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Doing Business in the Czech Republic

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MSI's guide on Doing Business in the Czech Republic provides current information about the financial, regulatory and legal considerations that could affect business dealings within Czech Republic For further assistance please contact one of our MSI member firms in Czech Republic.

Country overview

Population

The Czech Republic has a total population of 10.6 million inhabitants (January 2017).

Government

The Czech Republic is a unitary parliamentary republic. The current President is Miloš Zeman. The President does not have a political power; the government is responsible together with the Prime minister as the head of government. The Czech Parliament is bicameral; there is the Chamber of deputies and the Senate.

The head of state does not bear political responsibility and can therefore not be held politically accountable by the Parliament. The Czech Republic has 13 regions and the Capital city of Prague, each with its own local authorities.

Languages

The national language is Czech. Czechs are not really used to speaking foreign languages, though the number of English speaking citizens is increasing rapidly, especially with the younger generation growing up.

Currency

The national currency is the Czech crown. Although the Czech Republic is part of the European Union, the Euro is not widely accepted here. The Czech Republic has committed to adopt the Euro as a national currency, but the date is yet to be set.

Economic summary

GDP: €207 billion

Income per capita: €19,528

Inflation: 2.1%

The Czech Republic has experienced a significant economic growth in recent years. The aggregate supply started to reach its limits especially due to the labour market resulting in extremely low unemployment and increasing labour costs. The situation has also stimulated vast capital investments.

Main sectors of the economy

The country's location in the heart of Europe and its stable financial policy have turned the Czech Republic into a largely oriented import and export economy.

The Czech Republic plays an important role as a European transportation hub, thanks to its location in the centre of Europe. The country's most important industrial activities include the automotive industry, chemicals, foodstuff processing and the energy industry. Germany and the EU in general are the country's main trade partners.

EU country/ Non-EU and its impact on businesses and investors

The Czech Republic is a member state of the European Union. It is an attractive base for doing business and for investment. Its open and international outlook, well-educated work force and strategic location and competitive infrastructure are contributors.

The attractive fiscal climate and technological infrastructure create favourable propositions for international business. The Czech Republic is one of the most successful countries in central and Eastern Europe with regards to attracting foreign direct investment. This makes it a good place for overseas firms when expanding in Central and Eastern Europe.

Setting up a business

According to Czech law, a foreign individual or company may operate in the Czech Republic through an incorporated or unincorporated entity or branch. Czech corporate law provides a flexible and liberal framework for the organization of subsidiaries or branches. There are no special restrictions for a foreign entrepreneur to do business in the Czech Republic.

Business operations can be set up in the Czech Republic with or without a legal personality. If a legal entity has legal personality, the entrepreneur cannot be held liable for more than the sum that was contributed to the company's capital.

Legal types of business entities

The most common form of entrepreneurship is the *Limited-liability company (s.r.o.)*, where the partners have limited liability to the extent of their unpaid contribution. The minimum registered capital is less than €1. The statutory body of the entity is the registered director or more directors, who can be same as the partners, but in principle it can be anybody.

Another possible form of entrepreneurship is a *Joint-Stock Company (a.s.)*, with the minimum registered capital of €80,000 (CZK 2,000,000). The shareholders are not personally liable for the company's obligations. There is a two-tier board system with a board of directors and a supervisory board. The board of directors is an executive body, which makes key decisions and represents the entity. The supervisory board is a non-

executive body performing a monitoring role.

Another option is an *Unlimited Partnership (v.o.s.)*, where both of a minimum of 2 founders/partners are liable with no limit, all partners are managers as a default rule.

Contrary to the previous option, it is possible to also use the form of *Limited Partnership*, where one partner is the general (unlimited) one, and at least one other partner is a special (limited) one (k.s.).

It is also possible to set up a branch in the Czech Republic. A branch is not a Czech legal entity, but a commercial representation of its foreign parent company. Many foreign companies make use of a subsidiary rather than a branch. The main legal reason to set up a subsidiary (in the possible legal forms mentioned above), instead of a branch, is a limitation of liability. As a shareholder of a subsidiary, the foreign company's liability is basically limited to the extent of its capital contribution; whereas, if the foreign company makes use of a branch, it is fully responsible for all the obligations and liabilities of the branch. Further, there is a difference in accounting and tax matters related to branches or subsidiaries, which is also necessary to take into account.

Except of the above four basic types of business legal entities, there are other legal entities defined by the law, that serve specific purposes. Based on the law the business corporations also include cooperatives, typically established for housing, social or agricultural purposes.

The last group of legal entities are non-governmental organizations (NGOs) that are established primarily for other than profit purposes. These include charities, foundations, civil cooperations, syndicates etc. There are many legal types of these entities that correspond to the organization purpose. Due to tax relieves connected to these entities in relation with defined purposes it is very popular to use them for sport or culture or educational activities.

Process of how to set up a business

A Czech legal entity can only be incorporated by a notarial deed. A branch is incorporated by registration with the commercial register.

Financial year of taxes and financial accounts

The financial year is by default equal to the calendar year. However, legal entities may choose for a different financial year if they wish. All the legal forms of entrepreneurship are subject to corporate income tax. The branch is taxed with corporate income tax as well (the branch represents a permanent establishment from the tax point of view), so the foreign entity is liable to pay the income tax related to the branch activities in the Czech Republic.

Accounting and auditing

A statutory audit is required when:

- in case of a.s. 1 out of the following 3 criteria, or
 - in case of s.r.o. and other entities 2 out of the following 3 criteria
- for the past and the current financial year are met:

1. Annual turnover > **approx. €3.2 mil. (CZK 80 mil.);**
2. Total assets > **approx. €1.6 mil. (CZK 40 mil.);**
3. Number of employees > **50**

There are special rules for consolidated financial statements. It is necessary to prepare and audit the consolidated financial statements when 2 out of the following 3 criteria for the current financial year are met:

1. Annual turnover > **approx. €8 mil. (CZK 200 mil.);**
2. Total assets > **approx. €4 mil. (CZK 100 mil.);**
3. Number of employees > **50**

Economic and fiscal incentives

The Czech government offers a number of incentive schemes in various sectors to support companies in their business operations. Foreign entrepreneurs who set up companies in the Czech Republic and who register their companies with the Czech Business register can also apply for a number of incentive schemes.

The Czech Investment Incentives Act is one of the national programmes of State Aid approved by the European Commission. Under this programme, any State Aid that is granted is automatically regarded as compatible State Aid, thus bypassing the need for an individual review by the EC.

Incentives foreign investors/ local investors

Under the European EFRD (European Fund for Regional Development) programme for 2014-2020, different regions in the Czech Republic are conducting their own incentive policy. Within this programme the focus will be on subsidizing projects on innovation and research, digital agenda, SME support and low-carbon economy.

Taxation

The tax system in any given country is invariably an extremely important criterion when it comes to companies finding a country of incorporation. The current tax system in the Czech Republic was established in 1993, but has undergone a continuous harmonization process with the EU legislation.

In addition, the Czech Republic has also signed tax treaties with many other countries from both in- and outside the EU to prevent the occurrence of double taxation. These double taxation treaties are based mainly on the OECD Model Tax Convention. This vast network of tax treaties offers instruments for international tax planning.

The Czech tax system can be divided into direct taxes based on income, property and transfers, indirect taxes such as VAT, excise tax, customs duties or ecological taxes and other taxes as municipality fees and contributions to the social and health security system.

VAT

The general VAT rate is 21%. There is also the 1st reduced VAT rate, which is 15% and applies mainly to foods and non-alcoholic beverages, some medical equipment and care or shows and amusement parks. The 2nd reduced VAT rate is 10 % and applies to baby foods,

newspapers and periodicals, some books and some pharmaceutical products.

Personal income tax

The personal income tax rate is 15%. This rate is applied to both employees and entrepreneurs.

The personal income tax rate of 15% is applied to a tax base, which is calculated as 134% from the gross salary (34% is the insurance paid by the employer). The effective tax rate applied to the gross salary therefore equals 20.1%. If an individual's yearly income from employment is higher than 48 x of the average monthly salary, there is an additional solidarity tax rate of 7%.

Corporate income tax

The corporate income tax rate is 19%. There are many adjustments to profit or loss that business entities are obliged to make to calculate the tax base. Investment funds fulfilling set conditions have a special tax rate of 5%.

Registration procedures

Private persons and companies are registered with the tax authorities and are given a fiscal registration numbers. Communication with the tax authorities by way of tax returns and tax assessments is largely done in an electronic way.

Participation exemption

Participation exemption or substantial holding exemption is one of the main pillars of corporate income tax. The scheme was introduced to prevent double taxation. Profit distribution between group companies is exempted from tax.

A participation refers to a situation where a company (the parent company) is for at least 12 months the owner of at least 10% of the nominal paid-in capital of a company that is based either in the Czech Republic or within EU (the subsidiary). At the same time both the parent company and the subsidiary have to have a legal form listed in the EU law or listed in the Czech income tax law.

Wage tax

The basis and rates of a wage tax are described in the above part related to Personal Income Tax. The wage tax is a withholding tax and as such it is an advance payment that has to be settled at the end of the year.

Withholding taxes

Companies operating in the Czech Republic are required to withhold tax on payments of dividends, interest and royalties with the rate of 15% or 35% depending on many conditions. If however the tax treaty between the Czech Republic and company's residential country exists, the regulation of the tax treaty applies.

HR/ Labour Law

Employment law

In general, the Czech Labour code is set for legal protection of employee' status, safe working conditions and equal treatment of employees. The employer-employee relationship can be set up by a regular employment contract for a definite or indefinite period of time. It is not very easy to terminate a continuous employment contract. There is always a 2 months' notice period plus in most cases a compensation of 1 to 3 monthly salaries. Outside of a common employment contract it is possible to use an 'Agreement to complete a job' or an 'Agreement to perform work'.

Regular aspects of common employment contracts are a three month probationary period and four weeks' paid leave in accordance with the labor code. Many employers also provide various other benefits, incl. meal vouchers or pension insurance contributions.

Social security

Participation in a social and health security program is obligatory. The employer is obliged to pay contributions for each of his employees. The social security contribution of the employer is 25% of employee's gross earnings, health security contribution of the employer is 9 % of employee's gross earnings. The total cost the employer

has to pay for an employee is equal to 134% of the employee's gross salary.

The employee's contribution to social security is 6.5% of gross earnings and the health security contribution is 4.5%. In total the employee pays 11% of the gross salary to the Czech insurance system.

The employer is also obliged to pay a so called responsibility insurance that covers potential injuries caused at work. Rates differ depending on the sector of business from 0.28% to 5.04% of the gross income.

Pension

The Pension insurance fund is covered by the social security payments. If an employee pays the contributions to the social security for a long enough time, the employee is entitled to be the part of the pension programme and will receive the pension payments.

The age the pension starts varies depending on the future mortality rates. Currently it is set to 65 years, but the age will be increasing with respect to projected demographical structure.

As this state insurance system is pretty insecure for the future, many people take out an additional pension insurance. Many employers support this and offer pension insurance contributions as one of the employment benefits.

Payroll

When starting a business and employing staff, the company must register with the tax authority, social insurance authority, health insurance authorities (different employees may be insured at different health insurance authorities) and the responsibility insurance authority. The process of registration takes several weeks. However, staff can be employed even if the registration is not complete.

Wage tax and social and health security is paid monthly, the responsibility insurance is paid quarterly. In the monthly payroll the employer is obliged to include all tax discounts or relieves

that the employee is entitled to and asks for these via a personal tax declaration signed for the specific year.

At the end of the year under some conditions (mainly when having income from other sources) the employee is obliged to prepare and submit his/her personal income tax return. In this case the employer issues the confirmation of gross income, insurance and income tax paid through the year. In other cases the employer is obliged to settle the yearly employee income tax calculating the employee yearly tax obligation and compensating this with the tax paid through the year.

Visa and work permits

All EU inhabitants can work freely anywhere in the EU without a special working permit or visa. If an EU national from outside the Czech Republic is employed in Czech Republic, he/she usually becomes a Czech tax resident and thus pays the taxes.

People from outside the EU must apply for a work permit before taking employment in the Czech Republic.

Contact us

The information provided in this guide cannot be exhaustive and we recommend anyone considering doing business in the Czech Republic should seek professional advice from our member firms before making any business or investment decision***.

Contact our member firms in the Czech Republic to discuss your requirements:

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