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2019 Transfer Pricing Overview

Czech Republic



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APPLICABLE LEGISLATION

Local legislation

Income Taxes Act No. 586/1992 Coll. (Section 23 (7))

Section 23 (7) of the Czech Income Taxes Act stipulates that if prices agreed between related persons (parties) differ from prices agreed between unrelated entities in common business relations under the same or similar conditions and the difference is not properly documented, the taxpayer's tax base shall be adjusted by the ascertained difference.

International regulations

- Double Tax Treaties
- OECD Guidelines
- Arbitration Convention

OECD Guidelines

As a member of the OECD, the Czech Republic applies principles and recommendations issued by this organization. In this regard, the OECD issued the OECD Guidelines in 1995 which were subsequently updated in July 2010. The OECD Guidelines are not legally binding for the Czech Republic, nevertheless, are widely followed.

The Transfer Pricing principles defined by the OECD Guidelines were implemented into the Czech tax system by Guidance D - 332 of the Ministry of Finance. Even though not legally binding, Guidance D - 332 provides the guidance to taxpayers on how the Czech tax administration will approach the Transfer Pricing issues. Therefore, it is recommendable to follow the principles included in Guidance D – 332.



Arbitration Convention

The Czech Republic is one of the parties to the EU Arbitration Convention. This Convention establishes a procedure to resolve disputes where double taxation occurs between enterprises of different Member States as a result of an upward adjustment of profits of an enterprise of one Member State.

The Convention provides for the elimination of double taxation by agreement between the contracting states including, if necessary, by reference to the opinion of an independent advisory body.



RELATED PARTIES

The term „*related persons*” (“*related parties*”) refers to:

1. Parties that are related through capital, where:

- one person (party) directly participates in another person’s (party’s) capital or voting rights, or one person (party) participates in the capital or voting rights of more persons (parties) and this person (party) has a holding of at least 25% in the others’ registered capital or voting rights - in such a case all are regarded as mutually related directly through capital
- person (party) indirectly participates in another person’s (party’s) capital or voting rights, or one person (party) indirectly participates in the capital or voting rights of more persons (parties) and has a holding of at least 25% in the others’ registered capital or voting rights - in such a case all are regarded as mutually related through capital

2. Otherwise related parties:

- one person (party) participates in the management or control of another person (party)
- identical persons or close persons participate in the management or control of other persons (parties) and such other persons (parties) are otherwise related persons (parties); as otherwise related persons are not considered persons participating in supervisory board of the both persons (parties)
- involving a controlling person (party) and a controlled person (party), and/or also persons (parties) controlled by the same controlling person (party)
- being close person (as provided by the Civil Code)
- being persons (parties) having established a legal relationship predominantly for the purpose of reducing their tax base or increasing their tax loss



The word "METHODS" in a bold, white, sans-serif font, centered on an orange rectangular background.

The OECD Guidelines set out three traditional transactional Transfer Pricing methods and two profit-based Transfer Pricing methods.

Traditional transactional Transfer Pricing methods

- comparable uncontrolled price (“CUP”) method
- resale price minus (“R-”) method
- cost plus (“C+”) method

Profit based Transfer Pricing methods

- profit split (“PS”) method
- transactional net margin method (“TNMM”)



DOCUMENTATION



Obligations

Generally, there is no legal obligation to prepare Transfer Pricing documentation. However, under Section 92 (3) of Act No. 280/2009 Coll. (Tax Code) as subsequently amended, the taxpayer is required to provide documentary evidence of all facts which he is obliged to state in his tax return or other communication with the tax administration. **In this context, the taxpayer may be requested to prove how the Transfer Prices in its related-party transactions were determined, and whether they comply with the arm's length principle.**

The arm's length principle requires that Transfer Prices charged between related parties are equivalent to those that would have been charged between independent parties under the same circumstances.

Guidance D - 334

The Ministry of Finance therefore issued Guidance D - 334 that outlines the recommendations for taxpayers regarding the scope of documentation that may be used for the purposes of Transfer Pricing. Guidance - 334 was prepared in accordance with the principles defined in the OECD Guidelines and the Code of Conduct issued by the EU Joint Transfer Pricing Forum.

Guidance D - 334 provides legally non-binding recommendations that are, however, advised to follow to ensure a smooth tax audit.

It is essential for the taxpayer to have supporting documentation in case the tax authority inspects the transactions, as the burden of proof lies on the taxpayer. During the tax audit, the tax authority may request any documentation that reasonably justifies the substance of the transaction, its benefits for taxpayers, the appropriateness of the fees and the Transfer Pricing method selected.



ADVANCE PRICING AGREEMENTS (APA)

The Advance Pricing Agreements (APA) are binding agreements valid for up to 3 years (if conditions and the law remain unchanged) between the tax authority and the taxpayer, which set out the method for determining Transfer Prices in related party transactions.

This concept of **"binding ruling"** is set out by Section 38nc of the Income Tax Act which became effective as of January 1st, 2006. First, the taxpayer files a request and, consequently, the tax administrator decides whether the taxpayer has chosen a relevant Transfer Pricing method which would result in a transfer price determination on an arm's-length basis. The binding ruling can be issued only for transactions effective in a particular tax period or that will be effective in the future. It is impossible to apply for the binding ruling concerning the business relations that have already influenced the tax liability (tax base or tax loss) for the taxable period.

Guidance D - 333 describes the process for issuing binding ruling and the details for the application. Generally, the decision on the method of Transfer Pricing between related parties is effective for three tax periods following the day when the decision was issued.

The fee for APA in the Czech Republic is CZK 10,000 (approx. EUR 370) for one transaction.



OTHER ASPECTS

Mutual Agreement Procedure

Mutual Agreement Procedure is a dispute resolution procedure provided by Article 25 of the OECD Model Tax Convention. The subject of this procedure is the negotiation between two governments with the aim to resolve matters of taxation not in accordance with the particular tax treaty and to try to avoid double taxation.

Penalties

There are no specific Transfer Pricing penalties. Generally, when the tax authority successfully challenges Transfer Pricing, a penalty of 20% of the unpaid tax or 1% of the tax loss reduction will be applied. In addition to this, interest for late payment is assessed at 14% + REPO rate of the unpaid tax.

Additional obligations for taxpayers

Taxpayers are obliged to fill in the mandatory annex to the corporate income tax return related to Transfer Pricing. This annex describes the intragroup transactions. Qualifying companies must state the information regarding related parties (name, registered office) and state the relevant financial amount.

Disclaimer

Please note that our material has been prepared for general guidance on the matter and does not represent a customized professional advice. Furthermore, because the legislation is changing continuously, some of the information may have been modified after the material has been released and Accace does not take any responsibility and is not liable for any potential risks or damages caused by taking actions based on the information provided herein.

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