

# Tax Flash

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## The Fund of Qualified Investors will help decrease taxes

A number of changes in the law discussed and requested over the last few years regarding the Funds of Qualified Investors finally came into effect as of 1 August 2009. These changes may give positive stimulus to further developments of the fund industry in the Czech Republic.

The main benefit of a Fund of Qualified Investors (“FQI”) is a reduced Czech corporate income tax rate of 5% compared to the standard rate of 20% (19% from 2010). Allowing income from real estate, interest, receivables and other assets to be taxed at a reduced rate will be the key incentive to setting up those funds.

The amendment to the Collective Investment legislation removes the main barriers to the flexibility of these vehicles.

### Below are the main tax and legal characteristics of FQIs:

- Corporate rate of 5 % compared to the usual rate of 20 %.
- An FQI may be in the form of a joint stock company, which is the most beneficial for many companies with already established relationships.
- Withholding tax exemption on dividends if an EU corporate shareholder holds at least a 10% share for at least 12 months. Received dividends may also be exempt from corporate income tax for qualifying Czech corporate shareholders. Under the conditions for dividend exemption the capital gain from the sale of shares in an FQI may also be tax exempt from corporate taxation.
- For individuals the capital gain from the sale of shares in an FQI may be exempt if the individual holds the share for at least 6 months and the direct shareholding does not exceed 5 % in 24 months before the sale; in case of higher shareholding the exemption applies after a 5-year holding period.
- If an FQI performs a real estate development activity in the transfer of real estate, for example, in residential apartments, the fund is exempt from real estate transfer tax. This was confirmed in a non-binding interpretation by the Ministry of Finance.
- An FQI is subject to limited regulation and supervision of the Czech National Bank. Its investment strategy is not determined explicitly by law and the statute is the key document which defines the types of assets into which the FQI invests. There are also no restrictions on financing and leverage (for tax purposes a debt-to-equity ratio of 4:1 applies under thin capitalisation rules).
- Non-monetary (in-kind) contributions into an FQI are now allowed, so that the transfer of assets (e.g., real estate development projects, existing assets) from an existing structure into an FQI is more efficient.
- Mergers between an FQI and another unregulated collective investment vehicle (including foreign entities) are allowed provided that the FQI is the surviving entity.
- The establishment and administration of an FQI is substantially simplified if the fund is administered by a licensed investment company resulting in more cost efficiency.
- The original maximum life limitation of 10 years of an FQI in the form of a joint stock company has been cancelled.
- The disposal of shares in an FQI will now be much easier. The change of investors (shareholders) controlling the FQI, or having so-called qualified participation, will not be subject to Czech National Bank approval. Nor will the CNB examine connections between the FQI and other entities (especially those related to the investors).

The above-mentioned changes will hopefully kick-start the genuine development of the FQI fund industry in the Czech Republic. Implementation of an FQI into corporate structures of developers, manufacturing entities, financial institutions and others may be incentivised by the low taxation of interest income, income from real estate and other assets at the level of the fund. Given current market conditions, now is a very good time to consider how the use of an FQI can help optimise the overall group tax position.