



cutting through complexity

Investment in the Czech Republic

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KPMG in the Czech Republic

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Preface: Jan Žůrek

Dear Reader,

The Czech Republic is a popular destination for foreign capital and has been attracting high volumes of foreign direct investment (FDI) since the 1990s. FDI activities in the Czech Republic stand out because of one very important feature: profitability.

Compared to its regional peers, the Czech Republic is doing fairly well in terms of GDP per capita and competitiveness. It also clearly stands out as a regional champion for the inflow of FDI. Currently, the Czech Republic has recovered from the financial crisis and is experiencing growth across various sectors of the economy, including mergers and acquisitions activity.

The main attractive factors of the Czech Republic for foreign investors are its advantageous geographical location combined with a reliable infrastructure, the availability of suppliers and specialised inputs needed by foreign investors, the quality of life and social stability, cost competitiveness, financial stability and the availability of financing, investment incentives, a skilled workforce and a high level of education.

The purpose of this publication is to set out some general guidelines for investment and business in the Czech Republic for those interested in investing or doing business here. It reflects the situation as of March 2015.

I hope that “Investment in the Czech Republic” will prove to be a helpful source of background information and a constructive tool in making your investment decisions. If you have any questions, remarks or suggestions, please feel free to contact us or the respective KPMG specialists.



Jan Žůrek
Managing Partner
KPMG in the
Czech Republic



The Czech Republic clearly stands out as a regional champion in the inflow of foreign direct investment.

Chapter 1

Investment climate



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Why invest in the Czech Republic?

The Czech Republic...

- has been a popular destination for foreign capital since the 1990s,
- clearly stands out as a regional champion for the inflow of FDI,
- has key attractive factors such as a skilled workforce, a reliable infrastructure, cost competitiveness and a high level of education.

In the overall Global Competitiveness Report 2014–2015,¹ the Czech Republic came...

- 37th in the competition of 144 countries in the world,
- 2nd in the competition of 10 new member states of the EU.²

The Czech Republic is No. 1 among new member states of the EU in...

- the quality of its railroad infrastructure,
- the quality of its air transport infrastructure,
- the quality of its electricity supply,
- the intensity of local competition,
- business sophistication,
- ease of access to loans,
- local supplier quality,
- the state of cluster development,
- production process sophistication,
- the value chain breadth,

1) The Global Competitiveness Report 2014–2015 assesses the competitiveness landscape of 144 economies, providing insight into the diversity of their productivity and prosperity. The Report series remains the most comprehensive assessment of national competitiveness worldwide. At: <http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/>

2) Central and Eastern European new member states of the EU; this group consists of 10 post-socialist countries which entered the EU in 2004 and 2007: Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, Slovakia and Slovenia.

- its capacity to attract and retain talent,
- its capacity for innovation,
- company spending on R&D,
- the availability of research and training services,
- the availability of scientists and engineers.

The Czech Republic is...

- an advanced democracy and a country with a free-market economy,
- a member of the European Union (EU) and the North Atlantic Treaty Organisation (NATO),
- a parliamentary republic with a multi-party democratic political system since the end of communist rule in 1989.

The Czech Republic has...

- a population of 10.5 million,
- a working population of about 5.3 million,³
- a well educated and skilled workforce,
- favourable labour costs which is one of the main attractions of the Czech economy,
- Prague, the capital, and the largest city, with a population of 1.2 million,
- other major urban centres: Brno (378,327), Ostrava (297,421), Plzeň (167,472), Liberec (102,113), Olomouc (99,471), Ústí nad Labem (93,747), České Budějovice (93,467), Hradec Králové (93,035), Pardubice (89,467).⁴

3) http://www.czso.cz/csu/redakce.nsf/i/obyvatelstvo_lide

4) The Czech Statistical Office, Počet obyvatel v obcích České republiky k 1. 1. 2013; at: <https://www.czso.cz/csu/czso/katalog-produktu>

The Czech Republic enjoys...

an advantageous geographical location

- next to and with a certain cultural and historical affinity to Germany,
- in the geographical heart of Europe, close to most major Western European economic centres,
- with an area of 78,864 square kilometres (approximately 30,500 square miles) and three distinct regions: Bohemia in the west, and Moravia and part of Silesia in the east,
- with a reliable and quality overall infrastructure

the availability of suppliers and specialised inputs

- local supplier quantity and quality,
- value chain breadth and production process sophistication,
- local availability of specialised research and training services

quality of life and social stability

- with a solid societal framework,
- security, social stability and reliable healthcare,
- low income inequality with low or no risk of losses because of industrial disputes and strikes

financial stability and the availability of financing

- with relatively low external and internal macroeconomic imbalances,
- manageable levels of public debt and deficits,
- a stable and healthy banking sector with excess liquidity, able to meet the financing needs of both domestic and foreign investors,
- with the minimum risk of losses from financial crises and related instability.

The Ministry of Finance of the Czech Republic estimates that...⁵

- the economy will grow by 2.7 percent in 2015 and 2.5 percent in 2016,
- the average inflation rate will decrease further to 0.3 percent in 2015,
- inflation will remain below 2 percent in 2016,
- the unemployment rate will decline slightly, employment will rise modestly,
- the deficit will remain well below the threshold of 3 percent of GDP,
- the indebtedness of the general government sector will decrease from an estimated 43.2 percent of GDP in 2014 to 41.3 percent of GDP in 2015.

5) Macroeconomic Forecast - January 2015; at: <http://www.mfcr.cz/en/statistics/macroeconomic-forecast/2015/macroeconomic-forecast-january-2015-20405>

Main macroeconomic indicators: Current macroeconomic forecast

January 2015

		2014	2015	2016
Gross domestic product	growth in percent, const. pr.	2.4	2.7	2.5
Average inflation rate	per cent	0.4	0.3	1.4
Unemployment rate (LFS)	average in per cent	6.1	5.7	5.6

Crédit Agricole comment on the Czech Republic: “The outlook is good and upbeat for 2015, and GDP growth indicators should remain on the same trend as in 2014, especially as regards the rise in investment and industrial production. GDP is thus forecast to grow 2.5 percent. Public debt levels should again fall in 2015, a trend already observed last year with the ratio of debt to GDP running at 44 percent.”⁶

The Czech Republic is very positively rated by all three major rating agencies Moody's, Standard and Poor's and Fitch.

Credit Rating⁷

State	Year	Moody's	Standard and Poor's	Fitch
Czech Republic	2014	A1	AA-	A+
Hungary	2014	Ba1	BB+	BB+
Poland	2014	A2	A-	A-
Romania	2014	Baa3	BBB-	BBB-
Slovakia	2014	A1	A	A+

Investment grades⁸

Grade	Moody's	Grade	Standard and Poor's	Grade	Fitch
		AA-	Czech Republic, China, Estonia, Japan, S. Arabia, Taiwan, Chile		
A1	Czech Republic, Estonia, Israel			A+	Estonia, China, Chile, Czech Republic, Slovakia, Taiwan, Japan

6) Emerging Countries News, Monthly – No.15/01 – February 2015; at: http://economic-research.credit-agricole.com/medias/PE20150203_EN.pdf

7, 8) https://www.cnb.cz/en/about_cnb/international_relations/rating/

Foreign direct investments

The Czech Republic...

- has been a popular destination for foreign capital since the 1990s,
- is one of the most successful CEE countries in terms of attracting foreign direct investment,
- clearly stands out as a regional champion for the inflow of FDI.

The Czech Republic has...

- introduced investment incentives,
- attracted a high rate of foreign direct investment per capita,
- low inflation and modest interest rates,
- a relatively stable currency and a good rate of economic growth.

FDI by country of origin

- most of the FDI originates in the following countries: Germany, USA, Netherlands, Austria, Korea, Japan, France and Switzerland
- primary sectors: manufacturing, financial institutions, real estate, transport and communications
- strong vote of confidence from investors with first-hand experience of the Czech economic environment

Investment incentives

- systematic investment incentives scheme
- tax breaks for up to 10 years
- subsidies related to job creation and training employees
- support related to acquiring land
- see Chapter 2 for detailed information on investment incentives

Where to invest in the Czech Republic?

Information and communication technologies⁹

- one of Europe's top locations for ICT investments, outsourcing and offshoring IT-related services and software design
- strong inflow of high value added projects
- tradition of excellence in technical fields
- heritage of very good technical and mathematical education
- examples of global ICT companies with Czech origins: AVG Technologies, AVAST, Y Soft
- successful investors: Microsoft, Skype, DHL, NetSuite, Tieto, Red Hat, SolarWinds and IBM

Business support services¹⁰

- one of the world's most attractive locations
- location, infrastructure and skilled workforce with foreign language skills
- financial, accounting, IT, customer support, human resources, purchasing, logistics and legal services
- successful investors: DHL, Accenture, IBM, SAP, Infosys, Johnson & Johnson

Aerospace¹¹

- strong engineering background, excellent R&D (research and development) facilities, outstanding product reputation and high product reliability
- active member of the European Space Agency
- the headquarters of the European Global Navigation Satellite Systems Agency is in Prague
- successful investors: Honeywell Aerospace, GE Aviation, Latecoere

Automotive¹²

- one of the highest concentrations of automotive manufacturing – second largest passenger car producer per 1 million inhabitants globally
- among the 15 largest global passenger car producers by volume
- long industrial tradition and ability to compete at the global level
- more than half of the world's top-100 tier one suppliers are in the Czech Republic
- successful investors: Hyundai, Johnson Controls, Volkswagen/Škoda Auto, Bosch, Toyota/PSA, Valeo, Faurecia, TRW, Magna

9,10,11,12) Investment Climate in the Czech Republic, 2015, CzechInvest

High-tech mechanical engineering¹³

- world-class level of today's mechanical engineers
- turbines, transportation, air-conditioning equipment, construction machinery, machine tools
- over 80 percent of the sector's output exported
- successful investors: Ingersoll Rand, Siemens, Edwards, Daikin

Life sciences¹⁴

- state-of-the-art research
- growing network of clusters centred on research institutions
- successful antiviral drugs used in HIV/AIDS treatment (Viread) developed in the Czech Republic
- the Institute of Organic Chemistry and Biochemistry is at the forefront in developing antiviral drugs
- attractive location for manufacturing and contract R&D operations
- effective patent protection
- adoption of GMP, GLP and GCP standards
- government's policy goals comprising continuation of support for R&D
- successful investors: Sanofi, TEVA, Lonza

Nanotechnologies and materials¹⁵

- a world-class centre of nanotechnology research
- state-of-the-art research infrastructure
- a network of collaborating business companies around top research institutions
- Czech Nanotechnology Cluster and Nanotechnology for Society funding programme available
- institutions cooperating on the most prestigious projects (e.g. CEITEC, Regional Centre of Advanced Technologies and Materials, Technical University of Liberec)

Energy and environment¹⁶

- opportunities for investors to design, manufacture and deliver new technologies for environmental protection and energy savings
- technical competence and manufacturing excellence, cost effectiveness
- successful investors: Doosan, Solar Turbines

13,14,15,16) Investment Climate in the Czech Republic, 2015, CzechInvest

Must see, must experience

The Czech Republic has...

- many cultural monuments of global importance, from gothic architecture to modern art,
- many places famous for their architectural heritage (the UNESCO World Heritage List at: <http://en.unesco.org/countries/czech-republic>) such as Český Krumlov and Telč,
- spas as important centres of social and cultural life in Europe such as Karlovy Vary (Carlsbad), Mariánské Lázně (Marienbad), Františkovy Lázně (Franzensbad) where prominent composers and musicians (Beethoven, Mozart, Paganini), politicians and celebrities (King Edward VII), writers (Twain, Goethe), inventors and businessmen (Edison) from around the world have visited,
- one of the oldest continuously existing universities in the world (Charles University, 1348).

... one of the most beautiful cities in the world:

Prague, the Czech capital...

- is the most attractive tourist and meeting destination in the Czech Republic,
- has architectonic monuments, cultural heritage and historical sights,
- has been the inspiration for many significant artists and scientists from Franz Kafka to W.A. Mozart,
- has excellent operas, concerts, theatre and ballet performances,
- has a number of international film festivals and a gathering of the world's best classical music players for Prague Spring,
- is easily accessible to travellers from almost any country,
- is the crossroads of the most important trade routes, as well as the cultural and political centre of Europe,
- is one of the safest destinations with a great infrastructure offering a number of venues of different kinds,
- has a long tradition of hosting significant international meetings and summits,
- world-class services at a reasonable cost.¹⁷

17) Source: <http://www.pragueconvention.cz/about-prague/why-prague/>

Czech them out... famous and outstanding Czechs

Warning! If you mention them in a conversation, the Czechs will love you!

Politicians

- Sociologist and politician [Tomáš Garrigue Masaryk](#) was the first president of Czechoslovakia.
- Playwright and dissident [Václav Havel](#) rebelled against the Communist regime and became president of Czechoslovakia and later The Czech Republic.
- [Madeleine K. Albright](#) was U.S. secretary of state under president Bill Clinton.

Sportsmen and women

- The long distance runner [Emil Zátopek](#) won a unique triple (5,000 m, 10,000 m and marathon) at the Helsinki Olympics in 1952.
- The gymnast [Věra Čáslavská](#) charmed and conquered the Mexico Olympics in 1968.
- A tennis player and multiple Grand Slam winner [Martina Navrátilová](#) is considered by some the greatest female tennis player from 1965 to 2005.
- A former world no.1 professional tennis player [Ivan Lendl](#) dominated in the 1980s as one of the greatest tennis players of all time.
- A top tennis player [Petra Kvitová](#) has won Wimbledon twice (2011, 2014).
- [Jan Železný](#), a javelin thrower, won the gold at the 1992, 1996 and 2000 Summer Olympic Games.
- [Jaromír Jágr](#) is a professional ice hockey right winger who has won the Stanley Cup (1991, 1992), the Ice Hockey World Championships (2005, 2010), and the ice hockey Olympic gold medal (1998).

Filmmakers

- Film director [Miloš Forman](#) gained Academy Awards for Best Director for his *One Flew Over the Cuckoo's Nest* and *Amadeus*.
- Film director [Jiří Menzel](#) became internationally famous in 1967 when his film, *Closely Watched Trains*, won the Academy Award.



Musicians and artists

- [Bedřich Smetana](#) is often considered the father of Czech national music and was the composer of the opera *The Bartered Bride* and the symphonic cycle *My Homeland*.
- [Antonín Dvořák](#) composed the opera *Rusalka* and the 9th *New World Symphony*.
- [Karel Gott](#) is a Czech pop legend who has been at the top continuously since the 1960s and gained widespread fame in the German-speaking countries and Russia.
- [Alfons Mucha](#) was a painter and Art Nouveau graphic designer, producing illustrations, advertisements, and designs.
- [František Kupka](#) was a pioneer of Czech abstract painting and the abstract art movement.

Writers

- Writer of German-Jewish origin [Franz Kafka](#) wrote the novels *The Metamorphosis* and *The Trial*.
- [Jaroslav Hašek](#) is best known for his *The Good Soldier Švejk*, the most translated novel in Czech literature.
- [Karel Čapek](#) who fought against Fascism with his novels is best known for his science fiction, inventing the word robot.
- Poet [Jaroslav Seifert](#) was awarded the Nobel Prize for Literature in 1984.
- One of the best Czech writers of the 20th century [Bohumil Hrabal](#) wrote *Closely Watched Trains* and *I Served the King of England*.
- [Josef Škvorecký](#) was a publisher of banned works in exile and the author of several outstanding novels on totalitarianism and jazz.
- One of the world's best-known authors [Milan Kundera](#) wrote *Unbearable Lightness of Being* and was nominated for the Nobel Prize in Literature.

Entrepreneurs

- **Emil Škoda** was a Czech engineer and industrialist who founded the Škoda Works, later the parent company of Škoda Auto.
- **Emil Kolben** was an engineer and entrepreneur, the engineering company ČKD bears his name.
- **Václav Klement** was an automotive pioneer, co-founder of Škoda Auto.
- **Tomáš Baťa** was an entrepreneur, founder of the Bata Shoe company, one of the world's biggest multinational retailers, manufacturers and distributors of footwear.

Scientists and surgeons

- **Otto Wichterle** was a chemist who invented modern soft contact lenses.
- Jaroslav Heyrovský was a chemist and inventor of the polarographic method and received the Nobel Prize in 1959.
- **Antonín Holý** was a scientist who cooperated on developing important antiretroviral drugs used in the treatment of HIV and hepatitis B.
- **Bohdan Pomahač** is a plastic surgeon who led the team that performed the first full face transplant in the United States and the third overall in the world.



The Czech Republic currently has the most positive attitude to incoming investors in its history.



Chapter 2

Investment incentives and state aid

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Attracting new investment

The Czech Republic has significantly increased its focus on new investments, both green field and expanding existing investments, over the past few years. It currently has the most positive attitude to incoming investors in its history.

Investors can obtain the following financial benefits:

- investment incentives – tax holiday + cash grants
- subsidies from EU funds – cash grants
- R&D (research and development) tax allowance
- education tax allowance.

All benefits are provided based on the law and transparent rules that comply with the EU regulations. In this respect after a change in the EU rules in 2014, some measures have been redesigned. The EU rules have generally become stricter, which to some extent limits the possibilities of individual member states granting incentives. The Czech government has responded to the new rules by an amendment to the Czech Act on Investment Incentives which will be effective from May 2015. Its aim is to increase the attractiveness of investment incentives for investors and reduce the impact of the new EU rules on them. The information below is based on the new legislation.

Investment incentives

Forms of support

Incentives are provided in the following forms:

- corporate income tax relief for up to 10 years (tax holiday)
- employment subsidies as cash grants for job creation and training (only available in regions with high unemployment rates)
- cash grants for strategic projects
- land purchases at discounted prices
- exemption from real estate tax in selected industrial zones.

Main conditions

The main conditions for granting investment incentives differ according to the supported activity.

Manufacturing industry

- Establishing a new manufacturing plant or expanding an existing plant, including modernization and diversification of the product portfolio.
- The minimum amount of investment in tangible and intangible assets is CZK 100 million (approx. EUR 3.6 million or USD 4 million), in selected regions this is reduced to CZK 50 million. The machinery must be new.
- At least 20 new jobs must be created.

Technology centres

- Establishing a new technology centre, or expanding an existing technology centre.
- The minimum investment in tangible and intangible assets is CZK 10 million (approx. EUR 360,000 or USD 400,000), of which at least CZK 5 million must be invested in machinery. The machinery must be new.
- At least 20 new jobs must be created.

Business support services centres

- The investor must establish a new business support services centre or expand an existing business support services centre:
 - shared services centre
 - software development centre
 - high-tech repair centre
 - customer support centre
 - data centre.
- The main condition is creating at least 20 new jobs for software development centres, 500 new jobs for customer support centres or 70 new jobs for other business support services centres.

The following conditions apply to all types of investments:

- Assets for the project, including construction work, cannot be acquired before the incentives application is submitted
- The investment must be maintained (at the minimum amount and structure) for at least five years from when it is finalised.

Strategic investment (large projects)

- Large projects can qualify for Strategic Investment status.
- The main benefit of this status is the possibility of obtaining a higher proportion of cash incentives instead of tax relief.
- The cash grant can be as much as 10 percent and can be further increased to 12.5 percent for a combined manufacturing site and technological centre project.
- For a Strategic Investment in the manufacturing industry, the minimum amount invested in fixed assets is CZK 500 million, of which CZK 250 million must be invested in new machinery and at least 500 jobs must be created.
- For a technology centres Strategic Investment the minimum amount invested in fixed assets is CZK 200 million, of which CZK 100 million must be invested in new machinery, and at least 100 jobs must be created.

Income tax relief

Calculation

The calculation of the tax relief that can be claimed is the only significant area where the treatment of a new company (plant) differs from that of an expanded facility.

For a new company, the taxpayer is entitled to full tax relief, excluding tax on net interest income.

For an expanded plant, the amount eligible for tax relief is the difference between the tax relief that would be available for a new company and the average of the tax liabilities in the three years immediately preceding the first year in which relief can be claimed. The latter figure is adjusted taking into account industrial inflation and the current tax rate.

This formula can be seen as a rough attempt to restrict the amount eligible for tax relief to the additional profits from the expansion.

Permissible level of state aid and the amount of the subsidy

The total value of the incentives must not exceed the maximum permissible level of the state aid. The maximum amount of state aid is based on the rules set by the EU and is 25 percent of the eligible costs (investment in land, buildings, machinery and equipment and selected intangible assets) except in Prague, where no incentives can be provided...

For technology centres and business support services centres, the eligible costs alternatively be the wage costs of employees in newly created jobs within 24 months of the month in which a particular position was filled.

Job creation

Cash grants will be provided to an employer creating new jobs in a region where unemployment is more than 25 percent above the national average or in special economic zones. The cash grant is CZK 100,000–300,000 per new job.

Training and employee retraining

Cash grants for training and retraining employees will be provided to an employer as a partial reimbursement of the costs incurred. The subsidy covers 25 percent of the eligible costs of training and retraining employees.

Purchasing construction sites

This incentive can only be provided after negotiation with the owner of the land (state, region or municipality). The difference between the market price and the actual purchase price is treated as an incentive.

How can KPMG help investors with incentives?

In the Czech Republic KPMG is one of the leading advisors on investment incentives and can help investors with:

- an initial assessment of whether their project qualifies for investment incentives
- calculating the estimated benefits
- preparing applications for investment incentives
- full support during the approval process
- full support during the implementation phase
- negotiations with the government on extraordinary incentives
- site selection analysis.

For more detailed information, please contact Jan Linhart at jlinhart@kpmg.cz.

EU Structural Funds

The Czech Republic (excluding Prague)

Businesses set up in the Czech Republic can also obtain support from EU Structural Funds under several Operational Programmes.

EU funds are mostly available as investment cash grants. A wide range of grants is available. The grants below are the most relevant for new investors:

- production innovations,
- ICT projects,
- R&D centres
- energy savings
- reducing emission and water pollution precautions.

The first applications should be accepted in May or June 2015.

For more detailed information, please contact Jan Linhart at jlinhart@kpmg.cz.

R&D tax allowance

R&D companies can apply for a special tax deduction. The R&D deduction in fact allows companies to claim internal R&D costs twice: for the first time within the profit and loss account, for the second time as a special tax deduction. Effectively, savings can thus be up to 19 percent of the R&D costs. The deduction can be claimed every year and there is no limit on the maximum amount claimed.

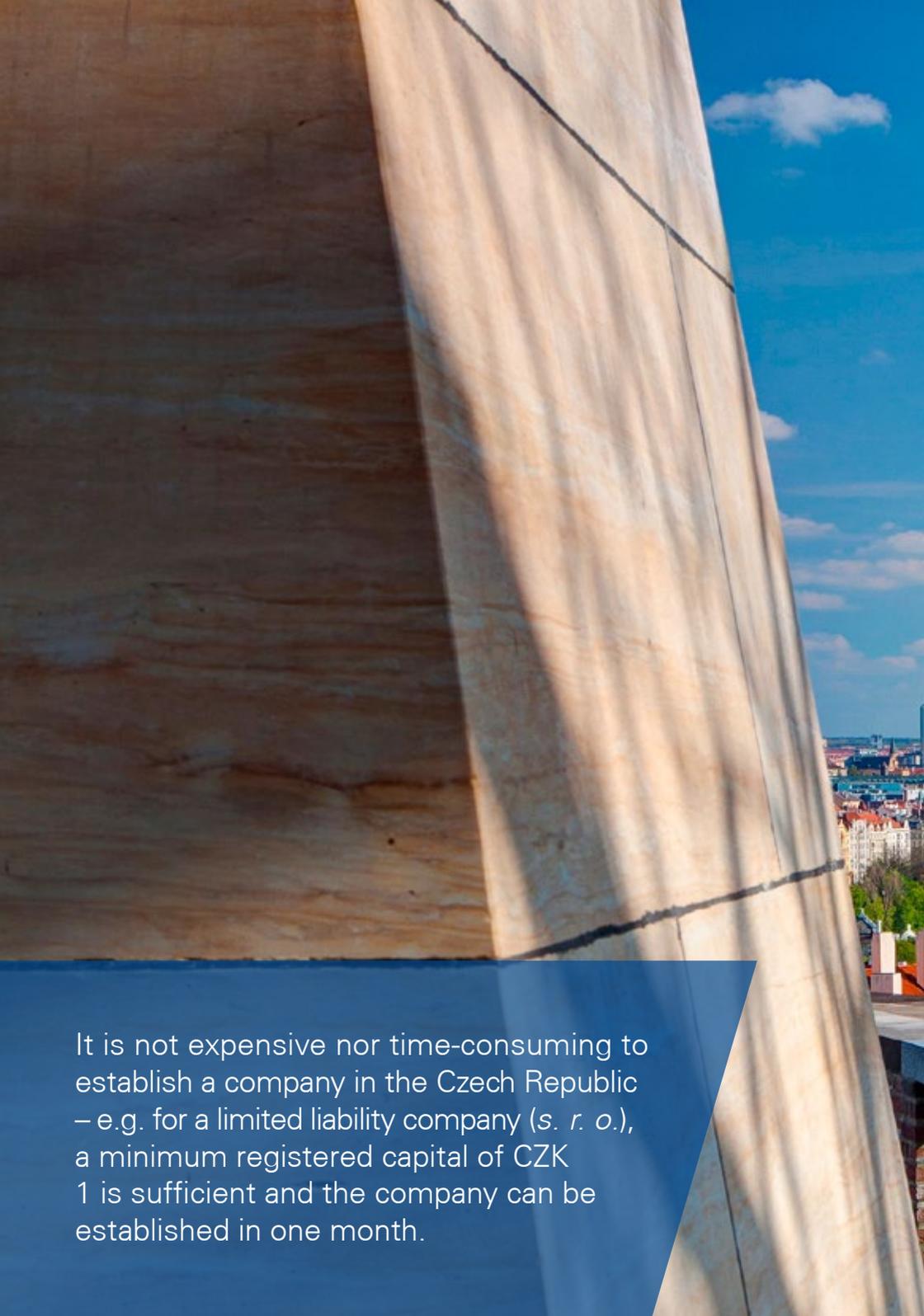
KPMG in the Czech Republic is an authorised advisor on R&D tax deduction and provides a wide range of related services. It can help clients with:

- defining an eligible activity
- calculating the deduction
- preparing the required documentation
- obtaining a ruling from the tax authority
- issuing a certified court expert opinion.

Education tax deduction

The education tax deduction is a new tool introduced in 2014. It allows companies to obtain a special tax deduction for particular costs of educational activities for professional education.

The deduction covers various activities of educating secondary school or university students on the premises of companies. Companies can also receive a deduction for assets acquired for this education.



It is not expensive nor time-consuming to establish a company in the Czech Republic – e.g. for a limited liability company (*s. r. o.*), a minimum registered capital of CZK 1 is sufficient and the company can be established in one month.



Chapter 3

Business structures

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The basic provisions governing business obligations and other specific aspects of doing business in the Czech Republic are set out in the Civil Code and the Act on Business Corporations, both effective as of 1 January 2014.

The Act on Business Corporations addresses the main aspects of Czech corporate law. It also regulates the relationship between companies and their statutory representatives, their rights and obligations and their liability for a breach of due care. In addition, it sets out the rules for holding companies and the liability for damage caused by their controlling entities.

Types of business entities

The Act on Business Corporations recognises the following types of business entities:

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

In addition, foreigners can establish a branch in the Czech Republic. A branch is not a legal entity but must be recorded in the Commercial Register.

The Act on Business Corporations regulates the status and activities of entrepreneurs and applies to both legal entities and individuals.

A Czech legal person is an entity that has its registered office in the Czech Republic.

Foreigners are defined as persons (individuals or legal entities) domiciled abroad or with a registered office outside the Czech Republic.

A foreigner's authorisation to carry out business in the Czech Republic comes into effect on the day they are recorded in the Commercial Register. This does not apply to citizens of member states of the EU, the EEA or Switzerland, their family members who have Czech residence permits, citizens of other states with long-term residence in the EU and their family members with long-term residence permits.

A foreigner can participate in establishing a Czech legal entity or become a partner or member of an existing Czech legal entity. A foreigner can also be the sole founder of a Czech legal entity, provided that Czech law permits a company to have a sole founder or sole shareholder.

The main characteristics of the various legal entities are described below.

Limited liability company

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

- The company must have a registered capital of at least CZK 1.
- The list of shareholders, the amount of each shareholder's contribution and the names of the members of the supervisory board (if one is established) must be recorded in the Commercial Register.
- The law allows different kinds of shares to be created. Shares with the same rights and obligations are one kind of share. The shareholder can own more than one share and also shares of different kinds.
- The share of a shareholder can be represented by a common share certificate (*kmenový list*) (however, this certificate cannot be a registered certificate and it cannot be publicly offered or admitted to trading on the regulated market).
- 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 and whose details, including information on their authorisation to act on behalf of the entity, must be recorded in the Commercial Register.
- A legal entity can also be appointed as the executive.
- 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:
 - the net turnover exceeds CZK 80 million per annum
 - the total assets are more than CZK 40 million
 - the average number of employees is more than 50.
- Establishing a company takes about one month from providing all the necessary documents and information.

Joint-stock company (*akciová společnost – a. s.*)

- The registered capital cannot be less than CZK 2 million or EUR 80,000.
- Non-cash contributions to the registered capital must be valued by an independent expert proposed by the founders (when a company is being established) or the company (registered capital increase). The valuation is binding on the company.
- 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:
 - the net turnover exceeds CZK 80 million per annum
 - the total assets exceed CZK 40 million
 - the average number of employees is more than 50.
- An annual financial statements must be published.
- The company can decide between two internal structures: either to have a supervisory board and a board of directors (dualistic organisation of corporate bodies), or an executive director and a managing board (monistic organisation of corporate bodies). The chairman of the managing board can be the same person as the executive director. A legal entity can also be appointed a member of a board of directors.

General partnership (*veřejná obchodní společnost – veř. obch. spol. or v. o. s.*)

- A general partnership is formed by two or more people (individuals or legal entities).
- The partners in a general partnership are liable for the debts of the company.
- The names and addresses or registered offices of the partners must be recorded in the Commercial Register.
- All the partners are entitled to act on behalf of the partnership and are jointly and severally liable for the partnership's obligations to the extent of their entire property.
- 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 people (individuals or legal entities). At least one of the partners must be a general partner with unlimited liability for the debts of the partnership. At least one partner must be a limited partner liable for the partnership's debts up to the amount of the unpaid contributions recorded in the Commercial Register.
- The names and addresses or registered offices of the partners, a statement on whether they are limited or unlimited partners, the amount contributed by each limited partner and the amount of their paid up contributions must be recorded in 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*)

- Co-operatives are formed by at least three members, either legal entities or individuals, to undertake business activities for the economic or social benefit of their members.
- Members are not liable for the obligations of the co-operative; however, the co-operative can demand contributions from its members to cover losses.
- 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 recorded in the Commercial Register.
- The entry should include details of the foreign business and its office in the Czech Republic, the scope of the business activities and the name and address of its director (general manager).
- A branch must obtain a trade licence from the regional Trade Licensing (Business Registration) Office.
- A branch does not have limited liability.
- The audit requirements are the same as for a limited liability company.

Company formation

- Memorandum of association
- Obtaining trade licences
- Contribution payment
- Registration in the Commercial Register

A company is formed after a founder's deed or a memorandum of association is executed. Limited liability companies and joint-stock companies must produce these documents as a notary deed.

After the founder's deed or a memorandum of association is executed, the future executives of the company must register their trade licences at the Trade Licensing Office and procure the documents needed to register the registered address of the company.

The company's founders name a contributions administrator who is responsible for proving to the Commercial Register that the contributions to the registered capital have been paid up by the shareholders.

After the future executives have collected all the necessary documents they can file an application to register the company in the Commercial Register. Once the court administering the Commercial Register registers the company, the process of the company's formation is complete. The whole process can take up to two months.

The Commercial Register

A company has a legal status and is entitled to commence business activities in the Czech Republic only after it is recorded in the Commercial Register. The courts have five business days to record the company in the Commercial Register after the application is submitted. The fees vary from CZK 6,000 for a limited liability company to 12,000 for a joint-stock company (approx. EUR 220 and 440).

An entry includes, for example, the name of the entity and the address of its registered office, the identification number of the entity, the scope of its business activities, the type of entity and the names and addresses of the executives or directors, together with details of their authorisation to act on behalf of the entity.

Access to the Commercial Register is freely available on the Internet (www.justice.cz).



The Czech Republic has a skilled and educated labour force.

A nighttime photograph of Prague, Czech Republic, showing the illuminated Prague Castle on a hill overlooking the city. The Vltava River flows in the foreground, reflecting the city lights. The sky is a deep blue with some clouds. The overall scene is a panoramic view of the city at dusk.

Chapter 4

Employment policy

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The Czech Republic has a skilled and educated labour force and the literacy rate is above 98 percent.

Czech labour law is not considered excessively rigid and is relatively flexible within the EU context.

Employment law is governed by the Labour Code. When an employee from another EU member state is sent by an employer to work in the Czech Republic as part of the trans-national provision of services, Czech Labour Code regulations apply to the basic conditions, such as the maximum working hours and the minimum length of rest periods, the minimum annual leave entitlement, the minimum wage and overtime rates, occupational health and safety, etc.

The maximum working week is 40 hours. The standard working week is Monday to Friday.

The maximum amount of overtime that can be ordered by the employer is 150 hours per year. The maximum amount of overtime (with the consent of the employee) must not exceed 416 hours annually. Overtime must be distributed evenly.

The retirement age for individuals ranges from 60 to 65 based on the sex, date of birth and number of raised children (applicable to women only).

Employment contracts

Employers are required to conclude written employment contracts with their employees. The contract must at least describe the type of work, the date the employee will commence work, and where the work will be carried out.

Generally trial periods cannot be longer than three months but for managers they can be concluded for up to six months.

A fixed-term employment contract can be concluded for up to three years and can only be repeated twice.

An employment contract concluded for an indefinite period or fixed term can be terminated:

- by agreement
- by notice
- by immediate termination
- by termination during the trial period.

A fixed-term employment contract also terminates on the expiry of the agreed period.

The employer or the employee can terminate a contract by giving written notice. The notice period for the employer and the employee is at least two months and the employee can give notice without stating a reason.

When the employer terminates an employment contract, it must be for one of the reasons stated in the Labour Code, such as:

- the employer is being liquidated or is ceasing to carry on business
- the employer is relocating
- organisational changes
- serious disciplinary breaches by the employee, etc.

When an employment contract is terminated for any of the reasons under points 1 to 3, the employer is obliged to pay the employee up to three months' severance pay depending on the duration of the employment relationship.

Specific termination conditions apply for disabled people, pregnant women and employees caring for minors. Specific termination conditions, severance pay and other conditions can also be included in a collective agreement, if in force.

During the trial period, the employment contract can be terminated by either side for any reason or without any reason being given.

Employment agencies

An alternative to an employment contract is agency employment. An employment agency provides its clients with human resources, without the necessity of concluding employment contracts with employees. Even though this option is more expensive, it provides much greater flexibility in allocating human resources.

Mass layoffs

If an employer terminates an employment relationship with a certain number of employees as defined in the Labour Code for the specific reasons set out above under points 1 to 3 within a period of 30 calendar days, this is considered a mass layoff and special conditions, such as a notification obligation to the Labour Office and unions, apply.

Unions and trade unions

Unions can be formed freely and the state or any other subject cannot limit their formation.

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

The role of trade unions in the Czech Republic is to formulate and ensure the labour, economic and social interests of employees. The aim is to reach an agreement with the employer based on collective bargaining.

Holidays

An employee is entitled to holiday pay if the employment contract lasts for at least 60 consecutive days during a calendar year. If 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. Holiday pay is calculated on the basis of the employee's average monthly salary.

Social security and health insurance

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

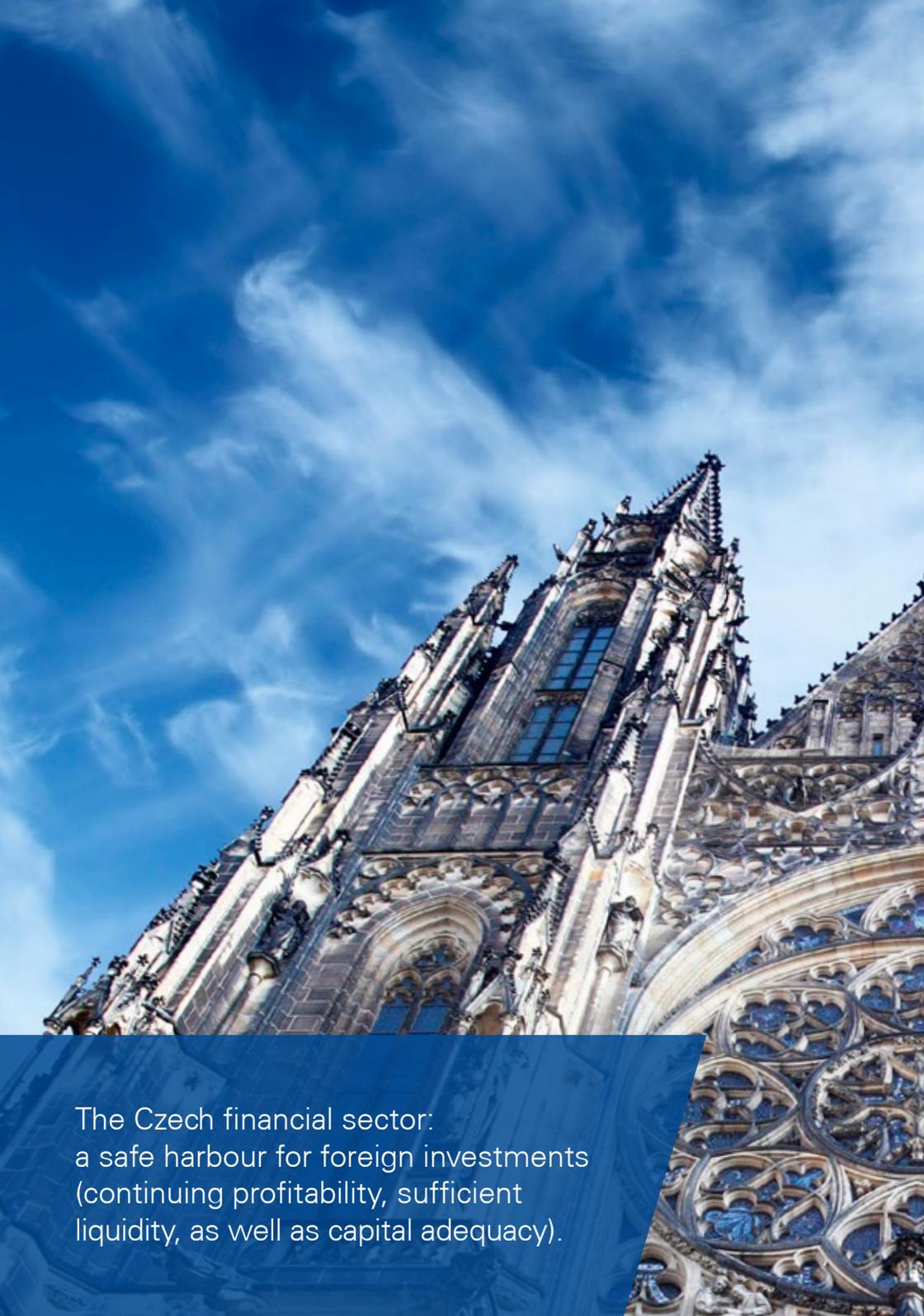
Payments from the social security insurance system typically include:

- pensions
- cash benefits such as sick leave, maternity benefits, social benefits, etc.

A social security treaty is concluded with certain countries and removes the burden of paying social security contributions to both countries.

Concurrence of an employment relationship with the execution of the office of director

The current legislation does not allow the concurrence of an employment relationship with the execution of the office of director.



The Czech financial sector:
a safe harbour for foreign investments
(continuing profitability, sufficient
liquidity, as well as capital adequacy).



Chapter 5

Financial services

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Regulation and supervision

The Czech National Bank (CNB) is the central bank of the Czech Republic. Its function is to determine monetary policy, carry out and coordinate supervision of the Czech financial market, issue banknotes and coins, and manage the circulation of the currency, the payment system and the settlement system between banks. More details can be found at: www.cnb.cz.

The Ministry of Finance is mainly responsible for preparing primary legislation for the financial market sector, the CNB assists in this process.

As an EU member, the CNB cooperates in supervision with European institutions (the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority) on unifying supervisory procedures and creating conditions for close cooperation between home and host supervisors.

Prudential rules for banks, credit unions and investment firms are primarily regulated by a decree issued in 2014 which is driven by measures agreed at the EU level and which implements the requirements of Basel III/CRD IV and the Capital Requirements Regulation (CRR) into Czech legislation.

Solvency II, a new, harmonised EU-wide insurance regulatory regime, will be effective from 1 January 2016 in all EU member states, including the Czech Republic.

Licences

The licensing of banks and other financial institutions and matters connected with mergers and acquisitions and other market entries are fully the responsibility of the CNB.

A foreign financial institution can enter the Czech market in the following four ways:

- as a new company, with up to 100 percent foreign ownership
- by acquiring an equity stake in an existing entity
- by establishing a branch of the parent institution with a licence, and
- by establishing a financial institution of the parent based on the licence of the parent institution (applicable to all banks and insurance companies with a registered office in the EU under the “single licence principle”).

Deposit insurance

Since 2010, the deposit limit for 100-percent protection has risen to EUR 100,000. The deposit claims of banks, foreign banks, financial institutions, health insurance companies and state funds are not insured.

All banks and branches of foreign banks (excluding branches of parent banks participating in the deposit insurance scheme in their parent country) are obliged to participate in the scheme and contribute to the deposit insurance fund in compliance with the Act on Banking.

Banking sector

The Czech banking sector consists of banking institutions with primarily international ownership. It is dominated by big foreign banking groups such as the Erste Group, KBC Group, Societe Generale, Raiffeisen Group, UniCredit Group and GE Money Group. Although the banking sector is significantly concentrated, small and medium banks have strengthened their position on the Czech market in recent years.

Typical activities include commercial lending to corporate and retail clients, customer accounts and deposits administration, credit card operations, international lending and loan syndications, mutual funds management and administration, bank treasury operations and back office activities.

As of 31 December 2014, there were 45 banks (including foreign branches) offering banking services to clients in the Czech Republic, of which 37 were controlled by foreign investors and eight by local stakeholders. The group of the four largest banks (banks with total assets of more than CZK 200 billion) played a predominant role in the banking sector in the Czech Republic.

As of 30 September 2014, their share of total assets was approximately 59 percent. Despite the environment of decreasing interest rates, the Czech banking sector maintained a very good profitability in 2014. The net profit for the first nine months of 2014 exceeded CZK 50 billion (for the whole year of 2013 it was more than CZK 61 billion) with the level of classified loans at approximately 6 percent.

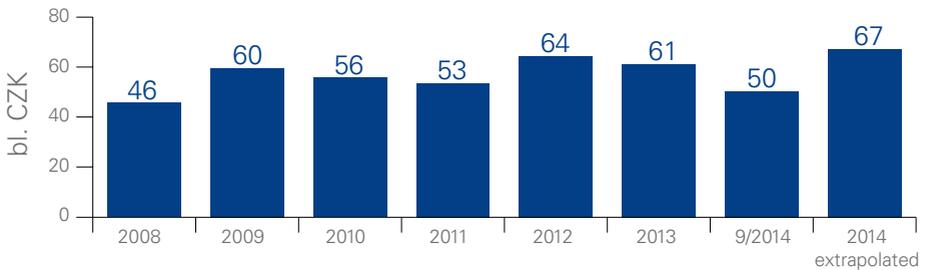


Figure 1: Net profit of the Czech banking sector, in billions of CZK

Source: http://www.cnb.cz/en/supervision_financial_market/aggregate_information_financial_sector/basic_indicators_financial_market/index.html

Insurance sector

The Czech insurance sector is dominated by two insurance groups Generali and VIG. The remaining TOP 10 insurance companies are composite insurance companies and the rest consist of bank-assurance and specialised insurance companies.

As of 31 December 2014, there were 52 insurers (including foreign branches) offering insurance services to clients in the Czech Republic and one reinsurance company. Twelve insurance companies are controlled by local and the rest by foreign stakeholders. The two largest groups reached CZK 71.7 billion of gross written premium (measured by the annual premium equivalent). The overall market profitability is approximately 13 percent return on equity and the market manages approximately CZK 490 billion of assets.

Typical products include both life and non-life insurance. The non-life insurance business is dominated by car insurance (compulsory Motor Third Party Liability Insurance and Casualty and Collision (automobile insurance)) and commercial insurance.

The insurance market is supervised by the CNB.

Investment management and funds

The Czech market consists of around 350 investment funds domiciled in the Czech Republic according to the CNB statistics as of 30 September 2014. In addition, approximately 1,200 foreign funds are registered for public offer in the Czech Republic.

According to the Act adopted in 2013, which extended the options for establishing new investment funds in line with the European regulation, investment funds can have the following legal forms:

- mutual fund
- trust fund
- joint-stock company
- investment company with variable capital (*société d'investissement à capital variable*)
- limited partnership
- limited liability company
- European company.

A minimum fund capital of EUR 1.25 million is required. The foundation of funds, which fulfil EU requirements, must be approved by the CNB. A notification duty to the CNB is only required for special investment funds that do not fulfil these requirements. However, the asset manager of each fund must have the approval of the CNB.

The investment fund market is supervised by the CNB.

The Stock Exchange

The Prague Stock Exchange (PSE) began trading in April 1993. Trading on the PSE is conducted via licensed securities dealers, who are also PSE members.

These are primarily major banks and brokers. If a common investor decides to invest in the Exchange, they need to contact one of the PSE members or become a member.

Currently trades can be concluded either directly through the regulated market (administrated by the PSE) or the non-regulated market primarily for OTC (over-the-counter) trades (administrated by the Central Depository). Since 2012, trades on the regulated market have been traded via the stock international exchange platform – Xetra. The basic criteria for trading and listing on each market can be found at: www.pse.cz.

Foreign exchange

Regulation

The Act on Foreign Exchange fully implemented the obligations that the Czech Republic accepted under international agreements in relation to the free movement of capital and the system of payments. The Czech Republic has concluded many agreements with other countries on the promotion and reciprocal protection of investments.

Market development

The foreign exchange rate of CZK to EUR, as well as other main currencies, was affected by the intervention of the CNB, which started in November 2013 (see significant movement in Figure 2). The CNB announced its intention to keep the Czech currency below the level of 27 CZK/EUR. The intervention was primarily driven by the fact that inflation had been well below the inflation target for a prolonged period; i.e. a potential threat of deflation occurred. The CNB announced that it would not discontinue foreign exchange market intervention as a monetary policy instrument sooner than 2016.

As of 31 December 2014, the foreign exchange rate of the CZK to the EUR was 27.725, the exchange rate of the CZK to the USD was 22.834.

As shown in the graph below, the CZK stayed below the threshold set by the CNB and was relatively stable to the EUR during 2014 moving around 27.5 CZK/EUR. On the other hand it depreciated against the USD in 2014 as a result of the weak euro.



Figure 2: CZK development during 2013 and 2014 (CZK/EUR and CZK/USD)

Source: http://www.cnb.cz/en/financial_markets/foreign_exchange_market/exchange_rate_fixing/year_form.jsp

Repatriation of capital and profit

The Czech currency is convertible outside the Czech Republic. Czech companies can freely repatriate both the current year's profit and retained earnings in whatever currency they desire. However, they should follow the minimum capital requirements – if applicable – imposed by the CNB.

The branches of foreign banks do not have such limitations as the capital is managed and monitored centrally.

The following types of payments from a Czech company to its foreign parent can 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.



The Czech Republic is a party to a large number of double taxation treaties and has implemented relevant EU directives.

A long-exposure photograph of a city street at night. The scene is dominated by horizontal light trails from moving vehicles, creating streaks of white, yellow, and red. The wet pavement reflects these lights, creating a shimmering effect. In the background, city buildings are lit up, and a tall, illuminated tower stands out against the dark blue sky. The overall atmosphere is vibrant and dynamic.

Chapter 6

Direct taxes

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Taxation of legal entities

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, the profits of a general partnership (*v. o. s.*) are not subject to corporate tax; instead, the partners' share of the profit is taxed in their own 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 limited partnership level, while the general partner's share is taxed in the same way as in a general partnership. In addition, trusts are subject to corporate tax even though they are not legal entities.

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

Since most of these legal entities by definition exist for the purpose of carrying on a business, virtually all the income and gains they realise are included when calculating their business profits (see 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 19 percent in 2015. A reduced rate of 5 percent applies to the income of qualifying investment funds and a reduced rate of 0 percent applies to qualifying pension funds. Full or partial relief from corporate tax can be claimed for certain qualifying investments (see Chapter 2 – Investment incentives and state aid).

Capital gains are generally included in income and taxed at the same rate. However, if at least 10 percent of the shares of a company are held by a parent company for 12 months, the 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 taxation 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 a company resident in the EU, Norway or Iceland and at least 10 percent of the shares have been held for 12 months.¹⁸

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

Dividends received by Czech resident companies from non-residents are taxed at a rate of 15 percent. They are exempt from tax if the payer is a company resident in an EU member state, provided that at least 10 percent of the shares have been held for 12 months.

The exemption also applies if all the following criteria are met:

- the payer is a tax resident of a state with which the Czech Republic has concluded a double taxation treaty
- the payer has a similar legal form to a limited liability company (*s. r. o.*), joint-stock company (*a. s.*) or co-operative (*družstvo*)
- the recipient has held at least 10 percent 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 percent.

¹⁸⁾ The same rules will apply to Liechtenstein from 1 January of the calendar year after the year in which a double taxation treaty between the Czech Republic and Liechtenstein becomes effective. It is expected that a double taxation treaty will become effective in 2015 so the beneficial treatment would apply to Liechtenstein from 1 January 2016.

Exemptions for capital gains and dividends do not apply if the parent company or the subsidiary:

- are exempt from corporate income tax (or similar tax), or
- can claim a corporate income tax exemption or corporate income tax relief, or
- are subject to corporate income tax at a rate of 0 percent or if the recipient is not the beneficial owner of the income.

Mergers and divisions of companies can generally be carried out on a tax neutral basis. The EU Mergers Directive and the EU Cross-Border Merger Directive have been broadly assimilated into Czech law. In general, domestic legislation maintains the tax neutrality of mergers and allows unused tax losses for transactions satisfying certain legal conditions (transfers of business and mergers), to be transferred provided that tax avoidance is not the main purpose of the transaction. Additionally, there is a “same activity” rule, under which tax losses can only be offset against income earned from the economic activity that generated the tax loss.

Taxation of business income

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

The tax year is generally the same as the financial year for companies. A financial year ending on a date other than 31 December can be adopted provided that it is the last day of a calendar month. If the financial year-end changes, there are provisions in the Income Taxes 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 on a calendar year basis.

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

A special deduction equal to the deductible expenditure on research and development (R&D) can be claimed which effectively means that this expenditure is deducted twice; this deduction, if not used in the period in which it arises, can be carried forward to the next three tax periods.

The Act on Reserves allows restricted deductions for bad debt reserves. 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, as long as the 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 on loan provisions for banks and reserves for insurance companies.

Tax depreciation can be claimed on fixed assets. For this purpose, fixed assets are divided into several categories broadly reflecting their expected useful life. Depreciation on most assets can be claimed on either a straight-line or an accelerated basis.

Tax losses can be carried forward for five years. Losses cannot be carried forward after a substantial change in the direct ownership of a company unless it can be shown that at least 80 percent 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 percent 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. Restrictions also apply in the case of certain corporate restructuring. A ruling can be obtained to confirm whether the loss can be used after a substantial change or restructuring.

Transfer pricing

As in other OECD countries, a review of transfer pricing is becoming one of the biggest priorities of tax authorities. The focus is not only driven by global BEPS (Base Erosion and Profit Shifting) initiatives, but also by the general focus of state administration on increasing the compliance of companies with the valid regulations and arm's length principles.

Czech legislation in this area is relatively simple. Transfer pricing is dealt with in a short provision that 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 base should be adjusted. It is possible to request unilateral or bilateral advance pricing agreements from the tax authorities on the method of setting the transfer price between related parties. Retroactive agreements are not possible.

In addition to the provisions of the Income Taxes Act, the Ministry of Finance has issued guidelines giving more detailed information especially on transfer pricing documentation (e.g. Decrees D-332, D-333, D-334 and D-10). These are not legally binding, but given that the tax authorities usually follow them, they represent useful guidance for taxpayers.

Recently, the Czech tax authorities introduced a new requirement to disclose types of transactions including amounts realised with each related party via a special electronic form, which was introduced as an enclosure to the corporate income tax return. The mandatory disclosure firstly applies to corporate income tax returns filed for periods commencing in 2014.

The enclosure will have to be submitted by Czech tax payers who meet one of the three criteria below:

- assets of more than CZK 40 million
- a net turnover of more than CZK 80 million
- a recalculated headcount exceeding 50 employees.

The obligation is further limited to companies meeting these criteria that:

- carried out transactions with related parties abroad, or
- incurred a tax loss or
- are the recipients of investment incentives.

There is currently no legal obligation to have transfer pricing documentation prepared. However, the tax authorities regularly require transfer pricing documentation to be provided during tax inspections with the usual deadline of 15–30 days.

Thin capitalisation

The thin capitalisation provisions act to restrict the deductibility of interest and other loan expenses where the borrower has insufficient equity. The rules can be summarised as follows.

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

Any upward adjustment of profit resulting from a transfer pricing or thin capitalisation adjustment relating to a non-EU or EEA resident counterparty can be treated as a dividend, i.e. is subject to dividend withholding tax, as reduced by the provisions of any applicable double taxation treaty.

Taxation of individuals

Individuals are subject to income tax, social security, health insurance, and taxes on land and buildings. The taxation of individuals primarily depends 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 sourced 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 a 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 in the above categories.

There are numerous exemptions, of which the most important are the exemptions from tax on the gains from the sale of shares and securities.

- Gains on the sale of securities acquired before 31 December 2013 are exempt if the securities have been held for more than six months and do not represent more than 5 percent of the registered capital and voting rights for 24 months preceding the sale.
- Gains on the sale of securities acquired before 31 December 2013 representing more than 5 percent of the registered capital and voting rights and any securities acquired on or after 1 January 2014 are exempt if held for three years.

Generally, no tax is payable if the income from the sale of securities does not exceed CZK 100,000 in a tax year.

Gains on the sale of shares in a limited liability company are exempt if the shares have been held for 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 before the sale. Gains from the sale of a dwelling are also exempt if it was used as the taxpayer's main residence for at least two years. If it was used for less than two years, the exemption applies if the gains are used for the taxpayer's housing in the future.

From 2015, exempt income exceeding CZK 5 million in a given tax year must be declared to the tax authorities.

The income of individuals is subject to a flat tax rate of 15 percent. An additional 7 percent (the "solidarity tax increase") is applied to income (sum of gross salary and tax base from self-employment) in excess of the maximum annual assessment base for social security contributions (CZK 1,277,328 in 2015).

Based on the current law the solidarity tax increase is applicable only until the end of 2015. The 15-percent flat tax on employment income is calculated on the basis of the “super-gross salary,” which is the gross salary increased by the social security and health insurance contributions payable by the employer. Foreign employment income that is taxable in the Czech Republic is increased by deemed contributions of 34 percent regardless of the amount of the social security and health insurance contributions actually paid. Thus, the effective tax rate is not 15 percent (or 22 percent for persons subject to the solidarity tax) but a higher rate, depending on the income level.

Dividends and certain types of other Czech sourced income are taxed separately and are subject to a 15 percent withholding tax at source.

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

The business income or other income of the self-employed can be reduced by actual expenses or by an optional lump-sum deduction ranging from 30 to 80 percent of gross income. The annual lump-sum deduction is limited to a maximum of CZK 1,600,000 for income from agricultural business, 1,200,000 CZK for business income based on a trade licence, CZK 600,000 for rental income and CZK 800,000 for other business income.

Employees must pay tax on all forms of income, whether in cash or in kind. In particular, benefits, such as the provision of a car available for private use, are taxable. An employee’s social security and health insurance contributions cannot be deducted 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. Employer contributions to defined private pension schemes up to CZK 30,000 per year are tax free for the employee.

Before 2013, the Czech pension system comprised two pillars – a mandatory pay-as-you-go pension system run by the government (the first pillar) and a voluntary additional pension system administered by commercial insurance companies (the third pillar). From 1 January 2013, a second pillar has been added. Employees who opt for the second pillar pay 5 percent of their salary into an account at a private pension fund and their obligatory payments to the first pillar are reduced by 3 percent.

There are no special provisions dealing with employee share option schemes, so that gains realised from exercising an option are regarded as taxable income. It is generally accepted, however, that no gain arises on the granting of an option.

The salaries of employees usually have the wage tax deduction withheld by the employer monthly, with possible annual reconciliations. Expatriate staff can be seconded through the permanent establishment of a foreign employer that, although taxable, is not registered in the Commercial Register. In this case, there is no liability to withhold tax. Instead, the employees themselves are liable to file tax returns and pay tax, normally in quarterly instalments.

There is another possible tax treatment for the employees of foreign companies, the “deemed employer” rule, which is essentially an anti-avoidance provision.

The rule can apply where the employees of a foreign employer work in the Czech Republic under the control of a Czech person who pays a fee to the foreign employer for their services. In this 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. Special treatment applies to licensed labour agencies.

Resident and non-resident individuals can claim a basic personal tax allowance of CZK 24,840 per year. Various other credits are granted to a resident, such as a tax credit of CZK 24,840 per year for a spouse living in the taxpayer’s household, if the spouse’s annual income does not exceed CZK 68,000 and tax allowance for children (for 2015 a tax allowance of CZK 13,404 for the first-born, CZK 15,804 for the second-born and CZK 17,004 for the third-born and other children. A tax allowance up to the amount of the minimum wage announced for a given tax year (CZK 8,500 for 2014) can be claimed for fees paid to preschool facilities.

Limitations apply to individuals earning business or rental income, who claim flat rate expense deductions.

The allowances are also granted to residents of the EU or EEA if at least 90 percent of their income is derived from sources in the Czech Republic. The amount of income from foreign sources should be confirmed by the foreign tax authorities in the state of residence.

Social security contributions, where payable, amount to 45 percent of an employee's salary (for income up to the annual cap for social security). This consists of the employee's contribution of 11 percent and the employer's contribution of 34 percent, made up as follows.

	Employer (%)	Employee (%)
Pension	21.5	6.5/8.5*
Sickness insurance	2.3	0.0
Unemployment insurance	1.2	0.0
Health insurance	9.0	4.5
Total	34.0	11.0/13.0*

* for employees participating in the second pillar of the pension system

The maximum annual assessment base for social security premiums in 2015 is CZK 1,277,328. There is no cap on health insurance premiums. Social security and health insurance contributions must be paid monthly. Social security contributions must be paid until the aggregate of the monthly assessment base exceeds the maximum annual assessment base. When this limit is reached the employer should stop paying social security contributions. The assessment base is very similar to the tax base.

Foreign persons under local employment contracts are subject to Czech social security. Foreign persons employed by a non-Czech employer, where there is a social security treaty between the Czech Republic and the country of the employer, are subject to Czech social security unless, under the terms of the treaty, they can remain in the social security system of the home state.

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.

Tax on the acquisition of immovable property

With effect from 1 January 2014, real estate acquisition tax replaced the former real estate transfer tax. The tax liability arises when the transfer of the ownership of real estate is registered in the land register. The tax is payable by the transferor (seller), although the parties can agree that it is paid by the acquirer.

The tax rate is 4 percent of the tax base. The tax base is the higher of the agreed price and the reference value. The reference value is calculated by the tax authorities based on the prices for similar transactions. If the tax authorities cannot calculate a reference value, the tax base is the higher of the agreed price and 75 percent of the value assessed by an expert. If real estate is transferred as part of an enterprise, the tax base is based on an expert valuation.

The taxpayer must submit a tax return by the end of the third month after the month in which the transfer is registered. The tax is due by the same deadline. The tax declared in the return is in some cases considered as a prepayment and is subject to review by the tax authorities.

Taxation of income from inheritance and gifts

From 1 January 2014, gift and inheritance taxes have been abolished and the taxation of this income is governed by the Income Taxes Act. Gifts are taxable unless the donor is a qualifying spouse or close relation and are subject to a flat rate of 15 percent for individuals and 19 percent for companies. No tax is payable on inherited property.

Tax on immovable property

The tax on immovable property is payable by the owners of the immovable property situated in the Czech Republic. This tax is generally small compared with other developed countries. Different rates apply to 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
Residential and agricultural	2
Industrial	10
Other business	10

An additional charge of CZK 0.75 per square metre is levied for each storey (above the ground floor) of a building used for business purposes if the area of the storey exceeds one third of the area of the ground floor.

The real estate tax on agricultural land is 0.75 percent of the deemed value. Special rates apply to forests, lakes and ponds. For other types of land, the tax is based on the area, and the rate is CZK 2 per square metre for building plots, CZK 5 per square metre for improved land surface used for business purposes and CZK 0.20 per square metre in other cases.

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

International tax issues

Companies with 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 the place where the effective management of the company is located. These companies are referred to as Czech residents.

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

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

Under certain double taxation treaties, however, the foreign income of Czech residents is exempt from Czech tax. In these cases, the expenses related to that income are not tax deductible. Credit for foreign taxes on income that is also subject to Czech tax is available only if there is a double taxation treaty with the other state. Otherwise, the foreign tax can only be treated as an expense.

The main types of Czech sourced income for non-residents are:

- the income of a permanent establishment in the Czech Republic
- the income from a dependent activity (employment) carried out in the Czech Republic
- the income from services provided in the Czech Republic
- the income from the sale or use of real estate situated in the Czech Republic
- royalties, dividends and other profit distributions, interest, and lease rentals
- the income from the transfer of shares in Czech resident companies, which is not tax exempt under domestic legislation
- the income from the sale of a business as a going concern located in the Czech Republic.

These tax liabilities are to some extent mitigated by tax treaties, where applicable. In particular, where there is a treaty:

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

Income liable to tax is generally subject to withholding taxes at a rate of 15 percent. The rate is increased to 35 percent if the income is paid to residents of countries which have not signed a double taxation treaty with the Czech Republic, when no arrangement is in place for the exchange of information on tax matters.

Withholding tax is a final tax that is generally reduced by double taxation treaties. Residents of other EU and EEA countries can file a tax return for some types of income (e.g. interest, royalties, freelance work) subject to withholding tax and claim a deduction for any related expenses (this does not apply to withholding tax from dividends). In this case, the withholding tax is considered an advance payment. This can result in a reduction of the tax burden as withholding tax is calculated on a gross basis.

The EU Parent-Subsidiary Directive has been implemented in the Czech Republic, which means that dividends paid by a Czech subsidiary to a parent company that is a tax resident in an EU member state may be exempt from withholding tax. These provisions also apply to dividends paid between Czech companies and dividends paid to Swiss, Norwegian and Icelandic corporate shareholders.

The EU Interest and Royalties Directive has also been implemented in the Czech Republic. As a result, interest and royalties paid to some associated companies resident in the EU, Switzerland, Norway and Iceland¹⁹ are generally exempt from withholding tax (subject to advance clearance procedures).

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

Other types of income paid to non-EU or 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 a prepayment for the ultimate tax liability. This tax is generally levied at the rate of 10 percent (1 percent for sales of securities or payments for receivables purchased from third parties), but can be reduced by prior negotiation with the tax authorities.

Beneficial ownership concept

A number of double taxation treaties concluded by the Czech Republic expressly limit their benefits to the beneficial owners of income.

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

¹⁹⁾ The same rules will apply to Liechtenstein from 1 January of the calendar year after the year in which a double taxation treaty between the Czech Republic and Liechtenstein becomes effective. It is expected that a double taxation treaty will become effective in 2015 so the beneficial treatment would apply to Liechtenstein from 1 January 2016.

Tax administration

Tax administration is mainly governed by the Tax Code 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 an annual taxable income of more than CZK 15,000 must file tax returns unless the income is tax exempt or subject to withholding tax. A return must also be filed by any individual who is liable to the solidarity tax. This means that, in general, low paid 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 also file a return.

The deadline for submitting 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 1 April. 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 its behalf.

Except for withholding tax, income tax is collected during the year by a system of prepayments based on the previous year's liability. The final deadline for settling the liability is the same as for submitting the return. The tax is regarded as paid when it is received by the tax authority.

The tax authority has the power to carry out tax inspections in order to establish or examine the tax base or other circumstances decisive to correctly determine the tax liability.

Tax cannot be assessed or additionally assessed after three years have elapsed from the deadline for filing the ordinary tax return. However, the deadline for assessing additional tax can be extended to a maximum of 10 years under certain circumstances, such as filing an additional tax return or a tax audit taking place. In the event of some tax-related crimes, additional tax can be assessed regardless of the fact that the period for tax assessment has ended.

Where a taxpayer has declared a loss, the period in which a tax audit can be carried out is extended by the period during which the loss can be used. Since losses can be carried forward for up to five years, if extended deadlines apply, an audit can be carried out up to 15 years after the tax return is due.

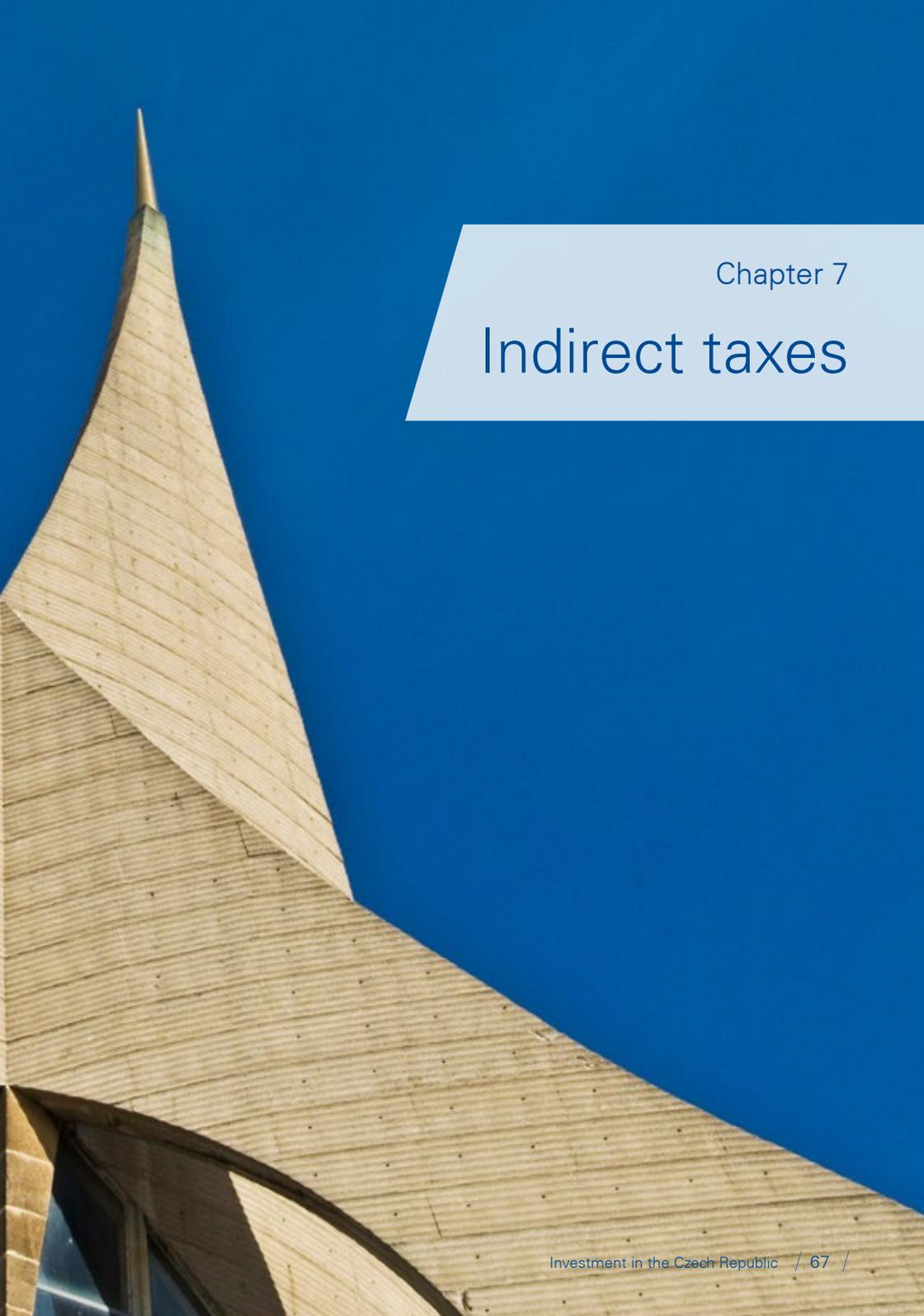
If an appeal is lodged against an assessment, the payment of any additional tax is deferred until the payment order is legally effective, but interest continues to be calculated on the outstanding amount.

Interest on overdue tax is assessed at the Czech National Bank repo rate plus 14 percent starting on the fifth working day after the due date for the first five years; no interest accrues after this date. Where additional tax is assessed by the tax authorities, a penalty of 20 percent of the additional tax is levied.

If a VAT refund is reduced, the penalty is 20 percent of the reduction. If a tax loss is reduced, 1 percent of the reduction is payable as a penalty. If the taxpayer corrects the tax base in an additional tax return, only the interest on the overdue tax is payable.

A low-angle photograph of a wooden building with a sharp, golden spire against a clear blue sky. The building's facade is made of light-colored wood, and the spire is a thin, golden point. The sky is a solid, vibrant blue. The image is used as a background for a text overlay.

The Czech VAT system is based on the harmonised principles of EU Directive 2006/112.



Chapter 7

Indirect taxes

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Value added tax (VAT)

The Czech Value Added Tax Act is based on the general principles of EC Directive 2006/112 and as such it is very similar to other EU countries.

VAT is generally due on any supply of goods or services, intra-community acquisition of goods and import of goods with the place of supply in the Czech Republic.

VAT rates

The standard VAT rate is 21 percent (effective from 1 January 2013). There are two reduced rates in the Czech Republic. The first reduced rate of 15 percent applies to, for example, food products, public transport services, social residential housing construction and the transfer of social residential houses, unless exempt. The second reduced rate of 10 percent (effective since 1 January 2015) applies to essential baby nutrition, pharmaceuticals for humans and veterinary purposes, books, mill products and their mixtures for producing the foods for those suffering from gluten-intolerance.

Exports and intra-community supplies of goods, as well as the international transport of goods relating to exports or imports of goods, are zero-rated.

Certain supplies of goods and services are exempt from VAT, for example:

- insurance and financial services
- postal services
- education
- health and welfare services
- transfer and financial leasing of immovable property under certain conditions, and
- renting immovable property (apart from short-term lease, leasing parking spaces and leasing safe deposit boxes).

VAT registration

A taxable person established in the Czech Republic, whose turnover for the preceding 12 consecutive months was more than CZK 1 million must be registered for VAT. There are also other situations that can lead to obligatory VAT registration (e.g. purchasing a going concern from a VAT payer, transferring the assets of a dissolved or spun-off entity that is a VAT payer to a taxable person).

A taxable person, who is not established in the Czech Republic, becomes a Czech VAT payer if they make a specific transaction with the place of supply in the Czech Republic, such as a zero-rated supply of goods to another EU member state or a Czech local taxable supply (supplying goods, providing services) on which they have to account for VAT. There is no registration threshold.

Taxable persons (both established and not established in the Czech Republic) can ask for voluntary VAT registration.

A group of related parties established in the Czech Republic or who have a VAT establishment in the Czech Republic, can register as a single VAT payer (group registration).

Persons identified for VAT

A taxable person, who is not a VAT payer, can become a person identified for VAT if they purchase a specific type of supply, where the place of supply is in the Czech Republic, e.g. they acquire goods from another EU member state or they supply services where the place of supply is determined in another EU member state under the general rule. A person identified for VAT is obliged to account for VAT on the received supply, however, they are not entitled to claim relating input VAT.

Reporting requirements

VAT returns

In general, VAT returns have to be submitted electronically monthly. Under certain circumstances, VAT payers can opt for a quarterly period. However, VAT groups and taxable persons whose turnover exceeded CZK 10 million in the previous calendar year cannot have a quarterly period.

VAT returns must be submitted by the 25th day of the month after the tax period. VAT payers who are not established in the Czech Republic and who do not have a VAT establishment in the Czech Republic and persons identified for VAT, only need to submit VAT returns for VAT periods in which they carried out taxable or zero-rated transactions.

VAT must be paid by the due date for submitting the VAT return. If there is excess input VAT, a VAT credit should be paid to the VAT payer within 30 days of the deadline for submitting the VAT return.

VAT returns must be submitted electronically via a special-purpose application.

There is a penalty for not submitting/delay in submitting a VAT return (max. CZK 300,000) and penalty interest applies for the late payment of VAT (14.05 percent p.a.).

EC Sales Lists

An EC Sales List must be completed if a VAT payer or person identified for VAT (where applicable):

1. supplies goods from the Czech Republic to another EU member state to a person registered for VAT in another EU member state, or
2. moves its own goods from the Czech Republic to another EU member state, or
3. acts as the intermediary in a triangular transaction between VAT registered traders in other EU member states, or
4. provides a service to a customer established in another EU member state, where the place of taxable supply is determined in that EU member state under the general rule.

The EC Sales List should be submitted electronically monthly, within 25 days of the end of the month in which the supply takes place. Quarterly VAT payers, who only provide services as described in point 3 above, can submit EC Sales Lists quarterly.

Intrastat declarations

Businesses that dispatch goods to, or receive goods from other EU member states that 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 monthly, by the 12th working day of the month after the month for which the declaration is filed. Intrastat declarations must be submitted electronically. A penalty of up to CZK 1 million can be imposed for failing to submit an Intrastat declaration.

VAT ledger statement

From 1 January 2016, the VAT ledger statement will have to be submitted by all VAT payers who have effected or received taxable supplies with the place of supply in the Czech Republic or traded in investment gold under a special VAT regime. The VAT ledger statement will also show transactions that have been carried out under the reverse-charge regime. The VAT ledger statements will have to be filed electronically.

Recovery of input VAT

In general, a Czech VAT payer is entitled to deduct input VAT for received supplies that are used for the VAT payer's business activities. Input VAT can be claimed within three years after the end of the tax period in which the taxable supply was made. A VAT payer must have a VAT invoice to exercise its right to deduct input VAT (VAT document).

A VAT payer is generally not entitled to deduct input VAT on taxable supplies used for VAT exempt supplies, representation (entertainment) or non-business purposes.

A partial VAT deduction could be claimed for taxable inputs related to both types of supplies, i.e. those qualifying for a deduction of input VAT and those not qualifying for a deduction (e.g. exempt supplies or non-business use).

The Czech Republic has implemented the general provisions of the EU directives on VAT refunds for entities registered for VAT purposes in other EU member states or non-EU businesses. VAT incurred in the Czech Republic is recoverable under the same conditions that apply to Czech VAT payers.

An application for a VAT refund should be filed electronically in the state where the taxable person has a registered office or place of business. The application must be submitted by 30 September of the year after the year in which the VAT was incurred.

Non-EU businesses can claim refunds of Czech VAT by submitting a written application to the Tax Authority for Prague 1. Refunds are only made on the basis of reciprocity (currently applicable only to Switzerland, Norway and Macedonia).

Other notes

Local reverse charge for selected transactions

The reverse charge mechanism applies for certain local taxable supplies. So far the reverse charge mechanism applies to supplies of gold, scrap materials and waste, construction and assembly works and emission rights.

Furthermore, since 1 April 2015, the application of the reverse charge mechanism was extended to certain types of cereal and technical crops, metals, mobile phones, integrated circuits, tablets, laptops, and videogame consoles. As of 1 July 2015 there was further extension in respect of cereal and technical crops. The mechanism will also be applied to sugar beets as of 1 September 2015. The mechanism will be applied when the commodities are supplied between two domestic VAT payers if the total tax base for all of the selected goods supplied exceeds CZK 100,000 (the limit is only relevant for goods newly liable to the local reverse charge mechanism in 2015).

Specific compliance obligations are linked to supplies subject to a local reverse charge.

Bad debt relief

A VAT payer is allowed to claim a VAT refund for uncollectible receivables (bad debts). A VAT refund should be possible for certain receivables after maturity, where the debtor is involved in bankruptcy proceedings.

Liability for paying VAT

A Czech VAT payer, as the recipient of a taxable supply, can be liable for VAT from the received supply if it is unpaid by the supplier. The tax authority can demand a VAT payment if:

- a supplier intentionally fails to pay VAT and the customer knows or should know of this fact
- the price for the received taxable supply is clearly different from an arm's length price, without business justification
- the consideration for a taxable supply is remitted to a foreign account
- the supplier is identified by the tax authority as an unreliable VAT payer
- the payment is made to a bank account that is not published in the tax authority's register (liability only applies if the payment is more than CZK 540,000, including VAT)
- fuel is supplied by a fuel distributor that is not published as a registered distributor of fuel at the moment of taxable supply.

Customs duties

The Czech Republic is an EU member state, and customs matters are therefore governed by EU law. Customs duties are payable on goods imported from outside the EU. Customs rates depend on the type of goods.

The Czech Republic has an Inward Processing Regime (IPR), which effectively allows a Czech manufacturer to import, process and export goods exempt of customs duty and VAT.

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 Czech Act on Excise Duty implements EU rules governing the production of excise goods and their release into free circulation. Generally they must 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. The regime of suspending exemption can be applied if excise goods are transported to another EU member state or exported.

Energy taxes

Energy taxes include the tax on natural gas and other gases, electricity and solid fuels. Only supplies of these products delivered within the Czech Republic are subject to tax. The rules for energy taxes are harmonised within the EU.

The rates of energy taxes are fixed at a set amount per unit for each group of products.

An exemption from energy tax can be claimed under certain conditions, e.g. if the energy is used in metallurgical or mineralogical processes, the electricity is generated from renewable sources or natural gas and other gases are used for producing heat for households and heating facilities.



The extent of disclosures in Czech accounting legislation is considerably less demanding compared to IFRS. IFRS can/must be used under specific conditions.



Chapter 8

Financial reporting and audit

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Financial reporting

Main features of financial reporting

- Czech accounting rules are close to International Financial Reporting Standards (IFRS), although there are some significant differences. In particular, Czech accounting rules are much less detailed compared to IFRS.
- The Act on Accounting is the main framework and detailed guidance is provided in Decrees on Double-Entry Accounting and Czech Accounting Standards.
- Different Decrees and Standards specify the rules and standards for different types of corporations (“accounting units”), e.g. companies, sole entrepreneurs, banks, insurance companies and non-profit organisations, as well as municipalities and institutions financed by the state.
- All corporations recorded in the Commercial Register are obliged to use double-entry bookkeeping. Some specific accounting units that are not recorded in the Commercial Register are permitted to keep simplified accounting records (“tax evidence”).
- All corporations recorded in the Commercial Register are obliged to publish their annual statutory financial statements, annual reports and consolidated financial statements in the Commercial Register; all financial data about all Czech corporations is thus accessible and visible to the general public.
- All accounting records must be in Czech.
- All accounting records must be kept and financial statements presented in Czech crowns (CZK).

- A business year-end other than 31 December can be specified.
- A physical count of inventory and fixed assets is required annually.
- The general structure of accounts must be in accordance with the standard chart of accounts.
- Statutory financial statements consist of a balance sheet, an income statement (at least classified by nature) and notes. They may also include a cash-flow statement and a statement of changes in equity.
- The exact layout, structure and headings of the balance sheet, the income statement and the cash-flow statement are set in prescribed templates, and the minimum disclosures in the notes are prescribed in the Decrees. The extent of disclosures in Czech accounting legislation is considerably less demanding than IFRS.
- A separate annual report must be prepared by all accounting units that are subject to a mandatory statutory audit.
- All accounting units with shares or bonds publicly listed in the EU must maintain books and prepare their financial statements in accordance with IFRS, as adopted by the EU.
- All other accounting units may choose to maintain books and prepare their financial statements in accordance with IFRS if they are consolidated by a parent or an ultimate parent company in accordance with IFRS or if they have to consolidate and if they prepare both stand alone and consolidated financial statements in accordance with IFRS.
- The Act on Accounting states that consolidated financial statements must be prepared for an accounting unit that is a controlling entity. Subsidiaries and accounting units over which a significant influence is exercised are deemed consolidated accounting units.

- The obligation to consolidate applies to groups that meet at least two of the following criteria:
 - the combined turnover (without elimination) exceeds CZK 700 million
 - the combined assets (without elimination) of the parent company and the subsidiaries exceed CZK 350 million
 - the average number of employees during the accounting period was more than 250.
- Consolidation is not obligatory where the consolidating entity is part of another consolidating entity that is governed by the law of an EU member state and where specific prescribed conditions have been met. However, this rule does not provide an exemption from the obligation to publish consolidated financial statements as mentioned above. A Czech corporation [using the exemption not to consolidate] has to translate and publish consolidated financial statements of its parent or ultimate parent.
- The above exemption from the duty to prepare consolidated financial statements does not apply to banks, insurers and re-insurers and publicly listed share or bond issuers.
- The Act on Accounting also states that all corporations for which an audit is compulsory (see below) must prepare, beyond financial statements, an annual report. The Act on Accounting and also some other acts specify the disclosure requirements of the annual report. Financial statements are an integral part of the annual report as well.
- The Act on Corporations states that all corporations [that are part of a group] must prepare a report on relations between related parties. This report is an integral part of the annual report where relevant.

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 previous accounting period, meet at least one of the following criteria:
 - net turnover exceeds CZK 80 million per annum
 - total assets exceed CZK 40 million
 - the average number of employees is more than 50
- all 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 authorising auditors and setting the standards for audits. Audits are carried out in accordance with 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.

The audit requirements also apply to audits of annual reports.

Auditors must be appointed by the general meeting, a supervisory board is responsible for supervising the audit quality and public interest entities are defined in the Act. Responsibilities for both public interest entities and their auditors are stipulated in the Act, e.g. audit committee, lead partner rotation and transparency report.

Large amendments to the Act on Auditors are expected by 2016 in relation to the new EU regulation that will require mandatory firm rotation for public interest entities and some other limitations of audit/non-audit services provided to public interest entities.



Corporate transactions have become an important feature of the Czech legal environment allowing entrepreneurs and business persons to expand or restructure their business activities in the Czech Republic.

Chapter 9

Corporate transactions



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Corporate transactions have become an important feature of the Czech legal environment, allowing entrepreneurs and business persons to expand or restructure their business activities in the Czech Republic. The process of mergers and acquisitions itself is primarily regulated by the newly adopted Civil Code, the Act on Business Corporations, the Act on Takeover Bids, the Act on Transformations of Business Companies and Co-operatives, accounting and tax laws, anti-monopoly regulations and a number of special regulations applicable to specific sectors, such as banking, insurance and other financial services.

Privatisation

Although it is not currently a hot topic, there are still a number of enterprises in sectors such as electricity and transport that may be privatised by being sold to strategic investors. The privatisation process is initiated by a government decision. All the transactions are subsequently carried out by the relevant ministry, generally through a tender.

Ownership of real estate

There are no restrictions on owning real estate in the Czech Republic.

Acquisition and disposal of Czech legal entities

There are also no restrictions on foreign individuals and legal entities owning a business or holding shares in companies and they can acquire and sell up to 100 percent of the share capital of a limited liability or joint-stock company. Similarly, they can also participate in companies with other legal forms.

The transfer of an ownership interest in a limited liability company must be recorded in the Commercial Register. The shares of certain joint-stock companies are registered with the Central Securities Depository Prague or deposited in escrow at the Central Securities Depository Prague, a bank or other entity entitled to maintain records of investment instruments. In the case of shares traded on the regulated securities market in the Czech Republic or another EU member state, the acquirer must notify the company (the issuer) and the Czech National Bank if its share of the company's voting rights exceeds a certain level. In addition, if a shareholder acquires a minimum of 30 percent of voting rights and actually controls the company, it is obliged to bid for the shares of the remaining shareholders.

Purchasing an enterprise

An acquisition can also be made by purchasing an enterprise or part of it, in which the buyer acquires the rights, assets and liabilities connected with running the business. The sale and purchase agreement for the acquisition must be approved by the general meeting or the shareholders of the company.

Contribution to a company

Another way of securing a share in a business is by making a financial or non-monetary contribution, where the general meeting of the company must decide on a new share issue. The increase is registered with the Commercial Court. In the case of a non-monetary contribution, an independent valuation of the investment must be submitted by an independent, generally accepted expert, listed on a special register(s), with some exceptions.

Transformation of a company

(merger, transfer of assets to a shareholder, demerger, change of legal form and cross-border relocation)

If more entities are controlled by one person, they can be consolidated or alternatively a business can be restructured.

In Czech legislation, mergers come under the category of “transformation of a business”, which also includes demerging a company, transferring assets to a shareholder, any change in a company’s legal form and cross-border relocation. A business can be transformed even if the company is in liquidation or involved in insolvency proceedings. The transformation can be undertaken as a national or cross-border transaction with legal entities registered in other EU or EEA countries, including a European Company (Societas Europaea).

Probably the most frequent form of transformation is a merger by acquisition: one of the companies carries on its activities and the other ceases to exist and its assets and liabilities are transferred to the successor company. Another option is a merger by forming a new company: all of the participating companies cease to exist, and their assets are transferred to a newly established successor company.

From a financial point of view, carrying forward the tax losses of wound up companies is generally allowed.

- Mergers are carried out on the basis of merger projects, which must be approved by general meetings.
- The merger date can be determined either retrospectively or prospectively.
- In some cases, the merger procedure can be significantly simplified.
- In the case of joint-stock companies merging, one available option is the voluntary buyout of new shares representing a minority share in the merging company, if the successor company owns more than 90 percent of the merging company’s voting rights.

Companies with a different legal form can also merge and the merger may involve more than two entities.

Cross-border mergers are possible, however there are a number of special regulations.

The transfer of assets to a shareholder is a legal form of company transformation, where a shareholder owning more than 90 percent of the company's registered capital, also representing more than 90 percent of the company's voting rights, can transfer the company's assets to itself.

A company can be demerged (divided) through:

1. demerger by forming new companies
2. "demerger by acquisition"
3. spin-off connected with forming new companies
4. spin-off connected with acquisition, or
5. a combination of the options mentioned under either 1 or 2, or under 3 and 4.

When a company is demerged by forming new companies or by acquisition, the company being demerged ceases to exist, without liquidation, while it does not cease to exist on a demerger by a spin-off.

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

Under certain conditions stipulated by Czech legislation, a foreign company with its registered office in another EU or EEA country can relocate to the Czech Republic and a Czech company can relocate to another EU or EEA country.

Public bid for purchasing or exchanging participating securities issued by a joint-stock company

If someone (an entity or individual) intends to make an offer to more than 100 shareholders or the amount of the requested securities exceeds one percent of the issue of the regulated market, the offer must be made as a public bid. If a public bid is required by law, the offer must correspond to the value of the participating securities. If the securities are traded on the regulated market, the bidder must submit an offer and provide evidence to the CNB (the Czech National Bank) that the consideration is adequate.

Takeover bids

Voluntary takeover bids

An investor can make a public offer to the shareholders for joint-stock companies traded on the regulated market if the bid allows it to gain control over the company.

Obligatory takeover bids

An investor acquiring a minimum of 30 percent of the voting rights in a target company traded on the European regulated market and who actually controls the company, must offer to buy out the other shareholders within 30 days of the acquisition (“obligatory takeover bids”).

An obligatory takeover bid can only be published after it is approved by the CNB.

Obligatory takeover bids are also required if a company decides to remove its shares from trading on the European or other foreign regulated market or changes the nature of its shares or their transferability.

Right to buy out participation securities (squeeze out)

A shareholder owning securities representing more than a 90-percent share of the voting rights of a joint-stock company (“major” shareholder) is entitled to ask the board of directors to convene a general meeting to decide on the transfer of all the other participating securities owned by minority shareholders (a “squeeze out of minority shareholders”). The general meeting of the company approves the squeeze out by paying them adequate compensation based on an expert valuation. If the shares are traded on the European regulated market a justification of the compensation and the prior consent of the CNB is required instead of an expert valuation.

On the other hand, the minority shareholder has the right to sell its shares to the major shareholder as defined above.

Regulation

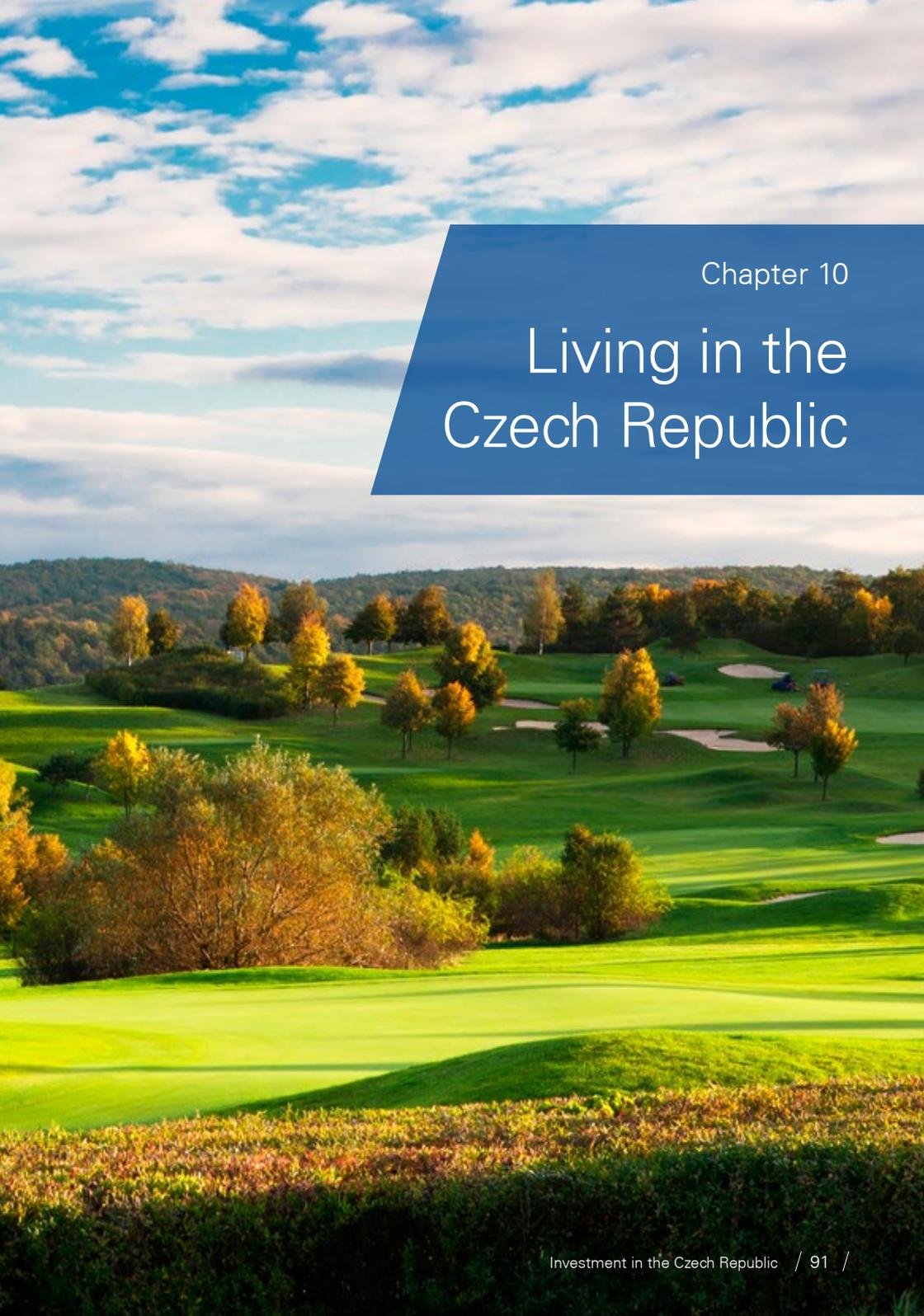
With regard to mergers and acquisitions, the interests of minority shareholders are protected as companies are obliged to provide early notification and, for the majority of transactions, the opinion of an independent expert is required to determine whether the parameters of the transaction, in particular 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 come into effect in the banking and insurance sector, the appropriate authorities (the CNB and the Ministry of Finance) must give their prior consent to 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 a transaction in the Czech Republic for the previous accounting period exceeded CZK 1.5 billion and at least two of the merging companies each recorded a net turnover of more than CZK 250 million in the Czech Republic for the same period, or
- one or more of the participants in the transaction had a net turnover in the Czech Republic of at least CZK 1.5 billion in the previous accounting period and the worldwide net turnover recorded by the other participant exceeded CZK 1.5 billion for the same period.



KPMG in the Czech Republic has become the advisor of choice for many of those who have chosen the Czech Republic as an investment location.



Chapter 10

Living in the Czech Republic

Schengen area

- The Czech Republic joined the Schengen area, a group of 26 European countries that have abolished all border controls between them.

Residency and visas

- Foreign nationals who come to the Czech Republic are subject to the so-called Foreigners Act, which establishes two categories of foreigners:
 - EU citizens and citizens of the EEA (European Economic Area: Norway, Iceland, Liechtenstein) and Switzerland and their family members,
 - nationals of third countries, i.e. countries outside the EU/EEA and Switzerland.
- Third country nationals may be subject to the visa policy. Lists of the countries can be found at: http://www.mzv.cz/jnp/en/information_for aliens/index.html
- To stay in the Czech Republic for more than three months, citizens of non-EU countries require a long-term visa or a long-term or permanent residence permit. See <http://www.mvcr.cz/mvcren/article/third-country-nationals-third-country-nationals.aspx>
- For recruiting and employing third country nationals, see http://portal.mpsv.cz/sz/zahr_zam
- Natural persons with a permanent residence outside the Czech Republic or legal entities with a registered office outside the Czech Republic can run a business in the Czech Republic under the same conditions and under the same limitations as a Czech person/entity. See <http://www.mvcr.cz/mvcren/SCRIPT/ViewFile.aspx?docid=21686490>
- More detailed information about foreign nationals in the Czech Republic can be found on the Ministry of the Interior website at: <http://www.mvcr.cz/mvcren/article/immigration.aspx>

Cost of living in Prague

- The average prices of goods and services are 54.3 (excluding rent) and 48 (including rent) compared to the New York benchmark of 100.²⁰
- The domestic purchasing power (subject to the net hourly pay) is 46.2 compared to New York's 100.
- Wage levels²¹ are 25.1, compared to the New York 100.²²

Residential accommodation and office space

- Prague and other major urban centres offer a wide choice of rented furnished and unfurnished housing for expatriates and their families and many estate agencies offer relocation services.
- Sales and rental prices of residential properties vary depending on the city, location, size and quality.
- For more information see
<http://www.czechinvest.org/en/life-in-the-czech-republic;>
<http://www.cushmanwakefield.com/~media/global-reports/OSATW%202014%20Publication%20updated.pdf>

Transport

- Compared to that of Western Europe, the public transportation system is comprehensive, efficient and reasonably priced.
- Every major urban centre has an excellent local transportation network.
- More information about driving licences at:
<http://www.mvcr.cz/docDetail.aspx?docid=21693331&doctype=ART>

20) Based on the cost of a basket of 122 goods and services weighted according to European consumption habits.

21) Calculated as the effective hourly wages for 15 professions, weighted by distribution; net after tax and social security deductions.

22) UBS, Prices and Earnings (Edition 2012); at:

https://www.ubs.com/global/en/wealth_management/wealth_management_research/prices_earnings.html



Medical care

- The Czech healthcare system provides a high level of professional medical care paid for by a range of health insurance providers.
- It is essential for a foreigner seeking medical care in the Czech Republic to have medical insurance to pay for the cost of care in the event of a sudden illness or injury.
- See <http://www.mzcr.cz/Cizinci> for detailed information on healthcare for foreign nationals.

Education

- There are a number of international schools in the Czech Republic, with a growing choice of foreign-language education programmes, ranging from kindergartens to Master of Business Administration (MBA) courses.
- The Institute for Language and Preparatory Studies, Charles University in Prague offers Czech language courses for foreigners, and prepares applicants for university studies. See <http://ujop.cuni.cz>
- Information on scholarships can be found on the Ministry of Education, Youth and Sports website at:
<http://www.msmt.cz/international-cooperation-1/scholarships?lang=2>

Leisure activities

- 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, with many clubs and venues for all of these throughout the country.
- It has a high number of golf courses per capita. More information can be found on the Czech Golf Federation website at: <http://www.cgf.cz>

There are many international cultural institutes or clubs run by embassies in Prague and other cities, e.g.:

- British Council in Prague and Brno (www.britishcouncil.org/czechrepublic.htm)
- American Center at the US Embassy in Prague (www.americkecentrum.cz)
- Goethe-Institut in Prague (www.goethe.de/ins/cz/pra)
- Österreichisches Kulturforum Prag (www.oekfprag.at)
- Institut Français Prague (www.ifp.cz)
- Instituto Cervantes in Prague (<http://praga.cervantes.es/cz/default.shtm>)
- Istituto Italiano di Cultura di Praga (www.iicpraga.esteri.it/IIC_Praga)
- Information and Culture Centre of the Japanese Embassy in the Czech Republic in Prague (<http://www.cz.emb-japan.go.jp/cz/jicc.html>)
- The Prague English speaking business and international community portal www.expats.cz provides extensive information essential to expatriates living in Prague.
- The International Women's Association of Prague (www.iwa-prague.com) is a very popular organisation offering its members numerous opportunities to participate in special-interest groups, social and cultural events, and charity work.

Restaurants and shopping

- Restaurants of all types abound, from the most luxurious to authentic Czech pubs and a wide variety of fast food facilities.
- In larger cities, all kinds of international cuisine including Haute Cuisine in Michelin starred restaurants are available, alongside the country's famous pubs offering traditional Czech food and famous brands of Czech beer. More information www.grand-restaurant.cz
- Local concepts of shopping and customer service are comparable to those in Western European countries.
- Major international retail chains and boutiques are all present on the Czech market.
- The Czech currency is the Czech crown (CZK or Kč), which is fully convertible. ATMs are widely available.
- Depending on the type of business and location, opening hours can vary: most offices and businesses, as well as smaller shops, are closed at weekends, while major stores are open and in larger cities some hypermarkets are open around the clock.



KPMG in the Czech Republic has become the advisor of choice for many of those who have chosen the Czech Republic as an investment location.



How KPMG can help

We understand the challenges and pressures faced by those looking to set up business in a new jurisdiction. We can work with you to focus on what matters, help avoid pitfalls and unnecessary costs while helping to ensure that investment projects start to deliver a measurable return in the shortest possible time.

We work with both leading names and start-up companies in every sector. As a result, KPMG in the Czech Republic has become the advisor of choice to many of those who have chosen the Czech Republic as an investment location, providing all the support required to ensure continued business success. As part of the KPMG global network of professional firms, we can also work with you in your home country to make sure your Czech Republic investment maximises its potential.

We can assist in the following areas

- **Initial assessment and start-up** – a timely, pragmatic and cost effective assessment of the key issues. These include the most beneficial corporate and tax structures available, the potential for maximising group taxation benefits globally and available grant assistance. We can also advise on employee benefit issues, for example those that relate to foreign and Czech state option schemes. We also provide practical business focused advice and support in dealing with areas such as incorporations and grant application and assessment.
- **Ongoing business** – we offer a range of audit, tax, advisory and legal services designed to ensure that investors in the Czech Republic continue to receive timely, proactive and relevant advice and support.

KPMG in the Czech Republic

KPMG has been active in the Czech Republic since 1990, when the first office in Prague was opened. Currently, KPMG Czech Republic employs 770 people, with offices in Prague, Brno, České Budějovice and Ostrava. KPMG Czech Republic provides Audit, Tax, Advisory and Legal services. Our 630 professionals include 28 partners, 28 certified auditors, 111 certified accountants and 71 tax advisors. In KPMG Czech Republic, a total of 22 qualified foreign practitioners are employed.

KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We operate in 155 countries and have 155,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.



Our services

Audit

- Audits of Czech Financial Statements
- Audits of Financial Statements (IFRS, US GAAP, HGB, etc.)
- Audits of Financial Reports and Information
- Audits of Prospective Financial Information
- Review Reports
- Reporting on Internal Control Systems
- Sustainability Reporting

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Tax Services

- Corporate Tax
- Indirect Tax
- International Executive Services
- International Tax
- Investment Incentives and Subsidies
- Mergers and Acquisitions
- Transfer Pricing
- Tax Inspections and Tax Disputes
- Tax Services for the Financial Sector
- Tax Outsourcing

Legal Services

- Corporate Law
- Transactions and Restructuring
- Labour Law
- Regulatory Issues

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Advisory

Management Consulting

- Corporate Strategy
- Enterprise Architecture
- Finance, Capital and Profit Management
- Programme and Project Management
- People and Change
- EU Funds Advisory
- Marketing Advisory
- IT Advisory
- Export Advisory
- Customer and Sales
- Business Intelligence (BI) and Data Management
- Sports and Gaming Advisory
- Operations Management
- Data and Analytics

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Risk Consulting

- Accounting Advisory Services
- Financial Risk Management
- Internal Audit, Risk Consulting Services
- Regional and Local Authorities and Organisations

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Deal Advisory

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- Restructuring
- Transaction Services
- Forensic

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- Management Reporting
- Financial Accounting
- Payroll Outsourcing
- Administrative Support

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Our industry experience

- Automotive
- Banking
- Building, Construction and Real Estate
- Consumer Markets
- Energy
- Food and Drink
- Government and Public Sector
- Healthcare
- Industrial Manufacturing
- Insurance
- Middle Markets
- Retail
- Sports and Gaming
- Telecommunications
- Transportation
- Travel, Leisure and Tourism

Our foreign desks

- Chinese Desk
- German Desk
- Japanese Desk
- Korean Desk
- Russian Desk

Useful addresses

Czech government offices

Ministry of Finance of the Czech Republic

Letenská 15
118 10 Prague 1

Tel.: +420 257 041 111
www.mfcr.cz

Ministry of Industry and Trade of the Czech Republic

Na Františku 32
110 15 Prague 1

Tel.: +420 224 851 111
www.mpo.cz

Ministry for Regional Development of the Czech Republic

Staroměstské náměstí 6
110 15 Prague 1

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

CzechInvest (Investment and Business Development Agency)

Štěpánská 15
120 00 Prague 2

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

Czech National Bank (the central bank of the Czech Republic)

Na Příkopě 28
115 03 Prague 1

Tel.: +420 224 411 111
www.cnb.cz

Banks active in the Czech Republic

An up-to-date list of banks active in the Czech Republic can be found on the website of the Czech National Bank, at:

http://www.cnb.cz/en/supervision_financial_market/lists_registers/

Business organisations

An up-to-date list of business organisations active in the Czech Republic can be found on the BusinessInfo portal, at:

<http://www.businessinfo.cz/cs/clanky/prehled-zahranicnich-obchodnich-komor4550.html>

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