



Legal and Economic Aspects of Virtual Organizations

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Abstract. The paper focuses on the issue of virtual organizations which can be also called as virtual offices, enterprises registered at virtual addresses etc. The paper solves several goals. First this contribution supports other findings that the number of this kind of businesses is significant in the Czech Republic. Second the legal environment is discussed. Then different reasons for using the virtual address are mentioned. These reasons are presented as legal and economic aspects. The paper tries to uncover enterprise incentives for the virtual address choice. The classical incentives are presented in the literature. Some incentives could be valid only for the specific national conditions. This paper uses available data as a support for its statements which should explain the current importance of the virtual addresses in the Czech Republic.

Keywords: Virtual organization · Virtual address · Economic advantage
Czech Republic

1 Introduction

This paper deals with an issue of enterprises registered at virtual addresses. It accents some aspects of this untraditional business form. It focuses especially on its legal and economic aspects. Although this kind of the enterprises can be set up worldwide the paper will discuss conditions in the Czech Republic. However, the introduction and literature review will be general and will not accent only the Czech reality.

First virtual organizations must be defined because there does not exist any uniform definition in the literature [2]. As a consequence, authors use terms as addresses, headquarters, offices, organizations or enterprises but always connected with the word virtual. The headquarter or the address is hardly used for running a business and its role is especially connected with the necessity of registration, administration or government statistic. This concept has been used in practice since 1990s [6]. Rapid extension was possible thanks to ICT development [10]. There still remain many industry branches which cannot use this concept because they need a regular place where they interact with their business partners (on one hand suppliers, on the other hand customers).

However, General Financial Directorate drew attention to an increasing number of Czech companies registered at a virtual address at the end of 2014 [11]. There occurs

even professional public's opinions that virtual enterprises seem to be less transparent and they can support the grey area of economy [12]. It leads to importance of this issue and therefore authors set out several goals which they want to fulfill on the following pages. The first objective is to support the statement of General Financial Directorate. It must be emphasized that the number of virtual organizations has increased and their amount is not low. Secondly the authors will focus on the legislative framework that has enabled a subsequent boom of enterprises registered at the virtual addresses both on the European and national level. The last point will be economic conditions contributed to the trend of virtual offices.

2 Literature Overview

The United States can be labelled as a birth place of the virtual offices in 1990s whose first offering authorities were Ralph Gregory and Richard Nissen [9]. The virtual office enables running a business without a traditional headquarter which is not needed anymore due to information and communication technologies. The traditional office connected with high rent, payments for furniture and utilities could be replaced by new forms. Five different kinds of the virtual offices can be distinguished as occasional telecommuting, hoteling, tethered in office, home-based mobility and fully mobile [7]. However, the business still usually needs some headquarter for legal or contact purposes. Therefore one address is shared by many entrepreneurial subjects. The amount of these subjects can exceed dozen, hundred and even thousand. It is possible because the enterprises do not use actively this office space. Therefore this address is called virtual or alternatively it is talked about virtual headquarter [1, 12]. The location of the "office" is usually very attractive in the city center. The concept of the virtual address is rarely used by Anglo-American authors because the address itself is not crucial. It is just a way to achieve goals.

It is hard to exactly define the virtual address. On the other hand, it is necessary for the paper's purposes. Becht et al. [1] suppose that the virtual address is the address which is used as the headquarter for more than 100 business entities. These entities especially use the address for the purpose of the official registration (state or regional). This definition will be used for fulfilling the first paper objective.

3 Empirical Findings

It has been already mentioned that General Financial Directorate drew attention to an increasing number of Czech companies registered at a virtual address at the end of 2014 [11]. General Financial Directorate detected that there are 53000 enterprises registered at the virtual addresses. Prague region was the main one because 43000 entities were registered at 280 addresses there.

The research team works permanently [15, 16] with the definition that the address is shared by more than 100 entrepreneurial entities. These business units were extracted from the Czech business register in 2015. Results are displayed in Fig. 1. There were in total 58435 virtual enterprises in 2015. The majority was detected in Prague whose

hegemony overweighs the importance of the capital and business center. There is a slight discrepancy between research and General Financial Directorate data. It must be emphasized that there is used another methodology and there is also a time shift of one year. It is possible that there was an increase of the enterprises registered at the virtual address.

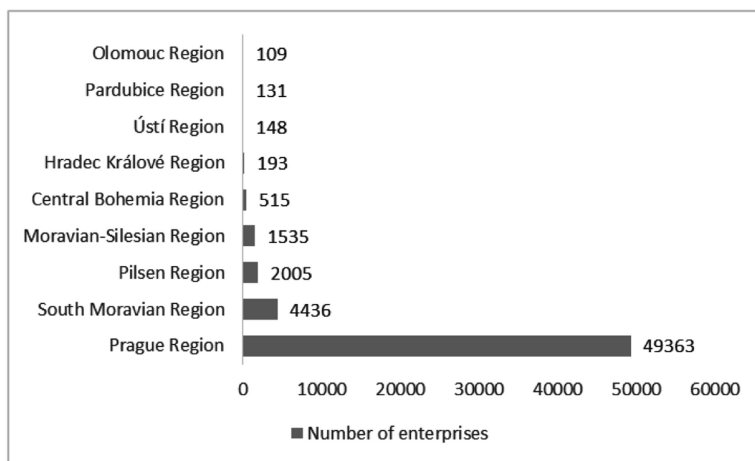


Fig. 1. Virtual enterprises according to regions. Source: authors.

Although Smrčka [13, 14] criticized the insolvency as well as business register in the Czech Republic. It is possible to gain some aggregated data proved by Fig. 1. However, detailed specifications have to be still gained manually, opening each document. Authors [12] proved that the virtual enterprises are more vulnerable because their insolvency rate was 4 times higher than for the classical enterprises. The insolvency findings go further in [15]. The recovery rate for creditors is significantly lower than in the case of the classical enterprises.

4 Legal Aspects

It may seem that the institute of virtual address is inconsistent with the law because the address is not used for almost any business activity or corporate governance. As a consequence, it could reduce the enterprise transparency. The registration of the enterprise on the so-called virtual address is fully consistent with the Czech legal framework, namely the Civil Code No. 89/2012 Coll. The Civil Code regulates the seat of the enterprise in Sects. 136 and 137. The definition is very general. The legal entity has an obligation to have an official seat of residence which can be contacted. When the official seat of residence is written in the business register, which is publicly available, the legal entity cannot object that the headquarter is somewhere else. Other sections of

the Civil Code just regulate the replacement of the headquarter to abroad from the Czech Republic or from abroad to the Czech Republic.

Free choice of the official headquarter was allowed to entrepreneurs in connection with the deregulation of EU corporate law. Free choice of the official headquarter does not depend on the real place of business. The full deregulation of EU law was a long way depending on individual decisions of the European Court of Justice. A timeline mapping shifts of the corporate mobility goes from the late 1980s to 2003. After 2003 the period is known as post-Centros [1]. Pre-Centros and post-Centros periods are terms used due to a discrepancy between EU law and national regulations. The inconsistency between the legal frameworks led to the necessity of interventions by the European Court of Justice. Key decisions of the European Court of Justice are included in Table 1.

Table 1. Corporate mobility decisions of the European Court of Justice. Source: own processing based on [1].

Decision	Date	Cause
Daily Mail	27 th September 1988	81/87
Centros	9 th March 1999	C-212/97
Überseering	5 th November 2002	C-208/00
Inspire Art	30 th September 2003	C-167-01

Cause “Daily Mail” confirmed that the free choice of the business establishment place has no effect on the applicability of the corporate law of a Member State. The cause “Centros” dealt with the enterprise Centros, Ltd. operating in Denmark but formally seated in the UK because of the stricter Danish rules on the minimum capital. Despite this fact, the enterprise could not be denied the registration in the Danish Business Register. The cause C-208/00 solved the fact that the enterprise Überseering B.V. (with the headquarter in the Netherlands but doing business in Germany) was not accepted by the German courts as a full legal entity in a cause against Nordic Construction Company Baumanagement GmbH. The European Court of Justice decided that the enterprise must not be denied to be the full legal entity because the enterprise cannot use any other court than German one in this case. The last cause was related to Inspire Art Ltd., based in the UK but doing business in the Netherlands. The Dutch authorities confirm that a company can operate in the Netherlands but must comply with the legal framework about foreign businesses. It has a consequence that enterprise directors bear personal responsibility and liability if the enterprise minimum capital is lower than the requirements for Dutch enterprises.

A number of key decisions of the European Court of Justice can be also found in the Czech legal framework. Particularly it is part of the Civil Code No. 89/2012 Coll. dedicated to the seat replacement (Sects. 138–143). Section 138 states that the legal entity domiciled abroad may transfer its registered headquarter to the Czech Republic when it is permitted by the law of the original state. After a replacement the enterprise follows the Czech legal framework, including the responsibility and liability of owners

as well as management for its debts. More detailed and stricter is the regulation when the originally Czech legal entity want to replace its headquarter to abroad. The Czech law allows the replacement when it is enabled by the foreign law of a country where the new headquarter should be. However, the relocation to abroad involves an increased risk of transferring property abroad (outside the Czech Republic) and violation of the rights of creditors. Therefore the Civil Code obliges publication of the replacement plan at least three months in advance. The creditors have a right to require additional collateral for their receivables.

Another aspect connected with the official enterprise seat is a so-called delegation in the Czech Republic. The delegation is based on Act No. 280/2009 Coll., Tax Code. Whether the enterprise itself or the tax administrator can initiate the next superior tax administrator to delegate the local jurisdiction of the tax administration to another tax administrator. It is detail described in Sect. 18 of Tax Code. The new tax administrator should be competent. The delegation itself should be effective and it can be done if the tax administrator requires extraordinary expertise. There has been a change in Tax Code since January 1, 2015 and it is not possible to appeal against the delegation. This change should increase effectiveness against tax evasions. It is impossible to lead an “infinite” struggle against the delegation through appeals anymore. According to General Financial Directorate’s Press Release [8] this restriction should affect especially the enterprises registered at the virtual addresses. Another institute leading to stricter conditions is so-called “unreliable payer”. This stricter rule came also from the end of 2014. In a relation to the enterprises registered at the virtual addresses there is a rule that a non-contact subject may be referred as an unreliable payer.

Professional public’s opinion has been already introduced as a help of the gray economy functioning and making more difficult tax administration. Although there are advantages from an economic point of view which will be discussed in a separate chapter the lack of transparency brings a shadow on the virtual address. First, traceability and contactability of the enterprise itself, its members and management are more difficult. Second, the official headquarter can be significantly far from the real place of business. In the case of tax administration it is solved by the delegation of local jurisdiction. The delegation is a process when the enterprise is sent to its real taxation office. In the case of supplier/customer relationships it can be solved by a good selection and monitoring of the cooperating entity followed by setting the terms of cooperation. The overall quality of the Czech business environment has been discussed for a long time how the Doing Business Data prove [17]. Doing Business Ranking places the Czech Republic on 68th place in the world in the case of enforcing contracts.

Entrepreneurial entities also search often the virtual addresses because they want to avoid controls of the taxation office. From their point of view, they prefer to be locally competent to the taxation office which has many duties. As a result, it decreases the probability of the control. Figure 2 shows the frequency of the repeat controls. In other words, the next control can be expected in how many years. The expectation is computed as an average for the time period 2005-2012. Although there are not all taxation offices the dominance of Prague is obvious. It is possible compare these results with the findings in Fig. 1. They are fully consistent as it is seen in Fig. 2. The darker color represents the regions where the virtual addresses have been detected and the brighter color is for the regions where none virtual address has been detected. It can be

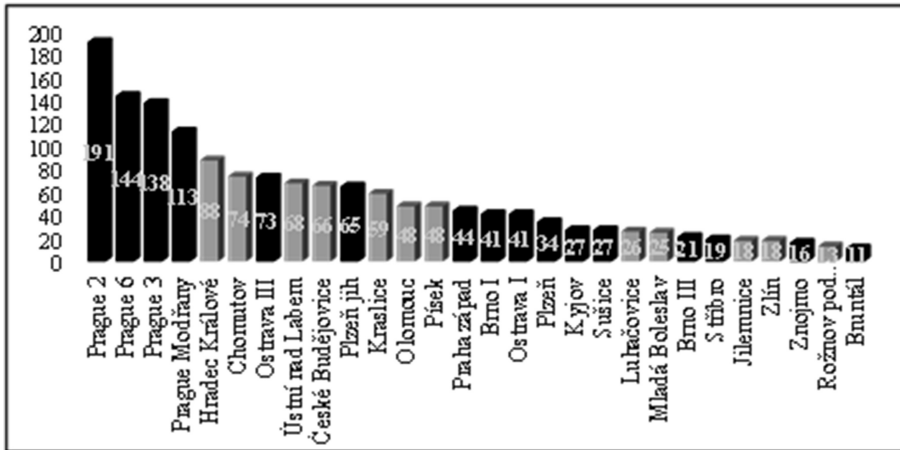


Fig. 2. Taxation office control frequency. Source: authors based on [11].

assumed the virtual enterprises usually choose regions whose taxation offices have many duties and therefore the control frequency is low. The most preferred regions for the virtual offices are Prague Region, South Moravian Region, Pilsen Region and Moravian-Silesian Region (Fig. 1).

The taxation offices from these regions have so many duties that the repeat control will take place on average once in dozens (even hundreds) years. It is visible from Fig. 2 where these regions are display by the darker color. On the other hand, there are also taxation offices which are situated in the regions which have not been detected as a location for the virtual addresses. The brighter color is used for their visualization. However, closer analysis shows that there are exclusively large business places which are mostly in a position of the regional capital. This statement is valid in a case of Hradec Králové, Ústí nad Labem or České Budějovice.

5 Economic Aspects

The last discussed area is connected with economic reasons. The virtual address is just only the formal headquarter which does not have to be used for active corporate governance. The original reason for using the virtual addresses was not connected with the legal aspects and low transparency. It provided economic advantages. The virtual office enables sharing the address by many entrepreneurial entities and therefore the office can be situated in the city center. It brings higher credibility for suppliers and customers comparing with the situation when the official headquarter is the owner home address. It is especially important in the case when the entrepreneurial entity provides consulting services. The original concept was connected with the professional service of a receptionist and possibilities of using the offices or boardrooms several hours a week.

The economic advantage is derived from the sharing. Not only the space is shared but also costs are shared. As a consequence, one single enterprise has to pay significantly lower rent. There is a decrease in rent, utilities and professional receptionist services. There are no One-off expenditure on furniture and equipment. It provides also a higher flexibility because classical renting contracts reduce a possibility of changing location or finishing immediately without contractual penalties. This higher flexibility can create the competitive advantage of the small and medium sized enterprises.

There have been already detected several reasons why Prague region is chosen so often as the virtual headquarter. Prague is as well as the capital as the business center of the country. The Prague address increases an enterprise reputation. Second, there is the low frequency of taxation office controls. Third reason is based on the economic conditions. The importance of the capital is visible also on the real estate market. Table 2 provides additional information about the real estate market. The second column is the price per m² of the office space. It can be taken into account that the office space can differ between 20 m² and 100 m². The third and fourth columns show the month possible budget which should be spent by the enterprise on the rent. The analysis of the real estate market is based on the regional discrepancies therefore the first column represents each region in the Czech Republic. According the price maps there are significant differences among the regions.

Table 2. Average office space rentals. Source: own processing based on [4].

Region	m ² in CZK	20 m ² in CZK	100 m ² in CZK
Prague	250	5000	25000
South Moravian	180	3600	18000
Central Bohemia	170	3400	17000
Karlovy Vary	160	3200	16000
Zlín	160	3200	16000
Vysocina	155	3100	15500
Pilsen	150	3000	15000
Olomouc	145	2900	14500
Moravian-Silesian	140	2800	14000
Pradubice	135	2700	13500
Hradec Králové	130	2600	13000
Ústí	130	2600	13000
South Bohemia	130	2600	13000
Liberec	125	2500	12500

The connection between the virtual addresses and office space rentals is obvious for the first three most expensive regions. Prague and South Moravian Region also occupy the first two places of the virtual addresses (Fig. 1). It is too expensive to rent the classical office and therefore the enterprises chose the virtual solution. The third place of the Central Bohemia Region could be surprising but it can be explained by the location. The Central Bohemia Region surrounds the Prague region. If the enterprises

want to save they would choose the Central Bohemia Region instead of Prague. But in the case of the virtual addresses it is better to prefer Prague because of the higher reputation discussed above.

It must be emphasized that prices per square meter written in Table 2 represent an average. As a consequence, these prices do not show the reality of Prague when the enterprise wants to have the headquarter in the city center. Table 3 illustrates the cost reality. The prices were converted from euro to CZK by the official exchange rate announced by the official authority [5]. Prague rentals are the most expensive. They can be a real cost burden. The best office spaces are available for the significantly higher price than the average spaces.

Table 3. Prague office space rentals. Source: own processing based on [3] and [5].

	m ² in CZK	20 m ² in CZK	100 m ² in CZK
First class office spaces	529	10581	52904
City center	448	8953	44765
Suburbs	393	7868	39339
Average 2016	358	7162	35812
Average 2012	250	5000	25000

The prices per the real office space are one of the discussed economic aspects influencing the use of the virtual addresses. The prices as one of the economic aspects also contribute to the explanation of the Czech situation. The most virtual addresses are in Prague region where the prices per real offices are the highest.

6 Conclusion

This paper was focused on the virtual organizations (also called as the enterprises with the virtual address). It solved several goals. The first one was the detection of the enterprises which have their headquarter at the virtual address in the Czech Republic. The number of this kind of enterprises has been increasing in the Czech Republic. Then the paper discussed the legal framework which enables to use the address only for the administrative purposes instead of the corporate governance. The legal norms were presented from the national point of view as well as accompanied by the view of the EU harmonization. However, there are many reasons why the virtual addresses are used and have become more popular. These reasons can be introduced as legal and economic. Among legal aspects it can be found the belonging to the appropriate regional tax office. Some offices have to many duties and therefore they do not have enough capacities to check the enterprises regularly. Some tax offices will do check again after dozens years. The economic reasons are especially connected with the issue of costs. The virtual office decreases costs. There are several categories as rent, utilities or furniture. Prices per square meter are the highest in Prague which has the most detected virtual addresses. The cost issue contributes to the Prague choice.

This paper has not answered many topics. The enterprise incentives have been discovered indirectly based on the other data. There was no questionnaire or interviews yet. It could be a next step of the research to discover the real enterprise incentives for the virtual address choice. These incentives could be compared internationally. The other way of the further research is connected with the lower transparency of this kind of businesses. The low transparency is mentioned all the time but it has not been proved fully yet.

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