



Tax&Legal Highlights

Czech Republic

[A New Transfer Pricing Guidance and the Czech Translation of the OECD Guidelines](#)

The General Financial Directorate (the "GFD") issued new Guidance D-34 on the application of international standards to the taxation of related party transactions. This guidance replaces existing Guidance D-332. Together with the new guidance, the Czech translation of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2017 Edition) was published in the Financial Bulletin of the Ministry of Finance no. 5/2019.

The purpose of Guidance D-34 is to ensure that a uniform approach to determining a tax base impacted by related party transactions is applied by both the Tax Administration of the Czech Republic and taxable entities. As opposed to the previous guidance, the update provides more detailed information on, for example, the following topics:

- Actual actions of the parties versus contractual arrangements;
- A functional and risk analysis, including typology of functional profiles, discussion on the key role of industry value drivers, the issue of legal versus economic ownership of intangible assets, or explanation of the difference between a function and an activity;
- Recommendations on how to prepare a benchmarking analysis, including a list of the most frequent quantitative criteria, or recommendations on the approach to updating the analysis; and
- Overview of the methods to identify transfer prices, including comments on their practical application.

What situations may occur or practical considerations

The new guidance also contains some of the GFD's own considerations which are, in our experience, often applied by tax administrators in conducting tax audits. Such considerations relate to, for example, the possible existence of related party transactions that are not explicitly referred to in contractual arrangements and accounted for but do exist in reality. This may involve a so-called "order of the parent company", which refers to a control of an independent transaction by a related party, such as when a parent company orders a subsidiary to execute a sale of goods to external customers for a lower than an arm's length price (and substantiate it by claiming that the transaction will generate a certain benefit for the group as a whole).

If the transaction constitutes a sale of goods to related parties, the tax administrator will try to arrive at a conclusion in the tax audit, by applying Section 23 (7) of the Income Taxes Act, on the difference between the referential price calculated by it and the identified price and subsequently adjust (increase) the entity's tax base by the identified difference.

However, if the sale of goods involves external entities, the situation will be seemingly more difficult for the tax administrator as it is an independent transaction (it is impossible to directly apply the approach under Section 23 (7) of the Income Taxes Act). Nevertheless, in such a case, the tax administrator can use the institute of the parent's company order as disclosed above and attribute the difference between the referential price and the identified price to that transaction. The tax administrator will subsequently conclude that the price in that transaction (in the form of a compensation to the subsidiary) shall be determined in an amount corresponding to the identified difference, increasing the entity's tax base as appropriate.

The above-specified example of the Tax Administrator's approach as well as the issuance of new Guidance D-34 as such demonstrate that the Czech Tax Administration closely monitors the international developments in the area of transfer pricing and does not hesitate to apply a highly sophisticated approach to its audit activities.

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Investment Incentives Will Have New Rules

On 7 June 2019, the Chamber of Deputies approved the government proposal of an amendment to the Act on Investment Incentives, Bulletin of the Chamber of Deputies no. 298 of 8 October 2018. The amendment can be expected to come into force approximately in September 2019. The approved amendment will represent the basic framework of conditions for awarding investment incentives. Most of the general conditions for granting investment incentives will be flexibly regulated by a governmental decree based on the economic situation and the needs of the labour market.

Following the amendment to the Act on Investment Incentives, support will be directed primarily to projects with higher added value, which should be ensured in particular by the condition of a higher ratio of employees with higher salaries and university education, by cooperation with universities and research organisations, or investments in research and development projects. These conditions should not apply to projects realised in the "supported regions" with higher unemployment.

Government approval will be needed

An important new aspect of the system of awarding investment incentives is the condition of the government's approval of all the applications with respect to the benefit brought to the region by the investment. A positive change concerns the cancellation of the condition of creating job openings for investments in manufacturing, and the halving of the limits of general conditions for small and medium-sized enterprises. Technological centres and centres for strategic services will attract more intensive support in the form of cash support of job openings in all regions or by decreasing the limits for new job openings for strategic investments.

Investment plans submitted before the effective date will be subject to the existing conditions for obtaining an investment incentive.

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