



## Tax&Legal Highlights

### Czech Republic

#### Change of the wording in the TRIO programme

As of 30 April 2018, the applied research and experimental development programme "TRIO" has a new wording approved by the government of the Czech Republic. It is a programme focused on supporting activities in the area of applied research and experimental development in order to increase the use of results of this area.

The individual projects use and support further development of the potential in the following key technologies:

- Photonics;
- Micro- and nanoelectronics;
- Nanotechnology;
- Industrial biotechnology;
- Advanced materials; and
- Advanced production technologies.

The main changes in the wording of the programme include an extension of the duration of the programme by one year, i.e. until 2022 (inclusive), and

an increased budget has been approved that brings the opportunity to announce a fourth public competition. Its announcement is planned for September 2018 with the anticipated competition period in September/October 2018. The basic conditions of the programme remain unchanged.

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### Announcement of the sixth public competition of the DELTA programme

**On 6 June, the Czech Technology Agency announced the sixth public competition of the Programme for the support of collaboration in applied research and experimental development through joint projects and technological innovation agencies (DELTA programme)**

The objective of the DELTA programme is to support projects of international cooperation of enterprises and research organizations in order to increase the amount of specific results of applied research that are expected to be subsequently put into practice. The anticipated results are e.g. an industrial and utility model, functional sample, verified technology, patent or software etc.

Applicants in this public competition may be enterprises and research organizations. However, one of the partners has to be from the country where the foreign partner agency is based (specifically, the countries include the Republic of Korea, the Socialist Republic of Vietnam, the Federal Republic of Germany, the State of Israel, the People's Republic of China – provinces of Jiangsu and Zhejiang, Republic of China – Taiwan).

The maximum grant percentage per project is 74% total eligible expenses, and the maximum amount of support per project throughout the period of project work is CZK 25 million. **The competition takes place from 7 June 2018 until 7 August 2018.**

### News in the application of the research and development deduction... Are better days ahead?

**2016 saw the first drop in the use of the research and development ("R&D") deduction in the entire 13-year-long existence of this business support. Taxpayers and the expert public noticed increased activity of tax authorities during tax audits focused on the area of R&D. In the last three years, several court rulings have been issued that established the practice of certain unclear legal provisions, but not all the key ones by far.**

Taxpayers have become reluctant to use the deduction and the Financial Administration has often been accused of targeted attacks. The Financial Administration responded with allegations of abuse of the support for tax planning, antedating of legally required documents and contesting of

activities that companies considered R&D. In this whirl of ill-will where there were essentially only minor changes made to the Income Taxes Act ("ITA") and the explanatory Decree D-288 throughout the period of availability of the support, the Ministry of Finance even considered removing the deduction from the law. As a consequence of this situation, the Government Council for Research, Development and Innovation created a working group whose activity resulted in the presentation of **conclusions that appear viable for all stakeholder groups**, i.e. representatives of the business and expert sphere, the Ministry of Finance and the General Financial Directorate ("GFD").

The representatives of the working group gathered a large amount of data, expert studies, rulings of the Supreme Administrative Court ("SAC") and international comparisons. At present, the ball is in the court of the Financial Administration, which should present the Chamber of Deputies with a draft amendment during the third quarter of 2018 so that the amendment could be approved by the end of 2018. The change in the ITA would also require an amendment to Decree D-288.

### **So what changes are coming?**

The current letter of the law requires taxpayers to prepare and sign an R&D Project before starting work on R&D activities. This causes distortions in practice and the **disputes between taxpayers and the tax administration** regarding whether the R&D Project was really created before the beginning of activities or later often end in a court case. And as confirmed by certain rulings of the SAC (e.g. "ELEKTROPOHONY" or "TRANSYS"), an unsigned or formally unfinished R&D Project is a reason for not recognising the full amount of the deduction and for imposing all sanctions from the additionally assessed tax liability allowed by the Tax Code.

The proposed solution assumes that the taxpayer would have an **obligation to send a notification** to inform the Financial Administration that it performs R&D activities and will claim the R&D deduction in the future. Based on the latest information, the notification would be sent to the Financial Administration, i.e. it would not be information included e.g. in public registers. The reported information should be limited to (a) the name of the tax payer, (b) name of the R&D project, (c) identification of the statutory representative (or the statutory representative's authorised representative).

The proposed provision assumes that the Financial Administration would consider the project (activities and expenses) to be initiated as of the effective moment of sending the notification. Activities performed (and expenses incurred) before the sending of the notification would not be investigated by the Financial Administration and the taxpayers would not be able to include them in the deduction. This would solve one of the major and crucial disputes in the current system, i.e. the preparation of the R&D Project before starting the work on it.

The R&D Project as we know it today would have to be **prepared no later than by the day of filing the tax return** where the taxpayer first claims the R&D deduction. This provision reacts to the practice abroad and to the criticism from business and the expert public that a great deal of information is unknown before the beginning of development activities, which leads to disputes with tax administrators regarding the sufficiency and correctness of the description included in the R&D Project.

According to the Financial Administration, taxpayers also often make errors in the method and sufficiency of the description of project assessment. The conclusion of the draft is to eliminate the set-up of the frequency and method of required audits. It will be completely up to the taxpayer to set up the audit system and the tax authorities will be able to audit compliance with the set rules only based on the specification determined by the taxpayer in the R&D project.

The draft amendment presupposes that a person responsible for signing the R&D project would still be required. The proposed amendment of the current wording of Section 34c of the ITA expects the introduction of a possibility of having the **project approved also by the authorised representative**.

As for the **indication of place of signing** the project, it is proposed to omit this requirement due to its strictly formal nature, and only the date of approval of the R&D Project would therefore be included.

In September 2017, the Information issued by the GFD stated that "The taxpayer is required to include a list of names of all persons who will provide expert management of the project". The issued Information deepened the doubts of businesses even further. In today's turbulent times characterised among other things by a high level of employee fluctuation, it is impossible to have a complete list of employees who will take part in the development in the following year(s) before the beginning of activities. The amendment suggests amending Decree D-288 **to allow changing the number of persons and changing the list of names of persons providing expert management of the project**.

The historically often debated **(non-)inclusion of vacation compensation** in the R&D deduction (e.g. the proposed conclusions of our colleagues' contribution to the Coordination Committee no. 451/22.04.15 that was not approved by the GFD) is not expected to be allowed in the amended text. An open (and in the opinion of this article's authors a fair) option is for the taxpayer to include the vacation compensation only in the percentage in which the employee was involved in R&D in the relevant period compared to the total number of hours worked.

The authors of the article believe that **the proposed measures could be the first essential step towards reducing the tax uncertainty of taxpayers that want to increase their competitiveness and use tax deduction for this purpose**. It is clear that the changes will require a more detailed expert interpretation for the individual cases occurring in practice. We will bring you more information as soon as any development of the planned amendment is known.

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