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LEGAL TAX AUDIT

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COMPREHENSIVE LEGAL, TAX, ACCOUNTING AND AUDIT SERVICES

NEWSLETTER
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THE NATIONAL ACCOUNTING COUNCIL'S INTERPRETATION CONCERNING RECEIVED FOREIGN CURRENCY ADVANCES

At its meeting held on 31 January 2022, the National Accounting Council approved the text of a new interpretation called I-47 Received Foreign Currency Advances, which loosely follows up on Interpretation I-43 Provided Foreign Currency Advances. The aim of both interpretations is to find an accounting solution for reporting foreign currency advances in financial statements, especially whether or not they should be converted.

In practice, advances are usually considered foreign currency receivables/payables that are subject to currency conversion. As soon as a supply is provided, the advance is recognized and converted again.

According to the National Accounting Council, this procedure does provide a true picture of the exchange rate risk because, for example, the exchange rate risk is no longer associated with the provided advance due to the fact that the payment has already been made.

For the sake of completeness, we would like to say that the interpretations of the National Accounting Council are not legally binding, nevertheless, they express its professional opinion and are publicized for the sake of a unified and appropriate application of accounting regulations. The following text presents the conclusions from these interpretations.

In the case that it is probable on the part of the seller that the transaction, for which the advance was provided, is going to be carried out:

- the received advance is not considered a payable that is subject to currency conversion;

- the accounting entity reports the balance of the received advance in the amount converted as of the date the funds were received;

- the received advance is reported in the balance sheet under accruals as deferred revenues;

- a part of the sale price that was not paid in advance is considered a separate part of the total sale price, which the accounting entity posts at the time of the sale transacti on, without converting the received advance.

In the case that it is probable on the part of the seller that the transaction, for which the advance was provided, is not going to be carried out (for example due to a lawsuit, etc.):

- the received advance is considered a foreign currency payable that is subject to currency conversion;

- the accounting entity reports and converts the balance of the received advance as of the balance sheet date, and this foreign exchange difference is included in the accounting entity's profit/loss;

- the received advance is reported as a payable.

The buyer recognizes provided advances the same way. In the case that the buyer expects the contract, for which the advance was provided, to be performed:

- the provided advance is not considered an asset subject to currency conversion;

- the balance of the provided advance is reported in the amount converted as of the date the funds were provided;

- the provided advance is reported as a fixed asset/inventory or deferred expense (if it concerns a purchased service);

- the total cost of the transaction that was not covered by the advance represents a separate part of the acquisition cost, which the accounting entity posts at the time of delivery of the asset or service, without converting the provided advance.

In the case that the contract is not expected to be performed, the provided advance represents, on the part of the buyer, an asset that is subject to currency conversion. It is reported in the balance sheet under receivables and converted as of the balance sheet date.

A completely new decision, NSS 4 Afs 170/2021–35 of 14 February 2022, on the conversion of exchange rate differences with respect to advances also agrees with the opinion of the National Accounting Council and confirms that only those items, for which a future cash flow is expected, should be converted in financial statements. In the case that this condition is not met, no currency conversion will be performed.

Barbora Kratochvílová
Tax advisor
barbora.kratochvilova@LTApartners.com

TAX DEDUCTIBILITY OF ADVERTISING COSTS

Tax audits of revenue offices increasingly focus on the cost of advertising services and on proving that these and other services were actually received. This trend has also been confirmed by publicized rulings of the Supreme Administrative Court; in the last year alone, at least nine of them concerned advertising services.

Some of these rulings are about whether or not the invoiced price of provided advertising services is reasonable. In particular if there is a chaining of subcontractors and a gradual price increase, the court often reaches conclusions confirming the financial administration's findings that the customary price is many times lower than the invoiced price. The court, for example, looks at the price lists of direct providers or advertising space agents in the media, the production price of advertising spots, etc. The tax base of the service recipient is then increased by the part of invoiced costs exceeding the customary price identified in this way, and the service recipient is charged an additional income tax.

Other rulings include cases where the provision of a certain advertising service is called into question. For instance, the court has long ruled that a tax-deductible expense pursuant to Section 24 of the Income Tax Act must meet the following four conditions: (1) the expense was actually incurred, (2) the expense was incurred in connection with generating a taxable income, (3) the expense was incurred during the given tax period and (4) the law stipulates that it is a tax-deductible expense.[1]

When assessing this matter, the court examines e.g. whether or not advertising costs were reasonable in view of the company's income, current financial situation and investment strategy. It is very problematic to defend the cost of services provided based on general contracts, such as brief advertising space lease contracts that do not specify the advertising space, location and size, or periodical commercial spots contracts that do not specify the advertising location, advertising space size and when and how many minutes the advertising will be shown.

The court also reiterates that expenses may not be automatically recognized simply because the goods or services were purchased or provided by „someone." In fact, the taxpayer should prove that a certain service was provided exactly as claimed in the tax document, including, for example, the contractor. The contractor may, of course, provide the service through its subcontractor; in such a case, however, it is necessary to clearly prove the relationship between the taxpayer and the contractor claimed on presented documents as well as the fact that the contractor at least ensured that the service be provided by its subcontractor (i.e. the relationship between the contractor and the subcontractor must be proven).[2] According to the court, it is not entirely crucial whether the declared service was provided by the entity shown on the accounting document as the contractor, but it is nevertheless important to identify the specific

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[1] *For instance. The Supreme Administrative Court's rulings no. 10 Afs 74/2020 from 20 December 2021 and no.1 Afs 21/2020 from 3 February 2022*

[2] *For instance. The Supreme Administrative Court's rulings no. 8 Afs 24/2019 from 11 February 2021 and no. 10 Afs 80/2021 from 24 January 2022*

provider. The Court of Justice of the European Union has ruled in a similar way by denying the right to deduct VAT on received advertising services since the actual service provider was not and could not be identified.[3]

In order to prove that an advertising service was indeed provided and when and to what extent, it is necessary to create and archive evidence during the advertising campaign, for example:

- Sufficiently specific contractual documentation, designs of advertising spots, posters, etc.;

- Internal records of random inspections of the provided advertising service performed by the employees of the service recipient - at different time intervals and locations;

- Photo documentation clearly showing where and when the photos were taken;

- Records of checking and evaluating the bene fits of advertising for the company;

- In the case of services related to a website, e.g. information about the history of the website, the date of its creation, the date of its modification or the source code of the website author;

- In the case that advertising is provided exclusively online, it is necessary to take a screenshot repeatedly throu ghout the provision of the advertising service; the screenshot must clearly show the date it wastaken (this applies mainly to Internet search engine services, e.g. Google AdWords) - According to the court,[4] simple records of the number of searches alone cannot prove that advertising was actually received, as they could be made later on, even if the service did not actually take place.

Current case law shows that the financial administration audits advertising and other services in a very detailed and sophisticated manner. This is why, we recommend to sufficiently document the received advertising services during the entire time of their provision and to have verified information about the actual service provider and a comparison of the invoiced price with the price of similar services on the market. These documents will very much help to defend the tax deductibility of advertising service costs during a potential tax audit. We will be happy to help you to prepare or check documentation related to provided services.

[3] The ruling of the Court of Justice of the EU, case no. C-154/20, Kemwater ProChemie s.r.o., from 09 December 2021
[4] The Supreme Administrative Court's ruling no. 10 Afs 74/2020 from 20 December 2021

Lenka Pazderová
Tax advisor
lenka.pazderova@LTApartners.com

CHANGES IN THE TAX INFORMATION BOX

In 2021, the financial administration launched the MY Tax portal to simplify and speed up electronic communication with the financial administration as well as the upgraded tax information box PLUS (called DIS+). This improved version of the original tax information boxes (called DIS) makes it possible to pre-fill selected data into forms and to send them directly without signing them and to set up access authorization for other users and provides many other features.

During the year 2021, the users of the original DIS could also log in to DIS+ and start using this upgraded version.

However, many users found activation and access to the new tax information box problematic because it works primarily based on Citizen Identity, which causes problems especially for foreign legal entities and potentially also for Czech legal entities whose statutory bodies are foreign nationals. For technical- security reasons, they cannot access DIS+ by using guaranteed identity or verified identity the way they log in to their data box, as they cannot be authenticated based on the response of basic registers.

These entities can currently log in only based on access data assigned by the financial administration after their activation by the tax administrator. However, in order to assign these access data, it is necessary to clearly verify the identity of the natural person to whom such access data are assigned. This means that the natural person must be present during the verification of his/her identity by the tax administrator,

which is again rather problematic for foreign nationals.

As required by law, the operation of the original tax information box was terminated on 28 February 2022. Nevertheless, in response to the requests of the general public and professional groups, the financial administration will temporarily allow access to selected information from the taxpayer's personal tax accounts and file kept by the revenue office, as part of the selected data consulting service. It is not possible to activate, or to request access to, this service in any way. Access will be provided to these users on www.mojedane.cz in a similar way these users consulted DIS, i.e. by using their recognized electronic signature or verified identity when logging in to their data box. This service will be available for up to nine months starting the second week of March 2022.

The taxpayer's representative (tax advisor) was allowed to consult the original tax information box (DIS) based on a special power of attorney. Since DIS has been terminated, this consulting option has been terminated as well. The originally granted authorization to consult DIS is not automatically transferred to DIS+.

The taxpayer, i.e. the natural person authorized to access DIS+ may authorize another natural person to access the tax information box by clearly identifying such a person either based on a code generated for this person by the information system of tax information boxes or based on this person's ID card number. The taxpayer will also define the extent to which this natural person should be allowed to access his/her tax information box.

Miroslav Pešek
Tax advisor
miroslav.pesek@LTApartners.com

TREND IN THE CJEU'S RULINGS ON CONTRACTUAL SANCTIONS AND FINES

We have recently witnessed the trend in the rulings of the Court of Justice of the European Union (CJEU) that concern contractual sanctions and provide less and less room for not charging VAT.

The latest ruling in this area was issued in January 2022 and concerned fines for unauthorized parking. It concerns Case C 90/20 Apcoa Parking Danmark A / S, where the CJEU concluded that fees (fines) that private companies operating private car parks charge in the case that the users of car parks do not comply with the general terms and conditions should be subject to VAT.

However, we would like to also point out other previous rulings (e.g. C 43/19 Vodafone Portugal - Comunicações Pessoais, SA), according to which amounts received by an economic operator in the event of early termination, for reasons specific to the customer, of a services contract requiring compliance with a tie--in period in exchange for granting that customer advantageous commercial conditions, must also be subject to VAT.

Milena Drábová
Tax advisor
milena.drabova@LTApartners.com

DISCLOSURE OF BUSINESS COMPANIES' FINANCIAL STATEMENTS

Every accounting entity listed in the public register is required to disclose its financial statements. This requirement is considered fulfilled by disclosing the financial statements in the Collection of Documents of the registration court.

Accounting entities audited by law disclose their financial statements and annual report after their verification by the auditor and approval by the competent authority, within 30 days of meeting both of these conditions; however, no later than 12 months after the balance sheet date of the disclosed financial statements. Non-audited accounting entities disclose their financial statements by the same deadline as accounting entities audited by law.

According to statistical data, roughly one in five accounting entities discloses its financial statements in the Collection of Documents in due time. However, the Accounting Act considers a breach of the obligation to disclose financial statements an offense, and the tax administrator may charge a fine of up to 3% of the total assets of the accounting entity. Registration courts also check the fulfillment of this obligation and may charge a fine of up to 100,000 CZK for failure to disclose financial statements. The registration court may also initiate a company's deletion from the register in the case that the company failed to disclose at least two consecutive financial statements in the Collection of Documents and disregarded the registration court's request for their disclosure.

Financial statements are usually sent to the registration court through the data box. Starting on 1 January 2021, accounting entities are allowed to disclose their financial statements in the Collection of Documents by means of their tax return. They can use this way of disclosure of their financial statements for the first time when they file their 2021 tax return. They must indicate in the annex to their tax return which specific documents they wish to disclose. Their obligation to disclose their financial statements is then fulfilled when their tax return is filed with the competent tax administrator.

If you wish to get more information or need help with disclosing your financial statements, do not hesitate to contact us.

Barbora Kratochvílová
Tax advisor
barbora.kratochvilova@LTApartners.com

EXEMPTION OF INCOME FROM THE SALE OF REAL ESTATE

As the deadline for filing tax returns approaches, we would like to point out the obligation to notify the tax administrator about income from the sale of real estate.

The conditions for exempting income from the sale of real estate have changed since 2021. In addition to extending the minimum ownership time for exempting income from the sale of real estate not used for own housing from 5 to 10 years, the exemption conditions have become stricter if the minimum ownership time is not met.

The taxpayer may claim the exemption even if the minimum time of real estate ownership is not met, provided that he uses the acquired funds to buy a residential property by the end of the following tax period. This option has already applied to real estate used for own housing (minimum ownership time - 2 years). It has recently been extended to real estate not used for own housing (minimum ownership period - 10 years).

To claim the exemption, it is necessary to notify the tax administrator about the received income by the end of the deadline for filing the tax return for the tax period in which the funds were received. Failure to notify the tax administrator about such income by the said deadline will result in the expiry of the exemption, even if the taxpayer uses the acquired funds to buy a residential property.

The deadline for filing the 2021 tax return is 1 April 2022, or 2 May 2022 (if the tax return is filed electronically), or 1 July 2022 (if the tax return is filed by a tax adviser).

Robert Koleňák
Tax advisor
robert.kolenak@LTApartners.com

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LTA
Lazarská 13/8
120 00 Praha 2
Česká republika
+420 246 089 012
LTA@LTApartners.com
www.LTApartners.com