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New trends in intellectual property and tax burden of innovative corporations

Ivana Košťuríková^{a*}, Monika Chobotová^a

^a*Silesian University in Opava, School of Business Administration in Karvina, University sq. 1934/3, Karvina 733 40, Czech Republic*

Abstract

Intellectual property is an important tool that helps to improve the competitive position of companies on the market. The government makes an effort to promote the protection of intellectual property in the Czech Republic; the current system of legal protection is in accordance with EU law and many agreements, which are related to this problem, are signed. This year a new form of patent so called the Single European Patent was approved and it should help to motivate the innovative companies to protect their intellectual property. The main aim of this paper is to evaluate the tax burden of innovative corporations focusing on the tax benefits that are related to income incurred by intellectual property. Secondary aim is to present the issue of intellectual property protection (definition and current legal system).

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1. Introduction

For companies investing their capital, quality and the specific form of tax environment is one of the most important criteria, which have substantial effects on selection of the right place of their business. In the sphere of direct taxes the important external factor is the tax competition between single countries and that is also in the frame of the expanded European Union. The comparison of the income tax of legal entities showed in the last decade unambiguously the decreasing tax burden of firms. However, beside that economic behaviour of companies in

* Corresponding author. Tel.: +420-596-398-624; fax: +420-596-312-069.

E-mail address: kosturikova@opf.slu.cz

connection with positioning their capital abroad reacts on comparability of tax conditions in single countries. You can find more information in paper “Implicit corporate taxation” (Košťurková, 2011).

The companies, that want to maintain and improve their market position, must also continually look for opportunities to create innovation. Sufficient innovation (or innovation performance) enables companies, which are localized in developed countries, to be successful in goods and services in increasingly interconnected world markets where they are confronted with strong competition from developing economies besides other things. The current dynamic development of the market environment transferred the intellectual property and its development to the forefront. The importance of patent protection is also increasing due to rapid technological developments in certain fields such as IT. On the market there are always new products, process marketing innovations that arise as a result of continuous customer needs. Some available statistical data can found in Licences 2012 (Czech Statistical Office, 2013).

This paper describes a system of legal protection of intellectual and industrial property in the Czech Republic. Furthermore, the paper presents new supportive factors to promote the protection of intellectual property and exemplifies corporate tax burden that companies can use as an advantage of tax allowance in the form of a patent box.

2. Determination of intellectual and industrial property

The authors of the paper are of the opinion the current system of intellectual property protection is fully in accordance with the principles of the market economy and follows legal regulations of intellectual property protection and the legal environment is fully harmonized with European Union law.

2.1. Intellectual property

Intellectual property (IP) is a specific area of the economy. The current terminology related to the issue of intellectual property is not quite the same in the Czech Republic. The authors understood and used in practice to describe the different categories of objects of intellectual property somewhat different terms. Intellectual property as a broad term is “a set of rights to inventions, industrial designs, trademarks, business firms and business names, scientific discoveries, the rights to protection against unfair competition and all other rights, which are related to intellectual activity in the industrial, scientific, literary and artistic spheres, that means trade secret rights, know-how, improvement proposals, plant varieties, topographies of semiconductor, appellations of origin and geographical indications, the so called intellectual property in the field of mental activities that means the industrial property or intellectual property in the strict sense” (Špindler, 2007).

Intellectual property in the strict sense can be understood as “a set of rights to copyright works as the individual results of creative activity and intellectual property rights, which associated with them, such as the performance artists, sound recordings, television broadcasts, etc.” (Špindler, 2007). A different definition is presented by Dobiáš, who sees intellectual property as “... the intangible assets that have arisen from mental activities. It is independent of the material substrate and as such can be used by an unlimited number of entities anytime and anywhere in the world without detriment on its essence. Intellectual property is a legal and economic abstractions, which is the sum of various objectively (perceptible by the senses) expressed intangible objects which are neither things in today's legal sense nor the rights themselves, but as the intangible assets they are eligible to be independent subjects of legal and economic relations. The subject of alienation (sale donation, contribution, inheritance or other transfer) cannot be intangible objects themselves, but only their rights can be. That is why we talk about intellectual property rights...” (Dobiáš, 2008).

In the Convention of the World Intellectual Property Organisation from 1967 there is not given definition of intellectual property directly, but there is only the following list of subjects, which the legal protection of intellectual property specifically refers to:

- literary, artistic and scientific works,
- artistic performances and artwork, phonographic records and radio broadcasts,
- inventions in all fields of human creation,
- scientific discoveries,

- industrial designs,
- trademarks, business names and designations,
- protection against unfair competition,
- all other rights flowing from intellectual activity in the industrial, scientific, literary or artistic.

Intellectual property is a synonym for intangible property; it is a good, which is a kind of elusive. It is not expressed in materialized form but as a creature formed human thinking. For the company the IP is an intangible asset that contributes to the performance of the company and is incorporated into the organizational structure of the establishment in the form of structural capital, into employees in the form of human capital and into relationships with suppliers, customers and partners in the form of trade capital, as shown in figure 1 (European Commission, 2010).

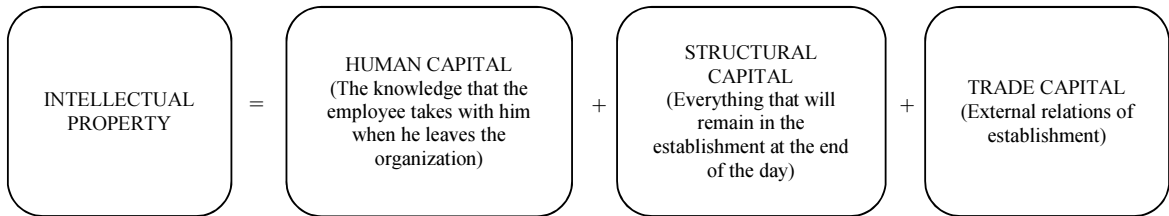


Fig. 1. Intellectual property in companies.

3. Industrial legal protection

If an enterprise wants to gain a monopoly position in the market, one the way to achieve this is to use industrial legal protection. Intellectual property rights give a certain protection which is intended to prevent illegal use. Owners of intellectual rights have the right to stop, allow, or even encourage the use of this right. Right to provide a license to use innovation allows the holders of the rights to exercise significant control over their innovations. Generally, there are two ways to protect your inventions, either in the form of trade secrets or legislative protection in the form of patents, utility models, industrial designs, trademarks, appellations of origin and geographical indications.

3.1. Territorial protection

All the tools of intellectual property (IP) are applied in the Czech Republic just as in member countries of European Union. Patent application and protection are provided by the relevant national authorities. So far, there is no example in the field of patents tool of protection in which the owner when filing a patent application and validation of acquired so-called “international patent”, which would guarantee protection immediately with more states at once. He always has to apply in each state separately. Current possibilities of territorial protection are:

- **National patent** provides national protection in a selected state, usually a patentee chooses a country where he lives or operates the business.
- **European patent** is a kind of protection, which is given by the European Patent Office (EPO). EPO is a separate organization, which has 35 member states.
- **International patent** is a global form of protection that can be applied to the 41 states that have a contract Patent Cooperation Treaty (PCT). However, owner of innovation must seek validation of protection separately in each of these countries. He can simultaneously seek patent protection for an invention in more than 5 PCT member countries when bringing a single international application under the PCT. This application can be filed at the national or regional patent office or the PCT receiving office at the World Intellectual Property Organization (WIPO) in Geneva, Switzerland.

Table 1. Advantages and disadvantages of territorial protection.

Territorial property	Advantages	Disadvantages
National patent	the most accessible financially	patentee must pay fees in each country where he wishes to patent property
Europe patent	in the same application can obtain protection in multiple countries	if the request was rejected, then already fail to get protection in some of the other member countries
International patent	can simultaneously apply for patent protection for an invention in more than 5 member states	substantive examination of an invention must be done through national patent offices in each country where protection is to be awarded

The current trend of total connection economies has resulted in the legal protection obtained only in one country does not ensure sufficient protection for the owner. On the other hand, obtaining legal protection in multiple countries is very expensive and costly. For this reason, there is a convergence of intellectual property rights in recent decades, especially the harmonization and provide adequate protection in particular through the conclusion of international treaties and agreements. An important role is performed by international organizations such as WIPO, WTO or the European Communities in these processes (Boháček & Jakl, 2002).

3.2. Patent family

The term “patent family” is not legally defined. A patent family is a set of either patent applications or publications taken in multiple countries to protect a single invention by a common inventor(s) and then patented in more than one country. A first application is made in one country – the priority – and is then extended to other offices. However, despite this it is possible to define certain generally accepted rules that apply to this concept. Following criteria are for definition the patent family:

- The starting point for the design patent family is the relationship between patent document and its priority or priorities in the importance of the provisions of the Paris Convention.
- The members of the patent family, the individual patent documents published in different countries published applications, granted patents, other forms of legal protection that they have, or at least based on one and the same technical solutions, which are identifiable by date of priority rights.

Patent family may take the form of a list of published patent documents from around the world, describing the same technical solution, or as a list of published patent documents that cite the common number and date of the priority application, but it is also a method of summarizing global legal protection of a technical solution. Alternatively, it may be a protective documents relating to technical solutions, which are not considered legal protection abroad does not exceed the number two or three publications (depending on the progress of a particular state in the publishing industry and legal documents). This type of patent family is most common in states with large internal market, such as Germany or Japan (Exelová, 2006).

4. New trends in support of the intellectual property protection

Order to support the protection of intellectual property there were created new support factors. Whether, it is a new form of legal protection in the form of the Unified European Patent, or various tax incentives, such as the Patent Box, which should help improve the current trend.

4.1. The Unified European Patent

At the beginning of 2013 there was signed international agreement creating a unified patent court, signed by ministers of 24 EU countries. In 2013, an agreement was signed also by Bulgaria after EU joins also Croatia. Only two states do not want to sign this agreement, and those are Poland and Spain.

This agreement is the third element of the patent package, which consists of the European patent with unitary effect of a translation of the patent and the agreement on the patent judiciary. The objective of the Unified European patent is to create a uniform system of protection for patents in EU member states, and especially cheaper access to patent protection for businesses. The patent agreement creates a new system of unified patent court for disputes of the European patent and the European patent with unitary effect.

In the Czech Republic a creation of a single EU patent is perceived as a very useful support for the intellectual property protection of European businesses and of course the Czech enterprises. The new system should provide a simpler and cheaper patent with effective protection. This form of protection should greatly contribute to strengthening the competitiveness of Czech exporters of goods with high added value, but also the strengthening of innovative enterprises in the EU. It is expected that the first European patent with unitary effect will be awarded as early as 2014.

It will mean an inventor can file a single application with the European Patent Office with no need to validate it one by one in each country, a process that involves complex validation requirements and huge translation costs. In the event that the owner wanted to get protection in multiple countries, he had in every state to file a patent application and get the validation. This activity increased patent costs associated with protecting innovation, because it was necessary to perform language translation, to pay administrative fees and businesses due to time and technical difficulty of having to hire a patent attorney, who is represented by the patent offices. Great positive aspect of this new patent will establish a unified patent court, which should be an intergovernmental agreement of participating countries during the year. The delegation of exclusive jurisdiction to the only judicial body should provide patentees with significant cost savings, which now arise because of the need to keep separate parallel proceedings in each state. Creating a unified patent litigation system with one set of procedural rules also facilitate access to justice. In particular, it is expected consistency in practice of EU patent matters (Kuba, 2013).

4.2. *The Patent Box*

In Hungary, it is so called “property box” in the United Kingdom there is used the name “patent box”. In both cases there is a special tax relief on income from intellectual property, patents, utility models, etc. The Patent Box (PB) focuses on patent protection than other forms of intellectual property, and because it has a strong connection to science and research is being used in innovative companies across many industries. PB is an incentive for innovative companies to develop new innovative patented products (Chrenko & Hrdlička, 2012).

In Hungary the Patent Box came into force on 1st January 2012 and it is the possibility to deduct 50 % of income so called “royalties”, which represent revenues from licenses, patents and all intellectual property, know-how, trademarks, business names, business secrets, copyrights etc., from the tax base of the corporate income tax (CIT). The maximum deduction is limited and must not exceed 50 % of the total pre-tax profit determined from the company's accounts. There is also another possible tax allowance. It is taxation of capital gains from the transfer of intellectual property, for which the company may decide on total relief from corporate income tax. If the company uses this opportunity, it will not include a potential loss associated with the transaction in the tax base of CIT. Practical experience has shown that holding companies dealing with intellectual property and operating in Hungary achieved effective tax rate from 0.5 % to 5 % (Chrenko & Hrdlička, 2012).

This form of tax allowance was introduced in 2013 in the UK. The tax rate is 10 % and is applied to all profits from intellectual property. The scheme is focused on three main categories of revenue:

- licensing revenue and royalties,
- direct sale of patent rights,
- proceeds from the sale of proprietary products.

This tax incentive is not used on intellectual property in the form of trademarks or names, but in Hungary it is allowed. Other income is taxed by the standard corporate income tax rate, which is now in the UK 24 %. In the UK the Patent Box entitled patents all national and European patents validated in a country, no matter when the patent is granted. Entitlement to PB does not arise only to the filing of a patent application, but the patent to be granted. Issue of patent cannot be only accelerated by the reason company wants to use the Patent Box (HM Revenue & Customs, 2013).

PB should not only help to increase the incentive of intellectual property protection but also to attract foreign companies with high added value. It should support the achievement of the objective of Great Britain, which is to become a future world leader in patented technologies (Chrenko & Hrdlička, 2012). The following table gives an overview of countries of the European Economic Area, which are entitled to use the Patent Box in the UK, including the basic amount of the corporate tax rate in 2013 (Intellectual property office, 2013).

Table 2. Countries with a claim to the Patent Box in the UK and their basic corporate tax rate in 2013.

Country	Tax rate	Country	Tax rate	Country	Tax rate
Austria	25 %	Finland	24,5 %	Portugal	25 %
Bulgaria	10 %	Germany	15 %	Romania	16 %
Czech Republic	19 %	Hungary	19 %	Slovakia	23 %
Denmark	25 %	Poland	19 %	Sweden	22 %
Estonia	21 %				

5. Tax burden of innovative corporations

When innovative corporations are taking a decision about the location and implementation of their business activities, they also find out the tax consequences of such activities. Kubátová (2010) claims taxes significantly influence decisions about financing and investment activities of companies. According to Široký (2008), appropriate adjustment of corporate tax rate may stimulate businesses for more economic activity. European Union does not intend to unify national tax systems; however it tries hard to achieve mutual comparability, which would be based on the previously accepted and introduced treaties in the EU. The major mission of the European Union tax policy is to ensure smooth operation of the internal market, particularly free move of goods, services and capital, not to unify national tax systems, but ensure equal conditions on the European market, remove tax obstacles of international business, fights against harmful tax competition (Blechová & Janoušková, 2011) and prosecute tax frauds.

The tax policy should also support other general goals of the EU, which include the economic growth, employment and competitiveness, as well as the environmental and energy goals. Discussions have been held in the EU for several years concerning harmonisation of direct taxation, particularly corporations, and in connection with the tax neutrality (Kolář, Vitek, Pavel, Kubátová, Štrach, Kubíček et al., 2005). In spite of that, taxation of companies with respect to the mobility of its base remains the subject matter of sharp tax competition among the individual states of the European Union (Baldwin & Krugman, 2004). Smith has already mentioned the tax competition in his work “An Inquiry into the Nature and Causes of the Wealth of Nations” (Smith, 2007).

The individual countries attempt to attract new investors, who would support the economic growth of the whole country in a form of additional tax income as well as new job positions. On the other hand, foreign investors select a country with a low tax burden for their company. Comparisons of taxation burden concentrate on a number of related facts. In most cases, entrepreneurs address the question by comparison of statutory corporate income tax rates.

5.1. Statutory taxation

The simplest alternative is the comparison of statutory corporate rates of income taxes. For its simplicity and easy availability of data, this comparison has been becoming the most commonly applied. The following figure 2 shows the top statutory rate of income tax of corporations in the individual countries of the European Union in 2013 (Eurostat, 2013). It may be deduced from it that the Czech Republic with the rate of 19 % amounts below the EU-27 average rate, which amounted to 23.2 % in 2013. The countries with the highest corporate rate over 30 % include France, Malta, Belgium and Italy, neighbour Poland with the rate of 19 % are on the same level; another group includes on the contrary, the countries whose rate amounts below 19% frontier include Romania, Latvia, Lithuania and Ireland and the lowest rate of 10 % can be found in two EU countries, i.e. Bulgaria and Cyprus.

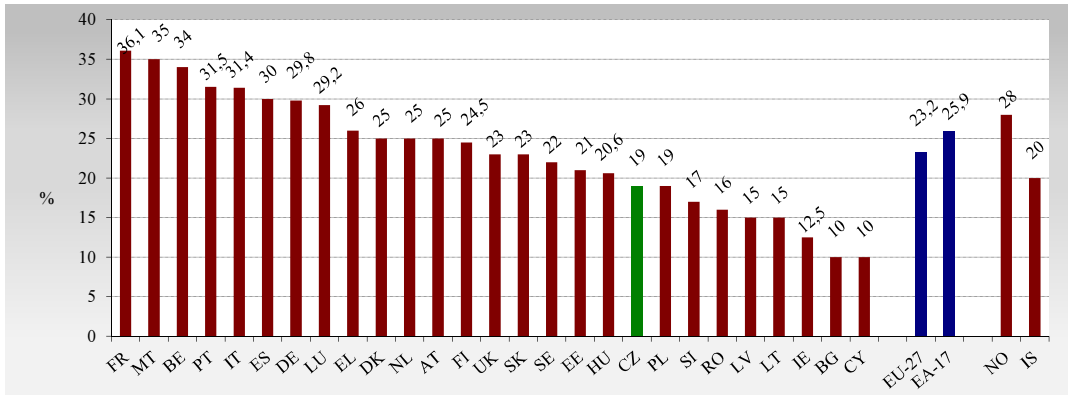


Fig. 2. The top statutory tax rate on corporate income in 2013.

The statutory income tax rates may include not only so called nominal tax rates, but also tentative or permanent additional taxes and reliefs, which requires sufficient attention. In addition, the construction of tax is different in the individual countries, because a considerable number of these countries levy corporate tax at different levels of the state administration.

Different rules for setting corporate tax base and its amount, which are caused by individual tax legislations in the particular countries, are also a substantial limitation for objective comparison of the burden of companies by statutory income tax rates in those countries. Consequently, for the purposes of the reciprocal international comparison, statutory tax rates are not quite an appropriate and objective indicator.

Implicit corporate tax rate appears to be an appropriate measure of comparison of effective taxation of corporations, which are tax rates where consideration is taken not only of the amount of the statutory tax rates from corporations' rates, but also other aspects of taxation systems determining the total amount of effectively paid taxes. Therefore, account is taken of the tax base and the method (if any) by which the systems of corporate and personal income taxes are integrated.

The following figure 3 (Eurostat, 2013) presents the development of the implicit tax rate of corporate income in the years 2000–2011. Data weren't available for Bulgaria, Romania and Croatia, therefore the implicit tax rate of EU-25 is stated here.

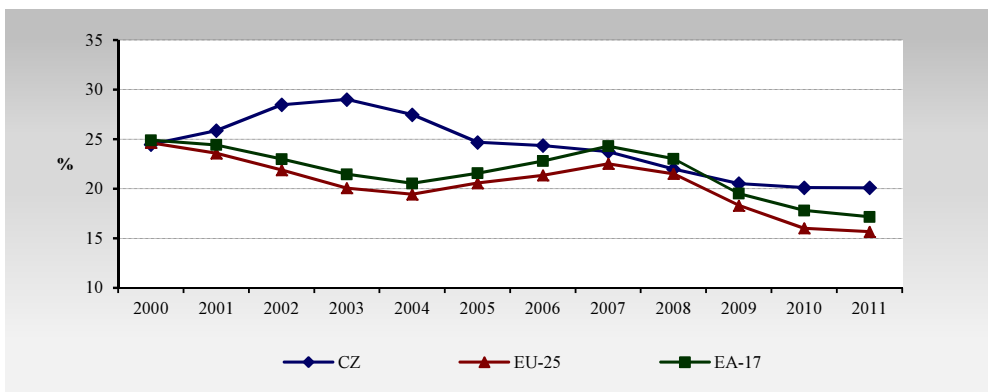


Fig. 3. The development of the implicit tax rate of corporate income in the years 2000 - 2011.

Even though statutory corporate tax rates decreased as a result of the tax competition, the proportion of the tax on companies' profit in the total tax incomes increased up to 2007, which is presented in figure 4 (Eurostat, 2013). However, as a result of the global economic crisis in future years there has been a decline in revenues of corporate

taxes, which still continues in the Czech Republic, while in the EU there has been a slow increase as a result of economic recovery from 2009.

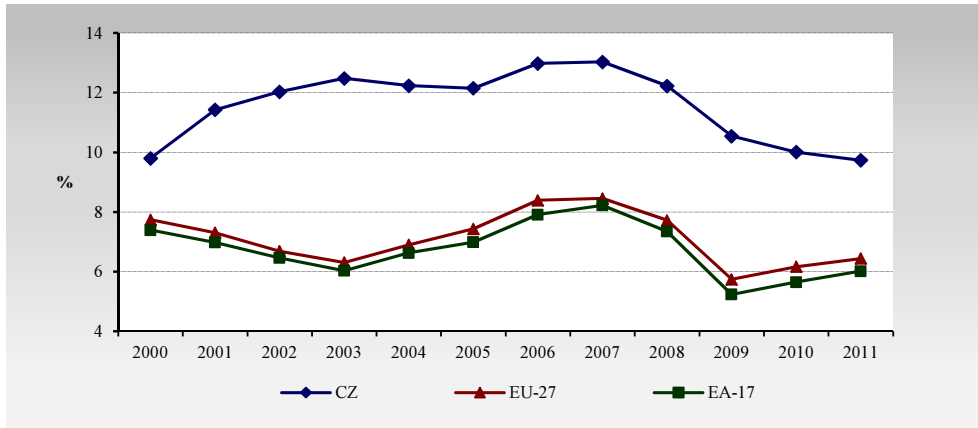


Fig. 4. The proportion of the tax on companies' profit in the total tax incomes in the years 2000 - 2011.

5.2. Tax burden with the application of the Patent Box

As already mentioned above, in the UK there has been applied tax allowance “Patent Box” in 2013. If a company chooses to use the deduction on income tax, which applies to the Patent Box, then it can make the following calculations according to the company’s tax return or separately in writing. This discount may apply within two years after the end of the accounting period in which incurred by the profits and revenues relating to the protection of intellectual property.

The full benefit of the regime will be phased in from 1 April 2013. Each company will need to apply an appropriate percentage to the profits that earns from its patented inventions. The appropriate percentages for each financial year are presented in Table 3 (HM Revenue & Customs, 2013).

Table 3. Percentage share in the profits in financial years.

Financial year	Profit share
1 April 2013 - 31 March 2014	60 %
1 April 2014 - 31 March 2015	70 %
1 April 2015 - 31 March 2016	80 %
1 April 2016 - 31 March 2017	90 %
from 1 April 2017	100 %

Before actually calculation is needed to calculate how much profit accrues to the protection of intellectual property and how it is thus possible to reduce the tax. Calculation of income tax after deduction of allowances associated with the Patent Box is as follows:

$$RP \times FY \% \times \left[\frac{(MR - IPR)}{MR} \right] \tag{1}$$

In the formula (1):

- RP is the profits of a company's trade relevant to Patent Box
- FY% is the appropriate percentage for each financial year
- MR is the main corporate tax rate

- IPR is the reduced rate of 10 per cent

This approach is used to avoid complications if company claims losses or other reliefs.

Examples

If a company has trade Corporation Tax profits of £3,000,000 in the financial year from 1 April 2013, which qualify in full for the Patent Box, and the main rate of tax is 24 per cent, then instead of arriving at a tax charge of £300,000 by multiplying £3,000,000 by 10 percent, the calculation is presented in table 4 by authors.

Table 4. Corporate income tax applying the Patent Box deduction in one financial year.

Calculation	Amount/percentage
Profits chargeable to Corporation Tax	£3,000,000
Patent Box deduction $£3,000,000 \times 80\% \times [(24 - 10) \div 24]$	£852,632
Profits chargeable to Corporation Tax	£2,147,368
Tax payable ($£2,147,368 \times 24\%$)	£515,368
Tax burden ($£515,368 \div £3,000,000 \times 100$)	17.18 %

Where the company's accounting period falls within more than one financial year it is necessary to apportion the profits that company earns from its patented inventions in that accounting period to each financial year. For example, a company has trade Corporation Tax profits of £3,000,000 in the year ended 31 December 2016 which qualify in full for the Patent Box, the profits are apportioned as follows (by authors):

- Profits falling in financial year 2015 (1 January 2016 to 31 March 2016): $91/366 \times £3,000,000 = £745,902$
- Profits falling in financial year 2016 (1 April 2016 to 31 December 2016): $275/366 \times £3,000,000 = £2,254,098$

Table 5. Corporate income tax applying the Patent Box deduction in two financial years.

Calculation	Amount/percentage
Profits chargeable to Corporation Tax	£3,000,000
Patent Box deduction $(£745,902 \times 80\% + £2,254,098 \times 90\%) \times [(24 - 10) \div 24]$	£1,531,489
Profits chargeable to Corporation Tax	£1,468,511
Tax payable = $£1,468,511 \times 24\%$	£352,443
Tax burden ($£352,443 \div £3,000,000 \times 100$)	11.75 %

In the Czech Republic there is no similar tax statutory instrument, which is associated to the protection of intellectual property, and does not plan for it, even though our country is criticized by OECD for over-reliance on industrial technologies, patents and researchers from abroad.

6. Conclusion

For a potential investor, who contemplates an extension of his business activities abroad, is the specific amount of the rate of corporate tax substantial information. The tax rate and its amount are not the only variable, but a significant role is also performed by the tax base, which is formed in a different way and which is used for the calculation of the final tax liability. In Europe there are created different incentive instruments to promote the protection of intellectual property; example is the so-called Patent Box, which is a special tax benefit, which applies to income incurred by the intellectual property protection. The approval of the Unified European Patent, which unlike the present form of the European patent will enable companies after filing a patent application to obtain intellectual property protection in several countries at once, is an another incentive.

Patent Box as a form of tax allowance is used in Hungary and Great Britain. If Czech companies own patent, which is validated in Great Britain, they can apply this benefit in this country. If the innovative corporations use this tax relief, then their tax payable will be £515,368 with the profits of 3 million pounds within one financial year and their tax burden will be 17.18%. If their accounting period falls within two financial years, their tax payable will be £ 352,443 for the same profits and their tax burden will amount to 11.75%. If they have not benefited from tax relief, their tax payable would be in the amount of £ 720,000 and the tax burden would correspond to a tax rate of 24 percent.

In the Czech Republic there is not enacted that form of tax allowance. Although there is the corporate tax rate 5% lower than the corporate tax rate in the UK, the tax burden of innovative corporations would be increased by almost 2% within one financial year and even 7.25% within two financial years due to the inability of the Patent Box.

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