

Tax, Legal & Business News

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Tax, legal, accounting, advisory and assurance newsletter

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Topic of the month

What are the differences in the non-competition clauses according to the labour code and commercial law?

A resolution of the Constitutional Court from January of this year on the violation of a commercial representation contract and its non-disclosure provisions started a discussion on non-competition clauses, their terms and usage. A non-competition clause can most often be found in employment contracts but can be concluded for other contractual types as well. For example, it protects the know-how, knowledge, experience or technological processes of a company from being released to the competition.

Non-competition clauses in employment contracts fall under the labour code, but some non-competition clauses are governed by commercial law. An example of the latter can be a clause contained in a commercial representation contract or an agreement on the exercise of the statutory body.

Non-competition clauses for employees are more strictly regulated and limit the contractual freedom of the parties. Under this clause, an employee agrees not to perform any gainful activity which would have been competitive against the employer for a maximum of one year.

On the other hand, a clause governed by commercial law should be accurately determined regarding the territory where it should be applied. Vague and broad clauses are regarded as disproportionately interfering with the right to freedom of enterprise according to the commercial law.

Another difference in these clauses is remuneration. An employee non-competitive clause must guarantee a monthly remuneration of at least half the average earnings of the employee. By contrast, compensation arrangements are not mandatory under non-competition clauses governed by commercial law.

However, a person concluding a non-competition clause according to the commercial law has the right to fair compensation and compensation for possible losses.

As regards the possibilities of termination, non-competition clauses governed by commercial law can be withdrawn on the basis of the reasons given by the law or on the basis of reasons that the parties have specifically enumerated in the clause.

Whereas in the case of employee non-competition clauses, the employer can withdraw from the clause only during the duration of the employment and the employee may terminate the non-competition clause if his employer did not pay the compensation or any part thereof within 15 days of its due date.

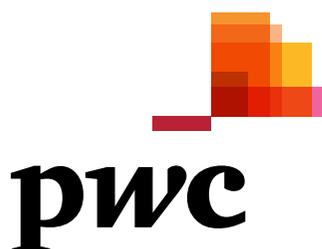
If the non-competition clause is breached, the employer can negotiate a reasonable contractual

penalty in addition to the compensation of any damage, whose quantification will be very difficult, if not impossible. By paying the penalty, however, the non-competition clause lapses for the employee without any further obligations.

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If you are interested in receiving Tax, Legal & Business News, please contact [Jan Keprta](mailto:Jan.Keprta@cz.pwc.com), jan.keprta@cz.pwc.com.

Tax

GFD specified the conditions for applying reduced VAT rate on medical devices

On 4 February 2013, the General Financial Directorate (GFD) issued a notification specifying the conditions for applying the reduced VAT rate on medical devices from 1 January 2013. This notification follows up on one from December from the Ministry of Finance regarding the VAT rate on medical devices. Further information can be found on the financial authorities' website [here](#).

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Do you classify your transactions for tax purposes correctly?

More sophisticated tax audits may be one of the responses to the report on Base Erosion and Profit Shifting (BEPS) published by the OECD in February 2013.

Transfer pricing, in particular the contractual allocation of risks and intangible assets, may be of special interest. The tax audit may focus on comparing the legal structure of intra-group transactions with the economic reality of such transactions.

The BEPS report also describes the effectiveness of measures to prevent

tax evasion and gives specific examples of tax planning aimed at tax evasion. The document is available on the OECD website [here](#).

The OECD should create an action plan for the tax administration on the basis of the above-mentioned report in June 2013. This plan should:

- specify the measures required to address BEPS,
- set down the specific deadlines, and
- identify the resources and methodology to implement the suggested measures.

The OECD report may be considered as a basis for fair tax planning. If you wish to discuss the details of this report and its potential impact on your business, please contact us.

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A new withholding tax rate established for residents of non-contractual states

From 1 January 2013, the withholding tax rate on income sourced in the Czech Republic is generally set at 35% for taxpayers deemed to be residents of a non-contractual state. Other taxpayers are subject to a 15% rate or a lower rate according to the relevant double tax treaty.

A non-contractual state is a state that is either not a member of the European Union or not part of the European Economic Area. It is also a state or jurisdiction with which the Czech Republic has not signed at least one of the following contracts (agreements): a double tax treaty, a tax information exchange agreement or a multilateral treaty in tax matters.

If a taxpayer is a resident of a contractual state, he is obliged to prove this fact, for example, with a valid identity card or an affirmation.

The fact that the taxpayer is a tax resident of the Czech Republic based on its place of abode or place of incorporation should be proved by a valid identity card for individuals, by entry in the appropriate public register for legal entities or by the affirmation that can be used instead.

Tax residency for the application

of the tax benefit resulting from the above-mentioned international treaties or agreements (e.g. a reduction in the withholding tax rate) shall be demonstrated in accordance with guideline D-286 of the Ministry of Finance. This involves:

- presentation of a certificate of the tax residency for the purposes of a specific international treaty
- statement that the entity is the beneficial owner of the income from the Czech Republic

The current valid data on taxpayers that is available in their databases can also be used to demonstrate tax residency. The taxpayer may request proof of other facts showing tax residency in case of doubt.

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New directive regulates exchange of information between Czech and foreign tax administrations

The European Union has released a Directive on administrative cooperation in the field of taxation which constitutes the legal basis for interstate information exchange between the Czech tax administration and the relevant

foreign authorities. The Directive is effective from 1 January 2013. In addition, it is supplemented by double taxation treaties and tax information exchange agreements (TIEAs).

The Czech tax administration has signed TIEAs with those countries with a low tax rate and strict bank secrecy (known as tax havens), so it can obtain banking and financial information about taxpayers from those jurisdictions. So far, the Czech Republic has signed TIEAs with these jurisdictions: the British Virgin Islands, Jersey, Bermuda, Isle of Man, Guernsey and the Republic of San Marino (agreements are valid), the Cayman Islands and Sint Maarten (agreements are signed).

Another instrument enabling the exchange of information is the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. In addition to the Czech Republic, it is signed by 40 other countries or jurisdictions. It has not yet been accepted by a number of tax havens and countries such as Luxembourg, Austria, Switzerland and Singapore. The Convention has been submitted to the Chamber of Deputies of the Czech Republic for a second reading; it is expected to be ratified in March 2013 and effective from 1 January 2014.

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BELOW IS AN OVERVIEW OF THE FORMS OF MUTUAL ASSISTANCE IN TAX MATTERS (SOURCE: OECD):

TYPE OF ASSISTANCE	MODELS*		INSTRUMENT
expressly mentioned or permitted in the treaties	Article 26 OECD and UN Model Tax Conventions	Model Agreement on Exchange of Information	Convention on Mutual Administrative Assistance in Tax Matters
Exchange of information on request	YES	YES	YES
Automatic exchange of information	YES	NO	YES
Spontaneous exchange of information	YES	NO	YES
Simultaneous tax examinations	YES	NO	YES
Tax examinations abroad	YES	JA	YES
Joint audits	permitted	NO	permitted
Industry wide exchange	permitted	NO	permitted
Assistance in tax collection	No (Article 27)	NO	YES

* Valid agreements in the Czech Republic are generally concluded on the basis of the model conventions, but it is necessary to verify their provisions under each concluded agreement.

Czech taxpayers should note the following:

- The statute of limitations is interrupted when the request for the exchange of information has been submitted and runs again once a response is received. The person whose income is subject to this request will not be notified about the fact that the tax administrations have started to exchange information (except in case of a witness hearing).
- There are restrictions on the provision of information which may be required from the taxpayers, such as if the provision of such information would reveal, inter alia, commercial or professional secrets. The obligation

to keep professional secrecy applies to the members of the Czech Chamber of Tax Advisors and the Czech Bar Association, and this also applies to client documents (including contracts, letters, etc.).

PwC regularly monitors the development in this area. We have practical experience with the application of double tax treaties and applications for the exchange of information. If you are interested in a consultation on your particular situation, please contact us.

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Employees

Authorities intensify checks on illegal employment

The authorities have intensified checks focused on the elimination of illegal employment. Coordinated checks are carried out by Labour Offices with the regional labour inspectorates in cooperation with the foreigner's police. They are focused on eliminating the so-called švarcsystém (the performance of dependant activities outside the employment relationship) practiced by Czech citizens as well as on the illegal performance of work by foreigners. The checks are also now consistently focusing on the legality of the employment of workers from EU countries which previously stood on the edge of the circle of interest. The main reason is the situation on the labour market and the increase in unemployment. In the case of foreigners from countries outside the EU, the inspectors are checking whether they are working under a valid work permit and whether they have a valid residence permit. Financial penalties for the illegal employment of foreigners can be very severe - up to CZK 10 million for legal entities.

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New tax credit approaching

The government introduced a draft law on the provision of child care in children's groups. Employees would newly be able to deduct a part of the expenditure incurred for preschool in the form of a tax credit on their income. The annual tax credit should be no more than the minimum wage for each child placed in an institution that takes care of preschool children, including children's groups.

Employers would be able to claim costs incurred in the provision of child care services for children of their employees as tax-deductible. Children's groups represent an alternative to the classic preschool. The number of children can be adjusted to the number of caregivers, available space or hygienic equipment, with up to 24 children in one children's group.

The aim of the amendments is to allow parents to maintain contact with their jobs thanks to the increase in the availability of child care services and to facilitate their participation in the labour market.

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Individuals renting immovable property must register for income tax

Individuals who receive income from renting an immovable property are obliged to register for income tax according to a new provision from January 2013. This obligation applies to Czech tax residents regarding rental income from both the Czech Republic and abroad. However, the financial authorities themselves do not yet have a clear opinion on how to proceed in respect of the taxpayers who have received the rental income in the past but did not register for income tax even though this income was subject to tax in their tax returns. A penalty of up to CZK 50,000 might apply for not fulfilling the registration obligation.

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**The Academy****New topics of open seminars in Prague and in Brno**

- **Accounting for provisions and impairment according to IFRS – 26 March 2013, Prague**

The seminar summarises the requirement of IAS 37 for the recognition and measurement of provisions. Practical examples show how the basic principle is applied; it means the existence of a current liability as the result of past events. The second half of seminar focuses on impairment testing of both tangible and intangible assets and goodwill according to IAS 36.

- **Consolidation - basics according to IFRS and difference to CZ GAAP – 16 April 2013, Prague**

Seminar is focused on consolidation of complex groups and accounting of changes in ownership of companies within groups during the year. You will gain knowledge of the implications of transactions under common control and of new and amended IFRS for consolidation - mainly IAS 28 and IFRS 10, which has the effective date of 1 January 2013.

- **Employment of foreigners and EU citizens – 15-16 April 2013, Brno**

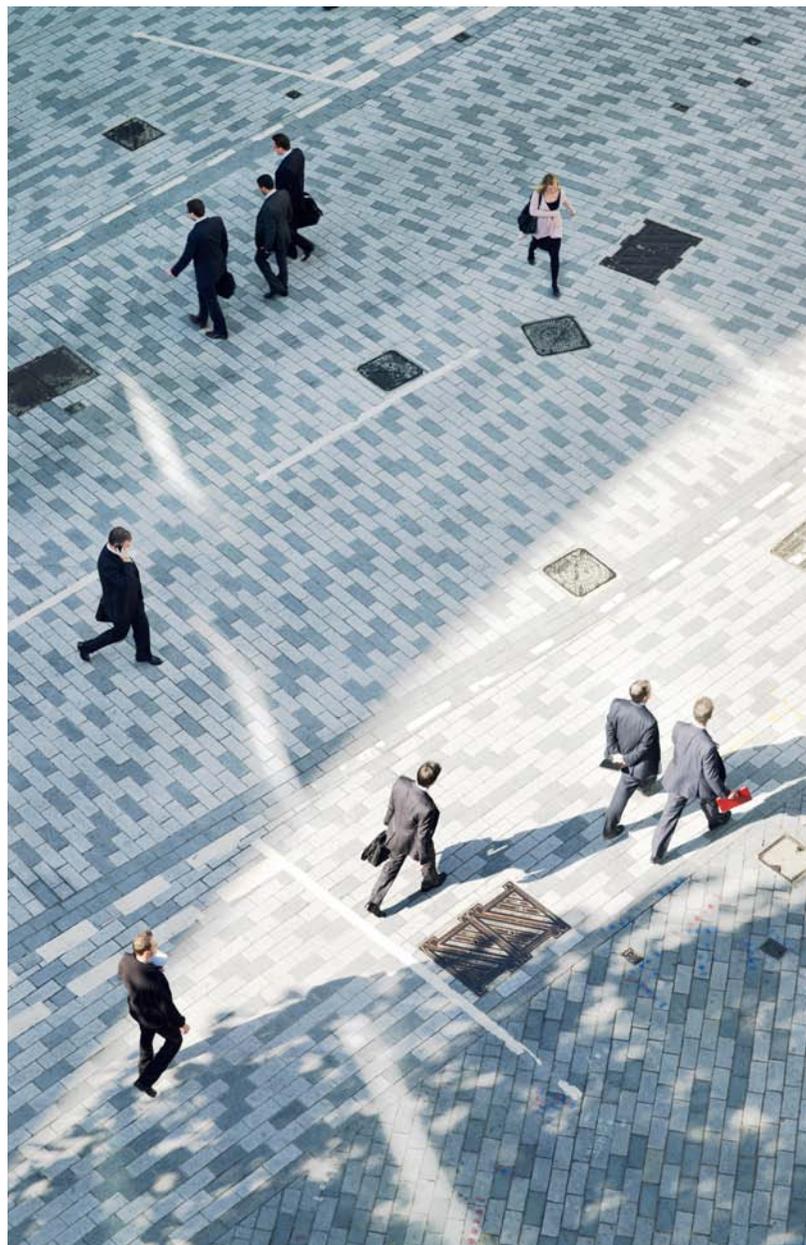
Our 2-days training will help you to be more familiar with the legislative changes in Foreigner's Stay Law, Law on Employment and Labour Code which became effective in years 2011 and 2012. Program is focused on practical exercises of all topics, so the participants will be able to handle all situations which may be raised when employing foreigners.

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How to reserve a place?

For more information and for registration, please fill in the registration form at www.pwc.cz/academy. Should you have any questions, please write an email to the.academy@cz.pwc.com or contact **Darie Šašková**, tel: +420 251 152 446.

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