



**CZECH  
REPUBLIC**

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Although the Czech legal system in terms of continental law overlaps with the German regulations, in connection with the assessment of company forms under corporate law basic problems frequently occur as described in the following.

German clients are used to the fact that representation of the company in addition to representation by the managing director can also take place jointly with a managing director and an authorised representative with power of attorney. At the present time, this type of representation regulation is not possible in the Czech Republic due to the fact that according to Czech law this power to act under company law is based on differing legal grounds (action due to original duty is with the managing director – power of attorney for the authorised representative).

In connection with a Czech GmbH this can lead to problems if for the existing dual control principle a second managing director is not to be appointed, whereby on the other hand this is a problem for GmbH & Co. KG solutions if the German Komplementär-GmbH has this representation regulation due to the fact that in this case the German authorised representative also has to be registered in the Czech commercial register.

In the course of examining existing company law structures, time and time again we see cases where either a German GmbH with only one shareholder holds or wants to acquire 100 % of the company shares of a Czech GmbH (společnost s ručením omezeným) or this construction already exists in the Czech Republic (the German company holds 100 % of the Czech GmbH which in turn should take over a further Czech GmbH). In spite of a violation of the prohibition of a two-layer structure for a sole trader GmbH, these cases are often registered in the commercial register, whereby the contracts to transfer the company shares, however, are essentially invalid. The company has been illegally founded and can be declared invalid by a court order. It is difficult to retrospectively find a solution to such a problem.

In addition, German clients assume that the parties retain the right to choose the legal form at will. According to Czech law, however, foreign law can only be chosen if there is a foreign element (e.g. a foreign partner, service performed abroad). The Czech subsidiary of a German company is a subject of Czech law and does not constitute a foreign element. Apart from that, the Czech company is obliged to maintain its financial accounting according to the law no. 563/19 and the 23 Czech financial accounting standards. In this respect, the legal form of an annual financial statement according to Czech law has a different form and structure compared to the form as known in Germany. For this reason, in addition to the local financial accounting, regular “adjustments” between the local financial accounting and the German or international regulations are often required. In addition to the foreign structure of the annual

financial statement there are also differences with regard to the content of the individual financial accounting ledgers and the currency (euros/Czech crowns).

In contrast to German tax law, according to the Czech legal regulations there is an obligation to prepare documentation of the transfer prices used. There is, however, a document from the finance ministry which recommends the documentation of transfer prices. If a company audit is undertaken by the tax authorities, the tax office will require the documentation of the transfer prices in the form which is recommended in the document from the ministry.

In 2012, in order to avoid sales tax evasion, liability for tax was introduced. In individual cases, the customer is now liable for sales tax if he pays the supplier the remuneration for performed deliveries or services into a foreign bank account or a bank account which is not made known to the Czech tax office or which was not published on the website of the Czech tax office. In order to avoid sales tax evasion, the financial authorities have drawn up a blacklist of unreliable entrepreneurs. In fact customers are also liable for sales tax from companies which are not included on the blacklist. These legal requirements seriously increase administrative costs for the entrepreneur.

According to the Czech tax code, the tax office can invoke different penalties. These penalties include penalties for late submission which are charged if the submission of the tax return is late or is not made, or penalties for delay which are charged if the payment of tax is delayed. The tax offices are obliged to determine incidental tax expenses. They are, however, not entitled even partly to dispense with these. Furthermore, the statutory disclosure requirement must be observed. If the annual financial statement is not disclosed, there is the threat of penalties from the registry court and from the tax office. The penalty payments for delay are determined according to the tax liability. The administrative fines for non-disclosure of the annual financial statement are determined according to the balance sheet total and for medium-sized companies may amount to several thousand euros.

# Practical examples

## Business Process Outsourcing

### Background facts:

A German parent company founds a subsidiary in the Czech Republic. As the German parent company, however, has already a number of terrible stories about Czech managing directors, under no circumstances does it wish to appoint such a managing director. The company prefers to take two of its own people from Germany and Austria in order to jointly take over the company management of the Czech subsidiary. Both managing directors are only authorised to manage the company together, but continue to reside in their own countries and in fact are never present in the Czech Republic. In addition to the tedious act of obtaining two signatures for important business decisions there are also communication problems and this results in lengthy negotiations, incorrect decisions and costs for courier services, etc.

### What can be done now?

In this case Rödl & Partner can only recommend a change to the situation as soon as possible and to only appoint a single managing director who is authorised to sign by himself and at the same time has his permanent residence in Czech Republic. This will simplify and accelerate decisions, lessen communication problems and therefore remove unnecessary costs.

### What should one have done differently from the beginning?

The German parent company should have recognised from the beginning that it is necessary to have a local managing director who is responsible for the operative business and will manage daily problems.

## Business Process Outsourcing

### Background facts:

In the Czech Republic electronic mail boxes are a popular method to transfer documents. These mail boxes are quick, secure and also easy to use because they are maintained in the Czech language. Yet it is precisely this which often represents an insurmountable problem for the German managing director of a Czech subsidiary because he just as many of his other German managing director friends speaks almost no Czech. As such an electronic mail box cannot really be so important, the German managing director simply neglects to observe the mail box until one day the company receives an official demand for payment in connection with the electronic mail box.

### What can be done now?

The legal department of Rödl & Partner quickly finds the reason for the official demand for payments. It concerns the non-compliance of a deadline for statutory obligation which was communicated to the company via the electronic mail box. In order to ensure that this situation does not repeat, Rödl & Partner now regularly checks the electronic mail box for the company. This ensures that in future a statutory deadline is not missed which could lead to a fine.

### What should one have done differently from the beginning?

Already with the legal founding of the company it should be clarified who is assigned to regularly check the electronic mail box.

## Taxes

### Background facts:

Mr. Michel, German joint owner of Kunst GmbH is happy about the quantity of works of art which one can purchase in the Czech Republic. "Great", he says and as a result follows his business instinct and decides to found a company in the Czech Republic which will take care of the purchasing of works of art from Czech artists. He therefore founds the company Umění s.r.o. The works of art purchased in the Czech Republic are then resold to German Kunst GmbH. Mr. Michel registers the Kunst GmbH in the Czech Republic as a taxpayer subject to sales tax. The business runs well and Mr. Michel is very satisfied that the Kunst GmbH can offer its German customers such a wide range of works.

After some time, however, he learns from a customer that his competitors offer works of art at lower prices. "How can that be possible?", he asks himself. In fact he starts to consider that the problem could have something to do with the sales tax and accordingly contacts the tax experts of Rödl & Partner.

### What can be done now?

The tax consultants of Rödl & Partner examine the transactions together with Mr. Michel and after a detailed analysis an important fact is determined, namely that in the Czech Republic the company Umění s.r.o. purchases exclusively from private persons who are not an entrepreneur in the sense of sales tax and therefore need not pay sales tax. The sale of works of art by the Kunst GmbH is also made exclusively to such private persons. Due to these conditions, the tax consultants of Rödl & Partner conclude that it would clearly be more favourable for Mr. Michel to use an existing sales tax special regulation.

### What should one have done differently from the beginning?

With the benefit of hindsight, Mr. Michel understands that the conventional sales tax regulation which he knew formerly is disadvantageous. The use of the special regulation allows him the possibility of not having to burden the total price for the works of art to be sold with German sales tax. Instead, only the price mark-up is subject to sales tax. This knowledge enabled Mr. Michel to lower prices to the satisfaction of his customers and thereby to become competitive again.

## Law

### Background facts:

Not a rare occurrence. The client X GmbH decides to reduce costs. For this purpose, the company would like to transfer a production line to one of its subsidiary companies, the Y s.r.o.. According to extensive pre-planning, on the advice of the legal department the shareholders now want to conclude a purchase contract. The legal department then makes this contract available to Rödl & Partner for a final check one week before the transfer of the production line. Here, however, a problem is encountered. Rödl & Partner determines that the share capital of Y s.r.o. only corresponds to the legal minimum of 200,000 CZK (approx. 7,700 euros). After it turns out that the purchase price of the production line amounts to 2,000,000 euros, Rödl & Partner points out that according to compelling regulations of Czech law the acquisition of assets to the value of more than 10 % of the registered capital requires the preparation of an evaluation report through a judicially appointed expert and the purchase price must correspond to the value in the expert evaluation.

### What can be done now?

On the basis of power of attorney, Rödl & Partner immediately appoints an expert assessor. The expert discusses the planned purchase price and further factors with the client and carries out a tour of the production line. Within a few days a value evaluation can be prepared which confirms the purchase price.

### What should one have done differently from the beginning?

The transfer of assets between associated companies represents circumstances with regard to normal trading relationships and also with regard to a one-off transfer which are subject to the special attention of the Czech authorities. Therefore clients should engage Rödl & Partner at an early stage as their competent advisor for the arrangements of the respective transfer in order to avoid tax problems in connection with transfer prices and competently and efficiently solve questions with regard to the legally secure implementation of the transfer.

## Law

### Background facts:

The ABC company has no operations in the Czech Republic either with an independent company or through a so-called organisational unit. It only delivers goods from Germany to a single customer in the Czech Republic, whereby in addition this is often made without a proper purchase contract, but just on the basis of an order. Sometimes it occurs that the Czech customer does not settle his invoice. Then Rödl & Partner comes into play to advise the German ABC company as the creditor.

Sometimes a reminder from a lawyer helps, but not always. Now the client wishes to take legal action to assert a larger claim. And this is usually the beginning of a long and frustrating process which is described in the following.

Everything has to be translated by a state-certified translator and some documents even have to be confirmed by an apostille under the Hague convention. There are no delivery notes which confirm acceptance of the goods. Legal proceedings are initiated before court. The court fee (4% of the value in dispute) must be immediately paid by the client. The proceedings have only just started and already so many costs have been incurred. This is justifiably disappointing.

And nothing happens for quite a long time – the Czech courts in fact work very slowly. If mention is made of this before court, the answer is: "There are still 300 cases in front of you." This represents a further disappointment.

After two years the day finally arrives. There is actually going to be an oral hearing. The defendant excuses himself due to illness which leads to a further adjournment. For the new court hearing the judge requires further documentation (translated into Czech naturally) and in addition the named German witnesses should be present. But unfortunately these persons no longer work for the ABC company. That results in further costs, the passing of more time and a further disappointment.

The next surprise comes without delay. The contract is determined by German law, whereby the judge discovers this after two years. As a result an opinion on German law is required and specifically from the ministry of justice which also leads to months of delays and so the frustrating situation grinds on.

### What can be done now?

Due to the fact that in this case all available financial means have been used up, it is no longer possible to do something about the situation. It is therefore even more important to allow for suitable regulations before the business transaction is concluded and to obtain expert advice.

### What should one have done differently from the beginning?

Prior to concluding the respective business, German companies should take legal advice. This allows changes to be made to the contract with the addition of arbitration clauses, applicable law and clarification of responsibilities which is important because after the delivery is made it is often too late. If something does go wrong, legal proceedings should be seen as the last resort and are to be considered together with the client taking into account the costs and benefits of such a time and cost-intensive procedure.