

Transfer Pricing Country Summary

Czech Republic

May 2022

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1. Introduction

The Czech tax authorities have begun to recognise the importance of transfer pricing, resulting in an increase in the number of tax audits that focus on related party transactions, or at least much more frequent scrutiny of these transactions.

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 basically reflects the arm's-length principle in 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 price differs from what would have been agreed between unrelated parties in current business relationships under the same or similar terms (conditions).¹

2. Laws & Regulations

a) References to OECD/EU/Local Rules

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"). Decree D-334 is expected to be replaced in the near future.

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.

¹ [czech-republic.pdf \(pwc.com\)](#), p. 1

b) 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.

c) Nature of Transfer Pricing Documentation

Since 1995, the Czech Republic has been an OECD member and has implemented the OECD Guidelines. The OECD Guidelines have been translated and published in Czech for the Ministry of Finance's use (MOF). The existing decrees are being updated as of today to reflect the changes brought about by the post-BEPS version of the OECD Guidelines (2022). The latest version of the OECD Guidelines (2022) are currently being translated into Czech.

Decree D-34 confirms the application of the OECD Guidelines and establishes that the OECD Guidelines qualify as context for the purposes of interpreting international agreements under Vienna Convention Article 31. The decree recommends that the Guidelines should be used as an interpretation rule for article 9 of Czech income tax treaties.

Furthermore, while the OECD principles apply to cross-border transactions, they can also be used as a supportive interpretive guideline in domestic transfer pricing transactions and cross-border transactions involving non-treaty jurisdictions, according to Decree D-34.

There are currently no significant deviations from the OECD Guidelines in the domestic guidelines, which instead primarily provide references to and outline the relevance of the OECD Guidelines.

d) Tax Havens & Blacklists

As of November 2021, the new government of the Czech Republic signed a power sharing agreement in order to target transfer pricing abuses, prevent companies in tax havens from receiving public funds and introduce a tax burden cap to prevent unlimited tax increases.²

² <https://news.bloombergtax.com/daily-tax-report-international/czechias-new-government-to-fight-tax-avoidance-cap-tax-hikes>

e) 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.

f) Audit Practice

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 totalling 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.

3. Transfer Pricing Documentation

a) 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.

b) Industry Analysis

By identifying value drivers for the relevant industry, a first indication of the level of profitability common in the industry is being given.

c) Company Analysis

A description of the management structure of the local entity, a local organisation chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.

A detailed description of the business and business strategy pursued by the local entity including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity.

d) Functional Analysis

In conducting a functional analysis, an assessment is made of the significant activities and responsibilities that are performed by the related parties relevant to the Intercompany Transactions under review, the tangible and intangible assets that are employed and the risks that are borne in undertaking the business activities. Such an assessment is consistent with the recommendations that have been made in the OECD Guidelines at paragraph 1.51.

e) Choice of Transfer Pricing Method

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.

f) Economic Analysis – Benchmark Study

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.

g) Inter-company (IC) Legal Agreement

Although an Inter-company legal agreement formalizes the business and financial relationship between group entities, the legal agreements have a lower ranking since the OECD 2017 Guidelines made the “conduct of parties” the prevailing concept.

h) Financial Statements

The corporate obligations related to the end of the financial period are:

- discussing and approving the Financial Statements,
- decision on the allocation of profit and loss.
- publication of these documents in the Collection of Deeds.

The Annual Financial Statements shall be discussed at the General Meeting of the company no later than 6 months after the end of the financial period. Therefore, if the financial period ended on 31 December 2020, the Financial Statements shall be discussed and approved by 30 June 2021.

Simultaneously with the Financial Statements, a proposal on the allocation of profit and loss shall also be submitted to the General Meeting for approval. The above documents shall be filed in the Collection of Documents of the relevant Registry Court.

Finally, the most recent amendment to the Act on Public Registers sets out that if a business corporation does not file in the Collection of Deeds the Annual or Extraordinary Financial Statements for at least two consecutive financial periods, a disciplinary fine of up to CZK 100,000 may be imposed.³

i) Production Process for TP Relevant Returns, Documents, Forms and Financials

In the chart below, the existence of the filing requirements with the details of which format is used, the latest filing date, notification requirement and its deadline, thresholds to be applied in case it exists, and the required languages are demonstrated. This information can be seen respectively for CIT, master file, local file, CbCR, local forms, annual accounts and segmented P&L documentations.

	Prepare or File?	Format	Deadline	Notification Deadline*	Threshold* (Yes/No)	Local Language (Yes/No)*(If "No", it can be filed in English)
Corporate Income Tax	File	Local format or IFRS ⁴	The CITR needs to be submitted three months after the year-end or six months	Not applicable	Yes	Yes

³ [Approval of financial statements in Czech Republic | News Flash - Accace - Outsourcing and advisory services](#)

⁴ <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-czechrepublichighlights-2022.pdf>

			after the year-end, if the taxpayer is subject to the obligatory audit or the tax return is filed by a certified tax advisor.			
Master File	Prepare	Not applicable ⁵	On request of tax authorities, 8-30 days.	Not applicable	Yes	Yes
Local File	Prepare	Not applicable ⁶	On request of tax authorities, 8-30 days.	Not applicable	Yes	Yes
CbCR	File	OECD's XML format	The report needs to be filed 12 months after the year-end.	By the end of the reporting fiscal year.	Yes	No
D-334	Prepare	Not applicable	On request of tax authorities (minimum	Not applicable	No	Yes

⁵ oecd.org/tax/transfer-pricing/transfer-pricing-country-profile-czech-republic.pdf

			of 15 days, which maybe extended upon request)			
Annual Accounts	Prepare	Local GAAP	31st March of the following year	Not applicable	Yes	Not applicable
Segmented P&L	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
* Czech Republic has signed the MCAA agreement for the filing of CbCR.						
* Czech Republic does not request as much and detailed information from smaller and less complex enterprises (SME's included) than it does from large and complex enterprises.						

j) Mandatory Language

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.

k) Notification Requirement

The notification filing deadline for CbCR is the end of the respective year. It needs to be filed only if there are changes in the filed information, compared with the notification for the previous year.

l) 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.

m) Penalties and Interest Charges

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).