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## **Developments in Czech Not-for-Profit Law**

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The modern roots of the Czech not-for-profit sector reach back to at least the early 19th Century. Article 646 of the 1811 Civil Code makes explicit reference to foundations, and the country witnessed a flourishing civil society sector prior to World War II. In 1950, the communist regime enacted a new Civil Code, which effectively abolished the 1811 Code. Together with subsequent social and nationalization policies, this act effectively merged the private not-for-profit sector into the communist-controlled public sector.

Reconstruction of the legal framework for not-for-profit organizations (“NFPOs”) began immediately after the Velvet Revolution. Between 1990 and 1992, the Czechoslovak Federal Assembly created the legal underpinnings for NFPOs through the enactment of the Law on the Right of Assembly, the Law on Associations of Citizens, the Law on Political Parties and Political Movements, the Law on Churches and Religious Communities, and the amended Civil Code. In addition, there were approximately twenty laws regulating fiscal matters, as well as some outdated laws governing organizations funded by the national or local government.

During this period, the fabric of civil society was comprised primarily of associations and foundations. In the civil law context, associations are membership organizations, while foundations are non-membership organizations based on property. In September 1995, the Czech Parliament adopted Act No. 284/1995 on Public Benefit Companies (in Czech “obecné prospesné společnosti”), which created a new legal form for NFPOs. Key characteristics of these three organizational forms are discussed below.

### **Founders**

**Public Benefit Companies:** Physical persons permanently residing in the Czech Republic, corporations domiciled in the Czech Republic, the State, or a municipality.

**Foundations:** Any physical or legal person, including foreign citizens.

**Associations:** At least three Czech citizens, one of whom is over 18. Legal entities may become members of associations.

### **Organizational Purposes**

**Public Benefit Companies:** They must provide “publicly beneficial services” (a term which is purposely undefined) equally accessible to the public. Moreover, any “economic returns (profit) may not be used for the benefit of founders, members of corporate bodies, or employees.”

**Foundations:** They must “serve public benefit purposes,” which include the development of intellectual values, human rights and other humanitarian goals, environmental protection, and the protection of cultural monuments. A recently-prepared draft law on foundations would restrict foundations to grant-making,

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<sup>1</sup> The International Center for Not-for-Profit Law (“ICNL”) provides technical assistance on laws affecting the not-for-profit sector worldwide. Under the USAID Democracy Network Program, ICNL has active projects in eleven countries in Central and Eastern Europe. For additional information, please contact ICNL at 1511 K St., NW, Suite 723, Washington, DC 20005, phone: 202-624-0766, or visit our homepage at “<http://www.icnl.org>”.

precluding them from directly undertaking public benefit services. There are presently an estimated 3000-4000 foundations in the Czech Republic. If the law is enacted as proposed, many foundations would be required to re-register.

**Associations:** Defined negatively -- they may not be formed “to subvert or restrict the personal, political or other rights of citizens based on their nationality, sex, race, origin, political or other views, religion, or social status; to kindle hatred or intolerance based on the foregoing; or to support the use of force or the violation of the constitution or the laws.”

The Ministry of the Interior has been working on an amendment to the Law on Associations that would permit the establishment of international associations with rights equal to those of other associations. There are currently more than 20,000 associations in the country.

### **Registration Authority**

**Public Benefit Companies:** Courts of registry.

**Foundations:** District Offices of State Administration. This function would be shifted to the courts of registry under the draft foundations law.

**Associations:** Department for Civic Affairs of the Ministry of Interior.

### **Internal Governance**

**Public Benefit Companies:** Board with 3-15 directors (number must be divisible by 3). At least two-thirds of the directors must be Czech citizens. Term limits for directors. Law provides for an Executive Director. Certain public benefit companies are required to have a Board of Supervisors.

**Foundations:** The law requires a Fund Administrator or Treasurer who is responsible for the endowed property or assets, but it does not enumerate required governing bodies. The draft law includes provisions pertaining to Boards of Trustees (Directors) and Boards of Supervisors.

**Associations:** The plenary session of members is the supreme governing body, but the law does not name other required governing bodies.

### **Reporting Requirements**

**Public Benefit Companies:** Mandatory annual reports, which must include, *inter alia*, a survey of activities and detailed financial information. Annual reports must be publicly accessible.

**Foundations and Associations:** Tax reports only. Organizations with income of less than 100,000 CZK, or with only exempt income, are exempt from this tax reporting requirement. No general program reports are required by law. The draft foundations law and the draft amendments to the Law on Civic Associations would require foundations and associations to prepare annual reports.

### **Commercial/Economic Activities**

**Public Benefit Companies:** Specifically authorized to engage in publicly beneficial services and, with certain restrictions, to engage in “supplementary activity,” provided that it does not imperil the quality,

extent or availability of publicly beneficial services. Public benefit companies may not participate in business activities pursued by other entities.

**Foundations and Associations:** They may not be formed for business purposes, although certain regulations imply that they may engage in occasional commercial activities which are complementary and subsidiary to the principle purposes of the organization. The draft foundations law contains restrictions on certain income-generating activities of foundations, including limits on their shareholdings in commercial companies.

### **Tax and Fiscal Rules**

As a general matter, the law does not distinguish between associations, foundations and public benefit companies for tax purposes. Therefore, they are subject to the same rules governing tax deductible contributions and exemptions from income tax, real estate property tax, inheritance tax, and gift tax.

Nonetheless, the new Law on Public Benefit Companies does require these organizations to transfer their end-of-year “profits” to their reserve fund. According to the law, the reserve fund must be used primarily to cover losses in subsequent accounting periods. This potentially causes problems for organizations that receive funds for a multi-year project because they would show an end-of-year “profit.” A Ministry of Finance official has interpreted this provision, however, to mean that the *primary*, but not exclusive, use of the reserve fund is to cover subsequent losses. Accordingly, his unofficial interpretation is that public benefit companies may also use their reserve fund for programmatic purposes.

### **Conclusions**

The new law is significant because it potentially decentralizes control over the provision of social services. Current legislation (and the draft foundations law) explicitly and implicitly restrict the ability of foundations and associations to provide income-generating, yet socially beneficial, services. Accordingly, state, or quasi-state, organizations currently carry the burden for these social needs.

The newly passed law creates legal space for the establishment of privately organized social service not-for-profits. In addition, the law provides that these organizations are entitled to the same tax preferences generally available to other not-for-profits. Therefore, with certain restrictions and limitations, these organizations are granted income tax exemptions and are entitled to receive tax-deductible contributions. Moreover, the law incorporates several principles important to the development of the sector (transparency, well-defined internal governance structure, court registration, etc.) While there are certainly problems with the new law (issues relating to the reserve fund, power of local district officers to appoint directors under certain circumstances, etc.), and there are questions about its practical impact, the consensus is that it is a step in the right direction.