Doing Business in the Czech Republic

This document describes some of the key commercial and taxation factors that are relevant on setting up a business in the Czech Republic.

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Background

Country overview

The Czech Republic is a fully fledged parliamentary democracy and one of the most advanced among the countries of CEE. The Czech Republic ("CR") covers approximately 79,000 km2 and its climate is mild and temperate. The CR lies in the centre of Europe and borders Germany, Austria, Slovakia and Poland. The national language is Czech.

The CR is part of the European Union (EU), which is comprised of 28 Member States. In common with a number of other EU Members, it has not joined the "Eurozone" in which a common currency, the Euro (€) is used. The currency in the CR remains the Czech koruna (CZK).

The population of the CR is 10.6 million people.

Economic overview

Compared to its regional peers, the Czech Republic is doing fairly well in terms of GDP per capita, competitiveness and the inflow of foreign direct investment.

The education system yields a highly-skilled workforce with a capacity for innovation. Foreign investors are attracted by investment incentives, cost competitiveness, financial stability and the availability of financing, quality of life and social stability.

The CR is known for its attractive investment climate, in particular for its safe investment environment, skilled and well-educated workforce, favourable labour costs, price stability, central location in Europe, dense and high-quality infrastructure, transparent system of investment incentives, strong focus on R&D, large number of suppliers, high quality of life, stable social and political system, and mentality, culture and attitudes similar to those of western countries. The country's investment grade ratings from international credit-rating agencies and its early membership in the OECD testify to its positive economic fundamentals.

The CR does not impose exchange controls and has a free market economy with few restrictions.

Transport infrastructure

The CR has a strong transport infrastructure with a relatively large motorway network for road transport between key commercial centres; there is also a very extensive rail network. This modern and reliable infrastructure is complemented by its position in the heart of Europe.

Choice of Legal Form

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

- limited liability company
- joint-stock company
- general partnership
- limited partnership
- co-operative
- Societas Europaea (SE, European Company)
- European Economic Interest Grouping (EEIG).

Foreign legal entities may also establish a branch in the Czech Republic.

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

- This is the most frequent used type of business entity;
- CZK 1 of registered capital is sufficient;
- The list of shareholders, the amount of each shareholder's contribution and the names of the members of the supervisory board (if one is established) must be recorded in the Commercial Register;
- Limited liability companies may also appoint legal entities as executives.

Joint-stock company (akciová apolečnost – a.s.)

- Registered capital has to be at least CZK 2 million or EUR 80,000;
- Non-cash contributions to registered capital must be valued by an independent expert;
- The company may decide between two internal structures: either a supervisory board and a board of directors (dualistic organization of corporate bodies) which is very common, or an executive director and a managing board (monistic organization of corporate bodies);
- The chairperson of the managing board may be the same person as the executive director (i.e., one person can secure the entire operation of a joint stock company);
- A legal entity may also be appointed as a member of the board of directors of a joint stock company;
- The executive director has to be a natural person.

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

- A general partnership is formed by two or more persons (individuals or legal entities);
- The partners in a general partnership are liable for the debts of the company;
- The names and addresses or the registered offices of the partners must be registered in the Commercial Register;
- All partners are entitled to act on behalf of the partnership and are jointly and severally liable for the partnership's obligations to the extent of their entire property.

Limited partnership (komanditní společnost – kom. spol. or k.s.)

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

- Only unlimited partners are permitted to manage the partnership.

Co-operative (družstvo)

- Co-operatives are formed by at least three members, either legal entities or individuals, to undertake business activities for the economic or social benefit of their members;
- Members are not liable for the obligations of the co-operative; however, the co-operative may demand contributions from its members to cover losses.

Branch of a foreign entity (odštěpný závod zahraniční osoby, formerly organizační složka)

- Foreign legal entities may also establish a branch in the Czech Republic. Foreign legal entities are defined as legal entities having their registered office outside the Czech Republic;
- A branch is not considered a legal entity, but must nevertheless be registered in the Commercial Register;
- Branches of foreign businesses can conduct business activities in the Czech Republic if they are registered in the Commercial Register;
- The liability of a founder of a branch is not limited since a branch is not an independent entity.

Audit Requirements

Requirement and thresholds

All accounting records must be in Czech. All accounting records must be kept, and financial statements presented, in Czech crowns (CZK). It is possible to specify a business year-end other than 31 December.

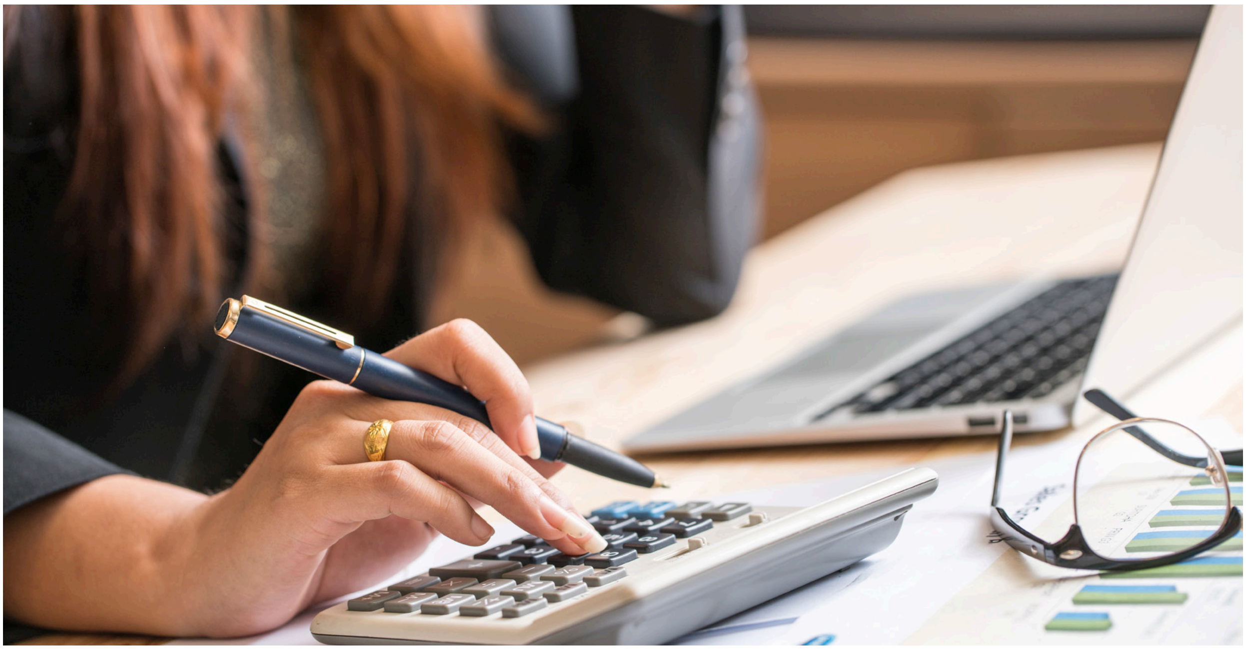
All corporations recorded in the Commercial Register are obliged to publish their annual statutory financial statements, annual reports and consolidated financial statements in the Commercial Register if applicable; all financial data about all Czech corporations is thus freely accessible at www.justice.cz.

All accounting units and groups are categorized depending on the following criteria: net turnover, balance sheet total, average number of employees, legal form, and other conditions. In total, there are four accounting unit categories (micro, small, medium and large).

Financial statements do not have to be audited if the accounting unit is considered a micro and at least two of the following criteria are not exceeded:

- net turnover exceeding CZK 18 million per annum (approx. EUR 700,000);
- total assets exceeding CZK 9 million (approx. EUR 350,000);
- average number of employees exceeding 10.

Taxation



Corporation tax

- Companies having their seat or place of effective management in the Czech Republic, i.e., Czech tax residents, are taxed on their worldwide income;
- Czech tax non-residents are taxed on Czech-source income only and are subject to specific rules;
- There are no provisions for group corporate taxation, i.e., consolidated returns cannot be filed, and each group company subject to Czech taxation must submit a separate tax return;
- The standard corporate tax rate is 19%.

Dividend payments and capital gains tax

Under the EU Parent/Subsidiary Directive rules implemented into Czech legislation, dividends paid by a qualified Czech subsidiary to a qualifying parent company that is tax resident in a member state are exempt from withholding tax.

A dividend received by a qualified Czech parent company from a qualified EU subsidiary is also exempt from tax.

Qualifying criteria include tax residency, having one of the listed legal forms required, and that at least 10% of the shares have been held by the parent company for at least 12 months.

Personal income tax

Taxable income includes the following:

- Income from dependent services (employment);
- Income from independent services (entrepreneurial activities);
- Income from capital (interest, dividends, etc.);
- Rental income;
- Other income.

For individuals, the tax year corresponds to the calendar year. For income tax purposes, income is taxed in the year when payment is actually received or, in the case of non-monetary benefits, in the year when the benefit is received. Employment income received in January relating to work performed in the previous year must be included in the tax base of the previous year.

The income of individuals is subject to a flat tax rate of 15 percent. The 15 percent flat tax on employment income is calculated based on the super gross salary, which is the gross salary increased by the social security and health insurance contributions payable by the employer. An additional 7 percent (a “solidarity tax”) is applied on income (the sum of gross salary and the self-employment tax base) exceeding the maximum annual assessment base for social security contributions (CZK 1,355,136 in 2017).

Land tax

Tax on immovable property is payable by owners of immovable property situated in the Czech Republic. This tax is low compared with other developed countries.

Value added tax

EU membership has greatly impacted Czech VAT rules and procedures, as EU directives, regulations and case law apply and must be adhered to by the taxpayers and tax authorities.

The standard VAT rate is 21 percent and applies to most goods and services. Two reduced rates are applied in the CR. The first reduced rate of 15 percent applies to, e.g., food products, public transportation services, social housing construction, and transfers of social housing, unless these are tax-exempt. The second reduced rate of 10 percent applies to essential baby nutrition, pharmaceuticals for human and veterinary purposes, books and newspapers.

Tax treaties

Income tax liabilities are, to some extent, modified or mitigated by tax treaties, where applicable. The CR has concluded 87 double taxation treaties. Also, the CR is one of the first signatories of the Multilateral Instrument amending double taxation treaties.

Transfer pricing rules

Transactions between related parties should be conducted in accordance with the arm's length principle. The arm's length principle should govern the evaluation of transfer prices among associated enterprises. Companies are obliged to disclose their related party transactions in financial statements and, in particular, in an appendix to the corporate income tax return containing information about all foreign related party transactions – subject to some limitations. This information is electronically reported directly to the tax authorities.

The Czech Republic, as a member of the Joint Transfer Pricing Forum of the European Union (EU JTPF) and the Organisation for Economic Cooperation and Development (OECD), follows the OECD principles and guidelines for the content of TPD (Master file and local file). The Ministry of Finance and the General Tax Directorate have issued several methodological instructions in this respect; they are not legally binding but they serve as useful guidelines for taxpayers.

In the CR there is no legal obligation to have transfer pricing documentation prepared.

Allowances

Depreciation

The following tangible fixed assets cannot be expensed directly and must be depreciated for corporate tax purposes:

- Separate movable assets and sets of movable assets with a purchase price exceeding CZK 40,000 and with an operational and technical life exceeding one year;
- Buildings, houses, flats, non-residential premises and constructions;
- Technical appreciation in the form of the modernization and reconstruction of leased assets performed by the lessee with a price exceeding CZK 40,000 (approx. EUR 1,500) and certain “other assets”.

Tangible fixed assets are classified into depreciation categories to which various depreciation periods from 3 to 50 years apply. Taxpayers are not obliged to depreciate an asset for tax purposes every year. The start of depreciation may be postponed and depreciation may be interrupted in any year and continued in a later year without a loss of depreciation potential.

Special rules apply to the depreciation of intangible fixed assets. The depreciation method differs depending on the year of acquisition and the type of intangible assets.

Investment incentives

The total amount of investment incentives is up to 45% of eligible costs, depending on the location and size of an enterprise.

Investment incentives and subsidies include

- Job-creation grants – Financial support for the creation of new jobs (EUR 3,800 – 11,500 per new job);
- Training grants – Financial support for the training and retraining of new employees (up to 50% of eligible training costs);
- Full corporate income tax relief for up to ten years for new companies, partial relief for existing ones.

Tax credits and allowances

Resident and non-resident individuals may claim a basic personal tax allowance of CZK 24,840 per year. Czech tax residents may claim:

- a tax allowance of CZK 24,840 for a spouse under strict conditions;
- a tax allowance for children (CZK 15,204 for the first child, CZK 19,404 for the second child and CZK 24,204 for the third child and any subsequent child);
- a tax allowance depending on the severity of disability (CZK 2,520 to CZK 16,140);
- a tax allowance for students (CZK 4,020);
- a tax allowance for placing a child into a private pre-school activity and
- other tax allowances.

In addition, various deductions from taxable income may apply, for instance, for interest paid on a mortgage, for private contributions paid to pension schemes and private life insurance, for gifts to charity, etc.

R&D tax allowances – R&D costs can be claimed twice, i.e., as a standard cost and as a special tax deduction in the tax return. There are no limits and the deduction may be claimed every year.

Education tax allowances – deduction of costs relating to vocational or professional educational activities. The deduction relates to costs incurred for the acquisition of assets and costs concerning various activities relating to the education of students on the entrepreneur's premises.

Employment

The employer must withhold income tax on employment income on a monthly basis and fulfil various reporting duties on a monthly and annual basis.

The Czech health insurance rate is 4.5% and social security contribution rate is 6.5% (for the employee) and 9% for health insurance and 25% for social security (for the employer) of the employee’s gross salary. Entrepreneurs contribute a percentage of the entrepreneurial tax base.

Social security contributions provide funding for three separate funds: pensions, unemployment benefits, and sickness, together with other benefits. Entrepreneurs can choose whether or not to contribute to the sickness fund. There is a cap on social security for both employees/employers and entrepreneurs.

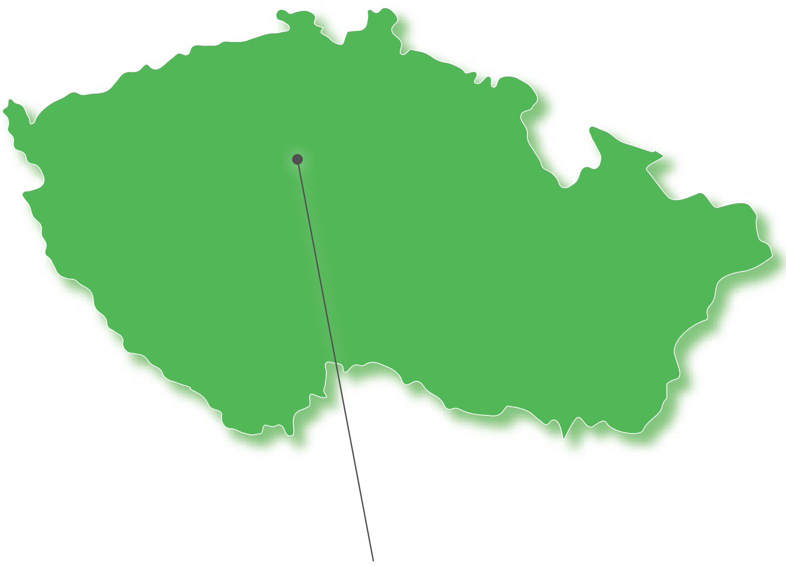
Withholding Taxes

The payments of dividends, interest, royalties and certain other payments are subject to withholding tax when made by Czech payers.

The tax rate of 15-35% may be reduced by a double-taxation treaty or subject to exemption by EU Directives.

This document is provided by Peterka and Partners as a general overview of matters to be considered when setting up an overseas business in the Czech Republic. It is essential to take advice on specific issues. No liability can be accepted for any action taken or not taken arising from the information provided in this publication.

Peterka and Partners is an integrated law firm with offices throughout Central and a Eastern Europe with which DFK cooperates on supporting cross-border business. The firm provides a wide range of legal services in the Czech Republic and throughout CEE. For their contact details, please see below.



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