TAX OPTIMIZATION OF INTANGIBLE ASSETS IN THE CZECH ENVIRONMENT

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Abstract: The aim of the article is to investigate the growing importance of intangible assets in the context of tax optimization in the Czech environment. The development of tax legislation regulating the substance of intangible assets and their depreciation is also analysed. There are discussed ways of tax optimization when transferring rights to this property. From the methodological point of view, the methods of synthesis, comparative analysis, induction and deduction were used in this work. From the research presented, it is clear that the tax regulation of intangible assets has undergone a long-term development. The Czech tax legislation reflects the initiatives of international communities aimed at reducing non-standard tax transactions related to intangible assets.

Key words: Aggressive tax planning, depreciation of intangible assets, double taxation agreements, IFRS, intangible assets, market distancing principle, transfer pricing.

1 Introduction

Intangibles form an important part of the company's assets. Since the early 1990s, the importance of these assets has been growing in a company management. In the so-called knowledge economy, sub-components of intangible assets such as knowledge, software, business secrets, copyrights and patents or customer relationships are an important part of corporate assets and make a significant contribution to the company's competitiveness. The structure of corporate assets shows a shift away from tangible assets towards intangible assets. This trend brings new problems and challenges. The aspects of displaying intangible assets in the accounting system and the potential of possible tax optimization are examined. The accounting legislation of the Czech Republic is currently developing in the field of intangible assets towards the provisions of international accounting standards. In the tax area, new possibilities for tax optimization of intangible assets are sought not only at national but also at international level. Thanks to their non-material nature, intangible assets are an attractive tool for broad tax optimization. Companies in the international environment use gaps and inconsistencies in the tax legislation of individual jurisdictions to reduce tax bases, or in other words optimization of the tax liability. The aggressive tax planning of companies, especially of transnational holding structures, causes unequal access to corporate taxation and disturbs the competitive market environment.

The tax legislation of the Czech Republic regulating the intangible assets sector has evolved over the years mainly in the area of intangible assets, the amount of the valuation and the possibility of depreciation as an item reducing the tax base. At present, it is clear that even in the Czech environment, the importance of intangible assets in corporate practice is growing. For this reason, the increased attention is paid to tax optimization of this property not only at national level, but also in the international environment.

2 Materials and methods

In recent years, intangible assets have gained an irreplaceable significance in the ownership structure of companies (Su, 2015). Intangible assets are perceived as key factors in the success of companies in a competitive environment (Bontempi, 2016). Intangible assets are also used as a tax optimization tool when calculating corporate tax. There are a number of works demonstrating the desire to use intangible assets in international tax planning (e.g. Ginevra, 2017). Some international tax planning methods are quite controversial and the OECD ranks them in the area of so-called aggressive tax planning (OECD 2013). Both the OECD and the EU are under pressure to reduce or eliminate these unfair practices that distort the competitive environment. In 2015, the BEPS (Base Erosion and Profit Shifting) initiative was established. In this initiative, the OECD identifies 15 Actions to help countries fight large-scale tax evasion and move taxes into jurisdictions with a more favourable tax regime (OECD/G20 2015). Actions 8-10 deal with transfer pricing (OECD 2017). This is closely related to the issue of intangibles. There is no reliable data on the substance, valuation, and usability of the transfer of rights to intangibles between associated companies. This opens up room for potential tax evasion. The tax administration does not have sufficient information to assess whether the rights to intangible assets have been transferred to a low value or overvalue compared to arm's length price (Alstadsæter, 2018).

Also, in the Czech Republic, in recent years accounting and tax aspects of intangible assets have been given a great deal of attention (Malikova, 2016). The importance of intangible assets for business management is examined (Drabkova, 2015) and relevant tax consequences are analysed (Lengenzova, 2017). In Czech accounting legislation, intangible assets are adjusted, inter alia, by Czech Accounting Standard No. 013 (ÚZ 2016) . Intangible fixed assets include, inter alia, intangible assets, software, valuation rights, goodwill, emission allowances and preferential limits (longer than one year). Czech accounting legislation defines the methods of acquisition, valuation and depreciation of these assets. The use of intangible assets is recognized as an expense in the income statement in the form of depreciation and / or payment for the use of a certain type of this asset. In the field of revenues, on the other hand, invoices or revenues for the rights to use intangible assets are recorded(ÚZ 2016) .

In recent years, national accounting legislation on intangible assets has been brought closer to the concept of intangible assets under International Financial Reporting Standards (further IFRS) (Strouhal, 2012). Intangible assets are addressed in particular in IAS 38. According to IFRS, intangible assets are identifiable non-monetary assets without physical substance. IAS 38 also provides examples of intangible assets. These are usually computer programs, patents, copyrights, movies, customer lists, customer or supplier relationships, market share, and marketing rights. In order for an IFRS item to be recognized as an intangible asset, it must meet the definition of an intangible asset (the asset must be clearly identified, the cost of the asset is reliably measurable, the asset is controlled by the entity, and there is a presumption of future economic benefits from that asset). The time of use of an intangible asset is also important. Each entity assesses whether the useful life of the asset is final or indefinite. In the case of an indefinite useful life, it is not possible to precisely determine the period for which the asset will bring the entity's future economic benefits. From this, the depreciation method is drawn (or intangible assets with indefinite useful lives are not depreciated, they are only annually tested for impairment of the asset) (IAS 38). In the Czech Republic, the tax aspects of intangible assets arise from the provisions of the Income Tax Act. The tax rules regulate the depreciation of these assets as well as the costs (or revenues) associated with the use of intangible assets (Zákon č. 586/1992).

In the context of the research activities of the project, the tax aspects of intangible assets in the Czech Republic are discussed in this paper. Primarily, the attention is paid to national legislation on income tax. A comparative analysis of the historical development of the partial provisions of the Income Tax Act, dealing with intangible assets or its depreciation options, was carried out. Using the statistics of the Ministry of Finance of the Czech Republic (providing selected information from tax collection in individual years), an analysis of trends in utilization of depreciation of intangible assets as a tax optimization tool was performed. In connection with the use of intangible assets, the partial provisions of the Income Tax Act

were synthesized and subsequently confronted with international legislative standards.

3 Results

The possibilities of tax optimization of intangible assets have historically depended on the basic characteristics of these assets, in particular their substance, valuation and method of calculating tax depreciation. For the purpose of calculating the tax base, or the tax duty of the company, it was always required to proceed according to the partial provisions of Act No. 586/1992 Coll., on Income Tax. Intangible property legislation has undergone a long-term development in this legal standard (just like the law that has been revised almost 160 times). At present, the regulation of intangible assets and depreciation is devoted to the provisions of §32a. The historical development of the tax treatment of these assets (basic characteristics, depreciation method, and entry price) is analysed in table 1 below.

Table 1 Development of the position of intangible assets in the Income Tax Act in the Czech Republic

Period	Characteristics	Depreciation methods	Entry price for depreciation
1993 – 1995	Subjects of industrial property rights; projects and software; other technical or other economically viable knowledge; acquisition costs.	as long-term tangible assets within depreciation groups	> CZK 20,000
1996 – 1998	Subjects of industrial property rights; projects and software; other technical or other economically viable knowledge; acquisition costs.	ditto	> CZK 40,000 > CZK 20,000
1999 – 2000	Subjects of industrial property rights; projects and software; other technical or other economically viable knowledge; acquisition costs.	ditto	> CZK 60,000
2001 – 2003	was not defined in the Income Tax Act	only accounting adjustment,	> CZK 60,000
2004 – present	Intangible R & D results, software, valuable rights, and other assets that are held in accounting as intangible assets designated in accordance with accounting policies.	Entry price/ usage period audio-visual work for 18 months; SW, science and research results 36 months, other intangible assets 72 months	

Source: author's own processing in accordance with the Income Tax Act in individual years of effectiveness

Since the date the Income Tax Act came into effect, the "long-term" of intangible assets has been accentuated by a requirement for operational technical functions (later the useful life) longer than one year. At the beginning of the new tax law, the limit for the classification of assets in the intangible assets category was set at CZK 20,000. Subsequently, by the end of 1998, the valuation limit in the act was set at CZK 40,000, and since 1999, the entry value of intangible assets has been set at CZK 60,000. In the past, the limit for classifying acquisition costs in the category of intangible assets was lower. Since 2016 they have been accounted only in costs. Until 2000 inclusive, intangible, as well as tangible assets, were classified into depreciation groups for depreciation purposes. It was depreciated in equal measure with the tangible property (evenly or accelerated).

During 2001 to 2003 intangible assets in the Income Tax Act were not defined. It was only defined by accounting regulations. It was depreciated only according to the accounting plan, mandatory from the valuation of CZK 60,000. The depreciation period has not been defined (except for the limitation of the depreciation period of 5 years for the establishment costs). Accounting depreciation was tax-deductible and reflected in the corporate tax base. Since 2004 the nature of intangible assets has been adjusted, as well as a change in the depreciation method. Assets in which the right of use is defined for a definite period of time are depreciated on a straight-line basis (calculated as the share of the input price and the period of use agreed upon by the contract). In the case of other assets, amortization is currently used (unless a specific time is agreed upon). From 2017, it is possible to apply these depreciations for longer (at least 18, 36 and 72 months respectively). In 2018, "research" was excluded from the "Intangible R & D Results" in line with IFRS. The reason is that the intangible results of the research do not meet the recognition criteria for long-term intangible assets under IAS 38 (research expenditure as of 1 January 2018 is recognized only in costs when incurred).

As the knowledge economy increases, the share of companies that rely on intangible assets and innovations in their activities is also growing **(**Boronos, 2016) . The share of intangible assets in the total assets of these companies is going up (EU 2017). This trend is supported by the Industry 4.0 call**.** Applied research, digitization and automation are key attributes of the future development of business activities in the context of this call. The trend of increasing representation of intangible assets in the structure of company assets is also reflected in the increase in the tax depreciation of this asset. The following figure 1 compares the development of the tax depreciation of intangible assets with the increase in the number of tax subjects.

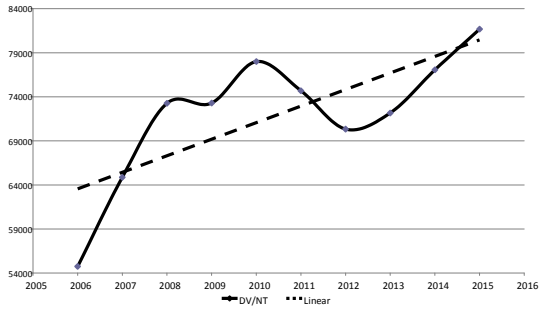

Figure 1 The development of the share of the depreciation value (DV) of the intangible assets on the total number of tax subjects (NT)

Source: author´s own processing

The initial data for the processing the trend was obtained from statistics of the Ministry of Finance of the Czech Republic. Information on the development of the number of tax subjects (commercial corporations) was investigated and data reflecting the growth in value of tax depreciation of intangible assets were analyzed. For the relevance of the data used, the period between 2004 and 2015 was chosen. In 2004, the tax legislation on depreciation of intangible assets (a separate category of depreciation of intangible assets) amended. This amendment is still valid today. The time series is limited to 2015 as data for the next period are not yet available. The figure shows that the linear trend reflecting the development of tax deductible depreciation (in relation to the growing number of tax subjects) confirms the thesis of the growing importance of intangible assets in the assets of companies.

The growing representation of intangible assets in the property structure of companies also generates new challenges for tax systems. Originally, taxes on these activities were levied on the basis of the legal ownership and physical location of a particular intangible asset. At present, the situation is much more complicated. Companies create complex tax structures that allow for sophisticated tax optimization in the field of intangible assets, when used. A healthy market needs a fair and efficient system of corporate tax collection, though. The underlying assumption is that businesses pay taxes in the country in which they make their profits (Dover, 2015). However, the aggressive tax planning of some multinational companies ignores this principle. This is detrimental to fair competition and, in accordance with Lawless, (2018), it is particularly maltreated by SMEs.

Multinational companies use the specifics of national tax systems for dealing with intangible assets. An intangible asset is owned by a member of a holding structure located in a tax-favorable jurisdiction (a country with a low tax rate or an appropriate approach to taxing intangible assets) and provides this asset to other members of the holding in different countries. Revenue from this transaction is not taxed by the owner of the intangible asset at all or at minimum (according to the chosen jurisdiction). The members of the holding then reflect the payments for the provided intangible assets in the costs. Thanks to this transaction, corporate profits are shifted to a country with a zero or moderate corporate tax rate. Both the OECD and the EU seek to reduce the impact of this aggressive tax planning (Collier, 2017). Both binding directives and recommendations are implemented by individual states in their national tax laws. In the Czech Republic, the above issues are addressed by the Income Tax Act. The tax regulation of intangible assets in the Czech Republic is analyzed in the context of royalty fees (see Table 2). Transactions associated with royalties are a frequent tool for tax optimization.

Table 2 Tax treatment of expenses and income from transactions with royalty fees in the Czech Republic

Income from royalty fees	Expenses associated with the use of royalties
Exemption from License Income (S.19 (1) (zj) (ITA)	Expenditure evaluation based on market access principle (S. 23 (7) (7) ITA)
Withholding tax on income from licenses (S. 36 (1) (a) (c) ITA)	
Act No. 92/2017 Coll. on international cooperation	

Source: author´s own processing

Czech tax legislation on licensing is based on the OECD and the EU initiatives (recommendations or guidelines). As of 1 May 2004, Council Directive 2003/49 / EC on a common system of taxation of interest and royalties between affiliated companies of different member states was implemented in the Income Tax Act (hereinafter "ITA"). The aim was to ensure a uniform approach for residents and non-residents, as well as to tax the payment of interest and royalties only in one member state (exclusion of double taxation).

In the Income Tax Act, the exemption of royalties in connection with the above-mentioned Directive is dealt with in Section 19 (1) (zj). This exemption relates to royalties from a company resident in another EU Member State, Switzerland, Norway from a commercial corporation that is a tax resident of the Czech Republic. The possibility of liberation is fulfilled under certain conditions. The basic condition is to carry out a transaction between the so-called capital-linked persons (the share represents at least 25% of the registered capital) and the second condition is that the beneficiary must be the real owner of this license. The exemption is made by decision of the tax administrator. The taxpayer must apply for this decision.

Unless the taxpayer fulfills the conditions for exemption, his income from royalties is taxed with a 15% of withholding tax (Section 36 (1) (a) of the ITA). Withholding tax can be subsequently calculated, under certain conditions, for the tax liability established on the basis of the tax return (submitted in the Czech Republic). In case the taxpayer comes from a state which has concluded a double taxation treaty with the Czech Republic, the provisions of this contract related to royalties prevail over the national regulation. Typically, the withholding tax on royalties in these contracts varies between 5-10%. However, if the taxpayer is not a resident of the EU or of the European Economic Area and the Czech Republic does not have a double taxation treaty with the taxpayer (or an international agreement on the exchange of information in tax matters), the withholding tax is 35% (Section 36, (1) (c), ITA). Assessing the relevance of the costs associated with the use of the license (or royalties) is rather complicated. The intangible nature of the licenses granted and the difficulty to identify properties (form of transaction, degree of protection, assumption of profit from the use of assets) form the basis for targeted tax optimization (in the sense of overestimating the licenses granted), especially among related parties (members of holdings). The OECD Transfer Pricing Directives (OECD, 2017) seek to prevent these unfair practices. In line with the principle of market separation, the same relationship should be established between related parties as between unrelated parties. In Czech tax legislation, the requirements of the Directive are implemented by provisions (Section 23 (7) of the ITA). In this sub-clause of the Act, the basic rule for transfer prices is laid down and also the related persons (not only capital-linked, but also persons of close or otherwise connected persons) are also defined.

The pressure of international communities to eliminate problematic tax practices has grown heavily in recent years. Besides legislative regulation of taxpayers' behavior, tools for fighting tax administrations against aggressive tax practices of holdings are also necessary to implement in the legislative environment. Act No. 92/2017 should help limit aggressive tax planning damaging national budgets. The essence of this law is the possibility of an international exchange of information not only on certain transactions but also on tax opinions of individual control authorities and the possibility of comparing the so-called usual prices in different countries. This should complicate licensing agreements that make it possible to export business profits to foreign countries. Earned business profits would thus strengthen the state budget in the country where the business operates. The mode of taxation of income (or expense) from licenses in the Czech environment and its impact on the state budget is synthesized in Table 3.

Table 3 Effect of the tax solution of revenues and expenses from license fees on the state budget of the Czech Republic

License provider	Taxation of income from royalties by withholding tax	Claiming fees for royalties in the Czech tax base	Influence on the revenue side of the state budget
EU residents (capital- linked persons)	exempt	in full (tax savings of 19%)	- 19%
CR non-residents, without contracts	35%	in full (tax savings of 19%)	+ 16%
CR non-residents, concluded contracts	5 -10%	in full (tax savings of 19%)	- 14%; - 9%

Source: author´s own processing

The table shows the impact of the tax levy of royalties on the revenues of the Czech state budget. In the event that royalties are paid to an EU resident (subject to the capital-linked persons), the proceeds of the transaction are exempt. The expenses associated with payment for licenses are reflected in the tax base of a domestic taxpayer. This creates a tax saving of 19% for the company. This amount will not be paid to the SR (for the SR there is a "loss"). In the situation when the license fees are collected by an EU non-resident (which does not have a double taxation treaty with the Czech Republic or an exchange of information agreement), this income is taxed at a rate of 35%. Compared to taxpayers' tax savings (from license fees), the revenue of the state budget represents only the difference between the withholding tax and the tax saving that is 16%. In the situation when the income from the license fee flows to the company from the state with which the Czech Republic has concluded contracts (Double Taxation Avoidance Agreement, Agreement on the Exchange of Information), the "loss" of SR is 14, or 9% (depending on the amount of withholding tax on royalties under individual contracts). From the above, it is obvious that it is important for tax administrations to monitor not only the regime of taxing income from licenses but also the relevance of license fees and their application in the tax base.
O legislative standards.

4 Discussion

Project research activities in the field of intangible assets focused primarily on the issue of Czech accounting and tax legislation. There are obvious trends in the accounting and tax area in approximating national legislation towards international regulation. Amendments to accounting legislation reflect the

provisions of IFRS regulating the substance of intangible assets, their useful lives and, subsequently, their depreciation. There are a number of expert works demonstrating the growing share of intangible assets in the structure of corporate assets and their importance for successful company management. With the growing importance of intangible assets, space for broad tax optimization is expanding. Trend analysis of depreciation utilization development as a tool for tax optimization confirms these facts. The tax legislation on intangible assets and the method of depreciation has undergone relatively dynamic developments. Since 2004, the basic attributes of intangible assets have stabilized from the point of view of income tax. However, tax optimization is not only related to depreciation. Holding structures transfer rights to intangible assets between affiliates in different countries to optimize their tax liability very effectively. These practices of aggressive tax planning are currently facing major criticism and regulation by the OECD and the EU. The article examines sources of Czech law related to transactions with intangible assets, or in other words to grant licenses. Czech tax legislation regulates both the taxation of income from licenses and the fees for royalties. Different regimes of licensing taxes are to a different extent reflected in the revenues of the state budget of the Czech Republic. In the next period, the research activities of the project will focus on the issue of intangible assets in the international environment and wider possibilities of regulation of transnational tax optimization.

5 Conclusion

The use of intangible assets and their tax optimization is currently a highly debated issue in the international economic environment. The OECD and the EU initiatives actively stand up against the practices of complex holding structures that purposefully transfer profits from one country and move them to favorable tax destinations. This aggressive tax planning is based on several key attributes. An intangible asset is an important tool in this process. The principle of tax optimization is the transfer of rights to intangible assets (e.g., transfer of royalties) between related companies operating within holding structures in countries with different tax regimes. This situation distorts the competitive equilibrium of the market, creates room for huge tax evasion and damages primarily small and medium-sized enterprises. These companies cannot, by their very nature, create complicated tax structures and tax fairly on income in the country in which they operate. In recent years, the pressure of the international community on the transparency and fairness of transnational transactions has grown. The backbone of this process are legislative norms that should eliminate or mitigate problematic tax transactions. The EU countries adopt the necessary measures in their tax legislation and national tax administrations communicate and exchange the necessary information on tax procedures. It is in the interest of all developed countries to limit or eliminate the above practices. The tax on business profits then remains in the jurisdiction in which it was generated.

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Primary Paper Section: A

Secondary Paper Section: AE