

Guidance of General Financial Directorate D – 32
Notification by General Financial Directorate in respect of binding ruling on transfer price in related parties' transactions and the method of determining the non-resident tax base from activities performed through a permanent establishment.

In amendment to the Act no. 586/1992 Coll. (Collection of Laws of the Czech Republic), on Income Taxes, (hereinafter "AIT") there has been a concept of "binding ruling on the method of pricing used in related parties transactions" incorporated in prov. of section 38nc of AIT with the effect as of January 1, 2006 which implemented so called Advance Pricing Agreements into the Czech tax law. With the effect as of January 1, 2018 there has been a concept of "binding ruling on the method of determining the non-resident tax base from activities performed through a permanent establishment" (hereinafter "the attribution of profits to permanent establishments") implemented in prov. of section 38nc of AIT.

Both provisions in respect of procedures extend the provisions of section 132 and section 133 of the Act no. 280/2009 Coll., on Administration of Taxes, as amended (hereinafter just AAT) regulating issuance of binding rulings in general. The binding rulings for a taxpayer represent some certainty as to how the tax administrator will consider the pricing method between related parties or method of determining the non-resident tax base from activities performed through a permanent establishment located in the Czech Republic. If in the period, for which the binding ruling was issued, the taxpayer meets all the conditions, based on which tax administrator made the decision, the tax administrator shall consider the price determined in this way as a usual price under section 23 par. 7 of AIT and shall consider the tax base stated in this way for a permanent establishment to be determined under the section 23 par. 11 of AIT in the frame of a tax audit or other tax procedures.

I. COMMON PROVISIONS FOR BINDING RULING UNDER THE PROVISIONS OF SECTION 38nc AND 38nd OF AIT

1. Submitting of the application

The application is submitted by the taxpayer, to whom the binding ruling shall apply, that is, the one that stipulates the price between related parties or non-resident taxpayer, whose permanent establishment the application relates to.

The application for submitting a binding ruling, including attachments, must be submitted in the official language stated in prov. of section 76 of AAT, i.e. in the Czech language.

The application for the binding ruling shall be submitted by the taxpayer to his local tax administrator. When filling the application on behalf of the legal entity or a permanent establishment the foundation of which is being planned, the application shall be submitted to the tax administrator who should be a competent authority for the legal entity after its foundation or for a non-resident taxpayer after the foundation of his permanent establishment.

When the legal entity stated in the application has not been established yet, another person may file the application, e.g. the founder of this legal entity or presentative in accordance with AAT. The condition is that the established legal entity has to be sufficiently identified, i.e. its name, company's form, presumed headquarters, place of doing the business, placement within the organizational structure of the enterprise group and the description of the business activities has to be stated.

In the case of a permanent establishment which has not been established, the application is submitted by a foreign entity that performs or will start to perform activities in the Czech Republic leading to the foundation of a permanent establishment.

The tax administrator can ask the taxpayer to clarify the facts stated in the application pursuant to the prov. of section 74 of AAT.

2. Period for which a binding ruling may be issued

The taxpayer may submit an application for a binding ruling for the taxable period in which the application is submitted and for the taxable periods that follow.

If the taxpayer applied the same method of transfer pricing determination or profit allocation to a permanent establishment under similar conditions in previous periods, he may assume in case of issuing a positive ruling, that in spite of the invalidity of the binding ruling for previous periods, the tax administrator in the case of a tax audit will proceed in the same way as is described in the binding ruling issued, and if all conditions are adequate, the same conclusions will be reached as to the way the price or tax base was determined, not in the amount of the agreed price or tax base.

3. Issuance of ruling

The relevant tax administrator, who is the tax administrator, to whom the application was filed, or the General Financial Directorate, decides on the application for a binding ruling, depending on whether the application concerns only one domestic entity or more domestic entities for which more tax administrators are locally competent.

In cases, when the application concerns exclusively taxpayers belonging to the competence of one locally competent tax administrator, this tax administrator issues a ruling on the application. In a situation when the taxpayer for whom the ruling is issued belongs to the local competence of more tax administrators, then the application is assessed and the ruling is issued by the General Financial Directorate. The General Financial Directorate also assesses so called bilateral or multilateral advance pricing agreements (hereinafter "APA"), i.e. agreements when the taxpayer requires them to be assessed by more than one tax administration.

The issued ruling always contains only one statement and beyond the principle requirements of the ruling under prov. of section 102 of AAT, the ruling issued must also contain the requirements under prov. of section 132 of AAT.

4. Binding ruling Effect

The binding ruling is, pursuant to prov. of section 133 par. 1 of AAT, effective in relation to the tax administrator, who decides on the tax liability of the tax subject, at whose request the binding ruling was issued.

It is only effective if, at the time of deciding on tax liability, the current state of matters is the same as that on which the ruling was issued.

The binding ruling comes into effect for the taxable periods stated in the ruling. Pursuant to prov. of section 133 par. 3 of AAT it is not effective for the assessment of tax consequences of the crucial facts taken place in the taxable period starting after the period of 3 years from the date when the ruling came into legal effect; unless the tax administrator determines the shorter period.

The ruling is notified to the other interested parties and other tax administrators. If the parties involved are the entities stipulated in section 2 par. 3 and section 17 par. 4 of AIT, and if the parties are residents of a state, which have in effect the Double Taxation Treaty with the Czech Republic, and if the Treaty allows the international exchange of information about taxpayers or if it is possible to exchange information on tax standpoints with a cross-border element with this country, then the ruling is notified to the competent authority of the contracting state. The mentioned procedure shall not be applied, if there has been a process of bilateral APA already initiated based on the relevant article of the Double Taxation Treaty.

If after the issue of the binding ruling it is proven that the conditions stated by the taxpayer in the application do not correspond to the facts (i.e. the facts stated were incorrect, incomplete or untruthful, eventually the conditions for pricing have changed) and the binding ruling was issued based on these conditions, such ruling is not applicable pursuant to prov. of section 133 par. 5 of AAT.

5. Other provisions

5.1. Administrative charges

Under the Act no. 634/2004 Coll., on Administrative Charges, the acceptance of an application for issuing a binding ruling is charged in amount of CZK 10 000 (Table of Charges, part I, item 1 (1) (n)). The amount of the administrative charge depends on the number of assessed facts (number of items subject to consideration) of the binding ruling, which the tax administrator will decide on separately in a single ruling.

In the case of an application under the prov. of section 38nc of AIT, the administrative charge depends on the number of transactions or sets of aggregated transactions specified in the application (part II (4)), which are the subject of the assessment, and in the case of an application under prov. of section 38nd of AIT, the administration charge is based on the number of permanent establishments for which method of determining the tax base will be assessed.

5.2 Remedies

No remedies can be applied in relation to the binding ruling under the prov. of section 132, par. 3 of AAT.

II. BINDING RULING UNDER PROVISIONS OF SECTION 38nc OF AIT

1. Determination

The prov. of section 38 of AIT defines the use of a binding ruling institute in cases of so called transfer pricing between related parties.

The binding ruling takes over the principles of the APAs within the meaning of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (hereinafter only as “OECD Guidelines”) and other international standards and adapts them to the conditions of the Czech tax law. Through a binding ruling, taxpayers can verify in advance whether their chosen way of pricing agreed between related parties (associated enterprises) is in compliance with the arm's length principle for the purposes of tax base definition as provided for in the Article 9 – Associated Companies of the Double Taxation Treaties (hereinafter DTT), as well as in prov. of section 23 par. 7 of AIT.

The methods for determining transfer pricing, the basic principles of transfer pricing and the definition of related parties are the subject of a separate guidance (D-332¹). When applying prov. of section 38nc of the AIT, the tax administrator shall proceed on the basis of practices recommended by the OECD Guidelines.

2. Who can apply for a binding ruling

The procedure under the prov. of section 38nc of AIT in connection with the prov. of sections 132 and 133 of AAT shall apply in cases when the taxpayer negotiates prices in business relations with persons who are related to him pursuant to prov. of section 23, par. 7 of AIT, the Article 9 of DTT and referring to the guidance D-332¹.

3. Application

The application must contain the data listed in prov. of section 38nc par. 2 of AIT. Therefore, the taxpayer shall specify and document in the application and within the submitted documentation (especially under letter *f*) of the mentioned provision) all facts that will affect or may significantly affect the way of pricing under assessment. That could be information concerning the group, company, distribution of risks and functions, business relation or other circumstances affecting the business relation, the way of determining the transfer price (containing information about independent comparable transactions both internal and external) etc.

In respect of the scope of relevant documentation, the Ministry of Finance has issued guidance D-334, Communication by the Ministry of Finance in respect of the scope of transfer pricing documentation.

4. Number of transactions

The application is usually submitted in respect of assessment of one transaction. If there are several transactions closely related (between the same entities concerning the same business, combined transactions), it is more appropriate to aggregate these transactions and assess the business relation as a whole, and thus evaluate it as a set of aggregated transactions together using one method.

The taxpayer may submit an application for the assessment of a set of transactions which are not closely related. In this case, each transaction will be assessed independently and separate rulings for each of them that may be positive or negative shall be issued.

The requirement concerning the number of transactions in the application cannot be generalized. It is necessary to assess each case individually.

¹ Guidance amended by General Financial Directorate D – 34, which replaces stated guidance after issuance

5. Procedure exercised by the tax administrator

The tax administrator assessing the way of transfer pricing considers exclusively data provided by the taxpayer. The tax administrator is not obliged to verify all the financial indicators, actual level of costs and revenues, actual volume of performance, product and service parameters or to determine possible substitute method. The tax administrator shall check comparable circumstances and shall assess whether the pricing proposed by the taxpayer is in compliance with the arm's length principle.

When issuing the binding ruling, the pricing method selected by the taxpayer is taken as a basis for the tax administrator's considerations. If the chosen method of pricing corresponds to generally accepted standards of transfer pricing between related parties, this method will be considered as appropriate for issuance of a positive binding ruling.

III. BINDING RULING UNDER SECTION 38nd OF AIT

1. Determination

Prov. of section 38nd of AIT regulates the use of a binding ruling institute for assessing the method of determining the tax base or tax loss attributable to a non-resident's permanent establishment located in the Czech Republic, through which the foreign taxpayer performs his activities.

The attribution of profits to permanent establishments is primarily based on accounting (tax records) of non-resident taxpayer. It is necessary to take into account the tax base which is usual in respect of tax residents in a similar situation. Determining the non-resident tax base from activities performed in the Czech Republic through a permanent establishment is proceeded pursuant to the prov. of section 23 par. 11 of AIT and in compliance with the Article 7 – Profits of enterprises of DDT.

It is also based on the principles stated in the OECD Report on the Attribution of Profits to Permanent Establishments from 2010, when one of the key principles is that the attribution of profits to a permanent establishment is the same as the attribution of profits to a separate and independent enterprise, including assessment of related functions and risks.

2. Application

The application is always submitted by a non-resident taxpayer, who has or will have a permanent establishment in the Czech Republic. The application must contain the particulars specified in prov. of section 38nd of AIT. If more than one identification number is assigned to a non-resident taxpayer because he has more branches (organizational units) in the Czech Republic, he shall indicate in the application all assigned identification numbers.

In case, that some of the necessary data will be known in the future, it is necessary to provide their estimates. At the same time, the underlying data for these estimates and their justification should be provided.

3. More permanent establishments

If a non-resident taxpayer in the Czech Republic reaches income through more permanent establishments, the method of determining the non-resident's tax base for each permanent establishment is assessed separately.

If a non-resident taxpayer performs the same or a very similar activity in the Czech Republic through more permanent establishments, resp. activities performed through these permanent establishments would be inseparably linked, it is possible to issue one binding ruling relating to the method of determining the tax base of a non-resident taxpayer achieved through all these permanent establishments.

4. Procedure exercised by the tax administrator

When assessing the application, the tax administrator relies exclusively on the data provided by the non-resident taxpayer. It is not the duty of the tax administrator to verify the data provided in the application. The tax administrator shall verify the method of determining the tax base and assess whether the proposed method of determining the tax base corresponds to the method of determining the tax base of a resident in a similar situation.

When issuing the binding ruling, the method of determining the tax base selected by the non-resident taxpayer is taken by the tax administrator as a basis for his assessment. If this method corresponds to the described rules, it will be considered as appropriate for issuance of a positive binding ruling.

IV. FINAL PROVISIONS

This guidance replaces Guidance D-333 issued under Ref.no. 39/86 838 / 2009-393 and it is applicable for taxable periods started after January 1, 2018.

Martin Janeček
General Director