



Investment in the Czech Republic

KPMG IN THE CZECH REPUBLIC

AUDIT ■ TAX ■ ADVISORY

Investment in the Czech Republic

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Preface



Dear reader,
Investment in the Czech Republic is one of a series of booklets published by KPMG in the Czech Republic to provide information to those interested in investing or doing business there.

This publication has been prepared to assist those contemplating investment or commencing operations in the Czech Republic. Its purpose is to provide some general guidelines on investment and business. The information in this booklet is of general nature and should be used only as a guide for preliminary planning purposes. As the tax and legal system in the Czech Republic is still comparatively immature, certainty as to the legal effects of transactions is sometimes therefore less easy to obtain than in more developed economies. In addition, Czech and EU legislation is frequently amended. Accordingly, the information should be viewed only as a general guide and should not be relied upon, without consulting KPMG in the Czech Republic for the specific application of the rules to your own situation.

KPMG in the Czech Republic and its several hundred professionals can render such assistance and would be pleased to provide more detailed information on matters discussed in this publication.

Every care has been taken to ensure that the information presented in this publication is correct and reflects the situation as of April 2009.

More detailed information on the matters discussed in this publication can be obtained from KPMG in the Czech Republic (www.kpmg.cz) which provides audit, tax and advisory services for Czech and multinational companies, government entities and inward investors.

Thank you for taking the time to read this guide to investing in the Czech Republic. All of us here at KPMG in the Czech Republic hope that you will find it helpful and informative.

František Dostálek

Managing Partner of KPMG in the Czech Republic and Regional Chairman and Chief Executive Officer of KPMG in Central and Eastern Europe (CEE)

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Chapter 1

General information about the Czech Republic

Overall characteristics

The Czech Republic is a fully democratic country with a market economy. The political and economic conditions are stable.

Internationally, the Czech Republic has been a member of the European Union since May 2004 and a member of NATO since 1999. For the first half of 2009 the Czech Republic holds the rotating Presidency of the Council of the European Union.

The Czech Republic is also a member of a number of major international organisations including the Organisation for Economic Co-operation and Development (OECD), the United Nations, the International Monetary Fund, the International Labour Organisation, the World Trade Organisation and the Council of Europe. The long-term economic development of the Czech Republic will be secured by meeting all the duties and obligations arising from membership in these organisations.

The Czech Republic is an industrial country with a highly developed industrial base. Its main industries include engineering, in particular automotive, construction, metallurgy, glass manufacturing and beer production; however, the service sector has also become much more developed over the past 19 years, particularly in the country's main urban centres and their surrounding areas. The record flows of foreign direct investment, the European dominance in computer production, the complete automotive supply chain, the track record in supporting global ICT operations, the burgeoning growth of Czech suppliers and the shift away from labour-cost-sensitive investments to high value added activities and extensive R&D as integral parts of global networks, are all pillars sustaining the Czech Republic's growth and underpinning its international competitiveness. The Czech Republic ranked as the most successful transforming country among 125 surveyed countries across the globe, according to the renowned Bertelsmann Transformation Index 2008.¹

¹ Bertelsmann Transformation Index 2008; at: http://www.bertelsmann-transformation-index.de/fileadmin/pdf/Anlagen_BTI_2008/BTI_2008_Brochure_EN.pdf

The Czech Republic has 627 km of motorways and 54,958 km of roads in operation, of which 6,156 km are class I roads (of these 336 km are expressways), 14,669 km class II roads and 34,128 km class III roads. This includes a network of international roads (including motorways) marked with the letter E, according to the AGR (European Agreement on Main International Traffic Arteries), for a length of 2,644 km. With a density of 0.70 km of roads and motorways per square km, the Czech Republic ranks among the leading European countries in terms of road infrastructure.²

Motorways and major roads carry the biggest portion of traffic volumes and connect the most important administrative, economic and resort centres. The highway network has its centre in Prague. The main highways run from the capital to Brno (then on to Slovakia and Austria), Teplice (on to Central and Northern Germany), and from Plzeň (on to Southern Germany and France) and Hradec Králové.

Economy and fiscal policy

The main principles of government economic policy in recent years have been:

- macroeconomic anti-inflationary policy, both fiscal and monetary
- price liberalisation
- support for development of the private sector and encouragement of foreign direct investment (FDI).

In recent years, the Czech Republic has had one of the lowest levels of inflation in Central and Eastern Europe – the average rate of inflation was 2.8 percent (2004), 1.5 (2005) and 2.5 percent (2006). The average rate of inflation in 2007 was 2.8 percent. However, inflation rose sharply to 6.3 percent in 2008.³ Unemployment has been in steady decline from 8.3 percent in 2004 to 7.9 (2005), 7.1 percent (2006), reaching its record level 4.9 percent in January 2008. However, the country saw a slight rise in the unemployment rate during 2008, reaching 6.8 percent at the end of January 2009.⁴ The outlook is less than positive with double-digit unemployment forecast.

² The Road and Motorway Directorate of the Czech Republic; at: <http://www.rsd.cz/Road-network>

³ Czech Statistical Office; at: http://www.czso.cz/csu/redakce.nsf//mira_inflace

⁴ Czech Statistical Office; at: <http://www.czso.cz/csu/csu.nsf/aktualniinformace>

Table 1: Czech Republic: key macroeconomic indicators – Real Economy Indicators⁵

Indicator		2004	2005	2006	2007	2008
GDP	CZK bn, current p.	2814.8	2983.9	3215.6	3530.2	3705.9
GDP per capita	CZK/cap, curr. p.	275 770	291 561	313 213	341 989	355 319
GDP per capita in PPS	PPS/capita, curr.p.	16 257	17 058	18 299	19 966	
GDP	%, y/y, real terms	4.5	6.3	6.8	6.0	3.2
Final consumption expenditure	%, y/y, real terms	0.9	2.6	3.5	3.8	2.2
Household consumption	%, y/y, real terms	2.9	2.5	5.4	5.2	2.9
Gross capital formation expenditure	%, y/y, real terms	9.1	-0.8	10.5	8.4	-1.4
Gross fixed capital formation expenditure	%, y/y, real terms	3.9	1.8	6.5	6.7	3.1
Exports of goods and services	%, y/y, real terms	20.7	11.6	15.8	14.9	6.9
Imports of goods and services	%, y/y, real terms	17.9	5.0	14.2	14.2	4.6
Domestic effective demand	%, y/y, real terms	1.6	2.4	4.3	4.6	2.5
GDP deflator	%, y/y	4.5	-0.3	0.9	3.6	1.7
Gross disposable income	CZK bn, current p.	2 658.5	2 837.1	3 033.2	3 299.1	3 401.6
Gross national saving	CZK bn, current p.	620.0	714.2	780.8	883.0	809.2
Gross national saving rate	%	23.3	25.2	25.7	26.8	23.8
Gross household saving rate	%	5.4	8.2	9.3	9.0	8.2
Aggregate labour productivity	%, y/y	4.3	5.2	5.0	3.3	2.0
Unit labour costs	%, y/y	1.5	-1.2	0.7	2.3	3.5
Energy specific consumption	%, y/y	-2.5	-6.1	-4.8		

⁵ Czech Republic: key macroeconomic indicators, CZSO, Ministry of Labour and Social Affairs of the CR, CNB, Ministry of Finance of the CR and Czech Hydro meteorological Institute, February 2008; at: http://www2.czso.cz/eng/redakce.nsf/macroeconomic_indicators

Indicator		2004	2005	2006	2007	2008
CO2 emission	%, y/y	0.8	-0.6	4.0		
Industry – sales	%, y/y, real terms	9.9	8.1	11.6	10.8	0.1
Construction – sales	%, y/y, real terms	4.5	3.7	13.9	7.4	-1.1
Services – sales	%, y/y, real terms	3.2	3.0	5.0	7.0	0.7
Agriculture – sales	%, y/y, real terms	0.0	8.0	-3.7	-6.6	-3.8
All first job holders in NE	%, y/y	-0.6	1.2	1.3	1.9	1.6
Registered unemployment rate	%, avrg.	10.24
Registered unemployment rate (new meth.)	%, avrg.	9.19	8.97	8.13	6.62	5.45
ILO general unemployment rate	%, avrg.	8.3	7.9	7.1	5.3	4.4
Long-term unemployment rate	%, avrg.	4.2	4.2	3.9	2.8	2.1
Average gross nominal wages4)	%, y/y	6.6	5.3	6.5	7.3	8.5
Average real wages	%, y/y	3.7	3.3	3.9	4.4	2.1
Avg. old-age pension/avrg. Wage	%	40.6	41.1	40.8	40.6	40.0
CPI	%, y/y, avrg.	2.8	1.9	2.5	2.8	6.3
CPI	%, y/y, Dec	2.8	2.2	1.7	5.4	3.6
PPI – industry	%, y/y, avrg.	5.7	3.0	1.6	4.1	4.5
PPI – construction work	%, y/y, avrg.	3.7	3.0	2.9	4.1	4.5
PPI – market services	%, y/y, avrg.	2.3	-0.3	3.3	1.6	3.8
PPI – agricultural producers	%, y/y, avrg.	8.1	-9.4	1.1	16.5	8.8
Prices of exports of goods	%, y/y, avrg.	3.7	-1.5	-1.2	1.3	-4.6
Prices of imports of goods	%, y/y, avrg.	1.6	-0.5	0.3	-1.0	-3.3
Exchange rates	%, y/y, avrg.	2.1	-1.0	-1.5	2.3	-1.3

Current monetary and fiscal policies are aimed at keeping inflation under control and preparing for entry into the Eurozone. The policy for reform has facilitated the transition to an integrated market economy and price controls have been significantly reduced over the past years. However, there is a public finance deficit with the main drain on resources being the high and ever-growing cost of the social welfare system. Billions of Czech crowns have also been invested into the country's infrastructure. Economic growth accelerated, with robust and steady GDP growth in 2004 (4.2 percent), 2005 (6.4 percent), 2006 (6.4 percent) and 2007 (6.1 percent). However, the global economic crisis is threatening GDP growth, with prospects ranging from the optimistic (growth will slow to zero), to the pessimistic (growth will be negative).

Table 2: Czech Republic: key macroeconomic indicators – Monetary indicators

Indicator		2004	2005	2006	2007	2008
CZK/EUR	avrg.	31.904	29.784	28.343	27.762	24.942
CZK/USD	avrg.	25.701	23.947	22.609	20.308	17.035
Nominal effective exchange rate	%, y/y	0.6	6.4	5.2	2.6	11.6
Real effective exchange rate	%, y/y	3.3	5.0	2.5	2.8	9.6
M2 *	%, y/y	4.4	8.0	9.9	13.2	6.5
Current account (CA) of balance of payments	CZK bn	-147.5	-39.8	-82.2	-111.3	-113.9
Financial account (FA) of balance of payments	CZK bn	177.3	154.8	92.4	125.8	151.2
Change in foreign exchange reserves	CZK bn	-6.8	-92.9	-2,1	-15.7	-40.1
CA/GDP	%	-5.2	-1.3	-2.6	-3.2	-3.1
FA/GDP	%	6.3	5.2	2.9	3.6	4.1
CNB international reserves (CNB IR)	CZK bn	636.2	726.7	656,6	631.0	715.8
CNB IR/GDP	%	22.6	24.4	20.4	17.9	19.3
Coverage of goods & services imports by CNB IR	month	3.9	4.2	3.4	2.9	3.2

Table 3: Czech Republic: key macroeconomic indicators – fiscal indicators

Indicator		2004	2005	2006	2007	2008
General government deficit (surplus)	CZK bn	-83.3	-106.7	-84.9	-21.5	-54.0
General government deficit (surplus)/GDP	%	-3.0	-3.6	-2.6	-0.6	-1.5
State budget balance	CZK bn	-93.7	-56.3	-97.6	-66.4	-19.4
State budget balance/GDP	%	-3.3	-1.9	-3.0	-1.9	-0.5
General government debt	CZK bn	855.1	888.6	951.5	1 020.7	1 105.8
General government debt/GDP	%	30.4	29.8	29.6	28.9	29.8
State debt	CZK bn	592.9	691.2	802.5	892.3	999.8
State debt/GDP	%	21.1	23.2	25.0	25.3	27.0

Privatisation of the banking sector and the gas and telecommunications industries has been completed.

Looking to the near future, a strong and stable government is now needed to initiate the substantial fiscal restructuring needed before the euro can be adopted, which will continue to be the main goal of Czech domestic policy.

Debates concerning euro adoption are still ongoing and a final date on adopting the currency has not yet been set by the authorities.

Inflow of FDI

The Czech Republic is one of the most successful transition economies in attracting foreign direct investment. The introduction of investment incentives in 1998 stimulated a massive inflow of FDI into both greenfield and brownfield projects. The privatisation of remaining government stakes in state-owned enterprises is expected to attract significant amounts of FDI, and the major inflow of greenfield projects is expected to continue.

Table 4: Foreign Direct Investments in the Czech Republic 2005 – 2008 in EUR thousands⁶

Year	Equity capital	Reinvested earnings	Other capital	Total
2005	6 188 482	2 624 027	561 030	9 373 539
2006	1 252 857	2 897 317	601 516	4 751 690
2007	2 069 568	4 706 015	-101 915	6 673 668
2008 (1 – 3 q)	1 332 542	3 688 599	550 525	5 571 667

Since 2000 the Czech Republic has attracted high foreign direct investment per capita according to the Vienna Institute for International Economic Studies. This confirms the country's continuing high level of attractiveness for foreign investors.

CzechInvest, the investment and business development agency of the Czech Republic, has commissioned a number of surveys to evaluate the investment climate and satisfaction of foreign companies in the Czech Republic during 2008.⁷

The investment agency's main findings included:

- Nearly two out of three new investment projects gained by CzechInvest in 2008 were focused on research and development or business support services.
- R&D and services surpassed production at a ratio of 2:1
- The most numerous investments in the Czech Republic are in software development – IT comprises 21 percent of all investments
- With CzechInvest's assistance, 213 investment projects are to be implemented, 76 of which are focused on research and development, 58 on services and 79 on production, representing a 6 percent increase
- 14,606 new jobs are to be created, nearly 4,000 of which will be filled by university graduates
- The value of new investments should reach CZK 30 billion

⁶ Czech National Bank; at: http://www.cnb.cz/en/statistics/bop_stat/fdi/fdi_flows_2008/pzi_flows2008_activities_eur.html

⁷ Investments in 2008: Services surpasses manufacturing for the first time (22 January, 2009); at: <http://www.CzechInvest.org/en/investments-in-2008-services-surpasses-manufacturing-for-the-first-time>

History and government

The Czech Republic has a rich cultural, industrial and scientific tradition. Charles University, the oldest university in Central Europe, was founded in Prague in 1348 and the first engineering college in 1707. Each May, Prague hosts a Spring Music Festival that attracts top artists from all over the world and is a fine example of the Czech Republic's musical heritage.

The Czech Republic was subject to communist influence from 1948 until November 1989, when the "Velvet Revolution", so-called because of its non-violent nature, signalled the end of communist rule. Since 1989 the Czech Republic has enjoyed a multi-party democratic political system. The first free elections in over four decades were held in June 1990, with the democratic parties emerging as the victors. The new Federal Parliament then confirmed President Václav Havel as head of state. In January 1998 he was re-elected for another 5-year term. In January 2003 Václav Klaus was elected to this position (and re-elected again in January 2008), having formerly held the positions of leader of the right-wing Civic Democratic Party, Minister of Finance and Prime Minister. Klaus is known as a liberal economist and a member of the "Chicago School".

Until 1993, the Czech Republic was part of a federation with Slovakia, making up the former Czechoslovakia. Peaceful negotiations concerning division of the country led to an agreement that the state of Czechoslovakia would cease to exist on 1 January 1993.

Today, the State's official name is the Czech Republic and the form of state is a parliamentary republic. The head of state is the President, currently Václav Klaus, re-elected by parliament to his second five year term in 2008. The lower house, the Chamber of Deputies, has 200 members; the Upper House, the Senate, has 81 members. The electoral system is defined as universal direct suffrage for party proportional representation, subject to a 5 percent threshold.

Main political parties: Czech Social Democratic Party (ČSSD); Civic Democratic Party (ODS); Communist Party of Bohemia and Moravia (KSČM); Christian Democratic Union-Czechoslovak People's Party (KDU-ČSL); the Green Party (SZ).

From 1998, a minority Czech Social Democratic Party (ČSSD) government held power. The elections in June 2002 resulted in a precarious coalition, (led by Prime Minister Vladimír Špidla succeeded in 2004 by Stanislav Gross and in 2005 by Jiří Paroubek), between the

Social Democrats as the largest single party, and a smaller centre party grouping. The coalition had the minimum overall majority of just one Member of Parliament.

The elections in June 2006 resulted in a stalemate when the right-wing party coalition won the same number of parliamentary seats as the left-wing bloc. After several months of negotiations, Miroslav Topolánek, Chairman of the right-wing ODS, was designated to form a coalition government by President Klaus. The government consists of ODS, KDU-ČSL and the Green Party and it gained a vote of confidence on 19 January 2007 only after having persuaded two MPs from the oppositional CSSD to vote for it. The Government announced ambitious tax, social and health reforms; however, its weak position cast doubts on its ability to realise and implement them. The ODS-led coalition suffered a heavy blow when defeated in the regional elections in November 2008, with the social democrats winning a majority in all regional parliaments except for the capital, Prague.

The government's main task for 2009 is to fight the financial and economic crisis and complete the Presidency of the European Union during the first half. On 8 January 2009 the government created the National Economic Council (the "Council," or "NERV" in the Czech acronym) as an expert advisory and consultative body to the Government of the Czech Republic. The Council will advise the government in the area of economics in concurrence with the Strategy of Preparedness and Growth Acceleration ("SPAR" in the Czech acronym) to address potential risks and threats to the Czech Republic resulting from the global financial crisis.⁸

The terms of elections in 2009 are: European Parliament (2009) and Chamber of Deputies (2009). The ODS-led coalition lost a vote of confidence on 24 March 2009 and demised. Political leaders agreed on premature elections which will be held in October 2009.

Geography and climate

The Czech Republic is located in the geographical heart of Europe, close to most major western European economic centres, and shares borders with Austria, Germany, Poland and Slovakia. The Republic consists of three distinct regions: Bohemia in the west, Moravia and part of Silesia in the east. It has an area of 78,864 square kilometres, or approximately 30,500 square miles. The topography ranges from agricultural plains to rolling forested hills and mountains. The climate is continental with hot but brief summers and frequently cold winters. Rainfall is generally moderate.

⁸ National Economic Council (7th January 2009), at: <http://www.vlada.cz/en/ppov/ekonomicka-rada/national-economic-council-51372/>

Population, language, education

The country's population is 10.23 million. The labour force comprises 5.2 million. One of the main attractions of the Czech economy is a skilled and well-educated labour force available at a fraction of the cost of western economies. According to the OECD, the Czech Republic is ranked among the countries with the highest percentage of science and engineering students. The number of university students increased from 118,000 in 1990-91, to 274,192 in 2003-04 and to 323 765 in 2006-7, due not only to changes in the education system but also a demographic spike of 18-26 year olds.

Educational level

The Czech education system has a very strong position in upper secondary education. In 2003 the percentage of the adult population that had completed at least secondary education in the Czech Republic was among the highest in all OECD countries. 89 percent of the Czech population aged 24-64 had completed at least upper secondary education, compared to an OECD average of 82 percent.⁹

The Czech Republic also has a very good position in tertiary education. There has been an increase in university-level skills in the adult population, as measured by educational attainment. There are currently more than 70,000 technical university students and students who study technical subjects at other universities. Nearly 8,000 university graduates in technical and scientific subjects enter the workforce every year, of which approximately 5,500 have studied primarily engineering or information technology.

Language skills

The proportion of secondary-level students studying English is as high in vocational courses as in "academic" areas, and at 95 percent is high by European standards. English and German dominate foreign language education. English predominates in primary schools while more German is taught in secondary schools. 76 percent of university students learn one foreign language, 20 percent learn two and 4 percent learn three or more foreign languages.

The official language is Czech. In addition, many people speak English or German. Russian is also widely understood by older Czechs.

⁹ Education at a Glance 2007, OECD Indicators, at: <http://www.oecd.org/dataoecd/4/55/39313286.pdf>

The population density is approximately 130 per square kilometre with the majority living in the cities. Prague, the capital, is by far the largest city with 1.2 million inhabitants. Other cities with a population of 100,000 or more include:

- Brno (367,000)
- Ostrava (316,000)
- Plzeň (165,000)
- Olomouc (101,000)
- Liberec (98,000)
- České Budějovice (95,000)
- Ústí nad Labem (94,000)
- Hradec Králové (94,000)
- Pardubice (88,000)

Living and working conditions

The cost of living in the Czech Republic is still lower than in Western Europe but prices, particularly in Prague, continue to move toward western European levels. The retail industry in Prague has expanded very rapidly and almost every type of consumer product is now available. The Czech Republic ranks 34th out of 111 countries in the worldwide quality-of-life index and second highest amongst Central and Eastern European Countries.¹⁰

Hotel capacity in the Czech Republic has expanded significantly. Accommodation of a western standard can be found throughout Prague but may still be difficult to find in other areas. This situation is expected to gradually improve as the country removes certain rent control restrictions.

Prague and all larger cities boast a wide range of rented furnished and unfurnished housing for expatriates and their families, ranging from centrally-located apartments to spacious villas in leafy suburbs. Many real estate agencies offer relocation services for a charge of one to two months' rent. The sale and rental prices of residential premises can vary widely depending on the city, location, size and quality. The purchase price of a three-room apartment in Prague varies from USD 700 to 4,000 per m², in Brno from USD 300 to 1,100 per m², and in Ostrava from USD 200 to 900 per m². The average monthly rent for a standard three-room apartment is USD 660 in Prague, USD 390 in Brno and USD 350 in Ostrava. The prices in other cities are lower than those in Prague or Brno.¹¹

¹⁰ The Economists Intelligence Unit's quality-of-life index; at http://www.economist.com/media/pdf/QUALITY_OF_LIFE.pdf

¹¹ CzechInvest; at: <http://www.CzechInvest.org/en/life-in-the-czech-republic>

The highest office occupancy costs are in the centre of Prague – approximately € 439 per m² per year (in 2007 it was € 340 per m² per year). This amount is standard for modern office space in Prague 1.¹²

A number of international schools have been set up in Prague and children can be educated in English, German, French, Japanese or Spanish. The Czech Republic boasts a significant and growing choice of foreign-language education programmes ranging from kindergartens to MBA studies.

There are over 40 universities, public and private, offering courses in foreign languages (primarily in English), and currently 23 institutions offering MBA degrees. The courses usually require tuition fees, but there may be exceptions (e.g. language course as part of a scholarship). The Institute for Language and Preparatory Studies (www.ujop.cuni.cz) offers Czech language courses for foreigners and preparation for university studies.

Foreign students can receive a scholarship under bilateral international agreements on cooperation in the field of education (offered by the Ministry of Education, Youth and Sport of the Czech Republic) or within the framework of Foreign Development Aid (offered by the Government of the Czech Republic). Information about these scholarships is available at Czech embassies and consulates. A number of higher education institutions offer student mobility programmes under bilateral university agreements and grant scholarships for students with excellent study results or for students with financial difficulties. European students can take advantage of a number of exchange programmes (e.g. Erasmus, EEA/Norway Financial Mechanisms, Aktion, Ceepus). The Erasmus Mundus programme also offers scholarships for non-European students to study selected degree courses. Further scholarship opportunities can be found on the CzechInvest website mentioned below.¹³

Medical Care

The Czech healthcare system is inspired by the European tradition, founded on public services and financed predominantly by public means. Czech physicians are at least of the same quality as in Western European countries. Prague and other cities enjoy a wide range of public and private hospitals and clinics.

¹² Office Space Across the World 2009, Cushman & Wakefield (3 Mar, 2009), at: <http://www.cushwake.com/cwglobal/jsp/newsDetail.jsp?Language=EN&repId=c23400005p&Country=1100090>

¹³ CzechInvest, 2009; National Agency for European Educational Programmes, 2009

For a complete list of hospitals and clinics in English see the following link www.czech.cz.

The number of private hospitals and clinics is growing, including, among others, Top Moravia Health Brno (www.tmhklinika.cz), Doctor Health Centre Prague (www.doctor-prague.cz), GHC Clinic Prague and Brno (www.ghc.cz), Canadian Medical Care Prague (www.cmcpraha.cz/en).

Transport

Public transport in the Czech Republic is comprehensive, efficient and reasonably priced compared to Western Europe. Large towns all boast excellent local networks. With regard to driving, foreigners spending more than 185 days per year in the Czech Republic must obtain a Czech driving license in addition to their own license. This can be done by presenting the original license at the local municipal authority covering the place of residence in the Czech Republic. The deadline for applying for a Czech license is 90 days after the issue date of the long-term visa.

Visas and work permits

A foreign national who is not an EU citizen must obtain the appropriate visa to enter the Czech Republic, subject to certain exemptions. Citizens of many countries do not require a visa for a stay of up to 90 days (e.g. the US, Japan, and most CEE countries), but travellers from certain countries must still apply for a visa in advance of any visit to the Czech Republic. If a visa is required, this must usually be obtained before arrival by applying to a Czech embassy or consulate.

Foreign employees (not citizens of the EU) will generally need the following documents if they wish to work in the Czech Republic:

- a work permit issued by the local labour authority, usually within three to four weeks of submitting the application
- a long-term residence visa exceeding 90 days, issued by the Foreign Police.

A foreigner who applies for a permit to live in the Czech Republic is obliged to apply for the residence visa in person at the Czech embassy in the country of which he or she is a citizen.

The law defines two types of long-term stay for foreign nationals in the Czech Republic – temporary residence and permanent residence. It is important to note that obtaining a long-term residence visa can take anywhere from six to nine months.

The following documents must be enclosed with the application for a residence visa exceeding 90 days:

- passport
- a document confirming the reason for applying for long-term residence, e.g. work permit
- proof that the individual will have accommodation throughout his or her period of residence
- evidence of health insurance
- extract from the Criminal Records of the Czech Republic not older than six months
- extract from the Criminal Records of the country of which the foreigner is a citizen or resident (if such a document exists)
- photographs
- Citizens of the EU need only register their business with the local authority and the social security and health insurance agencies.

Schengen Area

The Schengen Area is a group of twenty-five European countries that have abolished all border controls between each other. On 21 December 2007, the Czech Republic together with Estonia, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia entered the Schengen travel area. Any non-Schengen traveller having a valid Schengen visa has been allowed to travel throughout the 25 Schengen countries from that date.

Lifestyle

Although in most respects life in the Czech Republic has rapidly approached Western standards of living, the cost of living remains substantially lower than in Western Europe. According to the Union Bank of Switzerland, average prices of goods and services in Prague are 70.5 percent of those in New York. Domestic purchasing power in Prague is 58.7 percent of New York's level.¹⁴

¹⁴ Prices and Earnings. A comparison of purchasing power around the globe (2008 edition), UBS; at: http://www.ubs.com/1/e/wealthmanagement/wealth_management_research.html

Graph 1: Domestic purchasing power and total expenditures on goods and services (2008, New York = 100)¹⁵

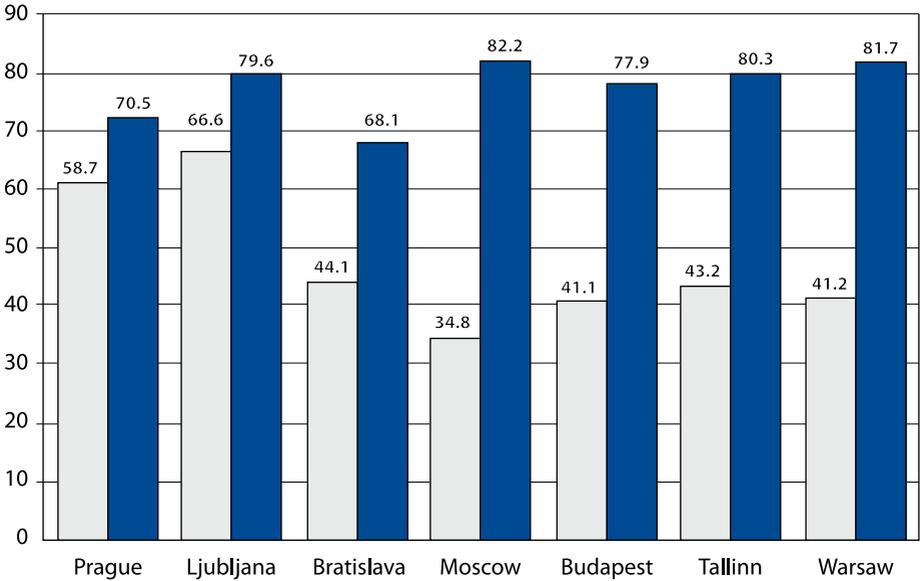


Table 5: Quality of life index, 2008¹⁶

Rank	Country	Score
1	Switzerland	9.71
2	Austria	9.64
3	Australia	9.28
4	Canada	9.27
19	Czech Republic	7.59
25	Slovenia	6.81
28	Slovak Republic	6.30
38	Hungary	5.25
49	Poland	4.26
51	Bulgaria	3.53
54	Romania	2.68

¹⁵ Prices and Earnings, Union Bank of Switzerland, 2008, at: <http://www.CzechInvest.org/data/files/fs-24-life-in-the-czech-republic-88-en.pdf>

¹⁶ Source: IMD World Competitiveness Yearbook 2008, at: <http://www.CzechInvest.org/data/files/fs-24-life-in-the-czech-republic-88-en.pdf>

Entertainment, arts and food

Prague and many cities in the Czech Republic are famous for their architectural heritage (see, e.g., the UNESCO World Heritage List at www.unesco.org, which includes twelve sites in the Czech Republic), museums, theatres, cinemas, galleries, historic gardens and cafes. A wide choice of cultural events is on offer, embracing all types of music and a long theatrical tradition. A number of foreign culture centres, ranging from the British Council to the Goethe-Institut, also offer a range of events and services.

Restaurants in the Czech Republic cater to a wide range of tastes. In larger cities all types of international cuisine are available, from renowned traditional Czech food to Asian specialities. Alongside the country's famous Czech pubs (which offer famous Czech beer brands), larger cities – particularly Prague – boast an extensive number of pubs and restaurants catering especially to foreigners, ranging from Irish pubs to Indian restaurants.

For more information, see the restaurant guides at, e.g., www.restauraceonline.cz or www.grand-restaurant.cz.

Prague was until recently among the cheapest places to dine out, but the strong Czech crown and large numbers of tourists mean that, in the centre, prices are now approaching those of Western Europe. Prices in Prague – the cost of a weighted shopping basket geared to western European consumer habits containing 122 goods and services including rents in Prague – are also relatively low. The price index is at 55 points benchmarked against New York (100). Wage levels (effective hourly wages for 14 professions, weighted according to distribution, net after deductions of taxes and social security contributions) in Prague are at the level of 34.7 points benchmarked against New York (100).¹⁷

Golf – the Czech Republic leads the way

The Czech Republic offers a wealth of sporting opportunities. The most popular sports are ice hockey, football (soccer), basketball, tennis, volleyball, swimming and table tennis, for which there are many clubs and venues in all regions of the country.

The highest number of golf courses in the Eastern European sub-region are located in the Czech Republic, where the tradition of the sport dates back to the early twentieth century (1904), when golf became popular thanks to state-of-the-art golf courses built near Western Bohemian spa resorts. Today, there are 133 clubs offering 120 courses.

¹⁷ Prices and Earnings. A comparison of purchasing power around the globe (2008 edition), UBS; at: http://www.ubs.com/1/e/wealthmanagement/wealth_management_research.html

For more information, see the website of the Czech Golf Federation (www.cgf.cz).¹⁸

Other leisure activities

Most embassies run clubs, groups and even bars for fellow nationals. There are many international cultural institutes in Prague and other cities, e.g. the British Council in Prague and Brno (www.britishcouncil.org/czechrepublic.htm), the Goethe-Institut Prag (www.goethe.de/ins/cz/pra), the American Culture and Trade Center Prague, Österreichisches Kulturinstitut Prag, L'Institut Français de Prague (www.ifp.cz), the Japanese Information and Culture Centre Prague or Istituto Italiano di Cultura Praga (www.iic-praga.cz).

The International Women's Association of Prague (www.iwa-prague.com) is a highly popular club for Czech and foreign women that organises classes, international activities, charity and social events and children's groups of all types. For further information about life in the Czech Republic, you can also visit the website at www.expats.cz.

Shopping

The retail sector in Prague and all larger cities has undergone a revolution in the past decade with many large shopping centres now located within and around the cities. Local concepts of shopping and customer service are now comparable to those of western European countries, and major international retail chains (e.g., Tesco, Billa, Makro, IKEA, OBI, Bauhaus and others) as well as boutique stores (e.g., Zara, C&A, Marks & Spencer, Promod, H&M, Next, Max Mara and others) are present in the Czech market.¹⁹

The currency is the Czech Crown (CZK or Kč) and is fully convertible. ATMs are widely available. Opening hours vary depending on the type of business and location. Most offices and businesses are closed all day on Sunday. Some major stores are open on Sunday and in the bigger cities there are an increasing number of hypermarkets open around the clock. General opening hours are as follows:

	Monday to Friday	Saturday	Sunday
Government offices	8:00-16:30	closed	closed
Banks	8:00-17:30	closed	closed
Major stores	8:00-18:00	9:00-20:00	9:00-20:00

¹⁸ Czech Golf Federation; at: <http://www.cgf.cz>

¹⁹ CzechInvest; at: <http://www.CzechInvest.org/en/life-in-the-czech-republic>

Chapter 2

Investment incentives in the Czech Republic

The Czech Republic offers incentives for investment in manufacturing industry. These incentives are provided in the form of tax relief and cash subsidies in all areas of the Czech Republic excluding Prague. As incentives are considered state aid, their level is set to ensure they do not breach EU rules governing the provision of state aid.

Investment incentives for manufacturing

Overview of incentives

Incentives are provided under the Act No. 72/2000 Coll., on Investment Incentives, and consist of:

- income tax relief for up to five years for the establishment of a new manufacturing entity and for the expansion of an existing manufacturing plant
- employment subsidies in the form of grants for the creation of new jobs and training (available only in regions with high unemployment rates)
- transfer of land at a discounted price.

General conditions

The general conditions for receiving incentives are as follows:

1. The investor must establish a new manufacturing plant, or expand an existing plant.
2. Most manufacturing activities qualify. However, the following are explicitly excluded:
 - extraction of minerals
 - electric power generation and distribution
 - gas and water treatment and distribution
 - construction
 - repairs of motor vehicles
 - trading in goods and services.

3. Acquisition at market value of machinery classified in chapters 84, 85 and 90 of the Customs Tariff. The machinery must be new (not yet used) and produced not earlier than two years before the acquisition. Machinery must be acquired at market price. Production machinery must represent at least 60 per cent of the total value of tangible and intangible assets.
4. The project must meet Czech environmental standards.
5. The investment in tangible and intangible assets must normally be at least CZK 100 million, of which at least CZK 50 million must be financed from equity. The minimum of CZK 100 million is reduced to CZK 60 million, or CZK 50 million if the investment is in a district with an unemployment rate which at the time of the application is at least 25-50 per cent above the national average respectively. The financing requirement is adjusted accordingly. The assets making up the minimum investment must be purchased. Assets subject to finance leases, for example, can not be included.
6. The conditions must be met within three years from the date on which incentives are formally granted. This is subject to a two-year extension in some cases (e.g., where there are unexpected delays beyond the control of the investor).
7. The acquisition of assets for the project including construction works may not start before the incentives application (Statement of Intent) is submitted to Czechinvest and confirmation issued by Czechinvest on eligibility of the project is received.
8. The investment for which the state aid was claimed (at least the minimum investment amount according to point five must be retained in the above requested structure at least five years or the period of actual claiming, whichever is longer. The number of new jobs must be retained at least five years from the first disbursement of the new jobs creation grant.

Income tax relief

Conditions

To be able to claim tax relief, a taxpayer must meet both the general conditions set out above and the special conditions in the Income Tax Act, which are as follows:

1. The taxpayer must claim the following tax deductions:
 - all depreciation must be claimed, although the method of depreciation (i.e. straight line or accelerated) is at the tax payer's discretion
 - tax deductible adjustments to receivables must be created
 - tax losses carried forward must be claimed in the first taxable period in which a profit arises.
2. Except for immovable assets and certain assets acquired from bankrupt taxpayers, the taxpayer must be the "first owner" of tangible fixed assets acquired for the project in the Czech Republic.
3. During the period in which tax relief is claimed, the taxpayer must not be dissolved or subject to bankruptcy proceedings, nor may another entity be merged with the taxpayer.
4. The taxpayer may not inflate profits through transactions at non-arm's length basis with related persons, or by transfers of assets of such persons which would result in their taxable income being reduced.
5. The taxpayer must acquire and record in its fixed assets register tangible and intangible fixed assets in at least the amounts stated in the Act on Investment Incentives (see general conditions above).

Calculation

Calculation of the level of tax relief is the only significant area where the treatment of a new entity differs from that of an expanded entity.

In the case of a new entity, the taxpayer is entitled to full tax relief, excluding net interest income, which will therefore remain subject to tax.

In the case of an expanded entity, the amount eligible for tax relief is the difference between the tax relief which would be available for a new entity and the higher of the tax liabilities in the two years immediately preceding the first year in which relief can be claimed, the latter figure being adjusted by reference to industrial price inflation and the current tax rate.

This formula is a rough attempt to restrict the amount eligible for tax relief to the additional profits created by the expansion.

In both cases, relief is available only in relation to the profits shown in the tax return originally submitted. If a higher tax liability is subsequently assessed, the additional tax must be paid.

Commencement and duration

The first period in which tax relief is available is the period in which the incentives conditions are met, but not later than three years from the date on which incentives are granted. This is generally interpreted as meaning that the investor may choose to postpone claiming tax relief until this three-year period has elapsed.

The tax relief may be claimed for five consecutive tax periods, or until the maximum amount of state aid is reached, whichever occurs first.

Sanctions

If the taxpayer fails to observe the general conditions in the Investment Incentives Act or the special conditions in the Income Tax Act (except for the requirement to claim all available deductions), the right to claim tax relief ceases to exist and any relief already received must be refunded, together with penalties for the late payment of the tax.

If a taxpayer fails to claim the deductions mentioned above, the tax relief is reduced, resulting in an additional tax depending on the amount of the deduction. This amount must then be paid to the authorities together with the appropriate penalties.

Creation of new jobs

Financial support will be provided to an employer who creates new jobs in a region where unemployment was more than 50 per cent above the national average in the last two half-year periods. Both Czech employees and employees from other EU Member States can be taken into account in this calculation. The financial support totals CZK 50,000 per new job. If 1,000 or more new jobs are created, the unemployment rate in neighbouring regions will also be taken into account. Investments in regions not seriously affected by unemployment will not qualify for this type of financial support.

Training and retraining of employees

Financial support for the training and retraining of qualifying employees will be provided to an employer in the form of a partial reimbursement of the costs incurred (employees from other EU Member States can also be considered). The subsidy covers 35 per cent of the eligible costs of training and retraining of employees. Again, investments in regions not seriously affected by unemployment will not qualify for this type of financial support.

Transfers of construction sites

This support can be provided in two forms:

- transfers of sites including infrastructure
- transfers of state-owned land for the purpose of constructing a plant.

The actual provision of this incentive depends on negotiation with the owner of the land (state, region, municipality).

Municipalities which intend to create industrial zones may also request financial support. The benefit to the investor of a subsequent purchase at a discounted price is taken into account when calculating the total amount of state aid.

Admissible level of state aid

The total tax relief, job creation grants, and benefits from transfers of land provided to a single investment project must not exceed the maximum admissible level of state aid.

The maximum level of state aid will be calculated for individual investment projects by the Ministry of Industry and Trade based on the rules set by the European Union and varies according to the individual regions of the Czech Republic.

Generally, the maximum amount of state aid may not exceed 40 per cent of eligible costs (investment in specified tangible and intangible assets). In accordance with the "Regional Map for the 2007-2013 period" the permissible level of state aid is lower in certain regions (e.g. South-West Region: 36 per cent. In some cases (e.g. investments exceeding EUR 50 million or production that does not fall under preferred manufacturing industries determined by the Government Resolution, e.g. production of electronics, cars, machinery equipment, chemicals, etc.) this maximum may be further reduced. For medium-sized enterprises the maximum level of state aid can be increased by 10 per cent, for small enterprises by 20 per cent.

In the case of tax relief, the percentage is applied on an annual basis by reference to the amount invested at the end of each taxable period. It is therefore possible that in some circumstances, e.g. if profits arise before the full amount of the investment has been made, the tax liability in a given period will exceed the amount of state aid available for that period.

Application for investment incentives

The process of obtaining incentives entails:

- submission of an initial application by the person intending to make the investment – often a foreign investor
- consideration of the application by the relevant government bodies
- following approval, an offer of incentives
- a formal application for the incentives by the person who will actually claim them – this may be a person other than the investor, e.g. a Czech subsidiary of a foreign investor set up following the offer of incentives
- final consideration and approval.

There are a number of significant issues related to this process to which careful attention should be paid. In particular, it should be borne in mind that incentives are available only for future investments and it is therefore imperative that the statement of intent be submitted before the project starts.

Please note that efforts are being made in 2009 to significantly amend the current wording and scope of the Investment Incentives Act. Due to the current economic situation (January 2009) the original plans to further reduce investment incentives are being re-considered. At the time of writing it seems likely that incentives will continue to be granted. In addition, other ways of extending the Act are discussed. Re-launching the programme for supporting technological centres and strategic services centres is also considered. Please do not hesitate to contact us for an update on current developments in this area.

EU structural funds

Businesses set up in the Czech Republic can also obtain support from EU structural funds under several Operational Programmes. The most important programmes for businesses are:

- the Operational Programme Enterprise and Innovation
- the Operational Programme Human Resources and Employment.

Although the majority of the programmes are focused on small- and medium-sized enterprises, there are several programmes aimed also at large enterprises.

All Operational Programmes should be available for the period 2007-2013. This, however, does not mean that they will offer similar conditions and subsidies over the whole period. Under each programme a set of different subsidies is available and conditions are changed frequently.

Chapter 3

Commercial Law

General

The basic provisions governing business obligations and other specific aspects of doing business in the Czech Republic (e.g. property leases, liens/mortgages on property), are set out in the Civil Code and in the Commercial Code.

The Commercial Code contains the main aspects of Czech corporate law. It also contains detailed provisions governing contractual relations in business transactions (e. g. purchase contracts, contracts for work, contracts on the sale or lease of a business, credit contracts). Insolvency is dealt with in the Bankruptcy Act.

Types of business entity

The Commercial Code recognises the following types of business entity:

- joint-stock companies
- limited liability companies
- general commercial partnerships
- limited partnerships
- co-operatives
- Societas Europea (European companies)
- European Economic Interest Grouping (EEIG).

In addition, foreign persons may establish a branch in the Czech Republic. A branch is not a legal entity but must be registered in the Commercial Register.

The Commercial Code regulates the status and activities of entrepreneurs and applies to both legal entities and individuals. An entrepreneur is:

- a person recorded in the Commercial Register, or
- a person engaged in business activity on the basis of a trade certificate (živnostenský list) or trade license (koncesní listina), or
- a person engaged in business activity on the basis of an authorisation issued under a special legal regulation (e.g. attorneys, doctors, auditors, tax advisers), or
- a natural person engaged in farming activities and who is recorded in an appropriate register.

An entity that has its registered office in the Czech Republic is a Czech legal person. Foreign persons are defined as persons (natural or legal) who are domiciled abroad or who have their registered office outside the Czech Republic.

A foreign person's authorisation to carry out business in the Czech Republic takes effect on the day on which that person is recorded in the Commercial Register. The business activity must be specified in the entry in the Commercial Register. This does not apply to citizens of Member States of the European Union, the European Economic Area or Switzerland, their family members who have Czech residence permits, citizens of other states with long time residence, the EU and their family members with a long residence permit.

A foreign person may participate in the founding of a Czech legal entity or become a partner or member in an existing Czech legal entity. A foreign person may also be the only founder of a Czech legal entity, provided that Czech law permits a sole founder or a single owner.

The main characteristics of the various entities are as follows:

Joint-stock company

(akciová společnost – "a. s.")

- The company exists independently of its shareholders, who are not liable for the debts and obligations of the company.
- The amount of registered capital and the extent to which it is paid up, the number, class, type and nominal value of shares, any restrictions applying to the transferability of shares and the names and addresses of the members of the supervisory board must be registered in the Commercial Register. In the case of a single shareholder joint-stock company, the sole shareholder must also be registered.
- Share capital may not be less than CZK two million or, in the case of a public offering of shares, CZK 20 million.

- Share capital is divided into a fixed number of transferable shares of a fixed nominal value; these shares may be registered shares or bearer shares.
- A reserve fund must be created of 20 per cent of the net profit for the first year of profit up to a maximum of 10 per cent of share capital. In addition, five per cent of the net profit after tax must be transferred to the reserve fund each year until it reaches 20 per cent of share capital.
- A joint stock company requires an audit if one or more of the following criteria are met for both the year in question and the preceding year:
 1. the net turnover exceeds CZK 80 million per annum
 2. the total assets exceed CZK 40 million
 3. the average number of employees exceeds 50.
- Annual financial statements must be published.
- The company must have a Supervisory Board and a Board of Directors. Each must have at least three members, appointed for terms not exceeding five years. Directors cannot be members of the Supervisory Board. In the case of a company with only one shareholder, the Board of Directors may have less than three members; however, the requirement for at least three members of the Supervisory Board would still apply.
- Non-cash contributions to share capital must be valued by an independent expert proposed by the founders (in the case of the founding of the company) or the company (in the case of a share capital increase), and appointed by the court, and the valuation is binding on the company.
- Rights to receive dividends and other rights attaching to the shares may be transferred separately from the shares to which the rights are attached.
- A share's issue price may not be lower than its nominal value.

Limited liability company

(společnost s ručením omezeným – “spol. s.r.o.” or “s.r.o.”)

- The company exists independently of its members (shareholders), who only are jointly and severally liable for the obligations of the company up to the amount of total unpaid contributions recorded in the Commercial Register.
- The name must include “společnost s ručením omezeným” or the abbreviation “spol. s.r.o.” or “s.r.o.”
- The list of members, the amount of each member's contribution and the names of the members of the supervisory board (if one is established) must be included in the Commercial Register.

- The company must have registered capital of at least CZK 200,000.
- Each member must contribute at least CZK 20,000.
- There is a maximum of 50 members.
- A reserve fund must be created of 10 per cent of the net profit in the first year of profits up to a maximum of five per cent of the registered capital. Five per cent of the net profit after tax must be transferred to the reserve fund each year, until it reaches 10 per cent of the registered capital.
- A Supervisory Board is only necessary if required by the Memorandum of Association.
- The general meeting appoints an executive ("jednatel") or executives, who are legally responsible for the management of the company.
- A limited liability company does not require an audit unless two or more of the following criteria are met, for both the year in question and the preceding year:
 1. the net turnover exceeds CZK 80 million per annum
 2. the total assets exceed CZK 40 million
 3. the average number of employees exceeds 50.

General commercial partnership

(veřejná obchodní společnost – "veř. obch. spol." or "v.o.s.")

- A general commercial partnership is formed by two or more persons (natural persons or legal entities).
- The partners in a general commercial partnership are liable for the debts of the company.
- The names and addresses or registered offices of the partners must be entered in the Commercial Register.
- Each partner is entitled to act on behalf of the partnership and is jointly and severally liable for the partnership obligations to the extent of his entire property.
- The audit requirements are the same as for a limited liability company

Limited partnership

(komanditní společnost – "kom. spol." or "k.s.")

- A limited partnership is formed by two or more persons (natural persons or legal entities). At least one of the partners must be a general partner who has unlimited liabilities liable for the debts of the partnership. At least one partner must be a limited partner who is only liable for the partnership's debts up to the amount of unpaid contributions recorded in the Commercial Register.
- The names and addresses or registered offices of the partners, a statement as to whether they are limited or unlimited partners, the amount contributed by each limited partner and the amount of their paid-in contribution must be entered into the Commercial Register.

- Only unlimited partners are permitted to manage the partnership.
- The audit requirements are the same as for a limited liability company.

Co-operative

(družstvo)

- Cooperatives are formed by at least five members (or by at least two legal entities) to undertake business activities for the economic or social benefit of their members.
- The amount of registered capital and the amount of the members' ,basic investments' must be entered into the Commercial Register.
- Members are not liable for the obligations of the co-operative.
- A co-operative must have a registered capital of at least CZK 50,000.
- A fund of at least 10 per cent of the registered capital must be created at the time of incorporation. At least 10 per cent of the profits after tax must be transferred annually to the fund until it reaches at least 50 per cent of the registered capital.
- The statutory representatives of the company must either be Czech citizens or have Czech residence permits.
- The audit requirements are the same as for a limited liability company.

Branch of a foreign person

(organizační složka zahraniční osoby)

- Branches of foreign businesses can conduct business activities in the Czech Republic if they are included in the Commercial Register.
- The entry should include details of the foreign business and its office in the Czech Republic, the scope of business activities and the name and address of its head (general manager).
- The branch must obtain a trade licence from the regional Trade Licensing (Business Registration) Office.
- The branch does not have limited liability.
- The audit requirements are the same as for a limited liability company.

Formation of a company

The legal documents required to form a company include:

- a draft of the company's Memorandum and Articles of Association or Deed of Formation (in the case of companies with a single founder)
- in the case of joint stock and limited liability companies, expert valuations of any non-monetary contributions
- the minutes of the first general meeting of shareholders

- the licence for trading activities issued by the regional Trade Licensing (Business Registration) Office
- proof that capital contributions have been paid in
- documentary evidence of the person authorised to sign documents in the name of the company or the members
- proof of identity of the members or shareholders
- an extract from the criminal register in respect of executives or responsible persons
- the contract for the lease of premises or a similar document confirming the right to use the official address
- evidence of a bank account in the Czech Republic (usually after formation but before registration in the Commercial Register).

The Commercial Register

The Commercial Register is maintained by the courts. It is only after registration in the Commercial Register that a legal entity has legal status and is entitled to commence business activity in the Czech Republic.

The entry in the Commercial Register includes the following information:

- the name of the entity and the address of the registered office
- its identification number
- the scope of business activities
- the type of entity
- the names and addresses of the executives or directors, together with details of their authorisation to act on behalf of the entity
- details of any branches and their heads
- in the case of a joint stock company – the nominal capital, number and nominal value of the shares of each class, names and addresses of the supervisory board members. If a joint stock company has only a single shareholder, the name of the shareholder.
- in the case of a limited liability company – the names and addresses of the members, the proposed nominal capital, the amount of each individual member's contribution and the names and addresses of the supervisory board members (if relevant)
- in the case of a general or limited partnership – the names and addresses of the partners
- in the case of a co-operative – the proposed registered capital and the amount of each member's contribution
- in the case of a branch – its business name and address in the country of incorporation, the scope of its business activities, the legal form of the company in its country of origin, the business address in the Czech Republic, the name and address of the Head of the Branch.
- Access to the Commercial Register is freely available on the Internet (www.justice.cz).

Statute of limitations

The Commercial Code generally sets the deadline for submission of business-related claims (i.e. the point at which they become “time-barred”) at four years, although claims against carriers or forwarding agents have to be notified within one year. Claims for compensation in respect of damages expire 10 years after the breach of duty arises. The person against whom a right is to become time-barred may repeatedly extend the deadline by providing a written statement to the other party, up to a maximum of 10 years.

Liquidation

Voluntary liquidation is dealt with in the Commercial Code. It is decided by a resolution of the members or shareholders of the company. A liquidator is appointed by the executives or directors, who also set his remuneration. He then assumes their powers. The liquidator is obliged to publish a notice of the liquidation in order to enable creditors to submit claims. Except in cases of bankruptcy, employee claims have priority.

The liquidator’s powers are restricted to acts necessary to complete the liquidation. If he ascertains that the company is insolvent, he must file for bankruptcy.

Upon settlement of all liabilities, the liquidator must produce a report indicating how any surplus assets are to be distributed. This is subject to approval by the shareholders.

The acts of the liquidator may be challenged in the courts by any interested party. Under certain circumstances the courts may dismiss the liquidator and appoint a successor.

Insolvency

A new Insolvency Act has come into force in the Czech Republic from 1 January 2008. The Act applies to both individuals and legal entities. A petition for insolvency can be submitted by either the debtor or any creditor. Proceedings are held at the regional or municipal court.

The debtor is obliged to submit a petition for insolvency where there is more than one creditor, liabilities are more than 30 days overdue and the debtor either is not capable of paying these debts, or where the liabilities are higher than assets, taking into account any future profits and other factors influencing the debtor’s solvency. If this obligation is not met, civil liabilities may ensue.

Insolvency can be resolved by:

- **Bankruptcy proceeding** (konkurs) consisting of a proportional rate settlement of debts. If the bankrupt's turnover does not exceed CZK two million and there are no more than 50 creditors, simplified proceedings can be used. The bankruptcy leads, de facto, to the liquidation of the bankrupt.
- **Reorganisation** consisting of a settlement of debts over time with the continuance of the bankrupt's business activities. Reorganisations are only automatically available for bankrupts with turnover exceeding CZK 100 million or at least 100 employees. Reorganisation for smaller enterprises needs the approval of more than 50 per cent of the creditors.
- **Debt forgiveness** (oddlužení) – similar to reorganisation but available only for persons not carrying on business activities.
- Special proceedings if certain conditions are met.

Once a bankruptcy order has been granted, the court appoints an administrator who then has the authority to handle the assets. The court will also convene a meeting of creditors.

The Act allows the trustee in bankruptcy to contest acts that restrict their ability to recover funds from the debtor. This action has to be granted within one year of the commencement of the insolvency proceeding. It is possible to overrun transactions that took place up to three years before submission of the petition for insolvency if the transaction was with related parties, or up to one year in other cases. In certain cases, transactions up to five years old can be contested.

Chapter 4

Accounting and audit

Accounting requirements

Changes in Czech accounting rules over the last few years have moved Czech accounting closer to International Financial Reporting Standards (IFRS), although there are still some significant differences.

The Act on Accounting serves as the main framework, while detailed guidance is provided in the Decrees on Double-Entry Accounting and Czech National Accounting Standards. The Decrees and Czech National Accounting Standards specify the rules and standards for the various types of accounting unit, e.g. entrepreneurs, banks, insurance companies, non-profit organisations, as well as the municipalities and institutions financed by the state budget.

The main features of the accounting regulations are as follows:

- All accounting records must be in Czech.
- Standard rules and accounting principles must be observed.
- The general structure of the accounts must be in accordance with a standard chart of accounts, although the specific details may vary according to individual organisational needs.
- All businesses registered in the Commercial Register are obliged to use double entry bookkeeping. Single-entry accounting can no longer be used. Accounting units that are not registered in the Commercial Register and whose annual turnover does not exceed CZK 25 million are permitted to keep simplified accounting records ("tax evidence system").
- The depreciation of assets for accounting purposes is determined by the individual accounting unit based on the estimated useful life of the assets.

- A physical count of inventory and fixed assets is required annually.
- Statutory financial statements consist of a balance sheet, a profit and loss account (as a minimum classified by nature) and notes. Financial statements may also include a cash-flow statement and a statement of changes in equity. The layout and headings of the balance sheet and the profit and loss account are prescribed in the Appendix to the Decrees.
- A separate annual report must be prepared by all accounting units that are subject to a mandatory statutory audit.
- All accounting units with listed shares or bonds must maintain their accounting and prepare their financial statements (and consolidated financial statements) in accordance with IFRS as adopted by the EU.
- The Act requires that consolidated financial statements must be prepared for an accounting unit that is a managing or controlling entity. Subsidiaries and accounting units over which significant influence (20 per cent of the voting rights) is exercised are deemed to be consolidated accounting units. This applies to consolidated groups which meet at least two of the following criteria as at the balance sheet date:
 1. the combined turnover exceeds CZK 700 million
 2. the combined assets (without elimination) of the parent company and the subsidiaries exceed CZK 350 million, and
 3. the average number of employees during the accounting period was more than 250.

The exemption from the duty to prepare consolidated financial statements does not apply to banks, insurers and reinsurers, and listed securities issuers.

Consolidation is also not obligatory where the consolidating entity is a part of another consolidating entity that is governed by Czech law or the law of an EU member state, and where specific conditions prescribed by the relevant decree have been met.

- As of January 2001 it has been possible to specify a business year-end other than 31 December, provided there are valid reasons.

Accounting principles and policies

The going concern, materiality, prudence, matching and consistency principles must all be observed during the preparation of Czech statutory financial statements. In recent years, the true and fair view concept has been fully introduced while the “fair value” accounting concept has been implemented only in certain specific areas and in the same scope as in IFRS. Legal form, however, frequently overrides substance.

Common accounting policies followed in the Czech Republic include:

- Fixed assets are stated at acquisition cost and are depreciated over their expected useful lives in accordance with accounting methods.
- There is an option to value an investment at amortised cost or at fair value. The definition of fair value in this particular case is the market price. If it is not available, then the net asset amount is allowed to be used.
- Inventories may be accounted for using standard, average, or first-in, first-out (FIFO) principles. The last-in, first-out (LIFO) method is not permitted.
- Goodwill (both positive and negative differences between the valuation of a business and the sum of the individually revalued asset items, reduced by liabilities taken over) is amortised over 60 months from the date of acquisition.
- Any adjustment to acquired fixed assets (both positive and negative differences between the valuation of a business and the aggregate value of the individual assets shown in the accounting records of the selling, investing or dissolving accounting entity, reduced by liabilities taken over) is amortised over 180 months.
- Both realised and unrealised exchange gains and losses arising from monetary assets and liabilities denominated in foreign currency are recognised in the profit and loss account.

Under Czech accounting legislation, there is no concept of finance leases (leased assets are generally treated as fixed assets by the owner, not by the lessee.)

Deferred income tax should be provided on all timing differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which it can be utilised.

Auditing requirements

Audits are compulsory for:

- all banks and mutual funds
- foundations and certain other non-profit organisations
- joint-stock companies that - in both the current and the previous accounting period – meet at least one of the following criteria:
 1. turnover exceeds CZK 80 million
 2. total assets exceed CZK 40 million
 3. average number of employees exceeds 50
- Other accounting units that meet at least two of the above criteria.

The Act on Auditors defines the responsibility of the Chamber of Auditors, which is responsible for the authorisation of auditors and for setting the standards for audits. The auditing guidelines issued by the Chamber of Auditors have been replaced by the International Standards on Auditing issued by the International Federation of Accountants (IFAC) and the relevant guidance (aplikační doložky) of the Chamber of Auditors of the Czech Republic.

A new Act on Auditors came into effect in April 2009, which implements the provisions of the EU 8th Directive.

This brings changes to many matters, including detailed rules regarding the appointment of auditors, rotation of audit partners and oversight of the audit profession.

Currently, there are approximately 2,000 state-registered auditors.

Chapter 5

Direct taxes

Taxation of legal entities

Dividends received by Czech resident companies are taxed at a rate of 15 per cent. They Corporate income tax is levied on the profits of legal entities, primarily limited liability companies (s.r.o.) and joint-stock companies (a.s.). Although partnerships are legal entities according to the Commercial Code, the profits of a general partnership (v.o.s.) are not subject to corporate tax; instead, each partner's share of the profits is taxed in his hands.

In the case of a limited partnership (k.s.), the limited partner's share of the profits is subject to corporate income tax at the level of the k.s., while the general partner's share is taxed in the same way as in the case of a v.o.s.

A branch or permanent establishment of a foreign company is generally subject to tax on the same basis as a company. It is also possible to tax them on a deemed profit basis, which is usually a percentage of revenues generated in the Czech Republic, or a percentage of costs.

Since most of these legal entities by definition exist for the purpose of carrying on a business, virtually all the income and gains which they realize are included in the calculation of their business profits (see Taxation of business income below). There are special rules for entities not established for the purpose of making profits. These enjoy certain restricted tax privileges.

The corporate income tax rate is 20 per cent in 2009 and 19 per cent in 2010 and onwards.

Capital gains are generally included in income and taxed at the same rate. However, if at least 10 per cent of the shares of a company is held by a parent company for

12 months, income from the sale of the shares is tax exempt if the parent is a Czech tax resident company and the subsidiary is resident in an EU Member State or a non EU Member State with which the Czech Republic has concluded a Double Tax Treaty (subject to certain conditions). Income derived by non-residents from the sale of shares in a Czech company is taxable, unless the seller is an EU resident company and at least 10 per cent of the shares have been held for 12 months.

There is no tax consolidation within the Czech Republic. Each company within a group is taxed individually, with no set-off of losses against profits between different companies. However, virtual tax consolidation can be achieved through a partnership structure.

Dividends received by Czech resident companies are taxed at a rate of 15 per cent. They are exempt from tax if the payer is a company resident in an EU Member State, provided that at least 10 per cent of the shares are held for 12 months.

The exemption also applies if:

- the payer is a tax resident of a state with which the Czech Republic has concluded a Double Tax Treaty, and
- the payer has a similar legal form to a limited liability company (s.r.o.), joint-stock company (a.s.) or cooperative (družstvo), and
- the recipient has held at least 10 per cent of the shares for 12 months, and
- the payer is subject to a tax similar to Czech corporate tax and the rate is at least 12 per cent.

The exemption only applies where the recipient is the beneficial owner of the income.

Mergers and divisions of companies can generally be carried out on a tax neutral basis, although any pre-2004 tax losses of the company which ceases to exist are forfeit. The EU Merger Directive has been broadly assimilated into Czech law. In general, this maintains the tax neutrality of mergers, but it also allows the transfer of unused tax losses for transactions which satisfy certain legal conditions (“transfers of business” and “mergers”), provided that tax avoidance is not the main purpose of the transaction. Additionally, there is a “same activity” rule, which provides that tax losses can only be offset against income earned from the economic activity which generated the tax loss.

Taxation of business income

The starting point for computing the taxable profit is the profit before tax disclosed by the accounts. This is then subject to adjustments under the Income Tax Act. Unless the Income Tax Act contains a provision to the contrary, income and expenses booked for accounting purposes are taxable/deductible. Where capital gains form part of business profits, they are taxable as normal income or are exempt under the participation exemption rules.

For companies the tax year is generally the same as the financial year. It is possible to adopt a financial year ending on a date other than 31 December provided that it is the last day of a calendar month. In the event of a change of the financial year end, there are provisions in the Income Tax Act for dealing with the resultant long or short period. However, these are not perfectly drafted and numerous issues can arise in such cases. Individuals are always taxed based on the calendar year.

The Income Tax Act attempts to define in some detail those expenses which are deductible and those which are not. The general rule is that expenses incurred for the purpose of generating, assuring or maintaining taxable income are tax deductible.

Disallowable expenses include:

- capital expenditure,
- most reserves (including those intended to recognize the realizable value of inventory),
- most valuation differences intended to show assets at fair value rather than cost,
- accounting depreciation of tangible and intangible assets,
- gifts and entertainment,
- expenses incurred to generate non-taxable income,
- distributions of profit,
- loan interest limited by the thin capitalization rules (see below),
- expenses of a parent company relating to holding shares in a subsidiary; interest on credits and loans taken less than six months before acquisition of the shares is considered to be an expense directly attributable to the shareholding in a subsidiary unless the payer can prove otherwise.

Indirect expenses relating to the holding shares in a subsidiary are restricted to five per cent of income from dividends and other profit shares paid out by the subsidiary unless the taxpayer can show that the actual indirect expenses are lower.

Deductible items include:

- tax depreciation of tangible and intangible assets,
- lease payments, subject to certain restrictions,
- certain reserves, as set out in the Act on Reserves,
- expenses on the liquidation of raw material, goods, work-in-progress and products; the reason for liquidation, means, time, place and the nature of the items should be documented.

From 1 January 2005, a special deduction equal to deductible expenditure on research and development can be claimed which effectively means that such expenditure is deducted twice; this deduction, if not used in the period in which it arises, may be carried forward to the next three tax periods.

Lease rentals are generally deductible in accordance with their treatment in the accounts, except for finance leases (“finance lease with subsequent purchase of the leased asset”), where

- the lease term must be at least equal to the asset’s tax depreciation period or 30 years for real estate,
- the sale price must not exceed the tax residual value calculated using straight line depreciation.

For leases which do not qualify, if the asset is sold to the lessee at the end of the lease term, the sale price must not be lower than the tax residual value as calculated above.

If the lease term is shorter than stated above, the lease expenses are tax deductible (provided that other relevant conditions are met), under the condition that the sale price is not lower than tax residual value.

The Act on Reserves allows restricted deductions for bad debt reserves and write-offs. It also allows taxpayers to create tax-deductible reserves for future repairs, subject to the existence of supporting evidence in the form of project plans, etc. However, reserves created from 2009 are only tax deductible if funds are transferred to a separate bank account by the due date for filing the annual tax return.

The Act on Reserves contains special rules for loan provisions for banks and reserves for insurance companies.

Tax depreciation can be claimed on fixed assets. Tangible fixed assets are divided into six categories broadly reflecting the expected useful life as follows:

Depreciation category	Period of depreciation
1 IT equipment, certain machinery etc.	3 years
2 Personal cars, office equipment, certain machinery etc.	5 years
3 Heavy machinery etc.	10 years
4 Pipelines etc.	20 years
5 Buildings other than category 6	30 years
6 Administrative and commercial buildings, hotels, department stores	50 years

Depreciation may be claimed on either a straight line or an accelerated basis. The accelerated depreciation method applies a series of “coefficients” to the input price of the asset. For example, the coefficients in the case of industrial buildings (category 5) are:

- year 1: 30,
- subsequent years: 31.

In other words, the coefficient for the first year is the depreciation life, and for the subsequent years it is the depreciation life plus one.

The depreciation is calculated as follows:

- in the first year the amount of tax depreciation is the input price divided by the coefficient,
- in subsequent years the depreciation is twice the residual value, divided by the appropriate coefficient less the number of years for which depreciation has been claimed.

A special accelerated rate may be used in the first year of depreciation (provided that other relevant conditions are met) which reduces the depreciation base.

The tax depreciation periods for intangible assets are:

- audiovisual products: 18 months,
- software and research and development: 36 months,
- incorporation expenses: 60 months,
- other intangibles: 72 months.

Goodwill is not an intangible asset for tax purposes. For tax purposes, goodwill is defined as the difference between the value of an enterprise or a part of an enterprise, acquired by purchase, and the aggregate of the market value of its individual assets, reduced by liabilities taken-over. Up to 2003, purchase goodwill was depreciated for both accounting and tax purposes over 15 years. In 2003, this was reduced to five years.

From 1 January 2004, however, the tax depreciation period of goodwill was set at 180 months, while the accounting depreciation period remains five years. Goodwill which does not arise on a purchase, e.g. on a merger, is not depreciable for tax purposes. Instead of accounting for goodwill, the difference between the aggregate of accounting residual values of an enterprise (decreased by liabilities) and the market value of the enterprise can be accounted for as a single revaluation difference without revaluation of the individual assets and liabilities. The accounting and tax depreciation period for this is 180 months.

Tax losses incurred up to 31 December 2003 may be carried forward for up to seven years. Those incurred after 1 January 2004 may be carried forward for five years.

Losses may not be carried forward following a substantial change in the ownership of a company unless it can be shown that at least 80 per cent of the company's revenues are derived from the same activities as those carried on in the period when the loss arose. A change of at least 25 per cent in the ownership of the registered capital or the voting rights, or a change resulting in a person obtaining a controlling influence in the company, is always a substantial change.

A taxpayer can apply to the authorities to confirm the availability the carried forward losses after the end of the taxable period in which the losses are to be used.

Transfer pricing/thin capitalization

The Income Tax Act contains two basic provisions relating to transfer pricing and thin capitalization.

Transfer pricing is dealt with in a short provision which states that if prices agreed in transactions between related parties are not at arm's length and the difference is not properly justified, the tax authorities will adjust the tax base. It is possible to request an advance pricing agreement from the tax authorities on the method of setting the transfer price between related parties. No retroactive agreements are possible. There is an administration fee of CZK 10,000 per transaction.

In addition to the provisions of the Income Tax Act, the Ministry of Finance has issued the following Guidelines:

- D-258 (January 2004) confirms that the OECD transfer pricing guidelines are applicable,
- D-292 (December 2005) provides detailed information about the procedure of advance pricing agreements,
- D-293 (December 2005) recommends transfer pricing documentation. It is based on the Code of Conduct issued by the EU Joint Transfer Pricing Forum in November 2005.

These Guidelines are not legally binding measures, but as the tax authorities should follow them, they represent useful guidance for tax payers.

The thin capitalization provisions act to restrict the deductibility of interest where the borrower has insufficient equity. Until the end of 2007 the provisions only applied to related party loans and restricted deductibility of interest if the debt:equity ratio exceeded 4:1. The law changes several times since then, but the current provisions are similar to those in force earlier.

The rules can be summarized as follows:

- Financial expenses arising from loans and credits received from related parties in excess of four times (six times for banks and insurance companies) the borrower's equity are not tax deductible.
- Interest on loans and credits received from unrelated parties, or those secured by a related party, is fully deductible on general principles, except for interest on "back-to-back" loans (i.e. where a related party provides a loan, a credit or a deposit to an unrelated party, which then provides the funds to the borrower) which is treated as interest on related party debt.
- Where the interest or other revenue is derived from the borrower's profit, all financial expenses on the loans or credits received is non-tax deductible.

Notwithstanding the thin capitalization provisions, financial expenses incurred which directly relate to taxable income (e.g. interest income) can be deducted up to the amount of that income.

The new rules can be applied to taxation periods (or periods for which a tax return is filed) starting in 2008.

Interest paid based on loan contracts concluded before 1 January 2008 does not fall within the ambit of the new regulation for tax periods commencing in 2008 and 2009. From the tax period commencing in 2010, all loans will be subject to the new rules.

Any interest or other expenses disallowed under the capitalization rules may be treated as a dividend, i.e. subject to dividend withholding tax, as reduced by the provisions of any applicable double taxation agreement or the EU Parent/Subsidiary Directive.

Taxation of individuals

Individuals are subject to income tax, social security, health insurance, inheritance and gift taxes, and taxes on land and buildings. The taxation of individuals depends primarily on their residence status. Residents of the Czech Republic are subject to tax on worldwide income, whereas non-residents are subject to tax on Czech source income only.

Residence is defined as:

- having a permanent home in the Czech Republic, or
- spending 183 days or more in the Czech Republic during the tax year (the year to 31 December).

Personal income tax is charged on:

- employment income,
- business income,
- investment income,
- rental income,
- capital gains,
- any other income not within the above categories.

There are numerous exemptions, of which the most important are the exemptions from tax on gains from the sale of shares. The exemption applies to sales of all securities acquired on or before 31 December 2008. For shares acquired on or after 1 January 2008, the exemption applies if held for six months and the shareholder has not had more than five per cent of registered capital and voting rights for 24 months preceding the sale. If these conditions are not met, the gains on the sale of the shares are tax-exempt after exceeding a holding period of five years.

Gains from the sale of non-business real estate are exempt if the property has been held by the taxpayer for at least five years prior to the sale. Gains from the sale of a dwelling are also exempt if the dwelling was used as the taxpayer's main residence for at least two years prior to the sale. If the dwelling was used for less than two years, the exemption applies if the gains are used for the taxpayer's housing in the future.

The income of individuals is subject to a flat tax rate of 15 per cent. The tax on employment income is calculated on the "super-gross" salary, which is the gross salary increased by social security and health insurance contributions payable by the employer. Foreign employment income which is taxable in the Czech Republic is increased by deemed contributions of 34 per cent no matter what amount of social security and health insurance contributions was paid by the foreign employer. Thus, the effective tax rate is not 15 per cent but a higher rate depending on the income level.

Dividends and other income are taxed separately and are subject to final withholding tax at source.

Foreign source investment income should be included in the tax base and is subject to a flat tax rate of 15 per cent.

Rental income may be reduced by actual expenses or by an optional lump-sum deduction equal to 30 per cent of the gross income.

Employees are subject to tax on income in all forms, whether in cash or in kind. In particular, benefits, such as the provision of a car which is available for private use, are taxable.

It is not possible to deduct an employee's social security and health insurance contributions from the tax base. However, items such as mortgage interest,

payments for supplementary pension insurance with state support, private life insurance premiums, and donations can be deducted if certain conditions are met.

There is little provision for private pension schemes in the Czech Republic. As a result, contributions paid by the employer are, with restricted exceptions, taxable benefits.

Similarly, there are no special provisions dealing with employee share option schemes, so that gains realized on the exercise of an option are regarded as taxable income. It is generally accepted, however, that no gain arises on the grant of an option.

The salaries of employees of Czech persons or registered branches of foreign persons are subject to deduction of tax at source on a monthly basis, with annual reconciliations. It is also possible to second expatriate staff through a permanent establishment of a foreign employer which, although taxable, is not registered in the Commercial Register. In such a case, there is no liability to withhold tax. Instead, the employees themselves are liable to make tax returns and pay the tax, normally in quarterly installments.

There is a further possible tax treatment of employees of foreign companies, namely the “deemed employer” rule. This rule, which is essentially an anti-avoidance provision, may apply where employees of a foreign employer work in the Czech Republic under the control of a Czech person which pays a fee to the foreign employer for their services.

In such a case, the Czech person is regarded as the employer for tax purposes and has to account for the employees’ income tax. In practice, this rule is rarely applied to employees of bona fide foreign investors, unless they choose to use it as an alternative to the permanent establishment described above.

Resident and non-resident individuals may claim a basic personal tax allowance of CZK 24,840. Other credits are granted to a resident, such as a tax credit of CZK 24,840 for a spouse living in the taxpayer’s household if the spouse’s annual income does not exceed CZK 68,000 and CZK 10,680 for a dependent child. These are also granted to non-residents if at least 90 per cent of their income comes from sources in the Czech Republic.

Social security contributions, where payable, amount to 45 per cent of an employee’s salary. This consists of an employee’s contribution of 11 per cent and an employer’s contribution of 34 per cent, made up as follows:

	Employer (per cent)	Employee (per cent)
Pension	21.50	6.50
Sickness insurance	2.30	0.00
Unemployment insurance	1.20	0.00
Health insurance	9.00	4.50
	34.00	11.00

The maximum annual assessment base (social security and health insurance cap) for 2009 is CZK 1 130 640. Social security and health insurance contributions must be paid on a monthly basis until the aggregate of the monthly assessment bases exceeds the maximum annual assessment base. Upon achieving this maximum limit, the employer should stop paying social security and health insurance contributions. The assessment base is very similar to the tax base.

If an employee changes employer during the calendar year, a new “cap” of CZK 1 130 640 will apply to the employee’s new salary. But if the aggregate of the assessment bases exceeds the maximum, the health and social security authorities will return to the employee, upon request, any excess contributions of the employee.

Foreign persons under local employment contracts are subject to normal social security contributions. If a foreign person is employed by a non-Czech employer and there is a social security treaty between the Czech Republic and the country of the employer, he or she is subject to Czech social security, unless under the terms of the treaty they can remain in the social security system of the home state. From 1 May 2004, the authorities take the view that expatriate employees of EU employers are subject to Czech social security based on the EU social security rules. In practice this means that expatriates are liable to Czech contributions, unless they remain in their home state system under the EU rules.

International tax issues

Companies having their “seat” in the Czech Republic are subject to Czech tax on their worldwide income. The company’s seat is defined as the registered office or where is the place of the effective management of the company. Such companies are referred to as Czech resident.

Other companies (non-residents) are only subject to tax on their Czech-source income, subject to the provisions of any double taxation agreements.

Foreign-source income of Czech resident companies is generally taxable in the Czech Republic, subject to the provisions of any double taxation agreements. The income of foreign branches or permanent establishments of Czech residents is included in taxable profit. Dividends from foreign companies are a separate source of income which is taxable at a special rate, currently 15 per cent, unless the Parent/Subsidiary Directive applies.

Under some double taxation agreements, however, the income of a non-Czech establishments is exempt from Czech tax. In such cases, expenses related to that income are not tax deductible. Credit for foreign taxes on income which is also subject to Czech tax is only available if there is a double taxation agreement with the other state. Otherwise, the foreign tax can only be treated as an expense.

Czech-source income for non-residents is considered to be mainly:

- income of a permanent establishment in the Czech Republic,
- income from dependent activity (employment) performed in the Czech Republic,
- income from services performed in the Czech Republic,
- income from the sale or use of real estate situated in the Czech Republic,
- income from performance and sporting activities in the Czech Republic,
- royalties, dividends and other profit distributions, interest, and lease rentals,
- lottery and gambling winnings in the Czech Republic,
- alimony and pensions arising in the Czech Republic,
- income arising from reduction of the registered capital,
- income from payment of a receivable acquired by assignment,
- penalties from contractual relationships,
- income from transfer of shares in Czech resident companies.

These tax liabilities are to some extent mitigated by tax treaties, where applicable.

In particular, where there is a treaty:

- income from services can usually be taxed only if the service provider has a permanent establishment in the Czech Republic,
- income from employment can usually be taxed only if the employee is employed by a Czech company or a permanent establishment, or if he or she spends more than 183 days in the Czech Republic.

Income of non-residents derived from the transfer of shares in a Czech tax resident company is tax exempt if at least 10 per cent of the shares in a Czech tax resident company are held by a Czech tax resident or an EU resident parent company for at least 12 months.

Income which is liable to tax is generally subject to withholding taxes, for example: dividends – 15 per cent,

- royalties (normally including lease rentals) – 15 per cent,
- services provided in the Czech Republic – 15 per cent,
- activities of entertainers and sportsmen – 15 per cent.

Where such withholding taxes are charged, they are a final tax. They are generally reduced by double taxation treaties.

The EU Parent-Subsidiary Directive has been implemented in the Czech Republic. Under the EU Parent/Subsidiary Directive, a dividend paid by a Czech subsidiary to a parent company that is tax resident in an EU member state may be exempt from withholding tax. These provisions also apply to dividends paid between Czech companies. From 1 January 2009, dividends paid by a Czech company to Switzerland, Norway and Iceland can also be exempt from tax if:

- the subsidiary and the parent have one of the forms listed in the Directive and are subject to one of the taxes listed in the Directive,
- the parent company holds at least 10 per cent of the capital of the subsidiary,
- the minimum shareholding has been held continuously for at least 12 months. The holding period requirement can be met subsequently, provided that the 10 per cent requirement was met on the day of the dividend declaration.

The EU Interest and Royalties Directive has been also implemented in the Czech Republic, but the Czech Republic has been granted a derogation until 2011 in respect of royalties. As a result, interest paid to associated companies resident in the EU is

generally exempt from withholding tax (subject to advance clearance procedures). From 1 January 2009, interest (royalties from 1 January 2011) paid to Switzerland, Norway and Iceland is also exempt under similar conditions as for EU resident recipients. Royalties remain subject to tax at a maximum rate of 15 per cent.

The Czech Republic has implemented the EU Savings Directive, which allows the provision of information about interest paid by Czech financial institutions to non-residents.

Other types of income paid to non-EU or non-EEA residents, notably from permanent establishments, real estate and sales of securities etc., are subject to withholding tax, which is not the final tax, but is a prepayment in respect of the ultimate tax liability.

This withholding tax is generally levied at the rate of 10 per cent (one per cent for sales of securities or payments for receivables purchased from third parties), but may be reduced by prior negotiation with the tax authorities.

The Czech Republic has numerous double taxation agreements, summarized on the next pages:

No.	Country of Residence of Recipient	Effective Date	Dividends (per cent)	Lower Rate on Dividends (min. per cent holding) (per cent)	Interest (per cent)	Royalties (per cent)
1.	Albania	1. 1. 1997	15	5 [25]	5/0 ¹	10
2.	Australia	1. 1. 1996	15	5 [20]	10/0 ¹	10
3.	Austria	1. 1. 2008	10	0 [10]	0	5/0 ²
4.	Azerbaijan	1. 1. 2007	8		10 ¹	10
5.	Belgium	1. 1. 2001	15	5 [25]	10/0 ¹	5/5 EQ./0 ⁴
6.	Belarus	1. 1. 1999	10	-	5/0 ¹	10
7.	Brazil	1. 1. 1991	15		15/10/0 ¹	25TM /15
8.	Bulgaria	1. 1. 2000	10	-	10	10
9.	Canada	1. 1. 2003	15	5 [10]	10/0 ¹	10
10.	China	1. 1. 1988	10	-	10/0 ¹	10
11.	Croatia	1. 1. 2001	5		0	10
12.	Cyprus	1. 1. 1981	10	-	10/0 ¹	5/0 ²
13.	Denmark	1. 1. 1983	15	-	0	5/0 ²
14.	Egypt	1. 1. 1996	15	5 [25]	15/0 ¹	15
15.	Estonia	1. 1. 1996	15	5 [25]	10/0 ¹	10
16.	Ethiopia	1. 1. 2009 ⁷	10	-	10/0 ¹	10
17.	Finland	1. 1. 1996	15	5 [25]	0	10/5OL/1FL/0 ²
18.	France	1. 1. 1975	10	0 [25]	0	10/5 EQ./0 ²
19.	Georgia	1. 1. 2008	10	5 [25]	8/0 ¹	10/5 EQ./0 ²
20.	Germany	1. 1. 1984	15	5 [25]	0	5
21.	Greece	1. 1. 1990	15	-	10/0 ¹	10/0 ²
22.	Hungary	1. 1. 1995	15	5 [25]	0	10
23.	Iceland	1. 1. 2001	15	5 [25]	0	10
24.	India	1. 1. 2000	10	-	10/0 ¹	10
25.	Indonesia	1. 1. 1997	15	10 [20]	12.5/0 ¹	12.5
26.	Ireland	1. 1. 1997	15	5 [25]	0	10
27.	Israel	1. 1. 1995	15	5 [15]	10/0 ¹	5
28.	Italy	1. 1. 1985	15	-	0	5/0 ²
29.	Japan	1. 1. 1979	15	10 [25]	10/0 ¹	10/0 ²
30.	Jordan	1. 1. 2008	10		10/0 ¹	10

No.	Country of Residence of Recipient	Effective Date	Dividends (per cent)	Lower Rate on Dividends (min. per cent holding) (per cent)	Interest (per cent)	Royalties (per cent)
31.	Kazakhstan	1. 1. 2000	10	-	10/0 ¹	10
32.	Kuwait	1. 1. 2005	5	-	0	10
33.	Latvia	1. 1. 1996	15	5 [25]	10/0 ¹	10
34.	Lebanon	1. 1. 2001	5	-	0	5EQ/10
35.	Lithuania	1. 1. 1996	15	5 [25]	10/0 ¹	10
36.	Luxembourg	1. 1. 1993	15	5 [25]	0	10/0 ²
37.	Macedonia	1. 1. 2003	15	5 [25]	0	10
38.	Malaysia	1. 1. 1999	10	-	12/0 ¹	12
39.	Malta	1. 1. 1998	5	-	0	5
40.	Mexico	1. 1. 2003	10	-	10/0 ¹	10
41.	Moldova	1. 1. 2001	15	5 [25]	5	10
42.	Mongolia	1. 1. 1999	10	-	10/0 ¹	10
43.	Morocco	1. 1. 2007	10		101	10
44.	Netherlands	1. 1. 1975	10	0[25]	0	5
45.	New Zealand	1. 1. 2009	15		101	10
46.	Nigeria	1. 1. 1991	15	12.5 [10]	15/0 ¹	15
47.	Norway	1. 1. 1980	15	0 [10]	0	5/0 ²
48.	People's Republic of Korea	1. 1. 2006	10	-	10/0 ¹	10
49.	Philippines	1. 1. 2004	15	10[10]	10/0 ¹	10/15 ⁵
50.	Poland	1. 1. 1994	10	5 [20]	10/0 ¹	5
51.	Portugal	1. 1. 1998	15	10[25]	10/0 ¹	10
52.	Romania	1. 1. 1995	10	-	7/0 ¹	10
53.	Russia	1. 1. 1998	10	-	0	10
54.	Serbia and Montenegro	1. 1. 2006	10	-	10/0 ¹	10/5 ²
55.	Singapore	1. 1. 1999	5	-	0	10
56.	Slovakia	1. 1. 2004	15	5 [10]	0	10/0 ²
57.	Slovenia	1. 1. 1999	15	5 [25]	5/0 ¹	10
58.	South Africa	1. 3. 1998	15	5 [25]	0	10

No.	Country of Residence of Recipient	Effective Date	Dividends (per cent)	Lower Rate on Dividends (min. per cent holding) (per cent)	Interest (per cent)	Royalties (per cent)
58.	South Africa	1. 3. 1998	15	5 [25]	0	10
59.	South Korea	3. 3. 1995	10	5 [25]	10/0 ¹	10/0 ²
60.	Spain	1. 1. 1982	15	5 [25]	0	5 ³ /0 ² /5 ⁵
61.	Sri Lanka	1. 1. 1979	15	-	10/0 ¹	10/0 ²
62.	Sweden	1. 1. 1981	10	0[25]	0	5/0 ²
63.	Switzerland	1. 12. 1996	15	5 [25]	0	5 SPEC
64.	Tajikistan	1. 1. 2008	5		7/0 ¹	10
65.	Thailand	1. 1. 1996	10	-	10/0 ¹	15/10 ³ /5 ² /15 ⁵
66.	Tunisia	1. 1. 1992	15	10 [25]	12/0 ¹	153/5 ²
67.	Turkey	1. 1. 2004 ¹	10	-	10/0 ¹	10
68.	Ukraine	1. 1. 2000	15	5 [25]	5/0 ¹	10
69.	United Arab Emirates	1. 1. 1998	5	0[25] 6	0	10
70.	United Kingdom	1. 1. 1992	15	5 [25]	0	10/0 ²
71.	United States	1. 1. 1994	15	5 [10]	0	10/0 ²
72.	Uzbekistan	1. 1. 2001	10	-	5/0 ¹	10
73.	Venezuela	1. 1. 1998	10	5 [15]	10/0 ¹	12
74.	Vietnam	1. 1. 1999	10	-	10/0 ¹	10
75.	Yugoslavia (only for Bosnia and Herzegovina)	1. 1. 1984	15	5 [25]	0	10

¹ Exemption for certain Government loans or investments

² Cultural royalties

³ Industrial license fees

⁴ Cultural royalties are exempt as of 1/1/2004 (10 per cent rate was applied from 1/1/2001 to 31/12/2003)

⁵ Royalties arising from any copyright of cinematographic films and films or tapes for television or radio broadcasting

⁶ The recipient of dividends is a Government or company which is at least 25 per cent Government-owned

⁷ For Ethiopia - effective date 8 July 2008

TM Trademark royalties only

^{FL} Financial lease

^{OL} Operating lease

^{EQ} Royalties for using equipment

^{SPEC} 5 per cent WHT according to Art. 2 of the Protocol to the Czech-Swiss Double Tax Treaty

Beneficial ownership concept

A number of Double Tax Treaties concluded by the Czech Republic expressly limit their benefits to beneficial owners of income.

In situations where an investor in the Czech Republic is a foreign entity or a trust which is tax transparent under its own tax laws, the Czech Republic will generally honour its transparency for the application of the Income Tax Act and Double Tax Treaties. The income paid from the Czech investment should normally be treated as the income of the ultimate beneficial owner of the investment via the transparent entity.

Tax administration

Tax administration is governed mainly by the Administration of Taxes Act with specific procedures provided by other acts.

All Czech resident companies, limited partnerships, and permanent establishments of non-resident companies must file tax returns. This does not apply to general partnerships where the partners declare their share of the partnership profits.

All individuals with monthly taxable income exceeding CZK 15,000 must file tax returns unless the income is tax exempt or subject to withholding tax. This means that, in general, employees of Czech companies or branches of foreign entities are not required to file returns unless they have other taxable income. Anyone who claims a tax loss must file a return.

The deadline for submission of a tax return is three months from the end of the taxable period. For all taxpayers, with the exception of legal entities that have adopted a non-calendar year end, the taxable period is the calendar year, and the tax return deadline is therefore 31 March.

This deadline is extended by a further three months if:

- the taxpayer is subject to a statutory audit, or
- the taxpayer engages a registered tax advisor to submit the tax return on his behalf.

Except for withholding taxes, income tax is collected during the year by a system of prepayments based on the previous year's liability. The final deadline for settlement of the liability is the same as for the submission of the return.

The tax authority has the power to carry out tax inspections in order to establish or examine the tax base or other circumstances decisive for the correct determination of the tax liability. Tax may not be assessed or additionally assessed after the lapse of three years from the taxable period in which the duty to file a tax return arose. However, if an act directed at the assessment of tax (e.g. tax inspection) is carried out within this period, the deadline for assessment of tax is extended by a further three years, up to a maximum of 10 years.

Where a taxpayer has declared a loss, the period in which an inspection may be carried out is extended by the period during which the loss may be utilized. Since losses may be carried forward for up to five years, theoretically an inspection could be carried out up to 15 years following the period concerned. However, this may apply only to companies which have been granted investment incentives.

Up to 31 December 2006, penalties for the late payment of tax were 0.1 per cent of the tax liability for each day in default. If tax was assessed as a result of an inspection by the tax authority, the penalty rate was doubled, i.e. 0.2 per cent of the additional tax per day in default. If tax was assessed based on a supplementary tax return filed by the taxpayer, only half the rate (0.05 per cent) per day in default is applicable. This applies for the first 500 days during which the tax is overdue; thereafter penalties accrue at 140 per cent of the Czech National Bank discount rate per annum.

Interest of overdue tax due on or after 1 January 2007 is assessed at the CNB Repo rate plus 14 per cent for the first five years; no interest accrues after this date. Where additional tax is assessed by the tax authorities, a penalty of 20 per cent of the additional tax will be levied. If a VAT refund is reduced, the penalty is 20 per cent of the reduction. If tax loss is reduced, a 5 per cent on the reduction is payable as a penalty. If the taxpayer corrects the tax base in an additional tax return, only interest on overdue tax will be payable.

Chapter 6

Indirect taxes

Value added tax

The Czech VAT Act is based on the general principles of the EC VAT Directive 2006/112 (a recast of the Sixth VAT Directive).

VAT is generally due on any supply of goods or services for consideration, where the place of supply is in the Czech Republic, made by a taxable person in the course of business activities carried out by that person. However, certain transactions carried out for no consideration, such as the provision of certain business gifts or the private use of business assets, are also subject to VAT.

The following transactions are subject to Czech VAT:

- delivery of goods and transfer of immovable assets whose place of supply is in the Czech Republic
- provision of services whose place of supply is in the Czech Republic
- intra-Community acquisitions of goods whose place of supply is in the Czech Republic
- goods imported into the Czech Republic.

The place of supply of certain services provided by entities without a registered office or place of business in the Czech Republic is regarded as the Czech Republic, provided that the services are supplied to taxable persons with a registered office, place of business, or permanent establishment in the Czech Republic (the “customer”). These supplies are taxable in the Czech Republic, and the customer is obliged to account for Czech VAT on them under the reverse-charge mechanism. The reverse charge applies to a range of services, including:

- transfers and assignments of copyrights, patents, licences, trademarks and similar rights
- advertising services
- advisory, engineering, consulting, legal, accounting and similar services, data processing and the supply of information; translation and interpreting services
- obligations to refrain from pursuing or exercising, in whole or in part, a business activity or certain rights
- banking, financial and insurance transactions, with the exception of the lease of safe deposit boxes
- supply of staff
- the hiring out of movable tangible property with the exception of means of transport
- telecommunications services
- radio and television broadcasting services
- electronically supplied services
- provision of access to transport and distribution networks for gas or electricity and provision of transport/distribution of gas or electricity through such networks, including directly related services
- services rendered by one person in procuring for another person any of the services
- described above.

Under certain conditions, the Czech Republic is regarded as the place of supply for entities/individuals without a registered office or place of business in the Czech Republic that provide the following services:

- services relating to Czech real estate
- transport services
- ancillary transport activities such as loading, handling and similar activities
- valuation and work on movable tangible property
- cultural services
- training services
- intermediary services
- and certain other services

If these services (or goods supplied with installation) are supplied to a taxable person with a registered office or place of business in the Czech Republic (the customer), they are subject to the reverse charge mechanism (i.e. the customer is obliged to account for VAT). Otherwise the supplier may be required to register for Czech VAT.

Generally, goods acquired from VAT payers in other EU Member States are subject to VAT in the Czech Republic. VAT should be self-assessed by the individual/entity acquiring the goods. With regard to the transfer of goods from another EU Member State to the Czech Republic, a "deemed" Intra-Community Acquisition of goods must be declared by the owner. Based on the general principles, the individual/entity acquiring the goods can deduct the related input VAT in the same VAT return.

The import of goods from outside the EU is subject to Czech VAT, which is payable by the importer. If the importer is registered for Czech VAT, import VAT should be declared using the standard VAT return. Based on general principles for VAT deduction (see below), the importer can deduct the import VAT in the same VAT return.

VAT Registration

If an entity/individual has a registered office or place of business in the Czech Republic, it is treated as a Czech entity for VAT purposes. A Czech entity which makes taxable supplies in the Czech Republic exceeding the VAT registration threshold of CZK one million per 12 consecutive calendar months is required to register and account for Czech VAT.

Even if the registration threshold is not exceeded, Czech entities can still choose to voluntarily register for VAT.

Foreign and EU entities/individuals who do not have a registered office or place of business in the Czech Republic are obliged to register for Czech VAT if they make a taxable supply in the Czech Republic on which they have to account for VAT (provided that the reverse-charge principle cannot be applied). This applies specifically to local supplies of goods and the provision of certain services to individuals/entities not registered for VAT in the Czech Republic. There is no VAT registration threshold for these entities/individuals, which means that VAT registration is obligatory if a Czech taxable supply of any value is made. Non-Czech entities are not obliged to appoint a fiscal representative in the Czech Republic.

Permanent establishments of foreign and EU entities in the Czech Republic must register for VAT from the moment of establishment.

A non-Czech entity can avoid registering for Czech VAT if the obligation to account for the VAT due can be shifted to a Czech customer, provided that the customer is

registered for VAT, or if any simplification can be applied. Simplification procedures have been specifically implemented in the following areas:

- triangulation supplies
- call-off stock sales, and
- supply and installation of goods.

As these provisions and a number of other supplies are subject to particular requirements, non-Czech suppliers should check carefully whether they comply with them.

A group of related persons with a registered office or place of business in the Czech Republic can register as a single VAT payer.

Format of VAT registration number

The format of a Czech VAT registration number is as follows: CZ1234567890 (the number of digits may vary).

Reporting requirements

VAT returns

If the annual turnover of a Czech entity/individual is higher than CZK 10 million, VAT returns must be submitted on a monthly basis. If the annual turnover is lower than CZK two million, VAT returns must be submitted quarterly. If the turnover is between CZK two million and CZK 10 million, the taxable person can choose whether to file monthly or quarterly VAT returns.

Non-Czech entities (including those that have a permanent establishment in the Czech Republic) may only file VAT returns quarterly, i.e. monthly filing is not allowed.

VAT returns must be submitted by the 25th day of the month following the tax period concerned, even if no tax liability arises. VAT liability must be paid by the due date for submitting the VAT return.

If excess input VAT arises, the VAT refund is paid to the VAT payer within 30 days of the deadline for submitting the VAT return without the need to request the refund. If a tax audit is initiated before the VAT is refunded, the time-limit is extended. In such cases, the VAT will be refunded within 30 days of the audit being finalised.

EC Sales Lists

The EC Sales List ("ESL") must be completed if a VAT registered business:

1. makes supplies of goods to a person registered for VAT in another EU Member State, or
2. makes a transfer of its own goods between the Czech Republic and another EU Member State, or
3. acts as the intermediary in a triangular transaction between VAT registered traders in other EU Member States.

The EC Sales List is submitted on a quarterly basis by the 25th day of the month following the calendar quarter concerned. A penalty of up to CZK 2 million may be imposed for failing to submit the ESL.

Intrastat declarations

VAT registered businesses that dispatch or receive goods to or from other EU Member States which exceed the relevant annual thresholds (CZK 8 million for dispatches or CZK 8 million for goods received) must complete and file an Intrastat declaration.

Intrastat declarations are submitted on a monthly basis by the 10th working day of the month following the month for which the declaration is filed (by the 12th working day if the Intrastat declaration is submitted in electronic format). A penalty of up to CZK 1 million may be imposed for failing to submit the Intrastat declaration. Electronic filing is obligatory for forms with more than 15 items.

VAT rates

The standard rate of VAT, which applies to most taxable supplies, is 19 percent. In addition, there is a reduced rate of 9 percent which applies to a number of goods and services including:

- construction services in respect of residential buildings and flats intended for social housing (a specific definition of flats and houses intended for social housing applies)
- reconstruction and repairs of residential buildings and flats
- sewage services, water supplies
- health and social services
- public transport services
- food products
- books, brochures, newspapers and magazines where advertisements do not exceed 50 percent of the space, picture books and books for children, certain health products and services and aids for handicapped persons, firewood.

The VAT payer can request the tax administrator for information about the correct VAT rate to be used in a specific case.

Exempt (zero-rated) supplies

The supplies mentioned below are generally exempt from VAT with the right to deduct related input VAT.

Intra-community supplies of goods

If goods are sold to a customer who is registered for VAT in another EU Member State and the sale involves the transfer of the goods from the Czech Republic (either by the supplier or by the customer) to another EU Member State, the supply is a zero-rated (exempt with credit) intra-Community supply. The supplier should obtain the customer's VAT number and indicate it on the invoice. Documentation verifying the removal of the goods from the Czech Republic should be obtained for the purposes of a tax audit.

If goods are sold and delivered to a customer who is not registered for VAT in another EU Member State, Czech VAT should be accounted for unless the "distance selling" threshold in the destination EU Member State is exceeded. Once the limit is exceeded the supplier may have to register for VAT in the other Member State.

Export of goods

The export of goods to customers outside the EU can be zero-rated provided that the following conditions are met:

- the goods are released into the customs procedure of exportation, outward processing or transit, or the goods are released into a customs-approved treatment of re-exportation of goods from the EU customs territory, or the goods are placed in a customs-free warehouse or zone in the Czech Republic
- transport is arranged either by the Czech exporter or by a third party authorised by it or
- transport is arranged by the customer (if the customer does not have a registered office, place of business or permanent establishment in the Czech Republic), or by any third party authorised by the customer.

The VAT payer should be able to prove the export of goods by an official document from the customs authority verifying the export of goods to a third country or the placement of goods into a customs-free warehouse or zone in the Czech Republic.

Exempt supplies

The items listed below are exempt from VAT:

- insurance services
- financial services
- postal services
- betting, gaming and lotteries
- education
- health and welfare
- TV and radio broadcasting
- certain other supplies of goods and services specified by the Czech VAT Act
- transfers of land (excluding land for development)
- transfers (including financial lease) of immovable property (buildings, flats and non-residential premises) 3 years after the first approval for use was issued by the construction authorities or first use of the property (whichever is earlier)
- lease of land and immovable property (apart from the short-term lease of buildings, lease of parking spaces, and lease of safe deposit boxes).

The taxpayer may opt to charge VAT on the lease of land and immovable property to other entities/individuals registered for VAT.

Recovery of input VAT

A Czech VAT payer is entitled to recover input VAT in respect of taxable supplies from another VAT payer or in respect of imported goods, if they are used for its business activity.

Full recovery of input VAT

A VAT payer is only entitled to recover all input VAT on taxable supplies in respect of:

- taxable supplies liable to Czech output VAT
- zero-rated (exempt with credit) supplies such as the dispatch of goods to other EU Member States and the export of goods to third countries
- supplies with a place of supply outside the Czech Republic as long as input VAT would have been recoverable if they had been made within the Czech Republic

- certain exempt supplies to which the right to deduct VAT does not apply, if they are supplied to a non-EU entity/individual (non-EU) which does not carry out business activity in the Czech Republic, or if the supplies are directly linked to the export of goods
- certain non-VATable supplies specified in Czech VAT law (e.g. sale of enterprise, provision of advertising material).

A VAT payer must evidence its right to recover VAT with an invoice (VAT document). The VAT Act contains a detailed description of the required content of invoices.

The earliest point at which the VAT payer can recover input VAT is in the VAT return for the taxable period in which the taxable supply was received or in which a related payment was received (including advance payments). A claim for a tax deduction cannot be made more than 3 years after the end of the tax period in which the taxable supply was made.

No recovery of input VAT

A VAT payer is generally not entitled to recover input VAT on:

- taxable supplies used to make VAT exempt supplies such as financial services, insurance, exempt rent of real estate, education, health services, etc.
- taxable supplies used for representation (entertainment) to the extent that they are not tax deductible for income tax purposes.

Partial recovery of input VAT

A VAT payer is entitled to partial VAT recovery in respect of inputs related to both types of supplies (i.e. those qualifying for full recovery of input VAT and those not qualifying for recovery). The recoverable amount is based on the ratio of usable supplies to total supplies.

With regard to fixed assets, a VAT payer is obliged to amend the input VAT claimed if the purpose for which the asset is used (full/partial/no deduction of input VAT) changes during the 5 years following the year of acquisition.

VAT refunds for foreign persons

The Czech Republic has implemented the general provisions of the EU Eighth and Thirteenth Directives in respect of VAT refunds for entities registered for VAT purposes in other EU Member States or non-EU businesses.

The conditions for a Czech VAT refund to an EU entity are as follows:

- The entity is established and registered for VAT in another EU Member State.
- During the period for which the VAT claim is submitted, the claimant did not have a registered office, place of business or permanent establishment in the Czech Republic and did not make any supplies in the Czech Republic except for zero-rated or reverse-charge supplies (e.g. imports of goods, exempt supplies to which the right to deduct VAT does not apply, provision of transport and services directly linked to the export of goods, and supplies subject to the reverse charge).
- The goods or services were purchased in the Czech Republic for the purpose of the claimant's business.

A VAT refund can be claimed on the same conditions that apply to a Czech VAT payer. Therefore, a refund cannot be claimed on goods and services for which the input VAT cannot normally be recovered.

The VAT refund should be claimed by means of a written application to the Tax Authority of Prague 1. This application must be submitted by 30 June of the year following the year in which the VAT was incurred. The application must be:

- in Czech
- supported by tax documents issued by a Czech VAT payer proving the supply of goods or services
- accompanied by a confirmation that the applicant is registered for VAT in another EU Member State, issued by the tax authority of the state of registration
- accompanied by a written declaration that the applicant has not supplied goods or provided services in the Czech Republic (apart from the exceptions referred to above)
- accompanied by additional documentation such as an extract from the Commercial Register, official confirmation of the claimant's bank accounts, etc.

If the conditions are met and the application is submitted with the requisite documents, the VAT should be refunded within six months of submitting the application and resolving any queries raised by the related tax authority. However, in practice refunds are usually received 6 – 9 months after the application.

A VAT refund can normally be claimed only if the period covered by the refund is at least 3 months, but less than or equal to a calendar year, and the amount involved is at least CZK 7,000.

A refund of less than CZK 7,000 may be claimed if it relates to the entire calendar year and the amount claimed is at least CZK 1,000.

Non-EU businesses can claim refunds of Czech VAT under a similar procedure, but not VAT on telecommunication charges, fuel, taxis, entertainment, travel or accommodation. A refund will only be made on the basis of reciprocity (currently only Macedonia, Norway and Switzerland met the condition).

Customs duties

The Czech Republic has been a member of the European Union since 1 May 2004 and customs issues are therefore governed by EU law.

The Czech Republic has an inward processing regime (“IPR”), which effectively allows a Czech manufacturer to import, process and export goods free of customs duty and VAT.

IPR takes two forms, namely:

1. the “drawback system”, under which imported components are released into free circulation; this entails the payment of customs duty and VAT on import; subsequently the customs duty is repaid (and the VAT recovered in the same way as any Czech input VAT) if the imported goods are exported from the Czech Republic in the form of upgraded products; or
2. the “suspension system”, under which imported components destined for export from the Czech Republic in the form of upgraded products are, ab initio, free from customs duty and VAT.

In both cases, the declarer on import is the manufacturer to whom the material is released. Ownership of the goods is irrelevant. Within the IPR, Czech materials can be added to processed foreign components. The application of the IPR must be negotiated with the local customs office. Given the complexity of the regime, it should be carefully considered in specific cases to ensure that the optimum customs and VAT treatment is achieved.

Excise duties

Excise duty is payable on hydrocarbon fuels and lubricants, wine, spirits, beer and tobacco products. Excise duties are fixed at a set amount per unit for each group of products.

The Excise Duty Act implements the EU rules governing the production of excise goods and their release into free circulation. These products must generally be produced in a tax warehouse. Once removed from the tax warehouse they must be released into free circulation and excise duty must be paid, or they can be transported under a suspension exemption to a licensed trader in another EU Member State or to another tax warehouse. They can also be exported outside the EU under the suspension system. Excise duty is paid at the moment the suspension regime is terminated. A licensed trader cannot store or sell the products under the suspension system and is obliged to pay excise duty upon receipt of the goods.

Excise duty is administered by the customs authority.

Environmental taxes

Environmental taxes include tax on natural gas and other gases, on electricity and on solid fuels. Only supplies of these products delivered within the Czech Republic are subject to tax. These taxes have been introduced in order to implement EC Directives 2003/96/EC and 2004/74/EC.

The tax rates are:

Natural gas and other gases	for engines from CZK 0 to CZK 264.80/MWh, for other purposes CZK 30.60/MWh
Solid fuels	CZK 8.50 per gigajoule, gross calorific value
Electricity	CZK 28.30/MWh

An exemption from environmental tax may be claimed in respect of energy used in metallurgical or mineralogical processes. Metallurgical processes involve the heated processing of ores or concentrates and the production of basic metals and metallurgical products classified under DJ 27 in the NACE nomenclature. Mineralogical processes involve the production of other non-metal mineral products classified under DI 26 in the NACE nomenclature. As a result, numerous activities of metallurgical plants and metal processors, producers of mineral insulation materials, glassworks and producers of building materials are exempt.

In order to claim the exemption, approval must be obtained from the customs authority.

Traders in electricity, gas or solid fuels may also purchase these products without tax, but prior approval of the customs authority is necessary.

Electricity or raw materials used in the production of energy are tax-exempt as long as they are not used as motor or heating fuel.

Examples of such purposes include:

- chemical reduction processes in blast furnaces (solid fuels)
- electrolytic processes (electricity)
- electricity production (natural gas, other gases, solid fuels)
- combined production of electricity and heat, using generators with a minimum level effectiveness, provided that the heat is supplied to households (natural gas, other gases, solid fuels)
- coke production (solid fuels)
- technological purposes necessary for the production of electricity or for the combined production of heat and electricity (electricity)
- technological purposes necessary for maintaining the ability to produce electricity or heat and electricity combined production (electricity)
- covering losses of a transfer or distribution network (electricity)
- operation of railroads and other rail networks, including transportation of persons and freight by railroads, tramways and trolleybuses
- fuel used for navigating waters within the Czech Republic, except by private recreational boats (natural gas, other gases, solid fuels)
- technological purposes in an enterprise where solid fuels are produced (solid fuels).

In addition, supplies of natural gas and some other gases are tax-exempt if they are used for the production of heat for households and heating facilities. No approval is required to claim the tax-exemption in these cases.

Real estate tax

Real estate tax is payable by the owners of immovable property situated in the Czech Republic. Different rates apply to undeveloped land, agricultural land and buildings.

The property tax on buildings used for business purposes is based on the area of the buildings using the rates below:

	CZK/m ²
Natural gas and other gases	1
Solid fuels	5
Electricity	10

An additional charge of CZK 0.75 per square metre is levied for each floor of construction above ground level.

Real estate tax on agricultural land is 0.75 percent of the deemed value. Special rates apply for forests, lakes and ponds.

For other types of land, the tax is based on the area, and the rate is CZK 1 per square metre for building plots and CZK 0.10 per square metre in other cases.

The rates are multiplied by a coefficient varying from 1-5 depending on the location of the property. In addition, the tax can be increased by another coefficient varying from 2-5 based on the decision of the relevant municipality.

Real estate tax is deductible for corporate income tax purposes.

Real estate transfer tax

A transfer tax of 3 percent of the higher of the purchase price or the appraised value is payable by the seller on all sales of land and buildings and other immovable assets. A special return must be submitted and the tax must be paid within 30 days of registering the sale. Where the seller does not pay the tax, the liability is transferred to the buyer. The tax is deductible for corporate income tax purposes.

Inheritance and gift tax

Inheritance tax is payable by the heirs of deceased persons who do not qualify as a spouse or close relation. Subject to certain exemptions, if the deceased was a Czech citizen with permanent residence in the Czech Republic, the tax is charged on the net value of all assets (except real estate abroad). Otherwise it is charged only on assets located in the Czech Republic.

Gift tax is charged on the gratuitous acquisition of property by a company or a person who is not a qualifying spouse or close relation. The taxpayer is normally the donee, but if the donor is a Czech resident and the donee is not, the tax is payable by the donor.

The gift rates are:

Value CZK	Rate
up to 1 million	7%
excess to 2 million	9%
excess to 5 million	12%
excess to 7 million	15%
excess to 10 million	18%
excess to 20 million	21%
excess to 30 million	25%
excess to 40 million	30%
excess to 50 million	35%
over 50 million	40%

For inheritance tax, the rates are reduced by 50 percent.

Chapter 7

Banking and finance

Local banking system

The Czech National Bank (CNB) is the central bank of the Czech Republic. Its function is to determine monetary policy, issue banknotes and mint coins, and to manage the circulation of currency, the payment system and settlement between banks. For more details, see: www.cnb.cz.

The CNB also integrates supervision over the Czech financial market incorporating the banking sector, capital market, insurance and pension funds sector, credit institutions, foreign exchange market and electronic money institutions.

To properly supervise, the CNB lays down rules safeguarding the stability of the financial market. It systematically regulates, examines, assesses and, where appropriate, issues penalties for non-compliance with these rules.

The responsibility for preparing primary legislation in the financial market area lies mainly with the Ministry of Finance. CNB assists in this process.

The Czech Republic, as part of the EU, has the obligation to adopt Directives issued by the European Committee. These Directives focus on the stability of the European financial market and are thus focused on more accurate measurement of risks, improvement of internal control systems, on increased transparency and customer protection. On the other side, these changes may also represent increased costs or uncertainty for financial institutions (Basel II and MiFID).

The licensing of banks or branches of banks (from countries outside the European Economic Area) and some matters connected with mergers, transfer of assets to partners, etc. fall fully within the responsibilities of the CNB.

A foreign bank can enter the Czech banking sector in four forms:

- as a new company, with up to 100 per cent foreign ownership
- by taking an equity stake in an existing commercial bank
- by establishing a branch of the parent bank, with a banking license
- by establishing a branch of the parent bank, based on the banking license of the parent bank (applicable for banks with a registered office in the European Union) – the “single license principle”.

Before it will grant a banking licence, the Czech National Bank requires:

- minimum registered capital of CZK 500 million (not applicable for a branch), fully repaid (minimum of CZK 500 million must be in the form of monetary investments)
- a detailed business plan based on a detailed economic analysis
- information about the founders and the amount, structure and source of equity capital
- scope of the expected activities, and
- information regarding the organization of the bank, its management and its internal control system.

Foreign-owned banks have the same rights and obligations as Czech banks. The same information must therefore be provided in connection with the setting up a branch office of a foreign bank. In addition, the branch office has to obtain approval from the regulatory body of the parent bank in the domestic state.

Branches operating under the “single banking license” principle have to fulfill the following requirements:

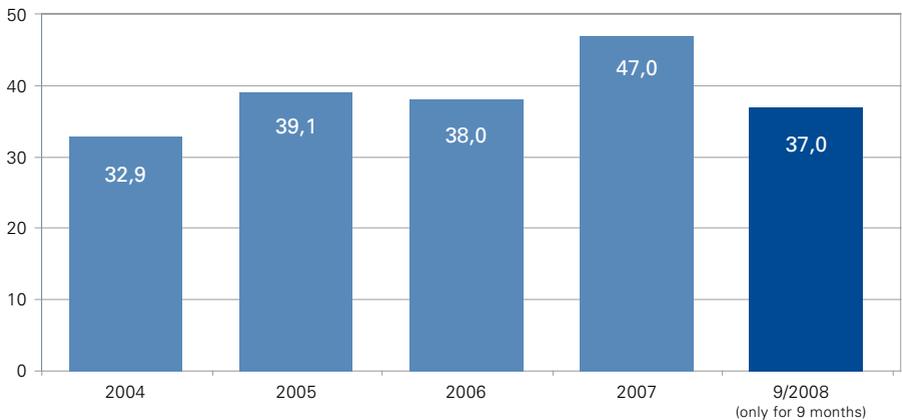
- the parent bank must hold at least 90 per cent of the voting rights and registered capital of the branch and must be governed by the law of the same state as the branch
- activities intended to be carried out in the local market by the branch must also be carried out in the domestic market of the parent bank
- the local branch must be included in the consolidation supervision of the parent bank for the purposes of regulatory supervision
- the parent bank must jointly and severally guarantee the commitments entered into by the branch
- the parent bank must satisfy the home supervisory authority regarding the prudent management of the branch.

A bank wishing to establish a branch within the territory of a host state has to notify the supervisory authorities of the domestic state and provide it with information regarding activities, organizational structure and addresses. Unless the supervisory authority of the domestic state has reason to doubt the adequacy of the administrative structure and the financial situation of the bank, it communicates within three months of receipt of this information to the host supervisory authority.

Within two months of receiving the information, the supervisory authority of the host state prepares for the supervision of the bank. The branch may commence its activities within the territory of the host state on receipt of the information about legal provisions of the host state that will apply to its activities within the territory of the host state or in the event of the lapse of two months without receipt of such information.

As at September 2008, there were 38 banks (foreign branches included) offering banking services to clients in the Czech Republic. 31 banks were controlled by foreign investors and seven banks were controlled by domestic owners. Also in 2008 in the banking sector a predominant role was played by a group of four big banks (meaning banks with total assets over CZK 100 billion). As at September 2008 their share of total assets equalled 60 per cent and their share of total net profits reached 71 per cent. The banking sector remained profitable in 2008. As at September 2008 the net profit totalled CZK 37 billion (for the whole of 2007 it was CZK 47 billion).

Figure 1: Net profit of Czech banking sector, in BCZK



Source: Czech National Bank

Since December 2008, the Deposit Insurance Fund provides insurance protection for 100 per cent of deposits, including interest accrued, up to a maximum balance of EUR 50,000 per client at a single bank. Deposit claims of banks, foreign banks, financial institutions, health insurance companies and state funds are uninsured. All banks and branches of foreign banks (excluding branches of parent banks participating in the deposit insurance scheme in the parent country) are obliged to participate in the scheme and to contribute to the Fund to the extent specified in the Banking Act.

The annual contribution of a bank to the Fund is 0.1 per cent of the average volume of insured deposit claims for the previous year, including interest accrued.

Additionally, to decrease the credit risk of the banks, the Central Credit Register has been established. The Register is an information system that pools information on the credit commitments of individual entrepreneurs and legal entities, and facilitates the efficient exchange of this information between Register participants.

The Czech National Bank issued a decree on prudential rules for banks, credit unions and investment firms in 2007. This decree introduced the principles of Basel II into Czech banking regulations. Banks in the Czech Republic are required to maintain a capital adequacy ratio of eight per cent. The Act on Financial Conglomerates tightens up prudential, mainly capital, requirements for economically-related groups, fulfilling the definition of financial conglomerates.

Prague Stock Exchange

The Prague Stock Exchange (PSE) began trading in April 1993. Currently it is possible to trade on main and official open markets which are both regulated by PSE. The conditions for trading on each market are as follows:

- Only companies that offer at least 25 per cent of their capital stock to the public within the EU and exist for at least three years are allowed to trade on the main market. The main obligation is however the issuer's obligation to make its financial information publicly available on a regular basis. The issuer also has to prepare its audited financial statements according to IFRS.
- Companies that offer at least 25 per cent of their capital stock to the public within the EU and have existed for at least three years can trade on the official open market. The main advantage of this market is less stringent rules concerning informational duties. The PSE also organizes trades on the special market with investment instruments other than securities (e.g. futures, emission rights).

Exchange deals are cleared by the Securities Center. Trading and exchange trading licenses are issued by the Securities Commission.

In 2004 a complex regulatory framework for the capital markets was introduced (the Act on Capital Markets). The Act defines investment instruments and investment services as well as the capital adequacy requirements for brokers, who are required to maintain a capital adequacy ratio of eight per cent. The calculation of the capital adequacy ratio is similar to the calculation for banks.

The Czech National Bank issued a decree on prudential rules on providing investment services for securities traders in 2008. This decree introduced the principles of MiFID into Czech regulations.

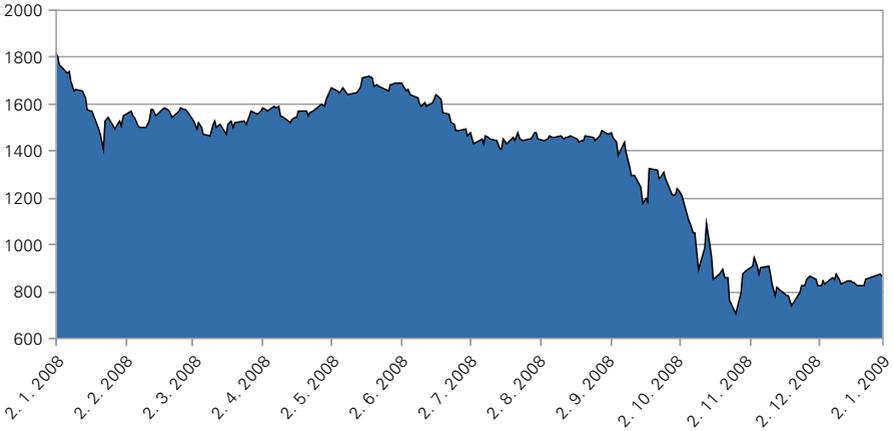
The Securities Act allows for trading off the stock exchange, primarily for smaller shareholders, through the RM System. This system matches buyers and sellers through "share shops" located throughout the Czech Republic. These act as organizers of the securities market and are independent of the Prague Stock Exchange. Individuals can buy and sell the shares of joint-stock companies through these share shops, which are connected to a central computer and appropriate pricing mechanisms.

The RM System differs from the Stock Exchange in that buyers and sellers need not use an intermediary broker. Both the security and the related cash consideration must be delivered on the trade date.

The regulatory and reporting requirements for companies listed on the RM System are also less stringent than for companies listed on the Prague Stock Exchange. For more details, see: www.pse.cz

The main index of the Prague Stock Exchange - called the PX Index - closed December 2008 at a value of 858 points (December 2007: 1,815) and dropped year-on-year by 52.7 per cent. The decrease was caused by the depreciation of almost all securities listed. The most significant decline related to real estate company shares. The overall trade volume of stocks in 2008 reached CZK 852,043 million. The market capitalization of the stock decreased to CZK 1,091,731 million in December 2008, of which CZK 788,650 million related to domestic issues and CZK 303,081 million to foreign issues. Market capitalization decreased by 40.7 per cent compared to the end of 2007. During 2008 there was only one IPO on the main market of the PSE.

Figure 2: Development of PX index during 2008



Source: Reuters

Foreign exchange

The Foreign Exchange Act, as amended on 1 October 1995, fully implemented the obligations the Czech Republic accepted within international agreements having substantial influence on free movement of capital and payments. The Czech Republic concluded many agreements with other countries on mutual prevention of capital and investments.

If granted a foreign exchange license, a bank may trade freely in foreign currencies and is not subject to the foreign exchange regulations.

The Act allows:

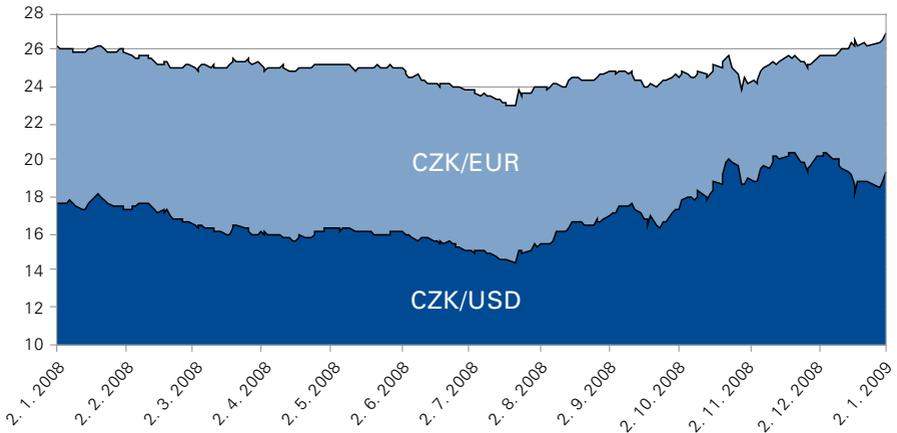
- a resident without a foreign exchange permit to undertake contractual obligations towards a non-resident and to fulfill the resulting commitments in either Czech or foreign currency
- a resident to acquire foreign currency or other rights denominated in foreign currency, to acquire property abroad and to export and import Czech and foreign currency, and
- a non-resident to purchase foreign currency or other rights denominated in foreign currency in exchange for Czech currency or vice versa, to acquire real estate (subject to restrictions) and to import and export Czech and foreign currency.

The above general clauses are restricted by certain qualifications. Usually the exchanges are subject to notification duty to the CNB.

The role of foreign exchange regulation as an important means of preventing or detecting money laundering is constantly growing.

The Czech currency fluctuated significantly in comparison to the American dollar and the European euro. It strengthened sharply until July 2008. However, by December 2008 the appreciation against the euro was offset, and the Czech currency actually depreciated slightly against the dollar in comparison to the end of 2007.

Figure 3: Value of the Czech crown during 2008 (CZK/EUR and CZK/USD)



Source: Czech National Bank

Repatriation of capital and profit

The currency is allowed to float freely and is convertible outside the Czech Republic. Czech companies may freely repatriate both current year profits and retained earnings in whatever currency they desire. However, they should follow the minimum capital requirements imposed by the CNB. Branches of foreign banks do not have such limitations as the capital is raised and monitored centrally.

The following types of payments from a Czech company to its foreign parent may be transferred abroad freely, subject to the appropriate withholding taxes:

- dividends
- interest
- charges for intangible property (e.g. royalties and know-how fees)
- management fees
- liquidation balance.

Chapter 8

Labour

General

The Czech Republic has a skilled and educated labour force. The literacy rate is over 98 per cent.

Employment law is contained in the Labour Code and numerous government orders. The maximum working week is 40 hours. The standard working week is Monday to Friday from 8:00 to 16:30, although manufacturing companies may start earlier.

The average retirement age is generally 60 for women, or earlier depending on the number of children, and 62 for men. The minimum retirement age for men and women will gradually be increased until 2030, when the retirement age will be between 62 and 64 for women, depending on the number of children, and 65 for men, childless women and mothers of one child

Employment contracts

Employers are required to conclude written employment contracts with their employees. Employers must inform employees about their rights and duties and the salary resulting from the contract. The contract must describe the type of work, the date that the employee will start work, and the place where the work will be done. Probationary periods cannot be longer than three months and must be agreed in writing.

Employment contracts are valid for an indefinite period of time unless their duration is explicitly stated in a contract. A fixed-term employment contract may be concluded for up to two years.

These rules do not apply to fixed-term employment contracts concluded between employment agencies and their employees for the purpose of work to be carried

out for another employer. Employment contract with an agency must be in writing. Employees can only be assigned to work for another employer with their written consent. This entitles the other employer to organise and control the employee's work.

An employee may have more than one employment relationship concurrently. The rights and duties ensuing from each are independent.

An employment contract which does not specify the period for which it is valid may be terminated as follows:

- by agreement
- by notice
- by immediate cancellation
- by cancellation during the probationary period.

Cancellation by agreement must be documented in writing.

The employer or the employee may cancel a contract by providing written notice. The notice period commences on the first day of the month following the date on which the notice was given. The notice period for the employer and the employee is at least two months. The employee can give notice without stating a reason.

When the employer terminates an employment contract, it must be for one of the following reasons:

- a) the employer (or a part thereof) is being liquidated or is ceasing to carry on business
- b) the company (or a part thereof) is relocating
- c) organisational changes
- d) the employee is not able to work for long-term health reasons
- e) the employee is not sufficiently qualified
- f) serious disciplinary breaches by the employee.

Where an employment contract is terminated for any of the reasons (a) through (c), the employer is obliged to pay a minimum of three months' severance pay.

Specific termination conditions apply in respect of disabled persons, pregnant women and employees caring for minors.

Specific termination conditions, severance pay and other conditions may also be included in a collective agreement if there is one in force.

Compensation for redundancy is set by law at a minimum of three months' salary. In practice, the amount varies depending on the company, existence of collective agreements, etc.

During the probationary period, the employment contract may be cancelled by either side for no reason. Cancellation must be in writing and it should be delivered at least three days before the termination date.

Mass redundancy

With regard to mass redundancy, employment contracts can only be terminated by the employer for the reasons stated above, i.e. letters a) through c). A two-month notice period commences on the first day of the month following the date on which the notice was served.

At least 30 days before termination notices are issued, the employer must inform the trade union or work council in writing and conduct negotiations with them to mitigate the scope and effects of the redundancies. If there is no union or work council, the employer must take the same steps in relation to all affected employees. At the same time, the employer must also inform the local Labour Authority of the redundancies.

The employer must submit a report on the final decision of the redundancies to the Labour Authority which contains the results of negotiations with the union or work council and the final number and arrangement of the redundancies.

Trade unions

Trade unions conduct collective bargaining at a national level. A Tripartite Council, including representatives from trade unions, employers and the government, meets annually to discuss labour issues.

Employment certification

Employers have a duty to provide certificates of employment to all employees, or their new employer, upon completion of an employment contract. It must contain information regarding the duration of employment, social/health insurance claims, the employee's liabilities to the company, and a schedule of the employee's annual salary for the period of employment.

Holidays

An employee is entitled to holiday pay if the employment contract lasts for at least 60 continuous days during a calendar year. Where the contract lasts for less than a year, one-twelfth of the annual holiday is accrued for each calendar month of continuous employment with the same employer.

The minimum holiday period is four weeks per annum, unless increased by a collective bargaining agreement or internal regulations. State employees are entitled to five weeks per annum. Holiday pay is calculated on the basis of an employee's average monthly salary.

Social benefits

There are two major social security schemes to which both the employee and the employer contribute: social security and health insurance.

Payments from the social insurance system typically include:

- pensions
- cash benefits:
 - a) sick leave
 - b) benefit for a family member's health treatment
 - c) parental benefits
 - d) social benefits
 - e) death benefits
 - f) maternity benefits

Chapter 9

Corporate transactions

During the 1990s, corporate transactions became a feature of the Czech legal environment, making it possible for entrepreneurs and businessmen to expand or restructure their business activities in the Czech Republic. This was a hugely important development, particularly in relation to the Czech Republic's accession to the EU, following which it is obliged to implement the legal regulations of the EU, including those allowing cross-border mergers. The process of mergers and acquisitions itself is primarily regulated by the Czech Commercial Code, Act on Takeover Bids and Act on Transformations of Business Companies and Cooperatives, the accounting and tax laws and antimonopoly regulations, and a number of special regulations applicable to specific sectors, such as banking, insurance and other financial services.

Privatisation

There are still a number of enterprises in sectors such as, for example, electricity and transport, awaiting privatisation through sales to strategic investors. The process of privatisation is initiated by a government decision. All transactions are then organised by the relevant ministry, generally by means of a tender.

Ownership of real estate

Foreign individuals who are citizens of EU countries can directly acquire real estate if they obtain a temporary residence permit in the Czech Republic. Non EU-citizens can also acquire real estate directly on condition that they are granted a permanent residence permit for the Czech Republic.

Foreign corporations registered in the EU are entitled to acquire real property in the Czech Republic on the condition that they have a branch or business in the Czech Republic and are authorised to undertake business activities in the Czech Republic. Non-EU corporations may buy real estate only through a Czech corporate entity.

The limitations relating to EU countries remain in force for a transitional period of five years (seven years for agricultural land and forests) following accession to the EU in May 2004.

Acquiring or disposing of Czech legal entities

Foreign private and legal entities are permitted to own a business or to hold shares in companies, and they can acquire and sell up to 100 percent of the registered share capital of a limited liability or joint-stock company. In the same way, they can also participate in companies which have other legal forms, but the transfer of ownership interest in a limited liability company must be recorded in the Commercial Register. The acquisition of shares in a joint-stock company is not restricted; however, the shares of certain joint-stock companies are registered with the Central Register of Securities (i.e. shares which do not exist in physical form, but whose existence and ownership are recorded). The ownership of such shares changes at the moment the acquisition is recorded in the records of the Central Register. In respect of shares traded on the regulated securities market (Prague Stock Exchange and RM-system) of the Czech Republic or of another EU Member State, the acquirer is obliged to notify the company (the issuer) and the Czech National Bank (the supervisory body of the capital market) if his share of the company's voting rights exceeds a certain level. Moreover, in the event that a shareholder acquires a minimum of 30 percent of voting rights and actually controls the company, he is obliged to make a bid for the shares of the remaining shareholders.

Purchase of an enterprise

An acquisition can also be made by purchasing an enterprise or part of it, in which the buyer acquires all rights, relations, assets and liabilities connected with the running of the business.. The associated Sale and Purchase Agreement must be approved by the general meeting or shareholders of the company before signing the transaction.

Contribution to a company

Another way of securing a share in a business is by making a financial or a non-monetary contribution, in which case the general meeting of the company must decide on the new subscription. The registration of such an increase is made at the Commercial Court and, in the case of a non-monetary contribution, an independent valuation of the investment must be submitted by an official valuer.

Transformation of a company (merger, transfer of assets to a shareholder, demerger, change of legal form)

In Czech legislation, mergers fall within the category of “transformation of a business”, which also includes the demerger of the company, transfer of assets to a shareholder and any change in the company’s legal form. The transformation of a business is possible even if the company is in liquidation or insolvency proceedings. Transformation of a company can be undertaken as a national or cross-border transaction with legal entities registered in other EU or EEA countries. If a company has the legal form of a European Company (Societas Europea), business transformations can also involve foreign companies.

Probably the most frequent form of transformation is merger by acquisition (one of the companies carries on its activities, while the others cease to exist and their assets and liabilities are transferred to the successor company), or merger by the formation of a new company (all of the original companies cease to exist and their assets are transferred to a new successor company).

From an economic point of view, an important issue is the tax losses carried forward in respect of the wound up companies. Based on legislation valid prior to 1 May 2004, these losses could not be transferred to the successor company. However, following accession of the Czech Republic to the EU, tax losses can now be carried forward. The first taxation period in respect of which losses can be carried forward is the period in which the Accession Treaty between the Czech Republic and the EU came into force (i.e., on 1 May 2004). Losses assessed in previous taxable periods cannot be carried forward.

Mergers take place on the basis of merger projects, which must be approved in advance by general meetings. Their key factor is the exchange ratios of the shares and possibly other arrangements after the merger. The merger becomes legally effective on the day it is recorded in the Commercial Register. However, from a tax and accounting point of view, the companies are considered a single entity from the merger date, which precedes all necessary steps and decisions in relation to the merger. In some cases, subject to the agreement of all shareholders or partners, the merger procedure can be significantly simplified. For mergers of joint-stock companies, a new option has been established, allowing for the voluntary buy-out of the other shares if the successor company owns more than 90 percent of the merging company’s registered capital. Should the legal status of shareholders of any participating company worsen as a result of the merger, under certain circumstances the successor company has an obligation to buy out these shareholders.

Companies with dissimilar legal status can also merge, and the merger may involve more than two companies.

There are a number of special regulations for cross-border mergers. An important condition is that the merger procedure must be regulated in the same way in the legal systems of the countries in which the participating companies are registered. The preparatory phase of the cross-border merger is undertaken according to the laws to which each of the participating companies is subject and the completion of the cross-border merger is governed by the laws of the country in which the successor company has its registered office.

The transfer of assets to a shareholder is a legal form of company transformation, where the shareholder owning more than 90 percent of the company's registered capital may transfer the company's assets to itself, provided it has obtained the consent of the general meeting; at the same time it has the duty to fairly compensate all other minority shareholders.

A company can be demerged (divided) through (i) demerger by the formation of new companies, (ii) demerger by acquisition, (iii) by spin-off connected with the formation of new companies, (iv) by spin-off connected with acquisition or combination of the options mentioned in either (i) or (ii) or in (iii) and (iv). Upon demerger of the company by the formation of new companies or by acquisition, the company being demerged ceases to exist without liquidation, while it does not cease to exist upon the demerger by spin-off.

Czech legislation allows a company to change its legal status, whereby the company does not cease to exist, but only changes its internal legal position and structure.

Public bid for purchase or exchange of participating securities issued by a joint-stock company

If someone intends to make an offer to more than 100 shareholders or the volume of requested securities exceeds 1 percent of the issue, the offer must be made in the form of a public bid. If the public bid is required by law, the consideration must correspond to the participating securities value. If the securities are traded on the regulated market, the bidder must submit an offer and support the adequacy of the consideration to the Czech National Bank.

Takeover bids

Voluntary takeover bids

For joint-stock companies traded on the regulated market, the investor can make a public bid in the form of a takeover bid to the shareholders if the bid allows it to gain control over the company. The bid is binding for not less than four weeks. If it is binding for more than 10 weeks, the investor shall publish a notice to the shareholders 2 weeks in advance. All shareholders must be treated equally; the statutory body of the target company shall maintain neutrality and is obliged to inform trade unions or other employee representatives. A new breakthrough rule has been implemented, whereby the restriction regarding the transferability of listed securities may be broken during the period of the takeover bid. Within the bid's validity period, the bidder can increase the consideration or prolong its validity. In addition, another person may make a counter bid during the validity period of the first bid. Bids for the takeover of a company may be published only with the prior consent of the Czech National Bank.

The Act on Takeover Bids also deals with the situation in which the target company is registered in the Czech Republic, but its shares are traded on the foreign regulated market, or in which the target company has its registered office in a foreign country, but its shares are traded on the Czech regulated market.

Obligatory takeover bids

An investor who acquires a minimum of 30 percent of voting rights in the target company traded on the regulated market and who actually controls the company must offer to buy out other shareholders within 30 days of the acquisition ("Obligatory takeover bids"). The consideration can be provided in cash, shares or their combination. The minimum consideration must correspond to the highest price for which the investor acquired shares in the target company in the last 12 months before the takeover bid obligation arose. If such a price cannot be determined, the minimum consideration must correspond to the weighted average of prices for which the shares were traded on the regulated market during the 6 months before the obligation arose. An obligatory takeover bid may be published after its approval by the Czech National Bank.

Right to buy out participation securities (squeeze out)

A shareholder holding participation securities representing more than a 90 percent share of the registered capital of a joint-stock company (major shareholder) is entitled to ask the board of directors to convene the general meeting to decide on the transfer of all the other participating securities owned by minority shareholders to him (a so-called “squeeze out of minority shareholders”). The general meeting of the company approves the squeeze out of minority shareholders by paying them adequate compensation on the basis of an expert’s appraisal, or other reasonable consideration if an expert’s appraisal is not required. An expert opinion is not required if the target company’s shares are traded on the regulated market. In such a case, the justification of the consideration is subject to approval by the Czech National Bank.

Regulation

With regard to mergers and acquisitions, the interests of minority shareholders are protected as companies are obliged to provide early notification and, for the majority of transactions, the opinion of an independent expert is required to determine whether the parameters of the transaction - in particular the price - are fair and reasonable. In the Czech Republic, mergers and acquisitions are also regulated by special legal measures. For example, for a transaction to be effective in the banking and insurance sector, the appropriate authorities (Czech National Bank, Ministry of Finance) must give their prior consent for a contract on the merger or acquisition of a bank or insurance company.

Mergers and acquisitions also fall within the jurisdiction of the Office for the Protection of Competition. Its permission is required if:

- the aggregate net turnover of the participants in the transaction in the Czech Republic for the past accounting period exceeded CZK 1.5 billion (approx. EUR 57.7 million) and at least two of the merging companies each recorded net turnover of more than CZK 250 million (EUR 9.6 million) in the Czech Republic for the same period or
- one or more of the participants in the transaction had net turnover within the Czech Republic of at least CZK 1.5 billion in the previous accounting period and for the same period, the world net turnover recorded by the other participant exceeded CZK 1.5 billion.

Note: Exchange rate CZK 26 / EUR 1 used

APPENDIX

Useful addresses

Czech Government Offices

Ministry of Finance of the Czech Republic

Letenská 15
118 10 Prague 1

Tel.: +420 257 041 111
Fax: +420 257 042 788
www.mfcr.cz

The Ministry of Industry and Trade

Na Františku 32
110 15 Prague 1

Tel.: +420 224 851 111
Fax: +420 224 811 089
www.mpo.cz

Ministry for Regional Development of the Czech Republic

Staroměstské náměstí 6
110 15 Prague 1

Tel.: +420 224 861 111
Fax: +420 224 861 333
www.mmr.cz

Czech National Bank

Na Příkopě 28
115 03 Prague 1

Tel.: +420 224 411 111
Fax: +420 224 412 404
www.cnb.cz

CzechInvest (Czech Agency for Foreign Investment)

Štěpánská 15
120 00 Prague 2

Tel.: +420 296 342 500
Fax: +420 296 342 502
www.czechinvest.org

Financial Institutions

LBBW Bank CZ a.s.

Vítězná 1/126
150 21 Prague 5

Tel. : +420 272 771 111
Fax : +420 267 197 291
www.lbbw.cz

Citibank a.s.

Evropská 178
166 40 Prague 6

Tel.: +420 233 061 111
Fax: +420 233 061 617
www.citibank.cz

COMMERZBANK Aktiengesellschaft

Jugoslávská 1
120 21 Prague 2

Tel.: +420 221 193 111
Fax: +420 221 193 699
www.commerzbank.cz

Czech Export Bank, a.s.

Vodičkova 34
111 21 Prague 1

Tel.: +420 222 841 100
Fax: +420 224 226 162
www.ceb.cz

Česká spořitelna, a.s.

Česká spořitelna, a.s.
140 00 Prague 4

Tel.: +420 261 071 111
Fax: +420 261 073 032
www.csas.cz

Československá obchodní banka, a.s.

Radlická 333/150
150 57 Prague 5

Tel.: +420 224 111 111
Fax: +420 224 119 560
www.csob.cz

Deutsche Bank Aktiengesellschaft Filiale Prag

Jungmannova 34
110 00 Prague 1

Tel.: +420 221 191 111
Fax: +420 221 191 411
www.db.com

GE Money Bank, a.s.

Vyskočilova 1422/1a
140 28 Prague 4

Tel.: +420 241 001 400
Fax: +420 241 001 409
www.gemoney.cz

HSBC Bank plc

Gestin Premier Centrum
V Celnici 1045/5
110 00 Prague 1

Tel.: +420 225 024 121
www.hsbc.cz

ING Bank N. V.

Nádražní 344/25
150 00 Prague 5

Tel.: +420 257 471 111
Fax: +420 257 473 555
www.ing.cz

J&T BANKA, a.s.

Pobřežní 297/14
186 00 Prague 8

Tel.: +420 221 710 111
Fax: +420 221 710 211
www.jtbank.cz

Komerční banka, a.s.

Na Příkopě 33
114 07 Prague 1

Tel.: +420 800 111 055
www.kb.cz

mBank ČR

Nile House
Karolinská 654/2
186 00 Prague 8

Tel.: +420 221 854 100
www.mbank.cz

Oberbank AG

I.P. Pavlova 5
120 00 Prague 2

Tel.: +420 224 190 100
Fax: +420 224 190 150
www.oberbank.cz

PPF banka a.s.

Evropská 2690/17
160 41 Prague 6

Tel.: +420 224 175 888
Fax: +420 224 175 980
www.ppfbanka.cz

Raiffeisenbank a.s.

Hvězdova 1716/2b
140 78 Prague 4

Tel.: +420 225 541 111
Fax: +420 225 542 111
www.rb.cz

UniCredit Bank Czech Republic, a.s.

Na Příkopě 20
111 21 Prague 1

Tel.: +420 221 112 111
Fax: +420 221 112 132
www.unicreditbank.cz

Volksbank CZ, a.s.

Lazarská 8
120 00 Prague 2

Tel.: +420 800 133 444
Fax: +420 221 969 951
www.volksbank.cz

Business Organisations

American Chamber of Commerce in the Czech Republic

Dušní 10
110 00 Prague 1

Tel.: +420 222 329 430
Fax: +420 222 329 433
www.amcham.cz

British Chamber of Commerce Czech Republic

IBC, Pobřežní
186 00 Prague 8

Tel.: +420 224 835 161
Fax: +420 224 835 162
www.britcham.cz

Canadian Chamber of Commerce in the Czech Republic

Klimentská 46
110 02 Prague 1

Tel/Fax.: +420 225 000 345
www.gocanada.cz

Czech-German Industrial Chamber of Commerce

Václavské náměstí 40
110 00 Prague 1

Tel.: +420 224 221 200
Fax: +420 224 222 200
www.dtihk.cz

Economic Chamber of the Czech Republic

Freyova 27
190 00 Prague 9

+420 266 721 300
Fax: +420 266 721 690
www.komora.cz

Enterprise Ireland Prague

Tržiště 13
118 00 Prague 1

Tel.: +420 257 199 621
Fax: +420 257 532 224
www.enterprise-ireland.com

Japan External Trade Organization, Praha

Pařížská 11/67
110 00 Prague 1

Tel.: +420 224 814 971
Fax: +420 224 813 998
www.jetro.go.jp

Netherlands Chamber of Commerce in Prague

Zlatý Anděl, Nádražní 25
150 00 Prague 5

Tel.: +420 257 473 740
Fax: +420 257 473 744
www.nlchamber.cz

Swiss-Czech Chamber of Commerce

Na Pankráci 1062/58
140 00 Prague 4

Tel.: +420 222 516 614
Fax: +420 222 513 685
www.hst.cz

Taipei Economic and Cultural Office, Prague, Czech Republic

Evropská 33c/2590
160 00 Prague 6

Tel.: +420 233 320 606
Fax: +420 233 326 906
www.roc-taiwan-cz.com

Italian-Czech Chamber of Commerce and Trade in the Czech Republic

Čermákova 7
120 00 Prague 2

Tel.: +420 222 015 300
Fax: +420 222 015 301
www.camic.cz

Joint Czech-Belgium-Luxembourg Chamber of Commerce in the Czech Republic

Thámova 20
186 00 Prague 8

Tel.: +420 221 890 738
Fax: +420 221 890 768
www.cblchamber.cz

CCFT – FČOK French-Czech Chamber of Commerce

IBC, Pobřežní 3
186 00 Prague 8

Tel.: +420 224 833 090
Fax: +420 224 833 093
www.ccft-fcok.cz

International Chamber of Commerce

Thunovská 12
118 00 Prague 1

Tel./Fax: +420 257 217 744
www.icc-cr.cz

The Slovak-Czech Chamber of Commerce

Ovocný trh 572/11
110 00 Prague 1

Tel.: +420 226 002 302
www.scok.cz

Czech-Arabian Chamber of Commerce

Freyova 27/82
190 00 Prague 9

Tel.: +420 296 647 194
Fax: +420 296 647 164
www.czaok.cz

Czech-Polish Chamber of Commerce

Janáčkova 10
702 00 Ostrava

Tel.: +420 596 612 230
Fax: +420 596 612 231
www.opolsku.cz

Czech-Israeli Chamber of Commerce

Nad Vršovskou horou 88/4
101 00 Prague 10

Tel.: +420 728 730 395
www.cemok.org

Nordic Chamber of Commerce in the Czech Republic

Václavské náměstí 51
111 21 Prague 1

Tel.: +420 774 123 370
Fax: +420 226 015 885
www.nordicchamber.cz

Czech-Moroccan Chamber of Commerce

Václavské náměstí 802/56
110 00 Prague 1

Tel./Fax: +420 224 032 519
www.cmok.cz

Chamber of the Czech-Portuguese cooperation

Bryksova ul. 720
198 00 Praha 9

Tel.: +420 281 917 909

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kpmg.cz