Transfer Pricing Country Summary
Czech Republic

13 April 2018
Legislation

Existence of Transfer Pricing Laws/Guidelines

The Czech transfer pricing rules are basically based on the OECD Transfer Pricing Guidelines which are generally accepted by the Czech tax authorities, although they are not legally binding. The Czech Income Tax Act deals:

- In paragraph 23(7) with the arm's length principle; and
- In paragraph 38nc with the scope and procedure of advance pricing agreements.

The Czech Ministry of Finance has updated the transfer pricing rules, in view of the 2010 amendments to the OECD Transfer Pricing Guidelines and changes in the area of tax administration. From 1 January 2011, new decrees replaced the existing ones, as detailed below.

- Decree D-332 (replacing D-258) on the application of international standards to taxation of transactions between related parties;
- Decree D-333 (replacing D-292) on the binding advance pricing agreements with regard to the method to determine the transfer price between related parties; and
- Decree D-334 (replacing D-293) on transfer pricing documentation of pricing methods between related parties in accordance with the Code of Conduct on transfer pricing documentation for associated enterprises in the European Union (“EU Code of Conduct on Transfer Pricing Documentation”).

Furthermore, in connection with the low value-adding services (i.e. the services having supportive nature and not creating major business activity of the service provider), the Czech Ministry of Finance issued the Decree D-10 defining the extent of the information that would be requested by the tax authority in the event of a tax audit. This Decree is valid from 1 January 2013.

Definition of Related Party

Based on the Czech tax legislation, parties are regarded as related if 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 parties whereby one person is a member of the supervisory boards of both parties.

Participation in management is sufficient to establish relationship, even without any equity ownership. Participation in control or capital means ownership of at least 25 percent of a company’s registered capital or voting rights. Individuals are related if they are close relatives. Parties, who enter into a commercial relationship largely for the purpose of reduction of the tax base or the increase of losses, are also deemed to be related parties.

Transfer Pricing Scrutiny
The interest in transfer pricing has risen in the last years in Czech Republic.

The Specialized Tax Office is the tax office on the national level in charge of controlling the transfer pricing operations. The tax authority focused on verifying the accuracy of transfer pricing, resulting in a vast number of tax audits that place extra emphasis on related party transactions, aiming to prevent possible tax evasion. The activities for the Specialized Tax Office regarding transfer pricing audit is limited to companies that have an annual turnover of at least CZK 2 billion, banks or other financial institutions.

Nevertheless, also companies that have an annual turnover below CZK 2 billion are currently subject to thorough transfer pricing audits from the side of the Czech tax administration, i.e. the audits are not limited only to biggest companies but to all the Czech tax payers that effectuate intra-group transactions.

The Czech tax administration scrutinizes multinationals to ensure arm’s length transactions, trying to prevent the transfer of profits from the Czech Republic to other countries via misallocation of taxable income between Czech companies and their subsidiaries abroad. The tax entities are chosen for control based on various analytical tools internally developed by the Czech tax administration, own searching activities for comparable data and significantly increasing experience from the previous tax audits.

Since 1 January 2015, the Czech tax administration also collects basic information about selected transactions with related parties through a compulsory appendix to corporate income tax return. The appendix must be filled in by companies that meet one of the three criteria for a statutory audit (i.e. assets totaling more than CZK 40 million or net turnover of more than CZK 80 million or a recalculated headcount exceeding 50 employees). If a company recognizes a loss or has been granted investment incentives, it has to complete the appendix in respect of all related parties with which it carried out transactions in a particular period (for each individual related party separately). In other cases, only transactions with related parties seated abroad have to be disclosed.

According to the General Annual Report of the Czech tax administration for the year 2016 (last available data), transfer pricing audits performed by the Czech tax administration in 2016 led to a collection of the additional corporate income tax in the overall amount of CZK 886 mil. and decrease of tax losses in the overall amount of CZK 8,500 mil.

Transfer Pricing Penalties

In the case of a successful challenge of a company’s transfer prices by the tax authorities, additional tax, penalties and interest on late payment may be due. The penalties and interest on late payments are calculated as follows:

- A penalty of 20 percent of the amount of unpaid taxes in the case of increased taxable basis and/or a decrease of tax reduction or an increase of tax;
• A penalty of 1 percent of the amount of unpaid taxes if a tax loss is decreased;

Interest on late payment is applied for each day of the tax arrears: it is calculated on the Czech National Bank’s repo-rate (repurchase agreement rate) increased by 14 percent points.

No penalty applies if the taxable basis is reassessed in an additional tax return (only interest on late payment applies in that case).

**Advance Pricing Agreement (APA)**

Advance Pricing Agreements can be obtained since 1 January 2006. The filing fee for an APA is CZK 10,000. Upon the taxpayer’s request, the tax authorities decide whether the taxpayer has chosen a transfer pricing method which leads to a transfer pricing determination on an arm’s length basis.

The maximum APA term of agreement is three years. The binding assessment can only be issued for transactions executed in a particular tax period or that will be executed in the future. It is not possible to apply for an assessment of transactions that already have affected the tax liability.

The Decree D-333 details the procedure and the necessary particulars for the application. There is no statutory provision imposing a deadline for the tax authorities to issue their decision. Generally, the practical experience shows that the average time needed for processing an APA in the Czech Republic is approximately eight months.

**Documentation And Disclosure Requirements**

**Tax Return Disclosures**

Based on the Taxes and Fees Administration Act, which governs tax audit procedures, the tax payer has to declare its tax liability to the tax authorities in a tax return. The compulsory appendix on related-party transactions creates a part of the corporate income tax return. Taxpayers have to disclose volumes of their foreign related-party transactions, if any of the following thresholds are met:

- assets of more than CZK 40 million
- a net turnover of more than CZK 80 million
- a recalculated headcount exceeding 50 employees

The appendix has to be filled out also in relation to domestic related party transactions if any of the following criteria is met:
- taxpayer incurred a tax loss in given fiscal year, or
- taxpayer is recipient of investment incentives in the form of a tax relief.

**Level of Documentation**

Generally, there is no legal obligation to prepare Transfer Pricing documentation. Transfer Pricing documentation is provided to the tax authority upon request in the course of a tax audit of local tax investigation. Typical deadline provided to taxpayers is from 15 to 30 days from the date of the request.

There is no statutory provision with regard to transfer pricing documentation. However, the Czech Republic has adopted the EU Code of Conduct on Transfer Pricing Documentation but it is at the taxpayers’ discretion to follow the code.

The Decree D-334 outlines, in accordance with the EU Code of Conduct on Transfer Pricing Documentation, the expected scope and nature of the documentation related to transactions between related parties: it should at least contain information about the group, the company, the transactions, the transfer pricing method and relevant circumstances affecting the transactions.

The Czech tax authorities display great discretion in deciding what level and nature of documentation is sufficient. During an audit, the tax authorities may request any documentation that reasonably substantiates the actual character and substance of the transaction, its benefit for the taxpayer, the appropriateness of the level of the consideration, and the selected transfer pricing method. A high level of formal evidence may be necessary to support various aspects of the transaction.

**Country-by-Country Reporting**

On 19 September 2017, the Czech Republic published Act No. 305/2017 amending Act no. 164/2013 on International Cooperation in Tax Administration and related acts for the purpose of Country-by-Country (CbC) reporting, as well as the Decree 306/2017 on the CbC report content and instructions.

**Record Keeping**

There are no specific transfer pricing regulations or rules dealing with record keeping. The record keeping regulations and rules of other disciplines (corporate income taxes, accounting legislation) consequently apply. Since the statute of limitations can last longer than the standard term of three years, it is in such cases worthwhile to keep the necessary records during these prolonged periods.
Language for Documentation

Documentation should be submitted in the Czech or Slovak language. A particular tax office might accept documentation in another commonly understood language (e.g. English) that the tax office is familiar with; this is however less frequent in practice.

Small and Medium Sized Enterprises (SMEs)

There are no specific provisions with regard to the documentation requirements for small and medium sized enterprises. Since the Czech tax authorities align with the EU Code of Conduct, it could be expected that they impose less stringent documentation requirements on small and medium sized enterprises.

Deadline to Prepare Documentation

There is no statutory deadline for preparation of transfer pricing documentation. As the documentation may be requested during a tax audit and the burden of proof remains with the taxpayer, it is highly recommended that the documentation is prepared in advance and that the transfer pricing methodology applied in transactions with related parties be properly documented (including functional analysis and benchmarking).

Deadline to Submit Documentation

There is no statutory deadline for submitting the documentation. If the tax authorities request transfer pricing documentation during a tax audit, the deadline is generally from 15 to 30 days after the request has been made. This time limit may be extended if the taxpayer so requests.

Statute Of Limitations

The standard statute of limitations applies, i.e. three years from the end of the taxable period during which the obligation to file a tax return arose. If a tax loss or its part may be claimed as an item deductible from the tax base and/or if an investment incentive has been granted in the form of a tax relief, the time-limit for tax assessment may extend up to 17 years.
Transfer Pricing Methods

Since the Czech tax authorities generally accept the OECD Transfer Pricing Guidelines, it is recommended to apply the methods described therein: the comparable uncontrolled price method, the resale price method, the cost plus method, the profit split method and the transactional net margin method. It is expected the most reasonable method is applied for each particular case.

Comparables

Czech comparables are preferred, an Amadeus database being available in this sense, but Pan-European benchmark searches are generally accepted by the Czech tax authorities.