LTA
LEGAL TAX AUDIT

- Payment of dividends in second half-year
- Criminal liability of legal entites
- Working hours of academic workers
- Tax implications of replacement of air-conditioning system

COMPREHENSIVE LEGAL, TAX, ACCOUNTING AND AUDIT SERVICES

NEWSLETTER
september 2019

PAYMENT OF DIVIDENDS IN SECOND HALF-YEAR

On 27 March 2019, the Supreme Court of the Czech Republic issued its decision no. 27 Cdo 3885/2017 which confirmed a turn in the then-applicable interpretation of the statutory time limit within which a general meeting of a company may adopt a decision to pay dividends. According to the new interpretation of the Supreme Court, annual financial statements drawn up for the prior accounting period may serve as a basis for distribution of profits until the end of the following accounting period.

Interpretation of this question has already seen several turns. The fact is that neither the old Commercial Code nor the current Act on Commercial Corporations set any time limit for the adoption of a decision to distribute dividends. It was therefore long assumed that since there is no specific statutory time limit to adopt such a decision, the decision may be adopted also in the second half of the following accounting period.

This interpretation took a surprising turn on 30 September 2009 when the Supreme Court issued its decision no. 29 Cdo 4284/2007. The Supreme Court argued that the statutory time limit of 6 months from the last day of the accounting period for the calling of an annual general meeting, which is set forth in Sec. 184a (1) of the Commercial Code, does not only prescribe before when the annual general meeting should approve the statements for the given accounting period, but also until when these statements are able to provide the annual general meeting with a realistic picture of the accounts of a joint-stock company which may serve as a basis for a qualified decision on distribution of profits. This interpretation meant that after the statutory time limit for the calling of a general meeting to approve the annual financial statements expired, the annual financial statements drawn up for the prior accounting period could not be used as a basis for the distribution of profits. As a result, companies adapted their practice and their general meetings adopted decisions to distribute profits only within the statutory time limit of 6 months from the end of the accounting period, since decisions adopted later could have been considered void. Managing directors or members of boards who would have decided to pay dividends on the basis of such decisions might have found themselves in breach of their statutory fiduciary duty and liable for any damage incurred by the company.

When the Commercial Code was replaced by the Act on Commercial Corporations on 1 January 2014, the prevailing opinion was that the approach of courts to the question of a statutory time limit to adopt a decision to distribute profits will remain unchanged, because the legislation itself also remained, at least visibly, unchanged. Under Sec. 181 (2) of the Act on Commercial Corporations, annual financial statements must be approved by the general meeting of a limited liability company within 6 months from the last day of the previous accounting period. The same provision is to be found in Sec. 403 (1) of the Act on Commercial Corporations for joint-stock companies. Companies were therefore rather careful and adhered to the statutory time limit of 6 months. This careful approach was confirmed by the High Court in Prague in its decision no. 14 Cmo 506/2015 issued as late as 22 March 2017. According to the court, a new institution of an advance payment on profits was supposed to be used in order to distribute profits in the second half of the accounting period.

However, the course changed again in 2017 and some in the legal community voiced na opinion that a turn in the official interpretation is to be expected soon. In that year, the second volume of the Commentary to the Act on Commercial Corporations was published, in which the authors claimed that even though the Act on Commercial Corporations does state that a share in profits shall be based on annual or extraordinary financial statements approved by the supreme body of the commercial corporation and that these financial statements must be approved within a certain statutory time limit, the current approach of the Supreme Court is no longer applicable. According to the authors, the reason was that the Act on Commercial Corporations – unlike

PAYMENT OF DIVIDENDS IN SECOND HALF-YEAR

the Commercial Code – sets an express requirement for an „insolvency test", which should be sufficient in order to achieve the goal pursued by the above decision of the Supreme Court, i.e. to prevent that dividends are paid to shareholders to the detriment of creditors.

Said insolvency test is to be found in Sec. 40 (1) of the Act on Commercial Corporations, according to which a company may not distribute profits or make other payments from the equity (or pay advances thereon) should it result in the company's insolvency as defined by the Insolvency Act. Insolvency, as defined by the Insolvency Act, has two possible forms – it is either a state of inability to pay debts as they fall due or a state when liabilities exceed assets.

However, this new interpretation was still a mere „opinion", despite being published by renowned authors, until confirmed by the above decision of the Supreme Court, in which the court basically used a word-by-word quote of the commentary. Moreover, it stated that from 1 January 2014, annual financial statements drawn up for the prior accounting period may serve as a basis for the distribution of profits until the end of the following accounting period.

It is worth noticing that even though this ruling concerned the lawfulness of distribution of profits, the disputed issue was not whether the 6-month period has been adhered to or not. The reasons provided by the Supreme Court to support its sudden change of heart are also interesting. The Supreme Court claimed that the reason was the „insolvency test" prescribed by the Act on Commercial Corporations, i.e. the express ban on payment of profits should it result in the company's insolvency. Is it supposed to mean that such a test was not necessary under the Commercial Code? From this point of view, the turn made by the Supreme Court might seem a bit forced. The positive result however is that annual financial statements drawn up for the prior accounting period may be used (without any material risk) as a basis for a decision on distribution of profits until the end of the following accounting period.

However, in complex or questionable cases, or should unusually high dividends be paid in the second half of the accounting period, it is still advisable to draw up interim financial statements reflecting the company's finances as of a more recent date. This will provide the management with a higher level of certainty that the conditions of the insolvency test have been satisfied.

Marek Demo
Attorney-at-law
marek.demo@LTApartners.com

CRIMINAL LIABILITY OF LEGAL ENTITIES

Criminal liability of legal entities was introduced into Czech law on 1 January 2012 when Act No. 418/2011 Sb. on Criminal Liability of Legal Entities and Proceedings against them (ZTOPO) became effective. This meant a departure from the until then applicable general principle that only natural persons are able to commit criminal offences. ZTOPO now makes prosecution and conviction of legal entities possible. Since it has been more than seven years since ZTOPO became effective and almost three years since its major revision in 2016, we would like to present you with the main principles of ZTOPO, the main trends in ZTOPO's application by prosecution and courts and last, but not least, with different strategies used to prevent criminal liability of legal entities (compliance programmes).

Criminal offence committed by a legal entity

Since legal entities are mere legal constructs, they do not have the actual capacity to directly commit an act violating the law. It is therefore construed that a legal entity is criminally liable when a criminal offence may be attributed to it. Attributability is one of the key requirements for the criminal liability of a legal entity. A criminal offence will be deemed to have been committed by a legal entity if it has been committed in the interest of the entity or in order to support its activities; it is not relevant whether it is ascertained or not which natural person committed the act. Offences which may be attributed to a legal entity are usually committed by governing bodies or their members or by senior personnel authorized to act on behalf of the legal entity or entrusted with management or supervisory responsibilities. Actions attributable to a legal entity may be committed also by a person outside the entity if such a person has a significant influence on the management of the entity and if the actions of such a person constitute at least one of the factors resulting in the criminal liability of the legal entity. Last, but not least, legal entity may also be found liable for the actions of its employees or other personnel carried out in the course of their work responsibilities.

A criminal offence will be attributed to a legal entity if the offence has been committed by actions of the entity's governing or other body or other persons or employees on the basis of a decision, approval or instruction of the entity's governing or other body, or because the governing or other body failed to adopt measures which they were legally obliged to adopt or which may reasonably be required of them, in particular if they neglected mandatory or necessary supervision of their employees or other personnel or failed to take measures to prevent or mitigate crime.

Concurrent liability of legal entity and natural person

ZTOPO is based on the principle of concurrent and mutually independent criminal liability of legal entities and natural persons. Criminal liability of a legal entity is not affected by the criminal liability of the natural person who committed the crime and vice versa. It is therefore quite usual that for a criminal offence committed for example by a sales director for the benefit of his/her company, both the sales director and the company may be prosecuted.

Criminal offences of legal entities

Selection of criminal offences which may be attributable to a legal entity is based on a principle that any criminal offence may be attributable to a legal entity with the exception of those included in an exhaustive list contained in Sec. 7 ZTOPO. The most frequent criminal offences attributed to legal entities are economic offences, such as subsidy fraud or breach of fiduciary duty. Prosecution of legal entities for fraud, credit fraud, blackmail, tax evasion, social security fraud or false accounting fraud is also quite common.

Release from criminal liability

ZTOPO allows for a release from criminal liability in its Sec. 8 (5) if the legal entity proves that it has made all efforts which may be reasonable required from it to prevent the criminal offence. According to a Methodology issued by the Supreme State Prosecutor's Office and to relevant court practice, the fact whether all reasonable efforts have been made will be assessed on a case-by-case basis. Prosecuting bodies must therefore correctly ascertain the facts of the case and deal with the question whether, in the specific situation of the case, the legal entity indeed made all reasonable efforts to prevent the crime. The question whether all measures and instruments which could have prevented the crime have been used, will be particularly important to assess the entity's criminal liability.

These measures and instruments should be specific and individual and should be made to fit the needs of the legal entity. A requirement of „all reasonable efforts" is assessed in particular with regard to the legal entity's „corporate culture". A corporate culture, whether laid down in writing or not, is the most important factor influencing whether legal and ethical norms are observed in a company. Corporate culture is reflected in the existence of instruments which mitigate the risk of breach of legal or other norms. These instruments include incorporation documents such as articles of association and by-laws, rules of procedure, staff regulations or delegations of authority. They however also include trainings, seminars, workshops or other events aimed at increasing the knowledge and skills of the entity's personnel. A powerful instrument may be a Code of Conduct which sets forth certain rules for the personnel of the legal entity. Adoption of an anti-corruption programme, either in the form of an internal directive or as a part of the Code of Conduct, is also helpful.

It is however necessary to point out that prosecuting bodies are not satisfied with the mere existence of such measures and instruments, but also assess to what extent they are used, implemented, enforced and revised. Therefore, should a legal entity wish to be released from criminal liability, it will not only have to prove that such instruments and measures exist, but also how that they are used, that their effect is regularly evaluated and that they are revised accordingly.

Compliance programmes

One of the most powerful instruments an entity may rely on to prevent its criminal liability is a „compliance programme" which presents a system of rules and principles serving to ensure that legal and ethical norms and internal regulations of the entity are observed by all personnel participating in the entity's activities. A compliance programme usually covers several areas and its criminal liability section usually contains a set of measures taken by the legal entity to prevent the entity's criminal liability. An efficient and well-designed compliance programme will not only increase the entity's chances to be released from criminal liability and prevent the risk of possible sanctions imposed by the state, but also protect the entity's reputation and prevent the risk of property and other damage. For the reasons above, we recommend that legal entities should adopt compliance programmes and include them in their internal corporate documents and that they should regularly evaluate and revise them.

Boris Brázdil
Attorney-at-law
boris.brazdil@LTApartners.com

WORKING HOURS OF ACADEMIC WORKERS

With the effect from 1 July 2019, an amendment to the University Act brought certain changes to the legal regulation of scheduling and tracking of working hours of academic workers. This change is similar to an already effective change introduced earlier for pedagogical workers.

Work schedules

The Labour Code states that working hours are scheduled by the employer who, among other things, sets the beginning and end of the worker's shift. This is both the employer's right and duty (except for employees who work outside the employer's workplace under Sec. 213 of the Labour Code). Breach of this duty may result in a penalty of up to CZK 2 million imposed by the labour inspection. Employees are required to be present at the workplace at the beginning of their shift and to only leave the workplace after the end of their shift.

The amendment reflects certain specifics of working hours of academic workers. Sec. § 70a of the Labour Code sets forth different categories of work carried out by academic workers. Under this provision, academic workers are required to be present at the workplace (or another agreed place) only for direct pedagogic work or should the employer specifically require so. Other activities, i.e. science, R&D, innovations or artistic or other creative activities, may be carried out at a time and at a place set by the employees themselves. Employers are not obliged to reimburse expenses incurred by employees who work outside the employer's workplace.

Tracking of working hours

The amendment also brings some changes into the regulation of tracking of working hours. Employer duties relating to the tracking of working hours are set forth in Sec. 96 of the Labour Code, under which employers are obliged to track the beginning and end of the employee's shift, overtime work, night work, standby duty and work carried out during standby duty. Breach of this duty constitutes an administrative offence for which the labour inspection may impose a sanction of up to CZK 400,000.

It is not prescribed how working hours should be tracked; employers may decide between electronic and paper databases according to their needs. A mere tracking of the employee's presence at the workplace does however not meet the statutory requirements for the tracking of working hours. The Supreme Court offered some views on the nature of such records in its decision no. 21 Cdo 1916/2004 from 5 November 2004; according to this decision, records should be transparent and must include several factors which play a role in the employee's remuneration and other claims. The amendment to the University Act states that employers are obliged to track only such part of the working hours which is scheduled by the employer (i.e. not by the academic workers themselves).

The amendment has managed to reflect the reality of academic environment where employees often carry out work outside the employer's workplace and to address certain points raised by the Council of Universities during its 6th meeting held in the 2018 – 2020 term (Resolution 6.6) concerning the duty to track working hours at universities.

Alice Mlýnková
Attorney-at-law
alice.mlynkova@LTApartners.com

TAX IMPLICATIONS OF REPLACEMENT OF AIR-CONDITIONING SYSTEM

The end of 2018 brought an interesting decision of the Supreme Administrative Court (3 Afs 229/2017) which, among other things, dealt with the recurring issue of classification of costs of replacement of air-conditioning and ventilation systems installed in a building. The case in question featured an administrative building acquired in 2005 which underwent renovation in 2009 which, among other things, included a complete replacement of air-conditioning and ventilation systems.

The tax administration considered air-conditioning and ventilation systems to be individual tangible assets and the costs or their replacement therefore treated as costs spent to acquire new tangible assets. The taxpayer was of a different opinion and claimed that the air-conditioning and ventilation systems are a part of the building which was renovated by their replacement.

The Supreme Administrative Court ruled on the following disputed points:

1. An interim provision in an amendment to the Income Tax Act applicable from 1 January 1995, which allowed for depreciation of individual movable assets (introduced by the 1995 amendment) as a part of a building until their disposal, does not apply as the tax payer bought the building in 2005. Due to the sale of the building, the building was „disposed of“ (by the seller of the building) in 2005 and the new owner must proceed in compliance with the new legislation.

2. The Supreme Administrative Court rejected the tax administration’s approach which was based on the perception that neither air-conditioning nor ventilation were present in the building at the moment of their replacement as the tax payer did not record them in its books (as separate movable assets). At the same time, the tax administration did not challenge the actual physical existence of the air-conditioning and ventilation systems in the building. In this context, the Supreme Administrative Court ruled (in compliance with

TAX IMPLICATIONS OF REPLACEMENT OF AIR-CONDITIONING SYSTEM

its older decisions) that the state of the books – albeit in conflict with the actual state – cannot be considered as „key evidence“ without which the tax payer cannot bear the burden of proof in the proceedings. In other words, the fact that the air-conditioning (ventilation) were not recorded as individual assets in the books does not mean that they did not exist.

3. Due to the disputed facts of the case, the Supreme Administrative Court also dealt with a question whether in this specific case, the (originally existing) air-conditioning and ventilation systems are individual movable assets or whether they qualify as a part of the building. In such a case, it is necessary to assess whether the technical parameters of the devices have been preserved (as had previously been ruled by a regional court). A similar dispute (air-conditioning as separate tangible asset vs. part of building) was addressed by the Supreme Administrative Court before, for example in 5 Afs 3/2010, in which the court ruled that the air-conditioning system was a part of the production plant.

4. The Supreme Administrative Court confirmed that replacement of original equipment by new equipment may qualify as repair when its functions are preserved – constituting thereby a „repair by replacement“.

The original decision of the regional court was therefore reversed, and the case returned to the court of first instance which subsequently cancelled the administrative decision and referred the case back to the tax administration for new proceedings.

Petr Benda
Tax advisor
petr.benda@LTApartners.com

LTA is a modern consultancy firm providing integrated legal, tax, accounting and auditing services.

The core principles of our business are professionalism, individual approach and transparent fee policy.

A member of mgiworldwide

LTA is a member of the international MGI Worldwide network, one of the 20 biggest networks of tax, auditing, accounting and consultancy firms. MGI Worldwide has over 5,000 specialists at more than 260 offices all over the world. Through MGI Worldwide, we provide qualified consultancy abroad and attend to cross-border transactions.

LTA
Anglická 140/20
120 00 Praha 2
Czech Republic
T. +420 246 089 010
F. +420 246 089 012
recepce@LTApartners.com
www.LTApartners.com