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Transfer pricing

In terms of Czech legislation

The basis of the transfer pricing concept is the so-called arm's length principle, which stipulates that transactions between related parties should be processed under the same or similar conditions as in the case of unrelated persons. In theory, this is easily applicable, however in practice, hardly feasible concept, which is internationally recognized and embodied in the OECD guidelines, in double tax treaties for the avoidance of double taxation and in the jurisdictions of individual countries.

The Czech Republic has not yet imposed an obligation to formulate documentation for transfer pricing, although the most of other EU countries, including the Slovak Republic, have already applied this requirement. Part of the legislation that relates to this issue is grounded in the instruction **D - 292** from the year 2008, where the way in defined in which the price is to be negotiated between related parties. Further in the instruction **D - 293** is stated the scope of the recommended documentation on how the pricing between related entities should be created. These guidelines are not legally binding, although they give persuasive recommendations on how to act in this area.

From 1 January 2006 may be the tax administrator asked by the tax payer to agree / disagree a method of setting transfer prices. This is called "authentic assessment" which is a tool for managing related tax risks, but it is a long process and requires numerous discussions between the taxpayer and the tax administrator.

To the transactions, that present the highest risk by tax control, belong for example charging of managerial services in international companies. In order to classify mentioned services as a tax deductible expense, the tax payer must demonstrate the compliance of the arm's length principle, provision of these services and also a benefit from the received services, which is a stumbling - block by tax control. Taxpayers are often not adequately prepared and tax administrators, on the contrary, have very unrealistic expectations.

Therefore it is recommended that international companies formally apply documentation of their own in this area, which should describe in exact terms what their transfer pricing process is. This is also used in case of tax control visit as their evidence of proper dealing. It needs to be based on the principles set out in the OECD model, and most of all it needs to be an argument based on commercial logic. However, the argument "they are our subsidiary, therefore they take the price we give" is not acceptable, as it is prima facie evidence that the price is not the same as the one that would be given and accepted between unrelated parties. Either your tax specialist can help you write it or can check and correct your draft, spot arguments that will work against you and help you improve it. It is a service that almost always adds much more value than it costs, especially with the increased frequency of control visits in the area of transfer pricing.



Tax Havens

Minimal taxation and high protection of personal financial data

Different tax rates in different countries around the world create a competitive environment regarding attractiveness for foreign investors. There are various definitions according which we can judge whether it is a profitable tax country, so called a tax haven or not. The OECD defines a 'tax haven' as a country that has little or no taxation applied, while the protection of personal financial data is very high.

These characteristics are for example met in case of Liechtenstein, Monaco and Andorra around the Europe and in other 35 countries around the world. In these days of e-mail and the internet, there is no problem to move the seat of the company or residency to the mentioned countries and tax their income with lower tax rates. Therefore, it is no surprise that tax havens sometimes have more registered companies than the number of their residents. The main advantage is the tax savings as well as ensuring the protection of investors and maintaining their anonymity.

- With regard to Andorra, for instance, there is no income tax, gift tax, inheritance tax and capital transfer tax. Employees must pay social insurance in the amount of 5% to 9% and the employer pays from the employee's gross income social insurance in the amount of 13%.
- Liechtenstein has always been known for its protection of banking secrecy, shockwaves from the 2008 Kieber affair notwithstanding. A high degree of anonymity and low tax burden are crucial when company decides about the location of its seat. The tax rate for value added tax varies from 2.4% to 7.6% depending on the type of goods or services provided. The tax rate for corporate income ranges from 7.5% to 15%, however in some cases the tax rate can amount to 20%.

- Monaco is specific because of nil tax rates with only various charges being imposed. For social insurance, employers pay from 28% to 40% from the gross income and employees pay from 10% to 14% from their salary.

There was discussion in the Czech Republic that an amnesty was going to be announced with regard to tax havens, but in the end this did not happen, as we already covered in our monthly published Tax Alert March edition. As estimated by the Tax administration of Ministry of Finance, Czech residents have on foreign accounts several billion tax-free Czech crowns, which could be a considerable benefit to the state budget. In order to prevent people from further concealment and non-payment of taxes, the Ministry of Finance will impose from 2011 a new set of tax rules, including agreements with tax havens for the exchange of information.

Employees' benefits and VAT

Changes in determining the VAT tax base

A new amendment to the VAT act effective from 1st January 2010 brought about a change in determining the VAT tax base, which in case of transactions between connected persons became the usual price determined on the date of taxable supply, thus the market price.

Among the persons effected by this assignation were those who are in a labour-law relationship to the payer, therefore the new amendment practically affected the taxation of the benefits which an employer provides to his employees at a lower than market price. VAT wouldn't have been calculated from the lower price, which an employee paid, but from the above-mentioned usual price, while the resulting difference wouldn't have represented a tax deductible expense of the employer.



In this context it is important to mention that the difference between a price established by an employer and an usual price might be immense, therefore would have some benefits become very expensive for an employer. The hottest discussion arose regarding the overhead tickets provided to employees of Czech Railways. Transport unions even threatened a national strike.

This discussion eventually concluded in a legislative shuffle, the result of which is, so to speak, a cosmetic change in the provision in question. Persons in a labour-law or a similar relationship to a payer are not defined as persons connected to the payer anymore, thus determining the tax base on a usual price level does not apply on them. This new amendment came into force on 29th April 2010; however, it might be used retroactively from the moment when the first amendment of the Act came into force, that is from 1st January 2010.

Although it should be taken into account that the tax base for the calculation of VAT on transactions with other connected persons, i.e. by capital or differently connected, related persons or persons running business with a payer pursuant to a contract of association, the usual price remains determined on the date of taxable supply.



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