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TAX FRESH

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Dear business partners,

The first issue of this year's Tax Fresh informs about the conditions for the payment of profit shares.
Should you have any questions, don't hesitate to contact our office, we would be glad to assist you.

Best regards

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PAYMENT OF PROFIT SHARES FOR 2021

In anticipation of the forthcoming deadline for the drawing up of the financial statements, we would like to summarise the basic aspects and conditions of the payment of profit shares.

The deadline for the approval of the financial statements for 2021 will expire on **June 30, 2022** (i.e. in a period of 6 months).

Nevertheless, a company may decide to pay out the profit shares (and other sources of equity) up to the end of the financial year following the financial year for which the financial statements are drawn up. In other words, based on the financial statements as at December 31, 2021, the company may decide to pay the profit share until **December 31, 2022**.

The profit share is then payable within 3 months of the decision on its payment, unless the Memorandum of Association or the General Meeting provides otherwise in its decision.

The decision on the payment of the profit share is usually made by the statutory body of the company. We would like to point out that if the statutory body of the company (or its members) agreed to the profit share payment in violation of the law, **they failed to act with due care**.

Please find below the essential conditions and rules for the payment of profit shares.

Beyond the so-called balance sheet tests described below, the statutory body of the company should, when deciding on the payment of shares, take into account in particular the so-called **insolvency test**.

The test determines whether the company is at risk of insolvency as a direct result of the payment of profit shares. It is frequently overlooked that the Insolvency Act allows the use of a so-called **liquidity statement** as evidence against a company's bankruptcy to prove the company's ability to meet its monetary liabilities. The liquidity statement can also indicate the so-called **"cover gap"**, which is defined as the difference between the due cash payables and the amount of available funds. The acceptable cover gap is a maximum of 10%.

Furthermore, let us introduce the **basic balance sheet tests** that the paying company must meet and the statutory body must observe:

- The amount to be shared in a limited liability company, a joint stock company or a cooperative may not exceed the sum of the profit for the last completed accounting period, the profit for the previous years and other funds reduced by losses for previous years and by allocations to reserves and other funds.
- A limited liability company, a joint stock company or a cooperative may not distribute profits if, after such distribution, the equity at the end of the last accounting period has fallen below the amount of the subscribed registered capital plus any funds which cannot be distributed in accordance with the law or the Memorandum of Association.
- If development costs are recognised as assets on the balance sheet, a limited liability company, a joint stock company or a cooperative shall not distribute profits or other equity resources unless the amount to be distributed is at least equal to the unamortized portion of the costs of the

development. The amount available for distribution is reduced by the amount of unamortized costs of development.

Your **accountant or tax advisor** can help you with the insolvency test or balance sheet test.

However, this does not end the list of the duties connected with the payment of profit shares. As of June 2021, the **Act on the Registration of Beneficial Owners** came into force.

(We have already informed you about it in previous issues of Proxy Tax Fresh. All our previous issues of Tax Fresh can be found on our website under the following link https://www.proxy.cz/tax-fresh).

The implementation of this Act may also affect profit share payments.

- If the beneficial owner of a business corporation is not entered in the Register of Beneficial Owners, the business corporation may not pay him or her a share of the profits, and a share of the profits may not be paid to a legal person or legal arrangement of which that person is the beneficial owner.

- Additionally, a business corporation may not pay a profit share to a legal person or arrangement that has no beneficial owner listed in the Register of Beneficial Owners.

In view of the above, **it is essential** to verify the entry in the Register of Beneficial Owners before deciding on the payment of the profit share.

As far as the **tax regime** is concerned, profit shares are either taxed with withholding tax or are exempt from tax. The withholding tax rate (if the payment is not exempt) is 15% in the case of domestic payments or modified by the relevant double taxation treaty in the case of cross-border payments.

Exemption of the payment of a profit share occurs when the profit share is paid by a subsidiary company that is a resident of the Czech Republic or the EU or EEA to its parent company. Furthermore, if the statutory conditions are met, income from profit share received by a parent company in the Czech Republic from its foreign subsidiary is exempt from tax.

The obligation to withhold tax (if the exemption does not apply) lies with the paying subsidiary and arises on the date of payment, but no later than the end of the third month following the decision to pay the profit share. In the case of distributions of profit shares from registered securities, the time limit for both the payment of the share and the withholding of tax is 1 month.

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