Tax & Legal

Taxes

Legal

World news

Case law

In brief

June 2019

Editorial

The legislators' idea to introduce a new reporting duty concerning tax-exempt income flowing abroad somehow reminded me of Sheldon Cooper in The Big Bang Theory. In one episode, he felt that two-person chess was not enough, and designed a three-person one, necessitating the addition of two new chess pieces – the serpent and the old woman. In the next scene, he is already playing the much improved version with many more characters and rules that, if written down, would be longer than an Airbus instruction manual. This is how the instructions on the new reporting duty would look like if they were to cover all aspects of reporting cross-border transactions that the legislators included in the reporting duty. And what is more, as at the deadline for the first-time filing, the forms' final electronic versions have not been made available, and everything works in a sort of temporary regime.

On another front, parallel battles befitting the Game of Thrones are taking place. While both the European parliamentary elections and the local skirmishes in many countries, including ours, may seem like common political scuffles, a lot is at stake behind the scenes. The topics out front conceal other – although at times quite clearly visible – issues. Among them are proposals that aim, with varying degrees of creativity, to change the tax rules, a topic that has resurfaced after years of lying dormant, and whose lack of substance is often compensated for by sheer populism. In the times ahead, we are thus likely to see many new Sheldonesque reports, and the related battles will be waged not just in Westeros.

In international trade, the situation has grown increasingly similar to Chernobyl: sudden outbursts of protectionist measures in various realms of the world are drastically changing the map of foreign trading. On one hand, some changes are to be expected – openness to the world clearly necessitates some reciprocity, otherwise it would not be sustainable in the long run. On the other hand, the evolution of business models is now driven by the crumbling of other pillars upon which business models have been based for decades. And this happens suddenly, without a warning or any time to prepare. And just like the consequences of the nuclear explosion could not be eliminated in a day, steps taken by some countries today are bound to affect foreign trade for a long time. After all, another Game of Thrones takes place here, and not just in Westeros; making the situation so complex that perhaps even Sheldon Cooper would find the rules hard to disentangle.

Jan Linhart
Partner
KPMG Czech Republic

Major changes to tax procedure rules ahead

The Ministry of Finance has released for intra-departmental comments an extensive amendment to the Tax Procedure Code. Its impressive 130 points will affect many old ways. For instance, the ministry proposes to change the system of charging interest, introduce a prepayment of a tax deduction, abolish the five-day sanction-free period for late filings of some tax returns, and extend the deadline for refunding excess deductions.

Jana Fuksová
jfuksova@kpmg.cz
+420 724 981 205

Karolína Tomsová
ktomsova@kpmg.cz
+420 222 123 854

The changes aim to allow for the implementation of MOJE daně, a simple and modern tax system, simplify inspection procedures and encourage electronic communication, thus reduce the administrative burden. The extent of changes is illustrated by the fact that the amendment is proposed to enter into effect no earlier than 6 months after its publishing.

A new regulation is also planned for tax information mailboxes. The ministry wants to motivate taxpayers to use electronic communication by making electronic filings more advantageous. The filing deadline for tax returns for annual taxation periods would automatically be extended by four months if filed electronically. And vice versa, electronically filed requests for a refund of tax overpayments would have to be resolved by administrators twice as fast – within 15 days, rather than the 30 days applicable for "paper" filings.

The amendment also reflects a number of recent ground-breaking court judgements. For instance, it proposes introducing prepayments for tax deductions. This would give tax administrators a tool to refund the parts of excess deductions that they have no intention to inspect. Upon initiating a tax inspection or a procedure to remove doubts, the tax administrator would have to consider whether the conditions for making such a prepayment have been met. On the other hand, the deadline for refunding excess deductions (typically of VAT) would be extended from today's 30 days to 45 days.

The ministry also proposes simplifying the tax administrators' inspection procedures. A personal hearing/discussion on the tax inspection report is to replace the delivery of a notice of termination of a tax inspection. Furthermore, if, after the amendment is passed, a tax administrator fails to call upon the taxpayer to file an additional tax return before initiating a tax inspection, this will not render the entire procedure unlawful; such a wrongly initiated tax inspection would retain all its effects, with the only difference that the taxpayer would not have to pay a penalty on the additionally assessed tax, if any.

Small entrepreneurs in particular will welcome the possibility of having another tax identification number assigned. They may apply for a change in their tax ID so that it no longer contains a general identifier comprising their birth certificate number, but instead a neutral number assigned by the tax administrator.

Fundamental changes are ahead for the entire system of interest charged both to taxpayers and tax administrators. The rate of late payment interest (interest on payment past due) is to be united with the civil law. The present repo +14% rate would thus decrease to repo +8%. The same interest rate is to apply to interest on incorrectly assessed tax (using the present terminology, interest on the tax administrator's unlawful procedure). Interest on postponed payments and interest on tax deductions should be reduced by half. And there will be yet another change to late payment interest, apart from the interest rate: the basis for calculating the late payment interest would no longer be taxpayer's total underpayment due to the tax administrator, but the tax due and unpaid or the amount due as a result of an incorrectly claimed deduction. Of the taxpayer's personal tax account, only those overpayments used to settle the underpayment will be taken into account. In practice, this means that the interest-bearing principal amount of an underpayment will, for instance, no longer be reduced by overpayments on other taxes that have then been refunded to the taxpayer.

The Ministry of Finance also intends to abolish the benevolent five-day sanction-free period for late filings of tax returns and tax payments. Late payment interest shall start to accrue already on the original due date. A late failing by up to five working days would only remain sanction-free for taxes with a taxation period shorter than one year, typically VAT, excise duties or gambling tax. According to the ministry, the sanction-free period of five days is a non-systemic exception which is only justified for taxes with short, 25-day deadlines for filing a tax return, where taxpayers may objectively have problems gathering necessary data.

The amendment, proposed by the Ministry of Finance, contains a number of controversial points. The proposal has now been released to other ministries and is likely to undergo changes before passing.

2019 VAT amendment: treatment of meal vouchers

In the March issue of Tax and Legal Update, we looked into whether meal vouchers meet the definition of a voucher for VAT purposes. The question of how to treat meal vouchers following the implementation of the Vouchers Directive in the amended VAT Act was answered by the Coordination Committee of the Chamber of Tax Advisors and the General Financial Directorate. What are the conclusions?

Petra Němcová
pnemcova@kpmg.cz
+420 222 123 781

Karolína Loucká
kloucka@kpmg.cz
+420 222 123 156

Kateřina Klepalová
kklepalova@kpmg.cz
+420 222 124 324

In the first paper, the GFD confirmed that meal vouchers are vouchers in the meaning of the VAT Act. The second paper gives more detailed guidance on how to treat meal vouchers: the VAT treatment will depend on whether they are single-purpose or multi-purpose vouchers. The paper concludes that in most cases, they will be multi-purpose vouchers, i.e. vouchers where the tax rate or the place of supply is not known at the time of their issue. Yet, it is also possible that the contractual conditions of some meal vouchers will make them single-purpose vouchers. The paper assumes that meal vouchers are transferred from their issuers to employers, and subsequently to employees, for consideration. How will the treatment of a single-purpose meal voucher differ from the multi-purpose one?

For VAT purposes, the transfer of a single-purpose voucher shall be treated as a supply of goods or services covered by the voucher. The company issuing the single-purpose meal vouchers will pay VAT on the amount of the voucher, including any commission charged to the customer (usually an employer), immediately at the point of their transfer to the employer. For catering services, the meal voucher including the commission paid by the employer will be subject to 15% VAT. The employers receiving and subsequently distributing the meal vouchers to employees for consideration shall pay the output VAT and shall have full entitlement to VAT deduction on the supply received (the amount of the meal vouchers and the commission). The intermediary’s commission charged by the issuer of the meal vouchers to their partners with whom the meal vouchers are used will be subject to a standard 21% VAT rate.

For multi-purpose vouchers, VAT shall only be paid at the time when the meal voucher is used by the employee. The tax base shall be the nominal amount given in the meal voucher, regardless of the amount of payment received from the employee. The commission charged to the employer and to the business partners will be subject to a standard 21% VAT rate.

As the issue and redemption of multi-purpose meal vouchers is outside the scope of VAT, a question has arisen whether the meal vouchers’ issuer will have the full entitlement to VAT deduction on these supplies. The paper concluded that the issuer indeed is entitled to VAT deduction in the full amount, on all direct and indirect costs connected with the issue, as well as the distribution or redemption of multi-purpose meal vouchers.

Employers who provide meal vouchers to their employees should therefore view them as vouchers and be careful about their VAT treatment.

Pitfalls of quick fixes: proving transport and chain transactions

In the May issue of Tax and Legal Update, we covered the first two changes arising from the draft 2020 amendment to the VAT Act. The amendment also contains important changes as regards proving transport to another member state and chain transactions.

Tomáš Havel
thavel@kpmg.cz
+420 222 123 615

Petra Němcová
pnemcova@kpmg.cz
+420 222 123 781

Marcela Hýnarová
mhynarova@kpmg.cz
+420 222 123 163

What do quick fixes in this area mean, what are their pitfalls, and how to prepare for them?

Proving transport to another member state

The issue of proving transport to another member state involves the most extensive and at the same time most complex changes. From 2020, a rebuttable presumption shall apply that transport has been proven if the person claiming the tax exemption has documents at their disposal as requested by the implementing regulation to the EU VAT Directive. For the purpose of the regulation, documents may be divided into two groups: A documents, directly related to the dispatch or transportation of goods, and B documents, comprising other supporting documentation.

A documents include, e.g., signed CMR documents or consignment notes, and invoices from the goods' carrier. B documents include official documents issued by a public authority confirming the arrival of the goods or receipts issued by a warehouse keeper.

Different numbers of documents will be required for sellers arranging the transport themselves (or for their account), and sellers leaving the transport up to the buyer. Where transport is arranged by the seller (or for the seller's account), two A documents or a combination of A and B documents must be submitted to prove it, whereas the submission of two B documents will not suffice. In any case, the two documents must not be contradictory and must have been issued by separate, independent parties. At the same time, their issuers must not be dependent on the seller or the buyer. The independence aspect in particular raises questions.

Where transport is arranged by the buyer (or for the buyer's account), the seller must also have (in addition to the above described documents) the buyer's written statement containing all prescribed essentials.

Chain transactions

A chain transaction is a transaction in which the right to dispose of the goods as its owner is transferred at least twice within a single transportation of goods. While the regulation of chain transactions is currently within the competence of individual member states, the rules have become quite unified, based on the case law established by the Court of Justice of the EU. The CJEU repeatedly adjudicated that in a chain of transactions, transport shall only be assigned to one supply. The situation is particularly problematic where the transport is arranged for by a middle party in the chain.

This issue has now been addressed by the new regulation. If transport is arranged by a middle party, the transport shall be assigned primarily to the first supply (from the seller to the middle party). Only if the middle party has communicated to the seller a VAT identification number issued to it by the state from which the goods are dispatched, the transportation shall be assigned to the second supply (from the middle party).

TACR announcing TREND support programme, project applications accepted until 11 July

On 15 May 2019, the Technology Agency of the Czech Republic (TACR) announced the first call under the TREND programme supporting industrial research and experimental development. This is an opportunity mainly for projects focusing on the development of new technologies and materials increasing the level of automation and robotisation, and on the utilisation of digital technologies such as artificial intelligence or photonics.

Karin Stříbrská
kpmg@kpmg.cz

Kateřina Balabánová
katerinabalabanova@kpmg.cz
+420 541 421 394

Project proposals are accepted from 16 May to 11 July 2019. Work on the projects should commence between 1 January and 1 April 2020, the maximum duration of the project should not exceed 60 months. The percentage of support depends on the size of the business, while for large enterprises, it is between 25% and 65% of eligible costs. The maximum amount of support is CZK 70 million per project. Eligible costs include namely operating costs, which are further divided into direct (wages, services of a research nature, etc.), and other indirect costs.

Project outputs must be in one of the defined forms:

- industrial design,
- applied design/a utility model,
- a prototype,
- a functional sample,
- software,
- a pilot plant,
- verified technology,
- other.

Preferential treatment for Industry 4.0 and regions

The programme supports projects regardless of the place of their implementation, meaning that support is also available to Prague entities. Businesses may file up to four project proposals, and may apply alone or in collaboration with other businesses or research organisations. Projects from Industry 4.0 and selected automotive areas are treated preferentially. The programme also gives preference to projects in structurally affected regions – Ústí nad Labem, Karlovy Vary or Moravian-Silesian region. The call for proposals stipulates a number of other parameters and conditions. We will be happy to discuss the individual criteria of your project and help you prepare a project application.

CNB to crack down on sales of bonds to non-professional clients

The Czech National Bank (CNB) issued Supervisory Benchmark No. 2/2019 on acquisitions of investment instruments by clients or investment funds, tightening the rules of acquiring complex investment instruments (namely corporate bonds) by so-called non-professional clients. The CNB is thus responding to the increasingly common practice of small and medium-sized enterprises and recently also start-ups that raise funds by issuing debt instruments that are very often acquired by non-professional clients.

Iva Baranová
kpmg@kpmg.cz

Kristýna Tupá
kristynatupa@kpmg.cz
+420 222 124 362

One of the problems the CNB identified was the inadequate pricing of the offered investment instruments. Quite often, they are priced at fair value, which is determined based on the prices at which identical assets and liabilities are traded in active markets. Yet, debt securities offered by many start-ups are in fact not traded.

According to the CNB, the risk associated with the offered investment instruments is not adequately classified either. The target market setting should always also reflect any additional factors affecting the non-professional clients' ability to assess risks (such as age, health, marital status, etc.). All information obtained then has to be assessed in a structured and logical manner to prevent offering unsuitable instruments.

When providing services that are subject to a proportionality test, securities brokers have the primary responsibility to set up the platform so that the instruments are not distributed to clients not matching the risk profile. The CNB has explicitly stated that merely formal compliance with the requirement to apply the proportionality test does not suffice. If securities brokers have any doubts whether their platform is visited by clients with an adequate risk profile, they for prudential reasons should not offer the product at all. In the future, a system where a high number of clients refuses to provide information needed for the proportionality test will also not be considered having been properly setup.

Although viewed from a different perspective, the same topic was recently also on the agenda of the Ministry of Finance, which prepared a corporate bond scorecard. This scorecard is meant to help investors, mainly non-professional clients, in their initial assessment of the suitability and risk level of the respective issue and issuer. This is also bound to raise client awareness of these factors.

It seems that bond issues are currently under scrutiny by a number of institutions, even on the EU level. On the other hand: if this way of obtaining finances is to become a viable alternative to the traditional types of funding, the conditions of its utilisation have to be transparent. And any enlightenment in this respect is welcome.

EU Copyright Directive finally adopted

In mid-May, the EU directive regulating copyright in the digital single market was published in the European Union's Official Journal. The final and concrete extent of the new rights and duties will only be known once Czech legislators adopt the respective amendments to Czech laws. The directive sets the deadline for this at 7 June 2021.

Ondřej Vykoukal
kpmg@kpmg.cz

Both the negotiations and the approval of the final wording of the directive have been on the front pages of Czech and foreign newspapers more than once. Unfortunately, the heated and often escalated debate somewhat obscured the content itself, as much of the talk was about the most controversial Articles 11 and 13 (now 15 and 17). Yet in total, the directive contains 32 articles that cover many other aspects of copyright.

First dealt with are the new exceptions from copyright: research organisations and cultural heritage institutions will be allowed to make copies for the purpose of text and data mining. This has to be for scientific research purposes; commercial use or mining by commercial entities is not allowed under the directive.

Furthermore, the directive stipulates certain tools to provide for wider access to copyright-protected contents. If you have difficulties negotiating a licence to make a movie available on the internet, for instance within your internet TV, you should have the possibility to use the assistance of an impartial body or mediator. The directive also specifies that it is not possible to limit the use of digital copies of works of visual art whose term of protection has already expired: this provision will among others affect online digital galleries that show digital copies of famous works of visual art.

The directive also introduces measures to achieve a well-functioning marketplace for copyright: among others, mentioned Articles 15 and 17 regulating press publishers' rights concerning the online use of their content and the use of protected content by online content-sharing services. And these are not the only measures introduced by the directive in this area.

Member states shall ensure that authors and performers who provide the licence are entitled to receive appropriate and proportionate remuneration. It is unclear how this duty is to be reflected in Czech law: currently, a licence can already be provided free of charge or for consideration, and it is fully up to the contracting parties, what variant they choose and what remuneration they agree on. Member states shall also ensure that authors and performers receive, at least once a year, relevant and comprehensive information on the exploitation of their works and performances from the parties to whom they have licensed or transferred their rights. Of course, we just have to wait and see how this duty will be implemented in Czech law; but it is obvious that the users of the works and performances will face increased administrative duties in this respect.

May ECOFIN: digital taxation and changes to black list

At its May 2019 session, the Economic and Financial Affairs Council approved changes to the EU black list. Ministers also exchanged opinions on the taxation of the digital economy before the upcoming debate at the G20 summit in June.

Diana Marková
dmarkova@kpmg.cz
+420 222 124 306

Aneta Macháčková
anetamachackova@kpmg.cz
+420 222 123 747

EU member states have not yet agreed on a common approach to the digital tax setup. The European Commission therefore strongly recommended that a consensus be reached before the June G20 summit in Japan where the topic is to be debated at the OECD level. At the ECOFIN meeting in May, European finance ministers were trying to find a common standpoint.

The Czech government decided not to wait for a common EU approach and will introduce a 7% digital tax on selected internet services rendered in the territory of the Czech Republic. Placement of targeted advertising, use of multilateral digital interfaces, and sale of user data will be taxed under a law that will enter into effect in the middle of 2020, and is to be published soon. We recommend that companies that generate revenues by using the digital space and whose turnover exceeds EUR 750 million or who are a part of a group with such a turnover should be watching this area closely, and perhaps already approach us at this stage.

Barbados, Bermuda and Aruba no longer on black list

The EU black list is a list of non-cooperating tax jurisdictions kept by the European Union as a part of its effort to limit tax evasion and promote tax transparency and fair taxation. Since its introduction in December 2018, it has been revised continuously. At the moment, twelve jurisdictions remain on the blacklist: American Samoa, Belize, Dominica, Fiji, Guam, Marshall Islands, Oman, Samoa, Trinidad and Tobago, United Arab Emirates, American Virgin Islands, and Vanuatu.

At the ECOFIN meeting in May, the eighth revision of the black list took place, as a result of a monitoring process showing that ten jurisdictions had not delivered on their commitments within the stipulated deadline. Three states – Barbados, Bermuda, and Aruba – were taken from the black list. The list of non-cooperating jurisdictions will continue to be updated regularly. So far, the Czech Republic has not introduced any direct sanctions or measures in connection with the above blacklisting.

Assessing agent's dependence in the context of permanent establishment

The Supreme Administrative Court (SAC) has described the key defining features of a dependent agent for the purpose of assessing whether a permanent establishment of a foreign entity has started to exist in the Czech Republic. Among its conclusions, the SAC stated that the Commentaries on the OECD Model Tax Convention on Income and on Capital were an appropriate guideline for the interpretation of double tax treaties.

Hana Greiff
hcurikova@kpmg.cz
+420 222 123 590

Kristýna Körberová
kkorberova@kpmg.cz
+420 222 123 175

The case is a continuation of a dispute we wrote about in May of last year. At the heart of the dispute was the question of whether activities carried out by a Czech company (an agent) in the Czech Republic for a company tax-residing in Germany met the characteristics of a dependent agent's activity, therefore giving rise to a permanent establishment. The German company claimed that all its business activities were managed and carried out in Germany, and that the activities of the Czech company (the agent) were solely of a preparatory or auxiliary nature. Therefore, it believed that under the Income Tax Act and under the Double Tax Treaty between the Czech Republic and Germany, no permanent establishment had arisen in the Czech Republic. The tax administrator and the regional court disagreed, arguing that the extent of the matters arranged by the agent on behalf of the company was such that it in fact substituted the company's own activity. The judgement thus concluded that a permanent establishment had indeed arisen in the Czech Republic as a result of the dependent agent's activity.

The SAC disagreed with the regional court's opinion, citing the provisions of the applicable double tax treaty which explicitly state that one of the conditions qualifying a person as a dependent agent is that the same person not be an independent agent at the same time. In other words, the person shall be assessed as a dependent agent unless they are at the same time an independent agent. What are thus the defining features of an independent agent? According to the SAC, to answer this question, it is appropriate to refer to the Commentaries on the OECD Model Tax Convention, which the court identified as a suitable interpretation guideline. The only limitation of using the commentaries is that the wording of the specific double tax treaty must be identical with the model convention.

SAC held that an agent is independent if they are independent of the enterprise both legally and economically, and acting in the ordinary course of their business when acting on behalf of the enterprise. The court then elaborates on this definition, defining the following features to assess independence:

- The agent's activities are not subject to detailed instructions or comprehensive control by the enterprise.
- The entrepreneurial risk is borne by the enterprise, not the agent.
- The agent possesses special knowledge and skills (according to the SAC, this feature may indicate independence).
- The number of entities the agent represents, as according to the SAC, independence is less likely where an agent has been carrying out activities exclusively or almost exclusively for a single enterprise for a long time.
- Independence is not established if an agent carries activities instead of the enterprise which in economic

terms fall under the enterprise’s scope of activity.

Based on the above, the court concluded that, in the case in question, the activity carried out by the agent (the Czech company) for the foreign tax resident was an activity of “another independent agent” carrying out predominantly administrative tasks. The foreign tax resident’s permanent establishment in the Czech Republic therefore did not originate.

VAT refund also for irrecoverable receivables from non-payers?

In response to an older ruling of the Court of Justice of the EU (CJEU) in the Enzo Di Maura case (C-246/16), the amendment to the VAT Act effective from 1 April 2019 has extended the scope of VAT refund also for irrecoverable receivables from non-payers? where previously paid VAT can be corrected. In its recent judgement (C☒127/18) concerning A-PACK CZ, a Czech entity, the CJEU held that the regulation is still not sufficient, and that Czech law is contrary to the EU directive and fundamental principles of VAT.

Martin Krapinec
mkrapinec@kpmg.cz
+420 222 123 499

Petra Němcová
pnemcova@kpmg.cz
+420 222 123 781

Karolína Loucká
kloucka@kpmg.cz
+420 222 123 156

In the case of A-PACK CZ, the CJEU dealt with whether the provision of the Czech VAT Act that prevents correcting the tax base for irrecoverable receivables where the debtors have ceased to be VAT payers is contrary to the EU VAT directive.

A-PACK CZ demanded a refund of VAT on an irrecoverable debt from a debtor in insolvency. The Czech financial administration refused to refund the VAT, arguing that correction was not possible under Czech law as the customer had in the meantime ceased to be a VAT payer. The company appealed the decision and the case appeared before the Supreme Administrative Court. In a prejudicial question, the court referred to the CJEU to determine if the provision of the Czech VAT Act requiring the debtor to remain a VAT payer to allow a correction of the VAT was in accordance with the directive.

The CJEU held that the member states may limit the refunding of VAT on irrecoverable debts solely on the grounds of uncertainty as to their non-payment. The requirement that makes the correction to the tax base conditional upon the debtor not ceasing to be a VAT payer does not take account of such an uncertainty. On the contrary, the fact that the debtor has ceased to be a taxable person in the context of insolvency proceedings is evidence of the definitive nature of the non-payment. The CJEU thus concluded that the provisions of the Czech VAT Act are contrary to the directive: generally, it is not possible for a VAT payer in the position of creditor to be liable to pay VAT they did not receive from their customers.

Although the A-PACK case did not directly concern debtors – non-VAT payers, we believe that the above judgement has significant potential also for creditors (VAT payers) facing the insolvency of their customers that are end consumers and non-VAT payers; VAT corrections should be also possible in these cases. Czech legislation will now have to respond to the judgement, as the present law is clearly contrary to the directive.

Case law

Supreme Court: employee may be personally liable for invalid termination notice

With its latest judgment, the Supreme Court has opened the topic of employees' liability for damage caused by invalid termination notices. The court held that it sufficed that an invalid termination notice had been an important but not necessarily the only cause of the incurred damage.

Ladislav Karas
lkaras@kpmg.cz
+420 732 529 392

Kateřina Randlová
krandlova@kpmg.cz
+420 222 123 465

In the case before the court, a director of a company decided to make organisational changes, based on which she gave a notice of termination to an employee on the grounds of redundancy. The court then found the termination notice null and void. The employer had to compensate the employee for wages plus late payment interest and cost of court proceedings, amounting to more than one million Czech crowns. The employer decided to claim damage compensation from the director, on the grounds of her liability for the incurred damage.

The Supreme Court disagreed with the lower-degree courts that had held that there was no causal link between the director's purportedly unlawful conduct and the incurred damage. The lower degree courts had also argued that the director's fault could not be established as managerial decisions were not subject to judicial review. In contrast, the Supreme Court summarised that the preconditions for an employee's liability for damage consist of a breach of the employee's work duties, causality between the breach of duties and the occurrence of damage, and fault on the part of the employee.

As for causality, the Supreme Court held that the breach of working duties does not have to be the only cause of the incurred damage, as long as it is an important, substantial and considerable cause. In the case in question, causality had clearly been established, as, had the director not breached her working duties (had not given a termination notice contrary to the Labour Code), no damage would have occurred.

As for fault, the Supreme Court held that considering all circumstances of the case and the personal situation of the director (namely her education, and practical experience so far), she should and could have known that she was acting unlawfully and could cause damage to the employer by issuing the termination notice.

The Supreme Court has thus opened a way to employees' liability for damage caused by giving invalid termination notices, stating that it sufficed that the null and void termination notice was an important, while not necessarily the only, cause of the damage. Fault in the form of simple negligence (should and could have known) can be established almost always when legal regulations concerning the individual's work are breached. For sake of completeness, please note that for fault by negligence, employees' liability for damage is limited to 4.5 times their average monthly earnings.

Constitutional Court reversing the Supreme Court's opinion on employer's entitlement to a penalty under a non-compete clause

Less than half a year ago we wrote about a rather surprising Supreme Court ruling concerning the proportionality of a penalty under a non-compete clause. The case involved a sales director who had breached her obligation not to work for her former employer's competitors for one year after the termination of her employment. As her new employment had only lasted four days, according to the Supreme Court it had been just a negligible breach of duty, and demanding the penalty under the non-compete clause would be contrary to good morals. The Constitutional Court was of a different opinion, and disagreed with the Supreme Court's conclusion.

Barbora Cvinerová
bcvinerova@kpmg.cz
+420 733 591 361

Kateřina Randlová
krandlova@kpmg.cz
+420 222 123 465

By a non-compete clause, an employee undertakes to abstain from carrying out gainful activity that would be identical with their employer's scope of business or competing with it by its nature, for a certain time after the termination of their employment, however, for no longer than one year. For each month of observing the non-compete obligation, the employee is entitled to at least one half of their average earnings. It is also possible to agree that in the event of a breach of the clause, the employee will pay a contractual penalty.

The employer's right to demand a contractual penalty was recently challenged by the Supreme Court. Although the Labour Code stipulates no such condition, according to the court, the employer's entitlement to the penalty depends on the extent of the breach of the clause, and a four-day breach is not enough. According to the court, the employer should have addressed the situation by suing for damages or by invoking protection against unfair competition. This judgement considerably limited the practical use of a non-compete clause.

The case then appeared before the Constitutional Court. The court held that the Supreme Court's decision had been against the elementary principles of justice – namely the constitutional right to own property, the right to free enterprise, and the pacta sunt servanda principle. The court emphasised the purpose and meaning of the non-compete clause, which is to protect the employer against information being leaked to competitors. Therefore, in terms of the entitlement to the penalty, it was only relevant whether the former employee had breached their obligation not to carry out the competing activity, not the duration of such a breach. It was also irrelevant whether the employee did indeed use the protected information for the benefit of the competitor.

The Constitutional Court thus demonstrated a much better orientation in common practices – pointing out that sensitive information or know-how may be transferred within minutes. The court further noted that requiring the former employer to prove the actual abuse of information by the ex-employee as a prerequisite for successfully claiming damages was rather unrealistic.

The Constitutional Court's judgement cannot be generally applied to all situations. The Constitutional Court agreed with the Supreme Court that in some cases the amount of the contractual penalty may be reduced with respect to good morals. In the case in question, however, there was no reason for this, as the penalty was agreed upon in the same amount as the remuneration that the employee would have received for observing the obligation.

The case illustrates that even the highest judicial instance, the Supreme Court, may draw a conclusion that does not conform to the constitution, and it may be worthwhile not to give up and pursue all remedies available, including a constitutional complaint.

Time clocks, really? CJEU's decision on recording working hours and its effect on Czech employers

In the middle of May this year, the Court of Justice of the EU (CJEU) issued a judgment holding that member states must stipulate the employers' obligation to set up an objective, reliable and accessible system allowing to measure the duration of time worked each day for all workers. The response was turbulent and not just in Spain – reports of the duty to install a time clock at all workplaces also appeared in the Czech media. What are the real implications of the ruling for our legal environment?


Barbora Cvinerová
bcvinerova@kpmg.cz
+420 733 591 361


Kateřina Randlová
krandlova@kpmg.cz
+420 222 123 465

The CJEU reviewed the compliance of Spanish laws regulating the recording of working time with the respective articles of the EU Working Time Directive and the Charter of Fundamental Rights of the European Union. These stipulate an employee's right to a limitation on the maximum number of working hours and to daily and weekly rest periods. Yet, the Spanish labour code only stipulates an employer's duty to keep records of working time for hours worked overtime. Therefore, while it sets the maximum working hours and minimum rest periods, it does not allow to measure, in an objective and reliable manner, the number of hours worked by an employee, their distribution and the number of overtime hours worked. The court held that, in the absence of a system enabling to measure this, it cannot be guaranteed that the workers' rights to a maximum working hours and a minimum rest period are observed.

Many media called the ruling ground-breaking, stating that it imposed a new duty on employers to keep records of working time for all employees – even those who are not usually present at the employer's premises, such as sales representatives or employees working from home. However, such an interpretation is incorrect. Under the Czech Labour Code, employers are already obliged to keep records of hours worked, for all employees, even to a wider extent that the ruling implies.

Czech employers are obliged to mark in their records the beginning and end of a shift worked, overtime work, night work, as well as the time when the employee was on stand-by duty (on call) and the time when they actually worked. Employers have to meet this duty for all employees, without a difference. Employees have the right to inspect the records, and make copies at the employer's cost. If an employer fails to keep the records in the prescribed scope, they face a penalty by the Labour Inspection Office of up to CZK 400 000.

The Labour Code does not specify in what manner the records of working time are to be kept; that is fully up to the employer. Yet, whichever way they choose must be supportable and provide a clear view of whether, when, and to what extent the employee worked the stipulated working hours. In no way does the judgment imply a duty to reintroduce time clocks or another attendance system.

As for employees who do not spent their working time or its part at employers' premises, their collaboration in keeping proper records is necessary. The employer may therefore impose a duty on the employees to provide information on their hours worked, on regular basis. This, however, does not liberate the employer from the duty to keep records of time worked – its purpose is solely to obtain all necessary underlying information.

Therefore, the CJEU judgment should not have any significant impact in the Czech Republic. Yet, record-keeping of working time should not be underestimated by employers – observance of duties concerning working time is frequently targeted by labour inspections. Furthermore, the media coverage of the judgment has raised awareness of this duty on the part of employees and trade unions.

Case law

CJEU: fuel cards a financing tool?

The Court of Justice of the EU (CJEU) ruled in the case of Vega International (C-235/18), dealing with the taxation of purchases of fuel supplied to subsidiaries. Considering the nature of the service provided via fuel cards, the court concluded that the service is most similar to the granting of credit.

Tomáš Havel
thavel@kpmg.cz
+420 222 123 615

Dominik Kovář
dkovar@kpmg.cz
+420 222 124 821

Vega International, an Austrian transport company, arranged the purchases of fuel for its subsidiaries (in various EU member states) via fuel cards issued to the subsidiaries' drivers. The fuel was invoiced to Vega, which then charged these supplies to its subsidiaries with a 2% surcharge and local tax.

The CJEU adjudicated that the transaction did not involve the supply of goods to Vega, i.e. the transfer of the right to dispose of the fuel as its owner. The fuel was purchased from gas stations directly by the drivers (or the subsidiaries) themselves, who were free to choose the quality, quantity and type of fuel as well as the time of its purchase and its consumption. The CJEU thus concluded that through the fuel cards Vega had provided a simple tool to finance fuel purchases by the subsidiaries. Hence, the service was most akin to granting credit, and therefore exempt from VAT in individual EU member states. The CJEU thus confirmed the conclusions previously worded in the Auto Lease Holland case (C185/01) of 6 February 2003.

In light of the above, we recommend paying increased attention to this area.

CJEU: new interpretation of EU social security regulations

The Court of Justice of the European Union (CJEU) ruled in a case concerning a social security system applicable to seamen. The judgement may affect determining the applicable social security rules for workers resident in the EU but working outside the EU, with their employers being companies established in the EU.

Iva Krákorová
ikrakorova@kpmg.cz
+420 222 123 837

Mária Marhefková
mmarhefkova@kpmg.cz
+420 222 123 498

The CJEU recently dealt with the question of which social security legislation applied to a seaman, a Latvian national residing in Latvia employed as a steward by a company established in the Netherlands and working on board a vessel flying the flag of Bahamas, but at the time located in the German part of the North Sea continental shelf (C-631/17 of 8 May 2019).

The CJEU ruled that the relevant country in terms of social security is the country of the seaman's residence. Although in the case in question the court dealt with the specific situation of seamen, the ruling is likely to affect the determination of applicable social security systems for cross-border workers of other professions as well.

Up to now, the interpretations of social security regulations (old Regulation No.1408/71, on the application of social security schemes to employed persons) and existing case law indicated that the country relevant for determining the applicable social security system for the above described persons was the country where the employer was established. Yet, in the above judgment, the CJEU concluded that such an interpretation was at variance with new Regulation No. 883/2004, on the coordination of social security systems.

According to the CJEU, an employee resident in the EU who is employed by an employer established in the EU and working outside the EU should be subject to social security regulations of the country of his or her residence. This means that employers may be obliged to register for social security purposes in the country of their employees' residence if different from the country where the employer is established. This is a substantial change from the current interpretation of rules coordinating social security systems: up to now, employers were paying social security premiums for these employees in the employers' country of establishment. The new interpretation may be more demanding for the employers in terms of administration.

In brief

Latest News, June 2019

Last month’s tax and legal news in a few sentences.

Václav Baňka
vbanka@kpmg.cz
+420 222 123 505

Lenka Fialková
lfialkova@kpmg.cz
+420 222 123 536

HOME NEWS IN BRIEF

- The Government approved the ‘rate package’ regulating the taxation of tobacco products, spirits and gambling effective 1 January 2020. The package also changes the method of calculating insurers’ technical provisions to provide more objective criteria for tax purposes. Beyond the scope of what was originally proposed, the amendment stipulates the taxation of interest income from ‘crown bonds’ issued before 1 January 2013, exempts certain landscape elements (such as groves) that may help to fight draught from tax, and increases the administrative fees for entering ownership titles in the real estate register.

- Various forms of sector tax are being discussed, including, for instance, a progressive tax on assets of up to 0.3% for assets exceeding CZK 300 billion, or a contribution to the National Development Fund in a so far unspecified amount.

- For external comments, the Ministry of Finance has released a proposed amendment to the ‘valuation decree’, responding, among other things, to the long-term problems of forest owners struggling with the bark beetle and going hand in hand with the government’s other measures to fight the bark beetle calamity.

- On its website, the General Financial Directorate has published information for taxpayers on filing the notice under Section 38da of the Income Tax Act.

- For external comments, the Ministry of Finance has released a bill transposing Council Directive (EU) 2017/1852 of 10 October 2017. The bill concerns tax dispute resolution mechanisms in the European Union (DRM), and regulates relations with other states with whom double tax treaties have been concluded.

WORLD NEWS IN BRIEF

- Apart from digital taxation and changes to the black list, covered in a separate article, ECOFIN also dealt with legislative proposals on excise duties. The directive on an excise duty on alcohol, intended to introduce to the EU legislation the possibility of exempt home distillation, did not pass. According to the Ministry of Finance, the Czech Republic did not support the proposal. Following that, a directive stipulating general rules of excise duties also did not pass.

- Through a referendum, Switzerland adopted a tax reform to transform its tax system so that the country would not be put on the EU black list of non-cooperating tax jurisdictions. Currently, the country is on a grey list. The changes are to enter into effect in January 2020.

- The Czech Ministry of Finance published information on reclaiming Austrian withholding tax in the context of the double tax treaty between the Czech Republic and Austria. It says that Austria has introduced a web-based procedure for reclaiming withholding tax, which also applies to refunds of tax collected contrary to the double tax treaty between the two countries.

- The French senate has passed a law introducing a 3% tax on income from digital services. The law limits the application of the tax to fiscal years 2019, 2020, and 2021, on the assumption that by the end of 2021 at the latest, consensus will be reached at the EU or OECD level.

- Upwards of 129 OECD/G20 member states including the BEPS platform have adopted the Programme of Work containing steps to develop a consensus solution to the taxation of multinational corporations. The document will be presented at the meeting of the G20 finance ministers on 8 June in Japan. It contains two pillars: the first pillar deals with the nexus, i.e. where and on what base the tax should be paid; the second pillar deals with designing a system for the taxation of multinational enterprises operating in the digital economy.

[LinkedIn](https://www.linkedin.com) | [Twitter](https://twitter.com) | [Facebook](https://www.facebook.com) | [Instagram](https://www.instagram.com)

www.kpmg.cz
Tel.: +420 222 123 111