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Content:

→ Law

When termination backfires: Wage compensation for invalid dismissals

Invalid termination disputes remain at the forefront of employment litigation. When a court rules that an employer's termination was invalid and the employee promptly submits written notice insisting on continuing employment, the employer must provide wage compensation. The question arises: can this compensation be reduced?

Václav Vlk
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The compensation, calculated at the employee's average earnings, runs from the date of notification until either the employer reinstates the employee or the employment relationship is properly terminated.

Faced with substantial compensation claims spanning months or even years, employers naturally explore potential reduction options. Section 69(2) of the Labor Code appears to offer some flexibility. Upon the employer's motion, courts may consider reducing the compensation obligation for periods exceeding six months. The assessment typically considers whether the employee found alternative employment, the nature of that work, earnings received, or reasons for unemployment. Employers frequently present evidence of suitable job opportunities matching the employee's qualifications to demonstrate labour market availability.

However, the Czech Supreme Court maintains a strict interpretation. The Court has consistently held that an employee's job-seeking efforts, or lack thereof, do not justify reducing compensation. A reduction might only be considered where evidence shows the employee declined a specific, concrete employment opportunity offering equivalent or superior conditions to their original position, without reasonable justification. The Court has explicitly stated that neither passive job-seeking behaviour nor failure to register with employment offices warrants compensation reduction. Furthermore, advertised positions, regardless of their apparent suitability, constitute mere opportunities to compete rather than definitive job offers. This position was recently reaffirmed in the Court's 25 January 2024 decision (case No. 21 Cdo 2973/2023).

Passive job seeking behaviour on the part of former employees does not entitle employers to reduce their wage compensation.

Consequently, employers face minimal prospects of reducing wage compensation obligations following an invalid termination ruling. Prudent employers should carefully evaluate whether termination meets legal requirements and assess litigation risks beforehand. While this assessment often proves challenging and outcomes remain uncertain, it remains preferable to facing extensive compensation claims.

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→ Taxes

Average wage and changes of tax thresholds in 2025

On the last day of September, a government decree was published in the Collection of Laws setting the average wage for the coming year. The average wage for 2025 is CZK 46,557, which is 6% higher than this year's average wage. The average wage is used to calculate other economic variables, including tax ones, across many laws, and its publication is therefore an important event.

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For example, the limit for exempting income in kind (benefits) paid by employers to employees is set at one half of the average wage since 2024. In the upcoming year, the exemption limit on the part of employees will therefore be set at 23,278.50 CZK; benefits that exceed this threshold will be liable to income tax and insurance premiums.

The limit for the higher-tier income tax rate is also linked to the average wage. In the Czech Republic, the higher tax bracket for the individual income tax, which is rated at 23%, will be inferred from 36 times the average wage in 2024, a reduction from previous years. For the year 2025, the threshold or the higher tax bracket will be 1,676,052 CZK.

The average wage also affects social insurance limits, one of which is the maximum assessment base, which is 48 times the average wage, and which will amount to 2,234,736 CZK for this year. Social insurance premiums are not collected from income that exceeds the maximum assessment base, as disclosed in the annual reconciliation.

The minimum eligible income for sickness insurance is increased to 4,500 CZK (compared to CZK 4,000 in 2022 and 2023). The same amount is also the eligible income for the so-called small-scale employment.

The average wage is also used to determine the minimum social security and health insurance premiums of self-employed persons or is used to determine the basis used to calculate the retirement pension.

All in all, average wage is essential for calculating wages and in accounting for costs.

Please contact us if you have any questions in this or any other matters.

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→ Taxes

New amendment to VAT Act for 2025 (Part 1)

A significant amendment to the VAT Act is scheduled to take effect on January 1, 2025, introducing numerous important changes. While the legislation is currently under review in the Chamber of Deputies, it not only implements the European VAT Directive but also brings substantial modifications to existing regulations. In this article, we present the first set of key changes.

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Turnover and compulsory VAT registration

Under current regulations effective until the end of 2024, prospective VAT payers must track whether their turnover exceeds CZK 2 million over any consecutive 12-month period. When this threshold is exceeded, the entity becomes subject to VAT registration from the first day of the second month following the month of excess.

From January 1, 2025, this system will transition to a calendar year-based calculation with two distinct registration thresholds. The first threshold will remain at CZK 2 million, and exceeding this amount will trigger VAT liability starting January 1 of the following year. The second threshold, harmonized across the EU, is set at CZK 2,536,500 (equivalent to EUR 100,000), with VAT liability taking effect immediately the day after this amount is exceeded.

Entities exceeding the CZK 2 million threshold will have the option to register for VAT voluntarily, provided they submit their application within 15 days of exceeding this turnover threshold.

Special scheme for small business

The amendment introduces a special scheme for small and medium-size enterprises (SME's). Under this scheme, SME's from other Member State that register for the scheme and whose annual turnover does not exceed EUR 100k, will be exempt from VAT in the Czech Republic. In practice, this will mean that small businesses will be able to conduct taxable transactions in the Czech Republic without having to register for VAT.

Since this modification stems from an EU directive, Czech entrepreneurs will enjoy similar conditions throughout the EU. By registering for the small business scheme in the Czech Republic and maintaining an annual turnover below CZK 2,536,500, Czech businesses will no longer need to register for VAT in other EU countries. This represents a significant improvement in facilitating international business operations.

Changes to the deadlines for claiming VAT deductions and correcting the tax base

A notable modification involves the reduction of the time limit for claiming VAT deductions. The current three-year period will be shortened to two years, expiring at the end of the second calendar year following the year in which the deduction was claimed. This same two-year limit will apply to additional tax base increases (through debit notes) and subsequent deduction claims.

Conversely, the timeframe for tax base corrections will be extended from three to seven years, reflecting an effort to better align with current market requirements.

Bad debts

The amendment offers more favourable conditions for VAT payers regarding tax base adjustments for bad debts. It shortens the adjustment period for enforcement and insolvency proceedings, and in certain cases eliminates the requirement to file claims in insolvency proceedings

The amendment also introduces a simplified tax base adjustment process for small claims. VAT payers will be able to adjust their tax base for receivables up to CZK 10,000 including VAT, provided the debt is more than six months overdue, the taxpayer has sent at least two written notices to the debtor, and the total adjustments against the debtor do not exceed CZK 20,000 including VAT per calendar year.

We will continue with additional changes in our next newsletter. For more detailed information about the 2025 VAT amendment or to participate in upcoming workshops, please don't hesitate to reach out to us.

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→ Taxes

Waiver of penalties for VAT payers affected by floods

The Minister of Finance has decided to waive the 1,000 CZK penalty for the late filing of the control statement by VAT payers who fell victim to the floods after 12 September 2024 or whose control statements were processed by a person affected by the floods (such as an external accountant).

The waiver of late filing penalties applies to control statements for the tax periods of August and September 2024 and to the subsequent control statements that should have been filed from 12 September to 31 October 2024. Two additional conditions must be satisfied to exercise the waiver: the control statement must be filed by 25 November 2024 while the tax authorities must be simultaneously notified by the same deadline that the VAT payer or the person processing his control statement has been affected by the floods. The template notice is available on the Ministry of Finance website.

The decision does not apply to the first late submission of a control statement in a calendar year when the fine does not arise automatically, or to higher fines (CZK 10,000, CZK 30,000, CZK 50,000), which can only be waived individually.

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→ Taxes

Parent company's pricing instructions for third-party transactions – another landmark ruling of the Supreme Administrative Court

The Supreme Administrative Court ruled in another case involving the application of transfer pricing rules on a transaction that appeared independent at first sight. But the independence of the transaction was illusory; in actual fact, the transaction and its pricing was affected by the parent company's instruction, which compelled the subsidiary to charge the price that was to its detriment. The tax authorities challenged this transfer pricing process and asked the parent company to compensate the subsidiary for the loss.

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Truly related?

Transfer pricing rules apply to transactions between so-called related parties, most frequently to companies associated by capital that are members of a multinational enterprise. This interpretation of the rules is s consistent with both domestic and international legislation, including the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

In recent years, however, there have also been cases where tax authorities have examined the arm's length price of seemingly unrelated transactions at their tax audits, typically when they discover a combination of an enterprise's membership in MNE, its recurring tax loss and the frequent purchases or provisions of management services. The Czech Supreme Administrative Court addressed several of such cases, most recently in its judgment in case No. 3 Afs 102/2023. Tax authorities typically focus on

Who determines the price?

The principal business activity of the company in question was the purchase and sale of scrap metal. The company transacted with independent undertakings, making long-term losses in the process. It therefore had to finance its activities by interest-bearing loans from its parent company. The parent company also provided management services to its subsidiary, including services in the area of sales and sales support. As part of these services, it negotiated commercial terms and set prices in transactions with suppliers of goods and recommended sales price values for goods.

The facts of the case were support both by contract made between the local and the parent company and by other evidence submitted to tax inspectors (e.g. correspondence with suppliers and customers).

In its defence, the audited company argued that it transacted with independent entities and that the prices were determined based on scrap metal prices charged on the commodity market.

Parent company's "service"

Interestingly, the tax authorities did not require that the audited company charge arm's length prices in transactions with independent enterprises. Instead, it classified the situation as a service rendered by the audited company to its parent company. The service consisted in the audited company's acceptance of trading at a loss in order to bring a commercial advantage to the parent company or to the group in general. The tax authorities insisted that the parent company pay its subsidiary for such service as remuneration equal to the difference between fair profit in the industry as determined by a comparability analysis and between the actual income earned by the subsidiary. The remuneration thus would be paid for the parent company detrimental instructions regarding the setup of prices with customers and suppliers that would compensate the subsidiary's loss and fair profit. The tax authorities argued that the subsidiary's losses were directly caused by the parent company's decision to charge prices that could not even cover the subsidiary's costs.

Based on its decision, the tax authorities assessed additional tax and charged the corresponding tax penalties. While the taxable entity (the local subsidiary) appealed, the tax authority's decision was upheld by the Appellate Financial Directorate, by the Regional Court and ultimately by the Supreme Administrative Court.

This was not the first SAC's judgment on this topic. In the past, the Court already found in favour of tax authorities on the issue of pricing interference in independent transactions and the necessity to compensate for the ensuing loss.

The present case was decided in accordance with the logic of functional analysis and the requirement to balance the functions (in this case, the function of deciding the price) and risks (incurring a loss when the difference between the sale and purchase price of the goods does not cover the incidental costs). Since the balance was clearly disturbed, the transfer prices were set incorrectly by the parties involved.

Conclusion

For companies that are members of multinational groups, this judgement represents a yet another important warning signalling that attention must be paid even to ostensibly "risk-free" transactions.

The proper general setup of the group's business model and the ensuing transfer pricing methodology should always take precedence. Once a tax audit takes place, the defence strategy becomes crucial. In the case discussed above, the outcome of the proceedings was strongly affected by the submission of evidence that clearly demonstrate the parent company's influence in the pricing setup.

If such a situation applies to you, entrust the safe set-up of processes and their subsequent defence before the tax authorities to the real experts.

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→ Taxes

Zero series is not a prototype: Defining R&D cost eligibility

A recent Supreme Administrative Court (SAC) judgment (No. 5 Afs 263/2023) from September has provided important clarification regarding the scope of research and development (R&D) costs, specifically addressing whether "zero series" or verification series production costs qualify for R&D tax deductions.

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The case involved a taxpayer who developed a machine through an R&D project. After development, the machine was manufactured in limited quantities for customer trials and dealer demonstrations. When the zero series was produced, the machine's development had already been completed, as evidenced by a previously obtained declaration of conformity. During the verification phase, only minor issues were addressed that didn't require additional experimental development.

The Court's interpretation establishes that R&D concludes with prototype production, aligning with the exhaustive list of eligible expenditures in Article 34b(1)(a) of the Income Tax Act (ITA). According to the MF-17 Guidance, a prototype is defined as "an initial model incorporating all the technical and performance characteristics of a new product or groups thereof, or the first manufactured units of a new product, where the primary objective is to verify the proposed solution or to further improve it; the threshold is the completion of the necessary modification of the prototype and the successful completion of the tests."

The SAC determined that the taxpayer failed to demonstrate that the zero series qualified as a prototype; instead, it concluded these activities fell outside the scope of R&D. For zero series production costs to qualify for R&D deductions, they would need to involve "reverse R&D" – a concept recognized in the OECD FRASCATI manual where problems identified during zero series production necessitate new R&D activities.

However, the taxpayer couldn't prove that the zero series involved R&D activities or reverse R&D. The activity lacked proper documentation, and the inspection report for the verification series indicated all basic product parameters were satisfactory. Furthermore, there were no written agreements with dealers who purchased the zero series products at discounted prices for testing, with reverse R&D arrangements being purely verbal, even if they were expected to verify product functionality and features.

While the zero series inspection revealed minor deficiencies (such as painting issues and sticker application problems) that could be corrected, the SAC maintained these didn't constitute R&D as defined by the Income Taxes Act. The court noted the absence of novelty and research-technical uncertainty. The legislation wasn't intended to incentivize all quality improvement activities. Consequently, the SAC upheld the tax office and regional court decisions, excluding zero series production costs from R&D deductions.

The judgment also reaffirmed that both the FRASCATI manual and D-288 Guidance (now MF-17) are integral to administrative practice and should be followed unless they conflict with existing law.

In conclusion, not all expenses linked to an R&D project automatically qualify for R&D deductions. When taxpayers claim expenses as R&D-eligible, they must provide comprehensive documentation demonstrating how these expenses relate to R&D within the project's progress and evaluation records.

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→ Taxes

Employee benefits under judicial scrutiny

In a recent case, the Supreme Administrative Court reviewed the exemption of non-monetary income from personal income tax on the part of employees who received the income as part of the employer's benefit system rather than as part of their salary.

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The Supreme Administrative Court addressed the matter of the exemption of employees' non-monetary income from their personal income tax. In the case at hand, the employer granted employees with credits for its inhouse benefit system rather than granting the benefit as part of their income. The employees could use the credit to purchase goods and services, such as recreation, medical aids and so forth.

The tax authorities refused to exempt this non-monetary income from personal income tax, arguing that adding credits to an inhouse benefit system constitutes an in-kind part of the wage rather than an employee benefit within the meaning of section 6(9)(d) of the Income Taxes Act.

The tax authorities also pointed out that this course of action may constitute an abuse of law on the part of employers, which could lead to an evasion of compulsory insurance payments. To this end, the tax authorities argue. Last but not least, this course of action discriminates against civil servants, as employees paid from the state budget, whose remuneration would be taxed differently as a result.

The Regional Court and subsequently the Supreme Administrative Court rejected the tax authorities' arguments. The Supreme Administrative Court noted that "Non-monetary benefits include such benefits for which the employer pays a sum of money to a person other the employee or the employee's next of kin." The third party subsequently renders certain services or provides certain benefit to such employee or his or her next of kin.

The Supreme Administrative Court also referred to its previous rulings, according to which a non-monetary benefit is a benefit which is not provided in money and is therefore not exchangeable for money or other similar means or benefits. In this context, the Supreme Administrative Court has also confirmed the possibility of using special-purposes vouchers. In this context, the Supreme Administrative Court noted that "the provision of a benefit in the form of a special-purpose voucher is a non-monetary benefit. It is a financial instrument, which serves a specific purpose and may not be exchanged for anything also other than the intended benefit; as a consequence, the fulfilment of its purposes is being ensured by its very nature. Such benefit is not a sum of money, but a voucher for the use of specified benefits of a certain value, that preserves the principle of its provision by the employer…"

The Supreme Administrative Court also addressed the tax authorities' argument about the fundamental difference between wages and remuneration paid in addition to wages or employee benefits in reference to Section 6(9)(d) of the Income Taxes Act. The Supreme Administrative Court re-iterated its finding from its previous rulings according to which the Income Taxes Act only uses the term "income" (příjem in Czech). Income is defined as any consideration granted by an employer to an employee in exchange for the employee's work. Section 6 of the Income Taxes Act does not deal with the concepts such as wage or remuneration in addition to wage or employee benefit.

The Supreme Administrative Court therefore concluded that to exercise the exemption under Section 9(6)(d) of the Income Taxes Act, the taxpayer must only satisfy the conditions listed in the said provision.

The Supreme Administrative Court also refused the argument about the potential abuse of law by employers. The Court emphasized that the taxable entity proceeded in compliance with the clear wording of law and therefore could not have violated the purpose of law. The Supreme Administrative Court also pointed out that the taxable entity may not be faulted for applying a provision of the Income Taxes Act. The taxable entity only availed itself of an option granted by law and provided non-monetary benefits to its employees. If the tax authorities wished to disallow the exemption, they could only do so on the basis of any failure to comply with the conditions laid down in Section 6(9)(d) of the Income Taxes Act.

Last but not least, the Supreme Administrative Court rejected the argument of the alleged discrimination against civil servants, noting that when an employee is employed by the State, it is up to the State to determine its remuneration policy in order to be competitive on the labour market.

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→ Taxes

Abolition of special depreciation regime for PvP powerplants

The pending amending bill to the Energy Act (Lex OZE III) proposes abolishing the special depreciation regime for photovoltaic power plant equipment (PvP).

The amending bill proposes erasing the entire section 30b of the Income Taxes Act. The PvP equipment will be tax-depreciated as regular tangible assets in the relevant depreciation group (mostly in the second and third depreciation group) at straight line or by accelerated method.

It will not longer be possible to tax-depreciate the PvP equipment over the period of 240 months without the option to interrupt depreciation; instead, it will only be possible to depreciate PvP equipment over 5 or 10 years with the option to interrupt depreciation.

The new law is planned to come into effect from 2025 and will apply to PvP equipment whose depreciation can start after 1 January 2025. Some lawmakers have also proposed the alternative to apply the new law also to PvP equipment whose depreciation is to start after 1 July 2024.

Please note that this change of law still has not been enacted and that the exact wording of the new bill may still change.

If you invested into PvP equipment after 1 July 2024, we will gladly assist you in setting up the correct tax depreciation regime.

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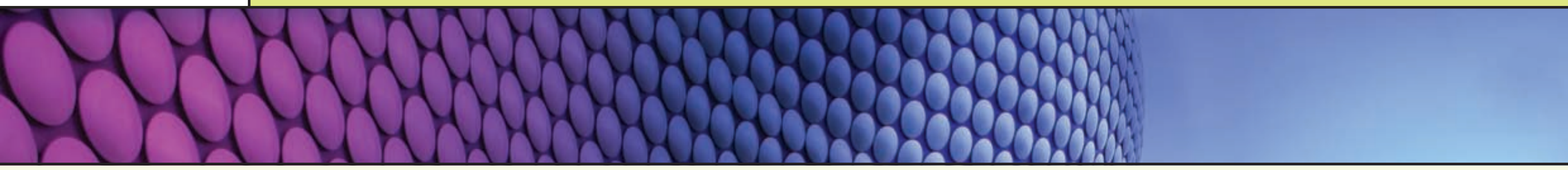

→ ESG Insights

ESRS E3 – E5

In previous editions of our "ESG Insights" series we've delved into standards like ESRS E1 and ESRS E2 in detail. This time, we're bringing you a comprehensive overview of the other environmental standards – ESRS E3 to E5 – which cover Water and Marine Resources, Biodiversity and Ecosystems, and Resource Use and Circular Economy.

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All three of these standards should be interpreted in conjunction with the cross-cutting standards ESRS 1 and ESRS 2. As with other ESRS standards, these also follow a fixed structure, as we've discussed in earlier parts of our series. In this article, we'll focus on the "Disclosure Requirements" section of each standard.

ESRS E3 – Water and Marine Resources

This standard zeroes in on water and marine resources. While marine resources might not typically be a significant topic in our region, water itself can indeed be a crucial issue.

Disclosure requirements

DISCLOSURE REQUIREMENT	UNDERTAKING MUST DISCLOSE	PRACTICAL EXAMPLE
POLICIES	Policies related to managing water (and marine) resources, including goals and measures to minimize negative impacts on these resources.	A goal to reduce water consumption by 20% over the next five years. This policy might involve installing water-saving devices, recycling water in industrial processes, or educating employees about efficient water use.
ACTIONS AND RESOURCES	Actions and resources allocated to protect water and marine resources.	Investing in wastewater treatment technology that enables water reuse in industrial processes. Another initiative could be implementing a rainwater collection system for irrigating green spaces on company premises.
TARGETS	Targets for water resource management.	Reducing the volume of wastewater discharged into natural water bodies by 5% annually.
INDICATORS	Indicators related to water resource management, including water consumption and intensity of water resource use.	eporting data on total water consumption, amount of recycled water, and volume of wastewater released into the environment..
FINANCIAL IMPACTS	Financial impacts associated with water and marine resources, including costs for remediation and investments in technologies to reduce water consumption.	Investing CZK 10 million to modernize the wastewater treatment system, resulting in annual savings of CZK 500,000 due to reduced water consumption and lower wastewater disposal costs.

ESRS E4 – Biodiversity and Ecosystems

The ESRS E4 standard pertains to an undertaking's relationship with terrestrial, freshwater, and marine habitats, ecosystems, and populations of related animal and plant species – including diversity within species, between species, and ecosystems – and their interconnection with indigenous peoples and other affected communities. Beyond EU regulations, it references global frameworks like the Kunming-Montreal Global Biodiversity Framework.

Disclosure requirements

DISCLOSURE REQUIREMENT	UNDERTAKING MUST DISCLOSE	PRACTICAL EXAMPLE
POLICIES	Policies related to protecting biodiversity and ecosystems, including goals and measures to minimize negative impacts in these areas.	A commitment to protect and restore local ecosystems. This might involve actions like tree planting, wetland conservation, or establishing nature reserves around production facilities.
ACTION PLANS	Specific actions and resources allocated to protect biodiversity and ecosystems.	Restoring natural habitats such as revitalizing rivers or reforesting areas. Another initiative could be creating ecological corridors to allow wildlife to move freely between different natural habitats. The action plan should specify resources like funding and personnel dedicated to these projects.
TARGETS	Measurable, scientifically-based targets for biodiversity protection.	Aiming to increase the number of protected species on company-owned land by 10% over the next five years.

DISCLOSURE REQUIREMENT	UNDERTAKING MUST DISCLOSE	PRACTICAL EXAMPLE
INDICATORS*	Measuring and disclosing performance in biodiversity protection, including the number of protected species and the area of protected zones.	Reporting the number of protected species present on company lands, the total area designated as protected zones, and the success rates of ecosystem restoration projects.
FINANCIAL IMPACTS	Financial impacts associated with biodiversity protection, including costs for ecosystem conservation and restoration.	Investing EUR 500,000 in wetland restoration projects, which led to improved water quality and increased biodiversity in the area.

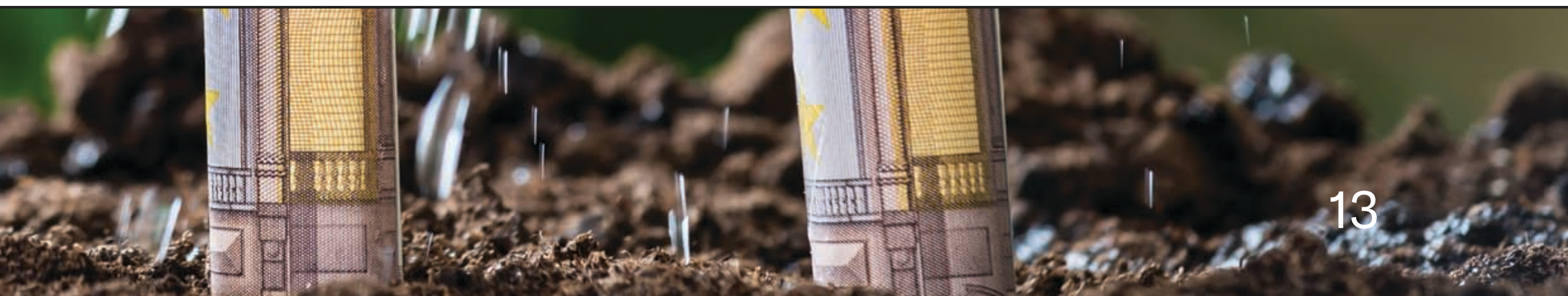
* For ESRS E4, setting biodiversity-related indicators is likely to be highly individual and may present the greatest challenge for undertakings. Accordingly, this standard allows for phased implementation of ESRS standard requirements under ESRS 2 provisions.

ESRS E5 – Resource use and circular economy

This standard essentially addresses three key areas: resource inputs, resource outputs, and waste. The aim of the circular economy is to maximize and preserve the value of technical and biological resources, products, and materials by creating a system that facilitates durability, optimal and repeated use, refurbishment, recycling, and nutrient cycling.

Disclosure requirements

DISCLOSURE REQUIREMENT	UNDERTAKING MUST DISCLOSE	PRACTICAL EXAMPLE
POLICIES	Policies related to resource use and the circular economy, including goals and measures to minimize negative environmental impacts..	Implementing a policy focused on reducing the consumption of non-renewable resources and promoting the regeneration of renewable resources. This could include measures like material recycling, using renewable raw materials, and waste minimization.
ACTION PLANS	A plan detailing specific actions and resources allocated to support the circular economy.	Initiating projects for waste recycling, establishing closed-loop production cycles, and encouraging ecological innovations. The action plan should specify resources like financial investment and personnel allocated to these initiatives.
TARGETS	Measurable, scientifically-based targets for resource use and the circular economy.	argeting a 20% reduction in the consumption of non-renewable raw materials over the next five years.
INDICATORS	Performance metrics in resource use and the circular economy, including the quantity of materials used and recycled.	Reporting the amount of raw materials consumed, the percentage of recycled materials used, and the success of projects supporting the circular economy.
FINANCIAL IMPACTS	Financial impacts associated with resource use and the circular economy, including costs for recycling and material recovery.	Facing a EUR 200,000 fine for non-compliance with waste recycling regulations due to insufficient sorting and processing, which led to negative environmental impacts. Subsequently, the company invested an additional EUR 300,000 to enhance its recycling processes and implement new technologies to ensure compliance and minimize future risks of sanctions.



From the requirements outlined in each standard, it's clear that they demand not only transparent and accurate reporting from undertakings but also encourage active engagement in environmental protection through innovative technologies and preventive measures. As with the ESRS E1 and ESRS E2 standards, involving experts in these areas will be absolutely crucial when preparing the sustainability report.

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Impressum

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