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NEWS ALERT MAY 2011
CORPORATE LAW/VAT/LABOR LAW

A decision on the payment of a profit share or a dividend may be passed only 6 months after the end of the fiscal year, i.e. in most cases by 30 June.

Most businessmen associate the last day of June with the necessity to file an income tax return. However, less known is a newer condition stipulated by the judicature that applies to the payment of profit shares or a dividend, i.e. the duty to approve financial statements and decide on a profit distribution via a dividend payment, all within the same deadline.

Approval of the financial statements

The statutory bodies have the duty to ensure due bookkeeping[1], which means, i.e., also the preparation of financial statements by the end of the fiscal period[2]. The statement must be approved by the General Meeting within six months from the last day of the fiscal period,[3] i.e. usually by 30 of June of the following year.

Conditions for dividend payment

If the statutory requirements are met, a shareholder is entitled to a dividend. The amount thereof is determined by the General Meeting (sole shareholder) of the company depending on the achieved economic results shown in an ordinary (or extraordinary) financial statement.

The financial statements are not only the "instruments" serving to monitor filed income tax returns but they also provide a picture of the company's accounting to the shareholders who would wish to distribute the profit.

The necessity to decide by 30 June

In the Czech Supreme Court's opinion[4], an actual picture of the economic status of company may be provided by financial statements not older than six months. If the entrepreneur's fiscal period complies with a calendar year (which it does in most cases), therefore the decision on a profit distribution or a dividend payment must be made also by the end of June.

It is not possible to decide on a dividend payment:

- without financial statements , or
- after 6 months from the end of the fiscal year for which the financial statement (ordinary or extraordinary) has been prepared.

The dividend paid upon such defective decisions would have to be returned and the statutory bodies which granted their consent

[1] Provision of Section 135 and Section 192 of the Commercial Code ("**CommC**")

[2] Provision of Section 18 of the Accounting Act

[3] Provision of Section 128 CommC

[4] decision no. 29 CDO 4284/2007

for the payment would be liable to the companies for damage.[5]

Although the aforesaid resolution of the Supreme Court was issued in connection with insolvency proceedings and several more arguments could be found against such narrow interpretation, the decision should be respected. Therefore, it is necessary to state 30 June as the ultimate date of the resolution in the minutes of the meeting held by the respective body which decides on the dividend payment.

Another negative impact of the aforesaid ruling is the Supreme Court`s opinion that the payment of "retained earnings" is also subject to (ordinary or extraordinary) financial statements not older than 6 months.

Appointment of a statutory auditor

The companies who have the duty to have their financial statements certified by an auditor also have to remember that the auditor must be appointed by the company's General Meeting (or, in exceptional cases, the Supervisory Board)[6]. When approving financial statements for 2010, we recommend having an auditor also appointed for the upcoming fiscal years.

Filing the financial statements with the Collection of Deeds

Entrepreneurs registered in the Commercial Register must file their financial statements with the Collection of Deeds.[7] However, this duty is often (even intentionally) omitted. The registration court may request the entrepreneur to file the statements; should he/she fail to do so, he/she may be sanctioned up to CZK 20,000.00, even repeatedly. We have recently noticed intensified inspections of the mandatory filing of documents (i.e. financial statements or annual reports); therefore, we recommend filing or at least have the financial statements ready for filing in the near future.

Liability for unpaid tax (Section 109 VAT Act)

As of 1 April 2011, a bill amending the VAT Act has come into effect. The bill was originally intended to come into effect as of 1 January 2011; however, given some delay in the passage in the Parliament, the effect was postponed by three months. The amendment contains several material changes that will affect all VAT payers; it namely attempts to deal with VAT evasion.

A new section has been added to the VAT Act under which a VAT payer who receives a taxable payment is liable for the VAT payment by the supplier to the tax collecting authority, provided that he/she knew or could or should have known that:

- the payment provider intentionally fails to pay the tax,
- the payment provider intentionally gets itself into a position where the tax cannot be paid,
- the tax is intentionally reduced or a tax advantage is elicited.

The payer is also liable for unpaid tax if the payment of a supply is obviously different from the standard price and there is no economic ground for such difference.
The fact that the customer duly paid for the supplier's performance including VAT does not affect the customer's liability. Therefore,

[5] Provision of Section 123 ss. 4 and Section 179 CommC
[6] Provision of Section 17 of Auditors' Act no. 93/2009 Coll.
[7] Provision of Section 38i CommC

the customer may have to pay the VAT from the supply twice if so requested by the tax administrator. In commercial litigation, the customer may subsequently claim such receivable from the supplier.

The aim of the reform was i.a., to prevent VAT evasions. Simply speaking, this is a situation where the goods are sold to the end customer by a dummy company who duly charges the end customer for the goods, files a tax return but does not pay the VAT stated therein. The end customer has a due tax receipt available and nothing prevents him from claiming a tax deduction. It is impossible to contact the statutory representative of the mediator (often a foreign national who no longer resides in the Czech Republic) and the tax administrator has no chance whatsoever to collect the VAT due from him. Under the prior wording of the VAT Act, the end customers had nothing to worry about.

Nevertheless, the liability provision is not very precise in its wording and may be applied by the tax administrator practically in all cases where the supplier, for any reason whatsoever, fails to pay the VAT. In order for the tax administrator to apply the liability provision, it is sufficient to consider the terms and conditions for the application met thereof. This consideration may not even be based on an instigated criminal prosecution of the supplier's statutory representatives. If the customer assumes that he could not anticipate the supplier's intention not to pay the VAT, the customer may appeal the invitation to pay the due VAT. The appeal has a deferring effect. However, the dispute would probably be decided by the Regional Court with which the customer may file an administrative complaint in case that his appeal is dismissed. The tax administrator must prove before the court that the terms and conditions of the liability application were ultimately met.

I order to improve the situation of the customer, Section 109a has o been added to the VAT Act, which enables the customer to avoid the liability by effecting the VAT payment from the received performance directly to the supplier's tax administrator. However, this option is also rather problematic – if the customer does pay the VAT on behalf of the supplier, he is thus not relieved of the duty to pay the total amount of the claim including VAT to the supplier. For example, in order for the customer to set off the payment effected in favor of the tax administrator against its liability from the payment for a performance, the customer might have to make an agreement with the supplier in this respect or the terms and conditions allowing unilateral setoff must be met.

With respect to the facts mentioned above, we would like to recommend thorough consideration of contractual arrangements made with new unknown suppliers. Should you wish, we will review your existing contracts with your suppliers and suggest changes that would eliminate, to the maximum, any prospective impacts of the liability.

Opening of the labor market in Germany and Austria as of 1 May 2011

Since 1 May 2011, the transitional provisions restricting the nationals of the EU member states, i.e. Latvia, Lithuania, Estonia, Czech Republic, Slovakia, Poland, Slovenia and Hungary ("**EU-8**"), no longer apply to their employment in Austria and Germany. In practice, this means that the citizens of these states are no longer required to obtain a job

permit in order to perform gainful activity in Germany and Austria.

Practical aspects of employment of the EU-8 citizens in Germany

Even after the German labor market has opened, there are still approx. 60 professions that are subject to special regulations. In order to perform these professions, it is often necessary to obtain a certificate on the acknowledgment of qualification from the Czech Republic. The process of qualification acknowledgment commences by filing an application for qualification acknowledgment. No practical tests are required. These professions include e.g. architects, engineers, medical doctors, nurses, building site managers and teachers. The list of these professions is available on *www.anabin.de*. Advisory in the issues of qualification acknowledgment is provided by the Zentrale Auslands- und Fachvermittlung (ZAV) authority under the Federal Job Agency (see *www.zav.de/arbeiten-in-deutschland*).

Opening of the labor market does not mean an absolute liberation from any administrative processes. If an EU-8 citizen wishes to work in Germany, he/she must report the place of his/her residence at the respective registration office. The respective registration office passes the information of the person under registration to the foreign nationals' authority at the place of residence of the EU-8 citizen, which will issue a confirmation of the right to stay within German territory. The foreign nationals' authority may require that the EU-8 citizen duly documents the grounds of his/her stay, including the employment contract made with his/her German employer. Therefore, we recommend that the employee already submit the employment contract to the respective registration office upon reporting his/her place of residence.

Expiration of the transitional period also has an impact on an employee's secondment to Germany – here again, there is no need to obtain a job permit.

Parallel performance of an office of a statutory body and employment

In the past two decades, the judicature of the Czech courts has maintained the conclusion that the office of a statutory body in a company cannot be performed simultaneously with the performance of the same activity under an employment contract with the same company. Such employment contract would be null and void from the very beginning due to a conflict with the law. However, it is estimated that one third up to one half of the Czech companies still breach this law.

In its recent ruling, the Supreme Administrative Court of the Czech Republic further explained the issue, stating that a Managing Director of a limited liability company cannot, as an employee, retroactively seek to be granted a sickness benefit which was denied by the District Social Welfare Administration in the event that he/she has concluded an employment contract the subject matter of which is the same or a similar office of a statutory body (namely the Executive Director's office). The key issue is the actual contents of the job description, not the title or definition of the job position in the employment contract.

Although the Supreme Administrative Court was, in this case, dealing with a health insurance issue, it is possible to deduce a suitable procedure also in other areas, namely those concerning tax-related issues.

The Czech Ministry of Justice responded to the ruling of the Czech Supreme Court by drafting a bill, which would remove the existing status forcing business entities to evade the law in a manner which has been so far an established practice. The amendment to the Commercial Code would explicitly admit the parallel existence of both business and employment relations covering the same activities and allow managers to hold office in statutory bodies as well as in offices as senior employees of the company. However, the enactment thereof is uncertain as this is just the beginning of a long legislative procedure. Despite the fact that the effect of the draft bill cannot be retroactive, some state authorities declared that they have no intention to retroactively challenge employment contracts of those managers who functioned simultaneously in a statutory body of the same company.

Nevertheless, we recommend that the companies should not rely on the (legally unbinding) declarations of the authorities and on the intention of the Ministry of Justice. We still recommend to avoid employment contracts with statutory bodies (rather the contracts on the performance of a Managing Director). Otherwise, they may be exposed to the following risks:

a) the employment contracts may be considered null and void and, in the extreme case, the steps taken by virtue of a void employment contract might be challenged (e.g. the steps taken by a Managing Director as a CEO);

b) subject to challenge may be the participation of persons acting in the position of a statutory body in the health (joint-stock companies) and retirement insurance, as well as the claims arising (payment of sick benefits or inclusion of a retirement insurance period);

The amount of tax-deductable costs might also be challenged (this is important namely in the case of Boards of Directors of joint-stock companies, given the fact that the remuneration paid to the members of the Board of Directors is not income tax deductable, as opposed to the salary paid to employees or Managing Directors in limited liability companies).

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