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# Global Transfer Pricing Review

## Czech Republic

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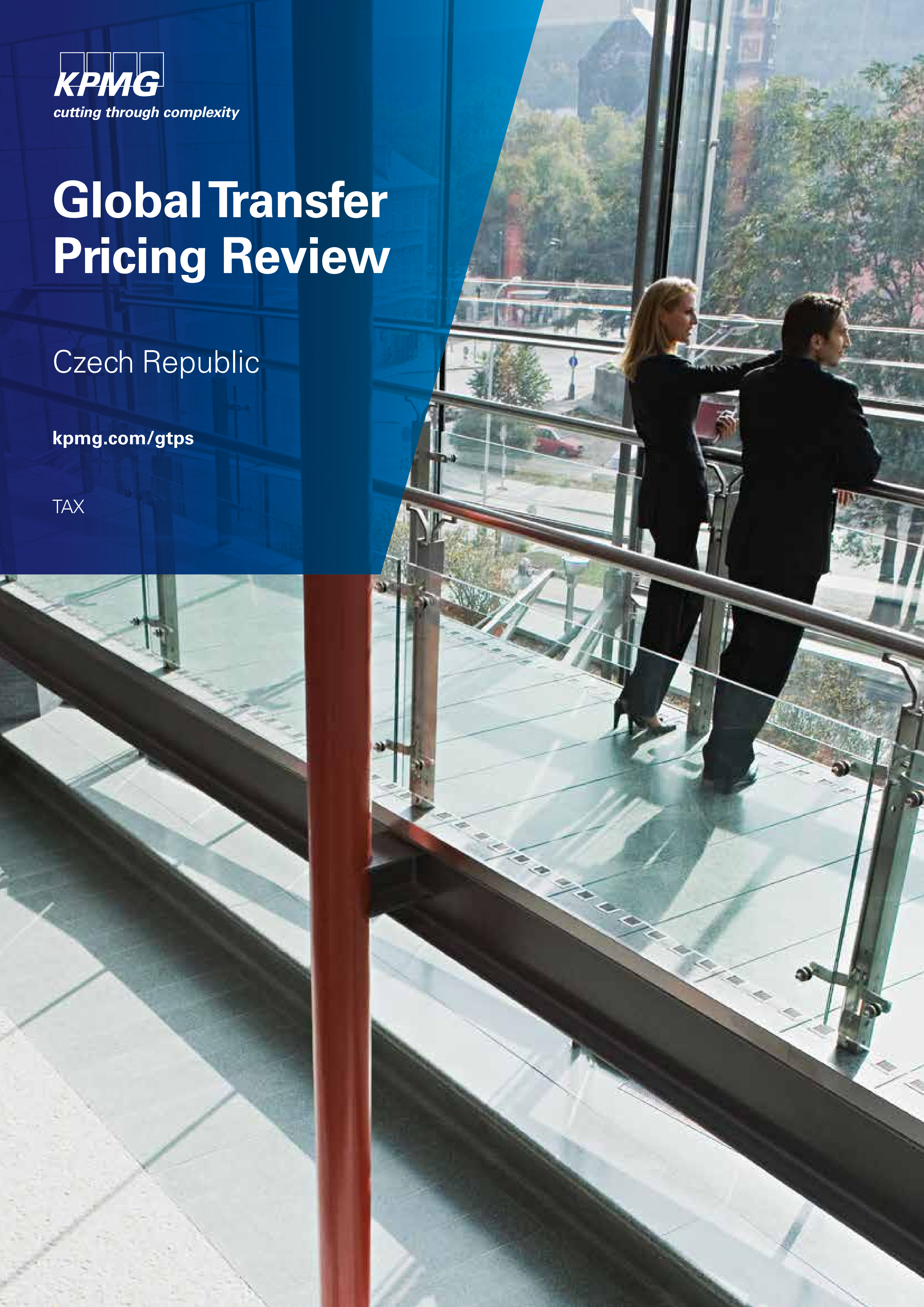

# Czech Republic

## KPMG observation

Transfer pricing in the Czech Republic has become a key issue in many tax audits, and transfer pricing is now a regular component of tax inspections, particularly for large companies and companies with investment incentives. In 2013, a Specialized Tax Authority (STA) was established for companies with turnover exceeding two billion Czech crowns (approximately 80 million US dollars (USD) and financial institutions. Transfer pricing is a strong area of focus for the STA. In fact, on 18 February 2015, the STA announced special tax audit action to review transfer pricing setting and prevent Czech tax evasion. Companies are selected for inspection based on an analysis of information and data obtained by the STA.

Beginning for tax years commencing in 2014, taxpayers must file an appendix to the income tax return describing transactions with related parties. This appendix describes transaction types and magnitudes for each related party and is used by the Czech Tax Administration (CTA) to determine primary transfer pricing areas of focus. Failure to submit this appendix may result in a tax audit focused on transfer prices.

The CTA is closely following the OECD's Base Erosion and Profit Shifting (BEPS) initiative.

Transfer pricing documentation serves as a tool to put the burden of proof on the CTA. While currently not specifically required by tax legislation, providing documentation at the outset of a tax inspection may significantly limit scrutiny in this area.

## Transfer pricing study snapshot

### The purpose of a transfer pricing study

| | Applicable | Not applicable |
|---|---|---|
| Legal requirements | | ● |
| Protection from penalties | | ● |
| Reduce risk of adjustment | ● | |
| Shifts burden of proof | ● | |

## Basic information

### Tax authority name

Specializovaný finanční úřad (Specialized Tax Authority) for companies with turnover higher than 2 billion Czech crowns (CZK) and financial institutions; Finanční úřad (Tax Authority) for other entities.

### Citation for transfer pricing rules

Income Tax Act 23 (7), Czech Ministry of Finance decrees D–332 (international standards for taxation of transactions between related parties), D–333 (advanced pricing arrangements) and D–334 (recommended scope of transfer pricing documentation), and General Financial Directorate decree D–10 (low value intra-group services).

### Effective date of transfer pricing rules

1 January 1993.

### What is the relationship threshold for transfer pricing rules to apply between parties?

Ownership of greater than 25 percent based on voting power, share capital, common control. No limit in the case of entering into a business relationship predominantly for tax evasion purposes.

### What is the statute of limitations on assessment of transfer pricing adjustments?

General limits for additional tax assessment apply. Additional tax may be assessed within three years from the due date for filing the corporate tax return for the respective taxable period. This deadline may be extended up to 10 years in case of repeated tax audits. Special rules further extend the deadline for companies with tax incentives and/or tax losses.

## Transfer pricing disclosure overview

### Are disclosures related to transfer pricing required to be submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Yes. In limited scope – Form 5404/Ea is required to be filed for tax years commencing in 2014.

### What types of transfer pricing information must be disclosed?

Form 5404/Ea summarizes a taxpayer's transactions with each related party (transaction type, magnitude, etc.). Separate forms must be filed in electronic format for each foreign related party that enters into transactions with the taxpayer. Companies granted investment incentives or reporting loss for the given period should report also transactions with domestic related parties.

### What are the consequences of failure to submit disclosures?

Failure to submit Form 5404/Ea may result in a tax audit focused on transfer prices.

## Transfer pricing study overview

### Can documentation be filed in a language other than the local language? If yes, which ones?

Yes. The representatives of Czech Tax Authorities will likely require the documentation in Czech language, however English may be accepted in certain circumstances.

### When a transfer pricing study is prepared, should its content follow Chapter V of the Organisation for Economic Co-operation and Development (OECD) Guidelines?

Yes, for all transactions. Additional information is usually required for received services, with a strong focus on the benefits test and proof that services were actually rendered. Detailed calculations are required for major transactions during tax audits.

### Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No.

## Transfer pricing methods

### Does your country follow the transfer pricing methods outlined in Chapter II of the OECD Guidelines? If exceptions apply, please describe.

Yes.

## Transfer pricing audit and penalties

### When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? And if so, how many days?

Yes, 30 days.

### When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? Please explain.

The CTA regularly requires transfer pricing documentation to be provided during tax inspections, within 15-30 days upon request. This deadline can be extended upon the taxpayer's request, i.e. minimum time limit could therefore be 30 days. Documentation is typically requested in the Czech language, however, a time-limit is usually provided for translation.

### If an adjustment is proposed by the tax authority, what dispute resolution options are available?

The taxpayer can initiate an appeal to the Appeal Financial Directorate before going to a regional court.

### If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

Yes. General tax penalties apply.

A penalty of 20 percent of the avoided tax or one percent of the overstated tax loss is assessed when a transfer pricing adjustment is made by the CTA. Furthermore, interest for late payment of approximately 15 percent is assessed (Czech National Bank REPO rate + 14 percent). In specific cases, withholding tax on a deemed dividend is assessed (together with penalty and interest). Companies with investment incentives granted in the form of tax holidays may forfeit the right to the tax holidays (even retroactively).

### To what extent are transfer pricing penalties enforced?

Tax sanctions are automatically enforced.

### What defenses are available with respect to penalties?

Only shifting the burden of proof through the use of proper documentation or defense files. Self-correction through filing supplementary tax return avoids the basic penalty (20 percent of additional tax or one percent of reduced tax loss); interest for late payment is always due but taxpayer could ask for a partial waiver.

### What trends are being observed currently?

The number of tax audits with a transfer pricing focus has increased considerably. The main areas of focus include subsidiaries of multinationals in a loss position, recipients of tax relief investment incentives, year-end transfer pricing adjustments, explanations of functional and risk profiles, intercompany services and their benefits to the taxpayer, financial transactions and interest rates. Investigating transfer pricing within a tax inspection is now the rule rather than the exception for multinationals.

Companies with investment incentives in form of a tax relief are subject to transfer pricing scrutiny. A self-correction through filing a supplementary tax return does not avoid the tax relief being challenged. However, potential penalties are reduced from May 2015: instead of a full loss of provided incentives, only additional tax will now be assessed.

During tax audits, the Tax Authority focuses on the profitability of intra-group transactions and requires detailed calculations to be provided and linked to the company's statutory financials.

## Special considerations

### Are secret comparables used by tax authorities?

Yes.

### Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?

Local comparables are not required, but can be used as support for regional analyses.

### Do tax authorities have requirements or preferences regarding databases for comparables?

The Tax Authority usually uses the Amadeus database. Other sources of information can be used as well.

### Does the tax authority generally focus on the interquartile range in a TNMM analysis?

Yes, always.

### Does the tax authority have other preferences in benchmarking? If so, please describe.

The Tax Authority typically accept multiple year (three or five years) average results of the comparables. In case of transfer pricing audit where benchmark is missing the Tax Authority tend to use retrospectively gathered data from Amadeus just for the period under scrutiny.

### What level of interaction do tax authorities have with customs authorities?

Very close.

### Are there limitations on deductibility of management fees beyond the arm's length principle?

No. Taxpayers are often asked to document that the services were provided and consumed for the benefit of the taxpayer.

### Are management fees subject to withholding?

No.

### Are there limitations on the deductibility of royalties beyond the arm's length principle?

No.

### Are royalties subject to withholding?

Yes.

### Are taxpayers allowed to file tax return numbers that differ from book numbers?

Yes. No specific legal provisions on compensating adjustments exist in the legislation. However, domestic legislation does not forbid taxpayers to make these adjustments. The Tax Authority would first audit whether the original transaction was set in accordance with the arm's length principle.

Transfer pricing adjustments are generally made before submitting a tax return. After this deadline, it could only be done by submitting a supplementary tax return based on new facts that are fully documented. In practice, taxpayers gradually adjust prices during the calendar year to minimize the need for yearly transfer pricing adjustments.

### Other unique attributes?

According to Decree D–10, an arm's length mark-up of three to seven percent should apply to low value intra-group services.

## Tax treaty/double tax resolution

### What is the extent of the double tax treaty network?

Extensive.

### If extensive, is the competent authority effective in obtaining double tax relief?

Frequently.

### When may a taxpayer submit an adjustment to competent authority?

The taxpayer should submit a supplementary tax return by the end of the month following the month in which the taxpayer discovered the reason for the tax base increase or tax loss decrease. In normal situations there is a time limit of three years (if not prolonged due to the Tax Authority audit or supplementary tax return filing). MAP procedure could breach this statute period.

### May a taxpayer go to competent authority before paying tax?

No formal rules exist except for Advance Pricing Agreements (APAs).

## Advance pricing agreements

### What APA options are available, if any?

Unilateral, bilateral, multilateral.

### Is there a filing fee for APAs?

Yes. CZK10,000, approx. 350 euros (EUR)/USD400).

### Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

No.

### Are there any difficulties or limitations on the availability or effectiveness of APAs?

Yes. Unilateral APAs on the transfer pricing method/approach are available and are the most common type of APA. Issued APAs are valid for three years. The Unilateral APA process takes nine to 12 months. Bilateral (or multilateral) APAs are not common; there are currently less than 10 in place. The process typically takes two to three years and needs to be agreed on with the Tax Authority on a case by case basis.

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