AUDITOR

Audit ▪ Tax ▪ Accounting

# Client Information

Czech Republic
November 2019

## Transfer Pricing News – update

*Tax audits frequently review transfer pricing between related entities. In May 2019, the Financial Administration issued an extensive D-34 guideline on this subject, dealing with the application of international standards in the taxation of transactions between associated enterprises.*

*The guideline follows the OECD Directive, summarises the interpretations and contains numerous recommendations. We would like to introduce you to some of them.*


### Benefit and Substance Test

Prior to focusing on transfer pricing, the tax authority carries out a benefit and substance test. The tax entity is obliged to prove **the execution of the received transaction (the substance test)** and its **benefit for the entity's economic activities (the benefit test).**

### Even Invoicing by an Independent Entity May Be a Dependent Transaction

As part of its audit, the Tax Administrator checks whether prices with independent entities are negotiated separately by the audited tax entity. If the mother company intervenes in the negotiations and orders it to invoice a price other than the usual price, **any difference should be compensated by the mother company.**

## Tested Party and Functional Profile

Prices are tested in the entity that performs less complex functions and bears less financially significant risk and, in particular, does not own any unique tangible or intangible assets. Thus, the tested party may be either the mother or the daughter company.

Based on the performed function and risk analysis, the Company is defined as either a **„routine enterprise“** or a **„fully-fledged enterprise“** according to the degree of dependency of individual transactions on the counterparty or the rest of the group.

The fewer functions a company performs and the less risk it bears, the lower but more stable its profit potential is. The **remaining profit or loss is then attributable to the „fully-fledged enterprise“**, i.e. the one which performs more functions and bears greater risk in the tested transaction.


## Benchmark Analysis

The purpose of the benchmark analysis is to select suitable and comparable external entities and to determine their profitability or prices.

The data collected by the benchmark analysis **determine a range** within which margins (prices) may fluctuate between the associated enterprises.

In the guideline, the Financial Administration recommends performing a **benchmark analysis every three years** and verifying each year whether there has been a significant shift in the profitability of the selected independent companies affected by market fluctuations.

## Transactional Net Margin Method

The guideline describes in detail the various methods for determining transfer prices. TNMM – the Transactional Net Margin Method is most commonly used, particularly if a comparable independent transaction is non-existent or difficult to establish from available sources.

This method is also very often used in cases where transactions are aggregated (i.e. mutually related and it is difficult and unnecessary to value each of them separately). When applying the TNMM method, the final price is determined on such a level that the company as a whole achieves net profitability corresponding to the net profitability determined by the benchmark analysis of comparable independent entities.

## Practical Use

When developing transfer pricing documentation, we base it on the principles described in international and local regulations.

The issue of transfer pricing is often underestimated in practice and documentation is only produced retrospectively or even during a tax inspection. Such an approach makes it very difficult to prove the correctness of transfer prices to the tax administrator. The prices set within the group often lack the verification of the „arm's length principle“, which should be part of the documentation.

**We recommend having the documentation processed in time and not waiting until a tax office audit.**

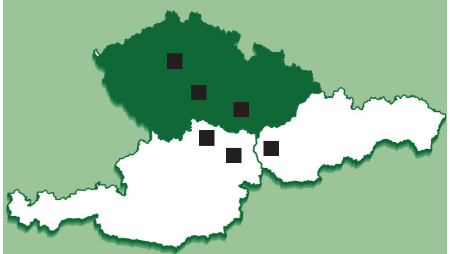
**ING. RENÁTA PŘECHOVÁ**
Tax advisor
T: +420 565 502 501
renata.prechova@auditor.eu



## AUDITOR in Central Europe

**AUDITOR** is an audit and tax consulting company with an international focus that has been providing services since 1991 years in **tax consulting**, **personel** and **payroll administration**, **financial accounting** and **business consulting**.

The company provides complex consultancy in Central European countries via sister companies in the **Slovak Republic** and **Austria** (using **Stöger & Partner** as a brand name). For solving global consultancy issues, AUDITOR is an independent member in UHY International, a network of independent consultancy companies in more than 80 countries of the world.



**Office Prague**
Haštalská 6, Prague 1
T: +420 224 800 411
praha@auditor.eu

**Office Pelhřimov**
Masarykovo nám. 30, Pelhřimov
T: +420 565 502 502
pelhrimov@auditor.eu

**Office Brno**
Dominikánské nám. 2, Brno
T: +420 542 422 601
brno@auditor.eu