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GLOBAL TRANSFER PRICING SERVICES

# Global Transfer Pricing Review

Czech Republic

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TAX



# Czech Republic



## KPMG observation

Transfer pricing in the Czech Republic has become a key issue in many tax audits, in particular in large companies and companies with investment incentives. Specialized Tax Authority (STA) was established for companies with turnover exceeding two billion Czech crowns (approximately USD100m) and financial institutions. The STA set transfer pricing as one of its major focus areas. Currently, transfer pricing is included in every tax audit of large taxpayers.

The Czech Tax Administration is closely following the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) initiative and is preparing legislation amendments.

Adequate documentation serves as a tool to show that prices applied are at arm's length. While still not specifically required by tax legislation, it is in practice expected to demonstrate compliance. Obligatory documentation preparation is likely to be introduced following the BEPS program.

## Basic information

### Tax authority name

Finanční úřad (Tax Authority).

Specializovaný finanční úřad (Specialized Tax Authority for companies with turnover higher than 2 billion Czech crowns (CZK) and financial institutions), Generální finanční ředitelství (General Financial Directorate) and Odvolací finanční ředitelství (Appeal Financial Directorate).

### Citation for transfer pricing rules

Income Tax Act 23 (7), legally non-binding regulations D-332, D-333, D-334 and D-10. 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, and entering 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 3 years after the end of 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 prepared or submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Transfer pricing disclosure is not required by tax legislation. The Corporate Tax Return Form contains only information about the existence of a link to foreign entities which can be viewed as a transfer pricing risk indicator. Limited information about transactions with related parties is

a part of the enclosure to the financial statements. The introduction of obligatory documentation for companies exceeding some thresholds is currently being discussed and is expected in the near future (related to BEPS).

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

The enclosure to the financial statements should include an overview of significant related party transactions that do not follow the arm's length principle.

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

Not applicable.

## Transfer pricing study overview

Is preparation of a transfer pricing study required – i.e. can the taxpayer be penalized for mere failure to prepare a study?

No, there is no statutory requirement regarding transfer pricing studies. However, the Tax Authority usually expects the documentation in form of a transfer pricing study.

**Other than complying with a requirement per the previous question, describe the benefits, if any, of preparing and maintaining a transfer pricing study?**

The main benefits are meeting the expectation of the Tax Authority for transfer pricing documentation during a tax audit, shifting the burden of proof from the taxpayer to the Tax Authority and the reduced probability of additional tax assessment and the related penalty.

**To satisfy the requirement and/or obtain the benefits, are there any requirements on when the transfer pricing study must be prepared and submitted?**

During a tax inspection, the Tax Authority can ask that the taxpayer to justify prices used in transactions with related parties. In this situation it is practically expected that the taxpayer will provide transfer pricing documentation. The usual deadline set by the Tax Authority is within 15 days of the request. Tax Authorities may provide a longer deadline if requested by the taxpayer.

**When a transfer pricing study is prepared, should its content follow Chapter V of the OECD Guidelines?**

Yes. Additional information is usually required for received services, with strong focus on benefit test. 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 specific designation is necessary. Taxpayers can prepare transfer pricing documentation on their own or via their advisors. On the other hand, it is possible to have it officially prepared by a designated expert approved by the Interior Ministry. KPMG in the Czech Republic is one of a few companies with this authorization. Case law confirms expert opinion to be important in court proceedings.

## Transfer pricing methods

**Are transfer pricing methods outlined in Chapter II of the OECD Guidelines acceptable?**

Yes.

**Is there a priority among the acceptable methods?**

No, but strict rules do apply. OECD Guidelines need to be followed.

**If there is no priority of methods, is there a “best method” rule?**

Practically, the best method rule applies.

## Transfer pricing audit and penalties

**When the tax authority requests a taxpayer’s transfer pricing documentation, how long does the taxpayer have to submit its documentation?**

The Tax Authority commonly expects documentation as a basic tool, assisting the taxpayer to justify its prices, within 15 days of request. This deadline can be extended by the Tax Authority upon the taxpayer’s request.

**If an adjustment is proposed by the tax authority, are dispute resolution options available to the taxpayer outside of competent authority?**

Yes. 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 1 percent (5 percent for tax liabilities before 2011) of the overstated tax loss is assessed when a transfer pricing adjustment is made by the Tax Authority. Furthermore, interest for late payment of approximately 15 percent is assessed (Czech National Bank REPO rate + 14 percent). This interest is calculated beginning the fifth working day after the original maturity day. This interest charge is applicable for a maximum period of 5 years. 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 defences 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 1 percent of reduced tax loss); interest for late payment is always due.

**What trends are being observed currently?**

The number of tax audits with a transfer pricing focus has increased considerably. The main focus is on services (benefit test) and profitability ratios. Interest rates and financial transactions are also being challenged by Tax Authorities. The Tax Authorities cross-check the local documentation and its link to local accounting information and require a high level of detail during tax inspections. Investigating transfer pricing within a tax inspection is the rule rather than the exception for multinationals. The Tax Authorities have specialized teams for transfer pricing and international tax. The Ministry of Finance regularly attends European Union Joint Transfer Pricing Forum (EUJTPF) meetings and is part of the international information exchange within the EU.

Companies with investment incentives in form of a tax relief are subject to transfer pricing scrutiny. We have encountered several cases in which the Tax Authorities challenged the tax relief claimed by companies with investment incentives who overstated their tax base (reverse transfer pricing applies). A self-correction through filing a supplementary tax return does not avoid the tax relief being challenged. 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?**

Yes. There is a preference to have local comparables in a benchmarking set.

However, not having local comparables does not automatically mean that the benchmark will be rejected. Broader geographic sets can be used where relevant.

#### 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.

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

Very close.

#### Are management fees deductible?

Generally yes. However, 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 tax?

A 35 percent withholding tax on services rendered in the Czech Republic by a company from a country with which Czech Republic has not concluded a double taxation treaty or treaty about exchange of information. Permanent establishment risk exists if the services are physically rendered in the Czech Republic.

#### Are year-end transfer pricing adjustments permitted?

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 3 to 7 percent should apply to low value intra-group services.

#### Other recent developments

Specialized transfer pricing teams at tax directorate level have been established. A specialized Tax Authority for both the biggest clients and financial institutions was established on 1 January 2012. This Authority has replaced the original local Tax Authorities for the biggest clients and financial institutions. Transfer pricing expertise is available under this supreme Tax Authority. In December 2012, the General Financial Directorate issued Decree D-10, which is an implementation of EUJTPF Report: Guidelines on Low Value Adding Intra-Group Services. The Ministry of Finance is preparing new legislation that should introduce obligatory documentation. It is expected that some thresholds may apply

#### 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 an additional 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.

##### 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?

A unilateral APA covering the transfer pricing approach selected by the taxpayer is available. The Czech tax law does not specifically provide for bilateral or multilateral APAs. However, the Tax Authorities allow for coordination with foreign authorities and therefore effectively enable bilateral APAs.

##### Is there a filing fee for APAs?

10,000 Czech Republic Koruna (CZK).

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

Only information about the number of APA applications is published. Approved unilateral APAs are usually communicated to tax administration in the other country.

##### Please provide some information on how successful the APA program is and whether there are any known difficulties?

Tens of APAs are approved each year. The APA process usually takes between 6 and 9 months to conclude.

#### Language

##### In which language or languages can documentation be filed?

Tax Authorities may require all documents in Czech. This is usually the case if they want to scrutinize transfer prices. However, some Authorities also voluntarily accept documentation in English, and taxpayers may agree with the Tax Authorities on which documents must be translated into Czech.

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