



# Doing business in the Czech Republic

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# Welcome to *Doing business in the Czech Republic*

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**Wherever you do business, we do business - and that includes the Czech Republic.**

At Ernst & Young we help clients earn the confidence of investors, better manage their risks, strengthen their controls, improve aspects of their business and increase their value. Our client work makes a difference for everyone who participates in capital markets, from the regulators who oversee them, to the people whose livelihoods and pensions depend on them, to investors everywhere. During 17 years of presence in the Czech Republic we have developed detailed knowledge of the local ever-changing business environment.

We have helped our clients succeed in every sector of the Czech economy and have advised on most of the country's major transactions. We currently provide services to 13 of the top 25 Czech companies and work with 3 of the 5 largest banks in the Czech Republic.

Now, we are ready to help you by sharing our knowledge of the Czech business environment.

This brochure is designed as an introduction to the Czech business environment. It provides an overview of key commercial legislation and answers many of the questions we most frequently hear from potential investors. However, it does not address the issues that are specific to your company or industry. We invite you to contact us to arrange a meeting so that we can tackle these issues with a detailed discussion of your plans for the Czech Republic.

We look forward to hearing from you and wish you success in your Czech ventures.

**Dirk Kroonen**  
Country Managing Partner, Ernst & Young



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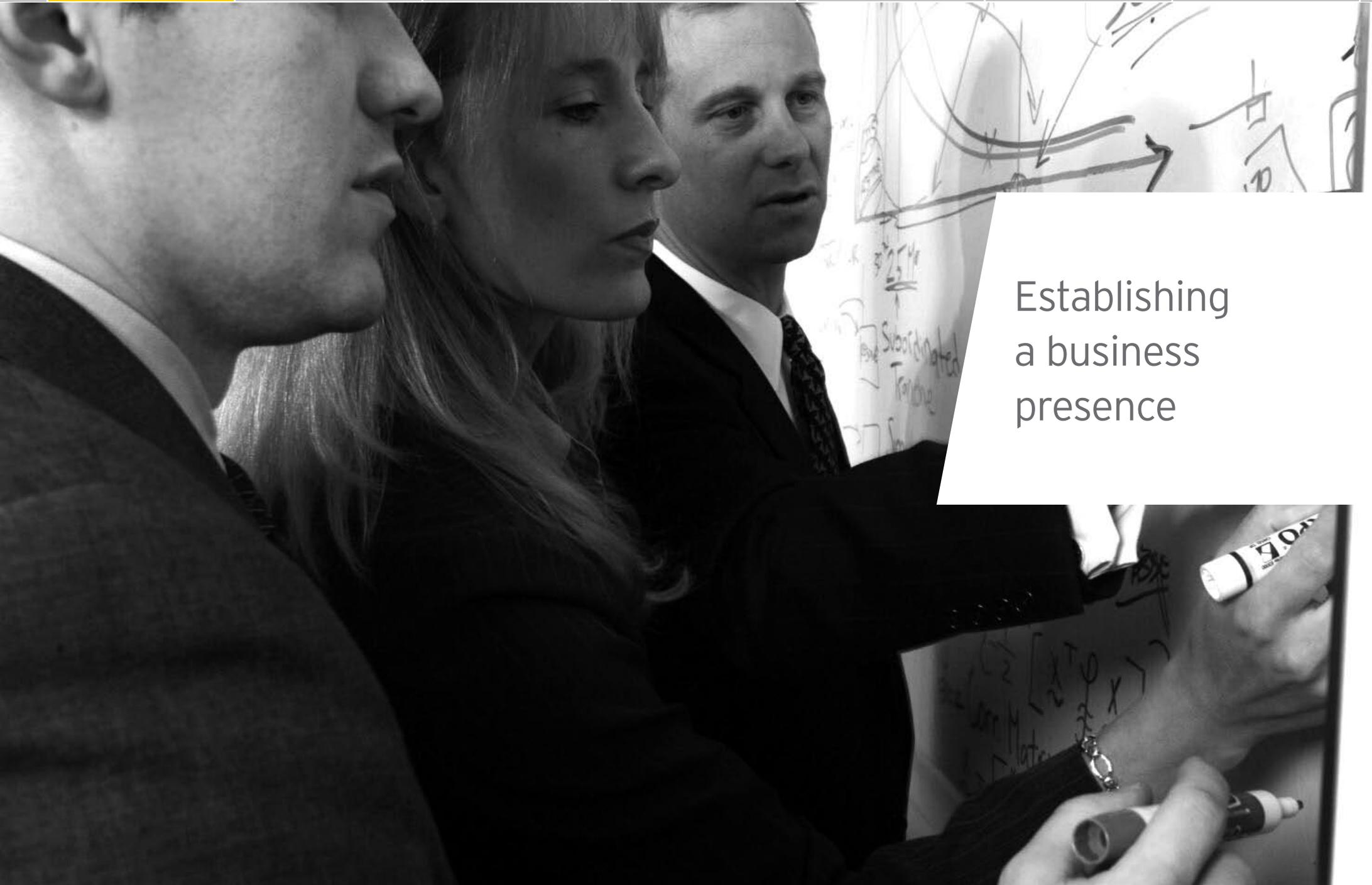
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## Establishing a business presence

# Establishing a business presence

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# Overview

The Czech Commercial Code and Civil Code specify the legal forms through which business may be conducted in the Czech Republic.

These are, in particular:

- ▶ branch
- ▶ joint-stock company
- ▶ limited liability company
- ▶ limited partnership
- ▶ unlimited partnership
- ▶ co-operative
- ▶ silent partnership
- ▶ unincorporated association
- ▶ sole proprietor (entrepreneur)

Under Czech law, of the forms listed above, only a joint-stock company, a limited liability company, a limited partnership, an unlimited partnership and a co-operative are considered to be legal entities.

Generally, there is no limit for the level of foreign participation in a Czech legal entity. Foreigners can establish both joint ventures and wholly-owned subsidiaries in the Czech Republic.

All of the above legal entities, as well as branches and foreign non-EU or non-EEA sole proprietors, need to be recorded in the Commercial Register



# Commercial registration

**As of 1 July 2005, registration proceedings in the Czech Republic have been significantly changed and standardized. Under the new legislation, applicants can fill in and submit standard forms to the relevant Commercial Register (registration court). The application must be accompanied by the documents specified by the legislation for each type of registration (e.g. registration of a new legal entity, change of the seat of a company, increase in registered capital). The new legislation also reduced the length of the registration process from several weeks or months to five working days. Applications may also be submitted electronically.**

To apply for entry in the Commercial Register, a Czech legal entity or branch of a foreign company must follow certain procedures:

- ▶ It must obtain a 'trade license' authorizing the entity to carry on business (a trade license must also be obtained by sole proprietors even if they are not required to register in the Commercial Register). For certain licenses, it must nominate an individual to hold the 'trade license'. The type of license and personal qualifications required are defined by the Trades Act. However, this requirement does not apply for most general licenses. In particular cases, special approval may be needed to carry on certain activities not governed by the above general trade-licensing regime. The affected industries include, among others, certain financial institutions (such as banks, securities dealers, insurance companies, investment funds, investment companies/mutual funds and pension funds), telecommunications, utilities, pharmaceuticals, broadcasting, gaming and employment mediation (recruitment, executive search, etc).
- ▶ One or more statutory representatives must be appointed. The statutory representative can be either a Czech national or foreign individual. Czech residency permits/visas are no longer required for foreign individuals to be registered in the Commercial Register as statutory representatives of Czech entities. The same person may act as both the trade license holder, if necessary, and statutory representative.

- ▶ If there are minimum capital requirements, a founding shareholder or a bank must be appointed as the administrator of contributions and must confirm that the required share capital has been paid up.
- ▶ Non-monetary capital contributions must be valued by an authorized appraiser.

The following supporting documentation is required:

- ▶ notarized copies of commercial registration or constitutional documents in the investor's home country
- ▶ for legal entities, a foundation deed (for a single shareholder) or articles / memorandum of association
- ▶ power of attorney for individuals handling the commercial registration process
- ▶ a lease contract or other approval from the owner of the Czech business premises that will constitute the registered seat of the entity
- ▶ Criminal Register extract (s) of the proposed members of the statutory and supervisory bodies of legal entities
- ▶ certain other documents depending on the circumstances.

If these documents are in a language other than Czech, they must be translated into Czech. Other requirements, e.g. notarization of signatures or an Apostille under the 1961 Hague Convention, may apply. The legal entity can commence business activities as soon as entry in the Commercial Register has been made.

# Commercial registration

## Collection of Documents

The business unit is required to file, from time to time, various documents in the Collection of Documents (part of the Commercial Register), including:

- ▶ the company's constitutional documents and any subsequent amendments
- ▶ resolutions on changes to the company's statutory bodies
- ▶ annual reports and financial statements (together with auditor's reports, if required)
- ▶ report on the relationship between related persons
- ▶ copies of resolutions on winding up the company
- ▶ details of any merger, transfer of assets, division or transformation, and related documents
- ▶ expert valuations related to non-monetary contributions and certain other cases
- ▶ any contracts on the transfer or lease of the enterprise, or part thereof
- ▶ contracts on the transfer or pledge of an ownership interest in a limited liability company
- ▶ control contracts; contracts on the transfer of profit
- ▶ certain other documents.

These documents are then publicly accessible by third parties.



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# Branch

**A branch is not a separate legal entity and, thus, any actions by the branch are actions of the entity registering the branch. A registered branch may generally undertake the same range of business activities as a Czech legal entity. However, certain types of business may be carried on only by a Czech legal entity.**

Entities establishing a branch must appoint an individual to act as the branch head. The head of the branch can either be a Czech national or a foreign individual. A Czech residency permit/visa is no longer required for a foreign individual to be registered in the Commercial Register as the head of a branch. The individual can sign and act on behalf of the founding entity in all matters related to the branch. A branch is not required to establish executive or supervisory boards.

A branch must keep a complete set of Czech double-entry accounting records in accordance with Czech accounting standards and the provisions of the Act on Accounting.

Branches are treated as 'non-resident' for the purposes of the Czech Foreign Exchange Act. They can conduct business in, and hold, either Czech crowns or any other currency. While non-resident, foreign companies with a Czech branch can acquire most types of real estate in the Czech Republic (excluding agricultural land and forests).



# Joint-stock company

A joint-stock company can be set up by two or more legal entities or individuals, or by a single legal entity. It can be established either by:

- ▶ the original founder (s) subscribing shares while complying with certain formalities, e.g. obtaining a notarial deed recording the establishment of the company, approving its by-laws, and appointing members of the company's statutory and supervisory bodies; or
- ▶ inviting other investors to subscribe shares, in which case a formal meeting of both the original founders and potential investors is required. The invitation to subscribe constitutes a public offer of securities that is subject to the requirements of the Securities Act, such as the publication of a prospectus approved by the Czech National Bank unless covered by an exemption.

## Share capital requirements

The minimum share capital requirement is CZK 2 million for companies set up without a public offer for share subscription, and CZK 20 million for companies set up with a public offer for share subscription, unless a higher minimum share capital is required by special acts.

The share capital must be fully subscribed before entry in the Commercial Register, with at least 30% of monetary contributions and 100% of non-monetary contributions paid-up.

A joint-stock company can issue either registered shares or bearer shares. The shares may be issued either in certificated or uncertificated (paperless) form.

Certificated registered shares are transferable by endorsement and delivery, the transfer taking effect upon the entry of the new owner in the company's shareholder list. Certificated bearer shares are freely transferable by delivery. For the transfer of uncertificated shares, registration in the Securities Register is required. The ability to transfer registered shares can be restricted by the company's Articles of Association. There is no minimum amount or other limitation on the par value of shares. A company's Articles of Association may enable employees of the company to acquire shares in the company under preferential conditions. If only a part of the issue price or purchase price for such shares is paid by the employees, the total of the unpaid parts of the price of all such shares cannot exceed 5% of the company's share capital.

Preference shares may be issued up to a maximum of 50% of the company's share capital. Non-voting preference shares may also be issued. The issue of interest-bearing shares whose yield is not related to the company's performance is not permitted.

As of 1 July 2005, a minority shareholders' squeeze-out procedure has been in existence. These newly introduced provisions allow a majority shareholder who has at least 90% of the target company's shares or votes in the target company to obtain full control over the target company by way of buying-out all the shares from the remaining minority shareholders for an adequate cash settlement without winding up the target company. The adequacy of the cash settlement to be paid to the minority shareholders must be reviewed and approved by the Czech National Bank prior to adoption of the resolution of the General Meeting on the squeeze-out. The majority shareholder is entitled to vote at the General Meeting. The whole amount of the cash settlement to be paid to the minority shareholders must be deposited with a bank or a securities broker on a special account prior to the General Meeting's decision on the squeeze-out.

# Joint-stock company

## Reserve fund

All joint-stock companies are required to establish a reserve fund. The reserve fund can be created on incorporation or, at the latest, in the company's first profitable year, when it must equal at least 20% of net profit, but not more than 10% of share capital. Subsequently, the fund must be increased annually by at least 5% of net profit up to the level specified in the company's Articles of Association, which cannot be less than 20% of the share capital. Additional details of the size and method of establishing the reserve fund can be set out in the Articles of Association. A reserve fund created on a mandatory basis may only be used for covering losses of the company.

## Management

The formal bodies of a joint-stock company are the general meeting, board of directors and supervisory board. An individual cannot simultaneously be a member of both the board of directors and the supervisory board.

## General Meeting

The general meeting is a joint-stock company's supreme body, which must be held at least annually no later than six months after the end of the company's financial year. If there is only one shareholder, it exercises the powers of the general meeting.

A simple majority is sufficient for most decisions, such as to elect and reappoint members of the board of directors and supervisory board, and to approve financial statements and profit allocations. However, a two-thirds majority of shares is required to amend the company's Articles of Association, to approve a debt equity swap or agreement on lease or a transfer of enterprise or its part, to issue convertible and preference bonds, or to dissolve the company by liquidation. A majority of two thirds of every type of shares outstanding is required to approve changes in share capital. A majority of three-quarters of the affected class of shares is needed to change the class, type, or underlying rights of shares, restrict the transferability of registered shares, or cease public trading of the shares. A majority of three quarters of shares is needed to eliminate or restrict pre-emptive rights to subscribe to new shares or convertible or preference bonds, to approve control and profit transfer agreements, to increase share capital through a non-monetary contribution, and to approve corporate reorganizations and sales, purchases and leases of an enterprise by the company or controlled companies.

## Board of directors

The board of directors is elected for a maximum of five years by the general meeting, unless the company's by-laws entrust this power to the supervisory board. The board must have at least three members who are either Czech nationals or foreign individuals. A Czech residency permit/visa is no

longer required for a foreign individual to be registered in the Commercial Register as a member of the board of directors. If there is only one shareholder, the board may have a single member.

The board oversees the day-to-day running of the company and is responsible for maintaining proper accounting and reporting procedures. Board members act and sign on behalf of the company, within the guidelines approved by the general meeting or stated in the Articles of Association.

## Supervisory board

A joint-stock company must have a supervisory board of at least three members, divisible by three, elected by the general meeting for a maximum of five years. If the company has more than 50 employees, at least one-third of the members must be elected by the employees. The board monitors the activities of the board of directors and the performance of the company, and reviews the financial statements and the proposed allocation of profit or compensation for loss.

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# Joint-stock company

## Distribution of profit

A shareholder's proportion of a company's profit which the general meeting has approved for distribution to shareholders is determined by the ratio of the nominal value of the shareholder's share(s) to the total of the nominal value of all shareholders' shares, unless stipulated otherwise in the Articles of Association in connection with priority shares.

## Winding up

A joint-stock company can be wound up:

- ▶ by resolution of the general meeting
- ▶ if the period for which it was established has expired
- ▶ if it has achieved the purpose for which it was set up
- ▶ by a court order
- ▶ in the event of bankruptcy; or
- ▶ in the event of a merger, division or transfer of property to a shareholder.

The company is dissolved at the moment when its entry in the Commercial Register is deleted.



# Limited liability company

Up to 50 individuals or legal entities (known as 'shareholders', 'members' or 'participants') can establish a limited liability company. The constitutional documents of a limited liability company are a Founder's Deed (where there is a single founding member) or a Memorandum of Association (where there are two or more founding members). Both documents must be drawn up in the form of a notarial deed. A single-member limited liability company may not be the sole founder or member of another limited liability company. One individual may be a single member of a maximum of three limited liability companies.

The liability of each of the members is limited to the total of the unpaid parts of all members' contributions to the registered capital as registered in the Commercial Register.

## Registered capital requirements

The minimum registered capital for a limited liability company is CZK 200,000, and each member is required to contribute at least CZK 20,000. At least 30% of each member's monetary contribution and all non-monetary contributions must be paid up before filing the application for entry in the Commercial Register. The minimum total value of the paid-up portion of all contributions must be CZK 100,000.

If a single member establishes a company, the registered capital must be fully paid-up before the company can be entered in the Commercial Register.

Unlike in the case of a joint-stock company, a member's participation in a limited liability company is represented by an aggregate of rights and obligations of the member known as an 'ownership interest', and no shares are issued by the company. The ownership interest is transferable, based on a special ownership interest transfer agreement. The ability of members to transfer the ownership interest to third parties (other than remaining members) must be specifically stipulated in the Founder's Deed/Memorandum of Association; the ability of members to transfer the ownership interest can be restricted by the company's Memorandum of Association. The ownership interest may also be subject to a pledge.

## Reserve fund

As with joint-stock companies, limited liability companies must establish reserves, which must be at least 10% of the registered capital. Details of the size and method of establishing the reserve fund must be set out in the Memorandum of Association. If the fund is not created on incorporation, it must be established in the company's first profitable year as a minimum of 10% of net profit, but not more than 5% of registered capital. Subsequently, the fund must be increased annually by at least 5% of net profit until the level specified in the Memorandum of Association is reached. This must be at least 10% of registered capital. A reserve fund created on a mandatory basis may only be used for covering losses of the company.

## Management General meeting

The general meeting is the supreme body of a limited liability company. It has rights similar to those of the general meeting of a joint-stock company and it must be held at least annually no later than six months after the end of the company's financial year. Again, if there is only one member, it exercises the powers of the general meeting.

# Limited liability company

## Statutory representatives (Executives)

The general meeting appoints one or more Executives, who can be either Czech nationals or foreign individuals. A Czech residency permit/visa is no longer required for a foreign individual to be registered in the Commercial Register as an Executive. No board of directors is required.

## Supervisory board

A supervisory board may be established for a limited liability company, but it is not mandatory. If established, it must have at least three members.

## Distribution of profit

A member's proportion of a company's profit which has been approved by the general meeting for distribution to members is determined by the ratio of a particular member's contribution to the company's registered capital, unless the Memorandum of Association stipulates otherwise.

## Winding up

A limited liability company can be wound up:

- ▶ if the period for which it was established has expired
- ▶ if it has achieved the purpose for which it was set up
- ▶ by a decision of the general meeting
- ▶ by a court order
- ▶ in the event of a merger, division or transfer of property to a shareholder
- ▶ in the event of bankruptcy; or
- ▶ for any other reason specified in the Memorandum of Association.

The company is dissolved at the moment when its entry in the Commercial Register is deleted.

# Partnership

**Two or more individuals or legal entities ('partners') can establish a limited or general partnership. The partners must draw up a partnership agreement.**

**Limited partnerships must have both a general and a limited partner. General partners are jointly and severally liable for the limited partnership's obligations, while the liability of limited partners is identical to the liability of members in a limited liability company. Each of the general partners can act on behalf of the limited partnership, unless the partnership agreement states otherwise. Each limited partner is required to make a contribution to the partnership's registered capital of at least CZK 5,000.**

In a general partnership, all partners are jointly and severally liable for the partnership's obligations. Partnership profits are shared equally unless otherwise specified in the partnership agreement. Any partner can act on behalf of the partnership unless otherwise stipulated. A Czech general partnership is a legal entity incorporated by its registration in the Commercial Register. There is no minimum capital requirement.

## Winding up

A partnership can be wound up:

- ▶ if the period for which it was established has expired
- ▶ by the withdrawal of a general partner, unless agreed otherwise by the remaining partners
- ▶ if it has achieved the purpose for which it was set up
- ▶ on a general partner's death, unless transfer to an heir has been agreed
- ▶ on dissolution of a general partner, unless transferred to a legal successor
- ▶ by the agreement of the partners
- ▶ by a court order
- ▶ in the event of bankruptcy of the partnership or any of the general partners, unless agreed otherwise by the remaining partners; or
- ▶ in other cases.

A partnership can also specify other reasons for winding up the partnership in its partnership agreement. A partnership is dissolved at the moment of its deletion from the Commercial Register.

# Other types of business entities

## Co-operative

A co-operative must have five or more individual members, or at least two members that are legal entities. Provided that these conditions are met, members may join or leave the co-operative without affecting its status. There is no maximum number of members.

The minimum initial capital is CZK 50,000. The members are not liable for the co-operative's obligations unless the co-operative's statutes state otherwise. When the co-operative is established, an 'indivisible fund' must be created equivalent to at least 10% of the registered capital. Subsequently, the fund must be increased annually by a minimum of 10% of net profit until the level set out in the co-operative's statutes is reached. This must be at least 50% of the registered capital.

The co-operative's supreme body is the members' meeting, which is held at least annually. It elects the board of directors to manage the day-to-day affairs of the co-operative and to act on its behalf, in accordance with decisions made during the members' meeting. The members' meeting also elects an audit commission to supervise the co-operative's activities and examine complaints by its members. Unless otherwise stated, a 'one member, one vote' system applies.

## Silent partnership

A silent partnership is established by a written contract between a silent partner and a Czech business, under which the silent partner invests in the Czech business in return for a share of profits. A silent partner can be either an individual or a legal entity. With the exception of immovable property or unless otherwise stated in the contract, the silent partner's investment becomes the property of the Czech business. Silent partners are only liable for losses to the extent of their original investment.

## Association

Two or more individuals or legal entities can establish an association, which is not considered to be a legal entity under Czech law. Members are jointly and severally liable for obligations arising from the association's activities. Profits and losses are shared equally unless the agreement specifies otherwise. Members may leave for cause at any time or without cause at a time which is not detrimental to other members.

## Sole proprietor (entrepreneur)

Individuals can carry on business activities in their own name on the basis of a valid trade license or other permission. In the case of a foreign non-EU or non-EEA individual, entry in the Commercial Register is also required.

## European Company (Societas Europaea)

Czech law has implemented European Council Regulation 2157/2001/EC, providing entrepreneurs with the option of forming a European Company, known formally by its Latin name 'Societas Europaea' (SE). An SE is able to operate on a European-wide basis.

Generally, an SE may be set up in one of four ways:

- ▶ by the merger of two or more existing public limited-liability companies from at least two different EU Member States ("Member States")
- ▶ by the formation of a holding company promoted by public or private limited-liability companies from at least two different Member States, or by public or private limited-liability companies having a subsidiary company governed by the law of another Member State for at least two years or having, for the same period, a branch in another Member State
- ▶ by the formation of a subsidiary of companies from at least two different Member States, or a subsidiary of companies having subsidiaries governed by the law of another Member State for at least two years or having, for the same period, a branch in another Member State
- ▶ by the transformation of a public limited-liability company which has had a subsidiary in another Member State for at least two years.

## Other types of business entities

An SE is a legal entity and its subscribed capital shall not be less than EUR 120,000.

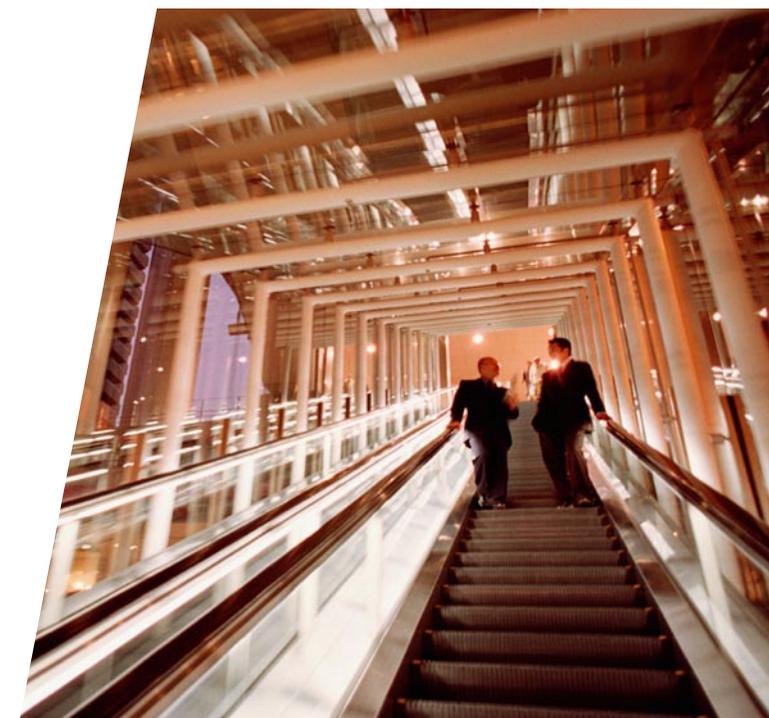
The capital shall be divided into shares, and a shareholder shall not be liable for more than the amount he has subscribed. The registered office of an SE shall be located within the EU in the same Member State as its head office. As a general rule, an SE shall be treated in Member States as if it were a public limited-liability company.

### European Economic Interest Grouping (EEIG)

In the European-wide context, it is also possible to establish a European Economic Interest Grouping. An EEIG is a legal instrument for promoting cooperation between European enterprises, particularly for SMEs wishing to participate in pan-European projects, and one of its main purposes is joint research and development.

An EEIG is an instrument for business which may be formed by persons from at least two Member States. It may not have as its primary purpose the making of profits, nor may it employ more than 500 employees. Such businesses are formed by an agreement on the formation of an EEIG. According to Czech law, groups registered in the Czech Commercial Register have a legal personality. An EEIG must comprise at least two companies, or two natural persons, or one company and one natural person, and shall be registered in the Member State in which it has its official address. No EEIG may initiate investment by the public. The members of an EEIG shall have unlimited joint and several liability for its debts.

The EEIG is a flexible and light structure which enables its members to interlink some of their economic activities while retaining their economic and legal independence. It can be used simply as a framework for coordinating and organizing its members' activities, and it can also conclude contracts in its own name and execute them.



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# Taxation

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# The tax system in the Czech Republic

The current tax system has been effective in the Czech Republic since 1 January 1993. It is broadly based on other systems in the EU and includes corporate and personal income tax and a standard VAT system. The regime is subject to frequent amendments, and significant changes were made as part of the Czech Republic's accession to the EU in May 2004.



# Corporate income tax

## Scope

Corporate income tax is levied on the worldwide income of Czech legal entities and of foreign entities whose place of management/control is located in the Czech Republic. For non-resident entities, only Czech-source income is subject to corporate tax. This specifically includes income attributable to a Czech permanent establishment (e.g. branch) of a non-resident entity, income from the sale of real estate located in the Czech Republic, and certain other listed types of income (e.g. lease payments, dividends, interest and royalties paid by Czech entities).

The legislation very broadly defines the concept of a permanent establishment. Generally, a permanent establishment represents a place located in the territory of the Czech Republic through which a foreign entity carries out its business activities (e.g. an office, a place of sale, a construction site). In addition, a foreign entity is also treated as having a Czech permanent establishment if it renders services for a period exceeding six months in any twelve successive calendar months in the Czech Republic (e.g. via seconding individuals to the Czech Republic). Care must therefore be taken when seconding the employees of foreign entities to the Czech Republic.

Czech general and limited partnerships are, for corporate income tax purposes, treated as transparent entities. The profit of a general partnership is not taxed at the company level but at the level of the partners. Also, profit attributable to the general partners of a limited partnership is taxed at the partners' level, whereas profit attributable to limited partners is taxed at the level of the company. The distribution of profit to the limited partners is then treated as a standard dividend distribution, generally subject to a 15% withholding tax (as of 2009, reduced to 12.5% for Czech residents). The profit attributable to non-resident general partners (not residing in a European Economic Area member state) is subject to a securing tax withheld at the standard income tax rate (for legal entities 21% for 2008, 20% for 2009 and 19% from 2010 onwards; for individuals 15% for 2008 and 12.5% from 2009 onwards).

## Rates

The standard corporate income tax rate applicable for taxable periods starting in 2008 was reduced to 21%, to 20% for taxable periods starting in 2009 and to 19% for taxable periods starting in 2010 and later. Investment funds, mutual funds and pension funds are subject to 5% tax. Certain types of income are subject to different tax rates, tax withholding or securing (refer to the section Withholding Taxes).

## EU rules

As of 1 May 2004, the Czech Republic is an EU member state. In preparation for accession, the Czech Republic incorporated the following EU Directives dealing with direct taxes into its corporate income tax legislation:

- ▶ Parent Subsidiary Directive
- ▶ Merger Directive
- ▶ Interest and Royalties Directive
- ▶ Savings Directive

The majority of the new rules became effective on the accession date. However, the date of coming into effect of some rules has been postponed (see below).

# Corporate income tax

## The Parent Subsidiary Directive

Based on the Parent Subsidiary Directive, a dividend distribution from a Czech company to an EU company or from an EU company to a Czech company is exempt from Czech taxation if the following conditions are all fulfilled:

- ▶ The legal form of the companies is as listed in Annex 1 of the Parent Subsidiary Directive [in the case of Czech companies, a joint-stock company (a.s.) or a limited liability company (s.r.o.)].
- ▶ The companies are subject to corporate income tax or a similar type of tax (as listed in the Parent Subsidiary Directive).
- ▶ A minimum shareholding of 10% in the registered capital of the company distributing the dividends is maintained for a period of at least 12 months. (This condition can be fulfilled subsequently.)

In addition to the rules stated by the Parent Subsidiary Directive, dividend distribution between two Czech companies fulfilling the above conditions is also tax-exempt.

As of 2008, the distribution of dividends by a subsidiary resident in a contracting country (i.e., third country which has concluded a double tax treaty with the Czech Republic) will be exempt from taxation. The exemption applies provided the following conditions are all fulfilled:

- ▶ The subsidiary resident in the contracting country has a legal form comparable to a Czech joint-stock company (a.s.), a limited liability company (s.r.o.) or a cooperative (družstvo).
- ▶ The parent company has held an ownership interest of at least 10% in the subsidiary for at least 12 months. (This condition can be fulfilled subsequently.)
- ▶ The subsidiary is liable to tax similar to corporate income tax which is not less than 12% (at least in the taxable period when the parent company accounts for the respective receivable and in a preceding taxable period).

In addition to the exemption of dividends, as of 2008 capital gains realized by a Czech parent company or a Czech permanent establishment of a company which is an EU resident will be exempt from taxation provided that the gain relates to a transfer of ownership interest in:

- ▶ a subsidiary which is resident in an EU country (including the Czech Republic - while meeting the conditions for exemption of the distribution of dividends); and
- ▶ a subsidiary resident in a contraction country.

This exemption does not apply to ownership interests acquired as part of the purchase of a business or part thereof.

Finally, as of 2008 the Czech Republic introduced the concept of beneficial owner as one of the conditions for the exemption of capital gains and distribution of dividends.

## The Merger Directive

The Merger Directive applies to corporate mergers and demergers, business contributions and share exchanges ("mergers"). Under the Merger Directive, mergers should be treated as a corporate income tax neutral transaction. Therefore, no corporate income tax obligations should arise for the participating companies due to the merger. On the other hand, due to the tax neutral character of the transactions, no tax step-up should generally be achieved in a merger.

The reserves, provisions and unutilized tax losses (assessed for taxable periods started in 2004 and future years) of a wound-up company may, under certain conditions, be carried over by the succeeding company.

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# Corporate income tax

## The Interest and Royalties Directive

Interest and royalty payments from a Czech company to its associated company established in an EU member state will (subject to conditions) be exempt from taxation in the Czech Republic. Exemption from taxation for interest payments became effective on 1 May 2004. The exemption from taxation of royalty payments will become effective on 1 January 2011.

## The Savings Directive

Under the Savings Directive, certain entities (paying agents) are obliged to notify the Financial Authorities of any savings income paid to individuals resident in EU member states. Under Czech tax legislation, the same rule also applies to savings income paid to individuals resident in Switzerland, Andorra, Liechtenstein, San Marino or Monaco.

## The Capital Duty Directive

The provisions of the Capital Duty Directive governing the taxation of, for example, changes in registered capital or in a company seat were not transposed into Czech legislation, nor is transposition of the Capital Duty Directive provisions expected in the foreseeable future. Changes in registered capital are, however, not subject to capital duty in the Czech Republic.

## Determination of taxable profit

Corporate income tax is generally payable on trading results (profit or loss) as reported in financial statements after adjustment for various assessable/non-assessable and deductible/non-deductible items. Non-deductible items include, for example, the following:

- ▶ entertainment expenses
- ▶ travel allowances in excess of statutory limits
- ▶ expenses incurred in raising registered capital
- ▶ expenses related to tax-exempt income directors' fees
- ▶ reserves and provisions, unless specifically deductible under Czech tax rules (refer to the section Receivables)
- ▶ financing expenses exceeding certain limits (refer to the section Financing Expenses)
- ▶ tax paid on behalf of other taxpayers
- ▶ losses on sale of land
- ▶ losses on sale of receivables
- ▶ capital losses (refer to the section Capital Losses)
- ▶ certain penalties and fines
- ▶ costs incurred by a parent company in connection with the holding of a share in its subsidiary (including financing expenses incurred in connection with holding shares).

## Receivables

The tax treatment of receivables is governed by special rules. The value of a receivable could, in the case of its assignment, be treated as a tax-deductible expense, though only up to the amount of income derived from the assignment plus the value of a reserve or provision created under special rules that is released upon the assignment.

The write-off of receivables may only be treated as a tax-deductible expense in certain cases specifically provided for in the legislation (e.g. the write-off of a receivable from a debtor in a bankruptcy proceeding). The write-off of other bad debts is tax deductible only up to the value of a bad debt provision created under special rules that is released upon the write-off.

Taxpayers are allowed to create tax-deductible provisions against bad debts arising after 31 December 1994 provided that the receivable is recognized in the books of the taxpayer and was accounted for in taxable revenues. A tax-deductible bad debt provision amounting to 20% can be created in respect of a receivable outstanding for more than 6 months and not exceeding CZK 200,000. Higher provisions (up to 100% over 36 months) may be created, but only if certain conditions are fulfilled (e.g. an arbitration, court or administrative proceeding has been initiated). For debts exceeding CZK 200,000 which are overdue more than 6 months, the 20% and higher provisions may be created

The tax system in the Czech Republic	<b>Corporate income tax</b>	Personal income tax	Returns and payments	Investigation and penalties	Value added tax	Customs duties	Other taxes	Tax treaties	Tax incentives for foreign investment
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## Corporate income tax

provided certain condition are fulfilled (e.g. an arbitration, court or administrative proceeding has been initiated).

Additionally, a 100% tax-deductible provision can be, under certain conditions, created against receivables not exceeding CZK 30,000 which are outstanding for more than 12 months.

Tax-deductible provisions cannot be created against specifically listed receivables arising, for example, from credits, loans, advances, penalties or inter-company debts. Further restrictions apply to receivables between related parties or where the debtor and creditor have mutual payables.

### Depreciation Tangible assets

Czech tax legislation specifies fixed depreciation periods for tangible assets ranging from 3 to 50 years based on 6 asset categories (refer to Table 3 below).

The rates apply for tax purposes only, and may differ significantly from those used for accounting purposes. Tax depreciation will be computed from the input price of assets using either a straight-line or accelerated method, with the choice being made irrevocably upon acquisition on an asset-by-asset basis.

Technical improvements to assets (expenditure over CZK 40,000 to improve the characteristics of the asset) should be depreciated together with the improved assets. A lessee may depreciate the technical improvement of a leased asset provided that the depreciation of the technical improvement is contractually agreed with the lessor and financed by the lessee.

Category	Examples	Depreciation period (years)
1	Office machines, computers	3
2	Passenger cars, machinery, trucks, furniture, vending machines	5
3	Heavy machinery, concrete and metal structures and parts thereof, hydraulic and pneumatic motors, air-conditioning equipment	10
4	Wooden or plastic buildings, pipelines, silos	20
5	Houses and buildings not specified in categories 4 and 6, highways, roads, wells	30
6	Administration buildings, hotels, shopping centers	50

Depreciation categories for tangible assets - assets that cannot be classified into any of these categories are generally considered to be included in Category 2, or in Category 5 in the case of buildings.

The tax system in the Czech Republic	<b>Corporate income tax</b>	Personal income tax	Returns and payments	Investigation and penalties	Value added tax	Customs duties	Other taxes	Tax treaties	Tax incentives for foreign investment
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# Corporate income tax

The depreciation charge in the first year may be increased by 10% of the acquisition price of certain new assets classified in depreciation categories 1, 2 and 3 (refer to Table 3) with the exception of planes and passenger cars unless used in the transportation business. In special cases (e.g. specific assets used in agriculture or for environmental purposes), the first year depreciation charge may be increased by 15% or 20% of the acquisition price of the respective asset. The total depreciation may, however, not exceed 100% of the acquisition price.

## Intangible assets

As of 2004, Czech tax legislation provides for the specific straight-line tax depreciation of intangible assets recorded in accounting books after 1 January 2004.

Depreciable intangible assets are divided into two categories – intangible assets that may be used for a definite time period and those that may be used for an indefinite time period. Intangible assets that may be used for a definite period are depreciated proportionally during that period. If the period for use is indefinite, the intangible asset is depreciated proportionally over the following periods:

Category	Period (months)
Audio-visual works	18
Software	36
Foundation expenses	60
Other intangible assets	72

Depreciation categories for intangible assets

## Capital gains

Capital gains are generally taxed at the normal corporate income tax rate (i.e. 21% / 20% / 19% for corporations; 5% for mutual, investment and pension funds). Under certain conditions, capital gains realized by Czech parent companies, or Czech permanent establishments of companies resident in another EU country, on the transfer of shares in subsidiaries resident in an EU country (including the Czech Republic) or contraction countries might be exempt from taxation (refer to the section EU Rules).

Capital gains realized by non-resident entities on the sale of shares to Czech taxpayers or Czech permanent establishments represent Czech-source income and are therefore generally taxable. Capital gains may be exempt from tax under the terms of an appropriate double tax treaty. Most of the Czech Republic's treaties, including those with France, the Netherlands, the United Kingdom and the United States, contain this provision, but there are some exceptions (e.g. the treaty with Germany). Capital gains realized by non-resident entities on the sale of Czech shares to Czech tax non-residents are outside the scope of Czech taxation.

## Capital losses

As of 2002, only losses on the sale of certain securities are fully tax-deductible. Losses on other securities such as shares not valued at market value, promissory notes and other items (e.g. receivables, plots of land, and ownership interests in a limited liability company, limited partnership or co-operative) are non-deductible and cannot be carried forward.

## Social security

Employers' social security contributions are deductible for corporate tax purposes if paid on time.

# Corporate income tax

## Donations

Donations to governmental and other bodies for charitable, cultural, educational or other designated public purposes are deductible up to the value of 5% of the donor's tax base in any given year. The donation to any one recipient must be at least CZK 2,000.

## Research and development cost deduction

In principle, costs for certain eligible research and development projects are deductible twice (first as tax-deductible expenses, then as a specific tax base decreasing item). Further conditions are set for the deduction.

## Loss carry-forwards

Tax losses assessed for taxable periods started in 2004 onwards may be carried forward for the five following taxable periods. Tax losses incurred in taxable periods started prior to 2004 may be carried forward for seven subsequent taxable periods.

The carry-forward may be lost if a "substantive change" in the persons participating in the equity or control of the taxpayer occurs. "Substantive change" is defined as a change in more than 25% equity ownership or a change resulting in a shareholder receiving a decisive influence. Special rules apply to joint-stock companies that issue bearer shares. Tax losses are transferable on mergers if specific conditions are met. No carry-back is permitted.

## Financing expenses (thin capitalization)

As of 2008, the tax deductibility of financing expenses is limited by the following rules (each of the rules will be considered separately):

- ▶ The tax deductibility of financing expenses on both related and unrelated party debt is capped at the referential rate relevant for the given currency increased by 4%, calculated from average credits and loans actually drawn.
- ▶ The interest on credits and loans that are subordinated to other liabilities is tax non-deductible.
- ▶ The interest on credits and loans that are profit related is tax non-deductible.
- ▶ Related party interest is subject to a 2:1 debt-equity ratio.
- ▶ Unrelated party interest is subject to a 6:1 debt-equity ratio (4:1 as of 2009).

## Transfer pricing

Transactions with related parties are generally required to be recorded for tax purposes at an arm's length price. Related parties are generally determined based on a commonality of management, control or ownership, with a 25% threshold applied for voting control and ownership. However, other criteria also apply. Generally, all group companies should qualify as related parties. Although not specifically stated in the tax law, the Financial Authorities should follow OECD Transfer Pricing Guidelines in determining arm's length prices.

## Tax consolidation

There is no tax consolidation (fiscal unity) regime for company groups. Each company in a group is taxed as a separate entity with no entitlement to an intra-group offset of profits and losses. In certain cases, however, tax consolidation may be effectively achieved using a partnership structure.

## Withholding taxes

### Payments to Czech non-residents

Withholding taxes apply to dividends and other income from shares (including liquidation surpluses and settlement shares), interest and other income from financial instruments, royalties, fees for commercial (technical) consultancy services performed in the Czech Republic, and operating and finance lease charges where these are paid abroad to Czech tax non-residents without a taxable presence (permanent establishment) in the Czech Republic.

The tax rate is 5% for finance lease payments and 15% for other types of income. The withholding tax rate may be reduced based on the relevant double tax treaty. As of 2009, the 15% withholding tax will be reduced to 12.5% for selected types of income (e.g. royalties or operational lease payments).

# Corporate income tax

According to the Parent Subsidiary Directive and the Interest and Royalties Directive implemented in Czech tax legislation, dividends, interest and royalties paid to residents of EU member states are, under certain conditions, not subject to Czech withholding tax (refer to the section EU Rules).

There is a separate system of securing tax, which requires deduction of tax at source from the taxable income of Czech tax non-resident companies not subject to withholding tax. Tax securing is not applicable on income paid to EU or European Economic Area member states. The standard tax securing rates are 1% and 10%. The 1% rate applies to income from the sale of investment instruments and from the collection of receivables acquired by assignment. The 10% rate applies to other Czech-source business income. In addition, a general partner's share in profit is subject to tax securing at the valid corporate/personal income tax rate.

Tax securing is a form of advance payment and is credited against the taxpayer's final tax liability as determined by the annual income tax return. The Czech Financial Authorities may decide in certain circumstances to decrease or waive the tax securing.

## Payments to Czech residents

The withholding tax rate of 15% generally applies to dividends paid to Czech tax resident entities. Such withholding tax is considered as a final tax payment. Dividend distribution between Czech tax resident companies may be exempt from withholding tax under the EU rules (refer to the section EU Rules). As of 2009, the 15% withholding tax will be reduced to 12.5%.

## Process of withholding

The income payer must withhold tax upon payment, transfer or credit of the payment to the recipient. However, for interest, royalties, service fees and lease charges paid to Czech tax non-residents, the tax must be withheld no later than on the day when the amount payable is accounted for in the payer's accounting books. With respect to dividends, the tax must be withheld upon payment, but no later than at the end of the third month after the general meeting approval of the ordinary or extraordinary financial statements and resolution on profit distribution or loss settlement. The tax withheld must be remitted to the Financial Authorities by the end of the subsequent month.



# Corporate income tax

## Elimination of double taxation

The elimination of double taxation of the foreign-source income of a Czech tax resident is regulated by the provisions of the double tax treaty concluded between the Czech Republic and the respective country. If no double tax treaty has been concluded between the Czech Republic and the country in which the foreign-source income was taxed, then the foreign-source income will be subject to Czech taxation in full, regardless of the foreign taxation.

In general, double tax treaties use either the exemption or credit methods to eliminate double taxation. Based on the exemption method, foreign-source income can be excluded from Czech taxable income. Based on the credit method, Czech income tax can be reduced by the amount of foreign income tax. The foreign tax can be credited only up to the amount of the Czech tax that would have been assessed on the foreign income. The excess part of the foreign tax that cannot be credited against the Czech tax is considered as a tax-deductible expense for Czech corporate income tax purposes.

## Binding opinions of the Financial Authorities

Taxpayers may apply to the Financial Authorities for the following binding opinions:

- ▶ advance pricing agreement
- ▶ binding opinion on technical improvement
- ▶ binding opinion on allocation of expenses to taxable income
- ▶ binding opinion on expenses incurred on research and development projects
- ▶ binding opinion on expenses incurred on buildings used also for private purposes
- ▶ binding opinion on application of VAT rate.

The tax system in the Czech Republic	Corporate income tax	<b>Personal income tax</b>	Returns and payments	Investigation and penalties	Value added tax	Customs duties	Other taxes	Tax treaties	Tax incentives for foreign investment
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# Personal income tax

## Scope and rates

Legally resident and non-resident individuals who are physically present in the Czech Republic for 183 days or more in a calendar year or who have established a permanent home in the Czech Republic are treated as residents for Czech tax purposes. They are generally subject to tax on their worldwide income. The Czech tax law allows relief from double taxation (i.e. by tax credit or exemption) only under a double tax treaty. In the absence of such a treaty, the foreign tax paid is in some cases allowed as a deduction against the relevant income. Individuals who spend less than 183 days in a calendar year in the Czech Republic and who do not have a permanent residence or domicile in the Czech Republic are treated as tax non-residents. They are liable to tax on their Czech-source income only, subject to the provisions of a tax treaty. The same applies to those who are regarded as tax non-residents under the relevant tax treaty.

With effect from 1 January 2008, the tax rate is 15%. From 1 January 2009, the tax rate will be 12.5%.

## Employment income

Taxable employment income includes all income arising from current or former employment, membership relationship, or a similar kind of relationship in which a taxpayer is obliged to follow his employer's instructions, and income paid to executive directors and members of statutory bodies of entities. In addition to basic salary, cash allowances and bonuses, employment income also includes non-cash benefits provided to employees (e.g. company cars used for private purposes, school fees and home leave). Under certain conditions, some of the non-cash benefits can be exempted from taxation.

The tax base for employment income is determined as the gross income of an employee plus the employer's part of mandatory Czech, or foreign, social security and health insurance contributions.

Non-resident employees whose period of assignment in the Czech Republic does not exceed 183 days in any 12 successive calendar months, and who receive income from a foreign employer that has no permanent establishment in the Czech Republic, can claim exemption from Czech personal income tax on such income. However, in certain circumstances, such individuals can be treated, for tax purposes, as employees of a local entity and taxed on their employment income irrespective of the period spent in the Czech Republic.

For tax non-residents, Czech-source employment income is defined as income received for duties performed in the Czech Republic. Where the level of this income is not stipulated in an individual's employment contract or assignment agreement, the amount is usually determined by prorating the total income based on the number of workdays spent in and out of the country. The location where income is paid or received is not relevant in determining its source.

## Self-employment and business income

Taxable self-employment and business income consists of income from business activities and professional services, less deductible expenses. Authors, lecturers, athletes and artists are considered providers of professional services. Net income from business activities and professional services is subject to tax with other income at the 15% rate (12.5% from 1 January 2009).

## Lump sum tax

Individual taxpayers with income derived from agricultural or private business who conduct their activities without employees or co-operating persons may pay a lump sum tax. Their annual income may not be higher than CZK 5 million for the previous 3 tax periods and they may not be a member of an association that is not a corporate entity. The Financial Authorities determines the tax base depending on the expected income and expenses.

The tax system in the Czech Republic	Corporate income tax	<b>Personal income tax</b>	Returns and payments	Investigation and penalties	Value added tax	Customs duties	Other taxes	Tax treaties	Tax incentives for foreign investment
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# Personal income tax

## Capital gains

Capital gains are defined as the difference between the proceeds from the sale of an item and the cost of its acquisition plus any improvements. In the Czech Republic, capital gains are taxed as ordinary income.

The sale of most movable items is exempt from tax under certain conditions. With effect from 1 January 2008, the sale of investment securities or securities under a collective investment scheme is exempt from taxation if the shares have been held for a period of more than 6 months and the individual had less than a 5% share in the company (direct or indirect) in the 24 months preceding the sale. The sale of other securities is exempted if the holding period exceeds five years. Any gain not exempt under these provisions is added to the individual's tax base.

## Dividends and interest

Czech-source dividends and interest are taxable income and are, in principle, subject to withholding tax at source (see Withholding Taxes). Except for some forms of interest, this withholding tax is deemed to have met the tax liability in full and the income is excluded from the individual's tax base.

## Determination of taxable income

The income received from all sources is added together to arrive at an individual's total tax base.

The following may be deducted from the total tax base:

- ▶ Charitable contributions of up to 10% of the tax base are deductible.
- ▶ A taxpayer may reduce his tax base by the amount of interest (reduced by the amount of state support) on loans used to finance personal housing needs (e.g. housing savings loans, mortgage loans). The maximum limit for the tax relief is CZK 300,000 on all the loans of all the taxpayers living in the same household. For Czech tax non-residents, this deduction is applicable if their Czech-source income constitutes at least 90% of their worldwide income.
- ▶ An individual's tax base can be reduced by the amount of life insurance paid for qualifying life insurance in the tax period, up to a maximum of CZK 12,000.
- ▶ An individual's contributions to a Czech supplementary pension insurance fund exceeding CZK 6,000 per year can be claimed as an additional tax base deduction if certain conditions are met. The maximum deduction is limited to a further CZK 12,000 per year.

## Tax relief

Several tax relief items deductible from the taxpayer's tax liability are available.

- ▶ General annual personal tax relief is CZK 24,840. With effect from 1 January 2009, the annual tax relief will be CZK 16,560.

- ▶ Tax relief of CZK 24,840 is granted for a spouse living in the same household as the taxpayer, unless the spouse's income exceeds CZK 38,040 in the relevant year. With effect from 1 January 2009, the tax relief will be CZK 16,560.
- ▶ Additional tax relief of CZK 2,520 for partially disabled persons and CZK 5,040 for totally disabled persons is available.
- ▶ A tax payer can deduct CZK 10,680 from the tax liability for each dependent child living with him/her in the household. With effect from 1 January 2009, the annual deduction will be CZK 10,200.

The tax relief items are available to non-residents only if the non-resident individual's Czech-source income accounts for at least 90% of his or her total annual income.

## Joint taxation of married couples

With effect from 1 January 2008, the joint taxation of married couples is no longer applicable in the Czech Republic.

The tax system in the Czech Republic	Corporate income tax	<b>Personal income tax</b>	Returns and payments	Investigation and penalties	Value added tax	Customs duties	Other taxes	Tax treaties	Tax incentives for foreign investment
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# Personal income tax

## Social security and health insurance

Participation in the Czech social security and health insurance system is required for individuals who work in the Czech Republic except:

- ▶ individuals who perform activities in the Czech Republic for an employer whose seat is outside the Czech Republic in a non-EU country with which the Czech Republic has not concluded a totalization agreement
- ▶ foreign nationals who are, according to the EU social security legislation or totalization agreement, obliged to contribute to their home country social security system and have obtained the respective E101 form/certificate of coverage.

The Czech Republic has concluded totalization agreements with the following countries:

Austria	Netherlands
Bulgaria	Poland
Bosnia and Herzegovina	Quebec
Canada	Romania
Croatia	Russian Federation
Cyprus	Serbia
Chile	Slovak Republic
France	Slovenia
Germany	Spain
Israel	Switzerland
Lithuania	Turkey
Luxembourg	Ukraine
Hungary	USA (The agreement should become effective as of 2009.)
Macedonia	
Montenegro	

EU social security legislation is effective in the Czech Republic as of 1 May 2004.

Most Czech legal entities must also contribute a small amount to an insurance fund for work-related accidents and illness based on the gross salary of all employees.

The combined social security and health insurance rates are summarized in Table 2 below. The assessment base is the sum of all income paid/provided to employees and is generally equal to taxable income. As of 1 January 2008, a maximum assessment base for employees will be applicable and will be calculated as 48 times the monthly average salary (for 2008, the maximum annual assessment base will be CZK 1,034,880). Income above this limit is not subject to social security and health insurance contributions, with certain exceptions for situations where the individual has multiple employers during the year.

Self-employed individuals pay health and social security contributions at a combined rate of 43.1% (13.5% health insurance plus 29.6% pension and unemployment) on at least 50% of the amount liable for income tax. Sickness insurance of 4.4% is optional. The maximum annual income on which social security and health insurance is calculated for self-employed individuals is currently limited to CZK 1,034,880.

The tax system in the Czech Republic	Corporate income tax	<b>Personal income tax</b>	Returns and payments	Investigation and penalties	Value added tax	Customs duties	Other taxes	Tax treaties	Tax incentives for foreign investment
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## Personal income tax

	Employer (%)	Employee (%)	Total (%)
Social security			
- Pension	21.5	6.5	28.0
- Sickness	3.3	1.1	4.4
- Unemployment	1.2	0.4	1.6
Health insurance	9.0	4.5	13.5
Total contributions	35.0	12.5	47.5

Social security and health insurance rates

The tax system in the Czech Republic	Corporate income tax	Personal income tax	<b>Returns and payments</b>	Investigation and penalties	Value added tax	Customs duties	Other taxes	Tax treaties	Tax incentives for foreign investment
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# Returns and payments

## Corporate income tax returns

Generally, the taxable period for Czech corporate income tax purposes is the calendar year or economic year.

Calendar year tax returns for corporate income tax must generally be filed by 31 March following the end of the tax year. This is extended to 30 June if

- ▶ a qualified Czech tax adviser prepares the return and the relevant power of attorney is filed with the Financial Authorities before 31 March or
- ▶ the company is required to have a statutory audit.

Corporations may decide, with the approval of the Financial Authorities, to adopt an accounting and tax period that is different from the calendar year. In such cases, the tax return is required to be filed within 3 or 6 months of the end of the taxable period, depending on the conditions outlined above. Special rules apply for filing in the case of liquidations, mergers and transformations.

A corporate income tax return must be filed by all corporations (even if a tax loss was incurred in the respective taxable period). An exemption applies for general partnerships as general partners are obliged to include their portion of the profit generated by the partnership in their own personal/corporate income tax returns.

## Personal income tax returns

The taxable period for personal income tax purposes is the calendar year. Personal income tax returns must generally be filed by 31 March following the end of the tax year. This is extended to 30 June if a qualified Czech tax adviser prepares the return and the relevant power of attorney is filed with the Financial Authorities before 31 March.

Individuals are not required to file a tax return if:

- ▶ their total annual taxable income is less than CZK 15,000; or
- ▶ all taxable income is from employment and is paid by a Czech legal entity or a registered Czech branch of a foreign entity (and other taxable income in the taxable period does not exceed CZK 6,000); or
- ▶ all earnings are from "special" categories of income (e.g. tax-exempt income or income subject to special rates of withholding).

## Income tax prepayments

Income tax prepayments are generally required quarterly or half-yearly during the year based on the previous year's tax liability. Prepayments are paid half-yearly when the previous period's tax liability ranged from CZK 30,000 to CZK 150,000 and quarterly when the previous period's tax liability exceeded CZK 150,000. Payment of any residual tax due must be made by the appropriate tax return filing deadline. Special rules apply for tax prepayments on taxable income derived from employment.

## Other

For some types of Czech taxes (e.g. payroll tax, withholding tax) a special reconciliation must be filed after the end of the respective taxable period.

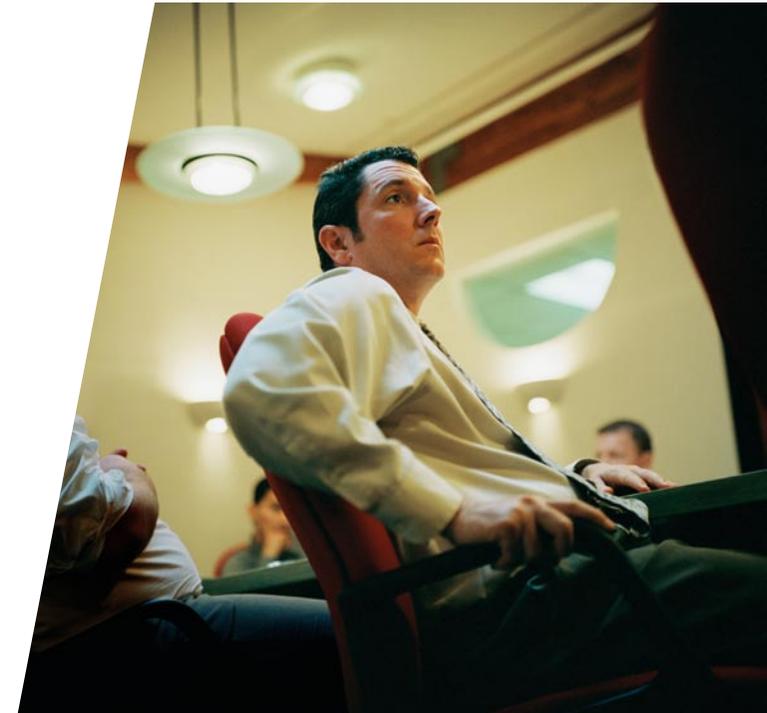
# Investigation and penalties

**The Financial Authorities may generally investigate and reassess additional tax for up to three years after the end of the tax period in which the tax return was due. This time period may be extended to up to ten years under certain circumstances: for example, if the commencement of an investigation within the three-year period triggers a new three-year period. Specific additional extensions may apply in cases involving finance leasing, losses carried forward and investment incentives. The burden of proof in an investigation falls on the taxpayer.**

The tax legislation prescribes penalties for specific non-compliance, including the following:

- ▶ Non-compliance with a non-monetary obligation (e.g. registration) may be subject to a penalty of up to CZK 2 million.
- ▶ The late submission of a tax return may be subject to a late filing penalty of up to 10% of the relevant tax.
- ▶ The late payment of tax due may be subject to a penalty of 20% of the additional tax assessed or 5% of the loss decreased (assessed by the Financial Authorities) and also subject to interest at the rate of the Czech National Bank Repo rate published on 1 January and 1 July plus 14%.

Under specific conditions, penalties can be waived upon application. Criminal penalties may also be imposed for cases falling under the Criminal Code.



The tax system in the Czech Republic	Corporate income tax	Personal income tax	Returns and payments	Investigation and penalties	<b>Value added tax</b>	Customs duties	Other taxes	Tax treaties	Tax incentives for foreign investment
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# Value added tax

## Basic information

Value added tax (VAT) was introduced in the Czech Republic on 1 January 1993. It is locally referred to as daň z přidané hodnoty (DPH). The 6th EU VAT Directive (now replaced by Directive 2006/112/EC on the common system of VAT) was implemented in the Czech Republic on 1 May 2004. The Ministry of Finance administers VAT through a network of Financial Authorities and Customs Authorities. VAT is generally chargeable on:

- supplies of goods and services and the transfer of immovable property affected by a taxable person for consideration with a place of supply in the Czech Republic
- the import of goods into the Czech Republic (administered by the Customs Authorities, unless VAT is applied directly through a VAT return)
- the intra-community acquisition of goods for a consideration effected by a taxable person in the territory of the Czech Republic.

Under certain conditions, the obligation to apply output VAT to selected services rendered by a foreign person to a Czech customer is transferred to the recipient of these services (“reverse charge”).

Certain transactions are not subject to VAT (i.e. they are non-taxable). This includes the sale of an enterprise (or its part constituting a branch office); certain compensatory transfers of assets; the transfer of a share in a limited liability company; the transfer of one’s own receivables; the supply without charge of advertising or marketing articles costing less than CZK 500 and not subject to excise duty (except for still wine); the recharge of heat, cold, electricity, gas, water; and services acquired from another VAT payer provided that the input VAT incurred on the acquisition of these goods and services was not deducted.

## VAT registration

A taxable person is an individual or legal entity undertaking business activities independently, or a VAT group.

A VAT group is a group of related entities with their seats, place of business or fixed establishment in the Czech Republic. If any of these entities has a place of establishment, place of business and/or fixed establishment outside the Czech Republic, that part is excluded from the VAT group.

### Domestic persons

A taxable person with its seat, place of business or fixed establishment in the Czech Republic whose turnover exceeds CZK 1m in twelve successive calendar months is obliged to register for VAT.

The taxable person is obliged to file an application for VAT registration by the 15th day of the month following the month in which its turnover exceeded the threshold. It becomes a VAT payer as of the first day of the third month following the month in which the turnover exceeded the threshold.

A person whose turnover does not exceed CZK 1m in twelve successive calendar months may register for VAT voluntarily.

### VAT groups

Provided that the application for the VAT registration of a VAT group is filed by 31 October, the VAT group becomes a VAT payer as of 1 January of the following year. If the application for the VAT registration of a VAT group is filed after this date, the VAT group becomes a VAT payer as of 1 January of the second year following the submission of the registration application.

### Foreign persons

Foreign persons register for VAT if they render taxable supplies in the Czech Republic regardless of the turnover achieved.

The tax system in the Czech Republic	Corporate income tax	Personal income tax	Returns and payments	Investigation and penalties	<b>Value added tax</b>	Customs duties	Other taxes	Tax treaties	Tax incentives for foreign investment
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# Value added tax

## Ordinary taxable supplies

The standard VAT rate of 19% is generally applicable to the supply of goods and the provision of services.

The reduced VAT rate of 9% applies to selected goods (e.g. foodstuffs (excluding alcoholic beverages), medicines, books, newspapers and other printed material, medical tools) and selected services (e.g. public transport, cultural activities).

## VAT-exempt supplies with credit

Exemption from VAT with entitlement to input VAT deduction is applicable to the intra-community supply of goods, export of goods, international transportation and services related to the import and export of goods, the international transportation of persons, and other specifically listed activities.

## Intra-community supply of goods

The intra-community supply of goods by a Czech tax payer to a person registered for VAT in another EU Member State is VAT-exempt with credit provided that the transportation of goods from the Czech Republic is carried out by the supplier or the customer, or a person authorized by either of these, and that the acquisition of goods is subject to VAT payable by the customer.

## Export of goods

Goods that are exported from the Czech Republic to third (non-European Union) countries are exempted with credit subject to the following conditions:

- ▶ The goods are exported from the European Union (i.e. physically leave the territory of the European Union).
- ▶ The transportation of the goods is carried out by the exporter, customer (having no seat, place of business or establishment in the Czech Republic), or by a person authorized by either of these.
- ▶ The exporter holds a tax document confirmed by the Customs Authorities proving the export of goods from the European Union.

The placing of goods in a customs-free zone is deemed to constitute the export of goods for VAT purposes.

## International transportation and services directly linked to export and import of goods

The international transportation of goods rendered with respect to export is exempt from VAT with credit. The international transportation of goods rendered with respect to the import of goods is exempt from VAT with credit on the condition that the costs of transportation are reflected in the amount taxable on the import of goods. Services directly linked to the export and import of goods have a similar VAT treatment.

The exemption from VAT on international transportation and services related to the import and export of goods must be supported by specific documents.

## International transportation of persons

Relating to the transportation of persons between EU Member States and between the European Union and third (non-European Union) countries, the part that takes place in the territory of the Czech Republic is exempt with credit.

## VAT-exempt supplies with no credit

Supplies of certain goods and services (for instance, insurance, education, financial services, health services, the lease of immovable property, postal services, radio and TV broadcasting, some lotteries and similar games) are VAT exempt with no credit.

The VAT payer can decide whether the lease of land, building structures, apartments and non-residential premises will be subject to Czech VAT if the lessee is VAT registered in the Czech Republic and uses the leased assets for its business. In this case, the VAT payer (the lessor) is entitled to the deduction of input VAT incurred in connection with the leased assets. There is no option to tax other services.

The tax system in the Czech Republic	Corporate income tax	Personal income tax	Returns and payments	Investigation and penalties	<b>Value added tax</b>	Customs duties	Other taxes	Tax treaties	Tax incentives for foreign investment
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# Value added tax

The transfer of building structures, apartments and non-residential premises after three years from the date of their acquisition or their approval for use (whichever occurs earlier) is exempt with no credit. The transfer of land is exempt with no credit with the exception of the transfer of building land.

## Input VAT recovery

### a) VAT deduction

A VAT payer can recover input VAT provided that it uses the received taxable supplies in the course of performing its economic activity. Any VAT should be detailed on a valid VAT document.

A VAT payer is entitled to a full VAT deduction in respect of received taxable supplies used for:

- taxable supplies liable to output VAT
- VAT-exempt supplies with credit
- transactions relating to economic activities carried out in another country that would be eligible for deduction of VAT if they had occurred in the Czech Republic
- other transactions stipulated by the Czech VAT Act (e.g. sale or contribution of an enterprise, small promotional articles).

A VAT payer is not entitled to a VAT deduction on received taxable supplies used for supplies that are VAT exempt without a credit.

Additional restrictions apply to the recovery of input VAT incurred on business entertainment and the acquisition of passenger cars, excluding the acquisition of passenger cars for their subsequent sale or financial lease.

A VAT payer is bound to reduce proportionally the deduction of input tax on received taxable supplies used for both of the purposes mentioned above.

Input VAT can be claimed no sooner than when the VAT point arises and no later than in the VAT return for the last taxable period of that calendar year. After this, a VAT deduction may be claimed through supplementary VAT returns, even though the Financial Authorities admitted recently that it is possible to claim it in the regular VAT return.

It is not possible to recover any input VAT once three years have elapsed from the end of the taxable period in which the VAT deduction could have first been claimed.

If deductible input VAT exceeds output VAT (an excess VAT deduction), a refund of the excess VAT will be made to the VAT payer within 30 days of the assessment of the excess VAT deduction by the Financial Authority.

Input VAT incurred on goods used in the course of business prior to a VAT payer's registration is generally recoverable provided these goods were acquired no more than 12 months before registration and the VAT payer records these goods in its business property at the day of the registration. Input VAT incurred on services prior to an entity's registration may not be recovered.

### b) VAT refund

Persons registered for VAT in another EU Member State that have no seat, place of business or fixed establishment in the Czech Republic may generally claim a refund of the VAT paid on goods or services purchased in the Czech Republic or assessed by the Customs Authority on the import of goods to the Czech Republic.

Taxable persons from third (non-European Union) countries may also claim a refund of VAT paid on the price of goods or services purchased in the Czech Republic under the reciprocity principle. Currently, the reciprocity applies to Switzerland, Norway and Macedonia.

The tax system in the Czech Republic	Corporate income tax	Personal income tax	Returns and payments	Investigation and penalties	<b>Value added tax</b>	Customs duties	Other taxes	Tax treaties	Tax incentives for foreign investment
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# Value added tax

The request for the VAT refund has to be filed with the Financial Authority by 30 June of the year following the year (or its part) for which the refund of VAT is claimed.

Foreign individuals from third (non-European Union) countries may claim a refund of VAT paid in the price of non-commercial goods (excluding fuel, tobacco products and alcoholic beverages) purchased in the Czech Republic and subsequently exported in personal luggage if the price of such purchased goods, including VAT, paid to one vendor in one day exceeds CZK 2,000.

## Returns and payments

Regular VAT returns must be filed monthly or quarterly. Quarterly VAT returns are filed by VAT payers whose turnover for the previous calendar year did not exceed CZK 10m or by VAT payers with no seat, place of business or fixed establishment in the Czech Republic. The VAT return should be filed even if the VAT payer effects no supplies in the taxable period for which the VAT return is filed.

The VAT return must be filed by the 25th day following the end of the taxable period (i.e. month or calendar quarter). Payment of any VAT due must be made by the same day.

VAT records and tax documents must be retained for a period of 10 years.

## VAT on imports

Import VAT is due on goods imported into the Czech Republic (European Union) and released into the relevant customs procedure. The rate of import VAT is the same rate as that which applies to domestic sales of goods (i.e. either 19% or 9%).

A VAT payer has to self-assess VAT on imported goods through his regular VAT return. The VAT payer is entitled to claim deduction of the self-assessed VAT under conditions similar to local purchases through the same VAT return in which the VAT liability from the import of goods was declared (i.e. there generally should be no VAT impact on the tax payer's cash flow).

The tax system in the Czech Republic	Corporate income tax	Personal income tax	Returns and payments	Investigation and penalties	Value added tax	<b>Customs duties</b>	Other taxes	Tax treaties	Tax incentives for foreign investment
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# Customs duties

**As a new member of the European Union, the Czech Republic has followed Community customs regulations since 1 May 2004, including the Community Tariff nomenclature, Community Customs Code and other Community customs regulations.**

**Goods imported from third countries into the Czech Republic are subject to import customs duties, excise duties, VAT and other commercial policy measures (collectively referred to as customs debt) based on the Community Customs Tariff. Goods imported to or exported from the Czech Republic can also be subject to import/export restrictions (e.g. import/export licenses, veterinary inspections). Goods imported and released into the free circulation customs procedure which are sent to or acquired from other EU Member States are not regarded as exported or imported.**

## Customs-approved treatment

Based on the provisions of the Community Customs Code, the following customs-approved treatments can be used for foreign goods:

- ▶ the placing of goods under a customs procedure
- ▶ entry into a free zone or free warehouse
- ▶ re-export from the customs territory of the Community
- ▶ destruction
- ▶ abandonment to the Exchequer.

The customs-approved treatment most commonly used by declarants is the placing of goods under a customs procedure.

In this case, goods can be declared into the customs procedures of:

- ▶ free circulation
- ▶ external transit
- ▶ customs warehousing
- ▶ inward processing
- ▶ processing under Customs Control
- ▶ temporary admission
- ▶ outward processing (for Community goods only)
- ▶ export (for Community goods only).

## Customs debt

On import into the Community, a customs debt is incurred when goods are released into free circulation or temporary admission, or if the goods are removed from customs supervision.

The debtor (declarant or a person in the name of whom the declaration is made under the indirect representation) must pay the customs debt assessed by the Customs Authority within 10 days of the date on which the customs decision on the assessment of the customs debt was delivered to him/her.

Generally, if the customs debt is not paid immediately, the Customs Authorities require provision of a customs guarantee amounting to the customs debt.

## Preferential agreements

The preferential rules of the Community are applicable to the Czech Republic as of 1 May 2004.

In addition to the customs union with Turkey, Andorra and San Marino, the European Union forms the European Economic Area with Norway, Iceland and Liechtenstein.

The tax system in the Czech Republic	Corporate income tax	Personal income tax	Returns and payments	Investigation and penalties	Value added tax	<b>Customs duties</b>	Other taxes	Tax treaties	Tax incentives for foreign investment
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## Customs duties

The European Union has a free trade area with the following countries (and groups of countries): Switzerland, the Faeroe Islands, Ceuta and Melilla, Macedonia, Croatia, the MAGHREB countries (Morocco, Tunisia and Algeria), MASHRAQ (Egypt, Jordan, Syria, Lebanon), Israel, Palestine, Mexico, Chile, Albania and South Africa.

In addition to the above, the European Union also provides preferential treatment to goods from ACP countries (Africa, Caribbean and Pacific countries), OCT countries (Overseas Countries and Territories) and Balkan countries. Based on the General System of Preferences, goods imported from developing and the least developed countries also qualify for preferential treatment.

### Customs clearance

Any person who has brought goods into the customs territory of the Community or, where appropriate, any person who assumes responsibility for carriage of the goods following such entry, is liable to file a customs declaration and present the goods to the Customs Authority.

For customs clearance purposes, any person may appoint a direct representative (acting in the name and on the account of the represented person) or an indirect representative (acting in his own name and on the account of the represented person).



The tax system in the Czech Republic	Corporate income tax	Personal income tax	Returns and payments	Investigation and penalties	Value added tax	Customs duties	<b>Other taxes</b>	Tax treaties	Tax incentives for foreign investment
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## Other taxes

### Excise duty

Excise duty is levied on the production and import of specified consumer goods in the Czech Republic. The obligation to pay excise duty arises at the moment the goods are released into tax-free circulation. Goods liable to excise duty include mineral oils, tobacco products, alcohol, beer and wine. Duty is charged at varying rates on the basis of the volume imported or produced.

### Taxation of energies

The taxation of energies was introduced on 1 January 2008. The taxation includes a tax on electricity, a tax on natural gas and a tax on solid fuel. Deliveries of these commodities to the end customer are subject to taxation. The suppliers, who are therefore subject to the tax liability, are obliged to register themselves as tax payers with the Customs Authority. Energy traders who purchase these commodities for resale are eligible to purchase them tax-free under special permission.

Certain customers are eligible to purchase energy exempt from tax. They particularly include energy-demanding operations, such as steelworks, glassworks, power plants, railways and water transport. The purchase of tax-exempt energy is only possible with special permission.

Taxpayers are obliged to file monthly tax returns by the 25th day of the month following the month for which the tax return is being filed. The tax liability is due by the same day.

### Real estate tax

Real estate tax is imposed on buildings and plots of land. The tax rates depend on the type/purpose of the building or land, the size and desirability of the locality, and the actual area of the plot of land in square meters or the size of the building. Real estate tax returns must be filed by 31 January in the year of assessment.

### Real estate transfer tax

Real estate transfer tax is payable by the transferor at a rate of 3%. The tax is imposed on most transfers of land and buildings based on the contract price or the market value of the property, whichever is higher. The market value is determined using the methods specified in the legislation.

### Gift tax

Gift tax is payable at rates varying from 1% to 40% depending on the market value and status of the recipient of the gift.

### Road tax

Road tax must be paid on all vehicles registered in the Czech Republic and used for business purposes, whether or not the vehicle is actually owned by a business entity. Annual rates for cars vary between CZK 1,200 and CZK 4,200 depending on engine capacity. The rates for trucks are between CZK 1,800 and CZK 50,400 depending on size and weight. The tax is reduced for specific types of vehicles.

### Environmental taxes

Currently, the Environment Authorities impose fees in respect of air and water pollution, municipalities impose waste deposit fees calculated based on the quantity and quality of released pollution, and the Financial Authorities impose water-drawing fees.

The tax system in the Czech Republic	Corporate income tax	Personal income tax	Returns and payments	Investigation and penalties	Value added tax	Customs duties	Other taxes	<b>Tax treaties</b>	Tax incentives for foreign investment
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# Tax treaties

Czechoslovakia entered into a multilateral tax treaty with other members of the Council for Mutual Economic Assistance (COMECON or CMEA). The COMECON treaty continues to apply to Kyrgyzstan and Tajikistan. This treaty provides for a 0% withholding rate for dividends, interest and royalties.

The Czechoslovakia-Yugoslavia treaty of 1984 continues to apply to Bosnia-Herzegovina.

The Czech Republic honors the other bilateral tax treaties of Czechoslovakia. It has also entered into tax treaties with many other countries. The following table lists the withholding rates under the bilateral treaties currently honored by the Czech Republic.

Payee resident in	Dividends (%)	Interest (%)	Royalties (q) (%)
Albania	5/15 (b)	5	10
Australia	5/15 (e)	10	10
Austria	10 (c) (s)	0 (t)	0/5 (a)
Azerbaijan	8	0/5/10 (g)	10
Belarus	10	0/5 (g)	10
Belgium	5/15 (b) (s)	10 (t)	0/5/10 (r)
Brazil	15	0/10/15 (g) (i)	15/25 (a)
Bulgaria	10	0/10 (g)	10
Canada	5/15 (c)	0/10 (g)	10
China	10	0/10 (g)	10
Croatia	5	0	10
Cyprus	10 (s)	0/10 (g) (t)	0/5 (a)
Denmark	15 (s)	0 (t)	0/5 (a)
Egypt	5/15 (b)	0/15 (g)	15
Estonia	5/15 (b) (s)	0/10 (g) (t)	10
Finland	5/15 (b) (s)	0 (t)	0/1/5/10 (m)
France	10 (b) (s)	0 (t)	0/5/10 (u)
Germany	5/15 (b) (s)	0 (t)	5

The tax system in the Czech Republic	Corporate income tax	Personal income tax	Returns and payments	Investigation and penalties	Value added tax	Customs duties	Other taxes	<b>Tax treaties</b>	Tax incentives for foreign investment
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## Tax treaties

Payee resident in	Dividends (%)	Interest (%)	Royalties (q) (%)
Georgia	5/15 (b)	0/8 (g)	0/5/10 (u)
Greece	15 (s)	0/10 (g) (t)	0/10 (a)
Hungary	5/15 (b) (s)	0 (t)	10
Iceland	5/15 (b)	0	10
India	10	0/10 (g)	10
Indonesia	10/15 (e)	0/12.5 (g)	12.5
Ireland	5/15 (b) (s)	0 (t)	10
Israel	5/15 (f)	0/10 (g)	5
Italy	15 (s)	0 (t)	0/5 (a)
Japan	10/15 (b)	0/10 (g)	0/10 (a)
Kazakhstan	10	0/10 (g)	10
Korea (North)	10	0/10 (g)	10
Korea (South)	5/10 (b)	0/10 (g)	0/10 (a)
Kuwait	0/5 (k)	0	10
Latvia	5/15 (b) (s)	0/10 (g) (t)	10
Lebanon	5	0	5/10 (r)
Lithuania	5/15 (b) (s)	0/10 (g) (t)	10
Luxembourg	5/15 (b) (s)	0 (t)	0/10 (a)

The tax system in the Czech Republic	Corporate income tax	Personal income tax	Returns and payments	Investigation and penalties	Value added tax	Customs duties	Other taxes	<b>Tax treaties</b>	Tax incentives for foreign investment
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## Tax treaties

Payee resident in	Dividends (%)	Interest (%)	Royalties (q) (%)
Macedonia	5/15 (b)	0	10
Malaysia	0/10 (l)	0/12 (g)	12
Malta	5 (s)	0 (t)	5
Mexico	10	0/10 (g)	10
Moldova	5/15 (b)	5	10
Mongolia	10	0/10 (g)	10
Morocco	10	0/10 (g)	10
Netherlands	0/10 (b) (s)	0 (t)	5
Nigeria	12.5/15 (c)	0/15 (g)	15
Norway	0/15 (c)	0	0/5/10 (u)
Philippines	10/15 (c)	0/10 (g)	10/15 (r)
Poland	5/10 (e) (s)	0/10 (g) (t)	5
Portugal	10/15 (j) (s)	0/10 (g) (t)	10
Republic of South Africa	5/15 (b)	0	10
Romania	10	0/7 (g)	10
Russian Federation	10	0	10
Serbia and Montenegro	10	0/10 (g)	5/10 (a)
Singapore	5	0	10

The tax system in the Czech Republic	Corporate income tax	Personal income tax	Returns and payments	Investigation and penalties	Value added tax	Customs duties	Other taxes	<b>Tax treaties</b>	Tax incentives for foreign investment
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## Tax treaties

Payee resident in	Dividends (%)	Interest (%)	Royalties (q) (%)
Slovak Republic	5/15 (c) (s)	0 (t)	0/10 (a)
Slovenia	5/15 (b) (s)	0/5 (g) (t)	10
Spain	5/15 (b) (s)	0 (t)	0/5 (n)
Sri Lanka	6/15 (o)	0/10 (g)	0/10 (a)
Sweden	0/10 (b) (s)	0 (t)	0/5 (a)
Switzerland	5/15 (b)	0	5/10 (p)
Thailand	10	0/10 (g)	5/10/15 (h)
Tunisia	10/15 (b)	0/12 (g)	5/15 (a)
Turkey	10	0/10 (g)	10
Ukraine	5/15 (b)	0/5 (g)	10
United Arab Emirates	0/5 (k)	0	10
United Kingdom	5/15 (b) (s)	0 (t)	0/10 (a)
United States	5/15 (c)	0	0/10 (a)
Uzbekistan	10	0/5 (g)	10
Venezuela	5/10 (f)	0/10 (g)	12
Vietnam	10	0/10 (g)	10
Yugoslavia	5/15 (b)	0	10
Non-treaty country	15	0/15 (d)	15/12.5 (v)

The tax system in the Czech Republic	Corporate income tax	Personal income tax	Returns and payments	Investigation and penalties	Value added tax	Customs duties	Other taxes	<b>Tax treaties</b>	Tax incentives for foreign investment
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# Tax treaties

- (a) The lower rate applies to royalties paid for copyrights; the higher rate applies to royalties paid for patents, trade-marks and any industrial or commercial scientific equipment or information.
- (b) The lower rate applies if the receiving company owns at least 25% of the payer.
- (c) The lower rate applies if the receiving company owns at least 10% of the payer. Under the Norway treaty, the 0% rate also applies to dividends paid to the government (or specified institutions).
- (d) Interest on mutual deposits with banks in the inter-bank market and interest on deposits of insurance companies with banks are exempt from tax. The 15% rate applies to other interest.
- (e) The lower rate applies if the receiving company owns at least 20% of the payer.
- (f) The 5% rate applies if the receiving company owns more than 15% of the payer.
- (g) The 0% rate applies to interest paid to (or by) the government (or stipulated institutions), subject to further conditions. Under the Azerbaijan treaty, the 5% rate applies to interest on bank loans. Under the Georgian treaty, the 0% rate also applies to interest from loans and credits guaranteed by governments or related to loan-financed sales of industrial equipment.
- (h) The 5% rate applies to royalties for copyrights; the 10% rate applies to royalties for patents and trademarks; the 15% rate applies to other royalties.
- (i) The 10% rate applies to loans and credits provided by a bank for a minimum period of 10 years which relate to sales of industrial equipment or a project, installation thereof, equipment of industrial or scientific units and/or related to public work.
- (j) The lower rate applies if the receiving company owns at least 25% of the payer for an uninterrupted period of at least 2 years preceding the payment of the dividends.
- (k) The 0% rate applies to a dividend paid to the government of the contractual state (or any governmental institution) or to a company which is at least 25% owned by the government of the contractual state.
- (l) The 0% rate applies to a dividend paid by a tax resident of Malaysia to a Czech tax resident who is the beneficial owner of the dividend.
- (m) The 0% rate applies to royalties for copyrights, the 1% rate applies to royalties for the financial lease of equipment, the 5% rate applies to royalties for the operating lease of equipment and for the use of (or right to use) software, the 10% rate applies to other royalties.
- (n) The lower rate applies to copyrights exclusive of royalties in respect of cinematograph films and films or tapes for TV broadcasting. The higher rate applies to other royalties.
- (o) The lower rate applies to dividends paid by a tax resident of Sri Lanka to a Czech tax resident.
- (p) The treaty provides for a rate of 10%, but a protocol to the treaty provides for a rate of 5% until Swiss domestic law imposes a withholding tax on royalties.
- (q) Effective from 1 January 2011, royalties paid by Czech companies to related companies located in other EU member states will be exempt from tax if the conditions stated in the EU Directive 2003/49/EC are met.
- (r) The lower rate applies to patents, trade marks and any industrial or commercial scientific equipment or information, the higher rate to copyrights. Under the Belgium treaty, the rate is 0% for copyrights if certain conditions are met
- (s) Dividends paid by Czech companies to parent companies as defined in Parent-Subsidiary Directive No. 90/435/EEC located in other EU member states are exempt from withholding tax if the parent company maintains a holding of at least 10% of the distributing company for an uninterrupted period of at least one year.
- (t) Interest paid by Czech companies to related companies (as defined in EU Directive 2003/49/EC) located in other EU member states is exempt from withholding tax.
- (u) The 0% rate applies to royalties paid for copyrights. The 5% rate applies to payments for industrial, commercial or scientific equipment. The 10% rate applies to royalties paid for patents, trademarks, designs or models, plans, secret patterns or production procedures and software, as well as for information relating to experience acquired in the area of industry, commerce or science.
- (v) As of 2009, the rate for royalties will be reduced to 12.5%.

# Tax incentives for foreign investment

**The Act on Investment Incentives, which came into effect on 1 May 2000 and has been amended several times, is designed to attract investment into manufacturing in the Czech Republic. Investors can select from a range of benefits based on their specific circumstances to create a tailored incentive package.**

**In June 2002, the government also introduced two new framework programs that provide specific grants for investment into strategic services and the creation of technology centers. These are provided for under a separate government decree and details are contained in the program rules. Both schemes were amended and combined into one in February 2004. The program was further amended in April 2007.**

**In addition, the Czech Republic gained access to the European Union Structural Funds and Cohesion Fund upon its accession to the EU on 1 May 2004.**

## **Act on Investment Incentives**

This incentive package is on offer to both foreign and Czech firms. The investment incentives cover new manufacturing operations and the expansion of existing production. Manufacturing industries in this context do not include the extraction of minerals, the generation and distribution of electric power, the treatment and distribution of gas and water, the construction industry, the repair of motor vehicles, trade or other services, or transport and agriculture.

## **General qualifying conditions**

The Investment Incentives Act amendment, which modifies selected investment incentives conditions, became effective on 2 July 2007.

- ▶ The minimum required investment is CZK 100 million (CZK 60 million/CZK 50 million for an investment carried out in a county or district whose unemployment rate is 25%/50% higher than the Czech average).
- ▶ At least 50% of the minimum required investment must be covered by the investor's own equity.
- ▶ Acquired machinery should be produced no more than 2 years prior to the acquisition.
- ▶ The machinery should represent at least 60% of the total tangible and intangible assets' value.

- ▶ Intangible assets (licenses and know-how) are eligible only if they are acquired from independent business partners for an arm's length price. Moreover, intangible assets are only eligible for up to 50% of the total tangible assets' (land, building, machinery) value.
- ▶ The above conditions should be met within 3 years of the issuance of the decision to grant the investment incentives. In justified cases, the Czech Ministry of Industry and Trade may, upon request, extend this period by a maximum of 2 years.
- ▶ The project that should be supported by investment incentives cannot be started prior to obtaining confirmation from CzechInvest (the Czech government agency that collects, reviews and processes the investment incentives application) that the applicant could meet the investment incentives conditions.
- ▶ The investment must be environmentally friendly and must be maintained for the duration of the incentives utilization period and in any event for at least 5 taxable periods following the taxable period when the conditions summarized above were met.

# Tax incentives for foreign investment

## Incentives available

The total benefits (excluding training grants) received by the investor must not exceed the benefits cap, which is set as a percentage of the total value of the actual eligible investment. The percentages differ according to regions (or districts in the case of Prague). For 2007 - 2010 they are 36 - 40%, and for 2011 - 2013 they are 30% - 40%. In the case of Prague, the percentages were 0 - 10% for 2007 - 2008. Training grants are provided on top of this cap.

### a) Corporate income tax relief

For a newly established entity, corporate income tax relief can be utilized over a period of up to five years. The tax relief will equal the tax that would have been paid in each year.

For the expansion of an existing plant, the corporate income tax holiday can be utilized over a period of up to five years for the incremental income tax generally attributable to the expanded production income.

The maximum tax relief amount is determined as the investment incentives cap reduced by the job creation subsidy and land subsidy (if applicable).

The special qualifying conditions for the tax relief incentive include the following:

- ▶ The taxpayer should make the maximum possible use of all provisions in the Income Taxes Act to reduce its tax base (in particular, full deduction must be made for depreciation, bad debt provisions and carry-forward tax losses).
- ▶ Except for immovable assets, the taxpayer shall be the first user of the assets acquired for an investment project in the Czech Republic.
- ▶ For the duration of the relief period, the taxpayer shall not be dissolved, subject to bankruptcy proceedings or merged with another entity.
- ▶ The taxpayer will not increase its tax base through non-arm's length transactions with related parties.

The first taxable period for which the tax relief can be claimed is the taxable period in which the taxpayer meets the general qualifying conditions (determined by the Investment Incentives Act) and the special conditions (determined by the Income Taxes Act), but not later than the third year after the year in which the investment incentives were granted.

### b) Job creation grants

A financial grant is provided to an employer who creates new jobs in a district which, at the time of the incentive application, suffers from an unemployment rate at least 50% higher than the Czech national average. A government decree specifies the amount of the grant for each new job to be CZK 200,000.

The jobs created must be maintained during the length of the support period and, in any event, for at least five years after the first claim. Other requirements and conditions are defined in an individual agreement with the Czech Labor and Social Affairs Ministry.

### c) Training grants

An employer who carries out employee training programs is entitled to a financial grant to fund the training costs. Again, this grant is only available to investors in a district which has an unemployment rate at least 50% higher than the Czech national average. The grant currently covers 35% of the training costs incurred, including the wages of the employees being trained. The requirements and conditions are defined in an individual agreement with the Czech Labor and Social Affairs Ministry.

# Tax incentives for foreign investment

## d) Land subsidies

In special cases, investors may be able to purchase land for an investment project from the Land Fund, or local municipalities in certain locations, at a favorable price, either with or without network connections.

## Technology centers and strategic services

This incentives package is provided to technology centers and business support services (customer contact centers, shared services centers, ICT expert solution centers, software development centers and high-tech repair centers) that can receive cash grants for payroll, training and retraining costs.

## General qualifying conditions

- ▶ Minimum investment of CZK 10 million into tangible and intangible assets required
- ▶ Creation of at least 20 new jobs (applicable to software development centers and expert solution centers), 30 new jobs (technology centers), 50 new jobs (high-tech repair centers and shared services centers) and 100 new jobs (call centers)
- ▶ Fulfillment of the above conditions within three years of obtaining the official Project Aid Decision

- ▶ Investment and jobs to be sustained for at least five years
- ▶ No work to be started prior to the issuance of a Confirmation of Project Registration
- ▶ In the case of business support services, project to be internationally oriented

## Incentives available

Incentives are available in the form of cash grants for:

- ▶ Payroll costs covering up to 40% (50% for mid-size and 60% for small enterprises) of wage expenses. In Prague, the range is 0 - 10% (10% or 20% for mid-size and 20% or 30% for small enterprises).
- ▶ Training and retraining covering up to 35% of 3-year training costs if less than 100 new jobs are created and up to 35% of 5-year training costs if at least 100 new jobs are created (45% for small and mid-size enterprises). In Prague, the limit is reduced by 5% to 30% (40% for small and mid-size enterprises).

## European Union funding

EU funding provides a number of opportunities for both the private and public sectors as the Czech Republic will receive EUR 26.7 billion in the programming period 2007 - 2013.

EU funding is governed by several programs. The program Enterprise and Innovation, the Human Resources and Employment Program and the Regional Operational Programs in the seven NUTSII regions seem to provide the best opportunities for the private sector.

Although the funding is also available for large companies, it is especially intended for small and mid-size enterprises, as defined by EC legislation, and for municipalities and local governments. It is possible to create cooperation between the public and private sectors in order to access certain funding schemes in upcoming years.

Grants from structural funds are mainly available in the following areas (activities):

## Research and development

- ▶ Research and development of products and processes
- ▶ Development of new technologies
- ▶ Software development
- ▶ Development of R&D capacities

# Tax incentives for foreign investment

## Environment and energy

- ▶ Purchase of low-energy equipment (renewable energy sources)
- ▶ Introduction of new environmental technology (e.g. construction, reconstruction and intensification of sewage water treatment plants)
- ▶ Low-energy and environment friendly transport systems
- ▶ Modal shift (instead of transport by car/truck, use rail or ship)

## Investment

- ▶ Purchase of engineering equipment and ICT
- ▶ Certification
- ▶ Investment into introduction of new production or expansion of existing production in manufacturing
- ▶ Construction of new, and development of current, industrial parks (including related infrastructure)
- ▶ Support infrastructure of newly established companies with innovation potential (especially start-ups and spin-offs)
- ▶ Support of the creation and development of business property, including the related infrastructure, enterprise zones and brownfield regeneration

## Personnel and training

- ▶ Education and training of employees
- ▶ Employment of unemployed persons or employees threatened by unemployment
- ▶ Construction and reconstruction of training centers

## Technological collaboration

- ▶ Collaboration with other Czech companies or R&D and knowledge institutions
- ▶ Collaboration with foreign companies or R&D and knowledge institutions

## Tourism

- ▶ Development of business infrastructure and tourist services - i.e. (re)construction of accommodation facilities, supplement services related to accommodation
- ▶ Marketing activities on tourist destinations (seminars, information campaigns)

## Export / international collaboration

- ▶ Export to and and/or investments in Europe
- ▶ Export promotion: knowledge exchange, visiting trade fairs, joint ventures (clusters)
- ▶ Marketing activities on tourist destinations (seminars, information campaigns)



## Calling in external advice

- ▶ Management support
- ▶ Market studies and strategy studies

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Taxation

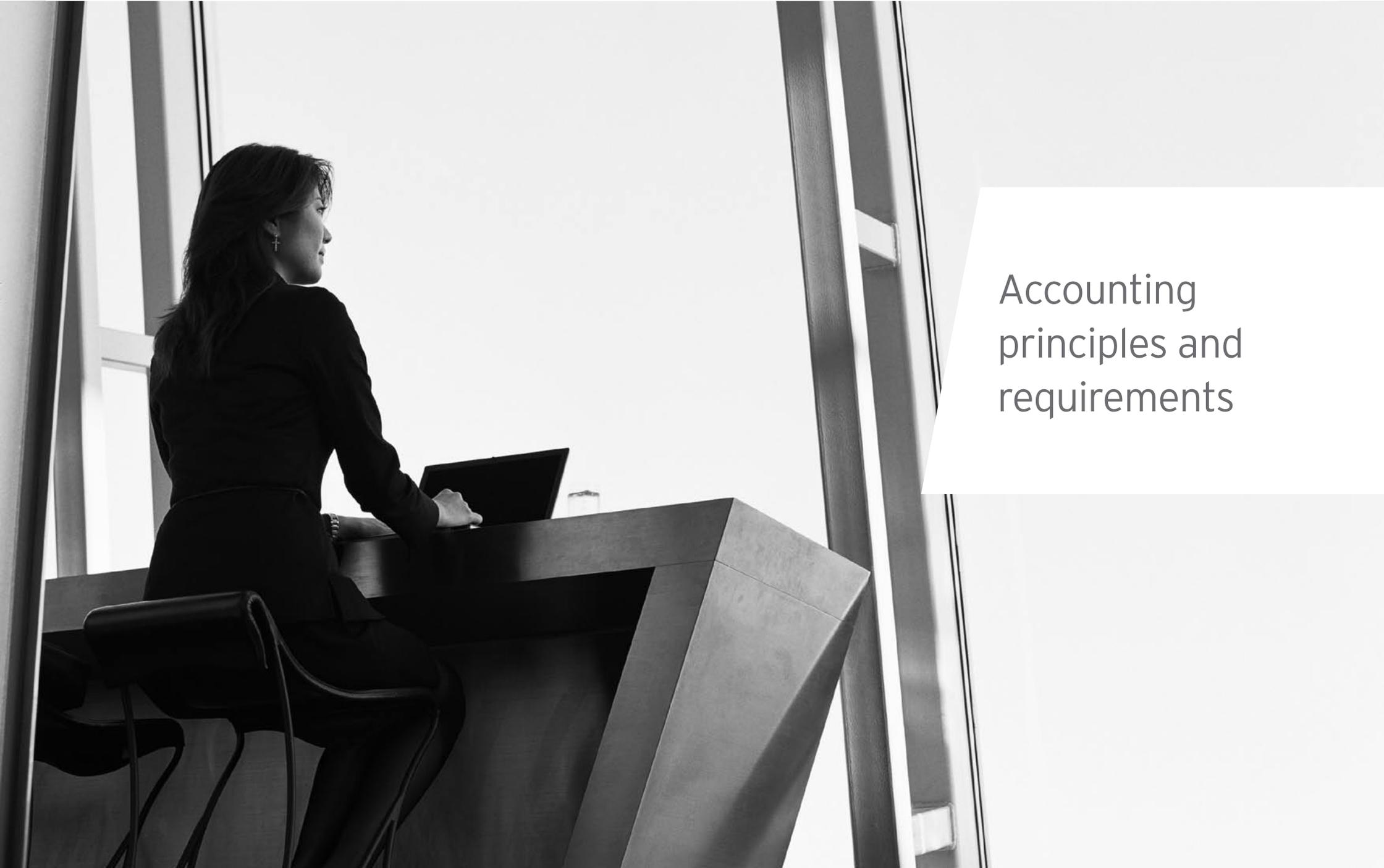
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## Accounting principles and requirements

# Accounting principles and requirements

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# Accounting and record-keeping

The current accounting system, accounting principles and requirements have been effective in the Czech Republic since 1 January 1993. The system is broadly based on similar systems in the EU and the latest amendments bring this system closer to International Accounting Standards.

The Act on Accounting was significantly amended with effect from 1 January 2002 and 2004 respectively, primarily to bring the Czech system closer to International Accounting Standards. However, there are still some differences. Other changes came into effect in 2004, when the Czech Accounting Standards were published.

## Chart of accounts and records

The Act on Accounting and implementation regulations allow the Ministry of Finance to prescribe mandatory formats for the chart of accounts.

Currently, a different chart of accounts format exists for each of the following groups of enterprises:

- ▶ Entrepreneurs (most businesses fall within this category)
- ▶ Banks and further financial institutions (e. g. pension and investment funds)
- ▶ Insurance companies
- ▶ Health insurance companies
- ▶ Municipalities, National Fund etc.
- ▶ Non-entrepreneurs (e.g. non-profit organizations, political parties, civic associations, and other similar bodies).

The chart of accounts for entrepreneurs is as follows:

Class	Description
0	Fixed assets
1	Inventory
2	Financial accounts
3	Receivables and short-term payables
4	Capital accounts and long-term liabilities
5	Expenses
6	Revenues
7	Closing and off-balance sheet accounts
8 & 9	Internal accounting

# Accounting and record-keeping

Two-digit ledger account codes (group accounts) for each class are prescribed - see Appendix 1 for the obligatory Chart of Accounts for Entrepreneurs which has been in effect since 1 January 2003.

Accounts must be in Czech crowns (and assets and liabilities denominated in foreign currency must also be recorded in that foreign currency) and books kept in the Czech language. Records must be retained for the minimum periods in Table 1.

In addition, all documentation which may be used for tax or criminal proceedings, for example, must be retained for a period that enables the requirements of other laws regulating such proceedings to be fulfilled. For example, most of the accounting documents of open tax years must be retained (tax years may be open for up to 17 years).

## Valuation

In general, assets should be recorded at acquisition price plus expenses related to the acquisition or own cost. In certain cases, assets might be recorded at replacement cost. Assets are depreciated over their useful economic lives as determined by the entity. Prescribed depreciation rates apply only for tax purposes.

From 1 January 2002, certain financial assets and derivatives should be restated at fair market value. Assets and liabilities of merged companies should also be re-valued to fair market value.

Stock is valued at acquisition price plus expenses related to the acquisition or own cost. The standard cost method may be used if the results approximate cost. The cost of inventories is assigned using the weighted average cost or the 'first in, first out' (FIFO) formula.

In accordance with the principle of prudence, provisions for a decrease in value should be established where there is a risk that an asset's realizable value is less than the amount shown in the accounts. If the risk ceases to exist, the provision should be reversed. The provisions are shown in a separate column in the balance sheet so that both gross and net values are disclosed. If contingent liabilities arise, reserves should be established.

Type of record	Period
Financial statements and annual reports	10 years
Other accounting documentation, e.g. chart of accounts, ledgers, invoices, stock records, etc.	5 years

# Accounting and record-keeping

## Stock-taking

The stock-taking of assets and liabilities is required as at the date of the preparation of the financial statements. Certain stock and moveable fixed assets may be counted throughout the year. For tangible and intangible property, physical stock-taking will be required; for receivables, liabilities and other property not available for physical stock-taking, the stock-taking of records is required (i.e. detailed listing by invoice). Stock-taking records must be kept for five years.

If year-end stock-taking is not possible, it can be carried out in the last four months of the year or the first month of the following year and rolled forward or back as required.

All differences must be reflected in the accounts of the period to which the stock-taking relates. Surpluses or shortfalls can be aggregated only under specific circumstances if they relate to similar items. If not, they must be recorded separately.

## Differences from internationally accepted accounting standards

The Czech accounting systems differs from International Financial Reporting Standards in many ways, both in concept and in detailed treatments. The following are some of the features of Czech accounting principles that may lead to differences:

- ▶ Major spare parts and stand-by equipment are treated as stock rather than fixed assets.
- ▶ The parts of items of fixed assets are usually not depreciated separately.
- ▶ Capitalization of interest relating to investment in fixed assets is not obligatory starting 2003.
- ▶ Long-term construction, manufacturing and service contracts must be accounted for under the completed contract method, or as provided in the contract. The percentage of completion method is not allowed.
- ▶ All leases are treated as operating leases except for leases of major segments of a business, which may be capitalized.
- ▶ Investments in subsidiaries and associates may be valued using the equity method in the separate financial statements.



# Financial statements and disclosure requirements

## Financial statements

The year-end financial statements consist of a balance sheet, a profit and loss account and notes, and may also include a cash-flow statement or statement of changes in equity. The notes must contain information needed to assess the entity's assets, liabilities, financial position and results. This includes the accounting principles, valuation methods and depreciation rates used in the period. The balance sheet and income statement must be prepared on pre-printed forms.

Changes in accounting policy or methods of estimation can only be adopted between accounting periods (i.e. at the beginning of the following period). The effect of any changes must be reflected in the year of change - prior year adjustments are not allowed. The reasons for any change and the effect on the financial statements must be stated in the notes. The effect of a change on the accounting method related to the deferred tax must be reflected in the equity.

Any offset of assets and liabilities, or income and expenses, is possible only in cases specified in the Czech accounting legislation.

The financial statements and the company's corporate income tax return must be submitted to the Financial Authorities within three months of the financial year-end. The deadline is extended to six months for companies that must be audited or have their corporate income tax returns signed by a qualified Czech tax adviser.

## Financial statements in accordance with IAS/IFRS

Companies which are registered on the Stock Market have to keep their accounting records and prepare the consolidated and separate financial statements in accordance with IAS/IFRS, instead of the Czech Accounting Standards. However, the corporate income tax calculation must not reflect the IAS/IFRS impact.

## Audit requirements

Statutory audits are required for:

- ▶ companies (e.g. joint-stock companies, limited liability companies, partnerships), entrepreneurs and co-operatives where at least two of the following criteria (for joint-stock companies, one of the following criteria) are met for both the current and previous years:
  - ▶ net turnover exceeds CZK 80 million
  - ▶ gross assets exceed CZK 40 million
  - ▶ average number of employees is over 50 persons.
- ▶ entities where the obligatory audit is required by another law (e.g. foundations, under certain conditions).

Audits are governed by the Law on Auditors and International Auditing Standards (ISA). The law also provides for a "true and fair view" opinion on the accounts.

## Disclosure requirements

### For all entrepreneurs registered in the Commercial Register

## Commercial Register

An integral part of the Commercial Register is a collection of documents (Sbírka listin), which must include at least the following, where relevant:

- ▶ Deed of association/partnership agreement/deed of corporate formation (their effective wording)
- ▶ Company statutes, together with any amendments
- ▶ Resolutions concerning changes to a company's statutory bodies
- ▶ Financial statements, together with an auditor's report, and annual report where required. For entities which are required to be audited, these must be filed within 30 days of completion of the audit and general meeting approval.
- ▶ Resolutions to wind up the company
- ▶ Details of mergers, changes in legal form, divisions or transfers of property to shareholders, including project documentation
- ▶ Decisions of a court regarding the invalidity of decisions of the general meeting
- ▶ Expert valuations of non-monetary contributions

# Financial statements and disclosure requirements

- ▶ Decisions of the court issued in accordance with the Bankruptcy Act
- ▶ Agreements on the transfer or lease of the whole or part of the enterprise, control agreements and agreements on the transfer of profit, including any amendments thereto
- ▶ Approval of the spouse on the use of property in the joint ownership of a husband or wife for business purposes
- ▶ Agreements on the transfer or pledge of the ownership interest/share in a company
- ▶ Records of general meetings or resolutions of a single shareholder in the capacity of the general meeting
- ▶ A decision of a court on the execution of the decision by sale of the ownership interest, sale of the enterprise or its part
- ▶ Certain other documents, as required by law

## Annual report

Audited entities must also prepare an annual report, including financial statements with notes, the auditor's opinion and commentary on the business's past and projected future performance, and financial position for the current period and the last two immediately preceding accounting periods. The annual report is a public document and a business entity must publish it in the Commercial Register.

The annual report must be published within 30 days of its authentication by the auditor and approval by the statutory body of the company and, in any event, by the end of the following accounting period at the latest.

If a control agreement is not concluded between controlling and controlled entities, the statutory bodies of the controlled entity must prepare a report on the relationships between the controlling and controlled entities, and on relationships between the controlled entity and other entities controlled by the same controlling entity. The report must be prepared within three months of the end of the accounting period, and attached to the annual report.

## Penalties

From 2002, the following two-tier structure of penalty fines may be imposed by the authorities for specific breaches of the Act on Accounting, calculated as a percentage of total gross assets (i.e. before deduction of depreciation, reserves or provisions):

- ▶ a penalty of up to 6% of total gross assets for failure to keep book of accounts from date of incorporation, non-preparation of financial statements or the annual report, for example
- ▶ a penalty of up to 3% of total gross assets if financial statements do not give a true and fair view, financial statements are not audited as required, the annual report is not published, or there is non-compliance with the archiving of documents.

# Consolidated accounts

## Consolidated accounts

Consolidated accounts must be prepared by any company that is a managing person, controlling person (as defined by commercial law) or a person who exercises substantial influence on the control or operation of another company. Substantial influence means significant influence on the management or operations of the business which is not decisive (as defined by commercial law). If not proved otherwise, a person having at least 20% voting rights shall be considered as having a substantial influence. Consolidated companies must adopt uniform and consistent accounting policies for the purpose of consolidation. Differences on consolidation (goodwill and negative goodwill) can be amortized over a period of up to twenty years.

Full consolidation is required for a company which is managed or controlled by another person.

Proportional consolidation is required for a company which is jointly managed by other persons (two or more) who hold the same share in the equity of the managed company.

The equity method is required for a company under the substantial influence of another person.

Consolidated financial statements consist of a consolidated balance sheet, income statement and notes. They are not used for tax purposes or for calculating distributable profits.

### Consolidation is not required where:

any two of the following criteria apply:

- ▶ the group's gross assets do not exceed CZK 350 million
- ▶ net turnover does not exceed CZK 700 million
- ▶ the average number of employees does not exceed 250.

In addition, consolidation will not be required (under certain conditions) in the following cases:

- ▶ the holding company is itself a subsidiary of a group that produces consolidated accounts in accordance with the Act on Accounting and Accounting Methods or International Accounting Standards
- ▶ the subsidiary or associated companies' share of net group assets and turnover is immaterial
- ▶ there are long-term restrictions on control
- ▶ the consolidation would not reflect a true and fair view.



The consolidating company may use the International Financial Reporting Standards to prepare the consolidated financial statements and the consolidated annual report. Consolidating companies registered on the Stock Market have to use the International Financial Reporting Standards.

# Appendix 1: General chart of accounts

## Class 0 - Fixed assets

- 01 - Intangible assets
- 02 - Tangible assets - depreciable
- 03 - Tangible assets - non-depreciable
- 04 - Intangibles, tangibles and financial investments in progress
- 05 - Advances for intangibles and tangibles
- 06 - Long-term financial investments
- 07 - Accumulated amortization
- 08 - Accumulated depreciation
- 09 - Provisions against intangibles, tangibles and investments

## Class 1 - Inventory

- 11 - Materials
- 12 - Internally developed inventory
- 13 - Merchandise
- 15 - Advances for inventories
- 19 - Provisions against inventory

## Class 2 - Financial accounts

- 21 - Cash
- 22 - Bank accounts
- 23 - Short-term bank loans
- 24 - Short-term notes payable
- 25 - Short-term financial assets
- 26 - Transfers between financial accounts
- 29 - Provisions against short-term financial assets

## Class 3 - Receivables and short-term payables

- 31 - Receivables (short- and long-term)
- 32 - Payables (short-term)
- 33 - Balances with employees and institutions
- 34 - Settlement of taxes and subsidies
- 35 - Receivables from partners, participants in an association and co-operative members
- 36 - Liabilities to partners, participants in an association and co-operative members
- 37 - Other receivables and liabilities
- 38 - Temporary accounts of assets and liabilities
- 39 - Provision against receivables and internal clearing accounts

## Class 4 - Capital accounts and long-term liabilities

- 41 - Basic capital and capital funds
- 42 - Legal reserve fund, indivisible fund and funds created from profit and transferred profit or loss
- 43 - Profit or loss
- 45 - Reserves
- 46 - Long-term bank loans
- 47 - Long-term liabilities
- 48 - Deferred tax liability and asset
- 49 - Sole proprietor

## Class 5 - Expenses

- 50 - Consumed purchases
- 51 - Services
- 52 - Personnel expenses
- 53 - Taxes and fees
- 54 - Other operational expenses
- 55 - Amortization and depreciation, reserves, prepaid expenses (several expense types) and provisions against operational expenses
- 56 - Financial expenses
- 57 - Reserves and provisions against financial expenses
- 58 - Extraordinary expenses
- 59 - Income taxes, transfer accounts and reserve for income tax

## Class 6 - Revenues

- 60 - Revenues from own production and merchandise
- 61 - Changes in internally developed inventory
- 62 - Capitalization
- 64 - Other operational revenues
- 66 - Financial revenues
- 68 - Extraordinary revenues
- 69 - Transfer accounts

# Appendix 1: General chart of accounts

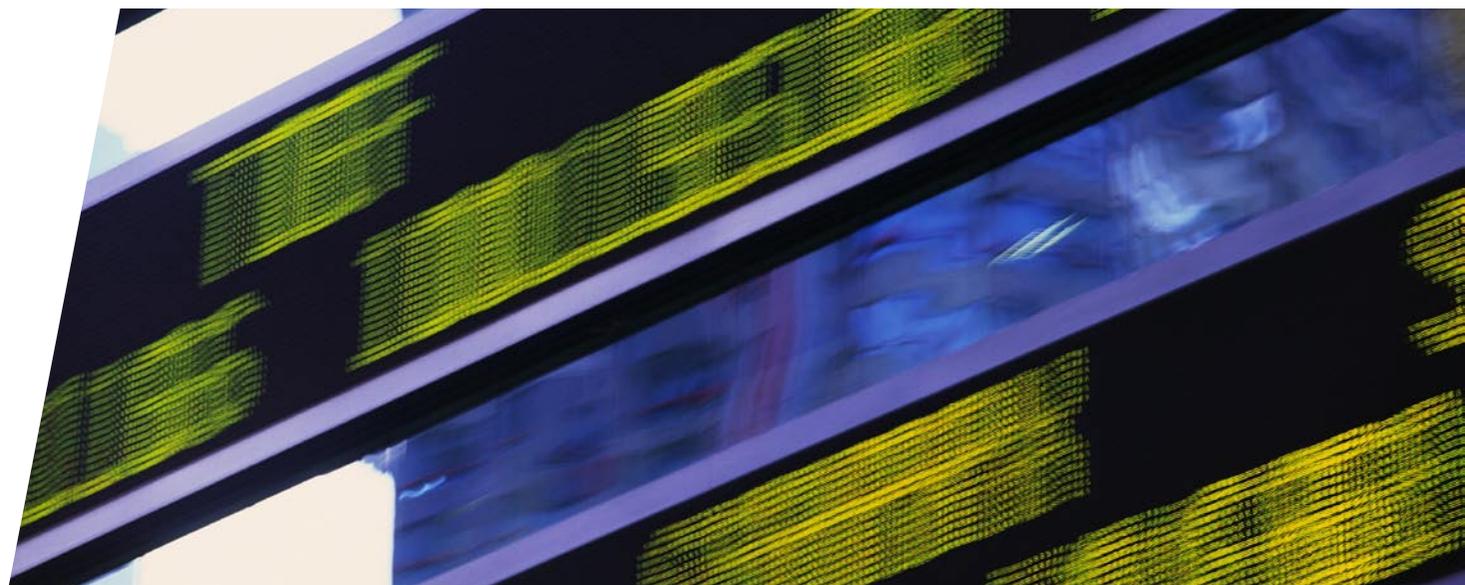
## **Class 7 - Closing and off-balance sheet accounts**

70 - Closing accounts

71 - Profit and loss account

75 through 79 - Off-balance sheet accounts

## **Classes 8 and 9 - Internal accounting**



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## Securities markets

# Securities markets

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# Markets

## Prague Stock Exchange

The Prague Stock Exchange (PSE) organizes the regulated market in investment instruments. In accordance with the Act on Undertaking on the Capital Market, the regulated market breaks down into two segments: the official market and the special market in investment instruments that are not securities (for example, futures).

For greater transparency, the Exchange subdivides the official market into two parts: the Main Market and the Official Free Market.

The Main Market is intended for companies that are willing to provide information flexibly about their economic management. The placement of issues on this market is a matter of prestige for the issuer.

The Official Free Market is intended for other companies that want their securities to be traded on the Exchange but that do not yet satisfy the requirements of the prestigious markets or that are not interested in the Main Market.

The trading rules and requirements regarding the issuers of securities differ significantly between markets. PSE trades can only be made via a broker who is a member of the PSE. Trades are made every trade day within a permitted price range. Continuous trading is permitted in a limited number of securities. Since May 1998, most liquid shares have been traded in the SPAD (System for Support of Shares and Bonds) segment of the PSE, which is based on a system of market makers (selected securities dealers) who guarantee the best prices.

## RM-System

The RM-System - the secondary market - is based on computerized bids and offer matching. Deals can be made through a broker, or directly via a nationwide network of approximately 60 offices. Most listed securities can be traded on this market.

## Over-the-counter market

Securities trading can also be conducted on the over-the-counter market. Deals are settled at the Securities Centre, which reports total volumes and prices on a regular basis.

## Securities Centre / Central Depository

Most Czech shares are registered in the computerized Securities Centre in an uncertificated (paperless) form. According to Czech legislation, substitutable bearer form securities can be replaced by an entry in the register stipulated by law (uncertificated securities).

In connection with the accession of the Czech Republic to the European Union, there has been an extensive law-making process in the area of capital markets law, the aim of which is the full harmonization of Czech law with EU law. The new legislation has been effective since 1 May 2004. One of the main changes brought about by this new legislation affects the recording of investment instruments (including uncertificated securities). The newly adopted act recognizes two basic types of investment instruments registers (i.e., the central securities register and the stand-alone investment instrument register), while the differentiator is the object of the registration and the person that is entitled to keep the register.

The central securities register is kept at two levels. Records on asset accounts are the first level. There are two types of asset accounts: an account kept in the name of an investment instrument's owner (the owner account) and an account maintained in the name of a person other than the investment instrument's owner (the customer account).

## Markets

The customer accounts register all investment instruments entrusted by their owners to the account owner. The owners of securities recorded in the customer account in the central depository are kept in the register of a person authorized to maintain registers, linked to the central securities register that includes owner accounts. These records represent the second securities register level.

A person keeping an independent register of investment instruments maintains the records in owner accounts or customer accounts. A person keeping a register related to the stand-alone register of investment instruments will maintain the records in owner accounts.

The act stipulates the assumption that the owner of investment instruments recorded in an owner account is the person for whom the owner account has been established, unless the act or a final court decision prove otherwise. This can have significant legal, accounting and tax implications for custodian arrangements. Conversely, the financial means and investment instruments of a client, entrusted to a securities dealer based on the asset management arrangement, are not part of the securities dealer's assets.

According to law, a new entity (the Central Depository), that would, among other things, keep the central securities register instead of the Securities Centre, will be established. There is also a difference in customer access to the Central Depository; securities owners will not communicate directly with the Central Depository (as opposed to the Securities Centre), but through Central Depository participants. The Central Depository will publish a current list of participants on a regular basis, in a manner allowing for remote access.

The act's provisions regulating Central Depository activities shall not apply until the Central Depository takes over administration of the register of uncertificated and immobilized (locked-up) securities kept by the Securities Centre. Until then, this register will be kept by the Securities Centre.



# Legislation and regulation

The principal laws regulating the securities markets include:

- ▶ the Act on Undertaking on the Capital Markets, covering particularly definitions of investment instruments, regulation of investment services providers (including the regulation in terms of the European passport), organizers of regulated markets, the Securities Register/ Central Depository and clearing systems, registration of investment instruments, regulation of a public offering, reporting requirements and state supervision - this act is effective from 1 May 2004 and supersedes the main part of the Securities Act and Stock Exchange Act
- ▶ the Act on Collective Investment, covering the operation and investments of investment companies, investment funds (including special funds trading in securities, real estate and special funds investing in funds) and mutual funds (including the issues relating to the European passport) - this act is effective from 1 May 2004, and supersedes the Act on Investment Companies and Investment Funds
- ▶ the Securities Act, covering mainly the issuance of securities, agreements on transfers and pledges of securities, securities custody
- ▶ Commission Regulation (EC) No 809/2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements
- ▶ the Bond Act, dealing with the issuance of bonds - this act is effective from 1 May 2004 and supersedes the previous Bond Act
- ▶ the Commercial Code, covering the issuance of shares and interim certificates, rights attached to shares and interim certificates, certain contracts related to securities and voluntary/mandatory buy-out offers in specific circumstances (e.g. majority takeovers, de-listing)
- ▶ the Civil Code covering consumer contracts and the distance marketing of consumer financial services
- ▶ the Act on Pension Funds, covering the operation and investments of private pension funds
- ▶ the Insurance Companies Act, covering the operation and investments of Insurance Companies
- ▶ the Act on Supervision over Capital Market, covering the supervisory powers of the Czech National Bank, including penalties it may impose on participants in the securities market
- ▶ the Act on Financial Conglomerates, dealing with the state supervision of entities considered members of financial conglomerates and stipulating certain obligatory limits and requirements applicable to these entities (e.g. the supplement requirement for capital adequacy, supplement requirements on risk concentration and operations and requirements for an adequate internal governance and control mechanism). The Act also implemented Directive 2002/47/EC on financial collateral arrangements. Due to such implementation, various existing acts, including but not limited to the Commercial Code and Bankruptcy Act, were amended.

In general, no special restrictions apply to foreign investors purchasing Czech securities. However, there are certain restrictions and special provisions in respect of certain entities and regulated activities. For instance, both foreign and domestic investors can acquire directly or indirectly an interest of 10% or more in a Czech bank only after having obtained prior approval from the Czech National Bank. This approval is also required for further acquisitions which would result in obtaining interest of 20%, 33% or 50%.

# Legislation and regulation

Non-Czech entities with their seat in any EU country wishing to engage in collective investment in the Czech Republic or in the provision of investment services can do so on the basis of their European passports. However, they have to act in compliance with Czech law. Entities from other countries must set up a branch office and obtain a license from the Czech National Bank.

Generally speaking, non-Czech banks which have their seat in any EU country can provide their services in the Czech Republic on the basis of the 'single passport' (under the conditions stipulated by the Act on Banks), either by means of a branch in the Czech Republic or without such branch, in the latter case subject to the fact that the nature of the activities of the bank does not constitute permanent economic activity. Before commencing services in the Czech Republic, the notification duty of the bank towards its domestic regulatory body must be fulfilled, and the Czech National Bank must be informed by the domestic regulatory body of the bank about the bank's contemplated activities in the Czech Republic. Other banks than those with their seat in any EU country wishing to provide services in the Czech Republic must set up a branch in the Czech Republic, obtain a license from the Czech National Bank (the Czech National Bank must ask for the standpoint of the Ministry of Finance) and seek the opinion of their home country banking supervisory authority.

The relevant regulatory and supervisory bodies concerned with capital markets are:

## **The Czech National Bank (supervisory and regulatory body)**

The Czech National Bank administers a register of short-term securities issued by the Czech Republic and Czech National Bank and the market of short-term bonds, and is responsible for supervising and monitoring the capital market.

The Czech National Bank performs state supervision, above all, over the activities of securities dealers, registered investment intermediaries, brokers and investment companies, and funds. It also supervises the stock exchange, RM-System, the Securities Centre, and settlement systems providers. The Czech National Bank also supervises the issue of listed securities in terms of the disclosure duty of their issuers. The Czech National Bank further approves the prospectuses of securities to be publicly offered (e.g., by means of trading on Czech regulated markets). However, a prospectus that has been approved by a regulatory body of any EU country does not need such approval of the Czech National Bank (the European passport).

The Czech National Bank also approves the terms and conditions of bonds to be issued under the Bond Act.



## **The Ministry of Finance**

The Ministry of Finance is a regulatory body for pension funds and insurance companies. However, the Czech National Bank supervises pension funds and insurance companies in terms of their activities relating to the capital market.

## **The Chamber of the Prague Stock Exchange and Board of the RM-System**

The Chamber of the PSE and the Board of the RM-System regulate trading on the PSE and the RM-System respectively, and have authority to approve securities for listing on those public exchanges.

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Foreign exchange controls and investment protection

# Foreign exchange controls and investment protection

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# Foreign Exchange Act

The Foreign Exchange Act came into force on 1 October 1995, and significantly liberalized the Czech exchange control regime. The Czech crown is now fully convertible into other currencies. In addition, Czech legal entities:

- ▶ no longer have to offer their hard currency earnings to Czech banks for conversion into crowns
- ▶ can buy and sell foreign currencies without restriction
- ▶ can receive loans from abroad without restriction
- ▶ can make 'direct investments' abroad without obtaining permission
- ▶ can repatriate profits abroad
- ▶ can acquire foreign securities
- ▶ can provide Czech non-residents with credits or loans
- ▶ can acquire real estate outside the Czech Republic without permission.

The Act contains limits on the ability of a foreign investor to acquire real estate in the Czech Republic (see Legal and Real Estate Matters).

Foreign exchange reporting requirements were also liberalized recently. However, the Czech Republic still has some foreign exchange reporting requirements which generally apply to Czech residents. Czech branches of foreign entities are treated as non-residents for this purpose.

Under the Foreign Exchange Act, the Czech crown is externally convertible for current account transactions, and fulfils the conditions of the International Monetary Fund regarding currency convertibility. The liberalization of foreign exchange control was extended in May 1997 when the Czech National Bank moved to a free-floating exchange rate for the Czech crown. Previously, the crown was pegged to the US dollar and the German mark.



# Investment protection

**The Czech Commercial Code and investment protection treaties guarantee the right to repatriate profits abroad. International investment promotion and protection treaties have been signed with the following countries:**

Albania, Argentina, Australia, Austria, Azerbaijan, Belgium, Belarus, Bulgaria, Bosnia & Herzegovina, Canada, Chile, China, Costa Rica, Croatia, Cyprus, Denmark, Egypt, El Salvador, Estonia, the European Union, Finland, France, Germany, Greece, Hungary, India, Indonesia, Ireland, Israel, Italy, Jordan, Kazakhstan, Kuwait, Latvia, Lebanon, Lithuania, Luxembourg, Macedonia, Malaysia, Malta, Mauritius, Mexico, Moldova, Mongolia, Morocco, Nicaragua, the Netherlands, North Korea, Norway, Paraguay, Peru, the Philippines, Poland, Portugal, Romania, Russia, Saudi Arabia, Singapore, Slovenia, South Africa, Spain, Sweden, Switzerland, Tajikistan, Thailand, Tunisia, Turkey, Turkmenistan, the United Arab Emirates, Ukraine, the United Kingdom, the United States, Uruguay, Uzbekistan, Venezuela, Vietnam, Yugoslavia.



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# Selected other legal and real estate matters

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# Employment law

**Czech legal entities can only employ foreigners if a Czech national cannot fill the vacancy. Foreign employees (other than EU nationals and their relatives) require work permits (issued by a local labor office) and residence visas (issued by the Foreigners Police). All foreign employees must register with the Financial Authorities. From 1 May 2004, EU nationals must be treated equally with Czech people in the employment area. Generally, they do not need a work permit and they are entitled to residence in the Czech Republic.**

**Czech legal entities can employ Czech nationals under a Czech employment contract. Foreign entities/branches can employ Czech nationals, and Czech entities can employ foreigners, on an employment contract concluded under the law of any country, unless a bilateral or international treaty concluded by the Czech Republic stipulates otherwise.**

## Wages and other aspects of employment

Individuals employed under a Czech employment contract must be paid in Czech crowns. Remuneration for duties carried out abroad can be paid in foreign currency. Employees employed under foreign law can be paid in any currency (but the regulation depends on the particular foreign law). Czech labor legislation includes the following provisions:

- ▶ Special conditions apply to employees holding positions in upper management. If agreed in the employment contract, they may be recalled from the position/resign at any time without any reason. However, their employment does not terminate by recall/resignation, and subsequently they must be either offered another job, or their employment be terminated by other means.
- ▶ Employees may have a probationary period of up to three months.
- ▶ The maximum working week is 40 hours. A compulsory rest period of at least 0.5 hours applies to employees working over 6 hours (4.5 hours for young employees). Breaks are not included in working hours.
- ▶ Overtime may be ordered up to 8 hours a week and 150 hours a year. For overtime, the employee is entitled to compensation amounting to his/her average earnings plus a premium payment of 25% of the average earnings; alternatively, the employer and employee may agree to provide the employee with time off instead of paying the premium.



- ▶ The remuneration of managerial employees may be agreed with regard to potential overtime within the scope of 150 hours per calendar year.
- ▶ The minimum annual paid holiday is four weeks.
- ▶ A minimum two months' notice is required from both employers and employees. A longer notice period can be agreed; however, it has to be the same for both the employer and the employee. Employment can be terminated if both the employer and employee agree. The exhaustive list of reasons for which an employer can terminate an employment contract is set out in the Labor Code. Stricter conditions apply to collective dismissals.

# Employment law

- ▶ The parties may conclude a written agreement (or include a clause in the employment contract) under which the employee agrees for a certain period of time after termination of the employment relationship not to engage in certain competitive activities provided, however, that:
  - ▶ the non-competition period lasts a maximum of 1 year
  - ▶ the former employee is compensated during this period
  - ▶ the extent and terms of the non-competition commitment are justifiable.
- ▶ Such agreements may only be concluded after the expiry of a probationary period (if agreed).
- ▶ Fixed-term employment contracts may only be concluded and/or renewed between the employer and the employee for a period of up to two years. Afterwards, only unlimited employment contracts may be entered into between the employer and the employee. Certain exceptions are provided by the Labor Code.
- ▶ The employer must notify or discuss certain situations with employees or employees' representatives - trade unions, works councils, European works councils, etc.



# Competition law

## General introduction

The Act on the Protection of Economic Competition established the Czech Office for Economic Competition (“the Office”).

### This Act:

- ▶ prohibits anti-trust arrangements (such as cartel and price fixing agreements)
- ▶ regulates enterprises with a dominant market position (competitors with a less than 40 % share of the relevant market are presumed not to have a dominant position unless proven otherwise), and
- ▶ sets out the approval required for all concentration (such as mergers, sales of an enterprise, acquisitions of control and full function joint-ventures) that exceeds a minimum threshold (a combination of criteria based on world-wide and Czech net turnover; see below for details).

## Concentration thresholds criteria

The threshold criteria were changed in 2004. Under the new wording of the Czech Act on the Protection of Economic Competition, the only concentrations which will require notification to the Office are those where, for the last accounting period, either:

- ▶ the total net turnover of all the undertakings concerned exceeded CZK 1.5 billion in the territory of the Czech Republic and, at the same time, at least two of the undertakings concerned each generated net turnover of at least CZK 250 million on the Czech market; or
- ▶ the net turnover in the territory of the Czech Republic (i) of at least one concentration participant (in the event of a merger), or (ii) of the acquired undertaking or its fundamental part (in the event of the sale of an enterprise or a part of enterprise) or (iii) of an undertaking over which control is acquired via the acquisition of the shares, ownership interest or other equity investments or another acquisition of control, or (iv) of at least one of the competitors constituting the jointly controlled undertaking, while another concentration participant's worldwide net turnover exceeded CZK 1.5 billion.

The Office envisages that as a result of the new turnover criteria the number of notified concentrations will decrease to a quarter of its current volume.

These turnover criteria have no impact on the assessment of the admissibility of a concentration, which is contingent on whether the given concentration would cause a substantial distortion of economic competition. It is deemed that in cases in which the joint share of the concerned undertakings on the relevant market does not exceed 25%, the given concentration does not result in a substantial distortion of economic competition (unless proven otherwise).

## Concentration proceedings before the Office

The notification on concentration can be filed with the Office either prior to signing the respective concentration contracts or after their signing but always prior to the effectiveness of the relevant contract. Once the Office receives the notification, it will determine within 30 days whether the concentration requires its approval or not. If so, the Office announces this fact to the concentration proceedings participants and it has to issue the decision within five months of the commencement of the proceeding (excluding the time when the participants submit additional evidence based on the Office's petition).

# Real estate

**Since 1 January 2002, foreign companies with a Czech branch or enterprise that possesses authorization to conduct business in the Czech Republic can acquire ownership title to most types of real estate in the Czech Republic, except agricultural land and forests. Other foreign legal entities and individuals often use a Czech legal entity as means to acquire real estate in the Czech Republic. Since 1 May 2004, foreign individuals with residency permits for a citizen of an EU Member State can acquire Czech real estate, except agricultural land and forests. Foreign individuals with residency permits for a citizen of an EU Member State can acquire agricultural land and forests provided that they are entered in a special register held by municipalities.**

Foreign legal entities without a registered Czech presence and foreign individuals without residency permits for a citizen of an EU Member State cannot generally acquire Czech real estate. Certain exceptions apply, e.g. for inherited property. Legislation on the restitution of property expropriated by the communist regime between 1948 and 1989 allow foreigners to reclaim real estate in specific circumstances. In most cases, Czech nationality and permanent residence in the Czech Republic must be adopted.

Czech legal entities, even foreign-owned, and Czech individuals can purchase and lease real estate without restriction. Apart from certain exceptions, the approval of the Ministry of the Environment is required, and certain fees must be paid when agricultural land is to be used for purposes other than agricultural ones.



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