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Recent Development of the Laws Regulating Not-for-Profit Organizations in the Czech Republic

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I. Introduction

In a transition period of ten years, the Czech Republic has moved from a system of suppressed democracy, unlimited power of one party, and totally state owned economy towards a pluralistic democracy based on free elections and market economy. This transition has allowed the Czech Republic to enter the family of countries forming the Atlantic Alliance and apply for membership to the European Union. With regard to the activities of civil society, the Czech Republic also underwent a dramatic change during these ten years. There are now about forty thousand associations and several hundred foundations and other legal entities, which form the third sector, referred to as non-governmental organizations (NGOs). The relatively advanced legal system and specific and in several aspects, unique system of state aid can enable and support the existence of NGOs.

The recent development in the Czech Republic, in both the political ambit, as well as the NGO sector itself, manifests the trends toward a qualitative change. As it appears, the period characterized by the transition towards a democratic and open society is being replaced by a period of consolidation and improvements in which more forms of citizen participation will find expression not only in NGOs increased professional activities, but also in the amendments, broadening of the related laws, and their implementation.

From this point of view, the next several years, specifically the period preceding the desired accession to the European Union, may make the Czech Republic again a country where the special interest of the international NGO community is centered.

This paper aims to summarize the status quo and to discuss recent developments of proposals and other trends in the legal framework of the Czech Republic, which may make the activities of non-governmental, not-for-profit organizations more important and citizen participation in many areas of social life more direct and commonly appreciated.

II. Structure of the Related Legal Framework

The legal system for the NGO sector developed in a specific way. Unlike many other countries in the region, the Czech Republic recognizes two main categories of NGOs: those based on membership and those not based on membership.

In the category of membership-based NGOs, the main legal form is **associations of citizens** regulated by the Act No. 83/1990. The same law regulates the **trade unions** and **unions of** both of which have a more liberal way of establishment compared even to the liberal requirements governing the establishment, registration, activities, governance and internal regulations of. Besides these, there are several **chambers of professionals**, the **Czech Red Cross**, **political parties** and **political movements** and **churches** and **religious congregations**, as well as **interest**

associations of legal entities, which may be established and operate under the provisions of specific laws. The very liberal nature of the laws governing all these types of NGOs enabled associations, despite certain basic limits set by the laws on their economic activities, to be an attractive tool for pragmatic entrepreneurship, without the restrictions on assets, registration obligations and any other features required from a commercial legal form. Currently, foreign and international associations also may operate in the Czech Republic with special permission issued by the Czech Ministry of Interior after consulting the Ministry of Foreign Affairs. <![endif]>

The category of non-membership-based NGOs since 1998, include not only foundations, as in other countries, but several other specific legal forms described in the Czech legal system. Specific laws now regulate the establishment, registering, self-governing principles, public reporting and accounting procedures, as well as certain other features of a) **foundations** with endowment, b) **funds** without endowment, c) **public benefit corporations** and d) public or private universities and **higher education institutions**.

The law requires foundations to possess from their beginning and to maintain through their existence a minimal registered endowment whose yields are fully exempt from corporate income tax. This income must be used for a public benefit purpose. The same law allows for the existence of funds without endowments, but provides less favorable tax benefits and limits more strictly their space for economic profit-generating activities. Foreign foundations and funds may operate their branches in the Czech Republic, and foreigners may become founders of Czech foundations or funds without restrictions.

Specific law regulates the establishment, registration, governing structure and operations of not-for-profit public benefit corporations with the specific purpose of providing under well-defined and non-discriminatory conditions, public benefit services accessible to anyone. These NGOs may engage in more economic activities to generate additional income and they may also apply for a state or local government subsidy.

In the Czech Republic, the national or local government budgets still fully or partially fund many state or municipal not-for-profit organizations. When creating the law on public benefit corporations, the Government apparently intended to use this new legal form as one of the possible ways to privatize budgetary and subsidiary organizations, mainly the universities, high schools, hospitals, theaters, museums, galleries, cinemas, swimming pools and utility services. However, limitations in the way ownership of state or municipal property was transferred to essentially private corporations made these expectations unrealistic. Only several hundred public benefit corporations exist today, and most of these have replaced foundations after the new Act on Foundations and Funds No. 227/1997 has become effective and required the foundations to register either as foundations with endowment, funds without endowment or public benefit corporations.

As a result of this development, the new law on higher education modified specifically the public benefit corporation from any public or private university or higher education institution, adding to their governing apparatus academic governing features and a more sophisticated access to the state subsidy per student, as well as the need for state permission to operate as a university based on accredited curricula.

This example from the field of education created the situation, when also the Ministry of Labor and Social Affairs, the Ministry of Culture and the Ministry of Health consider or even already work on drafting similar laws providing for specific public service providing but private institutions into which the institutions run by the state may be transformed.

In this short overview of the legal system of the Czech Republic, it may be noted briefly that there are specific tax and fiscal laws regulating the corporate profit tax, value added tax, customs regulations, real estate transfer tax, real estate property tax, donation tax, heritage tax, administrative fees etc. In all of these tax laws, specific articles provide certain tax or payment exemptions to not-for-profit legal entities and in several cases to a particular legal form, such as foundations, funds, public benefit corporations or associations.

Specific laws also regulate bookkeeping. In the Czech Republic there are still two procedures for income and expenditure accounting: double-entry accounting and bookkeeping based on the use of a

single-entry accounting book.

III. The Three Main Stages of Development and the Three Special Laws

The introduction of Act No. 248/1995 on Public Benefit Corporations started the three stages of development of the Czech legal system with regard to not-for-profit organizations. This law introduced for the first time, the notion of a not-for-profit standard, barring distribution of any profit to the founders, the members of governing bodies or to the employees. This law also provided for the first time, obligatory annual reporting, including comments on the annual balance of incomes and expenditures. Another important feature of the law was the introduction of the governing structure based on a board of directors, which may not remain unchanged forever and must rotate membership with limited possibility for reappointment of the same person to the board after the second term in office. Besides the board of directors, none of which might be employed by the corporation, there may exist also a separate body – the supervisory board. The supervisory board oversees both the board of directors and the corporation management to determine whether they have fulfilled the requirements set by the law, the founding document and the statute of the corporation. Both these bodies are in the hands of the founders, who appoint their members for a term of three years. Strict regulations address possible conflicts of interest among the members of the two governing bodies. And finally, the law provides for registration of the new legal entity at the commercial court, which maintains the Register of Public Benefit Corporations as a public document, currently available on Internet with the register of commercial legal entities.

The introduction of Act No. 227/197 on Foundations and Funds, replacing the liberal and incomplete provisions on foundations incorporated into the Civil Code since 1992, instigated the second stage of not-for-profit sector development in the Czech legal system. The new law not only defined the two distinct legal forms – foundations and funds – but it introduced the notion of an endowment and its maintenance, distinguishing between donation to the foundation and a grant by a third person. Finally, the law requires that any foundation or fund include in its statute certain limitations on the use of its assets and incomes for administrative expenditures. The law assumes several features from the law on public benefit corporations concerning the composition of the board of directors and supervisory board, but it is more liberal with respect to their self-reelection procedures and it is significantly less restrictive concerning possible conflicts of interest. This law also defines in a more positive way the public benefit categories in which foundations or funds may be established. The registering body is now the court and not the district state administrative office, as it used to be. The Register of Foundations and Funds is a public document available on Internet.

The third stage in the Czech development of the nonprofit sector started with presenting the governmental(?) Bill on Associations, approved already by the Government and currently in discussion at the Chamber of Deputies of the Czech Parliament. This new law is intended to replace the current law on associations of citizens. Its main features are similar to those of the above two laws: it introduces the notion of an association as a legal entity created voluntarily for the purpose of realizing the right to associate, but does not limit that right to citizens, making foreigners and citizens of the Czech Republic equally entitled to establish an association and to apply for its registration as a legal entity. Most important new features introduced by the Bill are: a) the more precise definition of the organizational structure with a definition of the statutory body and its responsibility for legal acts toward third parties; b) more detailed and transparent method of establishing and dissolving subunits with their own legal identity under the umbrella of the association statute; c) the regulation of the dissolution, merging and splitting of associations with liquidation or without liquidation of assets, which was entirely missing in the previous regulations and many times misused in commercial activities; d) registry with the Ministry of the Interior into a public Register of Associations; e) the obligation of reporting similar to that of public benefit corporations or foundations/funds, when the association obtains a substantial subsidy from a public budget or whenever it is engaged in some economic activity; f) the period of time in which existing associations must submit basic data on their statutory organ and other data to be put into the Register, as well as longer period of time for bringing the by-laws of the association into compliance with the Bill's new requirements.

In each of these three stages of legal development, government drafters exhibit both a better understanding of the needs of NGOs and a more professional approach to drafting. In all three stages,

experts of the present First Consulting were involved in advisory or co-drafting positions, making use of their experience gained during long-term co-operation with the International Center for Not-for-Profit Law.

IV. The Role of Courts in Implementing the New Laws <![endif]>

The new foundation law provided the whole 1998 year, in which the 5400(?) at that time existing foundations had to register with the commercial court as a foundation with endowment, a fund or transform itself into a public benefit corporation. Thus, the courts were chosen as the registering agencies in an effort to make the procedure more transparent and less dependent on any possible political influence.

However, the courts were already registering agencies for commercial legal identities and some judges were suspected to have used their power to postpone registering decisions when not given extra payments from companies' founders. In order to minimize the risk of corruption, some courts have adopted a special system of allocating registering cases to individual judges, which should eliminate the possibility of the judge dealing directly with the subjects applying for registration.

This situation has been only one of many difficulties encountered by foundations during the re-registering period. Evidently ill-acquainted with either the law on foundations or the law on public benefit corporations, some judges applied procedures of the registration process known to them from commercial companies cases, without acknowledging the basic differences between the commercial and non-commercial subjects. In some cases, the judges used arguments or required additional documentation going far beyond the requirements of the law. Despite these heightened expectations, many applications from foundations were submitted without required documents, incomplete or erroneously completed.

As a result, there remain several hundred former foundations' re-registration of transformation cases open and awaiting the judgment of the court of appeal, because the commercial courts have denied the registration in the first instance. Thus, in many cases, there are still subjects operating as a foundation according to the previous law and at the same time trying to operate as close as possible to the requirements of the new law on foundation and funds or to the law on public benefit corporations. Unfortunately, important and well-known foundations have chosen to close down rather than wait endlessly for proper registration.

In light of the better practice requirements promoted by the international NGO community, the World Bank and ICNL, this development may be considered a serious failure of the Czech judiciary system. Appropriate instructions to judges and/or making registration an administrative matter more than a case for courts' decision-making may provide a remedy.

V. Particular Legal Issues Concerning NGOs

There are several specific legal issues, which have or may have particular impact on the NGO sector.

Since 1996, the group of experts from the Conference of NGOs operating in the field of social care and health are involved in drafting laws, which will initiate a radical change of the social care and assistance to handicapped people. The new approach requires subsidies to handicapped people, so that they may order the service needed from any social service provider, be it the state institution or an NGO. The issue is closely related to the need to classify social services that should be made available to people in need and with a scheme of state licensing for providers of such services. The present government supports the idea in its basic premises, but postponed the final legal solution of it by dividing the complex original draft of the Bill on Social Care into several legal norms. Currently, the licensing issue is closest to being implemented; other parts of the series of legal norms (rules?) are still in the drafting process.

The Government and Parliament recently decided to distribute 500 million Czech crowns among nearly 40 Czech foundations as a contribution to their endowment. As a result, problems with courts supposed to register the endowment were further complicated by the issue of efficiently managing the foundations' endowments. The current law is restrictive as to the way in which the endowment assets might be invested

to generate income. It leaves several aspects open and unsolved, which lets judges decide identical cases in completely opposite ways. The situation invites analysis and amendment of current endowment regulations.

The Czech Government distributes annually about 1,6 billion Czech Crowns to associations via the line ministries. Until recently, the distribution process more or less followed the old style of subsidizing some chosen associations, without much opportunity being given to NGOs through some form of competition. In addition, the money comes from the state budget and as such, it must be distributed and used in the same fiscal year. The government(?) is looking for methods by which the procurement for this money may be made more transparent, the chance for equal access provided, as well as accountability through a several year period.

Ever-growing attention is being paid to the legal conditions related to the execution and use of volunteer work. Volunteer work brings certain values to NGOs and some financial experts have already warned NGOs about the risk of being asked to pay the tax on profit, whenever the value of assets produced by the work of volunteers exceeds the related expenditures. In some cases, this may burden NGOs' budgets. Moreover, nothing in the law protect volunteers against health risks while volunteering, and the question remains open of how, if ever, volunteer work should be evaluated.

Finally, the tax and accounting rules for entrepreneurial and not-for-profit legal entities differ. Demonstrated several times and evident from practical implementation, NGOs may pay a higher tax than a commercial entity involved in the same business even with the 30% deduction of the corporate income tax but separate accounting of every kind of income generating activity. Recently, a motion to the Constitutional Court has been considered as a way to overcome this unequal treatment. Aware of the situation, some government officials are working on the amendment of the tax law and the accounting regulations. Unequal treatment of NPOs and commercial legal entities has been noted recently in accounting and tax procedures – cases where it is better not to make use of any tax exemption.

VI. Do We Need Further Improvements or Change to the Whole System?

Further improvements may be needed for specific laws, but to continue in the series of new laws for any situation does not present a long-term solution. Therefore, there is an acute need for profound analysis of the present legal system in cooperation with the government task force for harmonization of the Czech laws with European Community law, so that a synergy in the government efforts and needs of the NGO sector may be reached to create optimal timing and content for further systematic reform. Several basic reforms are already underway. Recently, the Chamber of Deputies of the Czech Parliament approved the new Commercial Code. Similarly, the Civil Code is being redrafted currently. Also, new laws regulating the use of state property, the new tax system and laws addressing several other legal issues stand high on the present Czech government's list of priorities.

Both the NGO and public sector may benefit from a law more specifically regulating public benefit activities in general and providing for the existence of an independent agency capable of monitoring the behavior of public benefit organizations. The agency may use the organizations' reports and conduct non-intrusive, ad hoc checks at NGO premises in order to monitor public benefit behavior. Such an agency could detect misuse of the benefits or other violations of the law and might even provide additional certification to the registered NGO, recognizing its status as a public benefit service or funds provider. This status would then provide a certain degree of priority whenever the certified NGO would apply for a subsidy from public budgets or even from some private sources, like foundations, private sector mercenaries' donations or sponsors.

VII. Expected Development in the Near Future

In the two years remaining of the present government's term in office, a new Act on Associations, as described briefly above, and the amended Act on Public Benefit Corporations may be expected. Both laws are already in the legislative process.

The Donors' Forum, an association of donors and foundations operating in the Czech Republic, has begun

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preparations for significantly amending the Act on Foundations and Funds and has centered on improving endowment maintenance and use provisions, as well as the registration documentation and process. Soon, the final versions will be enacted of a series of laws regulating the social care and assistance provision and licensing for such services, which would involve NGOs as equal partners with public sector institutions. The government also prepares new state property law and changes to the public procurement laws.

NGO experts from Bohemia Corps have started the work already on a draft of a law regulating volunteer work. There is also a need to work on a sponsorship law. These initiatives may bring results during 2001.

VIII. Need for International Cooperation

Keeping in mind the scope and content of the new legal initiatives already in force and being prepared or considered in the Czech Republic, there is an apparent need for efficient cooperation with the international NGO community. The community might be interested in similar developments and may produce the synergy effects in improving the drafts being prepared, as well as realize necessary corrections or new impulses and ideas about consolidation and improving the quality of the Czech legal system's development stage concerning NGOs. This is true in the cooperation between the experts of Poland, Hungary, Slovakia, Slovenia and the Czech Republic.

Nevertheless, the assistance and support from the experts of the International Center for Not-for-Profit Law (ICNL) and presumably, from other international organizations as well, such as CIVICUS or the European Center of Foundations, would be not only appreciated, but potentially critical for the process's success.

ICNL expertise and organizational background provided by its Budapest Office may be especially useful due to its ability to prepare seminars on issues common in the region and to help instruct key persons in the NGO sector and government. ICNL's staff of internationally experienced lawyers and its contacts with United States government agencies are the organization's strengths. Likewise, the United States Embassy in Prague hosted informal meetings where experts from the NGO sector met those from the government. The friendly atmosphere of these meetings in addition to the respected position of the Embassy in the political establishment of the country have exercised a positive and facilitating effect in the past and potential for such a role continued into the future.

One of the most urgent issues currently might be to hold an international seminar of experts from Poland, Czech Republic, Slovakia, Slovenia and Hungary organized in Prague in the fall of 2000 that would open a forum for the discovery of new ideas supporting the improvement of the legal system and functioning of the judiciary in all these CEE countries who share similar political and economic environments as well as historical and cultural heritage.

IX. Challenges to the EU Accession

The EU accession process in the Czech Republic accelerates the reconstruction of the legal system. However, it is also delaying some changes in the legal system that are not directly necessary for harmonizing the Czech laws with the "acquis communautaire" of the EC. Therefore, the success of the consolidation period depends also on the development in the EU – as soon as the EC legislation dealing with EU institutions cooperating with NGOs will be formulated, supporting the future of the NGO sector in accessing countries, including the Czech Republic.

Again, to reach a common understanding of this need, the scope of contacts may be strengthened between NGO experts from EU countries and those in CEE countries. Here also, the European Foundation Center, ICNL and CIVICUS may play an important and even solitary role as proponents and organizers of the exchange of ideas, meetings of experts and presenter of seminars or conferences.

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The fate of the suggested law on associations in the Czech Republic

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In my article I pay attention to the process of accepting the new law on associations, which was ruled out by a majority of votes in the Chamber of Deputies of the Parliament of the Czech Republic, and to other connected issues.

Accepting the law No. 227/1997, on foundations and foundation funds, which replaced the unsatisfactory adjustment of the legal position of foundations in the Civil Code, and the very much discussed law No. 248/1995, on generally beneficial associations, has brought a certain order into the legal position of juristic persons of the so called third sector, whose bases are formed especially by certain property substrata.

The suggestion of "the law on associations and on the change of some other laws, (law on associations)", proposed by the Government, should not only replace incomplete and in many aspects unsatisfactory present adjustment of the legal position of associations, but especially cancel unconstitutional (but still valid) law No. 116/1985, on the conditions of activity of organizations with an international element in the Czechoslovak Socialistic Republic.

The purpose of the suggested law was to determine conditions, under which it is possible to found an association and its organizational units as juristic persons, rules for their activity and dissolution. It should also clearly lay down, in accordance with the Charter of Fundamental Rights and Freedoms, equal conditions for all citizens of the Czech Republic and foreigners, and make possible activities of foreign associations in the Czech Republic under the same conditions as activities of associations founded according to domestic rules.

The opinion that the law on associations is unnecessary, useless, too regulative and restricting the right to associate, embodied in constitutional rules and international documents, prevailed during the discussion in the Chamber of Deputies.

Dismissing the suggested law by the Deputies is probably caused by misunderstanding the purpose of the suggested adjustment. The purpose was especially to make clear the position of the "association" as a specific subject of law of the corporational type, founded in order to fulfill the right of association as a political right embodied in the Charter of Fundamental Rights and Freedoms.

In my contribution I deal with the necessity of the "unnecessary" law, and consider the valid law and suggested changes.