Czech
Private Equity
& Venture Capital
Association

Press Release

Abolishment of share sales income exemption to affect PE&VC transactions

Prague, 30 November 2020 – Representatives of private equity and venture capital funds perceive very negatively the proposal of Deputy of the Parliament Mikuláš Ferjenčík to abolish the exemption from taxation of income from the sale of securities exceeding 20 million CZK. There is significant concern among investors about unrealistic price expectations of sellers, as they may be forced to account for the increased tax burden within them.

According to the adopted (non-governmental) amendment, the exemption of an individual's income from the sale of a security (including the master certificate), resp. income from the share attributable to the investment certificate upon cancellation of the share fund, should be newly limited to the amount of 20 million CZK per taxable period. With regard to the absence of a special transitional provision, it is therefore possible that income from the sale of securities paid to an individual in 2021 will already be subject to a new taxation regime, even though the underlying securities were acquired by the end of 2020. Moreover, the proposed change would also affect the already closed transactions, as a substantial part of them has a so-called deferred purchase price payment depending on future economic results in a few years after the sale.

The CVCA very negatively assesses the fact that the proposal was neither discussed with the business experts, nor is in conflict with the proposals for capital market development resulting from the National Strategy for Capital Market Development, which had been approved last year. Furthermore, the proposal did not obtain a recommendation of the Budget Committee of the Chamber of Deputies of the Parliament of the Czech Republic. The preservation of the time test had also been recommended by the World Bank Report on the Development of the Capital Market in the Czech Republic, which the National Strategy has drawn upon.

At the same time, the members of the CVCA are afraid of interpretive ambiguities and potential risks when structuring transactions, as well as of the short time between the presumed approval and the real effectiveness. *"Any random and non-systemic taxation amendment brings major problems for the funds. The CVCA has long been calling for the predictability of the tax environment, and this proposal is in sharp contrast to this requirement. The objective of the governmental policy should be to support the financial sector, which works with high added value and supports Czech growth and innovative companies, not its destabilisation"* says Jiří Beneš, CVCA President, in his comment about the proposal.

Private equity funds are increasingly buying companies from their founders and, thereby, help them resolve the problem of succession. Such companies have been run by individuals / families for decades and they, in good faith, presumed that the yield from selling their businesses would be generally exempt of tax. The limit of 20 million is very low in this context. Only small companies are purchased within this price range, which are currently targeted by only a minimum of private equity funds. The proposed changes would have a considerably negative impact on the structuring of transactions and on purchase prices. At the same time, these family businesses are by nature businesses with a high added value and have significant potential for further growth in the future. Besides this, sellers – shareholders would be entirely unjustifiably disadvantaged as opposed to sellers – associates of private limited companies, or other types of companies which do not issue their shares in the form of securities. It is this aspect where it is possible to see another inconceivability of the entire amendment concerning these incomes. Moreover, the wording of the amendment in question raises a number of other ambiguities, for example, whether the limit applies to the seller's total income from the sale of all securities (shares) in the given year or to an individual income, or income from an individual security (i.e. the income from every share), or what part of the income in the given period will be exempt.

The venture capital funds, and founders and owners of start-up companies respectively, represent another negatively affected group as start-ups usually take the form of joint stock companies. Innovative technological funds should, on the contrary, be supported by the state, resp. they should not be unnecessarily hindered. The long-term objective of the state, especially today, should be the maximum support for technological development and innovative businessmen who take an active part in it by creating favourable conditions for products and services with high added value.

One can only hope that this conceptually inconsistent (non-governmental) amendment, which should be discussed in the Senate in mid-December 2020, will be reworked by the Senate and returned the Chamber of Deputies for comment.

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The Czech Private Equity & Venture Capital Association (CVCA) represents the interests of companies operating in the private equity and venture capital sector in the Czech Republic. Its members are companies investing private equity and venture capital (full members) and companies providing consultancy (associate members) in this field. CVCA is a member of Invest Europe (formerly the European Private Equity and Venture Capital Association (EVCA)) and is in close contact with other associations (especially those from the region of Central and Eastern Europe) through a network of national associations associated in Invest Europe. www.cvca.cz