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Real Estate

Czech Republic

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CZECH REPUBLIC

Law and Practice

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CONTENTS

1. General	p.4	4. Planning and Zoning	p.9
1.1 Main Sources of Law	p.4	4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning	p.9
1.2 Main Market Trends and Deals	p.4	4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction	p.10
1.3 Impact of Disruptive Technologies	p.4	4.3 Regulatory Authorities	p.10
1.4 Proposals for Reform	p.4	4.4 Obtaining Entitlements to Develop a New Project	p.10
2. Sale and Purchase	p.5	4.5 Right of Appeal Against an Authority's Decision	p.11
2.1 Categories of Property Rights	p.5	4.6 Agreements with Local or Governmental Authorities	p.11
2.2 Laws Applicable to Transfer of Title	p.5	4.7 Enforcement of Restrictions on Development and Designated Use	p.11
2.3 Effecting Lawful and Proper Transfer of Title	p.5	5. Investment Vehicles	p.11
2.4 Real Estate Due Diligence	p.5	5.1 Types of Entities Available to Investors to Hold Real Estate Assets	p.11
2.5 Typical Representations and Warranties	p.6	5.2 Main Features of the Constitution of Each Type of Entity	p.12
2.6 Important Areas of Law for Investors	p.6	5.3 Minimum Capital Requirement	p.12
2.7 Soil Pollution or Environmental Contamination	p.6	5.4 Applicable Governance Requirements	p.12
2.8 Permitted Uses of Real Estate under Zoning or Planning Law	p.6	5.5 Annual Entity Maintenance and Accounting Compliance	p.13
2.9 Condemnation, Expropriation or Compulsory Purchase	p.7	6. Commercial Leases	p.14
2.10 Taxes Applicable to a Transaction	p.7	6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time	p.14
2.11 Legal Restrictions on Foreign Investors	p.7	6.2 Types of Commercial Leases	p.14
3. Real Estate Finance	p.7	6.3 Regulation of Rents or Lease Terms	p.14
3.1 Financing Acquisitions of Commercial Real Estate	p.7	6.4 Typical Terms of a Lease	p.15
3.2 Typical Security Created by Commercial Investors	p.7	6.5 Rent Variation	p.16
3.3 Restrictions on Granting Security over Real Estate to Foreign Lenders	p.8	6.6 Determination of New Rent	p.16
3.4 Taxes or Fees Relating to the Granting and Enforcement of Security	p.8	6.7 Payment of VAT	p.16
3.5 Legal Requirements Before an Entity Can Give Valid Security	p.8	6.8 Costs Payable by a Tenant at the Start of a Lease	p.16
3.6 Formalities When a Borrower Is in Default	p.8	6.9 Payment of Maintenance and Repair	p.16
3.7 Subordinating Existing Debt to Newly Created Debt	p.8	6.10 Payment of Utilities and Telecommunications	p.16
3.8 Lenders' Liability under Environmental Laws	p.9	6.11 Insuring the Real Estate That Is Subject to the Lease	p.17
3.9 Effects of a Borrower Becoming Insolvent	p.9		
3.10 Consequences of LIBOR Index Expiry	p.9		

CZECH REPUBLIC CONTENTS

6.12	Restrictions on the Use of Real Estate	p.17	7.4	Management of Schedule-Related Risk	p.19
6.13	Tenant's Ability to Alter and Improve Real Estate	p.17	7.5	Additional Forms of Security to Guarantee a Contractor's Performance	p.20
6.14	Specific Regulations	p.17	7.6	Liens or Encumbrances in the Event of Non-payment	p.20
6.15	Effect of the Tenant's Insolvency	p.17	7.7	Requirements Before Use or Inhabitation	p.20
6.16	Forms of Security to Protect against a Failure of the Tenant to Meet Its Obligations	p.18	8. Tax		p.20
6.17	Right to Occupy after Termination or Expiry of a Lease	p.18	8.1	VAT	p.20
6.18	Right to Assign a Leasehold Interest	p.18	8.2	Mitigation of Tax Liability	p.21
6.19	Right to Terminate a Lease	p.18	8.3	Municipal Taxes	p.21
6.20	Registration Requirements	p.18	8.4	Income Tax Withholding for Foreign Investors	p.21
6.21	Forced Eviction	p.18	8.5	Tax Benefits	p.22
6.22	Termination by a Third Party	p.19			
7. Construction		p.19			
7.1	Common Structures Used to Price Construction Projects	p.19			
7.2	Assigning Responsibility for the Design and Construction of a Project	p.19			
7.3	Management of Construction Risk	p.19			

1. GENERAL

1.1 Main Sources of Law

Ownership of real property is recognised and protected under the Czech constitution in Section 11 of the Charter of Fundamental Rights and Freedoms. Title to real property and most other property rights and obligations are recorded in a public register, referred to in English as the Cadastral Register.

The Cadastral Register is administered by the Czech State and its records are legally determinative, except for very limited circumstances.

The Czech Civil Code (Act No 89/2012 Coll.) governs all matters related directly to real property, including fundamental provisions for conveyance contracts, rights related to liens and encroachments, condominium rights and obligations, commercial leases, and others.

There are strict laws that address matters of general public interest which can impact the use and development of real estate, including historical preservation and environmental conservation restrictions.

As in all jurisdictions, all existing and new buildings must comply with numerous administrative rules and regulations covering matters such as land use, construction design and methods, health and safety and others.

In addition to the above, municipalities can also impose rules and regulations regarding the use and development of real estate for reasons of public decorum and disturbance.

1.2 Main Market Trends and Deals

Despite the overall slowdown in investment activity on the Czech investment market resulting from the adverse effects of the coronavirus pandemic (eg, hotel transaction volume in

Prague dropped by 83%), there were still some notable transactions.

The Czech state authorities are continuing with the country's first public-private partnership (PPP) project, which consists in designing, financing and building a 32 km section of the D4 expressway, as well as related Operations and Maintenance (O&M). In December 2020, the preferred bidder, with a winning bid of CZK16.5 billion (approximately EUR600 million) was selected, and a final agreement should be signed in the first half of 2021.

The Australia-based Cromwell fund acquired a portfolio of 11 logistics and industrial parks in the Czech Republic and Slovakia from ARETE INVEST Group. These are mostly located in regions with further development possibilities.

Nevertheless, it is very unlikely that 2021 will see transactional activity return to the high levels of 2019.

Coronavirus pandemic-related restrictions imposed by the government on retailers have had a profound impact on shopping centre performance. Where the office market is concerned, an increased focus on the structure and size of office space, with increased interest in more flexible lease agreements, has been observed.

1.3 Impact of Disruptive Technologies

There is no information about any specific impact of disruptive technologies on the Czech Real Estate (RE) market.

1.4 Proposals for Reform

While the Czech Republic ranks in the top 35 of the world's most-developed countries, it is ranked 156th in "Dealing with construction permits" by the World Bank Group.

In order to address this longstanding problem, a new Construction Act is being prepared and discussed. However, the bill's first draft was not received with enthusiasm, and a significant number of comments and proposals to amend have been raised. The draft bill changes the entire structure of administrative bodies in charge of the construction and permitting processes and also introduces electronic files for all parties.

This new act is expected to be passed in 2021, with promulgation in 2022; however, if it is not passed by the end of summer 2021, it might be completely dismissed, as parliamentary elections will be held in October 2021.

In connection with the coronavirus pandemic, the Czech Parliament has passed a great number of specific new acts that address this unprecedented situation and alleviate the negative impact of the restrictive measures on business adopted by the Czech government.

2. SALE AND PURCHASE

2.1 Categories of Property Rights

Property (in rem) rights range from full ownership (title) to contractual usage rights (lease, encumbrance) which are, subject to certain restrictions, private contractual arrangements. Most forms of usage rights and encumbrances are recordable in the Cadastral Register (eg, mortgages, liens, etc), including rights of first purchase.

Records in the Cadastral Register are legally determinative, except for limited circumstances such as proven fraud.

2.2 Laws Applicable to Transfer of Title

The rules for a transfer of title are contained in the Civil Code. Procedural aspects of title and other record registration in the Cadastral Register are set forth in the Act on the Cadastral

Register (Act No 256/2013 Coll.). Additional obligations follow from specific laws if land parcels or buildings are purchased by or sold to municipalities or public authorities.

2.3 Effecting Lawful and Proper Transfer of Title

Transfers of real estate that is registered in the Cadastral Register must be recorded in the Cadastral Register in order to become effective. The transfer document (ie, a purchase agreement) must properly define and delineate the land parcels and buildings to the extent stated in the law. Non-compliance with this obligation may result in a defective transfer.

2.4 Real Estate Due Diligence

From 1 January 2015, the principle of "material publicity of entries in the Cadastral Register" (introduced under the current Civil Code) has applied, and therefore an excerpt from the Cadastral Register represents proof of ownership of real estate. As a result, each acquirer of real estate (or any right in rem to that property) who purchased it for consideration and in good faith can rely on the correctness of the relevant entry in the Cadastral Register and is protected against any third-party claims of ownership.

A proper real estate due diligence will include a ten-year historical review of the acquisition title chain. In addition to full title verification, the due diligence should include a review of encumbrances, construction compliance, environmental issues and all other aspects that are relevant to the nature of the property in question. While some local purchasers forego a proper due diligence and rely solely on the information set forth in the Cadastral Register, clients are advised to conduct a full independent review of all matters that may interfere with their future use of the property for its intended purpose.

In response to the measures taken to combat the coronavirus pandemic, the Czech government authorities adopted a number of subsidy programmes. As a result, when performing a due diligence in respect of share deals – which still dominate the RE sector – it is necessary to verify the target's compliance with the rules of any such subsidy.

2.5 Typical Representations and Warranties

Representation and warranties that are typically provided in a real estate transaction depend to a large extent on the business practices of the purchaser. Transactions involving international entities tend to include a broad range of representations and warranties that would be typical for prudent purchasers in developed jurisdictions. These include de minimis provisions, hold-backs, deferred payments, post-closing audits, etc.

Transactions involving local entities often rely on a prima facie acceptance of the Cadastral Register records and statutory provisions requiring good faith disclosure of all relevant facts related to the transaction at hand, which are generally interpreted to include a requirement for full disclosure of physical and legal defects. Most statutory provisions related to disclosure requirements and remedies can be modified by agreement and have a default time-limit of five years.

Remedies are based on either a contractual breach of representations and warranties or a breach of statutory liability for hidden or undisclosed legal and physical defects. In both cases (contractual and statutory reliance), care should be taken to ensure proper quantification of any related damages that may arise due to a breach of contract or law.

2.6 Important Areas of Law for Investors

This is not applicable in the Czech Republic.

2.7 Soil Pollution or Environmental Contamination

Czech law imposes primary responsibility for remediation of soil and other environmental contamination on the actual polluter. Moreover, the State is primarily responsible for all environmental contamination that occurred pre-1990 (ie, before the Velvet Revolution).

Accordingly, Czech authorities are entitled to issue orders for the remediation of polluted soil (or groundwater) only to the polluter.

However, Czech courts have ruled that in instances where environmental contamination is ongoing, the person with the closest relationship to the source of the contamination may be required to prevent any ongoing contamination. In most cases, this person is the landowner.

This type of liability is possible only if the source of the contamination still exists, the person in question knew about the contamination, and that person failed to take any remedial actions with respect to the contamination.

2.8 Permitted Uses of Real Estate under Zoning or Planning Law

Land zoning plans, including related restrictions and limitations on use and development, are publicly available. Potential purchasers must review applicable zoning plans to ensure compatibility with their development plans.

Development restrictions can arise from international, national and local requirements.

It is possible to enter into development agreements with local municipalities in order to facilitate approval of a project. However, these

agreements relate only to private law/commercial matters and cannot predetermine public law matters such as the approval of building permits, which must comply with construction norms in all cases.

2.9 Condemnation, Expropriation or Compulsory Purchase

The expropriation of real property is only permitted in exceptional circumstances and subject to fair compensation.

Despite repeated legislative changes, the expropriation process is very lengthy and as a result most expropriation cases are resolved through settlement with the landowner.

2.10 Taxes Applicable to a Transaction

Property transfer tax has been abolished in the Czech Republic with retroactive effect as from 1 December 2019.

Income Taxes

Profit received and receivable from a property sale is generally considered capital gains income for the purposes of income tax, for both natural persons and corporations, and will be taxed at the applicable rate (progressive rates of 15% or 23% for individuals, and a flat rate of 19% for corporations).

Natural persons are exempt from this tax on residential property if (i) title to the property was held for at least five years (ten years for property purchased as from 1 January 2021) or (ii) title to the property is held for at least two years and the proceeds are rolled back into a residential property.

No generally available exemptions from corporate income tax exist for transfers of real estate by corporations.

If the seller is a registered VAT payer, the transfer may be subject to VAT (see **8.1 VAT** for more detail).

2.11 Legal Restrictions on Foreign Investors

Except for cases where specific international sanctions have been imposed, there are no restrictions on foreign investors acquiring real estate in the Czech Republic.

3. REAL ESTATE FINANCE

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial real estate in the Czech Republic are typically financed by a combination of debt and equity.

Debt financing provided by local institutions generally requires that the purchaser provide at least 30% equity for a purchase.

Most debt financing for local real estate transaction is provided through secured bank loans, although bonds, and in some cases debentures, have also been used to secure financing for larger transactions.

3.2 Typical Security Created by Commercial Investors

In general, an investor looking for a bank loan will most likely need to provide a wide range of security, including in most cases, a mortgage and lien over all of the real and personal property of the investor, subordination of any shareholder loans, a pledge over cash and receivables, and other security such as promissory notes. In situations where the developer entity is under-capitalised, a parent-company guarantee or comfort letter may also be required.

In some cases, a Deed of Enforcement is also requested, which can simplify enforcement of a claim for the lender. A promissory note, if properly worded, can also simplify claim collection.

3.3 Restrictions on Granting Security over Real Estate to Foreign Lenders

No specific restrictions apply for granting security over real estate to a foreign entity, nor are there any specific restrictions on debt repayment to a foreign lender.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Cadastral registration fees are applicable to all recorded liens and pledges. These fees are minor and are not based on the value of the underlying security document.

Security that is created as a Deed will be subject to notarial fees, which are in most cases derived from the underlying value of the security document and can amount to several thousand euros.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Financial assistance restrictions are a complicated issue under Czech law and vary depending on the form of the entity in question. Transactions that could be considered financial assistance must be reviewed carefully and on a case-by-case basis.

In general, intra-group loans and debt guarantees are permitted if they are in the best interest of the company granting the loan or guarantee, and provided that the loan or guarantee is made for fair consideration (ie, for an arm's-length fee).

In all cases, proper corporate approvals must be obtained for any such transaction, consistent with the applicable provisions of the company's

Articles of Incorporation, and, if applicable, any valid and enforceable shareholder agreement.

3.6 Formalities When a Borrower Is in Default

Commercial contracts for large transactions of those involving sophisticated parties will set forth specific procedures covering instances of default, such as notification periods, default sanctions and other particulars that the parties may agree.

Enforcement of a claim is predicated on obtaining an Execution Order issued by a court or a recognised arbitration proceeding. A valid Deed of Enforcement also serves as an Execution Order and there are other legal means to simplify enforcement of security through proper wording and structuring of contracts.

An Execution Order is enforced by a certified and court-appointed executor, who will take the required legal steps to ensure the claim is monetarily satisfied. In most cases where real property was provided as collateral, the executor will sell the property at auction.

There is also the possibility of a private enforcement of a mortgage/pledge if explicitly agreed upon in the underlying mortgage/pledge agreement. Although certain requirements still have to be met in order to ensure fair treatment of the borrower, the lender is then allowed to arrange for a private sale of assets by the lender, or to keep the assets.

3.7 Subordinating Existing Debt to Newly Created Debt

Czech insolvency law recognises contractual subordination, provided that all of the relevant creditors and the debtor have agreed, which can include adjusting the order of any previously perfected security instruments. Czech law does not

recognise the concept of equitable subordination.

There are some instances of statutory subordination of receivables held by a company's shareholders; however, these apply only with respect to receivables that have arisen in connection with a shareholder's participation in the company, but this does not apply to shareholder loans. In almost all cases where shareholder loans have been provided to a company, creditors will require contractual subordination of the shareholder loans.

3.8 Lenders' Liability under Environmental Laws

In general, a lender holding or enforcing security over real estate cannot be liable under environmental laws.

However, court decisions tend to promote protection of the environment and, accordingly, it is not implausible that, in a situation of impending or ongoing environmental harm or calamity, an entity holding or possessing real estate solely for the purposes of collateral on a loan or by virtue of enforcement on a claim, and having knowledge of the situation, could be found liable by a court for not taking appropriate steps to forestall the harm or calamity.

3.9 Effects of a Borrower Becoming Insolvent

As in most jurisdictions, insolvency trustees have wide latitude in rejecting or challenging claims made in insolvency, including security interests.

Nonetheless, a properly granted and perfected security interest will survive the insolvency of the debtor and be settled in order of priority, which is based on the date of registration (unless adjusted by a subordination agreement) in the applicable register, which, in the case of real property, is the Cadastral Register.

Upon a declaration of insolvency, all claims against the debtor must be settled through the insolvency proceedings and no direct enforcement is possible.

Certain categories of claims have statutory priority in insolvency proceedings over secured interests.

3.10 Consequences of LIBOR Index Expiry

Most foreign currency loans in the Czech Republic are denominated in euros and a major disruption to the market due to the discontinuance of the LIBOR index is not anticipated.

Parties that have agreed on using the LIBOR index will need to rely on their contract for determining an alternative index and, if agreement is not reached, turn to their dispute resolution arrangements.

4. PLANNING AND ZONING

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Strategic planning occurs on a national, regional and local level and is governed by legislation that sets forth the method for creation of strategic plans and the socio-economic objectives that should be pursued through strategic planning.

National agencies, regional and local authorities co-ordinate strategic planning to the best of their ability. Approved strategic plans are incorporated into administrative rules and regulations, which are later reviewed and applied as part of zoning, permitting, occupancy, certification and other land-use proceedings.

Compliance with applicable rules and regulations is enforced by various government agencies.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Unfortunately, there is a myriad of legislation and regulation that applies to design, appearance and method of construction. In many instances, this is further complicated by applicable EU rules and regulations that must also be considered.

Inconsistency in terminology, interpretation and procedures in various localities and court circuits has resulted in the Czech Republic ranking 156th in construction-permit processing. The process requires preparation and persistence.

Each municipality (ie, a self-governing body) adopts its own zoning plan, which may impose additional requirements on the design, appearance and location of the construction (style of roof, maximum height for the construction, built-up limits, etc), whereas the zoning plan is interpreted by the local Building Authority (ie, a state administration).

4.3 Regulatory Authorities

Territorial and municipal agencies deal with the regulation of real estate development. National agencies may be engaged directly on larger projects that require special permitting, such as those that involve mining or certain infrastructure.

A local “Building Office” deals with all matters related to zoning and construction permits but co-ordinates with up to 35 other agencies, depending on the nature of the project at hand. The Building Office must ensure that conditions required by other agencies are incorporated in any permit and subsequently satisfied.

The new Construction Act is expected to change this burdensome and inefficient system and should restructure the organisation of the Building Offices, as well as how other agencies are involved in the permitting process.

Decisions of the Building Office can be reviewed by a higher administrative body and, ultimately, the courts.

Restrictions on construction and use are set forth and governed by national legislation, zoning and construction rules and regulation, including applicable EU rules and regulations, restricted “special” use designations, including UNESCO designations, and are subject to private property rights of neighbours and other “affected parties”.

4.4 Obtaining Entitlements to Develop a New Project

There are generally three stages of a new project or major refurbishment, and each needs a separate permit: planning, construction and use. Smaller projects may not require a planning or a construction or use permit, and larger projects may require additional permits. The permits are issued in the form of a decision following standard administrative proceedings or as a consent or acknowledgement after a simplified procedure. In addition, the planning or construction permit may be replaced by a public contract concluded with the Building Office. In all these procedures, third parties whose interests might be affected by the contemplated construction are involved.

A planning permit deals with urbanistic/zoning issues such as use, design, impact on traffic, pedestrians, environment, etc. Third parties that are affected by the project will usually have standing in the proceedings and may raise objections that must be considered by the Building Office as part of the permitting process. It should be

noted in this respect that private environmental associations have recently been excluded from participating in procedures other than those for bigger projects that require an environmental impact assessment.

A construction permit deals with design details and construction methods and will be issued within the parameters set by the planning permit. Close neighbours will usually have standing in the proceedings and may raise objections that must be considered by the Building Office as part of the permitting process.

A use permit is required for the occupancy and use of a construction that was subject to a construction permit. A use permit can be granted conditionally or temporarily and may include certain restrictions.

4.5 Right of Appeal Against an Authority's Decision

Decisions can be appealed to higher administrative bodies within the same agency or ministry with suspensory effect and, in limited circumstances, for judicial review to the courts. Appeals cannot be filed against consents or acknowledgements issued in a simplified procedure.

4.6 Agreements with Local or Governmental Authorities

Larger development projects will require an agreement with local municipalities and utility suppliers and, in many cases, permitting is not possible if appropriate technical solutions are unavailable. Arrangements vary by municipality, but developers are often asked to include public space in their projects. Utilities' suppliers base their contracts on commercial considerations.

4.7 Enforcement of Restrictions on Development and Designated Use

The Building Office monitors compliance on most construction-related matters, although

other authorities may also be involved, such as the Hygiene Office, Fire Marshal, etc.

Authorities have a broad range of remedial measures that they can apply to ensure enforcement of applicable rules and regulation and restrictions arising for applicable permit criteria. These range from fines to remedial construction/removal orders. Developers are liable for any costs that a State or local authority incurs in executing a remedial measure.

5. INVESTMENT VEHICLES

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

There are no specific restrictions with respect to real estate holding entities and, as a result, all types of Czech or foreign entities are available to investors. At the same time, there are no special real estate holding companies recognised under Czech law (except for condominiums).

Thanks to its simplicity and variability, the limited liability company known in Czech as *společnost s ručením omezeným* is the most commonly used entity, not only for business purposes, but also for property companies.

A Czech joint-stock company, known in Czech as *akciová společnost*, is also often used as a holding entity.

Investment funds are also fully recognised in the Czech Republic and the relevant EU directives have been implemented (such as Undertakings for Collective Investment in Transferable Securities (UCITS) directives, or the Alternative Investment Fund Managers Directive (AIFMD), which relates to the harmonisation of rules for alternative investment vehicles, such as hedge funds and private equity funds throughout the EU). Czech law typically recognises open and

closed mutual funds and investment funds; qualified investor funds are also a popular form. In addition, Czech legislation has also introduced alternative legal forms, such as a SICAV (a joint-stock company with variable share capital), into Czech law.

5.2 Main Features of the Constitution of Each Type of Entity

Limited Liability Company

The main features of a limited liability company are a very low minimum registered capital requirement, limited liability of its shareholders for the company's obligations, substantial flexibility as regards its organisation, and the possibility to be established by a sole shareholder.

Joint-Stock Company

A joint-stock company is the most widely used form for the operation of businesses involving larger investments. The company is fully responsible for its obligations towards third parties, and the founders can choose whether to have the company with a monistic (managing board) or dualistic (board of directors and supervisory board) corporate structure. As opposed to a limited liability company, where all the shareholders are public and their identity easily accessible online, shareholders of a joint-stock company can benefit from some anonymity.

Investment Funds

The offering of fund units is governed by the Act on Management Companies and Investment Funds, and the rules for offerings are quite complex. The Act clearly states that a reverse solicitation is not an offer and does not fall within the rules for offerings as set out in the Act.

5.3 Minimum Capital Requirement

Limited Liability Company

A limited liability company can have a symbolic registered capital as low as one Czech Crown.

Joint-Stock Company

The minimum registered capital of a joint-stock company is CZK2 million (approximately EUR80,000).

Investment Funds

The minimum initial capital of an investment fund is set at EUR300,000; the fund's equity must then reach certain thresholds, as set out in the Act on Management Companies and Investment Funds, following authorisation by the Czech National Bank (usually EUR1.25 million within six months).

5.4 Applicable Governance Requirements

Limited Liability Company

The general meeting of shareholders is the supreme corporate body of a limited liability company. The statutory scope of matters which fall within the powers of the general meeting can be increased (but not decreased) in the foundation deed or memorandum of association. The general meeting may also reserve or attract the right to decide upon other matters which otherwise fall under the competence of other corporate bodies. The general meeting must be held at least once in an accounting period.

The statutory body of a limited liability company, generally empowered to act on behalf of the company in all matters, is one or more managing directors. Each managing director is authorised to act on behalf of the company individually unless the foundation deed/memorandum of association stipulates otherwise.

Managing directors are responsible for the overall business management of the company (organisation and management of the company's business affairs, strategic decisions, day-to-day operations, etc).

A limited liability company has the option to form a supervisory board, the main competences and responsibilities of which are supervision of the activities of the managing director(s), revision of the company's accounts and financial statements, and informing the general meeting of its findings at least once per year.

Joint-Stock Company

The rules for the general meeting of shareholders are similar to those of a limited liability company, except for the impossibility to reserve or attract the right to decide upon matters not entrusted to it by law or by articles of association.

The statutory body of a joint-stock company with a default dualistic structure is the board of directors, which has three directors (unless the articles of association state otherwise). Each director may act on behalf of the company individually, unless provided otherwise in the articles of association. No one is entitled to give instructions to the board of directors regarding the management of the company. Directors are elected and recalled by the general meeting, unless the articles of association provide that the directors are elected and recalled by the supervisory board. The board of directors is responsible for the management of the company and its business and is supervised by a supervisory board.

The statutory body of a joint-stock company with a simplified monistic structure is the managing board. The managing board has three members (unless the articles of association provide otherwise), and its powers include any matters relating to the company unless they are entrusted by law to the competence of the general meeting.

Investment Funds

As with any other collective investment schemes, the fund needs a licence from the Czech National Bank (CNB). The CNB also approves the fund's

managers (members of the board of directors) and the fund's statute. A management company or an investment fund must observe the rules of prudent conduct and must work out the rules for internal business operations and a business plan.

On 1 June 2021 the new rules on registration of the ultimate beneficial owner (UBO) enter into effect. As a result, every natural person who can obtain, either directly or indirectly, at least a 25% share of earnings, or who has a significant share of the voting rights or controls or otherwise exercises a decisive influence on the company, will have to be registered as a UBO. It should be noted in this respect that important data (including the UBO's identity) will become public.

5.5 Annual Entity Maintenance and Accounting Compliance

Limited Liability Company and Joint-Stock Company

Both a limited liability company and a joint-stock company are obliged to keep accounts from the day of incorporation. The accounting period is generally one calendar year, but the company can change its accounting period to a fiscal year that is different from the calendar year. The companies are obliged to prepare financial statements for every accounting period, and these must be approved by the general meeting and then filed to the Commercial Register (where they are made available to the public).

Both a limited liability company and a joint-stock company are obliged to have their financial statements audited only if at least two of the following conditions are fulfilled:

- the total book value of the company's assets is more than CZK40 million;
- the company's yearly turnover exceeds CZK80 million; and

- the average number of company employees in the given accounting period was more than 50.

Investment Funds

Ongoing costs (including accounting costs) vary greatly, depending on the type of fund (the lowest being a qualified investors' fund), the type of administration/maintenance, and the third parties involved in the running of the fund (a depositor, fund administrator or an expert committee valuating the real estate).

6. COMMERCIAL LEASES

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

Czech law recognises the following arrangements allowing for the use of real estate for a limited period of time: lease, usufructuary lease, property loan, easement and right to build.

Lease and Usufructuary Lease

The most common means to occupy and use real estate for a limited period of time is a lease or a usufructuary lease. The difference between these two is that a lease allows the tenant to use the real estate, whereas a usufructuary lease also gives him or her the right to take its production and revenues. A usufructuary lease is typical for the lease of farming land.; however, it is also used for the lease of a restaurant or hotel. Although the statutory regulation of commercial leases offers freedom of negotiation to both parties, the regulation of dwelling leases is rather strict.

Property Loan

Although possible, a property loan is rarely used, as it is a gratuitous contract under which the borrower uses the subject of the loan free of charge.

Easement

An easement is another way to allow a third party to occupy and use real estate. It may be granted for a definite or indefinite period of time and in favour of a certain person or every owner of certain property. Typically, easements are used to secure access to the property via real estate owned by a different person. However, an easement can also grant another person the right to occupy and/or derive profit from the real estate. Easements created by contract require registration in the Cadastral Register to be effective.

Right to Build

A "right to build" is also a way for a person to use real estate. If granted, the builder is entitled to build or use a structure on land belonging to another person. The structure does not become part of the land (as would otherwise happen under the principle of *superficies solo credit*) until the right to build expires. The right to build can only be granted for a maximum of 99 years. With respect to the structure, the builder has the same rights as the owner; with respect to the land encumbered with a right to build, the builder has the same rights as under a usufructuary lease, unless stipulated otherwise. A right to build also requires registration in the Cadastral Register to be effective.

6.2 Types of Commercial Leases

Czech law knows only one type of lease. Leases are governed by the Civil Code, which includes general provisions on leases, as well as special provisions applicable to specific uses, such as for business premises, residential premises, etc.

6.3 Regulation of Rents or Lease Terms

Although the Civil Code regulates leases, the provisions applicable to commercial leases are mainly non-mandatory and contractual parties can freely deviate from the statutory provisions.

This is not the case for residential leases, where contractual parties can deviate from the statutory provisions only for the benefit of the tenant. Although rents are not regulated, the landlord cannot freely increase an agreed-upon rent and must follow certain specific rules.

Protection of Tenants with Respect to the Coronavirus Pandemic

Although there have been no changes to the Civil Code with respect to leases, in 2020 lawmakers introduced two special acts with temporary effectiveness, on certain measures to mitigate the economic effects of the coronavirus pandemic on tenants of residential and commercial premises. The purpose of both acts was to protect tenants from premature termination of their lease by the landlord because of non-payment of rent during Spring 2020. Under these acts, tenants were provided with a protection period until 31 December 2020. Should they fail to pay the due rent for the decisive period by 31 December 2020, the landlord could terminate the lease with immediate effect and irrespective of the text of the lease agreement. This protection was not provided to tenants in the subsequent months of 2020 and, so far, has not been provided in 2021.

Subsidy Programme

To support tenants of retail premises whose business activities in the leased premises were severely restricted as a result of the Czech government's extraordinary measures in response to the coronavirus pandemic, the government adopted the "Covid-Rent" programme. Under this programme, tenants may apply for a subsidy amounting to 50% of the rent paid to the landlord. So far, the government has issued three calls with different conditions for participation in the programme, which eventually covered 50% of the rent for the second, third and fourth quarters of 2020. These subsidies, however, are discretionary; ie, it is always up to the subsidy-provider whether it grants the subsidy or not.

6.4 Typical Terms of a Lease

Length of Lease Term

A lease with respect to business premises is typically concluded for a definite period of time. The term varies, depending on the subject of the lease and purpose of the lease. For example, retail and office leases are often concluded for at least five years. Renewal options or break options are very common. An indefinite period of time is unusual.

Maintenance and Repairs

Generally, tenants are obliged, at their own expense, to maintain the subject of the lease in good condition, keep it clean and execute non-structural repairs. Landlords are usually responsible for structural repairs and maintenance of common premises.

Rent Payments

Rent is usually paid monthly or quarterly. However, the parties may agree on a different payment schedule. Due to the coronavirus pandemic, turnover rent may be used more frequently, especially on the retail lease market.

Hardship Relief

Statutory hardship relief was almost always excluded from all commercial lease agreements. Under the Civil Code, if the performance of a contract becomes merely more difficult but is still possible, the respective party remains obliged to perform. However, in the event of a change in circumstances so substantial that it creates an excessive disproportion in the rights and duties of the parties, the affected party has the right to claim a renegotiation of the contract with the other party. Should the parties fail to reach an agreement within a reasonable period of time, either party may apply to the court for a change or cancellation of the contract. The court, in this case, has wide discretionary powers and may deviate from the solutions proposed in the parties' applications.

Before the coronavirus pandemic, parties usually avoided including statutory hardship relief in lease agreements and thereby excluded the right to seek a reopening of the contract negotiations. As this turned out to be a big issue for many tenants during the coronavirus pandemic, it is expected that in the future fewer tenants will be willing to accept the risk of a change in circumstances, and correctly setting hardship relief will be a very important point during lease negotiations.

6.5 Rent Variation

Provisions on rent indexation to cover inflation are typical for leases of business premises. Step rents or rent-free periods are also a common practice.

6.6 Determination of New Rent

Unless there is a mechanism for a change or increase of the rent in the lease agreement, such as an indexation clause, the amount of new rent is subject to the parties' agreement.

6.7 Payment of VAT

As a principle, the lease of real estate is excluded from VAT, except for:

- short-term leases;
- accommodation services' agreements;
- leases of parking spaces;
- leases of safety boxes; and
- leases of machinery or other fixed equipment.

Nevertheless, if both the landlord and the tenant are VAT payers, VAT may be charged on the rent. In practice, most commercial leases are subject to VAT and the tenant's obligation to remain a VAT payer is often included in the lease agreement. As from 2021, long-term leases of residential real estate will be exempt from VAT, without the possibility to apply VAT.

6.8 Costs Payable by a Tenant at the Start of a Lease

Tenants are usually required to pay a security deposit to the landlord or provide a bank guarantee to secure their obligations under the lease agreement. After the lease term expires, the security is returned to the tenant. The usual amount of security varies between three to six times the amount of rent and service charges, if applicable.

Unless the landlord decides to incentivise the tenant's decision to lease the premises, tenants are usually in charge of carrying out their own fit-out works, which remain, from a tax and accounting point of view, the tenant's asset and are depreciated during the term of the lease. After expiry of the lease, the tenant is also obliged to remove any such fit-out works at their own risk and expense.

Furthermore, tenants are often obliged to pay rent and/or service charges for the first rental period (ie, the period for which the rent is regularly paid) before the commencement of the lease.

6.9 Payment of Maintenance and Repair

Maintenance and repair of common areas used by multiple tenants is usually the landlord's responsibility. Tenants, however, are obliged to pay a pro rata share of the costs of this maintenance, according to the size of the leased area, usually as regular fixed advance payments which are reconciled after the end of the respective year.

6.10 Payment of Utilities and Telecommunications

Similarly, as with maintenance and repair of areas used by several tenants, tenants usually pay a pro rata share of the utilities and telecommunications charges, with respect to the common premises according to the size of the leased

area. This kind of cost is usually included as part of the common service charge.

With respect to actual use of utilities in the premises, tenants pay the costs according to consumption, either measured by separate meters or calculated on the basis of the size of the leased area.

6.11 Insuring the Real Estate That Is Subject to the Lease

Landlords usually insure against fire, floods, storms, explosions and other natural hazards. The costs of insurance are either borne by the landlord or distributed among tenants as part of the common service charge. Due to the fact that the tenant's contribution to the landlord's insurance is not a tax-deductible cost of the tenant, this fee is often subject to negotiation between the parties.

6.12 Restrictions on the Use of Real Estate

From a private law point of view, lease agreements usually stipulate the purpose and manner of use of the subject of the lease. Any breach by the tenant can be sanctioned by the landlord. Further regulations are usually contained in house rules prepared by the landlord.

From an administrative point of view, any real estate may be used only for purposes which comply with the issued occupancy permits. Any breach by either the tenant or landlord can be sanctioned by the competent authority.

Further restrictions on the use of real estate may be imposed by the Building Office or other administrative authorities in the relevant permits.

6.13 Tenant's Ability to Alter and Improve Real Estate

Any alterations or improvements to the real estate are usually subject to the landlord's prior

consent. Landlords usually require a copy of all documentation related to alterations and improvements to be submitted and maintain the right to inspect how the works are performed and to stop the performance of any works if they are not carried out in accordance with the provided specifications or rules and regulations set forth by the landlord or competent authority. The related permits are usually the tenant's responsibility.

6.14 Specific Regulations

Leases are generally governed by the provisions of the Civil Code. The provisions applicable to commercial leases are mainly non-mandatory, and contractual parties can freely deviate from the statutory provisions by agreement.

This is not the case for residential leases, where contractual parties can deviate from statutory provisions only for the benefit of the tenant.

As already mentioned in **6.3 Regulation of Rents or Lease Terms**, in connection with the coronavirus pandemic, special acts were enacted that forbade landlords from unilaterally terminating leases because the tenant defaulted on rent payments during Spring 2020. Despite the persistence of the pandemic and continuance of related measures that severally affect all business activities, there are currently no plans to introduce additional regulations on leases in this respect.

6.15 Effect of the Tenant's Insolvency

Under the Insolvency Act, if a tenant is declared bankrupt, the landlord cannot terminate the lease (i) due to the tenant's default with payments of rent or other payments under the lease agreement if the default occurred before the decision on the tenant's bankruptcy was issued, or (ii) due to the worsening of the tenant's property situation. At the same time, the insolvency trustee is entitled to terminate any lease with

a three-month period of notice, irrespective of the agreed term, including leases for a definite period of time.

Most lease agreements allow the landlord to terminate the lease prematurely if insolvency proceedings have been initiated against the tenant.

6.16 Forms of Security to Protect against a Failure of the Tenant to Meet Its Obligations

Tenants are usually required to provide landlords with security, which is usually in the form of a cash deposit or bank guarantee.

6.17 Right to Occupy after Termination or Expiry of a Lease

Generally, after a lease expires, tenants are not entitled to occupy the subject of the lease and are obliged to vacate the leased premises and hand them back to the landlord. However, if the tenant stays and the landlord does not request the tenant to vacate the subject of the lease within 30 days following the expiry of the lease, the lease is by operation of law renewed for an additional period up to one calendar year; the parties may exclude the application of this statutory provision in the lease agreement.

Usually, lease agreements include harsh penalties for tenants that remain in the subject of the lease after the lease has expired.

If the tenant refuses to vacate the subject of the lease after lease expiry, the landlord may file a legal suit with the court to evict the tenant; however, such proceedings can take several months, sometimes years, and experienced landlords make every effort to avoid such proceedings.

6.18 Right to Assign a Leasehold Interest

As a general rule, the tenant is entitled to assign wholly or partially its rights and obligations

under the lease agreement, or to sub-lease the premises, only with the landlord's prior written approval.

6.19 Right to Terminate a Lease

Both the landlord and the tenant may terminate the lease either in accordance with the provisions of the Civil Code (if their application is not excluded, as is often the case with the lease of the business premises) or for termination reasons set forth in the lease agreement.

Typically, a party may terminate the lease if the other party grossly violates its obligations under the lease agreement. The landlord is usually entitled to terminate the lease prematurely if the tenant is in default with payment of the rent or other payments under the lease agreement for a certain period of time, if insolvency proceedings are initiated against the tenant, if the tenant uses the subject of the lease contrary to the agreed use, or if the tenant sub-leases the subject of the lease or their part thereof without the landlord's prior consent, etc.

6.20 Registration Requirements

Lease agreements do not require any specific formalities to become valid, except for residential leases, where written form is mandatory. However, a landlord cannot claim invalidity for lack of written form to the tenant's detriment.

If the subject of the lease is registered in the Cadastral Register, the lease agreement may then be registered in the Cadastral Register. It is, however, up to the parties whether they wish to register the lease in the Cadastral Register; it is not a legal prerequisite and is rarely used.

6.21 Forced Eviction

The landlord may bring an action before the courts to evict a tenant. Such a proceeding, however, may last several months, even years.

No special eviction-related regulations have been enacted with respect to the coronavirus pandemic.

6.22 Termination by a Third Party

A private lease cannot be terminated by a third party. However, during an insolvency proceeding and under certain circumstances, the insolvency administrator may terminate the lease.

7. CONSTRUCTION

7.1 Common Structures Used to Price Construction Projects

The most common structures are based on itemised budgets, ie, unit prices are multiplied by the number of units delivered by the contractor. Although the price is fixed in most cases, the itemised budget serves for the purposes of monthly invoicing and the pricing of additional works or changes in the scope of work.

7.2 Assigning Responsibility for the Design and Construction of a Project

In most cases the responsibility is split between the architects and contractor(s), which might lead to various difficulties. Typically, the employer orders the delivery of a project and engineering works from an architect. Once a particular construction obtains its building permit, the employer selects (usually in a tender) a contractor, who builds the construction in accordance with the plans delivered by the employer.

The architects/engineers are responsible for design and its defects, whereas the contractors are responsible only for compliance of the construction with the presented design and their own quality of work. In the event of a defect, the employer can claim damages against both the architect and the contractor, and it is up to them to prove whether the issue was caused by a defect in project or in the construction. As a

result, it is much easier if the architect is a sub-contractor of the general contractor, who bears full responsibility for the project.

7.3 Management of Construction Risk

In order to manage construction risks, the following tools are commonly used in the Czech Republic:

- performance bonds which secure the contractor's due performance during the construction process and completion of the construction;
- all-risk construction insurance, which secures the construction and the contractor's liability for any damage caused to the construction or third parties during the construction process;
- retention of a part of the price that is due to the contractor in order to secure the contractor's due performance and completion of the construction; the retention amount varies between 5% and 10% of the invoiced amount and is paid by the employer after completion and handover of the completed work;
- the contractor's statutory liability for (hidden) defects, which is five years following the handover of the completed work; the statutory conditions can be amended by agreement;
- the contractor's voluntary guarantee for the quality of work, which goes from two up to ten years following handover of the completed work.

The above tools are determined and specified in the contract between the employer and contractor.

7.4 Management of Schedule-Related Risk

The schedule-related risks on construction projects are always subject to an agreement between the employer and contractor. These risks are most often managed through contractual penalties, which are due from the contractor

for each day of delay with the agreed milestone or completion of the work. The payment of this penalty is usually secured by a performance bond in the form of a bank guarantee issued by the contractor's bank.

Possible damages, if any, are usually claimed only if their amount exceeds the amount of penalties paid.

As an ultimate option, the employer is also entitled to terminate the contract for work with the contractor prematurely in the event that the delay exceeds a specified number of days. Such a termination generates additional complications (compensation for the work done prior to termination and the amount, handover of the construction site, further delays, etc) and is used in extreme cases only.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

The most common forms of security guaranteeing a contractor's performance are:

- retention of an agreed percentage (5% to 10%) from each invoice issued by the contractor during the construction stage of the project (provided the retention is paid by the employer after the completion and handover of the completed work); or
- performance bonds issued by the contractor's bank; or
- parent guarantees.

7.6 Liens or Encumbrances in the Event of Non-payment

Although a lien or another encumbrance on the property is possible and available to the parties, any such requirement would definitely be outside market practice and would compromise the financing bank's interests. Therefore, it is unlikely a contractor or designer might successfully agree to receiving such rights.

7.7 Requirements Before Use or Inhabitation

The use of any completed construction (or its part) which needed prior issuance of a building permit is subject to issuance by the Building Office of a use permit.

This proceeding usually follows completion of the construction and its handover to the employer, but is sometimes included as part of the contractor's duties, in which case handover takes place only after the successful issuance of a use permit.

8. TAX

8.1 VAT

The transfer of real estate for consideration is generally considered to be a supply of goods for value-added tax (VAT) purposes and is subject to VAT in the Czech Republic. VAT is applicable at the earlier of the delivery (handover) of the real estate or on the effective date of the registration of the ownership right in the Cadastral Register (upon completion of the construction of the real estate).

The sale of certain real estate after the expiry of five years from its first use, or from the date of its use-permit issuance, may be exempt from value-added tax. If the seller claimed an input VAT deduction at the time of its acquisition or upon carrying out a technical improvement of the real estate, it is obliged to adjust the VAT deduction, if the real estate is sold prior to the expiry of ten years from the year of acquisition or completion of the technical improvement.

The sale of land that is neither construction land by its designation nor land with a VAT non-exempt building on it, it is generally exempt from Czech VAT.

The sale of real estate that is not exempt from VAT is subject to a standard rate of 21%, except for the transfer of buildings for “social housing” (eg, apartments with a floor area of up to 120 square metres or a family house with a floor area of up to 350 square metres), which are subject to a reduced VAT rate of 15%.

The transfer of real estate after the expiry of five years from the final inspection between two VAT payers can be elected to be treated as taxable by VAT under the so-called “reverse-charge mechanism” if agreed between both parties. This election could be beneficial if the transferee is entitled to reclaim the VAT applied on the transfer, as the transferor would not be obliged to adjust his or her original claim on the input VAT made by him or her upon acquisition of the real estate.

8.2 Mitigation of Tax Liability

The real estate property transfer tax was abolished in 2020 with retroactive effect on all real estate property transfers effected as from 1 December 2019.

8.3 Municipal Taxes

There are no municipal taxes paid on the occupation of business premises in the Czech Republic.

In general, real estate tax is levied on all residential and commercial real estate in the Czech Republic. The real estate tax is levied per square metre of real estate and varies depending on the location of the real estate (the statutory rates can be increased by municipalities).

Real estate tax is relatively modest in the Czech Republic.

8.4 Income Tax Withholding for Foreign Investors

Withholding tax is generally levied on Czech-source income paid abroad (eg, dividends, inter-

est, royalties) unless an applicable double-tax treaty stipulates otherwise. Rental income paid to Czech tax non-residents represents Czech-source income subject to Czech taxation; however, withholding tax does not apply.

Czech tax non-residents receiving Czech-source rental income are generally obliged to file an annual corporate (or personal) income tax return and pay income tax at 19% (corporations) or 15%/23% (individuals) on the difference between the rental income and tax-deductible costs incurred to generate the rental income.

The Czech payer of rental income (Czech tax-resident or a permanent establishment of tax non-resident entity) may be required to withhold a “securement tax” of 10% of the payments made to foreign non-EU/EEA taxpayers receiving Czech-source rental income (eg, income derived from the rent of real estate property located in the Czech Republic).

The amount of securement tax withheld is treated as an advance tax payment of the foreign entity (individual), and may be credited against the final corporate (personal) income tax liability declared in the annual corporate (personal) income tax return of the non-resident recipient.

As noted above, capital gains on the disposal of real estate property (asset deal) are subject to ordinary taxation, ie, corporate income tax at the rate of 19% for corporations and 15%/23% for individuals payable on the difference between income from the sale and its tax residual value (or acquisition price if not depreciated for tax purposes).

Individuals may benefit from certain tax exemptions if they hold the real estate for a certain period and the real estate has not been part of their business assets.

8.5 Tax Benefits

Real estate or fit-out works performed by the tenant may be depreciated for corporate income tax purposes, either under the linear or reducing-balance method. The reducing-balance method is based on a formula using a ratio of coefficients, which vary according to the category of the relevant asset. Once a method of depreciation is chosen, it must be applied over the entire life of the asset.

Residential houses and buildings are depreciated over a minimum of 30 years for Czech corporate or personal income tax purposes, while for administrative buildings, department stores, historic buildings and hotels, there is a minimum depreciation period of 50 years.

Plots of land are not eligible for tax depreciation.

PRK Partners has provided top-tier, comprehensive legal services in all areas of law for over 25 years. The firm maintains offices in the Czech Republic – Prague and Ostrava – as well as in Bratislava, Slovakia. Since its founding in 1993, PRK Partners has built a strong real estate practice with services across all areas of real estate, including construction and development, transactions as well as administrative, environmental and regulatory issues. The firm has gained a strong reputation and recognition for its real estate project-financing expertise and for its ability and capacity to review, assess and prepare large real estate portfolios for financing. The RE team (four partners, ten legal practitioners and two tax advisers) has recently advised on, eg, real estate transactions (a sale

and leaseback transaction in respect of a hotel managed by a leading European budget hotel chain in Prague, an asset deal with respect to an acquisition of land by a Czech automotive parts producer, for a new production plant), real estate management (advice to large RE management companies such as KLEPIERRE and Revetas Capital), real estate financing (advice to a major Czech bank in multiple transactions regarding financing and refinancing of solar power plants and renewable energy sources, refinancing and investment financing of the multi-functional Galerie Šantovka shopping centre in Olomouc) and construction matters (eg, legal assistance to ASENTAL in the realisation of a brownfield project which will become a strategic industrial zone in northern Moravia).

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