Rödl & Partner

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Issue: November 2021

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Rödl & Partner

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Content:

→ Law

Can an employer withdraw from a non-competition clause?

An employer and an employee may agree on a non-competition clause that prevents the employee from engaging in a competing gainful activity for a certain period of time after leaving the current employer. The legalese on this matter raises many questions. The Constitutional Court recently addressed one of these questions, namely whether and under what conditions may an employer withdraw from a non-competition clause that both the employer and the employee agreed on, in one of its recent decisions.

Václav Vlk
Rödl & Partner Prague

Let's go over the basics – what is a non-competition clause in labour law?

If the employer and the employee agree on a non-competition clause, the employee may not, for a certain period of time after leaving the employer, but not longer than one year, engage in a gainful activity that is either identical to the employer's line of business or which competes with the employer's business. The employer must financially compensate the employee to the extent of at least one half of the employee's average monthly earnings for each month in which the employee complies with the non-competition clause. The employee's obligation to comply with the non-competition clause may be secured through a contractual penalty.

Withdrawal from a non-competition clause – case law

"An employer may withdraw from a non-competition clause only during the employment relationship." (section 314(4) of the Labour Code). The Supreme Court has repeatedly ruled in recent years that an employer may only withdraw from a non-competition clause for a reason provided for in the law or in the parties' agreement, and moreover, this may only happen during the term of the employment relationship. In one decision from 2020, the Supreme Court even concluded that it is invalid for the employer to withdraw from a non-competion clause during the term of the employment relationship if, at its discretion, the employer concludes that it would be unreasonable and/or impractical to enforce the non-competition clause in view of the value of the information, knowledge, and knowledge of work and technological processes acquired by the employee in the employer's employment or otherwise.

The Constitutional Court on withdrawal from a non-competition clause

The employer challenged the latter decision of the Supreme Court with a constitutional complaint. The Constitutional Court decided on 21 May 2021 (File number II. ÚS 1889/19) to uphold the constitutional complaint and returned the case to the municipal courts. Having done so, the Constitutional Court changed case law.

According to the Constitutional Court, the blanket prohibition of contractual arrangements expressly allowing an employer to withdraw from a non-competition clause during the term of an employee's employment without giving a reason, which is determined only by court decisions and not by law, is a constitutionally impermissible judicial refinement of the law. It violates the principle of separation of powers, the principle of autonomy of will and contractual freedom of individuals and the fundamental rights of the employer. However, the employer's right to withdraw from a non-competition clause even without giving a reason, if this possibility has been expressly agreed by the parties, does not mean that the employee, as the typically weaker party to the employment relationship, should not be protected against potential arbitrariness or abuse of this right by the employer. And so the courts must assess in each individual case whether the withdrawal from a non-competition clause constitutes arbitrariness or abuse of the right by the employer to withdraw from the non-competion clause, but they may not base their decision(s) only on such arbitrariness or abuse of right.

The court is to take into account, in particular:

- The time when the employer withdrew from the non-competition clause;
- If the employer withdrew from the non-competition clause just before the employee's employment ended, then consider why it could not have done so earlier;
- If the employer withdrew from the non-competion clause without giving a reason, the reason why the employer considered the parties' commitment to the non-competion clause to be undesirable, unreasonable, unsustainable or unfair;
- Facts indicating that the employee chose their future employment or other career with a view to their being bound by the non-competion clause (for example, the employee has already found a job that meets the requirements of the non-competion clause or, on the contrary, has refused a job offer that did not meet the requirements);
- Facts suggesting that the employer acted arbitrarily or abused its right to withdraw from the non-competion clause (e.g. it wanted to release itself of the obligation to provide the employee with monetary compensation at a time when it knew or could and should have known that the employee had chosen their future employment or other career with a view of their commitment under the non-competion clause).

To conclude, the Constitutional Court sided with employers in allowing them to negotiate the possibility of withdrawing from a non-competition clause even without stating a reason. At the same time, however, it created considerable uncertainty. The employer can now never be sure what conclusion the court will reach in a dispute after evaluating the above criteria. And so disputes arising from (not only) non-competition clauses will continue to clutter the court rooms of many a Czech court.

The employer can withdraw from a non-competition-clause, but ...

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→ Law

Higher fuel price compensation

On 18 October 2021, an extraordinary amendment to the Decree establishing the average price of fuel for the purpose of granting travel allowances for 2021 was published in the Collection of Laws.

The fuel price is especially important for employees using private cars on business trips. Up until 18 October 2021, the fuel price for these purposes was CZK 27.80 per litre for 95-octane petrol. With effect from 19 October 2021, the average price for 95-octane petrol will increase to CZK 33.80 per litre. However, all other average fuel prices, including the average price of diesel fuel, will remain at their original level for the rest of the year in accordance with Decree No. 589/2020 Sb.

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→ Taxes

Rödl & Partner scored again before the Supreme Administrative Court

Rödl & Partner successfully represented a major media group in tax and subsequent court proceedings before the Supreme Administrative Court in a dispute over the award of interest in connection with the tax authority's unlawful conduct.

Jakub Šotník
Rödl & Partner Prague

This is what happened. We did not claim tax credit for investment incentives when we filed our regular tax returns, which we filed successively for several tax periods. The tax authority made an implicit tax assessment based on the tax returns. We appealed against the payment orders and then claimed the tax credit. The tax authority upheld our client's claim only following subsequent proceedings before the Supreme Administrative Court.

We then sought interest on the tax authority's unlawful conduct as compensation for its refusal to recognise the tax credit for investment incentives, which resulted in the client being unable to dispose of the tax overpayment for several years.

The tax authority refused to pay the interest on the grounds that the tax liability was determined on the basis of tax returns prepared and filed directly by the client (his representative), and the tax authority does not examine or assess whether the tax base or the tax itself was correctly determined. According to the tax authority, the tax was assessed in accordance with the law and had nothing to do with the tax authority proceeding in an unlawful manner. And so, according to the tax authority, one of the conditions for the award of interest for unlawful conduct of the tax authority, namely that the client paid the tax based on an unlawful decision made by the tax authority, was not met. According to the tax authority, the fact that the client had to claim the tax rebate on appeal or in the course of legal proceedings has no bearing on the (dis)award of interest on the basis of the tax authority's unlawful conduct.

The Supreme Administrative Court upheld our appeal, stating that the purpose of interest is to provide compensation to persons who, as a result of unlawful decisions or incorrect official action, have been obliged to pay sums of money

which they would not otherwise have had to pay but for the unlawful decision or incorrect official action. Indeed, if the tax authority had assessed the tax at the correct rate on the client's appeal, the client would have had the tax in the amount of the overpayment at his disposal. Since that was not the case, the client is entitled to compensation in the form of interest. As the Supreme Administrative Court concluded, the assessment and the assessment-appeal procedure form a single unit, during the course of which the client paid more tax than he was supposed to pay. This also satisfied the second (disputed) condition for the award of interest on the tax authority's unlawful conduct.

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→ Taxes

VAT waiver for electricity and gas supplies

On 20 October, a decision was published in the Financial Bulletin No. 34/2021 of 20 October to waive VAT on supplies of electricity and gas acquired from another Member State or imported from third countries in the period from 1 November to 31 December 2021. The waiver applies to the supply of electricity and gas with the date of taxable supply (tax point) determined based on the date of reading the electricity/gas meters in the relevant month and the months in which the advances for the supplies were paid.

The waiver does not restrict the possible recipients of supply to a particular group or class, which means that VAT is waived even if the electricity or gas is supplied to registered VAT payers. In addition to suppliers of energies, the waiver therefore applies also to landlords.

The VAT invoice should not record the VAT. Failing that, the recipient may not claim a VAT refund on the supply charged in the invoice according to a statement by the General Financial Directorate.

For the sake of completeness, we note that the Ministry of Finance submitted an amending bill to the VAT act that intends to waive VAT on electricity and gas supplies with a right of deduction for the entire year 2022.

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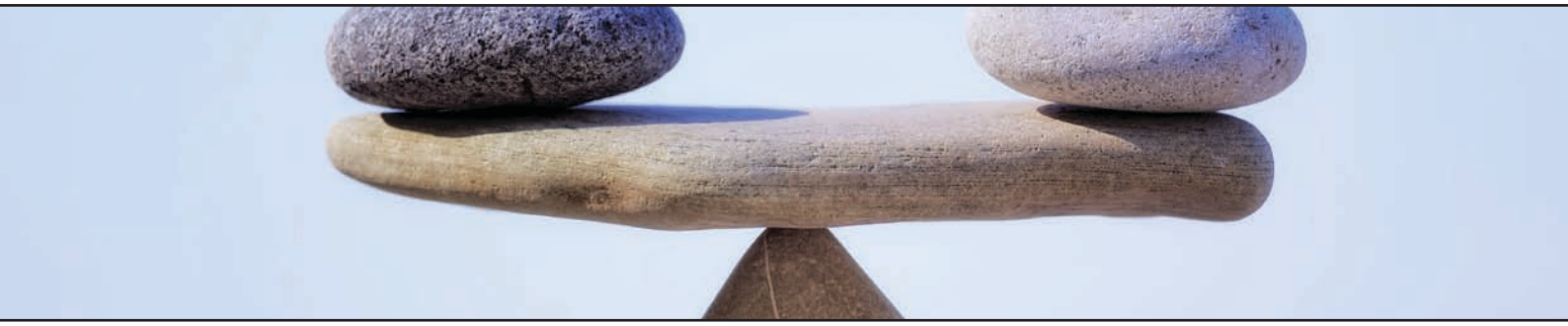

→ Taxes

Tax havens and offshore companies

The general public has had its eye on transactions carried out through so-called offshore companies based in tax havens for some time now. What exactly are these offshore companies, what purpose do they serve and where can we expect to find these so-called tax havens? In this article we will try to address these as well as other related questions.

Robert Němeček, Filip Straka
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The term offshore company can be used to describe almost any company that is officially based in a country with a favourable tax regime, most often in an exotic destination known as a tax haven. In doing so, significant tax savings can be achieved, as in most of these countries the overall taxation rate is significantly lower than in the Czech Republic, for example. There are of course several reasons for setting them up, but one of the most common ones is undoubtedly the intention to avoid paying taxes.

The main advantage of offshore destinations is the considerable administrative relief they pose. But the advantages do not end there. Depending on the local legislation, certain types of companies may be exempt from corporate tax entirely, or if they are not, they pay their tax at a low, fixed amount, regardless of their profits. In some countries, it is even possible to avoid the obligations associated with filing tax returns and, consequently, bookkeeping itself. As a result, by setting up an offshore ownership structure, a commercial corporation doing business in the Czech Republic may shift its profits to a jurisdiction where they are subject to considerably lower or even zero taxation, and avoid many other associated statutory and regulatory obligations.

In addition to being a truly effective tool for tax optimisation, offshore companies are also extensively used to obscure and obfuscate the information about the ownership structure. In this context, the question naturally arises as to where to draw the line between a legitimate optimisation instrument and a purposeful circumvention of the law and evasion of tax. The establishment of an offshore company is not in itself illegal; many entrepreneurs use offshore companies for purely legitimate purposes, be it for various preventive reasons or for privacy protection. Nonetheless, if an offshore company is established solely for an illegal purpose, typically to conceal beneficial ownership, to circumvent the law in an attempt to avoid paying taxes or even to launder money, then we can undoubtedly talk about targeted calculations, which tax authorities may evaluate as aggressive tax planning and tax evasion.

Countries that offer favourable conditions for anonymous ownership and whose legislation facilitates tax avoidance efforts are known as tax havens.

The European Union has been opposed to tax havens for a very long time now. Twice a year, the EU publishes a list of so-called non-cooperative jurisdictions. The list should act as a key tool in the fight against money laundering, tax evasion and any illegal tax avoidance.

The list, which was first drawn up by the Council of the European Union in December 2017 and which we mentioned in numerous Newsletters in the past, includes the following countries as of 12 October 2021, following a review by the European Union:

- American Samoa
- Fiji
- Guam

– Palau
– Panama
– Samoa
– Trinidad and Tobago
– US Virgin Islands
– Vanuatu

Czech entities may face tax implications if they engage in transactions with persons domiciled in a non-cooperative state. These include, in particular, the obligation to apply the highest withholding tax rate (i.e. 35%) to income that is subject to withholding tax under Czech legislation.

The Council of the European Union regularly reviews the fulfilment of the set criteria and the commitments resulting from the adoption of reforms under international tax standards, and updates the list of non-cooperating states. The current list, which contains only third countries supporting so-called unfair tax practices, is updated twice a year (since 2020). It will be reviewed again next February.

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→ Taxes

Global minimum tax rate approved

On 8 October 2021, the member states of the Organisation for Economic Co-operation and Development (OECD) came to an agreement that large multinational companies will be subject to income taxation at a minimum rate of 15 per cent from 2023.

According to the OECD, the agreement is not intended to eliminate tax competition altogether, but to set limits on it. The minimum tax rate would apply to companies with revenues exceeding €750 million. The OECD believes that the change in policy should generate an additional tax revenue of approximately $150 billion per year for the member states. It should also ensure a fairer distribution of income and mitigate the ongoing tax base erosion. According to the OECD, more than $125 billion a year should be shifted from the largest multinational companies to the countries where they operate and generate profits. As a consequence, multinational companies will pay their fair share of taxes in those countries, regardless of their physical presence.

Of the 140 countries involved in the negotiations, Kenya, Nigeria, Pakistan and Sri Lanka have not yet joined the agreement. The contemplated multilateral convention is planned to be signed in 2022 and come into effect in 2023.

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→ Taxes

Changes to Intrastat reporting effective from 1 January 2022

The Czech Statistical Office has issued an overview of the most important changes concerning Intrastat reporting that await reporting units in the coming year, in line with new Government Regulation No. 333/2021 Sb.. Some of the most important changes include simplified reporting and the extension of the current reporting data on the supply of goods to another Member State.

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As mentioned in the introduction, the scope of the data to be reported for the supply of goods to another EU Member State has been expanded. In addition to the existing items, the reporting unit will now also have to add information on the country of origin of the goods and the customer's tax identification number or similar number used for VAT purposes. Where goods are received from another EU Member State, the information required remains unchanged.

Another important innovation in Intrastat reporting is the introduction of the so-called simplified declaration. This allows the reporting unit to report data to Intrastat only once a year subject to certain conditions:

- the value of total annual acquisitions or dispatches may not exceed CZK 12-20 million in the current and previous year (the limit applies separately to acquisitions and dispatches)
- simultaneously, the reporting unit must not have traded in the current or previous year in commodities that exclude the possibility of simplified reporting (a list of these commodities is provided in the Communication from the Czech Statistical Office on the list of goods not intended for simplified reporting)

A simplified declaration is submitted separately for both directions, while the deadline for its submission coincides with the deadline for the January Intrastat declaration. If during the year a reporting unit exceeds the threshold of CZK 20 million or acquires or sends goods that are not intended for simplified reporting, it has to submit the monthly Intrastat report again from the month in which it exceeded the threshold (or traded goods that may not be reported in a simplified manner). This obligation continues to apply for the entire year to follow. The reporting unit therefore may only file a simplified declaration for the period before it exceeded the threshold (or before trading in excluded goods).

Smaller reporting units may use simplified reporting if they meet the conditions.

It needs to be noted that some transaction nature codes will also be changed. The Czech Statistical Office has issued a comprehensive converter of the transaction nature codes.

Other minor changes include an increase in the limit for small consignments from EUR 200 to EUR 400 and the rounding of additional units of measurement. These will now be rounded off mathematically to whole numbers if the value is greater than 1.

The changes will also affect the reporting of 100% credit in the Intrastat declaration. At

present, 100% credit notes are practically not reported in the Intrastat declaration, but the new rules will distinguish between transactions involving a physical movement of goods and transactions in which a business merely claims a refund. In the case of a refund without physical movement of goods, the value of the goods originally reported in the Intrastat declaration will have to be corrected. However, if in addition to a refund the goods have been returned along with a credit note, the data already reported in the Intrastat declaration will not be corrected. The return of goods will be reflected in the Intrastat declaration on the opposite side.

All changes effective from 1 January 2022 will also be included in the forthcoming 2022 edition of the Intrastat manual. For the moment, the Czech Statistical Office has published an overview of the changes here.

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→ Taxes

Cap on higher income tax rate for individuals in 2022

The Government has published the figures used to calculate, among other things, the average wage for the purposes of the Income Tax Act.

The average wage influences the personal income tax rate. In 2022, income exceeding CZK 1,867, 728 will be subject to a tax rate of 23 per cent. In 2021, the cap is CZK 1,701,168. For interest's sake, the cap in 2020 was CZK 1,672,080. The year-on-year increase from 2021 to 2022 is significant and it reflects current wage developments.

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→ Taxes

New German transfer pricing directive

The German Tax Administration issued a new directive in July for German taxpayers summarising and interpreting transfer pricing principles. Given intensive Czech-German business relations, the Directive also applies to Czech taxpayers as the principles described in it affect relations between Czech and German companies.

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As the title of the Directive suggests, the document sets out the principles for the taxation of income accruing to German companies from abroad. The intention is quite clear – to increase the revenue of the German state budget through transfer pricing adjustments.

The Directive takes into consideration the common understanding of the arm's length principle as defined by the OECD in double taxation avoidance agreement. It views a breach of the arm's length principle as grounds for adjusting the tax base of German companies. What is especially important is that the Directive explicitly states that not only the prices themselves must be examined, but that the other terms of business must also be put under the microscope. Thus, one can expect more thorough checks aimed not only at contractual documentation but also at the actual behaviour of the business partners within the group. Where Czech taxpayers are concerned, this means that they need to make sure that their contractual documentation is up to scratch as are their local files. It's worth mentioning that international cooperation between the Czech and German tax authorities is improving, so information submitted during a tax audit in Germany can be shared by the German tax authorities with the Czech tax authorities. As per our practical experience, in recent years, there have been very frequent cases of joint tax audits in both countries, or requests for information from a tax authority in the other country. For this reason, it will be necessary to pay careful attention to the consistency of any evidence submitted and it will also be in the interest of Czech companies that the parent companies in Germany submit evidence that cannot harm the Czech companies within the group. Naturally, the evidence submitted by Czech companies in any tax audits or inspections will also be very important. It is always essential that the tax authorities in both countries receive consistent information.

A part of the Directive addresses the matter of what the German tax authorities consider to be related parties. It is certainly worth mentioning that the definition of related parties has been broadened to include entities which, although not interconnected by shares, show signs of being linked for the purpose of a common commercial interest. Essentially, this means that the German tax authorities can also apply the arm's length principle to transactions between unrelated companies that carry out transactions under abnormal market conditions. This definition is similar to the so-called artificially related parties known from the Czech Income Tax Act. The permanent establishments of German founders in foreign countries are also regarded as related parties.

As far as the methods of determining transfer prices are concerned, the German Directive relies on all the methods that are commonly known and used in practice, so we need not worry too much about any major changes in this respect (in the Czech environment). Nonetheless, it is certainly worth mentioning that the German Directive refers to the OECD Directive, particularly to the method for calculating the operating results of tax entities for the purpose of determining arm's length profitability by means of comparative studies. In this respect, the German Directive also calls for consideration of all economic circumstances and consideration of whether other, seemingly non-operational variables such as interest costs and income or exchange rate differences should be included in the operating results. We also come across this approach in Czech tax audits, and discussions with the tax authorities about what constitutes a taxpayer's operating result will surely increase in light of the new German Directive.

From a Czech company's perspective, the section on loss-making group companies is also relevant. In this respect, the German Directive refers to the OECD Directive and explicitly states that loss-making companies should, in certain circumstances, be compensated by the entities that profit from such loss-making activity (assuming, of course, that there is a profit-making company).

Routine companies that are very much group-controlled and have a limited ability to manage their risks are expected to report profit, at least in the long term. Here, the German Directive sets a 5-year period within which routine companies should report a so-called cumulative profit, i.e. an average profitable result on a 5-year basis. Now, what will the Czech tax authorities think of this?
The Directive also focuses on intra-group services with low added value. It refers to the rules already defined in the OECD Directive and specifically regulates the criteria for defining such services, gives examples of such services and recommends a 5% profit mark-up on costs when using the cost plus method.

The German Directive also addresses now topical intangible assets, where it recommends the preparation of a so-called DEMPE analysis to determine the allocation of profits generated by these assets. It also addresses financing, where it recommends, among other things, examining the economic necessity of intra-group loans.

In light of the very frequent business transactions between Germany and the Czech Republic, we should not underestimate the importance of the new German Directive and its possible impact on Czech tax entities with links to Germany. Our transfer pricing experts will gladly assist you in examining the possible impact the Directive could have on your business.

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