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Real Estate

Czech Republic

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PRK Partners

chambers.com

2020

CZECH REPUBLIC

Law and Practice

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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, save 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

The Czech investment market continues to grow at a rapid pace. Total investment volume in real estate in 2019 is expected to reach EUR3 billion, with local investment funds and South Korean investors being the primary market movers in 2019. Half of these investments went into the commercial office space. Leisure and retail projects were also active sectors in 2019.

There has also been an increase in the volume of sale-and-lease-back transactions.

Important transactions in 2019 include Makro's sale and lease-back of 11 sites in three CEE countries, the sale of two iconic hotels in Prague (the Intercontinental Prague and the Don Giovanni), and the sale of the CTP logistics parks to the German Deka Immobilien fund.

1.3 Impact of Disruptive Technologies

There is no information about any specific impact of disruptive technologies on the Czech 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 long-standing problem, a new Construction Act is being prepared which should significantly streamline the approval process and greatly ease the administrative burden currently imposed on developers.

It is estimated that this new act will be passed in 2021, with promulgation in 2022.

In connection with the COVID-19 pandemic, there are certain new acts being enacted by the Czech Parliament within an accelerated process. These acts, if passed, will mainly impact the commercial leases and real estate finance.

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, a private contractual arrangement. 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) applies, 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 such 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.

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

Real Estate Acquisition Tax

A property transfer tax of 4% is levied on all direct conveyances of real estate.

The rate is derived from the higher of the agreed purchase price or 75% of the property's fair market value, as determined by the tax authority

As of 1 November 2016, the property transfer tax is payable in all cases by the buyer, without the possibility of transferring this obligation to the seller.

The first conveyance of a new residential unit or building for consideration is generally exempt from the real estate acquisition tax.

There are no property transfer taxes levied on transfers of shares (including mergers and demergers) of corporate entities holding property. However, property transfer taxes may be imposed on a conveyance through liquidation if certain holding thresholds are not met.

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 (15% individuals, 19% corporate).

Natural persons are exempt from this tax on residential property if (i) title to the property was held for at least five years 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 payee, 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 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 Government 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 Government 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.

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.

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 construction permit and larger projects may require additional permits.

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.

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 and, in limited circumstances, for judicial review to the courts.

4.6 Agreements with Local or Government 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 UCITS directives or 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 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 and statutory director) 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 statutory director, who is responsible for the business management of the company. The statutory director is elected by the managing board, which defines the primary focus of the management and supervises its proper performance. 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.

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), type of administration/maintenance, and the third parties involved in the running of the fund (a depositary, 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.

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. Although the statutory regulation of commercial leases offers freedom of negotiation to both parties, the regulation of dwelling leases is rather strict.

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.

An easement is another way to allow a third party to occupy and use real estate. It may be granted for both a definite or indefinite period of time. 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.

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.

6.4 Typical Terms of a Lease

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.

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 is usually paid monthly or quarterly. However, the parties may agree on a different payment schedule.

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.

6.8 Costs Payable by Tenant at Start of 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 of Communal Areas

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 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.

In connection with the COVID-19 pandemic, it is very likely a new act introducing a ban on landlords to unilaterally terminate leases for defaulting on rent payments from 12 March 2020 to 30 June 2020, in connection with extraordinary measures imposed by Czech government on businesses, will be enacted. The law will not provide for a waiver or discount on the rent payments but a limitation of the consequences of default with due rental payments.

6.15 Effect of 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 Failure of Tenant to Meet 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 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 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.

6.22 Termination by 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.

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). 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.

As a result, 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.

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 are 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 moment 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

Real estate property transfer tax would not be imposed on the sale, merger or demerger of shares of an entity owning real estate.

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, interest, 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% (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% 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 co-efficients 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 11 MAKRO Cash&Carry stores, the acquisition of the Prague Green Tower Building, and the acquisition of two hotels in Prague for Wenaasgruppen AS etc), real estate management (advice to large RE management companies such as Cromwell Property Group, KLEPIERRE or Revetas Capital) and construction matters (eg, legal assistance to Moneta Money Bank in connection with the relocation of its HQ, advice to International Campus with respect to a development of a first-of-its-kind student campus in Prague, and Acur Investments in connection with completion of a new office building in Prague).

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CZECH REPUBLIC LAW AND PRACTICE

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