount per project is up to CZK 20 million, again depending on the type of the research activity and applicant.

Project proposals can be submitted from 5 December 2019 until 5 February 2020.

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Announcement of the Second Call for Proposals in the Environment for Life Programme

On 20 November, the Technology Agency of the Czech Republic announced a second call for proposals in the Environment for Life programme, focusing on the support of applied research and experimental development and innovation in the area of the environment. Project proposals are planned to be submitted as part of sub-programme 3 – Long-term Environmental and Climate Perspectives.

Applicants in this call for proposals can include companies, research organisations and other legal entities.

The subsidy applies to staff costs, scholarships, subcontracting costs and other direct costs.

The maximum aid intensity under this call for proposals is up to 90% of total eligible costs for a single project, based on the type of research activity and type of applicant.

Project proposals can be submitted from 21 November 2019 until 22 January 2020.

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Higher Limits for Tender

The Ministry of Industry and Trade of the Czech Republic changed the conditions for announcing tenders as part of the Operational Programme Enterprise and Innovations for Competitiveness.

Specifically, the limit for announcing tenders increased from CZK 500 thousand to CZK 2 million (CZK 6 million for construction work). Therefore, no tenders will have to be announced below this limit.

The aim of this change is to simplify tender administration and control, as well as reduce tender errors. The changes are effective from 23 October 2019.

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Energy Savings Programme

A new call in the Energy Savings – Photovoltaic Systems with/without Accumulation for Own Use is planned to be announced in December 2019. The call supports projects focused on reducing energy consumption through the installation of photovoltaic systems (with or without accumulation of energy for the enterprise's own use).

Who can apply for the grant:

- Small, medium-sized and large enterprises.

What the grant applies to:

- Tangible fixed assets.
- Intangible fixed assets necessary for operating tangible fixed assets.
- Project documentation.
- Engineering.
- Energy report.

Expected grant amount per project:

- CZK 300 thousand – CZK 100 million.

Expected amount of subsidy per project:

- No more than 80% of eligible expenses for small enterprises.
- No more than 70% of eligible expenses for medium-sized enterprises.
- No more than 60% of eligible expenses for large enterprises.

Application acceptance:

- 13 January 2020 – 30 June 2020.

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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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Foreign Exchange Gains or Losses in the Financial Statements

The year-end is approaching, which entails financial statements for those companies whose reporting period corresponds to the calendar year. The financial statements involve a number of procedures, referred to as closing operations, including an accurate measurement of assets and liabilities as of the balance sheet date. The accurate measurement of assets and liabilities denominated in a foreign currency also involves their remeasurement as of the balance sheet date. This article aims to summarise basic procedures and draw attention to some remeasurement issues.

The Accounting Act stipulates that assets disclosed under Section 4 (12) of the Accounting Act need to be remeasured using the exchange rate promulgated by the Czech National Bank (hereinafter the "CNB"). Entities having a duty to calculate "unrealised foreign currency translation gains and losses" and reflect them in the value of assets and liabilities denominated in a foreign currency.

What is remeasured and how it is accounted for

Remember that aside from receivables and payables, shares in business corporations, rights arising from securities and book-entry securities and derivatives, stamps and vouchers denominated in foreign currencies and foreign currencies as such, assets to be remeasured also include provisions, reserves and technical reserves if the related assets and liabilities are denominated in a foreign currency. **Reserves and provisions will be in focus in the below paragraphs**. In particular, approaches to the remeasurement of provisions stir up a great deal of emotions in practice; the example below shows that experts' opinions vary.

Unrealised foreign currency translation gains or losses as of the balance sheet date are usually accounted for under financial expenses or income on accounts 563 or 663 – this relates to receivables, payables, stamps and vouchers, foreign currency treasury and foreign currency accounts.

Remeasurement of equity investments, i.e. shares in subsidiaries and associates, are recognised on equity accounts in accounting group 41, often on account 414 – Gains or losses from the remeasurement of assets and liabilities. This is not a black-and-white approach, whereby various expert opinions exist in practice. This topic will be discussed in detail in some of our future articles.

Debt securities, i.e. securities held to maturity, will be remeasured using the CNB's exchange rate as of the balance sheet date by means of financial income or financial expenses in accounting groups 56 and 66.

Foreign exchange gains or losses relating to securities measured at fair value and equity-accounted investments are part of the fair value measurement or equity method of accounting. A change in the fair value of securities available for sale is recognised on equity accounts in accounting group 41. A change in the fair value of equity or debt securities held for trading is recognised under financial expenses or financial income.

Remeasurement of provisions and reserves

Provisions and reserves created for assets or liabilities denominated, pursuant to Section 4 of the Accounting Act, in both CZK and a foreign currency must be accounted for in the same currency as of the date of the accounting event and, furthermore, remeasured using the CNB's exchange rate as of the balance sheet date.

It is necessary to decide how the foreign exchange gains or losses will be accounted for as of the balance sheet date with regard to the remeasurement of provisions.

In line with a decision passed in 2005 by the Coordination Committee, which no longer exists, the Ministry of Finance is of the opinion that these foreign exchange gains or losses are part of the value of the provision, which is why the remeasurement should be accounted for on accounts of accounting group 55 (such as accounts 558 and 559).

It is often the case that foreign exchange gains or losses arising from the remeasurement of a provision as of the balance sheet date are recognised on the accounts of financial expenses and financial income (such as on account 563 and 663). This entails the risk that unrealised foreign currency translation gains or losses relating to the provisions that are not created under a special regulation and, as a consequence, are not tax-deductible as such, will be included in tax-deductible expenses. See the following example demonstrating the key context.

Example

In 20x1, an entity recognised a receivable from the sale of goods in the amount of EUR 1,000 using the exchange rate of CZK 26/EUR. The receivable was not settled until the end of the reporting period. Due to its knowledge of the market situation, the entity had doubts as to the recoverability of the receivable, which is why it recognised a full provision against this receivable in November 20x1, despite taking measures for its collection. As of the balance sheet date (31 December 20x1), the exchange rate was CZK 25/EUR.

In June 20x2, the receivable was settled, using the exchange rate of CZK 24/EUR.

VAT is not considered for the sake of simplification.

How will these operations be accounted for and in which amounts?

Order	Description	Debit	Credit	Amount
1.	Recognition of a receivable EUR 1,000 using the exchange rate of CZK 26/EUR	311	604	26,000
2.	Creating a full provision (November 20x1)	55x	391	26,000
3.	Remeasurement as of 31 Dec 20x1 – receivable (loss)	563	311	1,000
4.	Option A: Remeasurement as of 31 Dec 20x1 – provision	391	55x	1,000
	Option B: Remeasurement as of 31 Dec 20x1 – provision	391	663 (563)	1,000
5.	Settlement of the receivable in June 20x2 EUR 1,000 EUR using the exchange rate of CZK 24/EUR	221	311	24,000
6.	Recognition of a foreign exchange loss (difference between the measurement as of 31 Dec 20x1 and upon payment)	563	311	1,000
7.	Option A: Release of the provision upon the receivable settlement	391	55x	25,000
	Option B: Release of the provision upon the receivable settlement	391	55x	26,000
	Recognition of a foreign exchange gain/loss on the provision	563 (663)	391	1,000

The options disclosed above demonstrate the context as well as advantages and disadvantages:

- The demanding and time-intensive character of individual provisions against receivables for tax purposes;
- In reality, this relates not only to a provision and a payment covering two periods but frequently, it also involves a long history of the whole list of receivables affected by various movements in exchange rates, partial payments, etc.;
- Furthermore, one has to consider the time requirements for recording and monitoring receivables from sales, or other types of receivables (such as related-party receivables);
- An individually-recorded foreign exchange gain or loss on a provision may be simply disregarded in preparing a cash flow statement as an adjustment reflecting non-cash transactions;
- It is strenuous (yet not impossible) to keep a close eye on an accurate allocation of the foreign exchange gain or loss upon the recognition of a provision, its update and subsequent release; and
- Book-keeping has an inherent control mechanism as regards balance sheet account 391 and profit and loss account 55x which cannot be used in option B.

There is no clear conclusion in practice as to which course of action is correct. We can see pros and cons of both options.

- Which of the above options do you use?
- Is your approach formalised in internal policies?
- Do you use software for the selected approach to updates, including the remeasurement of provisions?
- Do you disclose the selected approach in the notes to the financial statements in the event that the impact is material?

Remeasurement of accruals/deferrals and estimated items

Remeasurement of temporary assets and labilities must also be considered. Pursuant to Interpretation of the National Accounting Council I-37 "Accruals/Deferrals and Foreign Currencies", all temporary accounts that are a receivable or payable by nature have to be remeasured as of the balance sheet date. This means that as of the balance sheet date, account balances presented in item 'Accrued income' or 'Estimated receivables' and account balances in item 'Accrued expenses' or 'Estimated payables' have to be remeasured. Contrarily, the remeasurement of account balances in items 'Deferred expenses' (usually including comprehensive expenses) or 'Deferred income' would be inaccurate as cash flows have already been realised and these items are no longer exposed to any foreign exchange risk. In a wider context, reserves as an instrument for accrual accounting represent an item that will result in future cash outflow, i.e. is exposed to a foreign exchange risk, which is why it should be remeasured using the exchange rate as of the balance sheet date if the reserves concerned are settled in a foreign currency.

On-going remeasurement during the reporting period

As part of closing operations, it is necessary to ensure that foreign exchange remeasurement makes sense and does not cause any ungrounded overstatement of the movements on expense and income accounts. Typically, remeasurement made on a monthly basis during the year without cancelling the previous remeasurement may overstate the movements. In extreme cases, if there is no year-on-year change in closing exchange rates and the exchange rate was increasing in the first half of the year and decreasing in the latter half, the remeasured item should not result in any movements on the accounts of foreign exchange gains or losses. In practice, this inaccuracy is often caused by the setup of the accounting software.

This topic should not be underestimated; for example, foreign exchange gains are included in turnover for the purpose of categorising entities...

Foreign exchange gains or losses entail a great many problems. We recommend paying close attention to the closing processes concerning remeasurement, set up specific course of action in internal policies and minimise the risk of future issues arising from an incorrect remeasurement of assets and liabilities, including the risk of tax sanctions.

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The Ministry of Finance Presented a Consultation Document of the New Accounting Act

On 14 November 2019, the Ministry of Finance sent a consultation document on the Accounting Act for inter-resort comment procedure. It is expected that the material could be presented to the government in mid-2020.

The new Accounting Act should be the most important part of the design of new accounting legislation whose goal is to create a new system of accounting regulations, which will be able to respond better to new and existing trends in the area of accounting.

From the history of the project

The working group for the preparation of the new accounting legislation was created by the Ministry of Finance already in 2017. Its goal was to perform an analysis and assess the need for new accounting legislation. In addition to the Ministry of Finance employees, the working group includes members of professional organisations, chambers and academia.

The result of this working group was the preparation of a working document entitled "*Summary of solutions for the design of new accounting legislation 2020 – 2030*", which contains an analysis of the current situation as well as a proposal of the future treatment of accounting in the Czech Republic.

In November 2018, the material was presented for public consultation, where the expert public could familiarise itself with the new possible concept of accounting and comment on it.

In April 2019, the Ministry of Finance assessed the public consultation. In July 2019, it prepared a consultation document on the new Accounting Act and in mid-November 2019, it sent its slightly modified version to the inter-resort comment procedure. The deadline for addressing the comments is 14 January 2020. The consultation document on the Act is expected to be presented to the government no earlier than in mid-2020.

We describe below the primary changes that the new accounting policy should bring. Please note that the final form of the changes could differ from the proposed ones.

New system of legal regulations in the area of accounting

A new element should be the creation of a **conceptual framework,** which has so far been lacking in Czech accounting – a set of assumptions, principles and definitions that accounting is generally based on. It should be based on the current IFRS conceptual framework.

The **Accounting Act** in connection with the conceptual framework should regulate the basic rights and obligations of reporting entities and the general accounting requirements as such (e.g. demonstrability, archiving), including sanctions. One of the principles that should be clearly determined in the new accounting regulation is the principle of precedence of content over form. The Accounting Act should also regulate accounting deliverables (financial statements, consolidated financial statements and annual report or report of the management of the entity).

Matters concerning reporting and the use of accounting principles in typical or selected cases should be regulated at the level of implementing **regulations**. A joint regulation is expected for businesses and the non-governmental non-profit sector, i.e. merging current Regulations no. 500-504. There should also be a special regulation on consolidation, inventory-taking, health insurance companies, cash accounting and requirements for the approval of financial statements.

Several sets of the **Czech Accounting Standards** are expected to be issued, which will remain binding for reporting entities in the public sector but not for the others.

Application of IFRS

A significant change should come in the form of the proposed **obligatory application** of the International Financial Reporting Standards (**IFRS**) adopted at the level of the European Union (hereinafter "IFRS(EU)") for selected companies that are subject to supervision by the Czech National Bank and operate on the financial market (banks, savings and loan cooperatives, insurance and reinsurance companies, pension companies, investment funds and investment companies).

The application of IFRS(EU) would remain mandatory for business companies whose investment securities are admitted to trading on the regulated EU market.

Voluntary application of IFRS(EU) is proposed for reporting entities, which are part of a consolidation group where the consolidating entity (parent company) uses IFRS(EU) to prepare the consolidated financial statements, and for other entities active on the financial market.

No change compared to the current status is planned with respect to the application of IFRS(EU) for the preparation of the consolidated financial statements.

The consultation document on the Accounting Act states that a decrease in administrative burden is expected for all entities using IFRS(EU), provided that it will be possible to use the profit or loss determined based on these standards to determine the income tax base. This would be possible only if the proposed changes in Czech accounting legislation were connected to the relevant tax legislation, and this decision has not been made yet.

Currency of the financial statements

It is newly proposed to allow reporting entities to use a different currency than the Czech crown if it is efficient for the entity and this currency predominates in its transaction.

This proposed change would be made possible only if a concurrent change was made in tax laws to prevent a major increase in administrative burden.

Impact on businesses

The proposed legal regulation expects that it will ultimately decrease the administrative demands placed on businesses' bookkeeping, improve the information value for all users and last but not least, increase digitalisation of accounting in order to make bookkeeping clearer and easier.

The consultation document also makes provisions for a high number of micro and small reporting entities, for which it envisions certain simplifications, and it does not expect any significant changes in established accounting policies.

Effective date of the new Accounting Act

It is proposed that the Accounting Act should come into effect at least twelve months after entry into force, but in any case on 1 January of the following calendar year.

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Invitation to Seminars

News in Czech Accounting

Prague, Brno, Pilsen and Hradec Kralove

We would like to invite you to Deloitte's traditional autumn seminar focusing on financial statements and accounting in the Czech Republic. 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 introduce to you the concept of new accounting legislation for the period 2020 – 2030, which is in the process of preparation. We will also discuss the planned changes to the Czech accounting legislation related to the forthcoming amendment of the Act on Business Corporations.
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.

Seminars will be held in Czech and will be delivered by our professionals.

The seminar is not intended for consultants or employees of companies engaged in providing advisory services.

Dates

Prague:	10 December 2019
Pilsen	5 December 2019
Hradec Kralove:	11 December 2019
Brno:	12 December 2019

More information and registration on: akce.deloitte.cz

Cash Flow

Prague, Brno and Ostrava

We invite you to a seminar focused on the cash flow statement. We will address which reporting entities have to prepare the cash flow statement and what preparation methods exist. We will use practical examples to see what sources of data can be used when preparing the cash flow statement, what the information value of the individual parts of the statement is and how to approach the preparation of the cash flow statement effectively.

The seminar focuses on the preparation of the cash flow statement using the indirect method for the purposes of the annual financial statements. It does not include cash flow management as part of corporate planning.

The seminar is intended primarily for accountants, economists and finance managers who prepare financial statements under Czech accounting legislation or who are otherwise involved in their preparation.

Seminars will be held in Czech and will be delivered by our professionals.

The seminar is not intended for consultants or employees of companies engaged in providing advisory services.

Dates

Ostrava:	3 December 2019
Prague:	4 December 2019
Brno:	20 May 2020

More information and registration on: akce.deloitte.cz

ESMA has announced Enforcement Priorities for 2019 Financial Statements

On 27 October 2019, the European Securities and Markets Authority (ESMA) announced the priority issues that the assessment of listed companies' 2019 financial statements will focus on.

ESMA is an independent EU Authority that was established in 2011. ESMA's mission is to enhance the protection of investors and promote stable and well-functioning financial markets in the European Union.

The European national enforcers of financial information monitor and review financial statements published by issuers with securities traded on a regulated European market and who prepare their financial statements in accordance with International Financial Reporting Standards (IFRS) and consider whether they comply with IFRS and other applicable reporting requirements, including relevant national law.

The common enforcement priorities related to 2019 IFRS financial statements include:

- specific issues related to the application of **IFRS 16** ***Leases***;
- follow-up of specific issues related to the application of **IFRS 9** ***Financial Instruments*** for credit institutions and **IFRS 15** ***Revenue from Contracts with Customers*** for corporate issuers; and
- specific issues related to the application of **IAS 12** ***Income Taxes*** (including the application of IFRIC 23 *Uncertainty over Income Tax Treatments*).

ESMA selected these topics based on the significant changes that these new requirements introduced and their importance for European capital markets.

ESMA also highlights potentially significant implications of **transition from one interest rate benchmark rate to another** on financial reporting and the importance of timely disclosure of its consequences.

In addition, this year's priorities highlight the requirements to disclose **non-financial information**, with a focus on environmental matters. ESMA also highlights the importance of disclosures analysing the **possible impacts of Brexit**.

Additionally, the **harmonised electronic format for issuers' annual financial reporting** (the European Single Electronic Format, ESEF) will apply to annual financial reports containing financial statements for financial years beginning on or after 1 January 2020. ESMA expects issuers to undertake all the necessary steps to ensure compliance with the new requirements on a timely basis. To support implementation, ESMA has published information on its website designed to help issuers understand the requirements.

ESMA and European national enforcers will monitor and supervise the application of the IFRS requirements outlined in the priorities, with national authorities incorporating them into their reviews and taking corrective actions where appropriate. ESMA will collect data on how European listed entities have applied the priorities and will publish its findings in a separate report.

Public statement on enforcement priorities for 2019 is available here.

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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 6 November 2019.

As of 26 November 2019, 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 3 *Definition of a Business* (in October 2018)
- Amendments to IFRS 9, IAS 39 and IFRS 7 *Interest Rate Benchmark Reform* (issued in September 2019)
- 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 1 and IAS 8 *Definition of Material* (issued in October 2018).
- *Amendments to References to the Conceptual Framework in IFRS Standards* (issued in March 2018)

Click here for the Endorsement Status Report.

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US GAAP

FASB changed effective dates of certain standards

The Financial Accounting Standards Board (FASB) has issued a communication around the new or finalized effective dates for most recent standards. Changes allow more time to implement and adopt credit losses, leases, long-duration insurance contracts standards.

The new dates specific to selected new standards are documented and formalized in the published ASU No. 2019-10, Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842) and in the ASU No. 2019-09, Financial Services—Insurance (Topic 944).

The summary table below shows all effective date changes.

CECL, Leases, Hedging, and Long-Duration Insurance: How Effective Dates Will Change
(Chart assumes calendar-year-end reporting)

Standard	Public Business Entities (PBEs)		Private& All Others
	SEC Filers	All Other Public Business Entities (PBEs)	
Hedging	January 2019	January 2019	~~January 2020~~ January 2021
Leases	January 2019	January 2019*	~~January 2020~~ January 2021
CECL	January 2020 (Excludes smaller reporting companies, as defined by the SEC)	~~January 2021~~ January 2023 (Includes smaller reporting companies, as defined by the SEC)	~~January 2022~~ January 2023
Insurance	January 2021 January 2022 (Excludes smaller reporting companies, as defined by the SEC)	~~January 2021~~ January 2024 (Includes smaller reporting companies, as defined by the SEC)	~~January 2022~~ January 2024

= No change in effective date

*) Also includes Employee Benefit Plans and Not-for-Profit Couduit Bond Obligors that file or furnish financial statements with or to the SEC.

Source: FASB.org

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Insurance update: the Czech National Bank published answers to the most frequent questions regarding certain provisions of the Act on the Distribution of Insurance and Reinsurance

On 27 September 2019, the Czech National Bank (the "CNB") published responses to the most frequent questions ("FAQ")regarding Act No. 170/2018 Coll. on the Distribution of Insurance and Reinsurance, as amended (the "Act"), on its website. Responses are not a binding interpretation of a legal regulation; however, they provide practical guidance for the application of certain problematic provisions of the act. The published document summarises for example the conditions under which the Act will apply to operators of web insurance comparison programmes, obligation to obtain information from customers and provide recommendations and advice or the issue of the conflict of interest in insurance claims handling.

Insurance comparison programmes

The Act stipulates exemptions from its scope by directly listing which activities are not treated as mediation of insurance and therefore are not subject to the Act. These exemptions include the comparison of insurance, provided it does not include the possibility to procure insurance or arrange its change. The activities of web comparison programmes operators are therefore not included in the activities regulated by the Act, if the customer does not have the possibility to arrange insurance at the end of the comparison.

Internet comparison programme operators asked themselves whether their activities are regulated by the Act or not as numerous web portals include links to websites where customers may arrange insurance. In this context, the CNB specified that in a situation when a web portal provides, in addition to general comparison of product, a recommendation of a particular product arising from the needs of a customer, as he/she completed it on the portal, and concurrently provided with a direct or indirect possibility to arrange the specific insurance, such activity is treated as mediation of insurance.

According to the CNB, operators of web comparison programmes who, at the end of the comparison process, provide a link to a portal where it is possible to procure a particular product or operators who provide gathered information to insurers or insurance mediators to be able to contact a particular customer will have to newly adhere to the conditions of the Act. A helping distinguishing criterion is the fact whether the customer sees the arrangement of the insurance as one process.

Recommendation vs. advice

A frequently discussed topic in insurance practice are also new obligations of insurers and insurance intermediaries stipulated in Sections 77 and 78 of the Act. These include the obligation to obtain information from customers on their requirements, objectives and needs based on which customers are provided with recommendations thanks to which they may make a qualified decision whether they arrange or substantially change already arranged insurance, or an advice, if a reserve making insurance is to be procured or substantially changed. Unclarities in practice arose primarily from the distinguishing of recommendation and advice or a situation when a client does not provide sufficient information to the insurer or insurance intermediary.

As part of the FAQ, the CNB commented on numerous questions regarding this topic. The difference itself between the provision of an advice or recommendation consists in the level of detail. The obligation to find out the information on requirements, objectives and needs of a customer must be always fulfilled and cannot be replaced only by a general analysis of the target market and subsequent issuance of a general recommendation applicable to the target group of a specific product – the recommendation must be inherently personalised, even though it may mean a statement, in respect of rather simple insurance products, that the customer is compliant with the target market given the identified requirements, objectives and needs. In addition, the possibility to verify what information was stated by the customer in conclusion of a contract or substantial change is important. If the insurer or the insurance intermediary do not manage to get information in such scope so that they may recommend a particular insurance, they must not arrange insurance with a customer. The breach of this obligation may result in the liability for an offence or liability for caused damage.

In addition, the issue of provision of advice in change of the insurance procured before the Act took effect and upon procurement or change in the reserve making insurance with the minimum or zero reserve making component was discussed. In both these cases, there is the obligation to provide an advice. In respect of the insurance procured before the Act took effect, it is necessary to provide advice to a customer in respect of potential changes in the product and setting of current contractual relationships. In respect of the reserve making insurance, it is necessary to provide advice

exactly in respect of its amount and its possible change. If the insurance allows a change in the allocation ratio, advice is provided only upon its arrangement.

Last but not least, the CNB commented on the question how to respond when customers select another alternative of insurance than the one that was recommended. In such case, the insurer or insurance intermediary must ensure for customers to have sufficient information, notify the customer that it is not the recommended option and assess whether the customer is able to sufficiently understand the features of the product. If,
at the same time, the conditions of procurement of such insurance are not in conflict with internal risk management policies, it may be procured.

The CNB additionally confirmed that an advice in procurement or substantial change of reserve making insurance in accordance with Section 78 of the Act is an obligatory rule and the distributor must provide it, in accordance with the Act, before the procurement or substantial change in the reserve making insurance. The reserve making insurance therefore cannot be procured based on the execution only principle if the customer refuses to provide the distributor with any information.

Conflict of interest in mediation of insurance

The independent intermediary can be in two roles in accordance with the Act, either in the role of an insurance agent mediating insurance for an insurer, or an insurance broker mediating insurance for a customer. By definition, it is prohibited for the independent intermediary to play both roles at the same time, which is stipulated in Section 76 of the Act by a ban of concurrent activities.

The insurance claims handling is defined as "investigation necessary to ascertain the scope of obligation to provide performance from the agreed insurance, on behalf and on account of the insurer" and itself it does not have features of mediation of insurance. The situation is different in respect of help in exercise of rights arising from insurance which remains to be mediation of insurance by definition.
The activities of independent insurance adjustors were additionally included under Act No. 455/1991 Coll., on Trades (Trade Licensing Act), as amended, when the Act took effect.

The CNB explains the issue as follows: an independent intermediary may provide help to its customer in the exercise of rights arising from insurance without violating the ban of concurrent activities, if it does not get into a situation when it acts as an insurance agent in procurement of insurance and as a broker in the exercise of rights arising from the insurance. The independent intermediary must additionally avoid a situation when the insurance intermediary would act as an insurance broker and concurrently perform claim adjusting for an insurer as an independent insurance adjuster under the Trade Licensing Act.

In addition to the above issues, FAQ answers the following questions:

Exemption in accordance with Section 3, par 2, of the Act – only provisions exhaustively listed in Section 3, par. 2, of the Act apply to persons providing insurance as additional services to other products, e.g. travel agencies in respect of tours. The obligation to register as an additional insurance intermediary does not apply to these persons.

Termination of the authorisation for the activities of a tied agent – the notification of termination of the authorisation for the activities of a tied agent is made by the represented person through the Regis electronic application of the CNB for registration of entities. By this notification, the termination of the activities of a tied agent is concurrently announced.

Expertise – the Act introduced a new system for documentation of expertise for insurance distribution. For each of the groups listed in Section 57 of the Act, there is a list if professional knowledge that have to be documented. In accordance with Section 59 of the Act, each distributor must pursue 15 hours of subsequent education for the calendar year. In respect of distributors authorised to mediate insurance from several expertise groups, it is the minimum number of subsequent education that has to be pursued for all expertise groups. The Act thus does not require the distributor to pursue subsequent education for each expertise group separately.

Product management – With effect from 1 December 2018, the Act imposes the obligation of "product management" (refer to Section 57 of the Act) to the insurers, independent intermediaries and insurance intermediaries with the home state different than the Czech Republic. These obligations must also be met in respect of the products approved before 1 December 2018 (i.e. The product which went through an approval process as set by the producer in respect of the product nature), and the proportionality principle can be used in the introduction and meet only the obligation of ongoing nature, i.e. ongoing review and regular assessment of an insurance product, assessment of suitability of a distribution channel and approval of the product in its substantial change.

Minutes from the meeting – a record of requirements, objectives and needs of
a customer must be prepared from each meeting. However, a fine for the failure to prepare minutes from the meeting can be imposed only if the meeting resulted in the procurement of insurance. In practice, there was an opinion that it is possible to prepare minutes additionally, which the CNB identified as incorrect. In accordance with Section 92, par. 3, of the Act, it is necessary to present the minutes from the meeting to a customer with sufficient advance before the procurement or substantial change in insurance. It is necessary to bear in mind that the minutes are prepared for the purpose of protection of customer's interests and have to be prepared always as a precaution.

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How to correctly set up company compliance? Sensible rules and realistic expectations are key

Compliance is a phenomenon that attracts increasing attention in business circles. An effective compliance programme, from well-prepared codes of ethics to a balanced system of responsibility enforcement, is the foundation of high-quality, successful and secure corporate governance. However, keeping pace with the times and following the most modern trends is not an easy task for a company. Do you know how to set up such a company compliance system the right way?

Imagine a situation when an unexpected audit comes to your business, for example from the European Commission. How will you react? Such a scenario is a nightmare for most businesses, but it does not have to be the case – if compliance is set up correctly, such a situation should not lead to anything bad. However, all workers from common employees to top management should be sufficiently informed about internal rules and motivated to follow them.

Most common compliance myths

- **Myth: the bigger the threat of punishment, the better**
  Reality: Compliance set-up is not just about avoiding a fine, it is about increasing the value of your company, its reputation on the market etc.
- **Myth: It is about keeping the right records – that means paperwork.**
  Reality: It is important to focus on factual processes and engaging the company's management.
- **Myth: Problems only need to be addressed when they arise.**
- Reality: Compliance should have its own life cycle and be a standard feature of the corporate culture already at the level of prevention.
- **Myth: It is necessary to do (only) what the law says and what the authorities require.**
- Reality: Compliance is not just a theory or a dogma, it is necessary to seek a practical benefit in it.
- **Myth: We should not open Pandora's box; it could bring down the company.**
  Reality: Problems need to be resolved, but the solution itself does not necessarily have to be destructive.

Transformation of compliance in time

Legal, technological or even social changes go hand in hand with the increase in the emphasis placed on compliance programmes, which have to react to these changes. For example, the question of CCTV records was not so pressing 20 years ago, the law did not address in detail what and whom enterprises could record on camera, how long they should keep the records etc. Today, however, when a CCTV system is a completely commonplace and necessary part of even the smallest shop, this topic has to be provided for in the law.

However, it is not just technologies that change – changes happen in all types of audits by state or supervisory bodies that are related to compliance in some way. Changes concern not just their form and content, but also the subject of the observation. While the primary focus of tax audits of a few years ago was the investigation of accounting records through an endless provision of evidence, now attention is paid to traders, processes, risk management and the management of the company in general, etc.

Three pieces of advice on how to correctly set-up compliance

Whether you own a young, fast growing firm or a well-established company, the following rules can be applied when setting up the compliance programme at any time, regardless of the age or size of your company:

1. Paper-based compliance does not work
- Rules have to be practical and meaningful and most importantly, functional in practice.
- When setting up the rules, we have to have realistic expectations. Rather than a robust documentation, choose brief rules that employees will be able to remember and follow.
- Employees have to be properly trained and compensated – aggressive KPIs could instead motivate employees to unfair business practices.

2. Compliance has to be suitably managed
- Compliance roles within the company have to be appropriately divided and segregated, the head of compliance should report directly to top management.
- An audit by state authorities has to be managed from the very beginning and you need to know your rights; do not let state bodies and authorities overstep their power.
- In the event of an incident – if improper conduct is discovered – seek advice from an expert. It is crucial to secure evidence and know your rights with respect to the employees.

3. The compliance programme has to be seen through to the end
- Setting up practical rules is not enough, it is necessary to check regularly that the rules are observed and that they are up to date.
- If a breach of the rules occurs, the relevant people always have to be held responsible.

Why be compliant?

When we already know what compliance is, how to set it up correctly and how to maintain it, a question suggests itself – why should we even be compliant at all (aside from the fact that the law demands it)? It is not just about covering criminal law, tax or competition law risks. What we should actually be asking about are the business consequences – what happens if the company is not compliant?

The reasons are rather convincing: a potential drop in the value of shares or equity investments in the company and loss of trust of business partners and investors, loss of business opportunities, decrease in the value of the company in the event of its sale or search for strategic investors, paralysation of certain processes as a result of an internal/external investigation, damage to the good name and brand, negative publicity in the media and on social networks etc.

What is the compliance programme like in your company? Are you just starting and need help with its set-up? Or do you have an established company and wish to check whether its compliance system is in line with modern standards and the market situation? Then do not hesitate and contact us! We will be happy to provide you with comprehensive legal advisory.

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Filing a motion with the Office for the Protection of Competition will be free of charge again

On 13 November 2019, the Constitutional Court announced a major ruling in the area of public procurement, which will have a significant impact on the review of procurement procedures by the public. It is now possible again to file motions with the Office for the Protection of Competition regarding errors in public tenders without the necessity to pay the administrative charge of CZK 10,000.

The Public Procurement Act which has been effective since 1 October 2016, unlike the previous legal regulation, conditioned the right to file a motion to initiate proceedings due to an error in awarding a public contract with the payment of a non-refundable administrative charge. In addition, the Act did not allow an extension of the payment deadline or an exemption from the charge, nor even for administrative bodies or municipalities and regions. If the charge was not paid, the Office for the Protection of Competition did not address the motion at all. The public's oversight of public procurement thus incurred a financial burden, since even a proposal of a plaintiff was conditioned by the payment of a monetary deposit.

Since the rule about the payment of the charge was included in the act only through an amendment during the discussion in the Chamber of Deputies, its purpose is not clarified in the explanatory memorandum. However, the obvious goal of this regulation was to prevent the Office for the Protection of Competition from being overloaded with baseless motions. In 2015, the number of motions in the area of public procurement received by the Office for the Protection of Competition was 1,014, in 2018 there were 254, and the charge was paid only in relation to 98 of them. A visible decrease in the number of investigated motions is therefore apparent after the introduction of the charge.

Constitutional Court: the charge was absurd

The introduction of the controversial charge, and an unusually high one at that, has been accompanied by discussions regarding its compliance with the Constitution since the beginning. Like other authorities, the Office for the Protection of Competition is required to initiate proceeding *ex officio* whenever it has reasonable suspicion that a breach of the law has occurred, irrespective of how the suspicion arose. The plenary session of the Constitutional Court pointed out the absurdity of the charge for filing a motion and ruled that the failure to pay it precluded the settlement of a matter which the Office for the Protection of Competition is obliged to address pursuant to a different provision. The Court additionally mentioned the principle of the citizen's precedence over the state, whereby the state serves all citizens and not the other way around. In addition to the aforementioned internal contradiction in the Act, three judges of the plenary session pointed out in the dissenting opinion the reduction of the citizens' right to petition, since the obligation to pay a charge does not fulfil the objective of protection against baseless motions because the Act does not allow for refunding or exemption from the charge.

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Personal Data Processing News

This time we focus on the most important findings from the published information regarding inspections and decisions of the Office for Personal Data Protection in the first half of 2019. We are also reporting on further development concerning codes of conduct and certifications, on the procedure in the event of a security breach and procedure for informing customers about personal data processing, on an important decision related to cookies, and on an effort to unify the procedure for issuing penalties in Germany, and possibly the whole EU.

Office for Personal Data Protection Inspections and Decisions in the First Half of 2019

The Office for Personal Data Protection ("OPDP") published an overview of finished and ongoing inspections for the first half of 2019 in the area of personal data protection and unsolicited commercial communications. Below, you can find the summary and interesting facts about the conducted inspections.

- Inspection Frequency: In total, 43 entities were subject to inspections, both from the public sector (e.g. The Czech School Inspectorate, the Czech Television, various ministries) and the private sector (e.g. banks, insurance companies, IT companies).
- Inspection Triggers: In the area of personal data protection, about half of the inspections were initiated on the basis of the OPDP inspection plan; the other half was initiated due to a received notification or complaint, with 3 inspections being carried out as a result of security breach notifications made by data subjects. As for unsolicited commercial communications, all inspections were initiated due to notifications made by data subjects.
- Penalties Imposed: In total, 5 penalties were imposed in the area of personal data protection, the lowest being CZK 7,000 and the highest CZK 450,000, which was imposed to STEM/MARK a.s. for the processing of personal data without a legal title (the company bought a client database that leaked from one of the mobile operators). As for unsolicited commercial communications, the penalties ranged from CZK 25 to 80 thousand, usually for the breach of obligations under the Act on Certain Information Society Services (insufficient identification of the commercial communication or the sender).

Conclusions from the OPDP Inspection Activities and Advice:

- Balancing Tests: If personal data is being processed on the basis of a legitimate interest, the OPDP puts an emphasis on the data controller to create a "balancing test", i.e. to compare the interests of the controller and third parties with the interests and fundamental rights of data subjects and to properly record the results of this test as well.
- IT: If a computer system or software is attacked, the data controller needs to report the attack not only to the Police of the Czech Republic, but also OPDP.
- Financial Services and Insurance: If a business or its part is transferred, all contractual documents, including personal data, are transferred to the legal successor as well. The legal successor is obliged to process personal data in the same manner as the previous owner.
- Marketing: OPDP advices against purchasing databases from unknown sources, because this activity is basically illegal, as it involves the processing of personal data without a legal title.
- Biometrics: Using voice biometrics to authenticate the identity of a client during a phone call to a client centre is allowed, as long as the client gave consent with this, which they could have revoked at any time. OPDP considers the FaceID technology to be justified, because the inspected person was able to prove that its use was necessary and it was not possible to achieve the aim through other means.
- Obligation to Inform: In case of a request for access, the requester has to be provided (among other things) with the information on the specific recipients of their personal data. The requester can be provided with recipient categories instead only when the recipient identity is (yet) unknown to the controller, e.g. in case the personal data will be (or could be) transferred to the recipient in the future.

Further Development Concerning Codes of Conduct and Certification

The code of conduct is a self-regulatory tool, which enables the personal data processors and controllers to prove their GDPR compliance. The code itself should be specific enough to define fundamental principles, procedures and requirements for the processing of personal data, resulting from the GDPR for a group of controllers or processors in the same industry (e.g. banks, insurance companies). Therefore, a union, association or another group, which organises more entities in the same industry, often compiles the code.

The code has to be submitted to OPDP. However, OPDP does not create codes; it only reviews the text, issues an opinion on whether it complies with the GDPR and eventually approves it. Although a code of conduct is a voluntary method of GDPR compliance verification, in case the controller or processor declares to abide by it, they are obliged to undergo regular monitoring by an independent entity. Before the commencement of the entire process, OPDP needs to submit the accreditation requirements for the monitoring entities to the European Data Protection Board for approval. Until that time, it is not possible to submit codes of conduct to OPDP.

Another way of proving GDPR compliance is a personal data protection certificate. Again, the certification is voluntary and it

certifies that the activities of the controller or processor comply with the GDPR provisions. Besides other things, the certificate can facilitate trade (especially buying and selling specific products and services) or the transfer of personal data abroad. The certificate can only be issued by a certificate issuing entity accredited by the Czech Accreditation Institute ("CAI"). It is currently not yet possible to request accreditation from CAI, because it has not yet received the accreditation criteria for entities who would subsequently issue GDPR compliance certificates.

How to Proceed in Case of a Safety Breach and when Fulfilling the Obligation to Inform?

OPDP published its findings about the practice of reporting safety breaches by data controllers. However, these findings do not include just statistics; OPDP gives advice and recommendations on how to prevent such breaches and how to protect oneself against them. OPDP also published a form, which makes reporting breaches much easier, helping data controllers fulfil their obligation to inform.

Throughout its existence, OPDP received around 600 notifications. The most common type of breach is phishing – an attack on the information system of a user who accidentally provided their login details to an unknown entity, who subsequently misused them. The contacts, with which the user communicated, become the next target of the phishing attack. A large proportion of such attacks ends with the installation of ransomware (harmful software) into the system. This program encrypts all user data and offers to decrypt it again only when the user pays a certain sum of money as ransom. The best protection against such practices is a regular data backup.

If the misused data was successfully restored without other serious consequences, it is not necessary to report the incident to OPDP. Otherwise, the controller is obliged to report the safety breach. The new form, which makes reporting breaches easier, can help especially those controllers who do not have their own personal data protection specialist. The form not only makes the reporting itself easier; it also helps controllers fulfil their obligation properly.

How to Fulfil the Obligation to Inform Customers Properly

In trading, the exchange of relevant information is necessary for the creation and execution of a legal relationship. However, it is necessary to safeguard the information the customer provides to the business accordingly and to protect it against potential misuse. Moreover, the business has the obligation to process the information in an open manner and to provide the data subject with sufficient information on the manner of processing.

In its methodology, OPDP comments on the proper fulfilment of the obligation to inform. In practice, OPDP often sees customers being informed about the processing of their personal data by a reference to a separate document or by a reference to the terms and conditions. However, interpretation issues may arise from such procedure. Referencing is allowed in practice, but it is important to state all the information in one place in such a way that allows the customer to find all the information easily without complicated searching in more documents.

OPDP recommends the following procedure:

- Always define and describe the purposes for which the controller intends to process the personal data.
- The entity, which obtains data from data subjects, needs to inform the subjects whether the provision of data is a statutory or a contractual requirement, or a requirement which needs to be stated in a contract. The subjects also need to be informed about whether they are obliged to provide the data, and what the consequences are of failing to provide the data, if applicable.

Pursuant to Articles 13 and 14 of the GDPR, it is necessary to provide more information on the intended manner of processing for each processing purpose. In particular, this information has to include: the purpose and legal basis on which the personal data will be processed; the identity of the controller (and their potential representative) and their contact details; the identity of the potential recipient; and the existence of the right of access, rectification or erasure of the personal data, the right to restrict processing, the right to data portability, and the right to object.

Storing Cookies Requires Active Consent

On 1 October 2019, the Court of Justice of the European Union ruled in case C-673/17 (Planet49) that storing cookies requires the active consent of the internet users and a pre-checked checkbox does not suffice.

The German federal consumer rights group disputed the practice of Planet49, who uses a pre-checked checkbox for its online lottery service, through which the user gives consent to installing cookies on their browser and which the user has to uncheck if they do not want to give their consent.

The Court of Justice also ruled that the information the user has to receive from the service provider needs to include the cookies lifespan, as well as the possibility for third parties to access the cookies.

The verdict can be interesting for the Czech Republic, because German legislation (just like the Czech one), does not stipulate that the consent with storing cookies on websites has to be given actively; although according to the ePrivacy Directive it should. It might therefore be interesting to see whether the Court's ruling will spark a discussion about the need to change the respective Czech law.

German Authorities Trying to Unify the Penalising Procedure

The joint coordination body of the German data protection authorities ("DSK") agreed on a new methodology concept for issuing penalties under the GDPR. Technically speaking, the new concept specifies the requirements stipulated by Art. 83 GDPR and it will most probably undergo further debates and changes. The aim of the concept is to provide

the supervisory authorities for personal data protection with a common methodology, in order to set up a systematic and transparent administrative practice for assessing administrative delicts in the area of personal data protection and for issuing penalties for such delicts. The concept only applies to penalties resulting from proceedings against companies and does not therefore apply to penalties issued to societies or natural persons for delicts unrelated to their business activities.

According to German experts, the methodology will lead to issuing much higher penalties than is now common under the regular decision practice of the German supervisory authorities. The method of a mainly linear calculation (starting with a turnover) can pose a risk of heavy sanctions being imposed, especially against companies and groups with high turnovers. Despite being just a concept, the methodology is already beginning to take root in practice: for example, the Berlin Commissioner for Data Protection has recently announced his intention to issue penalties amounting to millions of euros. It was also announced that the methodology would be submitted for discussion to the European Data Protection Board, which organises the offices for personal data protection of the individual member states. Therefore, it is possible that in the future the methodology could be adopted in other member states as well.

The published concept is based on the assessment of two key factors: the type of severity of the violation and the size of the company in question. The first part of the document contains methodology for assessing the harmfulness of the violation through assigning a "severity level" (Schweregrad) to it. The concept categorises instances of violation as mildly serious (leicht), moderately serious (mittel), serious (schwer) and very serious (sehr schwer). For the severity assessment, the most relevant factors are the duration of the unlawful action, the manner, scope and purpose of the unlawful processing, the number of data subjects affected by the processing, and the scope of injury suffered by the data subjects. What should also be taken into account is the fault (negligence or intention), the adoption of measures for damage mitigation, the history of previous violation, cooperation with the supervisory authority, or the adoption of corrective measures imposed by the supervisory authority in the past.

The second part of the document contains guidelines on calculating the specific penalty amount, depending on the size of the enterprise in question. The methodology for enterprise size assessment is primarily based on determining a "daily rate" (Tagessatz), which is calculated on the basis of the global turnover of the enterprise (group) for the last 360 days. The methodology categorises enterprises into 4 groups (microenterprise, small enterprise, medium-sized enterprise, and large enterprise), which are then divided into subcategories in order to determine the most accurate value of the enterprise. Afterwards, the indicators are multiplied by a fixed coefficient, depending on the determined level of seriousness of the violation.

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What does the RTS on SCA bring with regard to statutory audits?

Regulatory technical standards for strong customer authentication (the "RTS to SCA"), which entered into force on 14 September 2019, brought about a number of new obligations to payment service providers, including banks and payment institutions. Although the media mention, in particular, new obligations related to the requirements for strong customer authentication, in particular when initiating electronic payments (whether it is card payments in the store, the purchase of goods in an e-shop, entering an order in online banking or other acts), which must newly be a two-factor one (i.e. consisting of a combination of two or more elements from the category of 'knowledge', 'possession' and 'inherence'), the above regulation also brings about new obligations of a purely internal nature. Specifically, the obligation to carry out internal audits, namely the audit of security measures ("audit of security measures") as well as an audit of the way in which the so-called transaction risk analysis ("TRA audit") is carried out. What are these two types of audits about and what is their substance?

The issue of audits is regulated in the RTS on SCA in two articles only, namely Article 3 and Article 19(2), whereby these provisions are so general that in relation thereto several questions have been sent to the European Banking Authority (the "EBA") to clarify their interpretation. Since audit reports on both types of audits are to be submitted only upon the request of the national regulator (in the case of the Czech Republic, the Czech National Bank), it would be desirable for the regulator to closely specify certain issues further in the interest of legal certainty. Some of these ambiguities, to which we do not yet know the answer, are mentioned below, in particular as regards the form of output and the expected timeframe of audits.

Who does the obligation to carry out audits concern?

The obligation to carry out the audit of security measures is based on Article 3 of the RTS on SCA, which obliges payment service providers to review their security measures under Article 1 of the RTS to SCA. Specifically, it concerns the obligations relating to the implementation of strong authentication and the exemptions from this obligation (if a payment service provider has chosen to implement them voluntarily), the obligations related to the integrity and confidentiality of security data of payment service users, as well as common and secure open communication standards between payment service providers. Compared to the audit of security measures, the TRA audit is mandatory only for those payment service providers who voluntarily decided to implement the exemption from strong authentication in the form of a transaction risk analysis. The TRA audit is then to specifically examine the methodology, model and reported fraud rate. To put it simply, it is primarily there to control what transactions are or vice versa are not included in the formula for calculating the fraud rate, which is a borderline for a certain maximum amount of the financial transaction in order to apply the exemption from strong authentication.

Auditor

As regards the requirements for the person carrying out the audit, it has to, in the case of auditing security methods and in the case of the TRA audits, have expertise in the field of information technology security and payments, while at the same time be functionally independent of the payment service provider. It should therefore not be the person who assisted with the implementation of the audited measures. In any event, the person carrying out the audit may be the internal auditor of the provider itself. In this respect, we thus perceive the auditor's designation in Article 3 of the RTS as a legislative acronym, i.e. that the auditor may, in the relevant case, be anyone who has the above-mentioned expertise and is functionally independent of the provider. The exception to this rule is the first and then in order each third TRA audit, which must, on the contrary, be carried out by an independent and qualified external auditor. Of course, this auditor must also have the above knowledge.

Audit report: when to be drawn up and in what form

The RTS to SCA does not then impose a specific form of audit report with regard to any of the audits. However, we believe that the audit report should at least show what potential deficiencies have been identified for the obliged entity, i.e. The form of the so-called differential analyses should be sufficient for the intended purpose. As regards the TRA audit carried out by an external auditor, the relevant form should be based on standards imposed on the outputs of auditors in the Czech Republic.

Perhaps the biggest ambiguity about the new audit obligations remains their timing or the moment when the audit report must be drawn up at the latest. Both types of audits are to be carried out annually. As regards the TRA audit, the audit report shall be drawn up no later than one year after the implementation of the exemption from strong authentication. Therefore, where the provider has implemented the exemption from strong authentication as of the effectiveness of the RTS on SCA, it shall draw up the audit report by 14 September 2020 at the latest. However, more complicated is the question of the obligation to draw up an audit report on the audit of security measures, when the audit period is to be determined taking into account the relevant framework for accounting and statutory audit for the payment service provider concerned. In view of the fact that for all payment service providers the subject of the audit of security measures will be compliance with the obligations under the RTS to SCA as of 14 September 2019 when the RTS on SCA came into effect, and the generally applicable accounting period lasts 12 calendar months, it is not quite clear when the historically first audit is to be done and what period it should cover. One option is to audit the period from 14 September 2019 to 31 December 2019 provided the historically first audit report on security measures will be drawn up in the first half of 2020. Another option is to connect the entire section of 3-month effectiveness of the RTS to SCA in 2019 with the period of calendar year 2020, with the audit report being only drawn up in the first half of 2021.

The interpretation of the RTS to SCA relating to the audit obligations of payment service providers is merely a fragment in a number of ambiguities that this regulation brings about. The hope is that the EBA or national regulators will bring more light into the above-mentioned uncertainties soon.

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