

# Demerger by spin-off as a new form of corporate transformation



An amendment to the Act on Transformations, effective as of 19 July 2024, introduced a new form of corporate transformation into Czech law - demerger by spin-off. This new form of transformation is similar to demerger by separation; however, there is one fundamental difference: the shareholders of the demerged company do not become shareholders of the successor company; instead, the demerged company itself becomes the shareholder. Demerger by spin-off therefore represents an alternative to establishing a company through an in-kind contribution or to increasing registered capital in this manner, while also providing an interesting tool for creating holding structures.

## Key Points – Legal Aspects

- 1 The July 2024 amendment to the Act on Transformations** introduced demerger by spin-off.
- 2 In a demerger by spin-off**, the shareholder of the successor company becomes the demerged company itself.
- 3 Demerger by spin-off involving the formation of a new company:** an alternative to establishing a single-member company through an in-kind contribution.
- 4 Demerger by spin-off by merger:** an alternative to increasing share capital through an in-kind contribution.

## Demerger by Spin-off – Legal Aspects

Demerger by spin-off represents a new form of division of a commercial company, which may be carried out either as a spin-off resulting in the establishment of one or more new companies, or as a spin-off by merger with one or more existing companies (or as a combination of both forms).

However, demerger by spin-off cannot be applied universally to all types of business corporations, its use is excluded in the case of cooperatives, while for partnerships (general partnerships and limited partnerships) it is permissible only in the form of a spin-off by merger.

Demerger by spin-off shares characteristics similar to demerger by separation, as the demerged company does not cease to exist and only part of its assets is transferred to the successor company. The key difference, however, lies in who becomes the shareholder of the successor company:

- in a demerger by separation, the existing shareholders of the demerged company become shareholders of the successor company;
- in a demerger by spin-off, the demerged company itself becomes the shareholder of the successor company.

### Demerger by Spin-off with the Formation of a New Company

In the case of a demerger by spin-off resulting in the formation of one or more new companies, the demerged company becomes the sole shareholder of the successor company, or respectively of the successor companies. This procedure therefore does not allow the transfer of assets from multiple demerged companies for the purpose of establishing a single new company with multiple shareholders. This form of demerger thus represents **an alternative to the establishment of a capital company with a single shareholder through an in-kind contribution**. However, it should be noted that demerger is a more formally demanding process than the establishment of a company by means of an in-kind contribution, as it includes, inter alia, the obligation to publish a transformation project and related notices, as well as the preparation of financial statements.

While an in-kind contribution may, as a matter of principle, consist only of assets, with liabilities transferring together with the contributed assets only in the case of a contribution of an enterprise or its part, a demerger may involve the simultaneous transfer of both assets and liabilities. Similarly to the establishment of a company through an in-kind contribution, the valuation of the spun-off assets is also required in the case of a demerger by spin-off with the formation of a new company.

The regime of liability for transferred debts also differs. In the case of a contribution of an enterprise, the contributor bears unlimited liability for transferred debts unless the creditor has consented to their transfer; for debts that do not pass to the acquirer, the newly established company does not assume liability. In contrast, a demerger gives rise to so-called cross-liability, whereby the successor company bears limited liability for debts that did not pass to it, and the demerged company bears limited liability for debts that were transferred to the successor company.

A demerger by spin-off with the formation of a new company is always subject to approval by the general meeting of the demerged company. By contrast, the general meeting of the founding company decides on an in-kind contribution only where the subject of the contribution is an enterprise or such a part of assets that constitutes a substantial change in the nature or scope of the founding company's business.

### Demerger by Spin-off by Merger

In the case of a demerger by spin-off by merger, the demerged company acquires a shareholding in one or more already existing companies. In practice, this form of demerger therefore represents **an alternative to an increase in a company's registered capital through an in-kind contribution.**

The conclusions set out above apply to this alternative accordingly. However, unlike a demerger by spin-off resulting in the formation of a new company, in the case of a demerger by spin-off by merger the valuation of the spun-off assets is required only where the successor company increases its registered capital as a result of the transformation.

A demerger by spin-off by merger must be approved by the general meetings of both participating companies. An exception applies where the demerged company is the sole shareholder of the successor company; in such a case, approval by the supreme corporate body of the successor company is not required, unless the demerger results in an increase of its registered capital.

By contrast, in the case of a standard increase of registered capital, a resolution of the general meeting of the company whose registered capital is being increased is always required. The general meeting of the contributing company decides on an in-kind contribution only where its subject is an enterprise or such part of assets that constitutes a substantial change in the nature or scope of the contributor's existing business activities.

### **Key points – Tax and Accounting Aspects**

- 1 Accounting:** The shareholding in the successor company is measured at the accounting net book value of the spun-off assets. If this value is negative, it is recognised at zero, with the difference reflected in equity.
- 2 Taxation (demerged company):** The acquisition cost of the shareholding is determined either by an expert valuation (in the case of an enterprise) or by the tax residual value of other assets. This cost is tax-deductible upon the subsequent sale of the shareholding.
- 3 Taxation (successor company):** The successor company assumes the tax residual values of the transferred assets. Tax continuity is maintained, meaning that the demerger by spin-off is tax-neutral.

### **Demerger by Spin-off – Accounting and Tax Aspects**

In the accounting records of the demerged company, the value of the shareholding in the successor company is determined on the basis of the accounting net book value of the spun-off assets. This value comprises the assets transferred to the successor company, reduced by related liabilities, provisions, and reserves attributable to the spun-off part of the business. In

the case of a spin-off of an over-indebted enterprise, the calculated net book value may be negative. However, under accounting regulations, the shareholding in the successor company cannot be recognised at a negative value. If such a situation arises, the shareholding is therefore recognised at zero, and the difference between the calculated net value and zero is reflected directly in equity (i.e. as an increase in the equity of the demerged company).

The tax implications of a demerger by spin-off depend on the nature of the spun-off assets. In the case of a spin-off of an enterprise, the tax acquisition cost of the shareholding acquired (or increased) by the demerged company in the successor company is determined in the amount of the value of the spun-off enterprise as established by an expert valuation. In other cases, i.e. where assets other than an enterprise are spun off, the acquisition cost is determined by the tax residual value of depreciable assets and the accounting value of other assets. This tax acquisition cost of the shareholding is a tax-deductible expense of the demerged company upon the subsequent disposal of the shareholding in the successor company.

The successor company assumes the tax residual values of the transferred depreciable assets and the accounting values of other assets. It therefore continues tax depreciation as applied by the demerged company, without any revaluation that would be relevant for tax purposes. As with other forms of corporate transformations, a demerger by spin-off is tax-neutral, meaning that the tax values of the spun-off assets cannot be increased at the level of the successor company.

## **Conclusion**

A demerger by spin-off represents a new form of corporate transformation that expands the existing possibilities of corporate restructuring. It may be implemented either through the formation of a new company or through a merger with existing companies, with both scenarios involving the transfer of part of the assets while the demerged company continues to exist.

This instrument is designed as an alternative to the establishment of a company through an in-kind contribution or to an increase in registered capital by such means. At the same time, however, it is subject to specific legal, accounting, and tax rules, including requirements for the valuation of the spun-off assets and the preservation of tax continuity.



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