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Czech Republic Country Report

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I. INTRODUCTION – POLITICAL BACKGROUND

Since 1993, when the Czech Republic became one of the two succeeding countries of the former Czech and Slovak Federal Republic the legal framework of the country is based on the democratic Constitution and the List of Human Rights and Freedoms. Today, in early 2002, the legal system and its implementation is nearly compatible with the requirements set by the Copenhagen accession criteria of the European Union. The laws protect not only basic civil rights and freedoms as in any other truly democratic political system, but also provide for free market economy, protection of property, investments and free enterprise. Already in early 1990, the basic legal framework has been created that enabled the renewal of non-governmental and not-for-profit activities based on free initiative of local or foreign, natural or juridical persons. This basic framework is formed by the amended Civil Code and Commercial Code, accompanied by a set of special laws, like the Law on Right of Assembly, the Law on Associating of Citizens, the Law on Churches and Religious Communities, the Law on Political Parties and Political Movements. Since 1992 there were also adopted certain tax benefits for legal entities that were not established for entrepreneurial purposes and which use the money saved from the income tax for their activities in certain public benefit fields, as well as other special legal provisions, which enable the development of the civil society.

However, this development, which started immediately after November 1989, has not been straightforward and easy. It slowed down after 1992 elections, when the right wing Civic Democratic Party lead by macroeconomist Vaclav Klaus and other influential political parties were mostly concerned with the profit making economy issues rather than ideas of not-for-profit or altruistic activities. The initial period of seemingly successful development of Czech economy lasted until 1997. However, already in this period some weaknesses of the new political and economical system began to slow down the development towards stable and sustainable democracy and welfare.

In January 1994, the New Year address of President Vaclav Havel and an article in response by Prime Minister Vaclav Klaus started a series of contentious debates. The notion of a civil society and the role of civic associations, foundations and NGOs in such a society had been questioned. President Havel, being the proponent of the civil society, asked for much greater attention to the civic grass-root activities, from which he expected to play important role in citizens' participation on political and common interest affairs. On the other hand, Mr. Klaus declared that the society of free and self-conscious citizens does not need any corporations or other artificial collective formations standing between the state and the citizens. These discussions culminated in 1995 during the parliamentary readings of several bills important for the enforcement of the civil society in

the Czech Republic. These were the Bill on Not-for-Profit Legal Persons, the Bill on Foundations, the Bill Amending the Act on Associating of Citizens, the Bill on the Czech National Foundation, the Bill on the National Ombudsman, as well as several other bills, concerning social and family affairs, health care and other important issues. The fate of some of these bills may be used to demonstrate the difficulties that accompanied the re-creation of the civil society and the overall political development after 1993 in the Czech Republic.

The Bill on Non-for-Profit Legal Persons had been drafted at the Ministry of Finance. Early in the drafting process a group of NGO experts was given a chance to participate. The main problem was that the working name of the bill was misleading. Many people and politicians expected a law that would provide regulation for all not-for-profit organizations. However, the ministry experts wanted a law that would enable privatization of governmental organizations into private, non-governmental and not-for-profit legal entities, which would provide public benefit services, similar to those provided by the former governmental or municipal organizations fully or partially dependent on public budgets. The compromise was reached in September 1995, when the Parliament adopted the governmental bill redrafted with the assistance of NGO experts, with the name of the law changed into the Law on Public Benefit Corporations (Companies). Simply said, the new law makes it possible to register as legal entities establishments, which provide public benefit services, are not based on membership, operate strictly under not-for-profit principles and are managed and supervised by a board of directors appointed by the founder and not employed by the same entity.

The first Bill on Foundations and Funds has been drafted already in 1992. The need for the law was reflected in the articles of the Civic Code amended at the same time, which restored the notion of foundations as legal bodies after their abolishment and repression during previous 40 to 50 years. However, after the split of the Federation the original Bill on Foundations and Funds from December 1992 has been abandoned. In 1993, the State Office for Legislation and Public Administration renewed the drafting procedure, once again, with the NGO expert group participation. At the same time, in an attempt to put the Government under pressure from the Parliament not to abandon the idea of setting-aside a part of the portfolio of privatized state companies for the needs of foundations (see also Part XI.A), the Bill on the Czech National Foundation had been drafted by the author and Mr. Tomas Jezek, Member of the Parliament. Besides, the Bill on the National Ombudsman – the watch-dog of the rights of citizens dealing with state authorities – was also on the agenda of the Parliament.

The Civic Democratic Party was opposed to the idea of the Ombudsman. In addition, it was not supportive to the use of assets from voucher privatization for the purpose of foundations, not to mention its very limited support for the idea of foundations themselves. This negative

attitude and, evidently, the impossibility to deal with approximately 150 bills awaiting approval from the Parliament during its last session before the June 1996 elections, resulted in cancellation of these important bills from the Parliament agenda, even when an easy vote was expected to enact most of them into the law.

The results of the parliamentary elections in 1996 brought about a situation that gave the coalition of the Civic Democratic Party and two other democratic parties only 99 out of 200 seats in the newly elected Chamber of Deputies of the Czech Parliament. The minority coalition government continued to be in power, but was exposed to strong opposition led by the Czech Social Democratic Party. In September 1996, the first elections to the upper chamber of the Parliament - the Senate - produced similar results, with a heavy loss for the Civic Democratic Party in the second round of elections.

The slightly reformed coalition government never resubmitted the Bill on the National Ombudsman. There was neither political support nor cooperation of NGOs to reopen the question of resubmission of the Bill on the Czech National Foundation. However, the Bill on Foundations was resubmitted to the Parliament in its original form. The new Parliament turned its attention to the weakest point of the Bill, namely the requirement of a compulsory endowment with a foundation. Having in mind the existence of more than 5,000 foundations, most of which were operating with very limited assets, this requirement could in practice result in a dramatic reduction of the number of these civic initiatives. A group of deputies worked with the author and other NGO experts and prepared a revised Bill, which introduced two types of philanthropic organizations - foundations with a minimal endowment, and funds, for which an endowment was not required. After dramatic discussions in both chambers of the Parliament, *Act No. 227/1997 on Foundations and Funds* was finally approved, substantially changing but completing the legal framework in which civic organizations may exist in the Czech Republic.

During 1997 the political situation in the Czech Republic underwent a deep crisis connected with the openly reported problems regarding funding of political parties. Rampant cheating within the Civic Democratic Party cost it its political power. Its chairman, Mr. Klaus, was forced to step down from the post of the Premier Minister. An interim government, led by Premier Minister Tashovsky was given the main task of preparing the country for extraordinary elections in June of 1998. However those who expected that the elections would make it possible to form a stable government that could rely on a strong majority in the Parliament, were very disappointed. The elections won the Social Democratic Party, but its victory was not strong enough to give it a clear majority in the Parliament. The political parties were unable to form a coalition government. As a result, for the last four years, the minority government of Social Democrats chaired by Mr. Milos Zeman stayed at power. This was made possible by the so called "opposition agreement" with the Civic Democratic Party led by Vaclav

Klaus. During this period of relative political stability the country returned to the trajectory of economic growth and is now close to being prepared for membership in the European Union. Even the Ombudsman office has been finally created by law and judiciary started to deal with several cases of economic crimes.

Despite this relatively positive political situation, or perhaps due to it, the NGO sector lost its momentum in pursuing its common interest. It disintegrated into several interest groups and was not active enough when the Government proposed to the Parliament several amendments and new bills. As a result, the fairly good and much needed Bill on Associations, Bill on Providing Social Services, amended Law on Foundations and Funds and several other initiatives have been refused by conservative majority of the Parliament.

In June 2002, the Czech Republic faces general elections to be followed in the fall 2002 by election of a third of the Senate and municipal elections. The political scene may change again, and with it may change also the environment, in which the civil society develops.

II. PROVISIONS OF THE GENERAL LAWS

A. Consistency and Clarity of the Laws

The general legal framework of the Czech Republic is consistent with the Constitution. However, some laws from the former socialist state are still in force, but the bulk of the legislation has already been either substantially amended or replaced by new laws harmonized with the *acquis communautaire* of the European Union. Thus, twelve years after the political turnover and in the tenth year of its existence, the Czech Republic is still reforming its legal framework. During the very recent years the Parliament enacted in average more than a hundred of laws per year and replaced or amended several hundreds of old regulations. On one side, due to the extended use of amendments, the Czech legal structure becomes increasingly complex. On the other side, in some parts, a more systematic approach adopted already makes it more transparent. This development may be demonstrated on the ongoing reform of judiciary, which shows gradually increasing efficacy and competence. However, there are still many cases pending with the courts and the overall situation may not be called fully satisfactory.

As concerns the civil not-for-profit sector and charitable or philanthropic activities, five basic regulations currently govern this field. These are the Civil Code, the Law on Citizens' Associating, the Law on Religions and Religious Congregations, the Law on Public Benefit Corporations and the Law on Foundations and Funds. There are also several older laws and regulations governing organizations funded by the state or by municipalities. Special laws deal with tax issues, customs regulations, accounting procedures, insurance, retirement schemes of

physical persons and wage regulations of all legal bodies, including those in the civil sector.

Some of the new laws have been enacted without proper technical support and accompanying regulations. As a result, the newly enacted laws are often amended and changed shortly after being enacted, which makes the legal framework less transparent. Such changes might be considered a natural occurrence, but as many critics claim, they probably result from the low quality of the legislative work of both the Government and Parliament.

As far as accessibility of general public to the texts of laws and other regulations is concerned, an important role already plays an ever-growing scale of the use of Internet tools and computerized legal support systems, which are regularly updated. These systems provide full texts of the laws in their current state, make it much easier to find, read, and print all relevant laws and regulations. Other systems provide for information on the legislative process, enabling even to follow the discussion about the laws in both chambers of the Czech Parliament.

B. Constitution

The Constitution of the Czech Republic fully supports the freedoms of association and other freedoms. In addition, the Czech Republic became a signatory of the International Covenant on Civil and Political Rights, which became an integral part of its constitutional arrangement since 1993. The Constitution explicitly guarantees these basic rights not only to citizens of the Czech Republic, but also to foreigners dwelling on the territory of the republic.

C. Types of Organizations in the Civil Sector

The following is an overview of civil sector organizations that may be established as legal entities in the Czech Republic:

1) Associations

Associations of Citizens (hereafter only "Associations") may become legal entities taking the form of clubs, unions, societies, leagues, guilds, federations, ..., just to name a few. They are established and operate on a membership basis to pursue interests of their members. However, associating for business, political, military or religious activities are to be covered by other special laws. According to the *Act No. 83/1990 on Associating of Citizens*, the members of an association may be natural persons, including foreigners, as well as legal entities. However, only natural persons may form the Preparatory Committee, which submits the Establishment Proposal and Association's Statute to the Ministry of Interior for registration in order to obtain the status of a legal entity.

In 2002, the Czech Statistical Office registers about 46,150 associations with additional 29,450 branches of associations, which have their own legal personality¹.

2) Foundations and Funds

According to the *Act No. 227/1997 on Foundations and Funds*, any natural or legal person may establish a foundation or a fund collectively or individually. To do so, the founder(s) need to prepare an agreement or a notary act, respectively. In the case of an individual, the establishment is possible also by a last will. The Act defines both the foundations and the funds as grant-making non-membership organizations, established to administer and develop assets and/or property provided by their founders at the time of establishment, as well as donated or endowed by other mercenaries and sponsors during their existence with the aim to be used exclusively for a public benefit purpose. Therefore, such organizations follow the civil law tradition of being formed around an aggregation of property and do not rely on the membership principle.

Prior to 1997 there was confusion about whether a foundation could be a membership organization or to which degree it may pursue economic activities. These and many other issues were clarified by the 1997 legislation. Foundations established prior to the 1997 law, which did not meet the requirements for foundations of the new law, mainly those, which did not have an income generating endowment of at least a minimal value, were required to transform themselves into other types of not-for-profit legal entities (e.g., funds without endowments or public benefit companies - see Part II.E.3). Those, which were *de facto* associations had to accept that and their members usually created a regular association, while the foundation ceased to exist. Foundations, which met the requirements of the 1997 law, have been re-registered as foundations and their endowment became a protected part of their property. A recent statistics shows², that in 2002 there are about 330 foundations, 770 funds and 710 public benefit corporations, part of which have their origin in foundations established before 1997. Some 2100 "old" foundations are still in existence and they are awaiting liquidation by the order of district branches of the public administration, where they have been incorporated.

There are two essential characteristics that distinguish a foundation from a fund.

First, a *foundation* must have an endowment whose value may not become less than CZK 500,000 (approximately USD 13,700). Only income generating property (money on a separated bank account, securities, real estate property, author or patent rights, pieces of art) may be registered as a part of the endowment of a foundation. Any income generated by the

¹ Spiralis: NGO Forum 2002, Partner Communities at Regions, Prague, March 2002

² see note 1

endowment is fully exempt from the corporate income tax. A *fund* is not required to possess any endowment and may use all of its property for the purpose for which it has been established.

Second, the only business activity a *foundation* may conduct consists of investing into the shares of joint stock companies (for more details see Part VII, B). On the contrary, a *fund* is not allowed to conduct any such activity on the capital market.

However, both a *foundation* and a *fund* may organize cultural, social, sporting and educational events, as well as lotteries and public collections to raise funds. Both may use their property only to support third persons in the framework of a public benefit purpose, for which they were established and which is defined in their founding act and statute. Their administration expenses must be limited by a rule unchangeable for a period of at least five years.

Self-perpetuating Board of Directors should govern both foundations and funds. The founder(s) should appoint the first board. Both must publish annual reports describing in detail their activities, income sources and use of property.

In addition to foundations and funds that were established prior to 1998 and foundations and funds newly established since that time, there exist several so-called "*state funds*," organizations with special status given to them by the specific law for their establishment. State funds are usually supported by the state budget or operate and distribute financial resources and other property assigned to them by the state. An example of such a state fund is the Fund for Children and Youth, which was established to operate with the property of the Union of Youth that was dissolved in 1990.

In 1999 and 2001, about 1.9 billion of Czech crowns (approximately USD 52,000,000) were distributed to about 70 foundations as a one-off state contribution to the endowments of registered foundations. This contribution represents a singular attempt to compensate for the non-existence of welfare and private philanthropy from 1938 to 1990, when in the democratic world the foundations grew thanks to the contributions from private donors and participation in the free market economy, while such an environment did not exist neither under Nazi nor Communist political order.

3) Public Benefit Corporations (Companies)

A Public Benefit Corporation (hereafter only "PBC") is a new type of civic organization, introduced by the Act No. 248/1995 on Public Benefit Corporations, which came into force on January 1, 1996. PBCs are service-providing, non-membership, and not-for-profit organizations governed by a Board of Directors appointed by the founder(s) from the general public unrelated to the PBC's employees. PBCs are one of the forms into which foundations registered prior to 1998 were permitted to transform before

December 31, 1998. Currently, several state or municipality-budgeted and contributory organizations, such as government-dependent not-for-profit service-providing organizations like theatres, private schools and hospitals, houses for aged, as well as municipal baths and similar common utilities have been transformed into PBCs. On the other hand, instead of forming an association, shelters for drug abusers, dossers or unemployed persons, protected workshops for handicapped and similar establishments, as well as consultancy and similar services may be offered in a form of a PBC. In 2002, about 710 PBCs are registered³.

4) Establishments of Churches and Religious Congregations

The Act No. 308/1991, *on the Standing of Churches and Religious Congregations*, the Act No. 161/1992, *on Registration of Churches and Religious Congregations* and the Act No. 218/1949 *on Economic Security of Churches and Religious Congregations* as amended by later laws, represent a set of laws governing the religious activities in the Czech Republic. For the purpose of this report it is important to mention the right of the registered churches to form their own establishments, which provide services not only in the field of spiritual education and religious training, but also for social care and charitable activities. These specialized establishments complement usual activities of religious orders and congregations, which use their facilities, properties and members time in the service to community and general public.

The establishments of churches are usually managed by an executive director and supervised by a competent central body, appointed by the church hierarchy. They are also entitled to the state subsidies provided by Ministry of Culture, where they are registered, and by Ministry of Labor and Social Affairs, for which they represent a serious and important partner in many aspects of the care for handicapped, unemployed, rug dependent and otherwise socially deprived people.

In the Czech Republic, two main organizations of this kind exist, which provide mostly social care services. These are the Caritas of the Catholic Church and the Diaconia of Evangelic and Protestant Churches. Each of them has several dozens of centers with legal personality and seats all over the country. They are recognized as entities not created for the purpose of entrepreneurship and therefore have the same tax regime, as associations, foundations, funds and PBCs.

According to recent statistics⁴, there are about 4810 establishments of churches and religious congregations.

The recent arrangements proposed by the Government may make the continuing activities of these important, active and recognized

³ See note 1

⁴ See note 1

organizations much more difficult, if not limiting. Amended law somewhat omitted to mention the right of the establishments of churches to provide also social services besides those expected and allowed in the spiritual sphere. Ministry of Culture suggests to the churches to reestablish their social services providing establishments as PBCs or associations and thus to accept the same legal regime as other civil organizations.

Since the internal life and regulations of this type of civil organizations are fully in the competence of the church, it will not be discussed in more detail in this paper.

5) Other Forms

In general, it is also possible to speak about new types of not-for-profit, non-governmental organizations with self-regulatory features – the “public institutions,” the concept of which should not be mixed with that of PBCs, despite the fact of many similarities in their features.

An example of this new phenomenon has been introduced into the Czech legal framework by the *Act No. 111/1998 on Higher Educational Institutions*. According to this law, public and private universities and other higher educational institutions are considered non-governmental and not-for-profit organizations governed by a dean or a rector, whose substantial property related decisions must be approved by a public board of directors and who are elected by the academic senate, which is in its own turn elected from academic personnel and students of the school. These institutions are allowed to use their property and intellectual potential for economic activities, the income from which must be used solely to support the furtherance of their academic activities.

Political parties and political movements are established according to *Act No. 424/1991 on Association in Political Parties and in Political Movements*.

Trade unions and unions of employers are regulated by *Act No. 83/1990 Sb. on Associating of Citizens*, but they acquire their judicial personality without being subjected to approval by the Ministry of Interior, which is otherwise the rule for other associations. These organizations only have to announce their establishment in order to be included in the statistical database.

There are also not-for-profit organizations established as professional chambers and regulated by a set of special laws. These include chambers of attorneys-at-law, commercial lawyers, notaries, accountants, auditors, tax advisors, physicians, dentists, and so on. These chambers monitor the ethics of the professions and regulate access to the positions where specialized education is required.

The Civil Code of 1964 as amended in 1990 permits also the formation of so called interest associations of legal bodies and consortia, which should be distinguished from associations of citizens as defined above (see also Part II.E.4).

D. Purposes

The major distinction between public benefit and mutual benefit activities of not-for-profit, non-governmental organizations in the Czech Republic may be found in tax legislation. There are particular benefit-relevant requirements of *Act No. 586/1992 on Income Taxes*, and in several other fiscal laws, which assign certain tax benefits only to activities that are of public benefit. Nevertheless, some provisions of other laws confine the activities of NGOs to publicly beneficial or appropriate activities.

The Law on Foundations and Funds imposes an affirmative requirement on the purpose of a foundation or fund. They must: "...serve public benefit purposes, namely those for the development of intellectual values, for the protection of human rights and other humanitarian goals, for the protection and development of the natural environment, cultural monuments and peoples traditions, as well as for the promotion of science, education and sports."

The permissible purposes of an association are defined in the Law on Associating of Citizens in negative way. They may not be established in order " ...to abolish or restrict the personal, political, or other rights of citizens due to their nationality, sex, race, social origin, political or other views, religious preference and social status, or to invoke hate and intolerance for the above reasons, or to support violence or any other way of disobedience to the Constitution and the Laws."

More generally, associations may not "achieve their goals by such practices that are inconsistent with the Constitution and other Laws" nor "...to assume a position and make actions reserved for the public administration or to churches, political parties or political movements."

With regard to PBCs, the law requires that they should "...provide to the general public commonly beneficial services under pre-defined and for all users equal conditions; any profit of a PBC must not be used to the benefit of its founders, members of its governing organs nor its employees, and must be used exclusively to finance the public benefit services for which the PBC was established."

The law does not restrict the extent to which civil organizations may engage in the legal process and other legislative or political activities. However, foundations and funds "...may not financially support political parties or political movements."

E. Registration or Incorporation Requirements

1) Associations

At least three citizens, one of them should be over the age of 18, can form a Preparatory (Founding) Committee that may establish an association. Associations are registered at the Department for Civic Affairs of the Ministry of Interior of the Czech Republic. To register an association, the Preparatory (Founding) Committee must present an Establishment Proposal, properly signed by the members of the Founding Committee and containing their full identification – home address and the Personal Identity Number or the date of birth, in the case of a foreigner. The document must also explicitly define the person, which is authorized to represent the association during the registration period. Two copies of the by-laws (statute) of the association must be attached to the Establishment Proposal. The name of the association may not be identical to any other name of an already registered legal entity. In practice, it is often difficult to check for the required uniqueness of the association's name because the register of associations, maintained by the Ministry of Interior, is not treated as a public document and, therefore, is not open to the general public. However, the Ministry must make it possible to provide the necessary data from the register on written request.

Registration of an association may be rejected only if the Ministry finds the purpose of the association not to be in compliance with the requirements of the law, as described above. The association must not resemble a political party or religious congregation, for which there are specific laws. There should also be no evident military or paramilitary activities inherent in the purpose and the Statute of the association, nor any memberships restrictions, benefits or obligations, which would violate basic human rights and freedoms. The Ministry should identify minor faults in the application for registration to the Preparatory Committee within five days of the submission of the proposal, so that the documents may be corrected and resubmitted. More serious objections to the Establishment Proposal must be conveyed to the Preparatory Committee within ten days. The association becomes a legal entity upon obtaining certification of registration from the Ministry of Interior (usually in a form of a certified copy of the Statute submitted for registration), or it becomes a legal entity by default if the Ministry does not inform the Preparatory Committee of its negative decision within 40 days of submission of the Establishment Proposal. A rejection of registration may be appealed to the Supreme Court.

2) Foundations and Funds

Both natural persons and legal bodies, including foreigners, may establish a foundation or a fund. To register, the founder(s) must present the proposal for registration to the district court, which is responsible for keeping the register of foundations and funds. The same court operates the

register of commercial legal bodies. The proposal must be accompanied by the Articles of Incorporation in the form of a Founders' Agreement, if there are two or more founders, or in the form of a Notary Act, if the founder is a single person. The Founder's Agreement must be signed on authority.

According to the Law on Foundations and Funds, the information provided in the Articles of Incorporation and in the Application for Registering must include the following:

- a. the unique name of the foundation or the fund and address of its headquarters (seat);
- b. the name of and other identification information about its founder(s) and their share in the property endowed;
- c. the purpose for which the entity is being established (which must be for public benefit, compatible with examples set by the law);
- d. in the case of a foundation, the list of endowment components and their identification together with certified overall value of listed endowment assets;
- e. the names of the members of the first board of directors (no less than three natural persons) and of the supervisory board (for smaller funds there might be one single person – the Inspector);
- f. the way in which the board of directors acts on behalf of the entity;
- g. general rules by which the granting procedure to third persons will be regulated; and
- h. a "ceiling" restricting the administrative expenses (see also part VIII.F).

Within 30 days of registration, the board of directors of a foundation/fund must submit its Statute, which specifies in more detail the governing structure and proceedings, as well as grant-making rules and any other specific internal regulations.

3) Public Benefit Corporations (PBCs)

A PBC may be established by a natural person or by a legal entity, including the Czech Republic or any municipality. The founder may be a single person or several persons acting together. The founder(s) present the proposal for registration to the district court, which is responsible for keeping the register of public benefit corporations. Again, this is the same court that maintains the register of commercial legal entities. The proposal must be accompanied by the Articles of Incorporation in the form of a Founders' Agreement, if there are two or more founders or in a form of the Notary Act, if the founder is a single person. The Founder's Agreement must be signed on authority.

According to the Law on Public Benefit Corporations, the information in the Articles of Incorporation and in the Application for Registering a PBC must include the following:

- a) the unique name and address of the PBC;

- b) the name and identification information for its founders and their share in the property endowed to the PBC, if there is such;
- a) the public benefit services which the PBC is to provide;
- b) the conditions upon which the public benefit services will be provided;
- c) the names of members of the board of directors (no less than three natural persons) and the supervisory board, if such a body is established;
- d) the way in which the board of directors acts on behalf of the entity;
- e) the specification, whether the PBC is being established for an indefinite period of time or for a specific one;
- f) the type of additional economic activities, if such activities are to be allowed to the PBC; and
- g) the means by which the obligatory annual report on activities will be published.

Some additional aspects of the law as well as other legal requirements include the following:

- a) The founder(s) or board of directors must also obtain a license for any licensed additional economic activities in which the PBC is to engage (e.g. health services, social care).
- b) The law is not explicit about the kind of services that might be proclaimed as public benefit services. As mentioned above, the only requirement is to make these services available to the general public under well-defined and equal conditions.
- c) The PBC may refuse to accept any obligation incurred in its name by the founder(s) during the period of time between its establishment and the date of registration, at which point the PBC becomes a legal entity.
- d) Within six months of registration, the board of directors of the newly registered PBC must decide on the Statute of the PBC. The Statute describes in more detail the governing structure and proceedings as well as rules for the provision of services together with any other specific internal regulations.

The Law on Foundations and Funds allowed foundations that were registered before 1998 to decide on their transformation into the PBC. In such a case, the statutory organ of the existing foundation was also entitled to decide about the founder(s) of the PBC, if the original founder(s) no longer existed or were not interested in the fate of the foundation. The existing foundation as such was not acceptable to the courts in the role of the founder, because its existence ceased with registration of the PBC, to which all the property, liabilities and rights of the former foundation were transferred. However, the courts' decisions on these specific cases were not consistent and some unresolved re-registration cases were open for several years. Even in 2002 there are still several cases appealed to the Supreme Court awaiting the court's final decision. Only its judicial decision may unify the interpretation of the law.

4) Umbrella organizations for not-for-profit organizations

Section 20(f) and the following subsections of the Civil Code (see *Act No. 64/1964, Civil Code, as amended by later Acts*) regulate the establishment of associations of legal bodies. These so-called "corporate associations" (to distinguish them from civic associations) may be established by a written founding agreement between the founding legal bodies or by a resolution accepted by representatives of the member legal bodies at the founding assembly. To the founding agreement or resolution of the founding assembly must be attached the written statute and a list of persons entitled to represent the corporate association. Such corporate associations represent an acceptable model for umbrella organization of other civic organizations.

In addition, *Act No. 83/1990 on Associating of Citizens*, provides explicitly for the formation of Unions of Associations. This provision is used mostly by trade unions, but there is also the Union of Nature Defenders of the Czech Republic and other similar organizations of the umbrella type, which make use of this provision of the law. In such a union, each of its members retains its own legal personality, while the union acquires separate legal personality as well.

5) General Rules for Becoming a Legal Entity

As a general rule, an entity acquires legal personality status only after the relevant authority has decided formally on its registration. Therefore, any legal action taken by the entity prior to this date is deemed invalid. The incorporation of the legal entity in the relevant register is essential to its legal status. To prove the legal status, the legal entities must obtain either a registration certificate or a stamped, registered copy of their statute, which was filed with the Ministry of Interior. When the registering authority is the court, a registration decision is issued, containing all the information filed in the register.

Registration of associations usually takes several days, but rarely more than a month. As a general practice, the officials at the Ministry are willing to provide basic information to those who failed to understand the law correctly and who are asked to correct minor faults in the submitted documentation.

Registration of PBCs, foundations or funds may take several months because the courts are not limited by any terms in their decision-making. In 1998 the average registration period of time was about four months, but there are cases of much longer terms. In many instances the court requires additional explanations or supporting documents. This makes the registration process rather difficult, and, as a rule, the courts decline any request to provide any explanation of the details of the law. There have been several cases when the court required the documents to be prepared

by an attorney at law. Since 2002, due to the reform of judiciary, the registration process with the courts seems to be more straightforward.

A general right of appeal exists when registration is denied. The request of the court to complete the application because it contains incomplete information is also rather numerous and may occur several times for the same case.

In the exceptional case of registering the foundations established before 1998 as foundations, funds or PBCs, a denial of registration and the confirmation of such a decision by the court of appeals, which is the Upper Court, would result in the liquidation and dissolution of the foundation by the District Administration Office. In such a case, the liquidation balance of the former foundation must be transferred to another foundation with a similar purpose. If such a foundation does not exist any more, and if the local self-government does not accept the property within 60 days, the remaining property balance goes to the State authority to be used for public benefit purposes. As mentioned above, there still remain about 2100 foundations, which did not re-register and whose property was not yet liquidated by the relevant District Office. The reason is simple – the District Offices claim not having budgeted money for doing so.

F. General Powers

All not-for-profit, non-governmental legal entities are permitted to carry out any legal function not forbidden to other legal entities, unless the specific legislation as described above stipulates explicitly otherwise. If an entity does not comply with the laws or Constitution of the Czech Republic, any person affected by the entity's misconduct is entitled to raise the issue with the appropriate court with jurisdiction over the organization depending on the seat of it.

G. Membership Organizations

Associations are given broad discretion to establish membership rules in their by-laws. According to the Law on Associating of Citizens, however, no one may be forced to join an association or be discriminated against in any way because of not doing so. Also, no one may be prevented from terminating membership in an association. Each organization determines its own rules for accepting, excluding and removing members.

III. GOVERNANCE

As it follows from previous explanations, the Czech laws require a legally organized not-for-profit organization to have at least one, and sometimes two, internal governance organs. The second organ is generally a supervisory or internal auditing organ. The existence of these organs,

their method of decision-making, and the rules under which they act on behalf of the organization must be specified in the founding documents of the organization. The statutory organ may be either a natural person, such as a President, Director, Chairman of the Executive Committee, etc., or a collective organ, such as a Board of Directors, Executive Committee, Presidium, etc.

The rules, which define the liability of the statutory organ(s) and its members for any harm caused to an organization, are found in the Civil Code. The members of the statutory organ are not liable in person. The liability is with the organization itself. However, the organization may claim a recovery of the damages caused from a responsible member of the board before a civil court. The organization may also recover up to a 4.5 times the average monthly salary of an employee for losses caused to it by a responsible employee. The organization itself is liable up to its current equity level for any harm to third persons caused by it or by its statutory organs, but any members of the governance organs are ordinarily not liable for damages. However, in the case of bankruptcy proceedings, the members of the statutory organ may be liable for damages to creditors up to all their personal property in cases where the statutory organ failed to proclaim bankruptcy as required by the law, and the organization is unable to repay all of its debts, even after selling its entire property.

The supreme governing organ of an *association* is the assembly of all its members. The general assembly convenes according to the rules specified in the by-laws (statute) of the association. In practice and if the association is large and territorially extended, its general assembly may also be convened in multiple smaller units. The general assembly usually elects a narrower executive organ, like an executive committee, whose chairman or president are considered a statutory organ, which represents the association and deals on its behalf between sessions of the general assembly.

The statutory organ of a *PBC* is its Board of Directors, which is nominated by the founder. It is not intended to be a self-perpetuating organ, and one-third of its membership must be rotated annually, allowing its members a three-year tenure. However, when the founder(s) are no longer able to appoint directors, the Articles of Incorporation provide guidance for the Board of Directors to elect its new members out of a defined group of natural persons, if a designation is made by the founder(s), or from the general public otherwise. The State District Office may remove a member of the Board of Directors of a PBC if he or she no longer fulfils the prerequisites for the position. However, there is no provision for removing a member of the board if he or she is inactive or displays disloyalty or any other breach of good morals. There is also a restriction on the membership of foreigners, providing that at least 2 out of 3 members of the board be Czech citizens. There is also a prohibition against any board member being related to an employee of the PBC. The governmental proposal to amend these strict requirements and replace them by milder ones has been

submitted to the Parliament, which should decide upon the proposal during its ongoing last session before the elections scheduled for June 2002.

Similar to the PBCs, the statutory organ of a *foundation* or a *fund* is a Board of Directors, which must be composed of at least three natural persons, in this case without any restriction based on citizenship or length of service. The regulations on term of service and its periodic change are similar as those for the Board of Directors of a PBC, unless otherwise specified by the founder(s) in the Incorporation Articles. *Foundations* must have also a second body – the Supervisory Board – when the total value of their endowment surpasses CZK 5,000,000 (i.e ten times the minimal value required by the law). Similar regulation holds for a *fund*, if its total assets surpass the same value. The Supervisory Board checks the activity and accounting books and must report any observed violation of law, Incorporation Articles and Statute to the Board of Directors. In case of need, it may convoke the meeting of the Board of Directors and enforce its dealing with its recommendations. This board also reviews the annual sheet of balance and the annual report of the foundation or fund.

In general, civic organizations have broad discretion in defining the rights and voting procedures of their governing organs. However for PBCs, foundations, and funds, the law designates a quorum of the Board of Directors to consist of a majority of its members and it also provides a decisive vote for the chairperson in case of an equal vote being cast.

The general rules dealing with conflicts of interest and self-dealing with respect to any legal body are prescribed by the Labor Code. According to it, the member of a statutory organ and its direct subordinates may not take part in any business activities on their own which would be of the same character as the activities of the organization they represent. Also, an employee may not engage in other activities similar to that of his or her organization without prior approval by the statutory organ of the organization.

In the case of a PBC, the law requires explicitly that a member of the Board of Directors must not be closely related to persons who are employees of the PBC or persons with whom the PBC has contracts. In addition, members of the Board of Directors of a PBC may not be financially rewarded for their honorary function. Such a restriction does not apply to the members of the board of directors of a foundation or a fund. Of course, the compensation of certain expenditures such as the refund of relevant travel expenses is not subject to this rule.

IV. DISSOLUTION, WINDING UP AND LIQUIDATION OF ASSETS

A. Voluntary Dissolution

1) Associations

The supreme organ (general assembly) of an association may decide to dissolve the association or merge it with another association, unless the by-laws specify otherwise. The by-laws may also permit an association's elected executive body to dissolve the association, but such delegations of authority are rare. In any case, the decision to dissolve the association must be forwarded to the Ministry of Interior within 15 days.

There is one legal problem caused by this relatively easy method of dissolution of an association. There are reported cases in which associations took part in transactions that were risky or even illegal and immediately thereafter these associations decided on their dissolution. Once dissolved, an association does not exist as an entity, and the Czech laws contain no rules under which liability can be assessed against the former members of a dissolved association. However, a recent decision of a court confirmed the possibility to suit the members of a dissolved association for not appropriate liquidation of assets upon dissolution, as required by the law and according to the creditors complaints.

2) Foundations/Funds

The rules governing the dissolution and winding-up of a foundation or a fund allow the board of directors to decide on such an action only when the purpose or the term for which the foundation or the fund was established, as specified in its articles of incorporation, has expired. When a foundation or a fund is dissolved, its endowment must be transferred to another foundation or fund with a similar purpose.

3) Public Benefit Corporations (PBCs)

The board of directors of a PBC may decide to dissolve the corporation if it is no longer capable of providing the required and registered public benefit services. However, such a decision by the board becomes valid only after the lapse of a 60 day waiting period, during which the founder(s) may decide otherwise and take over the responsibility for continuing the activities of the PBC.

B. Involuntary Dissolution

1) Associations

The Ministry of Interior is obliged to inform an association of any violation of the Law on Citizens' Associating before taking any action leading to the involuntary dissolution of the association. The causes for such a decision may be evidence of the carrying-on of activities prohibited by the law, such as the engaging in religious ceremonies and worship or behavior reserved to political parties or political movements. However, it may also be due to systematic profit making business activities being undertaken in the name of the association, resulting in the earning of profits

by members of the association in violation of the law. Another reason for involuntary dissolution of an association may be the evidence of its paramilitary activities or infringing upon the rights of other citizens or its members. If the organization continues to conduct such activities despite a written warning issued by the Ministry, it may be dissolved. The affected association may appeal to the Supreme Court, but its activities are banned until the court issues its decision.

2) Foundations/Funds

The court may decide to dissolve and wind up a foundation or fund on the proposal of a founder, a member of the board of directors, a member of the supervisory board or any other person who may prove legal standing. For such a decision there must be evidence that the foundation or the fund repeatedly violated the law, its articles of incorporation or its statute. Another reason for dissolution might be that the board of directors did not meet at least once in that year, that the board of directors or the supervisory board did not meet for more than a year or that seats on either board remained vacant. The foundation/fund may also be dissolved if it does not fulfill for more than two years the purpose for which it was established. The court is obliged to allow remedy of these faults before a final decision on dissolution is made.

3) Public Benefit Corporations (Companies)

The court may decide to wind-up and liquidate a PBC on the proposal of a state organ, a founder or a person who may prove legal standing. For such a decision there must exist evidence that the PBC violated the law. Another reason for winding-up a PBC might be that the board of directors did not meet at least once in that year or that the new boards were not appointed and previous board term of function has terminated more than a year ago. The court may so decide also upon evidence, that the PBC does not provide the public benefit services as declared in its Articles of Incorporation for more than six months or that in the period of six months the quality, scope and accessibility of the public benefit services was jeopardized repeatedly due to the excessive engagement in additional economic activities or that the incomes generated by the activities of the PBC or from the property provided to it were used contrary to the requirements of the law. The court may provide a term in which the claimed faults may be remedied.

C. General Rules on Liquidation

Articles 70 to 75 of the *Code of Commerce* provide the general rules for liquidation of a legal entity. Any organization may be liquidated by the decision of a court upon the initiation of bankruptcy proceedings against it, in which case a liquidation officer will be appointed to decide on the use of

the liquidation balance after all liabilities of the legal entity are met. Unless the law does not require otherwise, the liquidation balance is to be:

- a) used in accordance with the by-laws or statute of the organization;
- b) distributed according to the decision of the supreme or statutory organ in the case of voluntary liquidation; or
- c) used in the way decided by the liquidating officer, if such is nominated by the supreme organ or a court.

In the case of the voluntary dissolution of an association, the supreme organ of the association may appoint the liquidating officer. However, upon involuntary dissolution, the Ministry of Interior selects the liquidating officer. The Ministry also appoints the liquidating officer if an association has no supreme organ.

The articles of incorporation of a foundation or a fund may specify to which type of foundation or fund its liquidation balance assets should be transferred in case of voluntary liquidation, i.e., when its purpose was achieved. Similar regulation applies to PBCs.

In any case, even in the case of involuntary liquidation, the liquidation balance of a foundation, a fund, or a PBC must be offered, first, to another legal body of the same type (foundation, fund, or PBC, respectively) and of similar purpose. Second, these assets may be offered to the community, where the foundation or fund has its seat. Finally, only in cases when neither of these offers is accepted, the assets may be transferred to the state district administration to be used for a related public benefit purpose.

V. REGULATION

A. Regulating Authorities

The Ministry of Interior is expected to monitor the activities of associations, but in no case it may interfere with its activities. In the case, when the Ministry learns about an activity of an association, which violates the requirements of law, the Ministry is obliged to issue a warning to the association and if the warning does not lead to remedy, the Ministry may decide to dissolve the association. This decision may be appealed to the Supreme Court.

PBCs, foundations and funds are supposed to act in compliance with the law and their own statutes. They are also required to report their activities in an annual report, which includes an overview of their property, provided grants or services and acceptance of substantial donations. Any person, who proves a legal interest, may apply to the court of registry for permission to bring proceedings against a PBC, foundation or fund. The

court may decide on the winding-up or, in the case of a PBC, on financial sanctions, i.e. the loss of tax benefits for one calendar year.

The court will issue the decree on dissolution of the foundation, if its endowment does not permanently yield revenues and the foundation has no other assets to be able to fulfill the purpose for which it was established. Similarly, a fund may be dissolved by the court decision, if its property has been totally spent and the fund is no more able to fulfill the purpose for which it was established. Upon a proposal of a founder, the Testimonial Administrator or a person which proves legal standing, the court will issue the decree on dissolution of the foundation/fund as well, if it violates in a serious manner or repeatedly the law or its own Statute, if during the previous year there was not convened any single meeting of its board of directors or if the members of the boards were not elected for more then a year to replace persons whose membership in a board terminated, or if the foundation/fund does not fulfill the purpose for which it was established for a period of time longer than two years. In all this cases, there is issued a period of time within which there is a possibility given to remedy the violation determined by the court.

Every legal entity must file an annual tax report that includes information on its overall income and expenditures for the previous calendar year. Organizations earning over 5,000,000 Czech Crowns and all foundations are expected to use a cross-account method for keeping their financial records and must attach an audited financial report signed by an independent auditor. The tax report of all corporate persons must also include the account numbers at all banks where income is deposited. The district financial administration offices are the bodies that supervise the compliance of the legal entities registered in the district with the tax laws.

VI. FOREIGN ORGANIZATIONS

In general, foreign organizations may establish branch offices and actively operate in the Czech Republic provided that the branch office is properly registered at the Ministry of Interior as required by the *Act No. 116/1985 on Conditions for Activities of Organizations with an International Element*. This law requires that the person entitled to act on behalf of the statutory organ of the branch office be registered for permanent stay in the Czech Republic.

In particular, the Law on Foundations and Funds allows a foreign foundation to register a branch in the Czech Republic, provided it fulfills the requirements set forth for by the law. Organizations which have already been registered in compliance with the Act No. 116/1985, on Organizations with Foreign Element and which bear characteristics of a foundation or a fund according to the Law on Foundations and Funds may decide to register as a foundation, a fund or as a branch of a foreign foundation. However, the proposal for registration must have been submitted to the registering court before December 31, 1998. Those foreign foundations,

which failed to do so, have lost automatically their permission to operate in the Czech Republic beginning from January 1, 1999. It is important to distinguish in this context the "foundation-like" foreign organizations of non-membership type from philanthropic membership organizations, which bear the characteristics of an association and, therefore, are not affected by these regulations. In practice, several foreign foundations operating their offices in the Czech Republic have applied for re-registering as a foundation or a fund or as a branch of a foreign foundation. Some of them were waiting for the court decision for such a long time that they decided to terminate their activities or to establish new branch or to assist in the establishment of an independent foundation or fund.

Registration is always required for international organizations intending to conduct programs in the Czech Republic, no matter how long or short the organization's program will last. Small-scale and very short-term activities are not reported, unless they involve public relations or attract the attention of mass media.

VII. MISCELLANEOUS

A. Mergers and Split-ups

No special rules exist for mergers and split-ups of associations. An association may become a part of a union of associations, a member of another association, merge with another association or split into several associations or transform itself into a union of associations. Moreover, any legal entity may become a member of an association.

Foundations may only be merged into another foundation having a similar purpose. Such a merger would entail the merger of the two registered endowments. Funds may merge into a foundation or another fund. The law does not provide for split-ups of foundations or funds, but a foundation is not explicitly forbidden to become a founder of another foundation, fund or a PBC. A merge is allowed only if the foundation or fund property does not suffice for achieving its purpose. In other words, once property is endowed or donated to a foundation or fund to serve a given purpose, it must serve that purpose even after a merger with another foundation or fund.

PBCs may merge into another PBC or split-up into more than one PBC.

B. Dealings in Property

For associations there are currently no special regulations that permit or deny investments in real estate, bonds, and other commercial enterprises. This means that they may do so (see also Part VII C).

PBCs are substantially limited in their commercial activities and the use of property. A PBC may not participate in the commercial activity of any other legal body. However, its own services may be provided for reward and its additional activities might be commercial. At the end of the year, the profit of the PBC, if any, must be transferred to its reserve account, whose primary use must be to cover future losses.

The assets registered as a part of the endowment of a foundation may not be sold nor used as security for a loan. Foundations and funds may become owners of real estate and rent the property for profit, but never to members of their boards. Besides, foundations (but not funds) may invest more than 20 percent of their assets, which do not form a part of the registered endowment, into shares of joint-stock companies. An individual foundation may not possess more than 20 percent of the registered capital of any joint-stock company. The monetary part of the endowment may be exchanged only for bonds issued or guaranteed by the state. No other commercial enterprise or investment on capital market is permitted for foundations and it is fully denied to funds. These strict rules caused complaints as well as became controversial in cases of registering the recent endowment donation of the Parliament, which were used to buy shares in a Balanced Investment Fund of Foundations, specifically established for that purpose. While in most cases the registration has been confirmed by the court, in two cases the judge refused the registration and, currently, the situation awaits the final decision of the Supreme Court, to which the two foundations appealed.

A recently submitted proposal to amend the Law on Foundations and Funds in the part regulating the use of the endowment has been refused by the Budget Committee of the Parliament, which may result in the refusal of the proposal by the Parliament of the current session.

C. Investment abroad

PBCs are prohibited from opening a branch abroad. However, several PBCs actively provide their humanitarian or educational services abroad. An amendment canceling this restriction is currently (Spring 2002) pending in the Parliament.

In all other cases, civic organizations are subject to the same restrictions as any other legal bodies, as far as investments abroad are concerned. *Act No. 219/1995 on Foreign Currency Use* allows all civic organizations including PBCs to keep accounts in foreign currency, directly invest abroad including purchasing a real estate, accept loans from abroad, transmit bonds emitted in the Czech currency abroad and gain income in Czech currency from business activities with foreigners without limitations for transferring these incomes abroad. However, only those foreigners who permanently reside in the Czech Republic may purchase real estate in the Czech Republic. No such limitation exists for foreign legal entities, which have their official seat on the territory of the Czech Republic with the

exception of any international organization acting in the Czech Republic according to special laws. Since foreign foundations may register their branches in the Czech Republic, they may, apparently, purchase real estates for these branches without restriction.

D. Political activities

Associations may not be established to conduct political activities such as active participation in elections. Foundations and funds are not permitted to give financial support to political parties or political movements.

Despite these restrictions, it is obvious that all civic organizations may support or oppose the election or appointment of certain persons, participate in lobbying and public advocacy, as well as in providing information on issues of public interest. Whether a civil organization may engage in issue-oriented litigation depends on the case, but, in general, a judge would only hear parties with a direct relationship to the case.

VIII. FISCAL RULES

In the Czech Republic, the tax and fiscal laws form a special branch of the general legal framework. In general, they deal with all tax and fee duties and exemptions, as well as with other fiscal rights of any natural person and any form of legal entity with respect to the state and its institutions. However, in some specific cases these matters are also dealt with in the laws that regulate a specific form of legal entity.

The main laws, which regulate tax issues in the Czech Republic, are the following:

- a) *Act No. 586/1992 on Income Tax*, as amended by later laws and also by the *Act. No. 227/1997 on Foundations and Funds* and by the *Act No. 248/1995, on Public Benefit Corporations*
- b) *Act No. 588/1992 on Value Added Tax*, as amended by later laws
- c) *Act No. 593/1992 on Depreciation Reserves for Income Tax Base Establishment*, as amended by later laws
- d) *Act No. 587/1992 on Consumption and Excise Tax*, as amended by later laws
- e) *Act No. 16/1993 on Highway Tax*, as amended most recently by later laws
- f) *Act No. 338/1992 on Real Estate Tax*, as amended by later laws and also the *Act. No. 227/1997 on Foundations and Fund* and by the *Act No. 248/1995, on Public Benefit Corporations*
- g) *Act No. 357/1992 on Inheritance Tax, Donated Assets Tax and Property Transfer Tax*, as amended by later laws and

also by the Act. No. 227/1997 on Foundations and Funds and by the Act No. 248/1995, on Public Benefit Corporations

- h) Act No. 337/1992 on Tax and Fees Administration, as amended by later laws and also by the Act. No. 227/1997 on Foundations and Funds and by the Act No. 248/1995, on Public Benefit Corporations

In general, regulation of taxes depends either on the type of activity or on the legal form taken by the legal entity.

A. Tax Exemptions for Civic Organizations

1) Corporate Income Tax

First of all, the law distinguishes a corporate tax payer "which has not been founded or established for business purposes" from other tax payers. This category explicitly includes "interest associations of legal entities explicitly not established for income generating activities, associations of citizens including trade unions, political parties and political movements, registered churches and religious communities, public benefit corporations, foundations and funds, public higher educational institutions⁵, municipalities, organizational components of the state administration, regional self-governments, contributory organizations, state funds and other subjects defined so by a special law⁶". Taxpayers in this category must always report incomes derived from advertisements, membership fees, and property rentals. However, the incomes from "...membership fees paid in accordance with by-laws of an association, trade union, political party, and political movement" and incomes "...from church collections for liturgical acts and members' contributions in the case of registered churches and religious communities" must be reported but are exempt from the Corporate Income Tax. Tax-exempt status is also given to certain ecologically beneficial activities and incomes from lotteries organized according to special regulations, if more than 90% of the profit is used for public benefit purposes.

On the other hand, for tax payers in this category, incomes originating from "...activities corresponding to their mission, if the expenses are higher than the incomes and the relevant activities are well defined in statute, by-laws, establishment proposal or founding agreements of such a legal entity", they are not taxable. Similarly treated are incomes from "...donations and other forms of state or municipal subsidy, if these are provided in compliance with a special regulation"⁷ as well as incomes from

⁵ Recently, it has been realized, that the inclusion of only public higher educational institutions, i.e. those established by special law (universities) puts into difficult situation any private higher school, which was not established as a PBC or association.

⁶ E.g. Czech Red Cross

⁷ Special regulations are other laws or government regulations issued for certain purposes, such as regulations under which associations may be given subsidies from the state budget.

"interest from savings on a current bank account". Exempt from income tax are also incomes of foundations generated from its registered endowment, including rentals from real estates registered as a part of the endowment.

If an organization conducts both exempt activities and activities on which it must pay tax (e.g. advertising or property rental activities), it is required to pay tax on the income of the non-exempt activities only to the extent that income exceeds the expenses incurred to produce it. In general, this corresponds to the notion of a taxable income, as defined for the purpose of the corporate income tax for any legal entity. However, the civil organizations in the above mentioned category must account separately for incomes and related expenditures in the case of any activity, which generates net income. This, of course, creates a source of dispute about the accounting mechanisms that are required to regulate these arrangements. In other words, only for this category of legal entities the law stipulates that the account books must separate the tax-exempt incomes and related expenses from other taxable incomes and related expenses. By properly doing their accounting, civil organizations may avoid unnecessary problems during the randomly organized supervisory audits conducted by the taxation officers, on the expense of significantly higher cost of accounting in the case of greater organizations with many types of activities.

On the other hand, in addition to the tax exemptions mentioned above the not-for-profit organizations mentioned above may reduce their tax base by up to 30%, but not more than CZK 1,000,000 (about USD 27,500)⁸. However, this is possible under the condition that the assets acquired in such a way be used to cover the expenses for activities that are not tax liable. These are mainly the activities that do not generate any profit. When the 30% reduction of the tax base is less than CZK 300,000⁹, the taxpayer may retain up to the latter amount, but not more than the tax base itself. This rule is more clearly explained through an example, comparing the tax situation of a commercially oriented legal entity – e.g. a trading company and a not-for-profit NGO.

In the case of a trading company, when calculating the tax base, the total expenditures related to the total income may be subtracted. For example, assume a trading company generates CZK 1,500,000 in direct income from all of its activities and spends CZK 700,000 in deductible expenses. The balance, CZK 800,000, is liable to the income tax. The tax rate being 31%, the company will have to pay CZK 248,000 in taxes, leaving CZK 552,000 as a net profit.

Suppose an association organizes two fundraising concerts. From the first one, it makes a profit of CZK 1,500,000, while from the second concert there was a loss of CZK 700,000. The total balance of the two activities is a profit of CZK 800,000. The income from the first concert is

⁸ Note that until 2001 the reduction was allowed up to CZK 3,000,000 (USD 82,500)

⁹ Note that until 2001 this minimum has been set to CZK 100 000 (USD 2,750)

liable to the corporate income tax, while the income from the second concert is not taxable. However, the 30% tax base reduction may be applied to the income from the first concert. That would make CZK 210,000, which is less than the minimum of CZK 300,000 set by the law. Therefore, the minimum can be subtracted and the 31% tax is paid from CZK 1,200,000 tax base, that is CZK 372,000, leaving from the first concert CZK 1,128,000 as net income after tax paid. The reduction on tax, CZK 93,000 covers only a small part of the loss of CZK 700,000 from the second concert.

The overall income before taxation in both cases was the same: CZK 800,000. However, as a result of divided accounting of profit making and loss making activities the civic organization is in a less favorable position, because after taxation its net income in this example is less by CZK 124,000 compared to that of the trading company. Therefore, the 30% tax reduction for not-for-profit taxpayers combined with special accounting regulations makes their tax burden even worse than if not applied at all.

As of 1997 the effective national corporate income tax rate was 39%, for 2002 it has been reduced already to the 31% used above. For investment funds, the tax is even lower: 15%, which is of importance for foundations, which may use the specially created Balance Investment Fund of Foundations to collectively invest their money assets there.

2) Local Taxes

There is no direct local taxation in the Czech Republic. Municipalities receive total income from the property tax from land and real estates located on their territory, as well as 20.59% of the income tax of natural and legal persons (corporate income tax), as collected by the national government.

3) Value Added Tax (VAT)

The VAT generally applies to all transactions of those taxable persons whose total turnover during the three preceding calendar months was greater than CZK 750,000 (approx. USD 20,500).

Transactions resulting from the main activities of legal entities not established for entrepreneurial purposes (see also VIII.A.1) are exempt for VAT. Also any educational activities at educational organizations and provision of goods for educational purposes of these organizations are VAT exempt. Other transactions are liable to VAT.

Thus, if an association runs a hostel on its property and if that is its main activity according to its by-laws, the services provided in the hostel are not subject to the VAT. On the other hand, because civic organizations are not, in general, taxable persons under the VAT, they may not apply for reimbursement of the VAT paid to the providers of goods and services.

4) Customs Duties and Excise Tax

The exemption from customs duties applies to certain types of goods rather than to types of organizations. Exempt items include goods for educational purposes (such as books), scientific work (such as equipment and tools), and goods to be used for the purpose of enhancing the cultural and living standards of handicapped people; goods to be distributed free of charge by charities, office equipment and material donated to Czech civil organizations; and goods to be used by the blind.

The exempt is granted only to donated goods and goods for which there is not an equivalent produced in the Czech Republic or if the import may not jeopardize the interests of Czech producers of similar articles.

5) The Real Estate Tax

The tax on real property is determined by taking into account the size of the plot of land or the number of floors in the building. The tax also diversifies with respect to the category of the land use and the population in the municipality. Exempt from both real estate tax and the construction tax is the real property on which buildings stand that serve as churches or that cater to the activities of a religious congregation. This exemption is also applicable to the real property on which stands a building belonging and serving to a foundation, to a school, a museum, an art gallery, a public library, or to a health or social care institution, or which serve exclusively to the protection of environment. The lots belonging to a foundation with an endowment are also exempt from real property tax (funds without endowment do not receive this exemption). Also exempt from this tax are lots, on which stand cultural monuments. The tax ranges from 0,3 to 4,5 CZK per square meter, depending on the use and size of the municipality.

Tax exempt is also applied to several categories of buildings. These include buildings belonging to

- registered churches and religious congregations serving to religious purposes,
- associations of citizens and public benefit corporations,
- foundations, if these buildings serve to schools, libraries, museums, galleries, archives, health or social services, associations of handicapped people
- any person, if on a list of historical monuments open to general public.

The tax from buildings ranges from 0,3 to 15 CZK per cubic meter, depending on the use and size of the municipality. The tax further grows proportionally to the number of floors in the building.

6) The Tax on Donated Assets

No tax is paid on donated assets if the transfer is made "... to finance establishments and humanitarian actions in the field of culture, learning, science, health and social care, ecology, sports, education and protection of children" and if "... the property belongs to legal entities established for the above purposes and having their seat in the Czech Republic." Exempt from the donated property tax are "all donations to a the registered churches and religious congregations, public benefit corporations, political parties and political movements, foundations, funds, as well as all grants provided to third persons by a foundation or a fund, if they are used in accordance to the purpose and conditions related to the grant". Portions of real estates may be used for the purposes mentioned above. However, any portion used for commercial purposes such as renting is then liable for tax, unless specified otherwise by a special law (see C1).

7) Other taxes and fees

Foundations funds and PBCs are, in general, exempt from fees for court proceedings related to their registration, as well as from certain other fees.

B. Tax benefits for donors

The Czech legal system contains special rules for gifts and donations. Natural and legal donors are treated differently for tax purposes.

1) Gifts from Natural Persons

A natural person may deduct donations made to specific not-for-profit organizations within the limit of 10% of the person's tax base. To qualify for this exemption, however, a natural person must donate at least 2% of his/her tax base, but not less than 1,000 CZK. Donations qualified for tax exemption must be given to municipalities or to not-for-profit entities with headquarters in the Czech Republic, which organize a public collection according to a special law¹⁰. The donation must be used to finance "science and learning, research and development, culture, schools, police, fire squads, support and protection of young people, protection of animals, social and health care, ecology, humanitarian and charity purposes, religious purposes for registered churches and religious communities and sports." In addition, donations to natural persons living in the Czech Republic who use the donation to run "schools and health care establishments and care for abandoned animals or endangered species" are also exempt.

2) Donations by Legal Persons

¹⁰ This requirement has been included since 2002 in relation to the newly adopted Law No. 117/2001 on Public Collections, which requires to inform about a public collection the regional office in the term of 60 days prior to the beginning of the collection.

The rules for natural persons apply to for-profit legal entities, as well, but a legal entity may not deduct more than 5% of its tax base¹¹ and must donate at least 2,000 CZK to qualify for the deduction.

C. Endowment issues

1) Taxation of Endowments

In general, all income from investment of capital, such as bank savings (except for the current income/expenditure account), dividends, bonds, etc. is taxable. For bank accounts, the bank automatically deducts the 15% tax.¹²

An important issue introduced into the Law on Income Tax by the Act on Foundations and Funds (which amended several other laws, including the tax laws), is the statement, according to which "the incomes generated from the renting of real estates, ... from renting products of art..., from interest rates and dividends on shares, ..., from interest rates on financial assets... deposited on a special account at a bank ..., from authors and patent rights, ...which are registered as a part of an endowment of the foundations " are exempt from the corporate income tax.

Since at the beginning of 2002 there will be about 340 foundations with an average value of the endowment of about CZK 2,000,000 (due to the distribution of the privatization money), it is possible to make a rough estimate, according to which this special tax exempt provides about CZK 12,000,000 (USD 330,000) of annual savings on taxation for foundations. The estimate counts with the current 4% annual rate of interest and the total value of endowments of Czech foundations of more then CZK 2,000,000,000 (about USD 55,000,000) otherwise to be taxed by the bank tax of 15%.

2) Investments of Endowments

The overall value of the registered endowment of a foundation may not fall below CZK 500,000. The Law on Foundations and Funds prohibits the use the assets in the registered endowment of a foundation for investment - these assets must be kept in the form of monetary assets on a special account at a bank, real estate property, state guaranteed bonds, patent or author rights and products of arts which yield a permanent income. This does not limit the use of other assets of a foundation or all property of a fund to be invested into a real property or used in accordance with the purpose of the foundation or the fund. However, none of the property of a foundation or a fund may be used as a security to loans and other liabilities. In Part VII B the important investment exemption provided

¹¹ Note that until 2002 it used to be only 2%, exceptionally 3%.

¹² Note that until 2002 it used to be 25%

only for foundations with registered endowment and limited to 20 percent of their assets, which do not form the endowment is described.

Nevertheless, due to the possibility provided by the Parliament in its decision on distribution of assets from privatizations to endow foundations qualified in a open tender, several Czech foundations made use of a special Balanced Investment Fund of Foundations (BIFF), whose principal goal is to invest the endowment money of foundations according to the limitations of the law. The short experience of the years 2000 and 2002 shows, that the performance of the BIFF is a bit better then if the money were kept on a bank account. (For more details see Part XI A)

D. Commercial/Business/Economic Activities

1) Restrictions on Business Activities

Restrictions on business activities are found in the rules governing each of the different kind of organization. Civil organizations may not, in general, be established for business purposes. However, according to other legal requirements, associations and PBCs may engage in commercial and business activities, but, such an activity must not be done on a regular basis, and should be pursued only as complementary to the principal activities described in the organization statute, by-laws, and establishment documents. The law on PBCs allows these organizations to engage in activities other than their main public benefit service only if the additional activity provides for more effective use of the property without jeopardizing the quality, scope, and availability of its public benefit services.

Foundations are allowed to hold up to 20 percent of the shares in a joint stock company. To this end the foundation may use up to 20 percent of the property after subtracting the value of the registered endowment. This is not allowed for funds. However, both foundations and funds may rent their real estates on commercial basis, as well as organize cultural, social, educational and sports events with fundraising goals. For the same purpose they may also organize lotteries, raffles and public collections. Special laws regulate these activities.

2) Use of For-Profit Subsidiaries

The Act on Public Benefit Corporations prohibits participation of a PBC in a business conducted by any other legal person. A similar restriction holds for funds. Thus, PBCs and funds are not allowed to use for-profit subsidiaries.

As explained above, foundations may participate on business activities of joint-stock companies. Theoretically, five foundations may jointly held shares of a single company.

There are no explicit legal limitations whatsoever in this respect for associations, except the requirement that they may not be established for the purpose of business making.

3) Related and Unrelated Business

Only "related" activities are exempt from taxation, i.e. those which are explicitly related to the primary purpose of the civil organization and which are defined as such in the registered establishment document, statute or by-laws. The core problem with related or subsidiary business activities is in defining what is covered by the "principal" activity of the civil organization. Currently, practice has prevailed over legal rules and the taxing administration. For example, an association that works with handicapped people may sell products made by these persons as a business related to its main activity. If the same association sold products of another origin, for example, bananas, it would be considered to be conducting a clearly unrelated business activity. However, if the association sells products manufactured by handicapped people employed by some other civil organization, it would be very difficult to determine whether the association is engaging in a related or unrelated business activity.

E. Reporting

The specific rules on tax reporting are discussed above. Civil organizations with income of less than 100,000 CZK or only with exempt income are not required to file a tax return. However, they must be able to document their incomes and expenses for the past 10 years should the relevant authority of the Ministry of Finance decide to review the organization's accounting books.

Strict requirements are imposed on the annual reporting of PBCs, foundations, and funds by the new laws. They must produce and publish an annual report on their activities and economic results not later than six months after the close of the fiscal year and not later than 18 months after the original registration. The report should include summaries of all activities and their relationship to the public benefit services for which the PBC was established or to the granting and other activities of a foundation or a fund. The report must also include the annual balance sheet of income and expenses as well as the statement from an auditor, if an audit was made (an audited financial statement is obligatory for foundations, as well as for PBCs receiving state donation and funds with a turnover or total property value greater than CZK 3,000,000). The report should also include commentary about the assets of the organization and a commented overview of income and expenses. Income is to be reported separately according to its source. The expenses must be reported so as to distinguish between those related to public benefit services and activities and other additional activities and administration. The law also provides for sanctions for non-compliance with these rules. These sanctions may be limited to a

temporary loss of tax benefits for a PBC, or may result in liquidation in the case of a foundation or a fund.

Foundations and funds must include in their annual reports an evaluation of how effectively their grants were used by the grantees, as well as how they complied with the obligatory rule that limits their administrative expenses. The rule limiting expenses is a part of the registered information and must not be changed for 5 years (for more details see F1 below).

F. Miscellaneous

1) Limits on Administration Expenses and Salaries

The only regulation limiting administrative expenses is that found in the Law on Foundations and Funds. The administrative and operational expenditures of a foundation or a fund are limited by a rule, which must not be changed for at least 5 consecutive years. In the case of a foundation, this rule may be expressed as a percentage of the yield from the endowment, a percentage the endowment total value, or a percentage of the total yearly value of the grants made by the foundation to third persons. In the case of a fund, this rule may be expressed as a percentage of the yield from the property of the fund, a percentage of the total assets of the fund at the end of the year, or a percentage of the total yearly value of the grants made by the fund to third persons.

Until 1995, salaries in civil organizations were required to be in reasonable proportion to those paid by the government sector, regulated by a special law on wages. In July 1995, the government decided to eliminate these salary restrictions. In order to sustain the competition with the private sector on the skilled labor market, some civil organizations, seek to pay their employees on a level comparable more with the private than the public sector.

IX. COMPLIANCE

The Law on Public Benefit Corporations and the Law on Foundations and Funds contain sanctions to deal with non-compliance. These sanctions include a penalty, temporary loss of tax benefits (in the case of PBCs) or dissolution (in the case of foundations or funds). The court may decide on such a sanction only after a written warning has been issued to the violating organization, which failed to remedy the fault in a provided reasonable period of time.

No comparable sanctions exist for associations.

X. GOVERNMENT FUNDING

The Law on Public Benefit Corporations explicitly allows PBCs to apply for grants and donations from the state or municipal budget, but it

limits the possibility of obtaining such a subsidy to one public source for each individual project or activity.

Such a provision is not explicitly provided for foundations and funds. However, the Law on the Use of the State Property allows the Government to establish and endow foundations or funds, but such a move must be approved by the Parliament in a special law.

Nevertheless, substantial government resources (of the amount reaching approximately CZK 2,000,000,000 annually) are available at line ministries of the Czech Government, which operate in the field of interest of associations and PBCs. In 1999, the Council of Non-Governmental Not-for-Profit Organizations, which is an advisory body chaired by a Minister of the Government has initiated a change of the system, which introduced the obligation to provide state subsidies to associations and PBCs on the base of an open tender. All state donations are also registered in a register, which should become available to the general public and which will be combined with the database of NGOs, compiled by the Information Center of NGOs. This practice is supported by governmental tenders being published in the Bulletin of NGOs and in a Journal of Public Administration. This has been rule for many years in the fields of science, research and development, education, care for children and ecology. The new practice proved essential in the promotion of new methods and more client oriented social services, which may be provided by PBCs, associations and establishments of churches much more easily than by state run residential social care institutions.

Some civil organizations are dissatisfied with the low proportion of government funding in the ecology field and for care of cultural monuments, as compared with the amount spent on sports and other youth oriented activities. The issue of state participation in the funding of civil organizations will become even more acute after schools, hospitals, social care establishments, libraries, theatres, museums and other cultural state-run institutions are transformed into PBCs or similar forms of non-governmental public benefit institutions.

XI. CONCLUDING REMARKS

A. Use of the funds from voucher privatization

The Czech Parliament discussed in 1995 and 1996 a Bill on the Czech National Foundation. The proposal represented an attempt to provide a final and long-term solution to the dispute over the destination of the stock portfolios established to serve foundations, which were laid aside during voucher privatization in the Czech Republic to serve the rehabilitation of foundations. The State Fund of National Property (SFNP) is responsible for maintaining the portfolio, now worth of 2.8 billion CZK in market value of the shares in privatized industrial joint-stock companies. Beginning in the fall of 1996 the SFNP started to sell these shares. As of

November 1998, there were about CZK 500,000,000 already on the special account of the SFNP and another substantial part of the portfolio has been sold during 1999 for about CZK 1.700,000,000.

The idea of the Czech National Foundation proposed to be governed by a Board of Directors elected by the Senate of the Parliament has been abandoned during heated debates held between representatives of strong and smaller foundations during 1997 and 1998.

Finally, on the level of the Council of Non-Governmental Not-for-Profit Organizations there has been agreed a compromise solution, which found the support of foundations, SFNP and Government. It has been decided and later approved by the Parliament to distribute only the money from portfolio parts sold by the SFNP and to held an open tender to foundations for becoming custodians of parts of it with an obligation to add the state contribution into their registered endowment and to sign an agreement with the SFNP, according to which 80% of the income generated by the contribution will be distributed as grants to third persons winning open tenders announced by each of the foundation.

The distribution took place in two rounds. The condition for the first one was, that the applying foundation must have already been a grant-making foundation in 1995 and 1996 and in both of these years have distributed grants surpassing in total value 500,000 CZK. For the second round a similar condition reflecting already the existence of the new legal framework has been formulated, and the foundations were evaluated according to a multi-criteria scheme. Thus, in fall of 1999, there has been distributed about CZK 500.000.000 to 37 foundations. In the second round, which took place in 2001, about 60 foundations shared on the distribution of about CZK 1,700,000,000. These foundations are also entitled to obtain a proportion of the remaining funds generated from the sale of the rest of the original portfolio.

B. Amendment to the Act on Associating of Citizens

In summer of 1995, the Ministry of Interior started to work on an amendment to the Act on Associating of Citizens. The need for such an amendment was caused partially by the growing problems with associations that were suspected of not complying with the law, and, partially by the effect of new regulatory concepts in the Bill on PBCs and Bill on Foundations. The new Bill on Associations was expected to place the rights of Czech citizens and foreigners in associations on an equal legal basis, as well as to deal in a more specific way with the regulation of economic activities of associations. One of the gaps of the current law consists in a possibility to dissolve the association before any legal actions may take place to protect its creditors. Another discrepancy compared to other legal entities consists in the absence of a public register, where everybody may get information on the purpose, governing structure and statutory organ of an association. However, in May 2000 the Parliament

refused to support the Governmental Bill on Associations. The problems remain open. Only the Government, which will result from the June 2002 general elections, may brought about another proposal how to proceed in this matters.

In general, there is also a need to regulate access of associations and other civil organizations to the public assets and to other specific tax and fiscal benefits related to public benefit activities or with respect to the participation in public procurement procedures. In this context, the work on analysis of the categories and definition of public benefit activities and development of possible regulatory and public benefit status models related to it has been submitted to the Government. These works may continue in 2002 and result in a proposal of several new Bills and in proposals to amend existing laws so, as to better reflect the accumulated implementation experience and growing understanding and support of the civil society development in the Czech Republic.

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