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# Investing In ... 2023

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## **Czech Republic: Law & Practice**

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## **Czech Republic: Trends & Developments**

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# CZECH REPUBLIC

## Law and Practice

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## 1. Legal System and Regulatory Framework

### 1.1 Legal System

The Czech Republic has a continental civil law legal system based on Roman law and oriented within the Germanic legal culture. The principal areas of law are codified (civil, criminal, business corporations, administrative procedure, etc). The Czech Republic became a member of the European Union as of 1 May 2004, and Czech laws are harmonised with EU law.

The Czech Republic has a system of general courts that exercise all types of judiciary, save for the constitutional judiciary. The system of general courts comprises four levels: district courts, regional courts, courts of higher justice (or higher courts) and, at the top of the hierarchy, the Supreme Court and the Supreme Administrative Court.

The administrative judiciary is a special type of judiciary where general courts deal with lawsuits brought up against decisions by administrative authorities. These lawsuits are filed with the regional courts as the courts of first instance. Remedies against decisions by the regional courts can be sought before the Supreme Administrative Court. The Constitutional Court stands outside the system of the general courts and is in charge of deciding on constitutional complaints vis-à-vis civil proceedings.

### 1.2 Regulatory Framework for FDI

The Czech Foreign Direct Investment Act, Act No 34/2021 Coll, (the “FDI Act”), effective from 1 May 2021, has been introduced in response to the new EU Framework for screening of foreign direct investments throughout the EU (Regulation (EU) 2019/452 of the European Parliament). It introduces a level of vigorous screening for

non-EU investments in the Czech Republic, overseen by the Ministry of Industry and Trade. The new FDI rules will materially impact the process of investment and transactions by non-EU investors. See further **7. Foreign Investment/ National Security**.

## 2. Recent Developments and Market Trends

### 2.1 Recent Developments and Market Trends

The Czech Republic is one of the most successful CEE countries in terms of attracting foreign direct investment. According to the Czech National Bank, a total amount of more than EUR130 billion worth of FDI has been recorded since 1993. After the major pandemic-related fall in economies worldwide in 2020, the Czech economy partially recovered in 2021 with GDP growth of 3.3%. Nevertheless, FDI into the EU experienced a downward trend in both 2020 and 2021 and in the Czech Republic, 2021 saw a 38% decline in FDI compared to 2020. The Czech labour market continues to be tight, with an unemployment rate in the third quarter of 2022 at 2.2%.

Global economic challenges affecting the Czech Republic in 2022 included the war in Ukraine and the European energy crisis, which pushed inflation rates to 16.2% in November 2022. The application of FDI regulation is also specifically affected by the Russia-Ukraine war as the European Commission is now calling for a stricter assessment of Russian and Belarussian investments in the EU.

### Recent Czech Investment Trends

IT/technology and real estate were sectors showing the strongest activity during the COV-

ID-19 pandemic period and this has continued. The Czech Republic's IT innovators and system developers have established themselves as industry leaders and are in high demand from investors. Business information systems have experienced significant expansion in the fields of e-commerce, logistics, data centres, cloud systems, cybersecurity, payments systems, learning and games. Given the pandemic's acceleration of digitalisation throughout all economic sectors, the superiority of the Czech tech sector, and the drive of businesses to stay ahead of the curve in implementing digital solutions, it seems that technology and IT will continue to be key drivers of M&A activity.

### **Intergenerational Business Transfer**

The commercial landscape in the Czech Republic is currently undergoing a generational handover as family businesses are sold or transferred to successors after 25 to 30 years of development. This category of investment, which primarily consists of medium-sized businesses, is highly sought after by investors looking for high-quality, established businesses.

## **3. Mergers and Acquisitions**

### **3.1 Transaction Structures**

In the Czech Republic, the most common transaction structures are share deals and asset deals. Moreover, a business may be restructured through a transformation (usually a merger or demerger).

#### **Share Deals**

Share deals are the most common transaction structure to acquire minority shareholding both in private and public companies. The main advantage is their easy and quick implementation. Therefore, share deals are especially

suitable for large transactions which involve numerous assets whose transfer would be too time-consuming, financially and administratively complicated. However, the buyer also assumes all liabilities of the target company.

#### **Asset Deals**

Asset deals are particularly appropriate in situations where the buyer wishes to acquire only certain assets owned by the target company. The main benefit is that the buyer is certain that, apart from the rights and obligations directly connected with the transferred assets, it will not assume any other obligations of the target company unrelated to the acquired assets. On the other hand, the implementation of an asset deal is more expensive and time-consuming, as each asset must be transferred individually.

It is also possible to implement an asset deal in the form of transfer of a business enterprise (or its part) as a going concern, which includes all rights and obligations connected to the transferred business enterprise.

### **3.2 Regulation of Domestic M&A Transactions**

Aside from FDI clearance (if applicable), domestic M&A transactions may also be subject to economic competition clearance if certain thresholds are met, see 6. **Antitrust/Competition**.

## **4. Corporate Governance and Disclosure/Reporting**

### **4.1 Corporate Governance Framework**

The most prevalent company forms in the Czech Republic are a limited liability company (LLC) and a joint-stock company (JSC).

## LLC

An LLC is the most common private company type; it cannot be established as a public company. Its main benefits are limited liability of shareholders for the company's debts (shareholders are only liable up to the amount of their unpaid contributions) and no minimum registered capital requirement (a minimum contribution of each shareholder is CZK1).

An LLC has a quite simple governance structure – the general meeting as the supreme body, and one or more executives as the statutory body. A supervisory board is optional.

## JSC

A JSC may be established either as a private company or a public company. The minimum registered capital is CZK2 million or EUR80,000.

A JSC can have two possible internal structure systems. The dualistic system consists of the general meeting as the supreme body, the board of directors as the statutory body, and the supervisory board. The monistic system consists of the general meeting as the supreme body, and the management board as the statutory body; there is no supervisory body.

Shareholders are not liable for the company's obligations; they are only liable to the company up to the unpaid amount on their shares.

From an FDI perspective, selection of a certain corporate/other legal entity forms is not relevant; the Czech FDI law's purpose is to verify foreign investments in the Czech Republic in any form (even, for example, by means of purchasing assets).

## 4.2 Relationship Between Companies and Minority Investors

Generally, a principle of equal treatment of all shareholders applies. However, the Act on Business Corporations grants additional protective rights to certain minority shareholders of an LLC and JSC. The protection is provided to shareholders who own at least a 10% share or voting rights in an LLC, a 5% share in a JSC with registered capital equal to or lower than CZK100 million, a 3% share in a JSC with registered capital exceeding CZK100 million, or a 1% share in a JSC with registered capital equal to or exceeding CZK500 million ("qualified shareholder").

The typical rights of qualified shareholders include the right:

- to request the company's statutory body to convene a general meeting to discuss the issues specified in the request (applies to an LLC and JSC);
- to claim compensation for damages against a member of the company's statutory or supervisory body on behalf of the company (applies to a JSC only);
- to request that the statutory body include a certain question on the agenda of the general meeting (applies to a JSC only); and
- to request that the supervisory board reviews the performance of the board of directors' powers as specified in the request (applies to JSC only).

## 4.3 Disclosure and Reporting Obligations

Foreign investors may in certain cases be obliged to submit an FDI filing to the Czech Ministry of Industry and Trade under the Czech FDI screening regime, see 7. Foreign Investment/National Security.

## 5. Capital Markets

### 5.1 Capital Markets

Since the transition to a market-based economy that was initiated by the Velvet Revolution in the early 90s, capital markets in the Czech Republic have been in development for a little over 20 years now. Being relatively small and less mature than in many western jurisdictions (relative to GDP per capita), the main source of financing still remains in the hands of sponsor banks. Experience from recent years, however, shows that debt capital market instruments in particular are slowly gaining traction, where popularity is growing for corporate bonds with a prospectus, with issues for mid-to-large firms ranging typically from CZK500 million to CZK1 billion. Equity instrument-financings remain comparatively rarer and are used typically by investment funds, both on the fundraising, as well as on the financing side.

### 5.2 Securities Regulation

Securities remain governed predominantly by the Czech Civil Code as the primary private-law codex, while, depending on the type of instrument, certain particular aspects historically remain regulated by additional *lex specialis* legislation (eg, for bonds). Czech public-law securities regulation generally transposes EU-sourced rules, with, in particular, the EU Single Market Treaty freedoms well respected locally (via EU passport), and local specificities (gold-plating) being less common. Although a general tendency to create uniformity is apparent, in particular with respect to the distribution rules on capital markets, there still remains some material fragmentation and formally sector-specific rules are included in separate acts. With foreign exchange rules abolished, the forex policy remained very liberal until May 2021, when a tightening via the FDI Act's effects took place. Thereby, national-

screening mechanisms for certain foreign investors and their investments was introduced.

### 5.3 Investment Funds

Pursuant to the FDI Act, a foreign investor generally is any person or legal entity from outside the EU who makes an investment in the Czech Republic or a person or legal entity who is established in the EU but who is directly or indirectly controlled by a person/entity from outside the EU. Accordingly, any investment fund falling into this defined category will be subject to the FDI Act, but on the basis that it is a foreign investor, not specifically as an investment fund, and potentially could be screened if it exercises, because of its (prospective) foreign investment, an effective degree of control over the target object or target person (as defined in the FDI Act). The Ministry of Trade's annual review of FDI issued in August 2022 noted that, of the FDI investments assessed in the first year of the FDI Act's being in force, the majority were investment funds.

## 6. Antitrust/Competition

### 6.1 Applicable Regulator and Process Overview

The key competition legislation in the Czech Republic is the Act No 143/2001 Coll, on Protection of Competition, which deals with cartels, dominance and merger control. The relevant authority in the Czech Republic to apply merger control legislation is the Office for the Protection of Competition (*Úřad pro ochranu hospodářské soutěže* – the “Office”).

A merger of undertakings is subject to approval by the Office if:

- the total net turnover of all undertakings concerned achieved in the last accounting period in the market of the Czech Republic exceeds CZK1.5 billion and each of at least two of the undertakings concerned achieved in the market of the Czech Republic in the last accounting period a net turnover exceeding CZK250 million; or
- the net turnover achieved in the last accounting period in the market of the Czech Republic:
  - (a) in the case of a merger, at least by one of the parties to the merger;
  - (b) in the case of an acquiring the possibility to directly or indirectly control another undertaking or part thereof, by the undertaking or a part thereof over whom the control is acquired; or
  - (c) in the case of an establishment of an undertaking jointly controlled by more undertakings that perform all functions of an autonomous economic entity on a lasting basis, at least by one of the undertakings establishing the jointly controlled undertaking,
  - (d) is higher than CZK1.5 billion and at the same time the worldwide net turnover achieved in the last accounting period by another undertaking concerned exceeds CZK1.5 billion.

For the purposes of turnover calculations, the aggregated turnover of the undertaking does not include turnover achieved within the undertaking itself (in-house sales).

The Act applies to mergers abroad if these fulfil the notification turnover criteria mentioned above. There are no special rules of exemptions for foreign investors or investors.

Undertakings may not implement a concentration before the day of filing the concentration notification and before the day the Office's approval decision enters into force. For filing the concentration notification, an administrative fee in the amount of CZK100,000 applies.

The concentration notification:

- may also be filed prior to conclusion of the agreement establishing the concentration or prior to acquisition of control over another undertaking in any other way; and
- shall contain substantiation and documents certifying the facts decisive for the concentration; details are set out by the implementing legal regulation of the Office.

The concentration approval proceedings shall be initiated on the day when the Office receives the concentration notification containing all requisites. In case the notification does not contain such requisites, on the basis of information received, the Office may only issue a written opinion specifying whether the concentration is subject to approval pursuant to the Act and whether the notification is to be supplemented.

### Standard Procedure

According to the Czech Competition Act, in cases where the concentration will not result in a substantial distortion of competition, the Office shall issue a decision approving the concentration within 30 days of initiating the proceedings.

In the event that the Office finds that the concentration raises serious concerns as to a significant impediment to competition, primarily due to that fact that it would create or strengthen a dominant position of the undertakings concerned or any of them, the Office shall inform the party/parties to the proceeding in writing of this fact

within the aforementioned deadline and inform it/them that the Office is continuing the proceedings. In this case, the Office shall be obliged to issue a decision within five months of initiating the proceedings.

The Office may approve the concentration on condition that commitments proposed by the undertakings concerned in favour of maintaining effective competition are fulfilled.

The Office may request the party/parties to the proceeding in writing to supply further facts necessary for issuing an approval decision or to supply further evidence of such facts. The deadlines stated above shall be suspended for the period between the day on which the party/parties to the proceeding receives this request and the day on which this obligation is fulfilled.

## **Simplified Procedure**

A simplified notification of a concentration may be filed in the case of a concentration when none of the undertakings concerned is operating in the same relevant market, or where their combined share in such market does not exceed 15%, and at the same time none of the undertakings concerned is operating in the market vertically connected to the relevant market in which another undertaking concerned operates, or their share in every such market does not exceed 25%.

In cases when a concentration does not result in a substantial distortion of competition, the Office shall issue an approval decision within 20 days of initiating the proceedings. The grounds of the decision shall contain the identification of the undertakings concerned, the relevant market or sector in which the undertakings concerned operate, and the reasons due to which the decision was issued in the simplified proceedings. If the Office concludes that the concentration

could raise serious concern of a substantial distortion of competition, it shall request the parties to the proceedings within 20 days to file a complete concentration notification.

## **Pre-notification Consultations with Undertakings Planning to Notify a Merger**

The Office regards pre-notification consultations with merging undertakings as an important part of the whole merger review process. It is useful also in cases in which the merger seems non-problematic at first sight. The merging parties may always ask the Office for an informal and private consultation on a planned merger. The pre-notification dealings are initiated and conducted on the basis of a voluntary request by the merging parties.

The aim of the pre-notification consultation is to help the process of the subsequent merger approval proceedings to run more smoothly. If the pre-notification dealings between the Office and the merging undertakings proceed properly, delays in the merger review process should be minimised (delays may be invoked by the need to submit further documents and data necessary for assessing the possible impacts of the merger and for issuing the merger approval).

Moreover, the pre-notification consultation may cover the completeness of the merger notification and the individual details it should contain, particularly the questionnaire for the merger review.

The dealings in the pre-notification phase are of a strictly confidential nature, and the Office's representatives are subject to the obligation to maintain secrecy. Information and documents which are submitted by the merging undertakings in the course of the pre-notification dealings are available only to the Office and the merging



undertakings and do not form a part of the file for the subsequent administrative proceedings.

It is advisable that the merging undertakings provide the Office with a draft of the questionnaire for merger approval, which will be part of the merger notification. The Office will thus be able to check whether the questionnaire is complete and recommend the merging undertakings which further information should be submitted.

FDI that does not meet the relevant requirements to trigger a merger control notification can be hypothetically subject to a substantive competition review within the framework of the prohibition of the abuse of a dominant position by the undertaking acquiring control; ie, in cases where the merger could result in strengthening of a dominant position of the said undertaking. Nevertheless, this type of assessment in cases of mergers has not been carried out by the Office.

## 6.2 Criteria for Review

When deciding on concentration notification, the Office shall primarily assess the necessity of preservation and further development of effective competition, the structure of all markets affected by the concentration, the shares of the undertakings concerned in such markets, their economic and financial power, legal and other barriers to enter relevant markets by other undertakings, the alternatives available to suppliers and customers of the undertakings concerned, the development of supply and demand in the affected markets, the needs and interests of consumers and research and development, provided that it is to the consumers' advantage and does not form an obstacle to effective competition.

The decision on the concentration approval shall also apply to restrictions of competition declared

by undertakings in their concentration notification, having direct connection with the concentration and indispensable to its implementation.

The Office shall not approve a concentration provided it would result in a substantial distortion of competition in the relevant market particularly because it would result in or would strengthen a dominant position of the undertakings concerned. If the combined share of all undertakings concerned in the relevant market does not exceed 25%, it is presumed that their concentration does not result in a substantial distortion of competition, unless proven contrary during the assessment of the concentration.

## 6.3 Remedies and Commitments

The Office may approve the concentration on condition of the fulfilment of commitments that are proposed by the undertakings concerned in favour of maintaining effective competition before initiating the concentration approval proceedings or during its course, but no later than 15 days from the day when the last of the parties to the proceedings receives its statement of objections.

Provided the Office approves the concentration on condition of the fulfilment of commitments proposed by undertakings, the Office may lay down conditions and obligations necessary to secure fulfilment of these commitments.

## 6.4 Enforcement

If the Office finds that the concentration was implemented contrary to the Office's decision in force, it shall decide on measures indispensable to re-establishing effective competition in the relevant market. For this purpose, the Office in particular shall impose on the undertakings an obligation to sell an undertaking or part thereof, where it acquired the possibility to control

them, or discharge the contract, on the basis of which the concentration was realised, or to implement other adequate measures necessary for re-establishing effective competition in the relevant market.

The Office may also issue such decision in the case where it finds that the concentration was implemented without filing concentration notification. The imposition of measures aimed at re-establishing competition shall not exclude parallel imposition of a fine.

A legal person or a natural person who is an entrepreneur commits an offence as an undertaking inter alia if it implements a concentration before the day the Office's approval decision enters into force or does not fulfil a commitment or fails to implement the above-mentioned measures. An offender can be subject to a fine up to 10% of the net turnover achieved by the undertaking in question in the last accounting period.

An entity that has been given a fine or a remedy (ie, a certain form of obligation) can appeal the Office's decision to the chairman of the Office and subsequently file a lawsuit against these decisions in court.

## 7. Foreign Investment/National Security

### 7.1 Applicable Regulator and Process Overview

The Czech FDI rules are set forth in the FDI Act. The supervising authority in charge of applying the Czech FDI rules is the Czech Ministry of Industry and Trade.

The Czech FDI Act introduces a level of vigorous screening for non-EU foreign investments in the Czech Republic that meet the below conditions. There are no monetary thresholds per se.

#### Who is Deemed to be a Foreign Investor?

A foreign investor is any person or legal entity from outside the EU making an investment in the Czech Republic, or a person or legal entity established in the EU but directly or indirectly controlled by a person/entity from outside the EU. The definition of foreign investor also includes investors from Great Britain, Switzerland, Liechtenstein and Norway.

#### What Constitutes a Foreign Investment for the Czech FDI Rules?

The FDI rules are aimed at investments which provide the foreign investor with "effective control" of the Czech target. "Effective control" is defined broadly to encompass:

- acquisition of a stake of at least 10% of voting rights in the target;
- membership of the foreign investor (or a related party) in the statutory bodies of the target;
- ownership of assets used by the target to perform its business activities; or
- any other form of control which gives the foreign investor access to information, systems or technology which are vital for the protection of the security of the Czech Republic or its public safety and order.

It is important to note that acquisition of a shareholding is not essential to trigger the FDI rules; fulfilment of any one of the above conditions is deemed "effective control".

Any transaction which meets the requirements of providing "effective control" of a Czech target

by a foreign investor (as described in **3. Mergers and Acquisitions**) will be subject to the FDI rules. The definition of “foreign investment” may potentially include indirect acquisitions, both share and asset deals, greenfield investments, expansions of existing business and potentially even internal intra-group restructuring, if the relevant conditions are met.

Whether an investment falls within the meaning of “pursuing an economic activity in the Czech Republic” will be assessed on a case-by-case basis.

Czech authorities (principally the Ministry of Trade and Industry) are entitled to monitor transactions being carried out in the Czech Republic and to require that the FDI rules be complied with if a given transaction falling within its scope is not properly referred to them. The Ministry also has a power for discretionary retroactive review up to five years after completion on any foreign investment with the potential to affect the “security of the Czech Republic or its public order and safety”.

As a principle, if a planned investment falls within the scope of the FDI rules and fulfils the requirements for mandatory notification, the clearance of the Minister of Industry and Trade (which may be subject to conditions) shall be required (and obtained) and the transaction cannot be finalised prior to such clearance, which is a pre-closing condition.

It is mandatory to file a request for clearance before the completion of the investment within the scope of the FDI rules if the proposed transaction fulfils the requirements for mandatory notification.

Foreign investment clearance should therefore be a closing condition precedent to the completion of the transaction.

According to the Act, there is no specific deadline for notification of the relevant screening body (Ministry of Industry and Trade). Valid permission is, however, condition precedent to the transaction if the requirements for mandatory notification are fulfilled.

### Screening Periods by the Ministry

- Screening of foreign investment, that was not found to pose a risk: 90 days.
- Screening of investment, that has been identified as risk-prone, including the referral to and discussion by the government of the Czech Republic: 135 days.

These dates can be prolonged by 30 days in complicated cases. In cases specified by the law (eg, negotiations about conditions or mitigation measures) the proceeding can be paused.

### Information Required for Filing

Each filing must include the following information:

- information on the foreign investor (eg, name, registered office, jurisdiction of establishment, registration number);
- information on the members of the foreign investor’s statutory body, supervisory body or other body (eg, name, address, date and place of birth);
- information on the ownership structure of the foreign investor, including information on the final investor and the person who controls the foreign investor, their share and any changes in this information in the past year;
- information on the business activities of the foreign investor and the place of business;

- information on the scope of the foreign investment (such as the source and amount of financing, and the time frame of the investment);
- information on the target company (eg, name, registered office, registration number, information on ownership structure, business activities and place of business).

The filing of the request for approval of foreign investment or a consultation proposal is to be submitted in the Czech language using a form specified by Government Decree No 178/2021 Coll, signed by a statutory representative of the applicant.

Together with the application for the approval of foreign investment, the applicant shall submit a questionnaire (in English) with additional information on details of the foreign investment.

## 7.2 Criteria for Review

Pursuant to the Czech FDI rules, investments conferring effective control (as described above) will be subject to mandatory notification where the relevant sector is in one or more of the following:

- manufacturing, research, development, innovation or arranging for a life cycle of arms and military equipment;
- operations of critical infrastructure (including infrastructure related to energy, water management, food and agriculture, healthcare, transportation, communication and IT systems, financial markets, emergency services or public administration);
- administration of an information or a communication system of critical information infrastructure or of an essential service, or operation of an essential service; or

- manufacturing or development of dual-use items (ie, items that may be used for both civilian and military purposes) set out in Annex IV of the Council Regulation (EC) No 428/2009.

Mandatory notification to the Ministry also applies under the Czech FDI rules for certain foreign investments in the media sector. Specifically, a foreign investor must file a request for consultation if the target meets one of the following criteria in this sector:

- the target holds a nationwide radio or television broadcasting license; or
- the target publishes a print media publication with an aggregate average printed circulation of at least 100,000 copies per day.

## Which Investors Fall Under the FDI Regime?

The Czech FDI rules apply only to foreign investments made in the Czech Republic by a foreign investor – ie, a person that is not a national of, and does not have its registered office in, an EU Member State. Foreign investors by definition under the FDI Act may be also companies from the EU if their directly or indirectly controlling person comes from a third state. This also applies to trusts and similar foreign structures if the founder, trustee or beneficiary meets the definition of a foreign investor. The definition of foreign investor also includes investors from Great Britain, Switzerland, Liechtenstein and Norway.

As a principle, if a planned investment falls within the scope of the FDI rules and fulfils the requirements for mandatory notification, the clearance of the Minister of Industry and Trade (which may be subject to conditions) shall be required (and obtained) and the transaction cannot be finalised prior to such clearance, which is a pre-closing condition.

## 7.3 Remedies and Commitments

There is a possibility of a negative decision in respect of an FDI assessment if the Ministry of Industry and Trade or any of the mandatory consulted institutions assesses the FDI as high-risk. Risk can be substantially reduced by the agreement upon mitigating measures. If there is no agreement on mitigating measures for a transaction deemed high risk, then no permission is granted (for screening before the FDI is completed). If the FDI has already taken place, an order to divest may be given. Such a case is referred to the Czech government, which makes the ultimate decision.

## 7.4 Enforcement

### Sanctions

According to the FDI Act, the foreign investor will be subject to sanctions if:

- the foreign investor fails to comply with the obligation imposed by the decision prohibiting the continuation of the FDI;
- the foreign investor does not meet the conditions imposed by the decision on the conditional authorisation of the FDI or the decision on conditional admissibility of the FDI;
- the foreign investor makes the FDI without making an application for permission of the FDI; or
- the foreign investor does not submit a request for consultation where the target person holds a license for a national radio or television broadcast or a periodic publisher with a combined minimum printed cost of 100,000 copies per day for the last calendar year.

For the offence set out in the first two bullets above, a fine can be imposed up to 2% of the total net turnover achieved by a foreign investor for the last completed financial year, or from CZK100,000 to CZK100 million, if the amount of

total net turnover achieved by a foreign investor for the last completed financial year cannot be determined.

For the offence set out in the second two bullets above, a fine of up to 1% of the total net turnover achieved by a foreign investor for the last completed financial year, or from CZK50,000 to CZK50 million, if the amount of total net turnover achieved by a foreign investor for the last completed financial year cannot be determined.

### Breach of Conditions

If the foreign investor proceeds with a transaction irrespective of a negative decision by the Ministry of Industry and Trade or fails to uphold certain conditions imposed in the decision by the Ministry of Industry and Trade, the fine can be up to 2% of total net turnover for the latest accounting period or up to CZK100 million, if the turnover cannot be calculated.

### Investment Carried Out Without Approval

If a foreign investor fails to notify a transaction or request a mandatory consultation, the applicable penalty can be up to 1% of total net turnover for the latest accounting period or up to CZK50 million, if the turnover cannot be calculated.

## 8. Other Review/Approvals

### 8.1 Other Regimes

#### Investment Incentives

The Czech Republic offers a variety of investment incentives. The most prevalent in recent years have been incentives for investments in the manufacturing industry, but the range of eligible projects now include business support services, covering shared service centres, software development centres, high-tech repair centres and data centres. As incentives are considered

state aid, they are granted in full compliance with EU state aid regulations.

Incentives are provided under the Act on Investment Incentives, and consist of:

- income tax relief for up to 10 years for a new company established for an investment project and partial tax relief for up to ten years for an existing company which will be expanding an investment project;
- cash grant for up to 20% of capital investment in certain strategic projects; and
- employment subsidies in the form of grants for job creation and training with respect to technology centres (available only in regions with high unemployment rates).

## Possibility of Investor Visa for Non-EU Nationals

One of the categories of visa available in the Czech Republic is the so-called Czech “investor visa” (for third country nationals; ie, non- EU citizens). The main conditions for granting this investor visa are (i) creation of at least 20 full-time jobs (for EU-citizens) and (ii) investment in the amount of at least CZK75 million (approximately EUR2.85 million or USD3.25 million), whereby the whole amount does not have to be invested in cash. Up to 60% of this amount can be provided through assets (tangible or intangible) – eg, machinery, real property or know-how.

## 9. Tax

### 9.1 Taxation of Business Activities

Czech tax resident enterprises are subject to corporate tax on their worldwide income. An enterprise is considered to be a Czech tax resident if it is incorporated in the Czech Republic or if its management is located there. Czech

tax non-resident enterprises are taxed on their income sourced in the Czech Republic only and such taxation may be limited by a respective tax treaty. The standard corporate income tax rate in the Czech Republic is 19% applied on a general tax base. The tax base is derived from accounting profit or loss adjusted in accordance with Income Tax Act. If an enterprise is organised as a partnership it is treated as a flow-through entity and the income must be taxed by its partners.

### 9.2 Withholding Taxes on Dividends, Interest, Etc

Generally, dividends are subject to a final withholding tax at a rate of 15%. The tax rate is increased to 35% for dividends paid to Czech tax non-residents from countries outside the EU and European Economic Area that have not entered into a double-tax treaty with the Czech Republic or a bilateral or multilateral tax information exchange agreement that is binding on both the Czech Republic and the respective foreign country. However, dividends paid by Czech companies to parent companies that are located in EU countries are exempt from withholding tax based on the EU Parent-Subsidiary Directive – ie, if the parent company maintains a holding of at least 10% of the distributing company for an uninterrupted period of at least 12 months. Dividend distributions between two Czech companies are exempt from tax under similar conditions.

Interest and royalties sourced in the Czech Republic are generally subject to withholding tax in the Czech Republic at a tax rate of 15%. However, the exemption applies if the recipient is a foreign corporation that is eligible for the benefits arising from the EU Interest-Royalty Directive. Moreover, recipients who are tax residents of countries with which the Czech Republic concluded a double tax treaty may usually

benefit from a lower tax rate provided that they are actual beneficial owners of received interests or royalties. In the absence of income tax treaties and also in the event that a person does not qualify for treaty benefits that would be otherwise available, the withholding tax rate is 35% of the gross interest or royalty income.

### 9.3 Tax Mitigation Strategies

Companies are used to apply general tax-planning strategies such interest from loans provided from low-tax countries, royalty payments to low-tax countries and tax losses. Those costs are, however, subject to various limitations, in particular:

- the thin-capitalisation rules limit the deductibility of interest from loans provided by related parties whereby the loan/equity ratio should not exceed 4:1;
- tax deductibility of interest is also limited to interest from 30% of the borrower's EBITDA with a de minimis of CZK80 million net interest expense;
- any payment to a shareholder or related parties is subject to an arm's length test and might be treated as a hidden profit distribution; and
- restrictions apply to tax losses in case of a change of ownership.

### 9.4 Tax on Sale or Other Dispositions of FDI

Capital gains realised by a Czech or another EU parent company on the transfer of shares in a subsidiary established in the Czech Republic or another EU country are exempt from tax if the parent company maintains a holding of at least 10% of the subsidiary for an uninterrupted period of at least 12 consecutive months. Capital gains realised by a Czech or EU parent company on the transfer of shares in a subsidiary in

a contracting country (which is a third country that has entered into a tax treaty with the Czech Republic) are also exempt from tax if the following conditions are met:

- the subsidiary has a legal form comparable to a Czech joint-stock company, a limited liability company, or a co-operative;
- the parent company has held an ownership interest of at least 10% in the subsidiary for at least 12 consecutive months (this condition may be fulfilled subsequent to the date of the transfer); and
- the subsidiary is liable to a tax similar to corporate income tax at a rate of at least 12% in the tax period in which the parent company accounts for the respective capital gain and in the preceding tax period.

If any of the following circumstances exists the tax exemption does not apply:

- the parent company or the subsidiary is exempt from corporate income tax or similar tax applicable in its jurisdiction;
- the parent company or the subsidiary may opt for an exemption from corporate income tax or similar tax applicable in its jurisdiction; or
- the parent company or the subsidiary is subject to zero corporate income tax or similar tax applicable in its jurisdiction.

Other realised capital gains are included with other taxable income and taxed at the regular corporate income tax rate.

### 9.5 Anti-evasion Regimes

In the area of transfer pricing rules, the Czech Republic respects the rules applied by OECD, which arise from the OECD Transfer Pricing Guidelines for Multinational companies.

Although in the Czech Republic is still no obligation for companies to prepare transfer pricing documentation, it is highly recommended.

In accordance with the ATAD Directive, the Czech Republic implemented into local tax law anti-tax avoidance measures such as general anti-abusive rules, a hybrid mismatch provision, interest limitation and CFC rules.

## 10. Employment and Labour

### 10.1 Employment and Labour Framework

In the Czech Republic, issues related to labour and employment law are primarily regulated by the Labour Code, which is in accordance with the International Work Organisation's international treaties on labour law and with other relevant European legislation.

Trade unions are historically very strong in the Czech Republic and enjoy protection under law. There may be several trade unions established within one company, which would usually make the collective bargaining process difficult.

Collective bargaining in the Czech Republic can take place at both industry level – where the agreements reached are known as “higher level collective agreements” (KSVS) – and at company level, although many companies are not covered by any collective bargaining. As noted above, is also possible to set up a works council instead of a trade union, but the trade union is the more common option. The Labour Code sets out the differences between rights and obligations of employee representatives depending on whether they are part of a trade union or works council.

Only the trade unions have a right to be involved in collective bargaining. But there are also differences in the areas of information, consultation and where the agreement of employee representatives is necessary to make changes.

### Directors vs Managers

It is crucial to properly distinguish between a company's statutory body, which is a mandatory corporate element governed by the New Corporations Act (also effective as of 1 January 2014), and the members thereof, and a company's management, which is composed of company employees.

Directors perform their duties in a mandate (commercial) relationship with the company. They are not company employees and any employment agreement for purposes of executing the director's office would be contrary to the law. Concurrency of roles of a director and an employee is very problematic in Czech law.

### 10.2 Employee Compensation

Employee compensation is generally cash, together with statutory benefits provided by Czech employment law or collective agreements, if applicable.

The social security system in the Czech Republic comprises pension, sickness and health insurance systems, as well as a national employment policy system and the non-contributory social benefit system. The health insurance system is financed via health insurance funds. Other components of the system are financed from the state budget. Premiums are paid by employers and employees.

Employee benefits in the Czech Republic, established by law, include:



- minimum wages
- paid holiday
- working hours and overtime
- termination, notice periods and severance
- sick leave; and
- maternity allowances and benefits.

## 10.3 Employment Protection

In the event of a typical acquisition by means of transfer of shares, there should not be any impact on the employees of the target company. Their employment contracts remain unaffected.

In the event of a business transfer (transfer of undertaking or employees), the Czech Labour Code provides for a mandatory consultation with either a trade union or works council or, if neither exist, then directly with the employees. Employee contracts are transferred with the business, however the employees have the right to terminate their employment contracts with two months' notice.

Both the trade union and the works council have the right, as representatives of the employees, to be informed on:

- the economic and financial position of the company and its probable development;
- the company's activities and their impact on the environment; and
- planned changes in the company's structure, status and business activities.

There are specific rules on consultation in relation to collective redundancies affecting significant numbers of employees, where the trade union and works council must be informed and consulted in advance, with the intention of reaching an agreement aimed at avoiding redundancies, if possible, and, if not, at mitigating their adverse impact on employees.

## 11. Intellectual Property and Data Protection

### 11.1 Intellectual Property Considerations for Approval of FDI

Intellectual property rights are an important (sometimes even crucial) aspect in screening FDI in Czech jurisdiction. Czech regulation (Act No 34/2021 Coll, the Foreign Investments Screening Act) implements EU Regulation 2019/452. The Act has been effective since May 2021. Czech Ministry of Trade (MoT), which is the main national authority to conduct the screening, has published an initial report on FDI screening in which it specifically refers to screening being an essential condition for protection of IP rights in industries of strategic importance and national security and protection of any technology that might be of capacity to significantly "influence or change" public order.

Guidelines for foreign investors are yet to be published. The general legal conditions and criteria based on the Act are applicable for the process of review. In terms of IP rights, the criteria shall specifically include the scope of business, products and services of the target company, target product/services and ownership title (meaning also ownership title to any kind of IP rights) in the target product or service. Sectors of particular scrutiny are military materials, dual-use items or items pertaining to critical technologies or critical information infrastructure. FDI of such targets is subject to prior consent of the MoT (ex ante). Review by MoT affects sectors/industries of both current and emerging technologies such as IT, robotics, nanotechnology and biotechnology.

### 11.2 Intellectual Property Protections

Czech regulation provides for a strong protection of intellectual property rights, similarly to

other EU countries due to EU regulations, implementation of EU directives and IP-related international treaties. Czech acts regulating particular types of intellectual property contain definitions of the objects that may or may not be protected as a specific intellectual property type. Under the Czech Act on Inventions and Rationalisations Proposals, the Czech Industrial Property Office (“CZ IPO”) may, under certain conditions, issue a decision granting a “compulsory licence” to a patent (among others, if an important public interest is endangered). Trade secrets and know-how protection is well-established; however conditions for such protection may be difficult to prove. Monetary claims enforcement (damages, monetary satisfaction) is somewhat rigid. The decisions allowing for FDI may contain conditions of the investment which may, for example, guarantee that the investor does not get access to certain sensitive information or know-how.

## 11.3 Data Protection and Privacy Considerations

The GDPR is implemented in the Czech Republic by Act No 110/2019 Coll, on the processing of personal data, which will not have any significant impact on investors. What is more interesting is that there are a number of legal regulations in the Czech Republic that set out specific rules when processing certain categories of personal data (birth numbers, copies of documents, data from background checks), and these must be complied with regardless of the country of origin of the investor.

The sanctions imposed by the supervisory authority are so far rather lower (compared to other EU countries) and usually range from one to tens of thousands of euros. However, the authority does not hesitate to impose them.

## 12. Miscellaneous

### 12.1 Other Significant Issues

There are no important issues not already covered in this article.

**Kocián Šolc Balaščík (KŠB)** was established in 1990 and is one of the largest law firms in the Czech Republic with over 70 lawyers and tax advisers, and offices in Prague, Ostrava and Karlovy Vary. KŠB is a full-service law firm providing high-quality advice in all key areas of law, including corporate law and M&A, banking and finance law, real estate law, competition law, dispute resolution and litigation, energy law, IP law, labour law, consumer law and tax

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## Trends and Developments

### Contributed by:

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### Number of Investments in the Czech Republic

According to Czechinvest, the number of investments in the Czech Republic by country of origin and number of projects in 2022 was as follows:

- 22% – Czech Republic (463);
- 20% – Germany (406);
- 13% – USA (259);
- 7% – Japan (152);
- 5% – Great Britain and Northern Ireland (108);
- 5% – Netherlands (83);
- 4% – Switzerland (77);
- 4% – Austria (69);
- 3% – France (66);
- 3% – Italy (46); and
- 17% – Others (362).

Compared to 2021, when the share of new investment projects increased slightly, expansions of companies already operating in the Czech Republic, which comprised two-thirds of the projects, still predominate. New investors came mainly from the United States and Germany. A large portion of the investments will be placed in the Plzeň, Central Bohemia and Ústí regions, whereas Moravia-Silesia and South Moravia were chosen as the locations for the largest number of projects.

### Assessment of the First Year of FDI Screening in the Czech Republic

After the first full year of operation of the Czech FDI Act, the Ministry of Industry and Trade issued its First Annual Report in May 2022 to provide a review of the inaugural year of experience with the FDI Act. It is worth pointing out that the Min-

istry does not review all foreign investments in the Czech Republic; only those FDI investments that investors self-declare either on the basis of mandatory requirements under the FDI Act or alternatively as a request for a voluntary consultation with the Ministry under the FDI Act to gain legal certainty as to their investment vis-à-vis the FDI Act. The Ministry may additionally initiate a review of a planned or already-completed investment in the case there is a suspicion that the FDI may pose a security risk.

### *Numbers of reviewed investments under the first year of the FDI regime*

The Ministry received a total of 389 FDI notifications from partners in EU Member States and the European Commission between 1 May and 30 April 2022. These alerts concerned investments in other Member States, whose potential effects on the security and peace of the Czech Republic are being examined by the Ministry. This may initiate an ex-officio review. The Ministry handled a total of 12 domestic cases between 1 May and 30 April 2022. There were ten consultations in total, three of which continued with the complete screening process. Only two cases were reviewed as part of the screening protocol. One instance concerned a mandatory filing by an investor pursuant to the FDI Act and the second instance saw the Ministry initiating the screening process on its own.

As at the date of the report (May 2022), no investments had as yet been prohibited nor had any conditions been imposed. A total of eight out of ten completed cases were approved. In two cases investors withdrew their application

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and the investment did not proceed. As at 30 April 2022, two cases had not yet been closed.

### *FDI 2022—country of origin of foreign investor*

Out of the investments reviewed by the Ministry, five were from the USA, two from the UK and one from each of China, Singapore, Russia, Taiwan and Malaysia.

### *Types of investors*

The majority of investors were funds (seven cases), four investors were companies and only one investor was an individual person.

### *Industry sector of reviewed investments*

Two investments were in aviation as well as two in IT. Other investments were in each of the chemical industry (one), healthcare (one), engineering (one), biotech (one), water (one), telecommunications (one) and other areas (two).

Industry sectors of the assessed investments included telecommunications, chemical industry, aviation, healthcare, IT, biotech, water supply and engineering.

### **ESG in the Czech Republic**

Although Czech business might sometimes be said to be more conservatively inclined when it comes to following global societal trends, ESG is these days clearly starting to be on the radar for Czech business. Against the backdrop of the EU taxonomy and SFDR obligations, sustainability and sustainability-linked investments are becoming hot topics, even as Czech companies try to orient themselves to find their feet in the ESG universe. It is becoming evident that ESG issues are not just a globalist marketing fad, but an issue which can create real risks and fallout if not implemented carefully and if actions are not followed through.

Corporate greenwashing has not yet appeared to be a major issue in the Czech Republic, but it is likely that it is only a question of time until it becomes more prevalent. Business leaders and lawyers alike are no doubt reviewing with caution the growing number of Europe-wide greenwashing court cases and disputes with regulators.

In the summer of 2022, the Municipal Court in Prague ruled in favour of a lawsuit filed by an environmental civic association Klimatická žaloba against the Czech state. The court confirmed that the Czech state authorities are not taking sufficient steps to address the climate crisis and must increase their efforts to reduce greenhouse gases in accordance with the Paris Agreement.

The focus on ESG matters is perhaps greatest at present within the financial industry, due to the applicability of the SFDR obligations, nevertheless even non-financial Czech business is becoming more ESG fluent, due to the fact that exporting to certain destinations and within global supply chain models may become very much dependent on an ability to demonstrate upholding of sustainability metrics.

### **Amendment to the Czech Act on Ultimate Beneficial Owners (UBO Act)**

The Czech UBO Act was introduced in June 2021, however a significant amendment, applicable from 1 October 2022, provides a new and sole category of UBO in the Czech Republic, being persons who ultimately control or own an entity. The 2022 amendment contains significant penalties and consequences for breach, thus it is a significant issue for foreign investors to be aware of.

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Pursuant to the new broader definition of beneficial owners, the following criteria are listed upon which the UBO can be identified:

- if a person controls a share in the corporation or a share in the voting rights of more than 25%;
- if a person is entitled to a share in profit/equity funds, or the liquidation balance of more than 25%;
- if a person exercises decisive influence in the corporation, or in corporations which individually or collectively hold a share of more than 25% in the erstwhile corporation; or
- if a person otherwise exercises decisive influence in the corporation through other means.

Significantly, any shareholders with more than a 25% shareholding or equivalent rights is to be registered and classed as a UBO.

### *Penalties and consequences for non-compliance*

Companies that do not comply with the registration requirements face potential sanctions of up to CZK500,000. In addition, with harsher impact than merely a monetary penalty, companies with an unregistered UBO (or wrongly registered UBO) will not be allowed to distribute profits either to such UBO or to a legal entity with the same UBO. Furthermore, the UBO will not be allowed to exercise its voting rights at a general meeting.

### *New categories of entities now obliged to register the beneficial owner*

The list of entities required to register their UBO has been expanded by the Amendment and registration is now also required for:

- unions and employers organisations;
- association of unit owners;

- political parties and movements; and
- district and regional chambers;
- religious organisations; and
- hunting societies.

### **Electronic Communications Legal Updates Affecting Entrepreneurs**

#### *Deemed delivery now applies to communications between private parties via data mailboxes*

Czech “data boxes” are an electronic archival system that facilitates communications between citizens, businesses, and public administration bodies in the Czech Republic. The system’s web interface replaces the traditional exchange of printed documents. As of 1 January 2022, based on the amendment to the Act on Electronic Acts and Authorised Conversion of Documents, the rule that a message (document) is delivered on the tenth day after it arrives in the recipient’s data box (the so-called “fiction of delivery”) now also applies to messages delivered between private parties.

So far, the fiction of delivery has only applied to messages served by courts, authorities or other public agencies. Until now, fiction of delivery did not apply to documents served by private parties. If the data box holder (the authorised person) does not log into the data box, the message will be deemed to have been delivered on the tenth day following the date it was actually delivered to the data box. The rule will be the same for all parties who have a data box and who have not blocked the possibility of delivering documents from a private data box. It will therefore apply to everybody – businesses, non-businesses, individuals and legal entities.

In practice, this means that if, for example, parties to a contract agree that an invoice falls due on the 30th day following its delivery and the

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supplier sends the invoice to the data box, the invoice will be deemed to have been delivered on the date the recipient (the authorised person) logs into its data box, but no later than on the tenth day after the message was actually delivered to the data box. The invoice's due date will start running from the day after and the customer will be in default if it does not pay the invoice within the 30-day time limit. Parties who have a data box should log in regularly, at least every ten days. In 2023, there will be another change to look forward to. A data box will be automatically established for natural persons who are not entrepreneurs if they log in to the National Identification and Authentication Point.

## Technology Incubation Project

The Czech Republic's Technology Incubation Project, set up by Czechinvest, the government investment agency and the Ministry of Industry and Trade, was launched in June 2022. It is a major investment in the future of Czech industry and represents a strategic step in the positioning of the Czech Republic as an "innovation leader" on a global scale and a "country for the future", as part of the government's branding strategy.

It is anticipated that within five years of its launch, the project will support up to 250 innovative start-ups with approximately CZK850 million in the following key areas:

- artificial intelligence;
- mobility;
- the creative industries;
- space technology;
- ecology and the circular economy; and
- smart solutions in the area of healthcare, pharmaceuticals, cybersecurity and nuclear physics.

Throughout the selection process, the innovative nature of the given project in relation to the particular sector will be the factor receiving the greatest scrutiny.

The second call for applicants in the Technology Incubation Project is expected to be announced early in 2023. Of specific interest to foreign investors is the fact that for the upcoming second call for applicants, application proposals will be able to be submitted in the English language and furthermore, the Technology Innovation Project is not limited to Czech citizens. The only requirement is for an applicant company to be registered in the Czech Commercial Register.

## *What does the Technology Incubation Project offer?*

Within the framework of the Technology Incubation Project, selected technology start-ups will receive direct support in the amount of CZK1.1 million to CZK4.5 million and indirect support worth CZK500,000 in the form of workshops, seminars, assistance from incubation managers, consultations with business and technology experts and incubation for up to two years, all without losing their stake in the company.

Project support overview:

- financial support: up to CZK4.5 million is available without loss of shares and up to two years of incubation, plus indirect support of CZK500,000;
- technical mentoring: help with the technical development of products or services and connection to experts in the Czech Republic and abroad;
- business mentoring: help with business development or with preparing a pitch-deck for investors. Identifying grant opportuni-



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ties and investors in the Czech Republic and abroad;

- networking: through Czech and international events, conferences and trade fairs, new contacts and finding potential customers and partners;
- technological transfer: help with patents and technologies;
- office space: incubator start-ups can use the entire incubation network of the Czech Republic to develop their business; and
- national and international marketing and PR: promotion of incubator products or services on social networks and in the media or participation in start-up and space events in the Czech Republic and abroad.

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law. Apart from that, it also covers unique, niche areas, such as air and space law, data protection law, pharmaceutical law, environmental and sustainability law. KŠB is a four-time recipient of Chambers Europe Award for Excellence for the best law firm in the Czech Republic. Since its founding KŠB has been an acclaimed market leader, creating innovative and groundbreaking legal solutions for its clients involving new legislation and legal and business concepts.

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