

Tax Flash

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Tax Flash is an electronic newsletter prepared by PricewaterhouseCoopers Česká republika, s.r.o. to keep you up to date on the latest tax and legal news. A more complex look at key tax changes and their impact on your business is provided in our monthly newsletter, Tax & Business News.

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PwC offers a free online diagnostics tool to help companies identify and assess their transfer pricing risk - **Transfer Pricing Control Review**. Please see: diagnostics.pwc.com

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Significant Transfer Pricing Developments: New OECD Guidelines

On 22 July 2010, the OECD published the revised Chapters I-III of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Guidelines"), and issued a new Chapter IX to the OECD Guidelines related to business restructurings.

No effective date has been expressed for these changes. It can be expected that many countries will begin applying the principles set out in the revised text of the OECD Guidelines immediately. Where this is to their advantage, some tax authorities may seek to apply them to tax disputes arising in earlier years. It is yet to be seen how soon the new OECD Guidelines will be applied in new or open tax audits and requests for binding rulings in the Czech Republic.

Revised Chapters I-III

The most important changes in the revised Chapters I-III concern three key areas related to practical application of the OECD Guidelines:

- (1) hierarchy of transfer pricing methods,
- (2) comparability analysis, and
- (3) application of the transactional profit methods.

Practically, taxpayers are expected to see increased challenges on the comparability of data used to support the application of one-sided methods (transactional net margin method, resale price, cost plus), more focus on intangibles, and additional pressure to use profit split. Further, the revised text will likely lead to closer examination of the processes followed to establish and document transfer prices by Czech companies.

New Chapter IX on business restructurings

The new Chapter IX addresses several important transfer pricing aspects of the taxation of internal business restructurings and reflects the consensus views of OECD member states following a lengthy debate after the first draft was issued in 2008. These include:

- (1) allocation and transfer of risk among related parties,
- (2) whether and when internal business restructurings require arm's length compensation and/or indemnification,
- (3) how transfer pricing rules should be applied to the parties to a business restructuring transaction following the restructuring, and
- (4) whether and when governments have the ability to disregard a taxpayer's restructuring for purposes of applying transfer pricing rules.

Overall, the final guidance provides more certainty to the business community as the restructurings would be disregarded or recharacterised only in exceptional circumstances. However, taxpayers are expected to see challenges to internal business restructurings based on the principle of economic substance and when the restructuring does not make commercial sense from the standpoint of the Czech entity.

On the important topic of the "exit charge", the compensation is expected in cases when there is a transfer of "something of value" (i.e. rights or other assets), that would be compensated by independent parties in comparable circumstances. The compensation itself would be based on the options realistically available and the relative bargaining position of the parties in the restructuring.

Taking into account the revised OECD Guidelines, we recommend considering if documentation, benchmarking or other transfer pricing analyses would need any adjustments from the present approach, implementing transparent processes to establish future transfer prices, and reviewing any planned business restructurings affecting Czech businesses.

Further details on the new OECD Guidelines will be provided in the upcoming PwC's Tax & Business News. Should you be interested to discuss details of these changes, please contact **Natalia Pryhoda** or **David Borkovec**.