

## Overview

### LeitnerLeitner Tax s.r.o., Taxand Czech Republic

LeitnerLeitner Tax s.r.o. provides the full scope of transfer pricing services such as compliance and reporting, analysis, planning, strategy and tax audits. We can help you with the setup and the implementation of business models and group transactions. We will prepare transfer pricing documentation including the benchmark studies or submit a request for a binding ruling to the Czech tax authorities. Our experts with many years of experience will support you in the negotiations with the tax authorities. In addition, we can assist you with transfer pricing audits, with Mutual Agreements Procedures and with concluding bilateral or multilateral APAs in the Czech Republic.

### General : Transfer Pricing Framework

The arm's-length principle is governed by Section 23/7 of the Czech Income Taxes Act. In general, the transactions between related parties should be set up at arm's length. If the prices agreed between related parties differ from the prices which would be agreed between independent parties under the same or similar conditions and the difference between the prices is not reasonably justified, the tax base can be adjusted by the difference.

The Czech General Financial Directorate has published Transfer pricing guidance (Decree D-34) that refers to the OECD Transfer Pricing Guidelines. In addition, the Czech Ministry of Finance has published the guidance on the recommended scope of transfer pricing documentation (Decree D-334).

The transfer pricing rules and arm's length principle in the Czech Republic are generally in line with the OECD Guidelines.

### Accepted Transfer Pricing Methodologies

The OECD Guidelines are not incorporated in the Czech Income Taxes Act. Based on the Decree-34, the OECD Guidelines are regarded as internationally accepted guidance providing explanation and clarification of the arm's length principle. In line with the OECD Guidelines, the Czech tax authorities accept using the 5 basic methods.

When selecting an appropriate method, it is recommended to proceed from the CUP method, through other traditional transactional methods, to transactional profit methods. The taxpayer is allowed to apply any method or its combination as long as it can be demonstrated that it leads to a proper arm's length setup.

### Transfer Pricing Documentation Requirements

The transfer pricing documentation is not obligatory in the Czech Republic but is highly recommended. The documentation should be provided by the taxpayers during a tax audit or when applying for a binding ruling (APA) or MAP.

In addition, selected taxpayers are required to complete an Attachment to the Corporate Income Tax Return, which contains details about transactions with related parties. This includes items such as the name of the related party, the volume of the transaction, and the types of transactions carried out in the respective taxable period.

Multinational enterprises must prepare a country-by-country report, containing information on the worldwide distribution of their revenue, taxes, etc., if the consolidated group turnover amounted to EUR 750 million or more in the previous fiscal year.

### Local Jurisdiction Benchmarks

Benchmarking is a key instrument to demonstrate that transfer prices are at arm's length. There is preference to use domestic comparables and if no sufficient number of domestic comparables is available, foreign comparables are used. In practice, the geographic region used for most comparability studies are mainly EU or all European countries.

There is no preference to use a specific database in the Czech Republic, however the Czech tax authorities use the TP Catalyst database. The search strategy is recommended to be renewed at least every 3 years and at the same time the arm's length price range observed for selected independent entities should be updated annually.

The internal CUPS are generally acceptable (if available).

### Advance Pricing Agreement "APA"/Bilateral Advance Pricing Agreement "BAPA" Overview

Czech tax law provides for a possibility to conclude APAs as an instrument eliminating disputes between tax administration and taxpayers in respect of transfer pricing. In the Czech Republic, APAs are regulated in sections 38nc and 38nd of Czech Income Taxes Act and in Decree D-32. The fee for filing an application is CZK 10,000 (approx. EUR 400).

Based on the Czech tax law, the Czech tax authorities approve the proposed transfer pricing method or the methodology of profit allocation to a permanent establishment.

The APAs (both unilateral or bilateral) are in the form of a binding ruling and are valid for up to 3 years. The requirements for both APAs are in general the same. The unilateral APA is usually completed within approx. three to six months from filing, while bilateral APA (BAPA) can take approximately up to two years.



## Transfer Pricing Audits

The Czech tax authorities can carry out tax audits on a random basis and do not conduct audits on a regular basis. However, transfer pricing is currently the frequent subject of tax audit in the Czech Republic, especially in respect of loss-making companies.

The Czech tax authorities have broad experience with TP audits of contractual manufacturers/service providers with limited risks and they are increasing their experience with international MAP and BAPA procedures. The loss-making entities are of particular interest and a typical area of focus of the Czech tax authorities is the functional and risk analysis.

Regarding the intercompany services, the Czech tax authorities focus on three-tier testing: i) the substance test (if the services were actually received), ii) the benefit test (if the recipient has benefited from receiving the service), and iii) the arm's length test. The arm's length prices are tested only if both substance and benefit tests are confirmed. In addition, failing to prove substance and benefit test leads to tax non-deductibility of the costs plus an additional CIT and VAT liability assessed by the Czech tax authorities.

## The Burden of Proof in Transfer Pricing: Theory versus Practice

The burden of proof in transfer pricing plays a crucial role in tax audits and disputes between taxpayers and the tax administration. According to the general principles of tax procedure, the tax administration has the right to request additional information necessary for the correct assessment of the tax and, in case of further doubt, the obligation to prove facts that refute the credibility of this information and the underlying documents.

In Czech law, this concept is covered by Section 92(2) to (5) of Act No. 280/2009 Coll., the Tax Code, which states that if the tax administrator requests additional information or proof of facts, the taxpayer is obliged to respond to these requests accordingly. Although there is no official obligation to

prepare or publish transfer pricing documentation in the Czech Republic, the taxpayer must always be able to prove, upon request by the tax administrator, how it determined the prices between related parties and provide the documents on which it based its conclusion. Once the documentation has been provided, the burden of proof shifts to the tax administrator, who must provide a duly substantiated reason for doubting the accuracy or completeness of the information provided.

In practice the tax administration already requires the taxpayer to provide details of the economic context of the transactions in information requests, thereby indirectly forcing the taxpayer to cooperate to a similar extent as the taxpayer who bears the burden of proof. Therefore, the voluntary maintenance of high quality and detailed transfer pricing documentation is key to managing risk and avoiding potential disputes with the tax authorities.

## Transfer Pricing Penalties

No penalties are imposed for lack of having a transfer pricing documentation, as the documentation is not obligatory in the Czech Republic.

Fines up to a maximum of CZK 600,000 (approx. EUR 24,000) for non-compliance with the CbCR notification obligations, alternatively up to a maximum of CZK 1,500,000 (approx. EUR 60,000) for non-compliance with the CbCR obligations can be imposed by the Czech tax authorities.

## Local Hot Topics and Recent Updates

The Czech Supreme Administrative Court (SAC) recently ruled that when calculating the transfer price using the net profit margin method (TNMM), the amortization of the valuation difference (goodwill) resulting from the transformation of the company must be included in the cost base if a connection to the main business activity can be assumed. The case illustrates that for transfer pricing purposes, costs must be evaluated based on their economic relationship to a transaction rather than their tax deductibility.

# CZECH REPUBLIC



## Documentation threshold

Master file	N/A
Local file	N/A
CbCR	Turnover € 750 million

## Submission deadline

Master file	N/A
Local file	N/A
CbCR	Submission within 12 months after the end tax year

## Penalty Provisions

Documentation – late filing provision	N/A
Tax return disclosure – late/incomplete/no filing	Fines up to CZK 300,000 (approx. EUR 12,000).
CbCR – late/incomplete/no filing	Fines up to a maximum of CZK 600,000 (approx. EUR 24,000) for non-compliance with the CbC notification obligations
	Fines up to a maximum of CZK 1,500,000 (approx. EUR 60,000) for non-compliance with the CbC reporting obligations



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