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# ON TAX RULES FOR NGO'S IN THE CZECH REPUBLIC

Petr Pajas, First Consulting p.b.c., Prague, Czech Republic

## **Tax laws in general**

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

As a rule, there is a change in some of the provisions of the fiscal laws each year, so that it is fairly difficult to avoid a co-operation with experts in many tax and fiscal issues. The description which follows reflects the situation in the Czech Republic as in the fall of 1998.

## **The main tax laws in the Czech Republic**

The list of the main laws which regulate the tax issues in the Czech Republic is as follows:

- a) The Act No. 586/1992, on Income Tax as amended lastly by the Act No. 227/1997, on Foundations and Funds
- b) The Act No. 588/1992, on Value Added Tax as amended lastly by the Act No. 208/1997
- c) The Act No. 593/1992, on Depreciation Reserves for Income Tax Base Establishment as amended lastly by the Act No. 211/1997
- d) The Act No. 587/1992, on Consumption and Excise Tax, as amended lastly by the Act No. 303/1997
- e) The Act No. 16/1993, on Highway Tax, as amended lastly by the Act No. 239/1996
- f) The Act No. 338/1992, on Real Estate Tax, as amended lastly by the Act No. 248/1995, on Public Benefit Corporations
- g) The Act No. 357/1992, on Inheritance Tax, Donated Assets Tax and Property Transfer Tax, as amended lastly by the Act No. 203/1997
- h) The Act No. 337/1992, on Tax and Fees Administration, as amended lastly by the Act No. 61/1997

## **The types of NGO's in the Czech Republic and the laws regulating their activities**

The Czech legal order belongs to the system of continental law - civil law. The not-for-profit sector is subject to private law with some public law elements enforced especially in the registration process by state authorities. The wordings like "not-for-profit law", or "the law of not-for-profit organization" has no direct support in the Czech Republic law theory.

Moreover, in the Czech Republic there exists no single law regulating all types of not-for-profit or non-governmental organizations, even though there do appear some opinions it would be a good idea to draft and pass one umbrella bill for these legal forms, that would summarize their common features. Actually, the legal regulation of the particular types of not-for-profit organizations is rather fragmented.

The fundamental law regulating the general position of legal entities (corporations) in the Czech legal order is the Act No. 40/1964, Civil Code (the full wording, the Act No. 9/1992.)

The Civil Code in § 18 paragraph 2, classifies the legal entities into four categories according to their main characteristic features. These categories are:

1. associations of physical persons and legal entities,
2. specific purpose associations of property,
3. units of municipal authorities,
4. other entities set by law.

In the first category there are entities, which are characterized by representing a set of natural persons and/or legal entities. In this category, of the organizations allowed to operate in the not-for-profit sector, we can find the following ones:

- a) associations and trade unions (see Act No. 83/1990, on Associating of Citizens),
- b) interest associations of legal entities (see Civil Code, in Articles 20f to 21j),
- c) churches and religious congregations (see Act No. 308/1991Coll., on Freedom of Religion and on the Status of Churches and Religious Congregations, and The Act No. 161/1992Coll., on Registration of Churches and Religious Congregations),
- d) professional chambers and bars (there is a set of laws regulating these legal forms),
- e) political parties and political movements (see The Act No. 424/1991Coll. on Associating in Political Parties and Political Movements) and
- f) cooperatives (see Act No. 513/1991 Coll., The Commercial Code, Articles 221 to 260).

Into this category one would also classify

- g) the companies with limited liabilities (see Act No. 513/1991 Coll., The Commercial Code, Articles 105 to 153) and
- h) joint stock companies (see Act No. 513/1991 Coll., The Commercial Code, Articles 105 to 153 and 154 to 220).

However, these forms, which must be established explicitly for the not-for-profit purpose are not too frequent.

In the second category, the characteristic feature of an entity is to represent specific property assembled on some purpose. To this category belong

- i) foundations with an endowment (hereafter only "foundations") and
- j) grant giving funds without an endowment (hereafter only "funds") (see Act No. 227/1997, on Foundations and Funds).

The third category reflects the legal situation of a municipal establishment, when municipalities as such are specific subjects of the law.

The fourth category can be named complementary, for it includes the entities which may not be classified into some of the first three categories. These are treated as legal entities which may act only according to the a specific law. Of the not-for-profit organizations here we find

i) the public benefit corporations (see Act No.248/1995, on Public Benefit Corporations).

The state and municipalities may also establish the so called

j) budgetary organizations and subsidiary organizations (see mainly the Act No.576/1990 Coll., on the Principles of Managing the Budget Means of the Government and Municipalities in the Czech Republic).

which are semi-independent legal entities classified also into the fourth category, but, in general, these organizations are not considered as real NGOs.

### **Tax obligations and exemptions applicable for NGOs**

In general, the tax regulation depends either on the type of the activity or on the legal form taken by the legal entity as a tax-payer.

Let us look into the peculiarities of the individual tax regulations from the point of view of the not/for/profit organizations.

#### The Income Tax

As usual, the Income Tax for natural persons is different for that of corporate bodies.

As for the Natural Person Income tax issues, which might be of interest for those working for the NGOs. In this case the tax rate is constructed as progressively growing with the tax base, starting at the level of 15% for tax base less then about CZK 90,000 (approx. US\$ 3,000) up to 40% for tax base ranging over CZK 820,000 (approx. US\$ 27,300). There is a comprehensive procedure available, by which the tax base is to be calculated from the real annual income. The procedure includes subtraction of certain per head sums for tax payer and his/her family members, as well as a possibility to subtract essential expenditures classified as necessary for maintaining the income.

There are also specific income categories, such as income from capital investments, incomes from renting the real estates, incomes from interests of savings in the banks and incomes from foreign employer, which are treated separately and/or under specific and universal tax rate.

Let us now concentrate on the Corporate Income tax issues. Hereafter, the text written *"like this, in italics,"* will refer to a direct citation from the law.

First of all, the law allows to distinguish a tax-payer *"which was not founded or established for business purposes"* from other tax-payers.. This category includes explicitly *"interest associations of legal entities..., civic associations including trade unions, political parties and political movements, registered churches and religious communities, public benefit corporations, foundations and funds, municipalities, district offices of the state administration, budgetary and contributory organizations and state*

*funds*". Taxpayers in this category must always report incomes derived from advertisements, membership fees, and property rentals. However, the incomes from "membership fees paid in accordance with by-laws of an association, trade union, political party, and political movement" and incomes "from church collections, for liturgical acts and members' contributions in the case of registered churches and religious communities" are exempt from the Corporate Income Tax. On the other hand, for tax-payers in this category the incomes originating from: "activities corresponding to their mission, if the expenses are higher than incomes and the relevant activities are well defined in Statute, By-Laws, Establishment Proposal or Founding Agreements of such a legal entity" are not considered to be liable to the tax. Similarly are treated incomes from "donations and other forms of state or municipal subsidy, if these are provided in compliance with a special regulation"<sup>1</sup> as well as incomes from "interests from savings on a current bank account".

The above statement is made more precise by the requirement of the law, according to which the tax liability relates only "... to those individual incomes from the above defined activities, that were achieved under the condition of being greater than related expenses". This is, of course, a source of disputes over the accounting mechanisms required to clearly regulate these arrangements. In general, the Act requires to keep the books in such a way, that the tax exempt incomes are separable from those not exempt. By doing so, the NGO may avoid unnecessary problems during the randomly organized supervisory audits conducted by the taxation officers.

In general, the law requires NGOs to segregate their income and expenditures related to individual activities so as to allow for individual taxation of profit from these activities, not to speak about the general requirement of separate accounting for exempt income from that which is tax liable in the NGO's financial records.

An important issue introduced into the Act on Income Tax by the recently passed Act No. 227/1997, on Foundations and Funds, is the statement, according to which "the incomes generated from the renting of real estates ..., from renting products of art ..., from interest rates and dividends on shares ..., from interest rates on financial assets ... deposited on a special account at a bank ..., from authors and patent rights ..." are exempt from the corporate income tax, unless there were not used in contradiction to the Act on Foundations and Funds and under the condition that the sources of the income are incorporated into the register of foundation and funds kept by the registering court as a part of the endowment of a foundation. (This condition is in the text of the law on all places above, where is the clause " "). However, at the moment there are only tens of foundations registered according to the new law out of thousands which existed before the law was enacted. Therefore, this new tax exempt may become important for those foundations which registered a substantial endowment.

The tax-exempt status is also given to certain ecologically beneficial activities and incomes from lotteries organized according to special regulations if more than 90% of the net income is used for public benefit purposes.

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<sup>1</sup> Special regulations are other laws or government regulations issued for certain purposes, such as regulations under which associations may be given subsidies from the state budget.

The above mentioned organizations of the not-for-profit characteristics may further reduce their tax bases by up to 30%, but not more than CZK 3,000,000 (about US\$ 100,000), if the assets acquired in such a way shall be used to cover the expenses for activities, which are not tax liable. In the case, when the 30% reduction of the tax base is less than CZK 100,000, the taxpayer may retain up to the latter amount, but not more than the tax base itself.

This rule is more clearly explained through an example, comparing the tax situation of a commercially oriented legal entity – e.g. a trading company and a not-for-profit NGO.

In the case of the company, when calculating the tax base, the expenditures related to the incomes may be subtracted. So, let us assume a company generated CZK 600,000 in direct incomes from all its activities and spend for that CZK 300,000 in deductible expenditures. The CZK 300,000 are liable for the income tax. Let it be 30%, so that the company will have to pay CZK 100,000 as a tax, leaving CZK 200,000 as a net profit.

The NGO will organize two beneficial concerts. On the first one it makes net profit of CZK 600,000, while on the second concert the loss was CZK 300,000. The income from the first concert is liable to the corporate income tax and 30% tax base reduction may be applied to this income. Therefore, the 30% tax is paid from CZK 400,000 tax base, that is CZK 120,000, leaving from the first concert CZK 480,000 as net income, out of which CZK 200,000 must be used to cover the loss from the second concert. Therefore, the NGO ends up with a net profit of CZK 180,000.

The overall financial balance was the same before the tax, but the result of the NGO is by 10% less favorable compared to the result of the trading company.

### The Value Added Tax (VAT)

The VAT generally applies to all transactions of those taxpayers, whose turnover in the three preceding calendar months was greater than CZK 700,000 (approx. US\$ 23,300). Tax liable are also the transactions resulting from those activities of the not-for-profit legal entities, which constitute their main field of activities, but the same law provides for tax exemption for such a tax.

Thus, if an association runs a hostel on its property and if that is its main activity according to its by-laws, the services provided in such a hostel are not subject to the VAT.

On the other hand, once the NGO is not, in general, a VAT-payer, it may not apply for reimbursement of the VAT paid to the providers of goods and services.

### The Excise or Consumption Tax and Customs Fees

The exemptions from paying the consumption tax and customs fees applies to certain types of goods rather than types of organizations. Exempt items include goods for educational purposes (such as books), scientific work (such as equipment and tools),

and cultural purposes; goods to be distributed free of charge by charities, office equipment and material donated to Czech NGOs; and goods to be used by the blind and other handicapped people. The amount of the goods must be moderate and not in surplus for sale.

## The Real Estate Tax and Property Transfer Tax

The tax on real estate property is derived from the area of the lot and number of floors in the case of buildings. It is also diversified with respect to the category of the land use and number of population in the municipality concerned. The lots on which there is a construction, which serves to the needs of a church, a religious congregation or which serves to the religious activities of such bodies, as well as a lot on stands a building belonging to a civil association or a public benefit company, to a school, to a museum, to a gallery of arts, to a public library, to a health or social care institutions and to a foundation with an endowment (note: not a fund) or where there is a monument of architecture – all these are exempt from the both the real estate tax and construction tax.

## Tax on Donated Assets

No tax is paid on donated assets if the transfer is *"dedicated to finance establishments and humanitarian actions in the field of culture, learning, science, health and social care, ecology, sports, education and protection of children ... if the property is transferred to legal persons established for the above purposes and having their seat in the Czech Republic"*

Exempt from the donated property tax are *"all donations to a foundation or a fund as well as all grants provided to third persons by a foundation or a fund, if they are used in accordance to the purpose and conditions related to the grant"*.

Portions of real estates may be used for the above mentioned purposes, but the proportion used for commercial purposes or rented is then tax liable.

## Other taxes and fees

Foundations and public benefit corporations are, in general, exempt from fees for court proceedings related to their registration, as well as from certain other fees, but not from all.

## Tax Exemptions for Donors

The Czech legal system contains special rules for "gift" and "donation". Natural and legal donors are treated differently for tax purposes.

## Gifts of Natural Persons

A natural person may deduct up to 10% of his/her tax base for donations. To qualify for this exemption, however, a natural person must donate at least 2% of his/her tax base, but not less than 1,000 CZK. Qualifying donations must be given to municipalities or legal persons headquartered in the Czech Republic to finance "*science and learning, research and development, culture, schools, police, fire squads, support and protection of young people, protection of animals, social and health care, ecology, humanitarian and charity purposes, religious purposes for registered churches and religious communities and sports*", as well as to natural persons living in the Czech Republic who use the donation to run "*schools and health care establishments and care for abandoned animals or endangered species*".

## Donations by Legal Persons

The rules for natural persons apply to legal entities, as well, but the legal entity may not deduct more than 2% of its tax base and must donate as a minimum CZK 2,000, in order to qualify for the deduction. However, NGOs are not entitled to this deduction. The overall value of the registered endowment of a foundation may not fall below 500,000 CZK. Foundations and funds are not allowed to become partners of any commercial company or be silent partners to any company, with the only exemption for foundations described above. None of the property of a foundation or a fund may be used as a security to loans and other liabilities.

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