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A. Trade Licensing Act Amended

On 1 July, 2008, the anticipated large-scale amendment to the Trade Licensing Act, specifically Act No. 130/2008 Coll., amending Act No. 455/1991 Coll., on Trade (the Trade Licensing Act), as amended, and other related acts, entered into effect. For businesspeople this should mean significant simplification of administration in their entry into a trade and a reduction of their administrative burden in their contact with Trade Licensing Offices. The amendment should also enable Trade Licensing Offices to process trade licensing administration work faster, and, last but not least, all these changes, in connection with the amendment to the Act on Administrative Fees, should also be reflected in an overall reduction in cost of the trade licensing administration work for businesspeople.

We present here an overview of some of the most important changes:

- The Act now introduces only **a single unqualified trade**, with the obligation that, when declaring an unqualified trade, a businessperson is obligated to state the business activities which he/she will perform.

- The **local jurisdiction of Trade Licensing Offices is abolished**. For businesspeople this means the ability to declare a trade or request the issuance of a trade license or to provide notification of any change in the information to any municipal Trade Licensing Office in the Czech Republic (S. 71 of the Trade Licensing Act). In connection with the amendment to the Public Administration Information Systems Act it is also possible to file a submission to a municipal authority via a local public administration access point (Czech POINT), i.e. it is now possible to file a submission at places such as a notary public, at the post office and at the Czech Chamber of Commerce.

- The abolition of trade licenses and business licenses as proof of trade licensing authorisation. These documents are replaced by an extract from the Trade Registry. Thus a businessperson will now be able to prove his/her trade authorisation not with evidence such as several trade licenses, but with only **a single extract** from the Trade Registry. Updated trade authorisations and trade authorisation certificates, however, are retained, and will be replaced by an extract from the Trade Registry when the first change is made or at the businessperson's request.

- A businessperson's **notification obligation** is also limited. This now relates to changes only to information which the trade licensing offices are not able to acquire from databases available to the public and state administration authorities. Currently this should include databases such as the Commercial Register database, and for that reason the businessperson's obligation to notify the Trade Licensing Office of changes to information is abolished if such changes have already been entered in the Commercial Register. The Trade Licensing Office themselves will obtain the extract from the Czech Criminal Register for a businessperson (this also applied to the previous law in the event that an extract from the Criminal Register was not enclosed with the trade notification).

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- The Act sets out a new method for dividing offices; in the Trade Licensing Act the original deadline (at least 3 days in advance) for a businessperson to announce the commencement and termination of activity in an office was eliminated. The businessperson is now obligated to announce the commencement and termination of performance of a trade in an office to the Trade Licensing Office only "in advance". The obligation of a businessperson to have a trade authorisation certificate in the office for auditing purposes is cancelled.

- The Act now defines the notion of integrity as one of the general conditions for performing a trade; crimes of negligence have been deleted from the definition of loss of integrity.

- The requirements for professional qualifications of beginning businesspeople have been reduced; requirements for the mandatory professional experience of businesspeople performing vocational trades have been cancelled or reduced; the number of trades has been reduced and their definition is more transparent (some trades have been combined, for some trades special qualifications are no longer required, some permitted trades have become professional trades); carrying on a trade as an industry has been cancelled..

- A major change applies to the execution of functions of a legal representative: the number of businesspeople for whom one person is entitled to execute the functions of a legal representative has increased from two to four. Pursuant to S. 11 of the new Trade Licensing Act, nobody can be appointed legal representative for more than four businesspeople. At the same time, the obligation of a legal representative to announce the termination of his/her functions in case a businessperson does not announce such fact has been cancelled; however, the entitlement of legal representatives to announce the termination of their functions remains unchanged.

- The Act now stipulates that businesspeople can suspend performance of their trades for an indefinite period of time and not only for a maximum of two years, as stipulated by the Act prior to the amendment.

- The time limit to record an entry in the Trade Registry has been reduced from 15 to 5 days.

- Changes in administrative fees: due to the introduction of a single unqualified trade, businesspeople pay only one administrative fee of CZK 1,000 upon notification of their unqualified trade (regardless of the number of business activities specified in the notification). Actions such as a change of business activities within an unqualified trade, the issuance of the first extract from the Trade Registry after the recording of a businessperson in the Trade Registry, or a change in conditions of performing business activity, if the change is carried out by an administrative authority based on its own initiative are exempt from fees.

- Furthermore, certain procedural provisions have been deleted from the Trade Licensing Act; changes have also been made in the definition of activities which

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are not considered trades; in the penalty provisions, changes have been made in the definition of facts for infractions and other administrative delicts; the amounts of the penalties have been changed, etc.

- To conclude, it must be added that following the above-mentioned amendment an amendment was made in the area of recognizing professional qualifications. This resulted in yet another amendment to the Trade Licensing Act by Act No. 189/2008 Coll., amending Act No. 18/2004 Coll., on Recognition of Professional Qualifications and Other Competences of Nationals of Member States of the European Union and on the Amendment to Certain Acts (the Act on Recognition of Professional Qualifications), as amended, and other related acts (effective from 1 July, 2008). Among other things, the Trade Licensing Act now defines the scope of activities which are not considered trades (health care), and the conditions for and obligations of foreign entities providing services in the Czech Republic have been supplemented.

B. New Legislation on Transformation of Companies

A new act on transformation of companies and cooperatives (Act No. 125/2008 Coll., hereinafter the "Transformation Act") comes into force on 1 July 2008. Until now, transformation of companies has been governed by the Commercial Code; once the Transformation Act comes into force the relevant provisions will cease to be effective. By adopting the new Transformation Act the legislators had two objectives in mind: to extract provisions on transformation from the Commercial Code and to create a comprehensive piece of legislation on transformation of companies while at the same time implementing Directive 2005/56/EC on cross-border mergers of limited liability companies (the "Tenth Directive"). Thus similarly to Germany, by the Transformation Act consisting of 389 sections and soon coming into force, the Czech Republic will have a separate act on transformation of companies.

Below are the most important aspects of the new act:

I. New provisions on domestic transformation of companies

- Pursuant to S. 2 of the Transformation Act, transformation may have four different forms: (i) merger, (ii) division, (iii) transfer of property to a shareholder, (iv) change of legal status.

- The central concept in the Transformation Act is the "Project" based on which the transformation is to be performed. A project is a known concept from the legislation on division of companies currently in force as the act stipulates that a division project must be drafted. Henceforth, the concept of a project will relate to all types of transformations. Statutory bodies of companies participating in the transformation will be obliged to draft a transformation project in writing. The project then has to be approved by all the stakeholders in the wording drafted by the statutory bodies. However, the transformation project must be deposited in the Collection of Deeds of the Commercial Register Court at least one month before its approval and the information on the deposition must be published in the Commercial Bulletin.

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- Today, the Commercial Code in force stipulates that the company's supervisory board must review a transformation report drafted by the statutory body. This is no longer required by the new act; a written report on the transformation is drafted only by the statutory body.

- The currently existing legislation stipulates that there are two notarial records needed for the company's transformation: the first one contains consent to the draft contract on a merger (contract on a division or a contract on transfer of property) and by the second record the contract as such is executed. The new Transformation Act now requires only one notarial record, the subject matter of which is approval of the transformation by the general meeting and to which a transformation project is attached.

- Yet another new aspect must be mentioned in connection with mergers: in case of mergers by consolidation of a limited liability company, a joint stock company or a cooperative, it is admissible to publish a merger project without any data on future statutory bodies or the supervisory board of the successor company.

- In case of mergers of joint stock companies a share exchange rate must be defined. Should the share exchange rate be set and should the exchange, due to serious reasons, be performed so that shareholders of the participating companies are damaged, they are entitled to compensation. In this respect the Transformation Act newly sets forth that this entitlement shall not be limited.

II. Cross-border mergers regulation

Regulation of cross-border mergers is a brand new concept in the Czech Law. As already stated, it is a transposition of Directive of the European Parliament and Council on cross-border mergers of limited liability companies (2005/56/EC) into Czech legislation. The European Court of Justice believes that cross-border mergers should be allowed, as they, as expressed in the ECJ's judgement on SEVIC, represent an important means of smooth internal market functioning.

Cross-border mergers are governed by S. 180 et seq. of the Transformation Act. Cross-border merges are mergers of one or several companies or cooperatives with one or several foreign companies. The act stipulates that a cross-border merger is possible for all types of companies (joint stock company, limited liability company, limited partnership, unlimited company and cooperative) and the decisive condition is that the companies must have legal personality, i.e. they must be legal entities. Generally, the transferor and successor companies must have the same legal status unless legal regulations of Member States in which the merging companies have their registered seats allow for domestic mergers of companies with different legal status. The new act also allows that a company created by a cross-border merger choose its seat in any other EU Member State. This means that should a German joint stock company merge with a Czech joint stock company the resulting company can choose to have its seat for example in Austria. Similarly to domestic transformations there must be a merger project drafted containing all important facts on the merger.

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Participation of employees

The merger project must contain also information on involvement of employees in the company resulting from the merger. Involvement of employees is another specific feature of the Transformation Act and it derives from the above-mentioned Tenth Directive that governs employee involvement. In respect of employee involvement the Tenth Directive strongly focuses on provisions related to a European company (Regulation (EC) 2157/2001).

At the beginning of a merger the employees have a right to receive information about the merger project and to be consulted about it. During negotiations on the scope of employee participation in the new company, the employees are represented by a panel composed of employees of the merging companies. The employees of the company resulting from the merger have participation rights. This means that they are entitled to elect the supervisory board of the new company or to be elected as its members as well as to express their approval or disapproval with the election of the supervisory board. Should any of the transferor companies within the cross-border merger have more than 500 employees, the participation rights will be introduced automatically for the company resulting from a cross-border merger.

For the merger to be completed, a notary must certify compliance of the cross-border merger with the provisions of the Transformation Act.

III. Accounting and tax aspects of company transformations

The "decisive day" has been shifted. The decisive day – the same as in the previous legal regulation – is the day as of which any transaction of the transferor company or the company being divided shall be regarded for accounting purposes as a transaction effected on the account of the successor company or the successor shareholder. For mergers, divisions and transfers of property, the decisive day may not precede by more than twelve (until now nine) months the day when a petition for entry of the merger, division or transfer of property in the Commercial Register is filed.

From the accounting viewpoint, it is very important to know the decisive day of the transformation and specification of the structure in which the elements of equity and loan capital of the transferor companies not representing a liability are transferred to the successor company.

Accounting consequences

Final accounts must be closed as of the day preceding the decisive day. Should more than six months elapse from the closing of final accounts to the day of elaboration of the transformation project, the company is obliged to compile interim accounts. A transformation project must be drafted no later than three months from the day of drawing up the interim accounts.

Under S. 12 of the Transformation Act, if any of the participating companies is obliged to have its accounts audited, all of the companies involved in the given merger or division will have the same obligation. This rule also applies to interim accounts and initial balance sheets of the successor company.

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Cross-border mergers may apparently give rise to problems in the area of assumption of tax reserves, adjustments to receivables, tax depreciation and tax losses. The Transformation Act stipulates that the foreign exchange market rate announced by the Czech National Bank as of the decisive day of the company's transformation be used to convert the foreign price. Under the act, the final price is then called the "converted foreign price" and is considered the entry price also for the purposes of depreciation and amortization of assets.

Pursuant to the act, in case of a merger of parent and subsidiary limited liability companies, the shareholders may decide whether or not they will increase the registered capital of the successor limited liability company. Should the registered capital of the successor company not be increased, or should it only be increased from equity of the successor company, no expert valuation of the assets of the transferor company is needed. An expert valuation is only required if the existing contributions of the successor company are increased from the equity of the transferor company.

A precise structure of takeover of the equity components forms a significant part of a merger project. Accounting units are obliged to submit the initial balance sheet together with a written explanation containing all relevant facts associated with accounting transactions resulting from the transformation.

Tax consequences

For the purpose of further creation of reserves, it is necessary to satisfy the conditions stipulated by the Income Tax Act and the Reserves Act in order to determine the income tax base. Similarly, when assuming the loss incurred by a foreign transferor company before transformation of the company or its separate part, only a loss which has never been used abroad can be claimed, regardless of the manner and possibility of claiming a loss abroad. The purpose of this provision is to try to prevent double claiming of the same loss, even if in different countries in case of a cross-border merger.

Since the concepts of creation of reserves and calculation of tax loss are based on the national legislations of the individual countries, reconstitution of the correct tax base and conversion of tax loss within cross-border merger projects will be highly demanding, as it will require knowledge of both the national and community legislations.

Obligations following cross-border mergers

Should a company not physically relocate from the Czech Republic to the seat of the successor company in case of a cross-border merger, the original company becomes business premises of the foreign entity. As stipulated by the Accounting Act, business premises of a foreign entity are also obliged to keep accounting books in compliance with the Czech legal regulations. However, the Ministry of Finance currently holds negotiations which could lead to cancellation of this obligation for business premises. The obligation of business premises located in the Czech Republic to determine the income tax base pursuant to Czech legislation, however, remains unaffected.

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Summary

By adopting the Directive on cross-border mergers in 2005, the European Union implemented a task of utmost urgency: the topic had been discussed in the then EEA and later in the EU since 1972. A number of drafts of this Directive came to naught because the Member States were unable to agree on the issue of participation of employees in mergers. Only when the EU issued the Regulation on the statute for a European company and the supplementing Directive with regard to the involvement of employees in the European company in 2001, the EU Directive on cross-border mergers was finally approved. It can be appreciated that Czech legislators extracted the existing provisions on transformation of companies from the Commercial Code and issued a separate act on transformation while transposing the Directive on cross-border mergers. Compared to the existing provisions in the Commercial Code which contained a number of references, the new transformation regulation will be much simpler to apply.

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