

Czech Republic Transfer Pricing Services

Part of PwC's Global Transfer Pricing Network

Why is transfer pricing important?

- Having good transfer pricing methodology within the group means that your intra-group pricing is easy to manage, is transparent and understandable, and is aligned with your business model.
- Good transfer pricing significantly reduces the risk of a challenge by the tax authorities.
- It can also help you to properly allocate profits within the group and optimise the overall effective tax rate.

At first, the company should answer the following questions, which, based on our experience, the Tax Authorities mostly focus on:

- Are the purchase and sale transfer prices in accordance with the arm's length principle?
- Are the charges for services provided by the head office well-founded?
- Are the loan or cash-pool interest rates sufficiently defensible?
- To what amount is it possible to charge/pay royalties?
- Are the contracts in accordance with the transfer pricing policy and correspond to the reality?
- Is the company ready to face a transfer pricing audit?

Transfer pricing services:

Our team in the Czech Republic focuses on Czech and international taxation. Our experts in the field of transfer pricing have the knowledge of local specifics and many years of extensive experience gained abroad. Due to the global PwC network, we can get support from our colleagues from foreign PwC offices. **We provide, among others, the following transfer pricing services:**

- Assistance in **preparing transfer pricing documentation**
- Assistance in preparing and negotiating **Advance Pricing Agreements** ("APAs")
- Assistance in preparing **benchmarking studies**
- Assistance in preparing **expert valuations** in the transfer pricing area
- Assistance with **value chain transformation** (i.e., group or transactions restructuring)

- Advice on planning and developing **local and regional transfer pricing policies**
- Review of existing or planned related-party transactions from the perspective of compliance with the **arm's length principle**
- Review of **compliance with local investment incentives and price regulations**
- Assistance in reviewing **inter-company agreements** from the tax perspective
- Assistance during **transfer pricing audits** conducted by the Tax Authorities
- Assistance with the assessment of impacts of the **OECD Action plan** regarding the Base Erosion and Profit Shifting ("BEPS")
- Preparation of the transfer pricing disclosure
- Assessment of basic risks
- Detailed review of transfer pricing
- Simulation of tax audit in the area of transfer pricing

Contact



David Borkovec
Partner
+420 251 152 561
david.borkovec@cz.pwc.com



Natalia Pryhoda
Director
+420 251 152 647
natalia.pryhoda@cz.pwc.com



Matěj Vacík
Senior Manager
+420 251 152 588
matej.vacik@cz.pwc.com



Jindřich Ibl
Manager
+420 251 152 643
jindrich.ibl@cz.pwc.com

Summary of Transfer Pricing Developments

The Czech Republic has been a member of the OECD since 1 January 1996. Although the OECD Guidelines are not legally binding, they are generally accepted by Czech Tax Authorities.

Czech transfer pricing legislation covers transactions between companies as well as individuals, and applies equally to domestic and cross-border transactions. The legislation contains a general definition of the arm's length principle, which is basically in harmony with the OECD Guidelines.

The legislation states that a taxpayer's tax base will be adjusted for any related party transaction undertaken by the taxpayer in which the agreed price differs from what would have been agreed between unrelated parties in current business relationships under the same or similar terms (conditions).

In general, there are no provisions in the Czech transfer pricing legislation on how an arm's length price should be determined in related-party transactions. However, as mentioned above, the methods recommended by the OECD Guidelines are generally accepted by Czech Tax Authorities.

In addition, as a member of the EU, the Czech Republic has adopted the EU Transfer Pricing Documentation Code ("EUTPD" or "Masterfile approach"). However, it is at the discretion of the taxpayer to follow the EUTPD.

Effective from 1 January 2011, the following decrees were issued by the Ministry of Finance in respect of transfer pricing issues:

- D-332 Guidance in respect of the application of international standards in taxation of transactions between associated enterprises – transfer pricing
- D-333 Guidance in respect of the binding ruling on transfer pricing in related party transactions
- D-334 Guidance in respect of the scope of the transfer pricing documentation

Effective from 1 January 2013, Decree D-10 on low-value-adding intragroup services was issued.

The decrees are not legally binding; however, they represent the common practice of tax authorities when considering transfer pricing issues.

As at 2012, a new Specialised Financial Office was established and focuses on companies with turnover exceeding CZK 2 billion; banks, including branches of foreign banks; credit unions; insurance and reinsurance companies, including branches of foreign insurance and reinsurance companies; and companies which form a VAT group with the above entities. The Specialised Financial Office has audit teams dedicated to transfer pricing.

Further, in 2013 Czech Tax Authorities announced a new reporting obligation for legal entities that participate in transactions with related parties. Effective for taxable periods starting on or after 1 January 2014, the Czech taxpayers are obliged to file a separate disclosure form "Overview of Transactions with Related Parties" as part of their corporate income tax return. The Czech Tax Administration uses the disclosure reporting of related party transactions as part of a risk analysis when selecting entities for a tax audit.

Starting in 2015, the Specialised Financial Office as well as local tax offices are launching field investigations related to transfer pricing in multinational enterprises. The Czech Tax Administration cannot challenge the tax liability during a field investigation; taxes can only be additionally assessed during a tax audit. However, all findings are stated in a written report and are part of the taxpayer's file; the findings may lead to further steps taken by the Czech Tax Administration (e.g., tax audit).

These developments prove that the Czech Tax Administration recognises the importance of transfer pricing, resulting in an increase in the number of tax audits that focus on related party transactions, particularly those involving services, low risk functions, and losses. **Further, there is a growing trend of the Czech Tax Authorities relying on the Advanced Pricing Agreement ("APA") to resolve transfer pricing uncertainties.**

Current Transfer Pricing Regulations

Based on Czech tax legislation, parties are regarded to be related if, with at least 25 % controlling interest one party participates directly or indirectly in the management, control or capital of the other, or where a third party participates directly or indirectly in the management, control or capital of both of them, or where the same persons or their close relatives participate in management or control of the other (excluding situations where one person is a member of the supervisory boards of both parties). Participation in management suffices to assume a relationship, even without equity ownership.

Parties are also deemed to be related if they enter into a commercial relationship mainly for the purpose of reducing the tax base (or increasing a tax loss).

Based on the Czech Income Taxes Act, if a company is in doubt as to whether the prices applied in existing or future transactions are in compliance with the arm's length principle, it can submit a **written request to the Czech Tax Authorities for an APA, i.e., a binding transfer pricing ruling.**

The Czech tax legislation does not prescribe any obligation to maintain any transfer pricing documentation (including preparation of a benchmarking study or a functional and risk analysis). **Nevertheless, documentation proving that the arm's length principle was followed in related-party transactions is usually required by the Czech Tax Authorities during a potential tax audit.**

According to D-10, limited scope of documentation is acceptable in case of low-value-adding services. These services are considered to be such services which do not represent the core business, are of a routine nature and do not exceed 10% of turnover (and CZK 50 million) by the service provider and 20% of operating costs (and CZK 50 million) of the service recipient. The arm's length **cost plus mark-up** is considered to be 3–7%.

The burden of proof effectively lies with the taxpayer since, in order to mount a challenge, the Tax Authorities must only demonstrate that there is some basis for that challenge. It is the taxpayer who must then provide the evidence to refute the challenge. It is therefore strongly recommended that such documentation be prepared in advance and that the transfer pricing methodology applied in transactions with related parties be properly documented.

If there is a successful challenge of a company's transfer prices by the Tax Authorities, then additional tax, penalties and interest on late payments may be due.

Effective from 1 January 2011 (for tax due after 1 January 2011), the penalties and interest on late payments are calculated as follows:

- a penalty in the amount of 20% applies if tax is increased or a tax deduction is decreased
- a penalty in the amount of 1% applies if a tax loss is decreased

In addition to the penalty, the interest on late payments applies. It is calculated as the National Bank's repo-rate increased by 14% (percentage points). This interest charge is applicable for a maximum period of five years.

No penalty applies if the taxpayer reassessed the tax base voluntarily in an additional tax return; only interest on late payment applies in that case.

Besides the tax legislation, the Czech Business Corporation Act imposes an obligation on companies, which meet the characterisation of controlling and controlled entities. These companies have to prepare a written report within 3 months after the end of an accounting period on the relations between the controlling entity and the controlled entity and between the controlled entity and other entities controlled by the same controlling entity for the past accounting period (so-called report on relations).



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