

**DOING
BUSINESS
IN**

**THE
CZECH
REPUBLIC**



HLB PROXY

Audit & Tax Services

2015

*doing business
in the Czech Republic*

foreword

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general information

LOCATION

The Czech Republic is located in the centre of Europe and has shared borders with Germany, Austria, Poland and the Slovak Republic.

KEY FACTS

Area	78,866 km ²
Population	10.516 million (approx.)
Labour force	4.891 million (approx.)
Capital	Prague
Language	Czech
Currency *	Czech Crown (CZK)

*) Despite the fact the Czech Republic is a EU-member state, it is not member of the EURO-Zone.

The date of EURO introduction has not been determined yet.

The Czech koruna (CZK) is fully convertible. All international transfers (e.g. profits and royalties) related to an investment can be carried out freely and without delay.

CLIMATE

The climate of the Czech Republic can be described as typical European continental influenced climate with warm, dry summers and fairly cold winters. January is the coldest month with daytime temperatures usually around zero, but in some cases winter months can be very cold with temperatures far below zero and strong, cold winds.

In summer daytime temperatures reach 20-25°C, but sometimes quite higher, 30°C or more. July is the warmest month with an average temperature of nearly 20°C.

The weather is best May-September, when days are warm and the nights are cool, although it rains more in Spring than in summer. Autumn is usually a little chilly and wet, and the Winters can be very cold, damp, snowy and often foggy.

CONSTITUTION

Following the Velvet Revolution of 1989, Czechoslovakia to promote democracy, changed to a market economy. From 1993 the previous Czechoslovakia split into two separate countries – Czech Republic and Slovak Republic.

The Czech Republic is a parliamentary democracy. The parliament consists of two Houses, a House of Representatives and a Senate. The President, elected by the people, is the head of state.

LEGAL SYSTEM

In 1989 a new legal system in the Czech Republic was set up. The legal system is based on written laws. Compared to common law, of which a substantial binding part is created by judicial (court) decisions, the source of continental law mainly takes the form of written and binding acts, orders, bills and directives to be adopted and issued by competent legislative bodies, i.e. parliament, government and municipalities. Judicial rulings serve mainly as a subsidiary and supportive source for the purpose of interpreting the written codified laws.

EU legislation was adopted in preparation for EU accession; commercial, accounting and bankruptcy laws are compatible with Western standards.

EU AND OTHER MEMBERSHIPS

The Czech Republic became a full member of the European Union on 1 May, 2004. For more than ten years the country has enjoyed the business and trade benefits of being part of one large market governed by principles such as the free movement of goods, services, capital and persons.

The borderless importing and exporting of goods within the European market, no matter where the goods were manufactured, serves as one of the main benefits of the EU. Individuals and companies resident or registered permanently outside the Czech Republic may now even provide certain services without the need to establish any corporate presence (be it a company or other Czech entity) in the Czech Republic.

The Czech Republic is a member of NATO (1999) and also a member of the General Agreement on Tariffs and Trade (GATT), of the OECD and of the United Nations.

BUSINESS HOURS AND PUBLIC HOLIDAYS

8 a.m. - 6 p.m.

Opening hours vary depending on the type of business and locations. Most offices and businesses are closed all day on Sunday. Some major stores are open on Sunday and in the bigger cities there are an increasing number of hypermarkets open around the clock.

Public holidays are:

January 1st , May 8th, July 5th, July 6th, September 28th, October 28th and November 17th.

Other holidays are:

Easter Monday, May 1st, December 24th, December 25th and December 26th.

investment factors

SPECIAL FEATURES

The Czech Republic is one of the most successful transition economies in terms of attracting foreign direct investment.

The Czech Republic is fortunate to be located very close to the so-called “European Banana” – Europe’s industrial backbone. This area is considered the best choice for investments in transport and logistics because of its perfect location with regard to consumption and production zones. This, together with its EU membership, makes the country a perfect gateway to the single European market of 455 million consumers.

INVESTMENT PROTECTION

The Czech Republic is a member of the Multilateral Investment Guarantee Agency (MIGA), an international organization for the protection of investment, belonging to the World Bank-IMF group. The country has signed a number of bilateral international treaties which support and protect foreign investments, for example, with the United States, Germany, UK, France, Austria, Switzerland, Italy, Belgium, Luxembourg, The Netherlands, Finland, Norway and Denmark.

The Czech Republic is a signatory to the Bern, Paris, and Universal Copyright Conventions. Existing legislation guarantees the protection of all forms of property, including patents, copyrights, trademarks and semiconductor chip layout design. Trademark law and copyright law are compatible with EU directives.

FOREIGN EXCHANGE CONTROL

No restrictions are imposed on the import or export of capital. Repatriation payments can be made in any currency. Both residents and nonresidents can hold bank accounts in any currency.

REPATRIATION OF PROFITS

No limitations exist on the distribution and expatriation of profits by Czech subsidiaries to their foreign parent companies.

There are some obligations and special rules regarding the tax treatment for dividend payments from the Czech Republic. Detailed information is given in the tax part of this booklet.

EDUCATION

The Czech Republic combines an outstanding level of general education with strong science and engineering disciplines. According to a 2014 OECD study, the country ranked first among European countries in terms of the percentage of the population that has achieved at least upper secondary education. Technical education in the Czech Republic has a long tradition and enjoys a strong reputation around the world. The availability of technically educated graduates at a fraction of the cost of western labour creates a perfect environment for both manufacturing and R&D-oriented companies.

STABLE ECONOMIC PERFORMANCE

Since the Velvet Revolution in 1989, the Czech economy has grown steadily and the standard of living has been increased substantially.

International risk-rating institutions rank the Czech Republic in the long-term with an “A” rating. This high rating is one of the best in Central and Eastern Europe. The rating is based above all on low average inflation, the relatively low amount of gross foreign debt, the stable growth of gross domestic product and a wage level increase linked to productivity.

An export-led recovery began in 2013 and is expected to gather pace in 2014 as world

trade strengthens, reversing the two-year decline in private investment. Stronger consumer confidence and higher real income growth should raise private consumption growth. However, only in 2015 will the pace of GDP growth start to reduce economic slack and the unemployment rate.

The central bank started intervening in the foreign exchange market late in 2013, judging that unconventional monetary policy was needed to preserve the credibility of the inflation target in the face of a prolonged

period of low inflation and the threat of deflation. The authorities should return to the floating-rate policy as soon as deflation risks have definitively receded. Active labour market policies should be enhanced to avoid unemployment becoming entrenched.

The biggest advantages of Czech Republic are a stable macroeconomic balance, low inflation, its own currency (CZK) and a healthy and profitable bank sector.

BASIC ECONOMIC INDICATORS (OECD Study 2014)

Czech Republic	2006	2007	2008	2009	2010	2011	2012
GDP per capita (in tUSD)	23,288	25,423	25,872	25,875	25,835	27,046	26,985
GDP (%)	7.0	5.7	3.1	-4.5	2.5	1.8	-1.0
Unemployment rate (%)	7.1	5.3	4.4	6.7	7.3	6.7	7.0
Inflation rate (%)	2.6	3.0	6.3	1	1.5	1.9	3.3
CZK/EUR	28.343	27.762	24.942	26.445	25.29	24.586	25.143
CZK/USD	22.609	20.308	17.035	19.057	19.111	17.688	19.583

entrepreneurial environment

Since 2014 a New Civil Code (NCC) and a New Act on Business Corporations (ABC) have been introduced in the Czech legal system. The NCC comes from the Czechoslovak civil code of 1937, but it includes also principles of European Union legislation. The NCC is also inspired by different legal systems not only in Europe, but also in other countries as for example Canada. The Act on Business Corporations (ABC) contains the fundamental provisions on the formation and structure of companies, partnerships and cooperatives.

The NCC contains amongst other chapters fundamental provisions the creation, structures of corporations, partnerships and cooperatives, special provisions are provided by the ABC.

There are no restrictions in the NCC or ABC on the participation of foreign persons (individuals or companies) in any form of business entity.

Companies in the Czech Republic are established in two steps, i.e.: (i) foundation of the company by adopting a foundation document and (ii) registration of the company with the Commercial Register. It is only after the registration with the Commercial Register that the company starts to exist legally. The Commercial Register is publicly accessible on the internet (www.justice.cz) and contains basic information on each registered company (namely business name of the company, ID number, foundation documents, authorized representatives and registered capital).

Each company has to obtain in the period between foundation and registration a business license from the Trade Register held by the Trade Licensing Office. Certain activities, such as banking, insurance and broadcasting, require special licenses issued directly by the relevant State authority.

The general deadline for registration of the company with the Commercial Register is 5 working days once the application for registration is filed.

Since 2008 the new Act on bankruptcy has strengthened the position of creditors and enabled vital parts of a company to continue in their activities. At the same time a publicly accessible insolvency register was established, which increased the transparency of insolvency proceedings.

PRINCIPAL FORMS OF BUSINESS

The ABC offers following forms of corporate structures that can be chosen for running a business activity in the Czech Republic.

The most common forms of corporate structures used by foreign investors remained in the ABC the same as in the previous Commercial Code.

- Limited liability company (společnost s ručením omezeným/LLC)
- Joint stock company (akciová společnost /JSC)
- General commercial partnership (veřejná obchodní společnost/GCP)
- Limited partnership (komanditní společnost /LP)
- Cooperative (družstvo)

Based on the EU Regulations investors can also create following business entities:

- Societas Europea (evropská společnost)
- European Economic Interest Grouping (EEIG; evropské hospodářské a zájmové sdružení)
- European cooperative company (evropská družstevní společnost).

Finally, foreign investors (corporate bodies) can also run their activity in the Czech Republic through a Branch.

Moreover, individuals may run their businesses as sole entrepreneurs being registered with the Trade License Office.

LIMITED LIABILITY COMPANY (s.r.o./LLC)

General

It is the most frequent legal form for small and medium-sized businesses in the Czech Republic. Shareholders of the LLC are liable for the company's obligations (debts) up to the amount of their unpaid amount of shareholders' contribution. The LLC is wholly liable for any breach of its obligation with all of its assets. As of 2014 there is no obligation on a LLC to create a statutory reserve fund.

In comparison with the JSC the LLC is less regulated without the compulsory creation of a Supervisory Board. However the transfer of ownership interest is less flexible than transfer of shares in a joint stock company and can be subject to different restrictions too.

Process of establishing

The LLC may be created by one or more individuals or corporations.

The LLC is founded by a Memorandum of Association or Foundation Deed where there is only one founder.

Capital

There is no minimum registered capital because the ABC requires that the minimum contribution of each shareholder is only the amount of CZK 1. Each shareholder holds an "ownership interest", which corresponds to a percentage of the total registered capital depending on his contribution.

The registered capital can be created by monetary or non-monetary contributions (for example tangible assets, certain intangible assets or existing debts whose value is determined by an expert's opinion). Before the incorporation of the LLC at least

30 % of the contributions have to be paid up. The outstanding amount must be paid up within five years at the latest if shareholders did not agree a shorter deadline.

Statutory body and the Supreme body

The statutory body of the LLC is one or more executive directors ("jednatel"). It is also possible that the Memorandum of Association stipulates that two or more executive directors form a collective body.

The supreme body is the General Meeting which shall be convened by the company's executive directors at least once a year no later than six months after the last day of the accounting period.

Profit distribution

Shareholders are entitled to a profit distribution from the LLC once the financial statements have been approved by the General Meeting and such distribution has been decided by the statutory body. As of 2014 interim dividends being allowed paid to shareholders under certain conditions. Any profit distribution is disallowed if such distribution would lead to the bankruptcy of the company.

Audit

The Financial statements of a LLC are subject to an obligatory audit only if at least two of following conditions are met in the current and previous accounting period: (1) the net profit for the previous financial year exceeds CZK 80,000,000; (2) the gross assets of the company exceed CZK 40,000,000; or (3) the company employs more than 50 employees.

JOINT STOCK COMPANY (a.s./JSC)

General

A joint stock company may be formed by one legal entity or by two or more individuals and or entities. The capital of the JSC is divided into shares of a certain nominal value. Once a shareholder has fully paid up his investment contribution, he or she is not liable for the company's obligations (debts) during its existence. The company itself is wholly liable for any breach of its obligations with all of its assets. As of 2014 there is no obligation on a JSC to create a statutory reserve fund.

Shares are considered to be securities giving a shareholder the right to profits distribution, liquidation surplus and to participation in the company's management. The nominal value has to be set forth in the By-Laws, there is however no minimal value of shares required by the ABC. Generally shares are freely transferable unless this is limited by the By-Laws. The creation of Supervisory Board is compulsory.

The JSC, due to the level of its minimum registered capital requirements generally regarded as a most reliable form of business, in comparison with the LLC Shares of JSC can be publicly traded on a stock exchange and their transfer is more flexible. However the JSC is the most heavily regulated business type of corporation and is subject to higher administration requirements.

Process of establishing

The JSC is founded by By-laws. Founders of the JSC are obliged to accept the By-Laws of the JSC and take part in the subscription of its shares.

Capital

The minimum amount of registered capital required by the ABC is CZK 2,000,000 or EUR 80,000 if the company decides to keep accounts in EUROS.

The registered capital can be created by monetary or non-monetary contributions

(for example tangible assets, certain intangible assets or existing debts whose value is determined by an expert's opinion). Before the incorporation of the JSC at least 30 % of the contributions have to be paid up. The outstanding amount must be paid up within one year from the incorporation at the latest if shorter deadline is not agreed by the By-Laws.

Statutory body and the Supreme body

The statutory body of the JSC is the Board of Directors in the "dualistic" system or the Statutory Director in the "monistic" system. The Board of Directors is a collective statutory body formed by three members unless the By-Laws stipulates otherwise. The Statutory Director is named by the Administrative Body.

The Supreme body is a General meeting which has to be convened by the company's statutory body at least once a year no later than six months after the last day of the accounting period.

Profit Distribution

Shareholders are entitled to a profit distribution from the JSC once the financial statements have been approved by the General meeting and such distribution has been decided by the statutory body. As of 2014 interim dividends being allowed paid to shareholders under certain conditions. Any profit distribution is disallowed if such a distribution would lead to the bankruptcy of the company.

Audit

Financial statements are subject to an audit if any of the following conditions are met in the current and previous period: (1) the net profit for the previous financial year exceeds CZK 80,000,000; (2) the gross assets of the company exceed CZK 40,000,000; or (3) the company employs more than 50 employees.

GENERAL COMMERCIAL PARTNERSHIP (v.o.s./GCP)

General

A General commercial partnership is an entity in which at least two persons (individuals or legal entities) carry on a business activity under a common commercial name and bear joint and several liabilities for the obligations (debts) of the partnership with all their property.

Process of establishing

The GCP is formed by the Memorandum of Association.

Statutory body

The statutory body is formed by all partners of the GCP, unless the partnership agreement regulates the statutory body differently.

Capital

There is no minimum amount of registered capital, voluntary capital formation is possible. The transferability of investment contributions is not allowed.

Profit Distribution

Profits and losses of the GCP must be divided among all partners in equal proportions unless the Memorandum of Association states other proportions. Also Partners bear losses equally, unless the Memorandum of Association contract stipulates otherwise.

Audit

Financial statements of the GCP are subject to an obligatory audit only if at least two of following conditions are met in the current and previous accounting period: (1) the net profit for the previous financial year exceeds CZK 80,000,000; (2) the gross assets of the company exceed CZK 40,000,000; or (3) the company employs more than 50 employees.

LIMITED PARTNERSHIP (komanditní spo-lečnost/LP)

General

LP can be created by both individuals and legal entities. During its existence a limited partnership must have at least one general partner ("komplementář") and one limited partner ("komanditista"). The general partner is liable for the partnership's debt with all his or her property.

Process of establishing

The LP is formed by the Memorandum of Association.

Capital

An investment contribution is mandatory and must be agreed in the partnership agreement. There is no minimal amount required, so as in case of a LLC it could be CZK 1.

Statutory body

Only general partners can form the statutory body. The Memorandum of Association may provide that only some of the general partners will be authorized to act for the partnership.

Profit distribution

The profits of a LP are divided into two parts. The first one is distributed between general partners before taxation (general partners are also responsible for losses of the LP), the other one is distributed to limited partners after it has been taxed by the LP. Unless the Memorandum of Association provides otherwise, the portion of the profit to general partner is distributed among them equally, limited partners are only entitled to a profit corresponding to their contribution.

Audit

Financial statements of the LP are subject to a compulsory audit only if at least two of following conditions are met in the current and previous accounting period: (1) the net

profit for the previous financial year exceeds CZK 80,000,000; (2) the gross assets of the company exceed CZK 40,000,000; or (3) the company employs more than 50 employees

COSTS OF FORMING A COMPANY

The likely professional cost of forming a company is about 30,000 CZK (approx. EUR 1,091 USD1,371). These costs exclude share capital costs, cash expenses and VAT.

BRANCH (organizační složka)

A Branch of a foreign entity must be registered in the Commercial Register but from the legal point of view it is not a legal entity. Consequently, all legal acts of the Branch are considered as binding for its foreign founder. However from the accounting point of view it has to keep its own accounts and comply with other legal obligation which makes it similar to the registered companies referred to above.

The Branch is established upon the execution of a resolution of foundation and start to legally exist at the moment of its registration in the Commercial Register. Important limits for the activity of the Branch are that it cannot obtain other trade licenses than those that have been issued to the foreign founder in the State of its registered office.

Each Branch must have a director, i.e. an individual registered in the Commercial Register.

The principal advantage of a Branch is that there are no requirements for capital. The disadvantage can be that it is not a separate legal entity in the Czech Republic. Thus the foreign founder of the branch is liable for actions taken by the branch.

OTHER OPERATIONS WITH LEGAL ENTITIES

Apart from forming a new legal entity there are other ways of acquiring a business in the Czech Republic.

Purchase of shares (“share deal”)

An acquisition can have the form of the purchase of an enterprise or a part of it, by means of which the buyer acquires all the property, rights and liabilities relating to the operation of the business. The share purchase agreement (“SPA”) must be approved by the General Meeting or the shareholders of the company.

Contribution to an existing Company

The acquisition of a share in a company can have the form of a monetary or non-monetary contribution to the equity of an existing company. The registration of such a contribution is made at a Commercial Court and, in an case of non-monetary contributions, an independent valuation submitted by an official valuer is required (with certain exceptions).

Transformation of Companies

Mergers, company demergers, the transfer of assets to a shareholder and change of the company’s legal form are allowed under Czech law.

Such transformations of companies can be undertaken as national or cross-border transactions with entities registered in other EU-member states or another country within the European Economic Area.

a) Merger

Both forms of merger, either by acquisition (one of the companies continues in its activities, while the others cease to exist) or by the formation of a new company (all of the original companies cease to exist) are possible.

A merger project, which is subject to the approval of the statutory bodies of entities

taking part in the merger, is to be prepared for the purposes of the merger.

Mergers become legally effective on the day of their record in the Commercial Register, however from the taxation and accounting point of view, the companies are considered a single entity from the merger date, which in fact precedes all steps and decisions in relation to the merger.

Similar provision are applicable for both domestic, as well as cross-border mergers.

b) Transfer of assets to a shareholder

The transfer of assets to a shareholder is a legal form of company transformation whereby the shareholder owning more than 90% of the company’s registered capital may transfer the assets of the company to itself, provided it has obtained the consent of the General Meeting.

c) Demerger

A company can be demerged through

- (i) demerger by the formation of new companies,
- (ii) demerger by acquisition,
- (iii) by different kinds of spin-off actions.

d) Change of legal status

When the legal status of a company is changed, it does not cease to exist and only its internal legal position and structure change.

investment incentives¹⁾

The Czech Republic has been offering investment incentives since 1998. Investment incentives are available to only a legal entity with its registered office in the Czech Republic. Supported Areas are as follows:

- Manufacturing Industry - introduction or expansion of production
- Technology Centres - construction or expansion of research and development centres
- Business support services centres - shared-services centres, software-development centres or high-tech repair centres

The Investment Incentives Act stipulates for each activity conditions which must be fulfilled in order for the investor to apply for investment incentives.

MANUFACTURING INDUSTRY

Enterprises with an investment project which will be implemented within manufacturing industry can be supported. A basic condition is a minimum investment in long-term tangible and intangible assets in the amount of CZK 50 million (EUR 1.81 million; USD 2.29 million) in specially supported regions, of which at least CZK 25 million must be invested in new machinery, and CZK 100 million in most regions, of which at least CZK 50 million must be invested in machinery; at least half of the minimum investment amount must be financed with the investor's own capital.

The highest incentives are granted to so-called strategic investments. A strategic investment is considered to be an investment wherein the value of the minimum amount invested in

long-term tangible and intangible assets reaches the value of CZK 500 million (EUR 18.2 million; USD 22.86 million), of which at least CZK 250 million is invested in new machinery and at least 500 new jobs are concurrently created.

TECHNOLOGY CENTRES

Enterprises focused on applied research, development and innovation of technically advanced products, technologies and production processes for the purposes of use in production and increasing value added can be supported.

The minimum amount of investment in long-term tangible and intangible assets is CZK 10 million, of which at least CZK 5 million must be invested in new machinery, whereas at least half of the minimum investment amount must be financed with the investor's own capital. Concurrently, it is necessary to create at least 40 new jobs.

Also strategic investments are supported most. A strategic investment in the area of technology centres is considered to be an investment wherein the minimum amount invested in long-term tangible and intangible assets is CZK 200 million, of which CZK 100 million comprises the value of new machinery and at least 120 jobs are concurrently created.

BUSINESS CENTRES

Aid is available for shared-services centres focused on taking over management, operation and administration of internal activities such as accounting, finance, administration in the area of human resources, marketing and administration of information systems, and also for high-tech repair centres and software-development centres.

¹⁾ *CzechInvest* (www.czechinvest.org)

In order to qualify for the programme, it is necessary to create at least 40 new jobs in the case of software-development centres or at least 100 new jobs in the case of other business support services centres.

FORMS OF INVESTMENT INCENTIVES

The following forms of support are provided to investors:

- Corporate income-tax relief
- Transfer of land for favourable prices
- Job creation grants
- Training and retraining grants
- Cash grants on capital (in the case of strategic investments)

CORPORATE INCOME-TAX RELIEF

It is possible to draw corporate income-tax relief for a period of ten years or, as the case may be, for a period of ten consecutive tax periods when the first tax period for which tax relief can be utilised is the tax period in which the statutory conditions are fulfilled, though no later than in the tax period in which a period of three years has elapsed since the issuance of the decision to grant investment incentives.

There is a limit for tax relief up to the amount of the ceiling of state-aid intensity after deduction of job creation grants or the difference between the market and purchase prices of land and cash grant on capital investment. The current corporate income-tax rate is 19%.

TRANSFER OF LAND FOR FAVOURABLE PRICES

It is possible to obtain the favourable transfer of land or land equipped with infrastructure owned by the state or an organisational unit thereof or by a municipality. This depends on the consent of the owners of such land to the sort favourable transfer. The difference between the purchase price and the market price of the given land is considered to be an investment incentive in this case.

JOB CREATION GRANTS AND TRAINING AND RETRAINING GRANTS

Cash grants are available only in regions with an unemployment rate that is at least 50% higher than the average unemployment rate

in the Czech Republic, so-called A regions. Cash grant for one newly created job amounts to CZK 200,000. Cash grants for training and retraining are provided in the amount of 25% of the total expenditure on training and retraining.

CASH GRANT ON CAPITAL INVESTMENT

This form of support is provided only in the case of strategic investments in manufacturing or in technology centres. A cash grant on capital investment can be provided up to the amount of 5% of eligible costs (max. CZK 1.5 billion in the case of a manufacturing project and max. CZK 0.5 billion in the case of a technology-centre project).

If commencement or expansion of production and establishment or expansion of a technology centre occurs simultaneously within the given investment, the amount of a cash grant can be up to 7% of eligible costs. Aid is again provided up to the limit and must be approved by the Government of the Czech Republic prior to provision.

CZECHINVEST

CzechInvest, the Investment and Business Development Agency, is an agency of the Ministry of Industry and Trade. Established in 1992, the agency contributes to attracting foreign investment and developing domestic companies through its services and development programmes. CzechInvest also promotes the Czech Republic abroad and acts as an intermediary between the EU and small and medium-sized enterprises in implementing structural funds in the Czech Republic.

CzechInvest is exclusively authorized to file applications for investment incentives at the competent governing bodies and prepares draft offers to grant investment incentives. Its task is also to provide potential investors current data and information on the business climate, investment environment and investment opportunities in the Czech Republic.

CzechInvest's services (all CzechInvest's services are free of charge):

- comprehensive services for investors
- full information assistance
- handling of investment incentives
- business properties identification
- supplier identification
- aftercare services
- Business infrastructure development
- Access to structural funds

OPERATIONAL PROGRAMMES

There are plenty of other Operational Programmes run by the Ministry of Industry and Trade. Detailed information is available on the web site of the the Ministry of Industry and Trade www.mpo.cz..

employment regulations

THE LABOUR CODE

The Czech Labour Code is a key part of the law governing mutual relations between employers and employees. Under the Labour Code, all employers in the Czech Republic are obliged to conclude a written employment contract with their employees. It is mandatory for the employment contract to contain e.g. the type of work, the place where he or she will perform his or her work and the day when the employee will start working.

The employment agreement may include a probationary period of up to three consecutive months following the date of commencement of the employment relationship or, in case of managing employees, up to six consecutive months following the date of commencement of the employment relationship. During the probationary period, the contract may be cancelled by either the company or by the employee for any reason. Cancellation must be in writing and the employment ceases to exist as of the day of delivery of the cancellation (or later if so stipulated in the notice of cancellation). A fixed-term employment contract may be concluded for up to three years, and may only be repeated twice. It terminates also on the expiry of the agreed period.

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

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

Termination by agreement must be in writing.

WAGES & HOLIDAYS

Each employee is entitled to a minimum of 4 weeks of holiday per calendar year. Holiday time may be increased by additional days through a collective agreement, internal regulations or in an individual contract. Holiday pay is calculated on the basis of the employee's average monthly remuneration.

Wages in the Czech Republic are paid in Czech crowns and in a pecuniary form. The minimum monthly wage for 2015 is set by government regulations at CZK 9,200 (EUR 335, USD 390). The average monthly wage for 2015 is CZK 26, 611 (EUR 968, USD 1,217).

EMPLOYMENT AND RESIDENCY OF FOREIGN INDIVIDUALS

EU AND EEA MEMBER STATES NATIONALS AND SWISS NATIONALS

All EU nationals, nationals from EEA Member States and Switzerland as well as their family members have in the Czech Republic the same treatment as Czech citizens from the labour law point of view. Consequently they can work in the Czech Republic without any work permit or employee card. The Czech employer of these nationals or the Czech receiving company in case of secondment is obliged to file a special notification to the local labour office.

EU and EEA nationals are entitled to request a residency permit for a temporary stay but are not obliged to. Their only obligation in the Czech Republic is to register with the relevant Office of the Foreign Police if they intend to stay in the Czech Republic for a period exceeding 30 days.

However their family members who are not EU or EEA nationals have to request the permit of temporary residence of a family member of EU or EEA national.

THIRD COUNTRY NATIONALS

All non EU, EEA or Swiss nationals working in the Czech Republic have to apply for a Schengen visa and working permit if their employment is to not longer than 90 days, or for an employee card or the blue card.

EMPLOYEE CARD

An Employee card is a new type of combined permit (i) for long-time residence in the territory of the Czech Republic and for (ii) working in the Czech Republic.

The Employee card entitles the foreign individual to carry out all types of employment regardless of the level of required professional qualifications, to reside in the territory of the CR and, at the same time, to work in the job for which the employee card was issued.

An employee card is most often issued for the duration of the employer-employee relationship but not for more than 2 years, with an option to repeatedly extend its validity.

Due to the introduction of the employee card the visa for a stay of over 90 days for the purpose of employment, a long-term residence permit for the purpose of employment and a so called Green Card will not be issued anymore.

EU BLUE CARD

An EU Blue Card is a residential status designed for a long-term stay involving the performance of a highly skilled job (similarly to the employee card no separate work permit is needed as the EU Blue Card is a dual permit for residence and for work on the Czech territory). Duly completed university education, or higher vocational education, the duration of which was at least 3 years is deemed to be a high level of skills.

The Ministry of Interior must decide a Blue card application by 90 days. An EU Blue Card is issued with a period of validity that is 3 months longer than the period of time for which the contract of employment was concluded, but the maximum period of validity is 2 years (with option to be renewed).

CONCURRENCE OF AN EMPLOYMENT RELATIONSHIP

Current legislation does not explicitly allow the concurrence of an employment relationship with the execution of the office of director or member of a statutory body. Based on the provisions of a New Civil Code the the Ministry of Justice published its interpretation that such a concurrence is not allowed at all with the reasoning that there is no legal substance for execution of the function of the office of director of a statutory body according to an employment contract. Such an incorrect employment contract will be qualified as null and void.

social & health insurance

Based on Czech legislation each employee working for an employer with a registered office in the Czech Republic is liable to Czech social and health insurance system and must pay social security and health insurance contributions. The system covers also self-employed persons.

General health insurance is provided by seven health insurance funds, which are independent entities under private law. Individuals can freely choose their health insurance fund and their health care provider. Social insurance is governed by the Czech Social Security Administration (SSZ) which is a governmental body, and is in charge of collecting social security insurance contributions and of payment of benefits (sickness allowances, pensions etc.).

MAXIMUM BASE OF ASSESSMENT

The maximum annual assessment base for the calculation of social insurance contributions is the same for both employees and entrepreneurs. It represents 48 times the average salary in the national economy. The maximum base of assessment for 2015 is the amount of CZK 1,277,328 (EUR 46,448; USD 58,392). After the income cap is reached, no further social contributions have to be paid for the rest of the year. Therefore, the effective tax rate decreases from 20 % to 16 % after reaching this limit. There is no maximum assessment base for health insurance.

FOREIGN EMPLOYEES

**EU AND EEA MEMBER STATES
NATIONALS AND SWISS NATIONALS**
Regulation (EC) No. 883/2004 of the EP and of the Council on the coordination of social security systems as well as the Regulation (EC) no. 987/2009 of the EP and of the Council laying down the procedure for

implementing the Regulation 883/2004 applies in the Czech Republic as a EU Member State. These Regulations applies nationals of EU, EEA and Switzerland ("Member States") as well as to their family members.

Consequently the main principle that employees and self-employed persons are subject to the legislation of a single Member State applies to both, social security and health insurance contributions. The main principle "lex loci laboris", applies when the employee works only in the Czech Republic. If the employee is posted for a limited period not exceeding 24 months to the Czech Republic and other conditions are met, he/she can stay insured in the Member State where he normally works. If the employee works in two or more Member States Regulations indicates how to define the single Member where the insurance will be paid and from which the benefits of such insurance will be paid.

NATIONALS FROM CONTRACTUAL STATES

The Czech Republic is a contractual party to 17 social security agreements with non-EU countries (e.g. with USA, Japan, Canada, Israel or Russia) that allow to their citizens to remain insured in the home country during their temporary working activity in the Czech Republic. However the majority of those social security agreements cover only social security and not health insurance. Consequently, when employees from such countries are posted to the Czech Republic generally they remain insured with social security in their home country but they have to contribute to the Czech health insurance system (the general one or private one whether they have a local or a foreign employer).

THIRD COUNTRIES NATIONALS

Employees from third countries employed in the Czech Republic by employers with

a registered office in the Czech Republic are mandatorily insured in the Czech health insurance and social security system.

Employees of foreign employers generally do not become participants the Czech compulsory system of social security and in the general health insurance with certain exceptions.

CONTRIBUTION RATES

The total amount of general health insurance and social insurance in the Czech Republic is 45 % of the gross employee's salary, social insurance is 31.5 % of it and health insurance amounts to 13.5 %.

The statutory social and health insurance premiums are payable by employers and employees. The employer is obliged to withhold the employee's part from his remuneration and to pay it together with the employer's part to the respective insurance companies under its own responsibility.

MEDICAL TREATMENT

INDIVIDUALS INSURED IN THE CZECH REPUBLIC (MEMBER STATE AND THIRD COUNTRIES STATE NATIONALS)

Individuals insured in the Czech Republic are entitled the full health care provided by Czech health care providers (doctors, dentists, hospitals)

INDIVIDUALS INSURED IN ANOTHER MEMBER STATE

Individuals that unexpectedly fall ill during their temporary stay in the Czech Republic (on holiday, posted employees from another Member state) are entitled to necessary health care. It covers any medical treatment that the individual needs without being obliged to return to his home country earlier than he expected.

Individuals living in the Czech Republic but being insured to in another Member State are entitled to the full health insurance care as if they were insured in the Czech Republic.

INDIVIDUALS NON INSURED IN EU

As stated above, the Czech Republic has concluded with several countries social security agreements covering also health insurance (namely Serbia, Monte Negro, Macedonia and Turkey). Insured persons from these states are entitled to the same approach in the Czech Republic as if they were insured here. This entitlement is however limited to urgent healthcare.

Individuals from other states staying temporarily in the Czech Republic should be commercially insured for the purpose of healthcare treatment in case of need. Based on such insurance the individual is provided with the necessary medical treatment that must be paid directly to the provider of health care in cash or through such insurance.

CONTRIBUTION RATES

	Social insurance			Health insurance	Total
	Pension	Sickness	Unemployment		
Employer	21.5	2.3	1.2	9	34
Employee	6.5*)	-	-	4.5	11
Total	28	2.3	1.2	13.5	45

*) If the employee opted for the voluntary pension saving scheme the rate is decreased to 3.5% but the employee contributes another 5 % to the voluntary pension saving scheme. This system will be abolished in 2015.

taxation

GENERAL

The Czech tax system primarily differentiates between direct and indirect taxes. These are:

DIRECT TAXES

- Personal income tax (PIT)
- Corporate income tax (CIT)
- Inheritance and Gift tax ²⁾
- Road tax
- Real estate acquisition and Real estate transfer tax

INDIRECT TAXES

- Value added tax (VAT)
- Excise duties
- Tax on natural gas and several other types of gases
- Tax on solid fuels
- Tax on electricity

The most important taxes from the above lists are in the term of tax collection value added tax, excise duties, personal and corporate income tax. Nevertheless, social and health security contributions are the biggest source of state revenues.

²⁾ These taxes do not exist as of January 2014.
For more details see Page 45

personal income tax

Personal income tax (PIT), taxable income and the tax liability of individuals are governed in the Czech Republic by the Czech Income Tax Act (ITA).

Tax residents in the Czech Republic are liable to taxation on their worldwide income regardless of where it is received.

Tax non-residents are liable to Czech PIT only on income from sources in the Czech Republic – i.e. namely income from dependent work performed in the Czech territory, income derived from activities performed through a permanent establishment as well as if they receive capital income from Czech companies or permanent establishments of tax non-residents (namely dividends and interest), royalties or income from the lease of immovable property unless the respective Double Tax Treaty states otherwise. The Czech Republic has concluded approximately 80 Double Tax Treaties

TAX RESIDENCE IN THE CZECH REPUBLIC

Based on ITA an individual is considered a tax resident in the Czech Republic if:

- He has his permanent home in the Czech Republic, or
- He has his habitual abode in the Czech Republic.

The “permanent home” can be a flat or a house where the circumstances indicate taxpayer’s intention to live there permanently. The “habitual abode” means presence in the Czech Republic for at least 183 days in the relevant calendar year, either continuously or intermittently. Each “commenced” day of such stay is taken into account in the period of 183 days. Therefore, days of arrival and departure have to be considered too.

Tax non-residents are individuals who do not meet at least one of the above criteria

or those who are considered tax non-residents based on the relevant Double Tax Treaty. Also are considered tax non-residents those individuals who stay in the Czech Republic only for the purpose of study or medical treatment.

TAXATION PERIOD AND TAX RATE

The tax period for individuals is a calendar year.

A flat tax rate of 15 % is applied to the aggregate income tax base. An additional 7 % “solidarity surcharge” applies to the part of the gross employment income (including taxable benefits) and tax base from business income which exceeds 48 times the annual average wage (for 2015 CZK 1,277,328).

Because the tax base for employment income is calculated from the so called “super gross wage” that includes also compulsory social security and health insurance contributions paid by employer (34 %) the effective tax rate in case of employment income is higher.

WITHHOLDING TAXES

The majority of income of tax non-residents from Czech sources is subject to withholding tax. The general withholding tax rate is also 15 % unless the relevant Double Tax Treaty says otherwise. However, income from Czech sources paid to non-residents from countries that are not EU and EEA members, have not concluded a DTT with the Czech Republic, and have not concluded a bilateral agreement on exchange of information concerning income tax with the Czech Republic or a similar agreement on a multinational basis is subject to increased withholding tax rate of 35 %.

TAX RELIEFS

Czech tax residents can lower their tax base by using tax reliefs.

The main tax reliefs are as follows:

- Mortgage interest for taxpayer's permanent home, up to CZK 300,000 per year
- Qualifying donations to social, scientific, cultural, educational and sport institutions with their seat in the Czech Republic as well as in EU or EEA Member States up to 15 % of the tax base (minimum donations cannot be less than 2 % of the tax base or CZK 1,000)
- Contributions to private life insurance of up to CZK 12,000 per year and contributions to the state-contributory supplementary pension fund or to a voluntary pension fund of up to CZK 12,000 per year, including premiums paid under agreements with qualifying pension funds and life insurance companies established in other EU or EEA Member States.

Tax non-residents from EU and EEA Member States are allowed to the deduction of the above tax reliefs only if they can prove that their taxable income derived from Czech sources was at least 90 % of their worldwide income.

Other tax non-residents from third countries are not allowed to the tax reliefs at all.

TAX CREDITS

Tax residents can decrease their yearly income tax liability by different tax credits as follows:

- Basic personal tax credit of CZK 24,840 per year
- Tax credit of CZK 24,840 for dependent spouse living in the taxpayer's household if the spouse's worldwide annual taxable income does not exceed 68,000 CZK
- Tax credit for taxpayers entitled to disability pension from CZK 2,250 – CZK 16,140 per year depending on the level of their disability
- Tax credit of CZK 4,020 per year for studying tax payers not older than 26 years (28 years for doctoral studies)

- Tax credit up to 9,200 for placement of dependent children in a kindergarten (the amount is per child if the real documented expenses are not lower).

The above tax credits can be deducted only up to the amount of tax liability.

Tax residents are allowed also to deduct tax credits for dependent children CZK 13,404 for first child, CZK 15,808 for second child and CZK 17,004 for third and each following child per year. If the tax credit for dependent children is higher than the tax liability, it can be subject to a refund not exceeding the total amount of CZK 60,300 per year, subject to specific conditions.

Tax non-residents from EU and EEA Member States are allowed the deduction of the above tax credits only if they can prove that their taxable income derived from Czech sources was at least 90 % of their worldwide income.

Other tax non-residents from third countries are not allowed tax credits at all. The above restrictions for tax non-residents do not apply to basic tax credit and to the tax credit for studying taxpayers.

EXEMPTED INCOME

Starting from 2014 the inheritance tax and gift tax has been abolished and any gratuitous income is subject to PIT. At the same time much of such income is exempt from PIT. The main gratuitous exempt income is:

- Any income from inheritance,
- Income from donations from qualifying relatives,
- Occasional income from donations up to CZK 15,000 per year.

There exists also other exempt monetary and non-monetary income, namely:

- Income from the sale of a flat or a family house that was a seller's permanent home for at least 2 years before the sale,
- Income from the sale of other immovable property owned by the seller for at least 5 years before the sale,
- Income from the sale of motor vehicles, airplanes and ships owned by the seller

for at least 1 year before the sale, income from the sale of other movable property being exempt without any deadline.

The above exemption does not apply if the movable or immovable property was part of the business property of the seller. In this case exemption is subject to special conditions.

TAXATION OF EMPLOYMENT INCOME OF TAX RESIDENTS

Based on ITA the income from dependent activity of employees includes:

- income from current or former employment or similar activity when the employee is obliged to obey the employer's instructions during performance of his work;
- income from work performed by members of cooperatives, members of limited liability companies and limited partners in limited partnerships
- income of members of statutory bodies and
- income from current, future or previous performance of dependent work even if such income is not paid by the payer for which the employee performs the work.

The tax base for income from employment corresponds to "super gross wage" which is calculated as a gross wage and taxable monetary and non-monetary benefits increased by the amount corresponding to mandatory social security and health insurance contributions paid by the employer (34 % of the taxable income). The taxable income over the maximum social security assessment base (CZK 1,277,328 from 2015) is not increased by employer's part of social security contributions (25 %), however there is no threshold for health insurance contributions (9 %) that have to be paid without any limits.

As regards monetary benefits and benefits in kind, some of them may be tax exempt or are not subject to PIT, namely:

- Employment-related training
- Value of consumption of meals and beverages at the workplace,
- Temporary free accommodation up to CZK 3,500 per month, if provided in

connection with the performance of the work and subject to other conditions,

- Meal allowance and refund of travel expenses up to statutory limits.

Other benefits and income connected with employment (e. g. use of the professional car for private purposes, temporary accommodation and travel allowances above statutory limits, transport to the place of work etc. are added to the tax base).

TAXATION OF EMPLOYMENT INCOME OF TAX NON-RESIDENTS

Based on ITA employment income of a tax non-resident from work performed in the Czech Republic is subject to Czech PIT. Nevertheless, reference should be made with regards to any relevant Double tax treaty, which usually limits the taxation of employment income to the state of residence if the criteria below are cumulatively met:

- The employee is employed on the territory of the Czech Republic for a period not exceeding 183 days in any twelve month period/during a calendar/tax year,
- The remuneration is not paid by, or on behalf of employer who is tax resident in the Czech Republic and
- The remuneration is not borne by a permanent establishment which the employer has in the Czech Republic.

Consequently the remuneration of non-residents for their employment is subject to taxation in the Czech Republic if the work is performed in Czech territory in the following situations: employee spends in relation to the employment more than 183 days in any 12 months period/calendar or tax year on Czech territory (depending on the relevant Double Tax Treaty) or an employment contract is concluded with a Czech employer or a foreign employer has in the Czech Republic a permanent establishment for which the employee works.

The taxation method is the same as in case of Czech tax residents. The method of "super gross wage" is applied even if employees participate in a mandatory foreign contributions system based on the

EU Social Security Regulations or bilateral social security conventions.

PERSON OBLIGED TO WITHHOLD THE ADVANCE PAYMENT FROM EMPLOYMENT INCOME

Generally it is the legal employer who is obliged to withhold the advance payment of PIT from the dependent income of the employee. However in certain cases when an employer that is Czech tax non-resident assigns its non-resident employees who are managed and instructed by the Czech tax resident, the Czech tax resident is considered an economic employer and all obligations to withhold the advance on PIT is transferred to the Czech tax resident. Such situation is called international hiring-out of labour.

Such a transfer of the obligation to withhold the advance to PIT does not apply in case of international hiring-out of labour where the non-resident companies with their seat in the EU or EEA member states have in the Czech Republic a branch whose authorized business activity is as an "employment agency".

TAXATION OF REMUNERATION OF BOARD MEMBERS AND MANAGING DIRECTORS - NON-RESIDENTS

In case of tax non-residents the income of members of boards and executives of limited liability companies is subject to a withholding tax amounting to 15 %. Generally, relevant Double tax treaties allow taxing such income in the state of its source without any limit of the tax rate.

Such income paid to tax non-residents from countries that are not EU and EEA members, have not concluded Double Tax Treaty with the Czech Republic, and have not concluded a bilateral agreement on exchange of information concerning income tax with the Czech Republic or a similar agreement on a multi-national basis is subject to the withholding tax increased to 35 %.

In both cases the tax base is calculated as a "supergross wage" but there is no additional solidarity increase of the tax.

Tax non-residents – EU and EEA Member States residents can file an income tax return through which the withholding tax can be considered as an advance payment and subject to special condition they are allowed to tax credits. However in such a situation the income will be subject to the solidarity increase of the tax too, if the remuneration exceeds the threshold of CZK 1,277,328.

TAXATION OF FREELANCERS

The tax base for income acquired by business activities and incomes of freelancers is the difference between revenues and expenses without using the super gross method of calculation as in case of the incomes of employees and board members. In some cases, even for rental income, it is possible to calculate expenses using a determined percentage (from 30 to 80 percent). In such cases it is not necessary to prove the real expenses to the tax administrator however the base for calculation of the determined percentage cannot exceed CZK 2,000,000.

Under Double Tax Treaties tax non-resident's income from business activities and incomes of freelancers can be taxed in the Czech Republic only if there is a permanent establishment or a fixed base. In case of tax residents of other countries, such income can be taxed in the Czech Republic if the business or freelancer's activity is performed on the Czech territory.

corporate income tax

Corporate income tax is levied on corporate entities, including joint-stock companies, limited liability companies, general partnerships and limited partnerships. The last two entities are considered for tax purposes transparent and therefore taxed at their partners' level.

Legal persons with a registered office or a place of management in the territory of the Czech Republic are subject to tax liability, which is related to their worldwide income. Non-residents are subject to tax only on income from resources in the territory of the Czech Republic.

The taxation period for corporate income tax is generally a calendar year or a business year, which shall start on the first day of a month except January and run for twelve successive months. Any change of an accounting and tax period from a calendar year to an economic year, and vice versa, must be notified to the relevant Tax Office at least three months prior to the planned change.

TAX RATE

The tax rate applied on taxable profit amounts to 19 %.

A reduced rate of 5 percent applies to the income of qualifying investment and pension funds. Exemptions from corporate tax may be claimed for certain qualifying investments.

Shares of profits, dividends, settlement shares, royalties, interest and other income are subject to a withholding tax amounting to 15 % unless the relevant double tax treaty or legislation of the European Union stipulates something else.

TAX BASE AND TAX DEDUCTIBLE ITEMS

The tax base results from accounting profit, which is calculated according to Czech

accounting laws and practice. However, the final tax liability is calculated using a tax base with adjustments made for tax non-deductible expenses, tax depreciation and losses, items not recorded in the accounts etc.

In general, tax deductible costs are only costs incurred in order to generate, assure and maintain taxable incomes.

Examples of tax deductible expenses are:

- Tax depreciation of tangible assets and tax amortization of fixed intangible assets
- Mandatory health and social security payments made by employers
- Rental paid for lease of business premises
- Financial leasing installments (subject to certain regulated limits) and operating lease installments
- Certain taxes paid (e.g. real estate tax, road tax, VAT that was not claimed as VAT deduction etc.)
- Business trip expenses (e.g. expenditure on accommodation, travel expenses and meal allowances up to certain statutory limits)
- Employee benefits which arise according to any internal company regulation, a collective bargaining agreement with any applicable union or employment or other agreement, unless tax law stipulates otherwise for some kind of benefits

Naturally, all documentation (invoices, receipts) must be properly kept to support tax deductibility. For tax audit purposes, a Czech translation of such documentation in foreign languages may be requested.

On the other hand typical tax non-deductible items include for example:

- Entertainment expenses and gifts and donations
- Non-contractual fines and penalties
- Accounting provisions and accounting reserves

- Interest on credits and loans under thin capitalisation rules
- Expenses related to non-taxable or/and tax exempt income
- Taxes paid on behalf of another taxpayer.

TAX DEPRECIATION RULES

Depreciation of tangible (purchase price more than 40,000 CZK) and intangible (purchase price more than 60,000 CZK) assets are tax deductible under conditions stated in Czech corporate income tax law. Otherwise, the accounting rules are used (e. g. for assets with purchase price lower than 40,000 CZK or 60,000 CZK). Tax depreciation is allowed to the legal owner of assets only.

Companies can choose between accelerated or linear depreciation at prescribed rates, nevertheless they cannot switch the selected method after the start of depreciation. Depreciation cannot be interrupted in the case of intangible assets.

The statutory depreciation rates rely on depreciation groups which the assets are classed into. The depreciation periods are 3 years (e.g. PCs, tools), 5 years (e.g. cars, industrial machinery), 10 years (e.g. big industrial machinery), 20 years (e. g. small buildings), 30 years (e. g. factory buildings, warehouses) and 50 years (administrative buildings and hotels).

Expenditure on technical improvements to fixed assets exceeding a certain threshold increases the acquisition/residual value of the asset and must be depreciated together with the improved asset; a special regime applies to improvements of leased assets financed by the lessee and when the improvement may be depreciated by the lessee as a separate fixed asset.

CARRYING FORWARD LOSSES

Tax losses may be carried forward and offset against profits made in the following five tax periods given the fulfilment of certain conditions. The basic condition is, the loss carry forward may not be deducted from the tax base if the composition of the

persons directly participating in the capital or control of the company has significantly changed (more than 25%) and the subject of business activity has not changed by more than 20% after the significant change.

A legally binding ruling may be obtained from the Czech tax authorities on whether a tax loss can be utilized in a particular case.

THIN CAPITALISATION

The thin capitalisation provisions act to restrict the deductibility of interest and other loan expenses where the borrower and creditor are related parties and borrower has insufficient equity.

The maximum allowable related party debt-equity ratio is 4:1 (6:1 for banks and insurance companies). Limitation of tax deductibility of expenses in connection with debt-equity ratio is not related only to interest but to the whole area of financial expenses (e.g. different types of bank fees and charges, expenses connected with assurance, processing of credits, fees for guarantees, etc.).

Interest on loans and credits received from unrelated parties, or those secured by a related party, is fully deductible on general principle, 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 related party debt.

Tax deductibility of financial expenses is not limited only by the situation of non-satisfaction of the debt-equity ratio. Financial expenses whose interest rate is variable according to the results (profit or loss) of the business are also tax non-deductible.

Any adjustment of profit resulting from thin cap rules relating to a non-EU or EEA resident may be treated as a dividend, i.e. is subject to withholding tax, as reduced by any applicable double taxation treaty.

TRANSFER PRICING RULES

Related party transactions must take place at usual market prices.

Persons related by capital are generally those whose direct or indirect participation in the capital or voting rights in one company by another company is greater than 25%. Persons related by another manner are those who have relationships between persons directly or indirectly participating in management or control, or have entered into a legal relation for the purpose of decreasing the tax base or increasing the tax loss.

Expenses exceeding the usual price can be adjusted by the tax authority and the differences between the actual charged price and the usual market price can be considered tax non-deductible provided the difference is not properly justified. Furthermore, this would also lead to an assessment of additional taxes and related penalties.

According to the Guidelines of the Czech Ministry of Finance, the OECD Transfer Pricing Guidelines and the concept of the EU Transfer Pricing Documentation can be used in proving the arm's length principles in the Czech Republic.

It is possible also to request an advance pricing agreements from the tax authorities on the method of setting the transfer price between related parties. No retroactive agreements are possible. An administration fee of CZK 10,000 is charged per transaction.

TAXATION OF INVESTMENT FUNDS

Czech legislation differentiates between a domestic investment fund and a mutual fund. Nevertheless, both of them are liable to a preferential corporate income tax amounting to 5%. The most important tax difference between the above mentioned funds is the person of taxpayer. While an investment company is the taxpayer in case of a mutual fund, the investment fund is the taxpayer on its own. Investors of in both

types of funds are generally liable to a 15% withholding tax, but the actual facts of each case have to be analysed.

TAXATION OF REAL ESTATE INVESTMENTS

Real estate investments are taxed under the same conditions as every other corporate investor and the rules for business incomes are applicable as well for rentals or leasing payments. There are no special legal rules for the taxation of income from the transfer of shares in a real estate project company (i. e. special purpose vehicle). Therefore this income would not be taxed as an income from a sale of a real property and would not be subject to the real estate transfer tax.

From 1. January 2014 the principle "superficies solo cedit" has been re-introduced into Czech law by the new Civil Code. It explicitly sets forth that the following items shall be understood as part of a land plot:

- the space below and above the surface of the land plot;
- constructions built on it and other equipment (excluding temporary constructions);
- plants growing on it.

However from accounting and tax perspective the land plots and constructions built on it will be treated separately.

From 1st January 2014 a loss derived by a legal entity from sale of a land plot is tax deductible.

TAXATION OF SHAREHOLDERS

Income from dividends and shares in profit, as well as from transfers of shares in a company, paid by a subsidiary to its parent company is exempted from income tax in Czech Republic provided conditions of the EU Parent/Subsidiary Directive are met.

EU PARENT SUBSIDIARY DIRECTIVE

This was implemented into Czech tax law for dividend distributions approved after 1 May

2004; distributed dividends are exempt from tax under the following conditions:

- The dividend is received by a parent company established or effectively managed in the Czech Republic or a tax resident of another European Union country, Norway, Iceland or Switzerland;
- The parent company has the legal form of a limited liability company, a joint stock company or a joint venture under Czech commercial law or a legal form mentioned in the Annex to Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States;
- The parent company is the beneficial owner of the dividends;
- The parent company keeps at least 10% of the registered capital of the subsidiary for a period of at least 12 months, either prospectively or retrospectively;
- A Czech subsidiary has a legal form of either a limited liability company, a stock exchange company or a co-operative; and
- The Czech subsidiary is not in the process of liquidation.

On satisfaction of certain conditions the said tax exemption is also applicable to income flowing to tax residents in the Czech Republic from their participation in subsidiaries being tax residents of states, with which the Czech Republic has concluded effective double taxation agreements. Should the mentioned directive not be applied, income tax amounting to 15 % will be withheld, unless the relevant double tax treaty stipulates something else.

TAXATION OF ROYALTIES AND INTEREST

Royalties (licence fees) and interest arising to a company, which is a tax resident of another EU member state are tax exempt under the EU Interests Licence Directive provided its conditions are met. This exemption has legal effect in the Czech Republic as from 1st January 2011. Should the mentioned directive not be applied, income tax amounting to 15 % will be withheld, unless the relevant double tax treaty stipulates something else.

A receiver must obtain a special decision of the Czech tax authorities (Prague 1) on application for the tax exemption.

LIQUIDATION

Profits arising on liquidation are taxed as corporate income at the normal corporate income tax rate. Distribution of liquidation proceeds to shareholders is subject to withholding tax in the same way as dividends.

RESEARCH AND DEVELOPMENT DEDUCTION

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

ACT ON RESERVES

The Act on Reserves allows restricted deductions for bad debt reserves and write-offs. It also allows taxpayers to create tax deductible reserves for future repairs. For this purposes the existence of supporting evidence in the form of project plans and the transfer of funds to a separate bank account by the due date for filing the annual tax return are needed.

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

“inheritance, gift”, road, real estate and tax on the acquisition of immovable property

INHERITANCE AND GIFT TAX

From 1 January 2014, gift and inheritance taxes have been abolished and the taxation of such 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.

ROAD TAX

Vehicles registered and used for business purposes in the Czech Republic are subject to road tax. Its taxpayer is the user of a vehicle, but it could be e. g. an employer as well, if travel expenses are reimbursed to employees for using their private cars. The tax base depends upon the engine cylinder capacity or the maximum permitted weight and the number of axles.

REAL ESTATE TAX

The tax payer is, in the case of real estate tax, the owner of land or a building located in the Czech Republic. The tax base depends on the size of the real estate, its location, kind and the purpose which is used for.

For some types of property, the rates are multiplied by a coefficient (set by municipalities for every respective year) 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.

Real estate tax is deductible for corporate income tax purposes once it is paid.

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, 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 in some cases is calculated by tax authorities based on prices for similar transactions. If 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 following the month in which the transfer is registered. The tax is due by the same deadline. The tax declared in the return is considered as a prepayment and is subject to review by the tax authorities.

international tax issues

DOUBLE TAX TREATIES

Czech Republic has a broad double tax treaty network; currently 82 double tax treaties are in force following the OECD model. The purpose of these treaties is the avoidance of double taxation on income earned in those countries. The OECD Commentary and the OECD Model Tax Convention on Income and on Capital are not binding on the Czech tax and judicial authorities but often used as soft-law.

TAX INFORMATION EXCHANGE

The Czech Republic participates in the international tax information exchange based on OECD double tax treaties, bilateral memorandums and any EU regulation, which was implemented to Czech tax law. The Czech government has already signed a number of memorandums of understanding with more than 15 countries.

SOURCE OF INCOMES FOR NON-RESIDENTS

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

- income of a permanent establishment in the Czech Republic
- income from dependent activity (employment) performed in the Czech Republic
- income from services provided in the Czech Republic
- income from the sale or use of real estate situated in the Czech Republic
- royalties, dividends and other profit distributions, interest, and lease rentals
- income from the transfer of shares in Czech resident companies
- income from the sale of a business located in the Czech Republic

TAXATION OF BRANCHES OF FOREIGN CORPORATIONS

Trading branches that are considered as permanent establishments based on the

relevant double tax treaty are usually taxable on actual profits as is recorded in their accounting records, in the same manner as Czech companies (corporate income tax). Non-trading branches of foreign companies may be liable to corporate income tax on anticipated profits. The basis on which anticipated profits are calculated must be negotiated in advance with the local Financial Authority.

TAXATION OF PERMANENT ESTABLISHMENT

“Permanent establishment” means a taxable presence of a foreign entity in the Czech Republic (not though necessarily a legal entity or branch office). It is usually created through:

- (i) existence of a fixed place of business in the territory of the Czech Republic (e.g. an office, workshop, mine, building site), or
- (ii) based on provision of services (if employees of a foreign company or individuals working in other capacity for the foreign company provide management, consulting or similar services to a Czech entity, and their presence during the provision of such services in the Czech Republic exceeds 6 months in any 12-month period of time), or
- (iii) through the activities of a dependant agent, entitled to conclude agreements on behalf of a foreign, non-resident company.

The above applies unless an applicable double tax treaty overriding Czech legislation stipulates otherwise.

The method of taxation of a permanent establishment is either in the same manner as for Czech companies or it may be liable to corporate income tax on anticipated profits.

value added tax (VAT)

As the Czech Republic has been a member state of the European Union from 1st May 2004, the Czech VAT law is based on the principles of the common system of VAT given by the VAT Directive. VAT is generally due on a supply of goods or services with the place of supply in the Czech Republic carried on by a taxable person in the course of economic activities. The taxable supply usually means goods or services provided for a consideration. However, certain transactions carried out for no consideration represent also a taxable supply, e.g. private use of business assets and provision of gifts.

REGISTRATION

VAT registration is obligatory for a person who has a registered office, place of business, or establishment in the Czech Republic (hereinafter Czech entities), if their turnover exceeds 1,000,000 CZK (36,000 EUR; 45,714 USD) in twelve consecutive calendar months. Even if the threshold is not exceeded, Czech entities may choose a voluntary registration.

Entities that have no seat, place of business, or a fixed establishment in the Czech Republic are obliged to register for Czech VAT once they make a taxable supply in the Czech Republic on which they have to account for a VAT. There is no registration threshold and these entities cannot register voluntarily.

VAT ID AND CODE OF THE CZECH REPUBLIC

The Czech tax identification number comprises the code of the country "CZ" and core part of the VAT ID (i.e. in most cases it is a birth number of a natural person or company ID = IO in the case of the legal entity). That means that the code CZ is at the beginning instead of the existing code

of the tax administrator. Each taxpayer is obliged to state its VAT ID in its tax documents regardless whether it does intra-Community transactions or just domestic business transactions.

The information whether the respective VAT ID is registered can be obtained at the server of the VIES.

SUPPLY OF GOODS INTO EU-STATE, EXPORT OF GOODS

Supply of goods into another member state is considered to be an VAT-exempt transaction with the entitlement to claim VAT deduction in a case that:

- an acquirer of goods is registered for VAT in another member state of the European Union, i.e. it was assigned a tax identification number (VAT ID; in Czech: DI) for VAT,
- and the goods were actually sent or shipped to another EU member state by a payer or an acquirer or an authorized third person.

Exemption cannot be exercised in the case of goods supplied to a person, for whom the goods acquired in another member state will not be subject to taxation. To exercise tax exemption the supplier will be obliged to state and check the validity of VAT ID of its customer, which was assigned in another member state of the European Union.

When the goods are supplied to third countries outside of the European Union the current regulations for export of goods will be maintained.

VAT RETURNS

The taxable period of Czech entities is a calendar month (exceptionally a calendar quarter). A VAT payer can opt for a quarterly

taxable period provided that certain conditions are met (e.g. his turnover in the previous calendar year did not exceed CZK 10 million). VAT returns must be submitted to the relevant tax office, for foreign entities that have no seat, place of business, or a fixed establishment in the Czech Republic the relevant tax office is Prague 1. VAT returns can be submitted only via electronic forms.

RECAPITULATIVE STATEMENT

To ensure checks of eligibility of an exercised right to exemption from VAT upon supply of goods or service into another member state, VAT-payers are obliged to submit a tax return together with so-called "recapitulative statement".

In the recapitulative statement a tax-payer gives summary information about the goods that were supplied and about the provision of services to taxable persons registered for VAT in another member state. The tax payer declares the following information concerning the customer:

- code of the country where the customer is registered,
- VAT ID of the customer,
- Total value of goods or relevant services supplied to the customer in a respective month / quarter.

For the submission of recapitulative statement it is necessary to use only electronic form.

TAX RATES

VAT in the Czech Republic is charged at three rates:

- The standard rate of 21 % on the sale of goods and services
- The first reduced rate of 15 % on the transfer of certain residential houses, on the sale of certain goods such as food products, nappies etc. and certain services such as transport by waterway, accommodation, air transport of passengers, certain cultural activities etc.
- The second reduced rate of 10 % on the sale of certain goods such as pharmaceuticals used for health care, books and baby food etc. (as from 1st January 2015).

RECOVERY PROCEDURE

VAT can be recovered by businesses on all goods and services. However there are certain exceptions, when VAT is not deductible (restaurant expenses etc.). Also specific conditions must be met (e.g. a deadline date to send application by 30th September of the following year for entities from EU and 30th June for non EU entities, the minimum amount claimed shall exceed CZK 1,000 for the calendar year). An institute of VAT tax representatives (tax agents) does not exist from 2005 in the Czech Republic.

Representation before Financial Authorities is permitted generally by the Administration of Taxes Act (tax advisers, jurists, representatives acting with a power of attorney).

TRIANGULATION

Triangulation is governed by the Czech VAT Act as a form of business carried out within EU when it is possible to exercise the simplified VAT rule for supplies and acquisition of goods between persons registered for VAT in different member states. The simplified rule can be used only when all statutory conditions are met.

Triangulation is a deal made by three persons (seller, agent, buyer) registered for tax in three different member states, and an object to this deal is the supply of goods between these persons provided that the goods are directly sent or shipped from seller's member state into buyer's member state. This rule allows the agent to purchase and sell the goods in the Czech Republic without being registered for VAT here.

INTRASTAT

With respect to EU legislation, an Intrastat system of collecting intra-Community trade information is also used in the Czech Republic. The obligation to file Intrastat reports arises on exceeding the stated threshold for arrival (CZK 8 million) or dispatches (CZK 16 million).

VAT GROUPING

The VAT Act amendment introduces the option of VAT grouping. A VAT group generally consists of related entities with an address, a place of business or a branch in the Czech Republic. VAT grouping should simplify administrative procedures related to filing VAT returns within group companies and minimise non-recoverable VAT. Group companies that register as a single VAT entity by 31 October of the current year become a VAT group effective 1 January of the following year. The VAT group is then treated, for VAT purposes, as a single entity, i.e. only transactions with nongroup members are subject to VAT. VAT grouping is not compulsory.

excise taxes

Excise taxes are fiscally one of the most important sources of state revenues. They are fully harmonised with the EU regulations and separate from VAT. Excise taxes are levied on gasoline, tobacco and alcohol. Tax payers are all persons that are obliged to pay the tax by the releasing of goods for free circulation. The tax base is the volume of particular goods.

Excise products can be produced, transported or stored under duty suspension arrangement, i.e. tax liability is deferred until these products are released for free tax circulation.

energy taxes

Taxes on electricity, solid fuels and natural and other gases were introduced in the form of three separate acts. They are fully harmonised with EU legislation and the customs authorities are responsible for their collection. At the moment, energy taxes form a small part of total state revenues because the tax rates are still relatively low.

tax administration

As from January 1, 2011, a new tax administration act entered into force which represents the biggest change in the Czech tax administration system in its modern history. The new act adopts the previous decisions of Czech courts and reflects the changes in the organizational structure of the Czech Tax administration.

ORGANIZATIONAL STRUCTURE

The central body of the Czech Tax Administration is the General Financial Directorate (GFD) established in 2011. GFD manages the administration of all taxes and Financial Directorates whose decisions it examines. Furthermore, GFD provides analytical, conceptual and legislative activities related to the tax legislation, tax administration and direct management of the automation of the tax agendas.

The Financial Directorates are bodies of tax administration having regional competencies and are superior to Tax Offices. Tax Offices conduct the administration of taxes, tax payments and advance payments, conduct proceedings on tax delinquency within their field of activity and provide international assistance in the Tax Administration.

TAX FILINGS

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 partnership profits. All individuals with annual taxable income exceeding CZK 15,000 must file tax returns unless the income is tax exempt or subject to withholding tax.

Corporate tax returns must be filed within 3 calendar months after the end of the tax period. However, this deadline is automatically

extended by an additional 3 calendar months if a power of attorney is granted by the company to a registered tax advisor/advocate to file its tax return. Moreover, this 3-months extension is automatically granted to all taxpayers who are subject to Czech statutory auditing

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 the submission of the return. The tax is treated as paid when it is received by the tax authority.

TAX AUDITS

The tax authority has the power to carry out tax inspections in order to establish or examine the tax base or other circumstances decisive for the correct determination of the tax liability.

Tax cannot be assessed or assessed additionally more than three years after the end of the taxation period in which the obligation to file the tax return originated. Where a taxpayer has declared a loss, the period in which a tax audit may be carried out is extended by the period during which the loss may be utilised.

The tax authorities have to provide a taxpayer with written reasons justifying their decisions, however the additional tax is usually due before the appellate procedure is completed.

TAX PENALTIES

- Penalty of 0.05% of actual tax liability for each day (up to 5% of actual tax liability, maximally up to CZK 300,000) when a tax return is filed after the statutory deadline
- Penalty of 20% when a taxpayer's tax liability is increased or its tax deduction is reduced by the tax authorities during a tax audit
- Penalty of 1% if the tax authorities reduce the amount of a taxpayer's tax losses

MERGERS AND ACQUISITIONS

Mergers and the other forms of transformations are generally treated as a tax neutral operation. Mergers are not allowed for the purpose of obtaining tax benefits. Tax-effective reserves, provisions and losses of a company, which ceases to exist, may be utilized by its successor under certain conditions that are:

- all the companies involved have legal forms set by law (e.g. limited liability company, joint stock company),
- the merger cannot be tax driven, i. e. the main purposes of the merger is not "avoiding tax liability",
- the losses can be applied only up to the amount of the tax base of the surviving entity that relates to the same activity undertaken by the dissolved company.

audit

Audits in the Czech Republic are regulated by Act No. 93/2009 Coll. on Auditors, effective from 14th April 2009. Provision of this Act has made the legislation fully conformant with the EU directive on audit services prescribed by Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts. Nevertheless, the Act on Auditors will have to be amended in accordance with the new legislation that improves the quality of statutory audit across the EU (Directive 2014/56/EU).

In accordance with the effective Act, responsibility for regulation of the audit profession in the Czech Republic has been delegated to the Chamber of Auditors of the Czech Republic (also abbreviated KAČR). The Act has also established the Public Audit Oversight Board, which plays an important role, amongst others, especially in relation to audits of public interest entities. Statutory audits of financial statements must be performed by certified auditors registered in the list of auditors and auditing companies regulated by the Chamber of Auditors of the Czech Republic.

Audits in the Czech Republic are carried out according to International Auditing Standards (ISA). Certain national differences in the application of ISAs are determined by Application clauses issued by KAČR. The Code of Ethics issued by KAČR is based on the IFAC Code of Ethics. The aforementioned differences in the application of auditing standards and the Code of Ethics are however not of a significant nature.

The Supervisory Committee of KAČR oversees the quality of auditors' work, compliance with the Act on Auditors and other legislation, and with the Chamber's internal regulations. The inspections are performed on a regular basis - the auditors performing audits of public-interest entities are reviewed at least every three years; the other auditors at least every six years. The Public Audit Oversight Board supervises the performance of auditing activity and is also

authorized to supervise the activities of KAČR and is independent of auditors' profession.

According to the Anti-Money Laundering Act, the auditor is, inter alia, obliged to identify the person with whom the auditor enters into a contract of an amount exceeding an equivalent of EUR 1,000. Audit of financial statements is not primarily focused on fraud detection; however auditor is obliged to notify any "suspicious transactions" to KAČR that he or she had identified during the course of an audit. The auditor fulfils the requirements of the Anti-Money Laundering Act which set up the obligation to notify the Ministry of Finance of suspicious transactions.

The effective accounting Act sets up the obligation for the certain entities to have their financial statements audited by a statutory auditor. The criteria for statutory audit are the following:

A) joint stock companies

If at least one of the following criteria for the current and preceding period met or exceeded:

- 1) The Yearly turnover amounts to CZK 80 million (approx. EUR 3 million, USD 3,7 million)
- 2) Total assets (at cost -without accumulated depreciation and impairments) amount to CZK 40 million (approx. EUR 1.5 million, USD 1,82 million)
- 3) Average number of employees exceeds 50.

B) All banks and regulated financial instituti-ons

C) Foundations and certain other non-profit organizations

- D) Other businesses that have, for the current and preceding period, met or exceeded at least two of the three criteria stated in paragraph A) above.

Based on the draft of the new accounting Act, we do not expect any significant changes in these criteria after amendments in accordance with the new EU legislation.

consolidation

Companies in the Czech Republic must prepare consolidated financial statements if their group has met or exceeded at least two of the following criteria:

- 1) Yearly net turnover of CZK 700 million (EUR 25.5 million, USD 32 million)
- 2) Total assets (gross) of CZK 350 million (EUR 12.8 million, USD 16 million)
- 3) Average number of employees exceeds 250

Banks, insurance companies and listed companies are obliged to prepare consolidated financial statements.

All companies with listed shares or bonds within the EU have to use IFRS for their consolidated financial statements and the annual report. Other companies may use IFRS for their consolidated financial statements and the annual report.

A continuing company and a new company established by a merger should submit an audited opening balance if at least one of these fulfils the criteria for statutory audit.

accounting

GENERAL

Legal persons with a registered office in the territory of the Czech Republic and foreign persons doing business in the territory of the Czech Republic (e.g. through a branch office) are obliged to keep accounting records from their establishment (i.e. since the date of incorporation in the Commercial Register).

Sole traders registered in the Commercial Register are obliged to keep accounting records from the day of entry in the Commercial Register.

Sole traders not registered in the Commercial Register are liable to keep accounting records when their turnover exceeds the amount of CZK 25 million. Sole traders whose turnover is less than this amount are not subject to the Accounting Act and use only a „tax evidence“ system.

The accounting period shall be 12 successive months, unless it is stipulated otherwise. It shall either correspond to the calendar year or the “economic” year. The “economic” year shall be an accounting period which can only commence on the first day of a month other than January. Companies can adopt an “economic” year provided they inform the Financial Authority at least three months in advance or in case of a new established company within 30 days from the foundation of the new company. The accounting period immediately preceding a change of accounting period or in case of business combinations may be shorter or longer than the stated 12 months. The accounting period may be longer than 12 months as well in case of an establishment of a company within three months before the end of a calendar year.

ACCOUNTING LEGISLATION AND PRINCIPLES

- The framework for accounting in the Czech Republic is given in the Accounting Act.

- Accounting records must be kept in the Czech language and in the Czech currency
- The Act on Accounting stipulates general principles and conditions for preparing of accounts (true and fair view, going concern, matching principle) and its qualitative characteristics (comprehensibility, completeness, accuracy, etc.) These definitions more or less correspond to the definitions stated in the conceptual framework of IAS/IFRS. On the other hand the Accounting Act does not contain any “conceptual framework” and many basic accounting principles and definitions are missing (e.g. assets, liabilities, revenues, gains, cost, expense, loss etc.).
- Accordingly, the Act on Accounting regulates general principles for compilation and publication of the financial statements, methods of evaluation, stocktaking of assets and liabilities, accounting records filing and sanctions for non-adherence to the act.
- Detailed accounting guidance is given in the Ministry of Finance Decree on Accounting and Czech Accounting Standards and more specified in the Czech Accounting Standards (CAS). There are separate accounting rules, i.e. Decrees and Standards, for businessmen (entrepreneurs), banks, insurance, municipalities, non-profit organization, political parties and other. All Decrees include also a baseline chart of accounts which define main sub-ledger accounts and their numbering. These baseline charts of accounts are compulsory and companies must set their individual chart of accounts to be in line with them.
- The National Accounting Council has been working there since 2004 to clarify and interpret some unclear and/or missing accounting principles, methods and definitions (an analogy to IFRIC).

All companies incorporated in the Czech Republic with listed shares or bonds in any European Union country are required to prepare their financial statements in accordance with IFRS. However all companies

preparing their financial statements under IFRS must be able to adjust them to CAS to determine a tax base for corporate income tax.

STATUTORY FINANCIAL STATEMENTS & ANNUAL REPORTS

Annual financial statements must be drawn up and submitted, together with the income tax return, to the Financial Authority within first three months of the next financial year. This deadline is extended to six months for all companies with a compulsory audit or which use the services of a registered tax adviser.

There is no obligation to draw up and file any monthly/quarterly interim financial statements for companies keeping their accounts under CAS.

The companies are obliged to draw up so called "extraordinary" financial statements in exactly defined situation, e.g. an entry of a company into liquidation or bankruptcy proceeding, a decisive day for business combination etc.

Financial statements must contain a balance sheet, a profit and loss statement and notes. A layout of balance sheet and profit and loss statement including a marking and description of each line is an attachment of the Decree to the Accounting Act and companies cannot depart from this layout (template). A decree to the Accounting Act also stipulates the minimum contents of Notes to Financial statements, namely a description of accounting and valuation principles used by a company, detail of material items in the balance sheet and P&L, summary of receivables /payables to state which are overdue, summary of transactions to related parties etc.

The accounting unit may include with the financial statements its cash flow statement and a statement on changes in shareholders' equity.

A by-law to the Act on Accounting for business entities stipulates a different scope for the financial statements of non-audited companies and companies that require

statutory audit (so called full-scope financial statements).

Annual financial statements must be published within one month after its approval by a general meeting in the Commercial register but until the end of the next financial year at the latest.

Additionally, all companies requiring a statutory audit must prepare an annual report make it publicly accessible and file with the Commercial Register. Since 2001, entities controlled by another party must attach to their annual reports a „Report on relationships with related parties“.

These reports are also subject to a review by the auditors.

ESSENTIAL DIFFERENCES BETWEEN THE CZECH ACCOUNTING STANDARDS (CAS) AND IAS/IFRS

(This is only a comparison with CAS for entrepreneurs and the most significant and the most frequent differences):

- CAS fails to define any conceptual framework and some basic accounting definitions (assets, liabilities, revenues, cost, gains/loss etc.);
- CAS has no accounting standard for accounting for long-term contracts (IAS 11) and applies only standard valuation of work in progress;
- For evaluation of tangible fixed assets as to the balance sheet date CAS apply exclusively evaluation by the historical price contrary to IAS 16 or IAS 40;
- CAS fail to apply accounting for financial leases according to IAS 17 (tangible fixed assets are recorded and depreciated only by an owner in fact);
- CAS fail to apply the concept of a functional currency (IAS 21), accounts are kept solely in CZK
- CAS has no accounting standard for a valuation of long-term employee benefits and fail to apply accounting for "share-based" payments
- Differences in the methods of recognition, evaluation and depreciation of goodwill in case of business combinations (IFRS 3).

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