<u>CONTENT</u>

1. Preface

All of us know the very famous sentence mentioned on many places and in movies, „There is nothing certain but death and taxes“. It is often heard that taxes are the price we have to pay for civilized society. One of the first definitions of tax by U.S. Supreme Court described a tax as „ an extraction for support of the government“. Predecessor of current tax we can already find in ancient Roma and Greece.

Tax system is in every country determined by sufficient law sources. Tax regulations and laws can vary from country to country. Tax system is the mirror of the current state economic situation and it is not by chance that the tax laws that are due to many changes very often. The governments are in this situation constantly under the pressure. States need to collect as much money as possible to be able to expand their activities. On the other hand people and companies want to pay less and less on taxes. Some taxes are connected with international trade so the governments are trying to unify their taxes with other states. When considering a tax rate, government has to respect social, technical and economical aspects of tax collection too.

From all these we can understand that taxes are something unavoidable that helps the government with fulfilling our demands for various services such as medical care, education system, defense, roads and etc. Taxes were, are and will be.

Corporate income tax is sometimes called Queen of the tax in connection with other taxes. To be able to answer all the questions and solve all the problems connected with Corporate income tax we have to know not only law connected with Corporate income tax, but accountancy regulations and all the other basic regulations connected with Income Taxation too.

These are main reasons why I am interested in this topic and why I am going to write my bachelor thesis on the topic Corporate income taxation in Czech Republic and USA. USA is the main business partner of European Union and many Czech companies are somehow connected with the companies in USA. So it can be very interesting to get to know similarities and differences of Corporate income taxation systems of both countries.

2. Goal of the work and methodology

The aim of this work is to compare the system of Corporate income taxation in the Czech Republic and USA and to demonstrate the differences on the practical examples.

First of all I created structure of the work and discussed it with my lecturer. I had to characterize basic terms in area of taxation. Also I needed to find information especially about USA tax systems because there were not many books available in Czech libraries. Then I read needed materials and selected the most important aspects of Corporate income taxation of both countries. Another step was, to compare selected information about Corporate income tax in Czech Republic and USA. I mainly used descriptive and comparative methods in these parts.

During my work I was informing my lector about the development and the results of the work. I went ahead step by step, like I wrote above, using methods of data comparison, graphs and calculations.

All work is separated in to two main parts; Theoretical and Practical part.

In the theoretical part I explained basic terms often used in my work then I tried to point out main aspects of Corporate income tax in Czech Republic and I did the same with USA Corporate income tax. I was first interested in source of the Corporate income tax, concepts of the Corporate income tax and its history. Later on I continued with definition and explanation of main terms like; Tax payer, Subject of taxation, Tax base, Tax rate, Taxable period, Techniques of tax collection (Tax return and Withholding tax), Tax prepayments.

In practical part I compared differences in Corporate income tax of both countries, term by term with respect to theoretical part. The goal of the practical part was to show some interesting differences on calculation of practical examples using data of fictional companies.

In Appendix, all forms needed for correct filing of tax return are included. In this work I tried to show who and when can file which form.

The goal of this work was not complete and detailed description of both taxation systems, but to make general, simplified survey. So my work is not and as bachelor work can not be a complex study of corporate income taxation in both countries.

3. Theoretical part

3.1. Basic terms

Tax - Internal Revenue Service defines a tax as „an enforced contribution, exacted pursuant to legislative authority in the exercise of taxing power, and imposed and collected for the purpose of raising revenue to be used for public or governmental purposes. Taxes are not payments for some special privilege granted or service rendered and are, therefore, distinguishable from various other charges imposed for particular powers or functions of government“

Tax is kind of involuntary contribution required by law to finance government and function of state.

In general the tax is calculated as: Tax = Tax base x Tax rate

Tax avoidance - avoiding paying tax using legal methods

Tax evasion - avoiding paying tax using illegal methods

Tax haven - is a place where taxes are lower than average

Tax payer - a person who or organization that pays taxes

Tax return - a statement of a person's income for purposes of tax assessment

Tax shelter - financial arrangement to minimize tax liability

Tax therapist - a tax advisor who helps with the completion of income tax forms

Taxation – the act of levying taxes; amount raised as a tax

Tax-deductible - legitimately deducted from income before tax assessment

S corporation - according to the Murphy, K.E. – Higgins: A corporation that elects to be taxed as a conduit entity. An S corporation retains the non-tax characteristics of a corporation, while allowing the income of corporation to be taxed to the shareholders.

S corporation is a corporation that is not carrying a capital loss from, or to, a year for which it is an S corporation. Than to be able to qualify as an S Corporation, a corporation must fulfill these obligations-

- Must be a domestic corporation
- May not have more than 100 shareholders (who can not be nonresident aliens)
- Can not have as their shareholder's only individuals, estates, tax-exempt organizations, certain trusts
- Must have only one class of stock outstanding

- Must have the consent of all shareholders to the election of S corporation status

Tax base – is the value that is subjected to the tax, for the federal income is called taxable amount

Tax rate - when working with federal income tax we can calculate different measures of the rate paid every year. To compare this it helps us to make better decisions about future and tax planning.

1. The marginal tax rate - is the rate of tax that will be paid on the next dollar of income or rate of tax that will be saved by the next dollar deduction
2. The average tax rate - total federal income tax divided by taxable income that is taxable
3. The effective tax rate - total federal income tax divided by the tax payer's economic result (taxable income plus nontaxable income)

Tax rate structures - is the structures explain how the tax rates varies according to the tax base

1. Proportional rate structure - the average tax rate remains the same as the tax base increases (referred to as *flat tax*)
2. Regressive rate structure - the average tax rate decreases as the tax base increases
3. Progressive rate structure - the average tax rate increases as the tax base increases

Exclusions - is an increases in a tax payer's wealth and recoveries of the tax payer's capital investment that government has decided should not be subject to income tax

Deferrals - is an item that does not affect the current period's taxable income but will influence taxable income in the next taxable year

Gross income - is an income minus income items that are excluded from taxation. It is starting point for reporting income items on a tax return

Deductions - are matter of legislative grace, subtractions from gross income (expenses, losses, exemptions)

Exemptions - are amounts that are permitted to be subtracted to determine taxable income

Tax prepayments - are used in the pay-as-you-go system that requires the payments of the tax as the income is earned and when the tax payer has resources available for paying the tax

Tax credits - is a direct reduction in the income tax liability

Tax evasion – occurs when a tax payer uses a not legal methods or deceptive behavior to hide the actual tax liability

Tax avoidance – is the use of legal methods allowed by the tax law to minimize a tax liability (like tax planning)

3.2. Corporate income tax in Czech taxation system

Since the last tax reform in year 1993 Czech taxation system has following structure:

- Direct taxes - Income tax, Property tax, Inheritance tax, Gift tax, Real estate tax, Real estate transfer tax, Road tax
- Indirect tax – VAT, excise duties

The Czech Corporate income tax rate is *direct* and *proportional.* It means that the tax rate is still the same no matter how much is the tax base of the tax payer and is paid straight to the tax authority. Just for comparison, the personal income tax is progressive. That means the higher is income, the higher is the rate of tax when calculating tax liability of tax payer.

3.2.1. Sources of Czech Corporate income tax law

The current statutory source of Corporate income tax is in Collection of Laws, Income tax Act. The Law number 586/1992 of law collection, about income tax. The highest Czech Tax Authorities are Ministry of Finance, Financial directory and financial office where tax payer has to submit his tax return.

3.2.2. General concepts of Czech tax system after the last amend a law in 1.1.1993

1. Concept of fairness - the same rights for all companies
2. Concept of general taxation - all types of properties are taxable
3. Concept of effectively - by the taxation motivate right activities
4. Concept of harmonization - with EU taxation systems

3.2.3. History of the Czech Corporate income tax

During the years the tax rate was dropping as we can read from the Table 1.

Table 1: History of the Czech Corporate income tax in numbers

Year	**Tax rate**
2006	24%
2005	26%
2004	28%
2003	31%
2002	31%
2001	31%
2000	31%
1999	35%

Very interesting trend we can read from Table 2. The lower the tax rate was the more money government collected on taxes.

Table 2.: Government income by collection of taxes in Czech Republic

	2001	**2002**	**2003**	**2004**	**2005**
Nominal Income of government by collection of tax (in billions CZK)	92	106	116	120	*139
Inflation rate (%)	4,1	0,6	1,0	2,8	*2,5
Tax rate (%)	31	31	31	28	26

Source: Ministry of finance (http://www.mfcr.cz/cps/rde/xchg/mfcr/hs.xsl/makro_pre_21388.html)

*Prediction MFČR

3.2.4. Tax payer

Tax payers of Corporate income tax are subjects not considered as a payer's of personal (individual) income tax and organizational parts of government.

Corporate income tax is levied on all incomes from the activities of the legal entities.

The most important legal forms of enterprises are:

- Sole proprietorship
- Partnership
  - Co-partnership
  - Limited partnership
- Corporation
  - Limited company
  - Joint-stock company
- Co-operative

1. Co-partnership is tax payer of Corporate income tax that is not obliged to fill the tax return. Because the subject of Income tax of Co-partnership company is divided between their members.
2. Czech National Bank is totally exempted from Corporate income tax.
3. Tax payer, resident and non-resident:

In the case of legal entities the tax payer with unlimited tax liability (resident) is considered to be the entity with its seat in CR and is obliged to pay income tax from incomes flowing from all the resources situated on the area of Czech Republic and also from incomes from the resources situated abroad.

Tax payer with limited tax liability (non-resident) is obliged to pay income tax only from the incomes flowing from the resources situated on the area of Czech Republic.

3.2.5. Subject of taxation

The subject of Corporate income tax is income from all activities and from every manipulation with properties. Income can be both monetary and non-monetary.

Subject of Corporate income tax is not:

- Income gained from shares in „ Privatization"
- Income gained from inherited or gifted property – that is subject of inheritance tax or gift tax
- And some other others according to the tax regulations

According to § 18 Tax law some tax payers (Fond of National Property, Public Universities, Health Insurance companies, Politics parties, Government Funds, Churches, Municipality offices, etc.) have different regulations for specifying their tax base. These organizations do not tax incomes obtained by fulfilling their mission.

The subject of taxation of non-profit organizations is:

- Income from advertising
- Membership contributions
- Income from renting (exemption is income from renting state owned properties)
- And some others according to the law

The subject of taxation of non-profit organization is not:

- Income from activities fulfilling their mission, if costs on this activities are higher than incomes from this activities
- Income from grants and donations from government or state municipalities
- Income from monetary interests on current accounts
- And some others according to the law

Exclusions - incomes excluded from taxation (according to the Jaroš 2005):

- Membership contributions
- Contribution of the members of the church, incomes from the church acts, revenue from church collections
- Incomes from the operating of ecological facilities
- Incomes from state price regulated rent on flats, garages
- Incomes from operation of small water power stations up to performance 1 MW
- Incomes from Funds of children and youth
- Incomes from lotteries and other similar games
- And some other cases according to the § 19

Corporate income tax Computational Framework according to Vybíhal (2003):

1. Income (broadly defined) = Revenue - Expenses
2. Gross Income = Income - Excluded items – (Operations that decrease the tax base + Operations that increase the tax base)
3. Taxable Income = Gross Income - Deductions and exemptions
4. Taxable Income = Tax base (rounded down on all thousands)
5. Tax = Tax base x Tax rate - Tax credits

3.2.6. Tax base

Tax base is computed after adding operations that higher it and subtracting operations that lower it and rounded down on all thousands.

The model of double-entry bookkeeping that is used in our country is not tax accounting. That means the income from the operations needs to be adjusted to become a tax base.
To calculate the tax base we have to add to the income, income from operations, operations that higher it and subtract operations that lower it.

Operations that increase the tax base:

- Made out invoice which was not recorded in book-keeping
- Unpaid delay charges that was not recorded in book-keeping
- Representation expenses (but not including the gifts with the business logo or the name of the company with the value under the 500 CZK)
- An amount by which the accountancy depreciation exceeds the tax depreciation
- The sum of social and heath insurance which was withheld by employer but was not paid yet
- Paid gift tax
- Costs of meals over the limit according to the law
- Pocket money on the business trip abroad over the 40% of the meal limit
- Transport cost of employees to work place and back (as a transport vehicle is considered vehicle able to carry 10 or more persons)
- Cost of employee’s accommodation temporary carrying work out off work place (up to 3500 CZK a month)
- Etc.

Operations that decrease the tax base:

- Invoice that was not recorded in book-keeping
- Unpaid delay charge that was not recorded in book-keeping (company has made out invoice but he invoice was not paid yet)
- Silent partner's share in profit
- An amount by which the tax depreciation exceeds the accountancy depreciation
- Etc.

Deductions - Items that can be deducted from the tax base (according to the Jaroš 2005):

- The loss (can be transferred into 5 after each other following years, tax loss is rounded up on all hundreds, loss can not be deducted if in a tax paying subject, major change in high management who is controlling and directing capital was made - by major change we understand change of partners or vote rights which is bigger than 25 %, or when one partner gains major influence on company)
- Gifts (at least 2000 CZK and up to 5 % of the tax base or up to the 10% in case of gift to universities or public research institutions, non-profit organization can not deduct gift from tax base. Gift can be made on behalf of municipalities, regions, organizational parts of government, legal entities with the seat in Czech Republic, individuals that run educational organization, medical organization, organization for environmental or animal protection, or individuals who are disabled or with long term illness or kids for covering rehabilitation tools, medical care and educational tools. Gift can be made on science, research, educational, medical, charitable, cultural, sport, ecological, animal protection purposes and as help to run political parties and policy or fire security of Czech Republic.)
- The cost connected with research and development (from the taxable period starting in year 2005 the tax payer can deduct 100% of costs on research and development, the tax payer can not use this deduction on research and development connected with services or if on this research was already used grant from public funds or if the result of research is intangible. If is not possible to use deduction due to financial loss in year when there is right to use it, tax payer can deduct this amount in next taxable period when company shows financial profit or in the next following 3 taxable periods.)

- Non-profit subject can decrease their tax base by 30 % but 1 million at maximum, if 30% is less than 300 000 CZK, then can be deducted 300 000 CZK. That means non-profit organization with lower tax base than 300 000 CZK does not pay any tax.
- So called reinvestment made under the conditions before year 2004 (tax payer can deduct 10%, 15%, 20% from acquiring costs on tangible property if following conditions were met: it has to be property on which is possible to use deduction according to the law, tax payer has to be the first owner of this property, the renter must be the first renter of the property which is the lender first owner and did not use this deduction of reinvestment property by himself. Right to use deduction of reinvestment expires if in following 36 months after the end of taxable period where deduction of reinvestment was made if property was discarded or rented)
- Education of pupils on secondary schools in training centers (tax payer can deduct 30% of costs on secondary education of youth)
- Employee fringe benefits (Pension contributions - up to 3% of the year gross salary of the employee, Private life insurance - up to 8000 CZK in one taxable year for one employee, Meals during the working time - up to 55% from the price of the meal for one employee in one working period or max 70% of all meal costs in case of business trip in length of 5 to 12 hours) - according to the (Děrgel 2002).

3.2.7. Tax rate

Corporate income tax rate in 2005 was 26% and in the year 2006 is24%. There is a reduced tax rate for certain types of corporations.

A reduced rate applies to:

- investment companies
- investment funds
- pension funds

The rate of Corporation income tax is reduced constantly to encourage economic activity, so that for instance, the rate of corporation tax in 1992 was 45% as compared to the current rate of 24%. See the Table 1: History of the Czech Corporate income tax in numbers.

- A tax of 15% is imposed on dividends paid by Czech corporations
- Income from interest is deemed ordinary income and as such is taxed at 26%

Special Tax rates:

In case of withholding tax generally tax rate of 15% is applied. Mainly used for taxation of income from dividends or share of profit.

There are also items that can be deducted from tax liability - Tax credit:

- 18 000 CZK for every disabled employee
- 60 000 CZK for every heavily disabled employee
- One half of the tax liability, if the employer employs more than 25 (from year 2005) employees and more then 50% of than are disabled.
- Tax credit for tax payers with promise of investment incentives according to the law (this tax payers can use for following 10 years so called „tax holidays“)
- One half of the acquiring costs of registration cash register, max. 8 000 CZK and only until 30.6.2006
- 30% of technical improvement of cash register fulfilling conditions for registration cash register max. 4 000 CZK and only until 31.12.2006

Tax does not have to be paid if the tax liability is lower than 200 CZK. The final tax liability is rounded up on full CZK.

Allocation of tax

The tax must be allocated in three years from the end of the taxable period. If there was made an action or step in allocation the tax the three years period starts to run from this moment again. The three years period is repeatable renewable. The latest date for allocation of tax is 10 years from the end of taxable period. There are some special deadlines for allocation of tax in §35 law number 337/1992.

3.2.8. Taxable period

Taxable period for legal entities is after the amendment of law:

- Calendar year
- Accountancy period, if this is longer then calendar year
- Economic year, accountancy period that can start only by first day of different month then January

The taxable year in the Czech Republic is for most of the companies the calendar year ending on December 31.

3.2.9. Techniques of tax collection

- Tax return - collection by tax return
- Withholding tax - collection by separate tax base

3.2.9.1. Tax return

Every legal entity is obliged to file tax return whether or not they have taxable income.
Tax return does not have to be submitted by:

- Non-profit organizations if their income is not subject of tax
- Co-partnerships (because their taxable income is divided between their members and their tax it separately)

The annual return must be submitted by March 31 (3 months after the end of the tax year). If you use service of an authorized Czech tax advisor, you may make an application to submit the return by June 30. If you have an income from abroad you can postpone submitting of tax return up to 10 months (October 31).
In a case of liquidation, the tax payer has to submit tax return in the end of the following month after the end of accounting period. A delay in submitting an annual return will entail fines, in most cases, of 10% of the tax liability. Fines are imposed even after tax has been prepaid.

Types of tax return:

- Regular tax return (submitted until 31. March)
- Corrective tax return (has to be submitted in the same date like regular tax return but will correct the first one)
- Supplementary tax return (submitted after the regular tax return)

If the tax payer records real expenses he must - record revenues and expenses with precise date, tangible and intangible property that can be depreciated, claims and liabilities in the period when the rental is finished, wage sheets in case he is employer. The penalty is charged if the tax payer fails to submit the tax return on time. Penalty is calculated as 0, 1 times the amount owed by the tax payer in the first 500 day of delay. After that day penalty is calculated as 140% of Central bank discount rate of the first day of each quartile. If the tax return was not submitted on time, the tax officer can increase the tax liability by 10% in total.

Tax return has to be submitted to Tax Office.
Tax forms are included in Appendix A, B.

3.2.9.2. Withholding tax

Withholding tax is collected there, where is tax some percentage of income in the moment of acquiring this income. The tax payer must pay withholding tax until the end of the following month after the date when he was supposed to pay this tax to local financial office. If he did not paid this tax he would be penalized for that.

<u>By withholding tax specific incomes are taxed by rate</u>:
1% - Incomes from leasing payments by financial leasing
15% - Income from dividends, share in profit, leaving company share, share in profit
in case of company liquidation, prizes from public competitions, interest and other returns from loans, credits, other similar incomes of legal entities, returns on investment, return on deposits, benefits from life insurance reduced by paid insurance, share on participation in process of unit trust liquidation, bonds, obligations, notes, deposit certificates, etc.

Tax form is included in Appendix C.

3.2.10. Tax prepayments

Rates of tax prepayments are similar for both Corporate income tax and Personal income tax. According to the amount of last tax liability; the tax payers are obliged to pay tax prepayments every half or quarter of the year.

- Tax payers whose last tax liability did not exceed the amount of 30 000 CZK and municipalities, regions are not obliged to pay tax prepayments.
- If the last tax liability was higher than 30 000 CZK but did not exceed 150 000 CZK, the tax payer is obliged to pay tax prepayments. The rate is amounted to 40 %

of the last tax liability. The first prepayment is payable by 15th day of the 6th month and second by the 15th day of the 12th month in the taxable year.

- If the last tax liability exceed 150 000 CZK, the tax payer is obliged to pay tax prepayments. The rate is amounted to ¼ of last tax liability. These tax prepayments are payable by 15th day of 3rd, 6th, 9th, 12th month in the tax period.
- According to the § 67 law number 337/1992 the tax officer in some cases can change the amount of tax prepayments or cancel them at all for the tax payer.
- Tax prepayments are rounded up on all hundreds
- If the last known tax liability was calculated from period shorter or longer than 12 months, we have to recalculate it for purpose of calculating current year tax prepayments in this way:

(Last known tax liability calculated from period of X months / X months) * 12

3.3. Corporate income system tax in USA Taxation

An official income tax has not always existed in the United States. After the years of oppression under the thumbs of corrupt corporate executives, in early 20th century Congressional leaders created a national income tax law (in 1914) primarily to make the wealthiest to pay their fair share.

These days in the USA exist 2 types of income taxes. Federal Tax that is something like the Corporate income tax in Czech Republic and then State income tax. Each state has different tax law and regulations for the State tax. The aim of this work is to compare USA Federal Corporate income tax and Czech Corporate income tax. So in following text I am going to intent on Federal Tax only.

Major type of U.S. taxes-

- Income Taxes (Individuals, Corporations, Estates and Trusts)
- Employment Taxes (Social Security taxes - 7,51% paid by employee and the same amount paid by employer as well, Self-employment tax, Unemployment taxes: SUTA-State unemployment tax - 0,8% and FUTA - Federal unemployment tax - 5,4%)
- Sales Taxes
- Property Taxes
- Other Taxes (Excise taxes, Wealth transfer taxes)

3.3.1. Sources of tax

Primary sources of Federal Income Tax Law

<u>Legislative sources of Federal Income Tax Law</u>:

The authority for the imposition of the federal income tax law is found in Article I, Section 7, of the U.S. Constitution. The current statutory source of federal income tax law is the *Internal Revenue Code of 1986 and Tax Treaties.*

<u>Administrative sources of Federal Income Tax Law</u>: The Internal Revenue Service is part of the Treasury Department that is responsible for interpreting and administering the tax law. The overall interpretation of the Internal Revenue Code is called *Treasury regulations* and is issued by Treasury Department. The Internal Revenue Service issues revenue rulings and revenue procedures in fulfilling its function interpreting and administering the tax law.

Judicial sources of Federal Income Tax Law: The first institutions where tax payer can initiate litigation are Trial Courts (there are three: U.S. District Court, U.S. Court of Federal Claims and U.S. Tax Court). Decisions of the district courts and a Tax Court are appealed to regional U.S. Courts of Appeals (there is 12 of them in U.S.). All decisions of appellate courts may be further appealed to the U.S. Supreme Court.

Secondary sources of Federal Income Tax Law

Tax services: Tax services are tools for locating the primary authorities related to various factual situations.

Citators: Citators are used to determine the history of judicial decisions.

Tax periodicals: Publications dealing with tax issues served as secondary source of tax information.

3.3.2. Concepts of U.S. Income tax system

A concept is a broad principle that provides guidance on the income tax treatment of transaction. Concepts are broad. A construct is a mechanism that has been developed to implement a concept. A doctrine is a construct that has been developed by courts.

- General Concepts: Ability-to-Pay Concept, Administrative Convenience Concept, Arm's Length Transaction Concept, Pay-as-You-Go Concept
- Accounting Concepts: Entity Concept, Annual Accounting Period Concept
- Deduction Concepts: Legislative Grace Concepts, Business Purpose Concept, Capital Recovery Concept
- Income Concepts: All-Inclusive Income Concept, Legislative Grace Concept, Capital Recovery Concept, Realization Concept, Wherewithal to Pay Concept

General concepts of USA tax system (according to the Adam Smith)

- Equality - A tax should be based on the taxpayer's ability to pay. The payment of a tax in a proportion to the taxpayer's level of income results in an equitable distribution of the cost of supporting the government.
- Certainty – A tax payer must know when and how to pay tax. And he has to be able to determine the amount of tax to be paid.
- Convenience – A tax should be levied at the time it is convenient for the tax payer and when he is able to pay that means when he receives income.

Economy – A tax should have minimum compliance and administrative costs. So the amount that goes to U.S. Treasury is as large as possible.

3.3.3. History of the USA Income tax

The first income tax law was issued, on August 5, 1861 as part of the Revenue Act of 1861 in order to help pay for war effort in American Civil War - (3% of all incomes over US $800 - cancelled in 1872). Again was income tax introduced in 1913. The rate was 1 % on taxable net income above $3,000 ($4,000 for married couples) - less deductions and exemptions. It rose up to a rate of 7% on incomes above $500,000. During World War I. the top rate rose to 77 percent. After the war the top rate was scaled down (to a low of 25 %). During the Great Depression and World War II, income tax rate was reaching 91%. In 1964 the top rate was cut to 70%, and then to 50% in 1981. The Tax Reform Act of 1986 reduced the top rate to 28%. During the 1990s the top rate was standing at 39.6%. The Job Creation and Workers Assistance Act of 2002 provided tax relief to businesses and included a 13-week extension on unemployment insurance and tax breaks for taxpayers affected by the Sept. 11, 2001, terrorist attacks. The Jobs and Growth Tax Relief and Reconciliation Act of 2003 accelerated the tax rate cuts that had been enacted in 2001, and temporarily reduced the tax rate on capital gains and dividends to 15%.

3.3.4. Tax payer

Corporation

Rules to determine whether a business is taxed as a corporation:

- A business formed under a federal or state law that refers to it as a corporation, body corporation, or body politics
- A business formed under a state law that refers to it as a joint-stock company or joint-stock association
- An insurance company
- Certain banks
- A business wholly owned by a state or local government
- A business specifically required to be taxed as a corporation by the Internal Revenue Code (for example certain publicly traded partnership)
- Certain foreign business

Partnership

Generally partnerships do not pay tax on their income because all profit or loss is divided between their members (partners) who are tax on their share of the income or loss. Partners must include partnership items on their individual tax return.

(An unincorporated organization with two or more members is generally classified as a partnership for federal tax purposes if its members carry on a trade, business, venture or financial operation and divide its profit between them. An organization is classified as a partnership if it has two or more members and it is none of the previously written as rules to determine corporation.)

I case of *S Corporation*, shareholders are taxed on their share of the income.

In case of *Sole proprietorship* the owner is taxed on the income.

3.3.5. Subject of taxation

Exclusions - incomes excluded from taxation (according to Murphy & Higgins):

Donative's Items:

- Gifts (received gifts are not subject of taxation, but the donor is subject to the gift tax rules on the making the of a gift)
- Inheritances

Investment-related Exclusions:

- Municipal bond interest (in general, interest income is fully taxable but the tax law provides an exclusion on interest earned on bonds issued by municipalities)
- Stock dividends (does not constitute a realization of income. A dividend paid in stock of the same company is merely "slicing the pie" into small ownership units, with no resulting increase in shareholders wealth.)
- Discharge of indebtedness (borrowing money or repaying back borrowed money is not a taxable event but if the lender forgives all or portion of the debt of the borrower, the borrower realizes increase in wealth from the reduction of liability and is taxable on discharge of indebtedness)
- Improvements by a lessee (owner does not have income when lessee makes improvements to the owner's property. This allows the property owner to defer the gain

in value of the property from improvements until the property is sold, at which time the owner will have the money to pay the tax on the increased value from the improvements by lessee)

Income tax Computational Framework (according to Murphy & Higgins):

1. Income (broadly defined) – Excluded items = Gross Income
2. Gross Income – Deductions and exemptions = Taxable Income
3. Taxable Income x Tax rate = Income Tax
4. Income tax – (Tax credits + Tax prepayments) = TAX (refund) due with return

3.3.6. Tax base

Corporation

The corporation rounds off cents to whole dollars on its return. If corporation does not round the whole dollars, it must round all amounts. The corporation must round down amount smaller than 50 cents and round up amounts from 50 to 99 cents.

Deductions - Items that can be deducted from the tax base (according to Murphy & Higgins):

- The loss (A corporation can deduct capital loss only up to the amount of its capital gains, the remaining loss is carried forward up to 5 years and carried back up to 3 years.)
- Below - Market Loans (A loan on which no interest is charged or on which interest is charged at a rate below the applicable federal rate.)
- Charitable contributions (In case of Corporation, can be claimed up to 10% of the taxable income for the taxable year and excess of contribution may be carried forward for five years. In case of Partnership and S Corporation, it is separately stated item. Partners and shareholders can deduct it as itemized deduction. In case of sole proprietorship it is not deductible in calculating operating income, must be deducted on owner's return as itemized deduction. Charitable contributions can be made in behalf of religious, charitable, educational, scientific, literary organizations and federal, state, local governments.)
- Certain dividends in some percentage (Dividends from domestic corporations, small business investment companies - can deduct 100% of dividends received from taxable

domestic corporation, ownership dividends, dividends from regulated investment companies, dividends on deposits.)

- Extraordinary dividends
- Capital expenses – must be qualified as a business start up costs (Costs you incur to get your business started such as surveys and analyses of the market, travel to develop the business and local customers and suppliers, advertising the new business, salaries to train employees, start up legal and accounting fees, certain costs can be chosen to be amortized over the period of 60 months and more.) or an organizational costs (Legal service, accounting service, fees paid to the state, expenses to the temporary directors and management team, employee fringe benefits.). Start up costs and organizational costs are deductible up to $5,000 and the remainder is amortizable over 180 months. Expenditures must be qualified as ordinary, necessary and in reasonable amount.

Business expenses – Most common expenditures in trade or business like utility payments, salaries, rental payments etc., are not subject of any special rules. But some certain types of expenses have both business and personal aspect and are subject to special rules.

Meals and entertainment: A tax payer may deduct 50% of costs of meals and entertainment connected with business purpose.

Auto expenses: A tax payer can choose two methods for computing deductions for using a car for business purpose. Standard mileage method (is easier to calculate but results in smaller deduction, tax payer can deduct 40, 5 cents for each mile in year 2005) and actual cost method (more complicated to calculate but results in higher deduction). The costs of using a car for driving from home to work and back is not considered as business expense.

Travel expenses: Travel expenses include transportation, lodging, 50% of the costs of meal, incidental costs. For an expense to qualify as business travel must be the employee or tax payer away from his home overnight.

Business gifts: A tax payer can deduct up to $25 per year per donee for gift to business customers.

Education expenses: Education expenses can be deducted if it is requirement for the tax payer to continue employment or if the education improves the skills required in the tax payer’s business.

Insurance expenses: Insurance paid to protect tax payer’s business from loss is deductible.

Taxes: Some taxes are allowed as deductions some are not. Common types of deductible taxes (state, local and foreign real estate taxes; state, local and valorem personal property taxes; state, local and foreign income taxes; payroll taxes imposed on an employer; sale taxes, excise taxes, fuel taxes, franchise taxes, and other miscellaneous taxes).
Legal fees: Legal expenses are allowed as deductions if they have a business purpose.

The year in which a deduction is taken is determined by the tax payer's accounting method. He can choose from two accounting methods: Cash method (expenses are deduct when paid) and Accrual method (expenses are deducted when the all events and economics performance has occurred). Accrued expenses, owed to a related cash basis tax payer, are not allowed as deduction until the product or service is paid and included in the cash basis tax payer's income.

Related persons

A corporation that uses an accrual method of accounting can not deduct business expenses and interest owed to a related person who uses cash method of accounting until
the payment and corresponding amount is containable in the related person's gross income.
For purpose of this rule, related persons are:

1. Another corporation that is member of the same controlled group.
2. An individual who owns more than 50% of the value of the outstanding stock of the corporation.
3. A trust fiduciary when the trust or the grantor of the trust owns more than 50% in value of the outstanding stock of the corporation.
4. An S corporation if the same persons own more than 50% in value of the outstanding stock of each corporation.
5. A partnership if the same person owns more than 50% the value of the outstanding stock of each corporation and more than 50% of the capital or profits interest in the partnership.
6. Employee-owner if the corporation is a personal service corporation.

Partnership

Partnership income or loss: Partnership computes its income and files its return in same way like corporation. But certain deductions are not allowed to the partnership. A partner's income or loss is partner's distributive share of partnership income or loss.

Figuring distributive share in Partnership: The partner's distributive share of the partnership items is generally determined by the partner's interest in the partnership.

Partner's interest in partnership: If a partner's distributive share of a partnership can not be determined under the partnership agreement, it is determined by his or her interest in partnership.

Partnership expenses paid by partner: A partner can not deduct partnership expenses paid out of personal funds unless the partnership agreement requires the partner to pay the expenses.

Partnership distribution (according to the IRS): is including the following –

- A withdrawal by a partner in anticipation of the current year's earnings.
- A distribution of the current year's or prior year's earnings not needed for working capital.
- A complete or partial liquidation of partner's interest.
- A distribution to all partners in a complete liquidation of the partnership.

The basis of partner's interest:

The basis of a partnership interest is the money plus the adjusted basis of any property the partner contributed. Basis of an interest in a partnership is increase or decrease in by certain items:

Increase –

- Additional contributions to the partnership, such as increased share of or assumption of partner's liabilities.
- The partner's distributive share of taxable and nontaxable partnership income.
- The partner's distributive share of the excess of the deduction for depletion over the basis of the depleted property unless the property is oil or gas wells whose basis has been allocated to partners.

Decrease –

- The money and adjusted basis of the property distributed to the partner by the partnership.
- The partner's distributive share of the partnership losses
- The partner's distributive share of nondeductible expenses that are not expenditures.

The partner's deduction for depletion for any partnership oil or gas wells, up to the proportionate share of the adjusted basis of the wells allocated to the partner.

3.3.7. Tax rate

In U.S, Corporate income tax rate is progressive. That means the higher is taxable income the higher is tax rate. See tax rate schedule Table 3.

Table 3.Tax rate schedule

If the taxable income is :			
Over-	But not over-	Tax is:	Of the amount over-
$0	50,000	15%	-0-
50,000	75,000	$ 7,500 + 25%	$50,000
75,000	100,000	13,750 + 34%	75,000
100,000	335,000	22,250 + 39%	100,000
335,000	10,000,000	113,900 + 34%	335,000
10,000,000	15,000,000	3,400,000 + 35%	10,000,000
15,000,000	18,333,333	5,150,000 + 38%	15,000,000
18,333,333	-	6,416,667 + 35%	18,333,333

Exemptions:

Qualified personal service corporation is taxed at a flat tax rate of 35% on taxable income.

To be considered as qualified personal service corporation, corporation must meet following conditions:

1. All the corporation's activities involve the performance of personal services.
2. At least 95% of corporation's stock is owned by employees performing the personal service or retired employees who had performed the personal services.

Items that can be deducted from tax liability - Tax credits
(according to Murphy & Higgins):

- On fuels used for certain nontaxable purposes
- Credit for prior year minimum tax
- Foreign tax credit
- No conventional source fuel credit
- Possession corporation tax credit
- Qualified electric vehicle credit
- Qualified zone academy bond credit
- Research and experimental credit (available only to corporations and in amount of 20% of qualified research expenditures)
- Child care cost credit (the credit is the sum of 25% of the qualified child care expenses the employer incurs plus 10% of qualified child care resources and referral expenditures associated with providing these services)
- General business credit (major tax credits that make up the general business credit: Investment tax credit, Jobs credit, Alcohol fuels credit, Research credit, Low-income housing, Empowerment zone employment credit, Disabled access credit, Childcare cost credit, Indian employment credit, New markets credit, Welfare-to-work credit, Work opportunity credit), the purpose of general business credit is to limit the amount of tax credits that can tax payer claim. The general business credit is limited to be regular tax liability minus the greater of the tax payer's alternative minimum tax or 25% of the tax payer's net regular tax liability in excess of $25,000. General business credit may be increased by the carry back or carry forward of business credits from other years. To claim this credit the tax payer must get the special form for special kind of business credit. If the tax payer is claiming more general business credits, he has to file more forms.

The alternative minimum tax rate

AMT is nearly like separate, parallel system with special rules and conditions that need to be fulfill in aim to pay alternative minimum tax. AMT is flat rate, for corporations - 20%, individuals – 26% on the first $175, 00 of the alternative minimum tax income and 28% on the alternative minimum tax income in excess of $175,000. Small corporation exemption - can be claimed if it is first year of existence of corporation or it was treated as a small corporation exempt from the AMT for all prior tax years beginning after 1997 and its average annual gross receipts for the 3-tax-year period did not exceed $7,5 million. In this case the corporation can choose to pay AMT.

3.3.8. Taxable period

The annual accounting period concept requires reporting the economic result of operations on an annual basis. The period for which the entity reports is called taxable year.

Taxable year can be:

- Calendar year (ending the December 31)
- Fiscal year (called Tax year as well, is a period of 12 months ending on the last day of any other months than December or a 52 – 53 week taxable year ending on the same day of the week each year)

Corporation

The corporation must figure its taxable income on the basis of a tax year. Accounting year is considered from 1st of January till 31st of December. Generally, corporations can use calendar or fiscal year.

Partnership

The partnerships determines their taxable year as if they were a tax payers. In general, a partnership must use its required taxable year by Internal Revenue Code and conform its taxable year to its partner's taxable year.

Partners can change their taxable year only if IRS allows them to do so. (Corporation can change their accounting period without prior approval.)

Sole proprietorship

Sole proprietorship must use the same taxable year as its owner.

S Corporation

In general, S corporation must use a calendar year for reporting their incomes.

3.3.9. Techniques of tax collection

The federal income tax is a pay-as-you-go tax. A corporation must make estimated tax payments as it earns or receives income during its taxable year. At the end of the year, the corporation must file an income tax return.

3.3.9.1. Tax return

Corporation

All domestic corporations in existence for any part of a taxable year (even corporations in bankruptcy) must file an income tax return whether or not they have taxable income.

Last day of filing the income tax return is 15^{th} of March (or 15^{th} day of the 3^{rd} month after the end of its taxable year).

If the last day of filing the income falls on a Saturday, Sunday or legal holidays, the corporation can file next business day. Tax payers who can not complete their tax return by the regular due to day can apply for extensions of the time for filing the tax return. Corporations are allowed an automatic six-month's extension. Partnerships and trusts can automatically extend their filing date by three months. Using the filing extension does not extend the date for paying the tax. Applications for extension must show and include payment of estimated due tax with the final return.

Corporations must generally file Form 1120 - U.S. Corporation Income Tax Return (Appendix D) or Form 1120-A - U.S. Corporation Short-Form Income Tax Return (Appendix E) if they meet some special requirements and have their gross receipt, income and total assets each under $500 000.

Limited liability companies with more than one owner formed under the state law, general partnerships, limited partnerships and limited liability partnerships are generally treated as partnership for federal income tax purposes and files Form 1065 – U.S. Return of Partnership Income (Appendix F).

Certain organizations like Farmer's cooperative, Religious or apostolic organization, foreign Sales Corporation, Life insurance company, file special returns.

S corporations file the Form 1120-S - U.S. Income Tax Return for an S Corporation (Appendix J).

The corporation must pay any tax due in full no later than the 15^{th} day of the 3^{rd} month. There are two methods how to pay. First one is electronic deposit or deposits with special Form 8109.

Partnership

Every partnership that is engaged in business or has a gross income must file an information return, Form 1065 - U.S. Return of Partnership Income (Appendix F). In this form partnership must show their incomes, deductions and other required information like names and addresses of each partner. The Form 1065 must be filed by 14th of April following the end of the calendar year if it was the accounting period as well. The automatic extension after filing special form is 3 months for partnership.

To help to ensure that tax returns are filed in correctly and on time, the law provides penalties for failure to do so. The penalty is $50 times the total number of the partners in partnership during any part of the taxable year for each month the return is late, up to 5 months. The penalty will not be charged if the partnership can show reasonable cause for its failure to file on time.

Income reporting for partnership requires to report separately some items like (investment income, investment expenses, capital gains and losses, passive activity items, charitable contributions, tax benefit rule items, alternative minimum tax preference and adjustment items, nondeductible expenses and personal expenses of partners, tax credit).

On the Partnership income, partners are taxed according to their partner's share. For this purpose they file Form 1065 (Schedule K1) - Partner's Share of Income, Deduction, Credits, etc.

Sole proprietorship

Sole proprietorship operates as conduits. The individual owner is taxed on the income of the business. For tax return purpose file the Form 1040 (Appendix G).

S Corporation

An S Corporation has similar tax characteristics like partnership and do not pay tax. The income of S Corporation flows through to its shareholders for taxation.

Form 1120-S - U.S. Income Tax Return for an S Corporation (Appendix J) is used to report operating result to government. On the S Corporation income, shareholders are taxed according to their shareholder's share. For this purpose they file Form 1065 (Schedule K1) - Shareholder's Share of Income, Deduction, Credits, etc.

3.3.10. Tax prepayments

Corporation

A corporation must make installment payments if it expects its estimated tax for the year to be more than $500. Generally each required installments is 25% of the income tax shown on the tax return for the previous year. To figure each required installment of estimated tax the tax payer uses Form 1120-W (Appendix H).

Prepayments are due by 15th day of 4th, 6th, 9th, 12th months of the corporation's tax year.

If corporation does not pay prepayments by its due date it may be subject to a penalty.

Tax payer can pay prepayments by electronic deposit or deliver its payment by special Form 8109 to an authorized financial institution.

A corporation that has overpaid its estimated tax for the taxable year may be able to apply for a quick refund of an overpayment of estimated tax by Form 4466 (Appendix I) if: at least 10% of its expected liability and at least $500 was overpaid.

Partnership

Partners have to pay estimated tax on their partnership income during the taxable year.

Estimated tax for individuals is the smaller of the following amounts:

1. 90% of the tax expected to be shown on the tax return of the current year.
2. 100% of the total tax shown on the tax return in the prior year.

4. Practical part

4.1. The Comparative study of Corporate income tax in Czech Republic and USA

Both taxation systems went during the years through many changes a development. In my opinion U.S. taxation system is a bit more complicated and sectioned. U.S. taxation system is more complex with many safety barriers to protect taxpayers against injustice. In last 8 years Czech taxation system decreased the Corporate income tax from 35% to 24%. So we could say that Czech taxation system is still on the way to find the balanced tax rate, where both tax payers and government would be satisfied. U.S. did not change their Corporate income tax rate so rapidly in last years. In both countries the Corporate income tax is direct but in Czech Republic is proportional and in U.S. is progressive.

4.1.2. Tax payer

In Czech Corporate income tax is used for taxation of Corporations (Limited company, Joint-stock company), Partnerships (Co-partnership, Limited partnership), Sole proprietorship and Co-operatives. In USA Corporate income tax is levied on Corporations, Partnerships, Sole proprietorship and S Corporations.

In case of sole proprietorship in both countries the rule for determining its tax liability is the same. In USA Corporations and in Czech Republic Corporations and Partnerships are taxed on their income. But in case of Co-operatives in Czech Republic and Partnerships and S corporations in USA the members and shareholders are taxed on their share of the income. So the main difference I see in case of Partnerships.

In Czech Republic Partnerships are taxed on their income but in USA the Partnership's profit or loss is divided between their members (partners) who are later on tax on their individual income.

4.1.2. Subject of taxation

Income tax Computational Framework is very similar in both countries. There is always some broadly defined Income that is calculated like Revenues minus Expenses. Then from this calculation of Income we deduct deductions and excluded items and multiply it by tax

rate. At the end we subtract tax credit and tax prepayments. Items like received gifts and inheritance are exempted from Corporate income taxation in both countries.
In Czech Republic non-profit organizations have specific regulations for determining their tax base.
In Czech Republic are better conditions for operating social responsible organizations. Contribution of members of the churches, incomes from Funds of children and youth, incomes from operating of ecological facilities and some others are exempted from taxation.
On the other hand in USA municipal bond interest or stock dividends are exempted from taxation. Municipal bond interests are excluded because it lets municipalities raise money for projects at lower interest rate than comparable taxable bonds. That means the investment activities are more supported in USA.

4.1.3. Tax base

The tax loss is in both countries deductible and can be transferred in to 5 following years. In USA can be even carried back up to 3 years.
In USA bellow market loans are deductible.
Charitable contributions are deductible in USA up to 10% of the taxable income for the year and may be carried forward for five years. This is in my opinion very good way how to motivate donators to donate to charity. In law is exactly written who can be donated. In Czech Republic this kind of charitable contribution is called gift and can be claimed if it is at least 2000 CZK. The amount cannot exceed 5% of the tax base or 10% in case that the gift is to universities or public research institutions. In Czech Republic the gift can be gifted to individual person too, if he is disabled and needs to cover his medical care.
The costs connected with research and development is in Czech taxation law deductible up to 100% as a deduction from tax base. In USA taxation system the issue research and development costs is looked after by research and experimental credit (available to corporations and only up to 20%) and research credit that is part of general credit and is deductible from tax liability. So from this I would say that research and development should have better conditions in Czech Republic.
In Czech taxation system is special deduction on education of pupils on secondary school in training centers.

In USA taxation system certain dividends and extraordinary dividends are deductible. Special attention is paid to expenses at all. Capital expenses are deductible in all amounts if they meet conditions for classification as business start up costs and organizational costs. Appealing is the fact that employee fringe benefits are considered as more deductible costs in USA taxation system but not in Czech taxation system. In Czech taxation system are some limitations for including employee fringe benefits as costs for tax reason. From this fact I would make a conclusion that employers in USA are more motivated by government and its taxation system to make the best effort in providing additional financial help and support to their employees than in Czech Republic.

In USA Corporate income taxation system is specially stated what is meant by business expenses and up to which amounts they are deductible. Very interesting for me was to learn that meals and entertainment expenses are deductible up to 50% and in case of business gifts up to $25 per donee per year.

In Czech Republic the deduction of employee's accommodation costs in case they work temporary out of their working place is limited up to 3500 CZK and is newly added to Czech taxation law for the year 2005. In USA the amount is limited to 50% of costs which I think is better. When we start to calculate; for 3500 CZK the employee temporary working out of his working place could be accommodated for about 3-7 nights depending on the location. So in case the employee would be temporary working out of his working place for longer than 3-7 nights employer could not deduct more than Czech taxation law allows him.

In the Czech Republic some other taxes (like excise tax, road tax or franchise tax) are deductible some are not (like income tax as itself).

4.1.4. Tax rate

In tax rate I would see the main difference between Czech Corporate income tax and its "relative" in USA. Both taxes are direct but Czech Corporate income tax is proportional and USA Corporate income tax is progressive. USA Corporate income tax is starting somewhere at 15% at the minimum and ending at the 35% at the maximum. Czech Corporate income tax with the rate 24% is nearly at the middle of that range. I tried to show these differences on the Fig.1.

In Czech Republic are more exemptions from the proportional tax rate 24%.

In case of investment companies, investment fund and pension funds reduced rate is applied. Withholding tax has special rates too. On the other hand USA Corporate income tax rate has some exemptions as well. In case of qualified personal corporations the flat tax rate of 35% is applied.

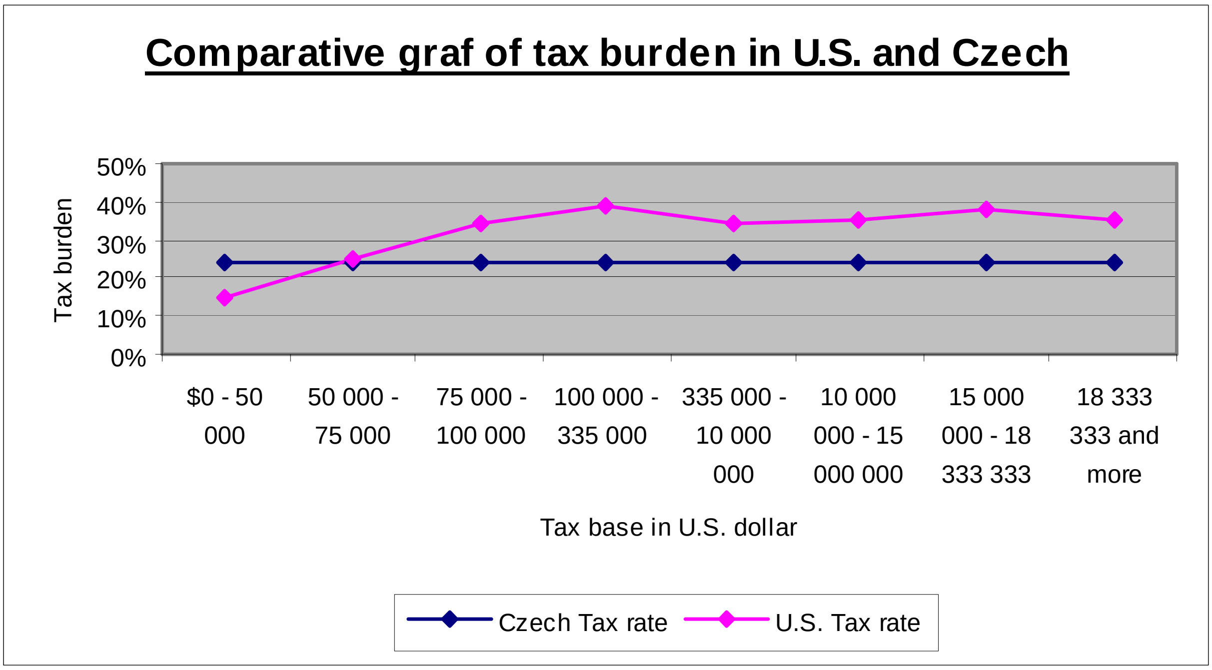

Fig.1: Comparative Graph of tax burden of legal entities in USA and Czech Republic.

In USA tax payers can obtain more various tax credits than in Czech Republic tax payers can. In Czech Republic mostly tax credits for employing disabled employees are applied. Then tax credits connected with new law requirement of cash register and tax credit for tax payers with promise of investment incentives can be applied.

In USA tax payer can choose from many tax credits like (credit on fuels used for certain nontaxable purposes, foreign tax credit, qualified electric vehicle credit, qualified zone academy bond credit, research and experimental credit, child care cost credit and general business credit – the Investment tax credit, Jobs credit, Alcohol fuels credit, Research credit, Low-income housing, Empowerment zone employment credit, Disabled access credit, Childcare cost credit, Indian employment credit, New markets credit, Welfare-to-work credit, Work opportunity credit and some others.)

Another exemption in USA corporation taxation rate is 26%-28% alternative minimum tax rate. In Czech Republic we do not have anything like that, only a rule that if the tax liability is lower than 200 CZK then the tax does not have to be paid at all.

Interesting table comparing Corporate income taxes of OECD countries, I found at OECD tax database:

Tax arrangements affect the decision to invest in a particular country and Corporate income tax rate is the important rate on which to focus. The following Table 4. shows the Corporate income tax rates, net of any credit for paying tax at the state or provincial level and inclusive of any surcharges, of various OECD countries in 2005. Where the state/provincial (sub-central rates) are noted, adding the central and sub-central government rates together derives the overall rate. From this table we can see that the tax burden should be lower and investors should be more attracted to invest in Czech Republic than in USA. Comparing to other countries the results of Czech Republic are good.

Table 4: Corporate income tax rates (2005)

Country	**Central Government Nominal Rate %**	**Representative Sub-Central Government Nominal Rate %**
Australia	30	
Canada	22.1	14 (8.9 – 17)
Czech Republic	26 (24-in year 2005)	
Hungary	16	
Korea	25	10 (5-15)
Ireland	12.5%	
Mexico	30	
New Zealand	33	
Portugal	25	10
Slovak Republic	19	
Spain	35	
Turkey	30	
United Kingdom	30	
United States	32.7	6.6 (6.5–9.99)

Source: Leslie Nielson, OECD Tax Database, Table II.1 Corporate income tax rates[9]

4.1.5. Taxable period

In general, in both taxation systems we can find Calendar year as the main taxable period for most of the legal entities.

USA Fiscal year is in Czech taxation system called Economic year and it is period 12 months long starting first day of different month than January. In Czech tax law we can see another term Accountancy period for longer taxation period then a calendar year. In Czech Republic companies can choose which taxable period they are going to use. In USA, there are some restrictions and recommendations for different kind of legal entities.

4.1.6. Techniques of tax collection

In both USA and Czech taxation systems we can see similar techniques of tax collection. Both of the countries use tax prepayments system. In both countries must legal entities file an income tax return no matter if they will be required to pay a tax or not.

In Czech Republic can company choose from collection by a tax return and withholding tax - collection by separate tax base.

4.1.6.1. Tax return

In tax systems of both countries the tax return must be submitted by every legal entity whether or not legal entity has taxable income.

In Czech Republic exists exemption; tax return does not have to be submitted by Non-profit organizations and co-partnerships. In USA there is not any exemption like that for Partnerships. In USA every Partnership that is engaged in a trade or business or has a gross income must file an information return on Form 1065 showing its income, deductions, and other required information.

In Czech Republic tax return has to be filed by March 31 or three months late if the company uses authorized Czech tax advisor. On the other hand in USA tax return must be submitted by 15^{th} of March and corporation can use automatic 6 months extension, partnerships 3 months extension. There is not a rule that legal entity would have to use authorized tax advisor to be able to use this extension.

In both countries the late submission of tax return is penalized.

In Czech Republic tax can be collected by withholding tax (collection by separate tax return) as well. Specific incomes are taxed by special rate in this case.

In USA there is not any other possibility than to collect tax by tax return. In same special cases company can choose AMT (Alternative minimum tax rate) but still has to file tax return. AMT can be chosen by corporate in the first year of performing its business. AMT is collected by flat rate 20%, which I think is very convenient for small and starting companies.

4.1.7. Tax prepayments

In Czech Republic tax payer is obliged to pay tax prepayments if his last tax liability exceeded the amount of 30 000 CZK. On the other hand tax payer in USA is obliged to pay tax prepayments if he expects his tax liability for the current taxable year to be more than $500. There I see the main difference.

In Czech Republic the tax payer must pay 40% of the last tax liability on prepayments if his last liability exceeded amount of 30 000 CZK and did not exceed the amount of 150 000 CZK. If the last tax liability exceeded 150 000 CZK the taxpayer must pay ¼ of the last tax liability on prepayments. In USA the corporation tax payer is required installments of 25% of the income tax shown on the tax return for the previous year. No matter how high was his last tax liability. First prepayments are due to 15^{th} of March in Czech Republic, April in USA. Other prepayments are due on 15^{th} of 6^{th}, 9^{th}, 12^{th} months in both countries.

In case of partnership, USA tax payers (partners) are obliged to pay tax prepayments as individuals on their partnership income, in the smaller of the following amounts: 90% of the tax liability expected for this year or 100% of the last tax liability. In Czech Republic there is no special treatment for tax prepayments from partnership income.

In Czech Republic tax officer in some case can change the amount of tax prepayments or cancel them at all for the tax payer. This is not possible according to the U.S. Corporate income tax.

4.2. Study cases

4.2.1. Task 1: Figuring distributive share of partner's loss in partnership

Greenwood is a calendar year partnership with three partners, Jane, Mike and Bill. Under the partnership agreement, profits and losses are shared in proportion to each partner's contributions. On January 1 the ratio was 80 % for Jane, 10% for Mike and 10% for Bill. On December 1 Mike and Bill each contributed additional amounts. The new ratio was 40 % for Jane, 30% for Mike and 30% for Bill. For the tax year ended December 31, the partnership had a loss of $2,100. This loss occurred equally over the partnership's tax year.

U.S. version of taxation and loss division among the partners:

Table 5: U.S. version of taxation and loss division among the partners

Partner	**Ratio %**	**X Part of the year held**	**X Total loss**	**= Share of the loss in $**
Jane	80	11/12	$ 2,100	1540
	40	1/12	$ 2,100	70
Mike	10	11/12	$ 2,100	192,5
	30	1/12	$ 2,100	52,5
Bill	10	11/12	$ 2,100	192,5
	30	1/12	$ 2,100	52,5

Czech version of taxation and loss division among the partners:

In Czech Republic the loss division between the partners would be in the same ratio. But in this case we have to be very careful about using the term „Partnership“. In Czech Republic the U.S. term Partnership can have two meanings; Co-operative or the Partnerships (Co-partnership and Limited Partnership). In both cases, there are different rules for taxation. Only the Czech Co-operative is comparable with USA Partnership when we talk about loss division between the partners who can deduct their portion of company loss from their individual tax base. Czech Partnerships are obliged not only file the informative tax return like USA Partnership but pay taxes as well. That means they can use possibility of loss deduction in total amount of loss from their Partnership tax base.

Conclusion:

In both countries the portion of loss division between partners is the same. But in Czech Republic this division of the loss between their partners can be used only in case of Co-operatives. To answer correctly, the task should give us more information about the company. Using these information we could determine whether the company fulfill the legal aspects of Czech Co-operative or not. Then we could answer correctly. In both countries the deadline for deduction of the loss from tax base is 5 years.

4.2.2. Task 2: Calculation of tax liability of corporation JAJA Ltd.

Corporation JAJA Ltd. operates a business that sells fresh cut flowers and plants and files its returns on the calendar tax bases. The Corporation JAJA Ltd. showed economical results 2 300 000 CZK ($1 000 000) in the end of accounting period for the year 2005. Another cases in year 2005:

1. Company showed loss in amount 500 000 CZK in previous year and 200 000 CZK out of that were not used as deduction yet.
2. Company employed 2 disabled, full time employees in the Flower shop garden.
3. Company gave 250 000 CZK as a gift to local University.
4. Company is supporting pupils attending secondary gardening school in training center by amount 50 000 CZK every year.
5. Company had income 150 000 CZK from operating of ecological facilities in flower shop garden, accountant Mr.Bobes forgot to include this income into economical result earlier.
6. Company owned some dividends of Czech company Berka s.r.o. and gained 50 000CZK as income from extraordinary dividends.

Calculation of tax liability of corporation JAJA Ltd. in USA:

2 300 000 – 200 000 = 2 100 000 – (2 100 000* 0,1) = 1 890 000 – 0 = 1 890 000 + 150 000 = 2 040 000 = TAX BASE (CZK)

Tax base in U.S. Dollars[1]: 88 695

Tax liability: 13 750 + 0,34 * (88 695 – 75 000) = $18 406

Final tax liability = $18 406 (423 400 CZK)

[1] For simplificatiton I calculated like $1 = 23 CZK

Economical result was 2 300 000 CZK we have to deduct 200 000 CZK as a loss from previous years, then 210 000 CZK charitable contribution, because tax base was 2 100 000 CZK - we can deduct only 10% of tax base in case of charitable donation. Even when company donated 250 000 CZK, only 210 000 CZK are deductible. Another deduction should be another charitable contribution on education of pupils in training centers, but we already deduct as much as we could (10% of tax base) in case of so called "gifts". But the company can carry over this excess of charitable contribution into the next accounting period, up to 5 years. Incomes from extraordinary dividends are exempted from taxation.

<u>Calculation of tax liability of corporation JAJA Ltd. in Czech Republic</u>:

2 300 000 – 200 000 = 2 100 000 – (2 100 000 * 0, 1) = 1 890 000 – (50 000 * 0, 3) =

1 875 000 + 0 = 1 875 000 = TAX BASE

Tax: 1 875 000 * 0, 24 = 450 000

Tax from dividends: 50 000 * 0, 15 = 7 500

Tax in total: 450 000 + 7 500 = 457 500

Tax minus tax credits: 457 500 – 2 * 18 000 = 421 500 CZK

<u>Final tax liability = 421 500 CZK ($18 326)</u>

Economical result was 2 300 000 CZK we have to deduct 200 000 CZK as a loss from previous years, then 210 000 CZK as a gift because tax base was 2 100 000 CZK - we can deduct only 5% (10% in case the gift is made on behalf of universities) of tax base in case of gift. Even when company made gift 250 000 CZK, only 210 000 CZK are deductible. Another deduction is in case of supporting pupils attending secondary education on training centers – 30% of costs. Income from operating ecological facilities is not taxable income. Incomes from dividends are taxed by withholding tax – 15%. From the tax liability we have to deduct tax credit for two disabled employees – for each 18 000 CZK.

<u>Conclusion:</u>

The final results of tax liabilities were very similar which was surprising for me. When I was calculating the task I thought I am using much more deductions and tax privileges in Czech taxation system. In USA taxation system I could not use charitable donation for pupils attending training centers and tax credit for disabled employees. On the other hand in USA the income from extraordinary dividends did not have to be taxed. But that was only small amount which would not make big difference in result. So I was curious to see what would be tax burden if we were calculating tax liability straight from economical result without using any deductions or tax credits.

Economical result was 2 300 000 CZK ($1 000 000).

In Czech Republic tax liability would be: 2 300 000 * 0, 24 = 552 000 CZK ($24 000).

In USA tax liability would be: 13 750+ (25 000 * 0, 34) = $22 250.

So in this case tax burden in Czech Republic is higher than in USA. But we can not generalize that, because tax rate in USA is progressive. So if the company had different economical result our calculation would be different too. On the top of that, each item in company-search for final tax liability can make a big difference if some special tax rule like possibility of deduction or tax credit can be applied. Or if in the case of tax credit or deductible items excess can be carried over into the next taxable period.

4.3.3. Task 3: Figuring tax prepayments for the corporation Indus Ltd. in year 2005

Corporation Indus Ltd. had tax liability in year 2004 – 115 000 CZK ($5 000)[2]. For the year 2005 tax liability was expected to be somewhere about 138 000 CZK ($6 000) as well. But later on the Corporation Indus Ltd. calculated their tax liability for the year 2005 with result - 92 000 CZK ($4 000). Corporation Indus Ltd. uses calendar year as taxable period.

<u>Figuring tax prepayments for the corporation Indus Ltd. in USA:</u>

Because the tax liability in current year 2005 was expected to be more than $500, the tax payer Indus Ltd. was obliged to pay tax prepayments in amount 25% of the income tax in last taxable period.

5 000 * 0, 25 = 1 250

These tax prepayments are paid by and in amount of:

1. 15th of April …..$1 250
2. 15th of June …..$1 250
3. 15th of September…..$1 250
4. 15th of April …..$1 250

[2] For simplification I calculated like $1 = 23 CZK

So in total the company Indus Ltd. paid $5 000 (115 000 CZK) on tax prepayments. That means company can apply for quick refund of overpayment of estimated tax $1 000 (23 000 CZK), because the company fulfilled the condition, that at least 10% of expected liability and at least $500 had to be overpaid.

Figuring tax prepayments for the corporation Indus Ltd. in Czech Republic:

Because the tax liability in last taxable period was 115 000, the company Indus Ltd. is obliged to pay tax prepayments twice a year in amount 40% of last tax liability.

115 000 * 0,4 = 46 000

These tax prepayments are paid by and in amount of:

1. 15th of June……46 000 CZK
2. 15th of December…..46 000 CZK

So in total the company paid 92 000 CZK ($4 000) on prepayments. Which is exactly the amount of tax liability in year 2005. So there will be no refund or additional payment of tax needed.

Conclusion:

From this case we can see, that tax prepayments in USA are settled to collect on tax prepayments about the same amount as was last tax liability of the tax payer in previous taxable period. No matter how high was his last tax liability. In Czech Republic there are three different levels according to the last tax liability of the tax payer. If the company's last tax liability was smaller in amount than 30 000 CZK, there are no tax prepayments required. If the last tax liability was somewhere between 30 000 CZK and 150 000 CZK, tax payer is obliged to pay tax prepayments twice a year in amount of 40% of tax payer's last tax liability. That is in total 80% of last tax liability a year. Only the tax payers with last tax liability over the 150 000 CZK are obliged to pay on tax prepayments 100% of last year tax liability like in USA. So from this point of view small companies have better conditions when we talk about tax prepayments obligation in Czech Republic. Because in USA every company pays tax prepayments in total amount 100% of last years tax liability if they expect current liability over $500.

5. Conclusion

Nearly all governments are funded by some form of taxation on their citizens. Some of these taxes are collected at the time of a sale or service, but others are collected at the end of a 12-month period called a fiscal year, taxable period.

Corporate income tax is in the United States considered as a progressive tax because the corporation's financial obligations rise with the level of reportable income. A progressive tax is based on the premise that those with higher income can afford to pay more on taxes, and conversely, those with low income should pay less on taxes. However, U.S. tax system has become far beyond progressive. Fully half the taxpayers contribute almost nothing in individual income taxes. On the other hand in Czech Republic the Corporate income tax rate is flat. There is the main difference in Corporate income taxation in these two countries.

In both countries, Corporate income tax can only be levied on positive income, not a net loss. A table provided with the official tax forms by Internal Revenue Service in USA and Financial Office in Czech Republic shows the actual amount of income tax owed to the government according to the company's income. If the amount withheld by the payroll department is higher than this number, the government will issue a refund for the difference. If the number is lower, then the company owes more income tax and must pay the Internal Revenue Service in USA or Financial office in Czech Republic.

Companies can deduct expenses related to their business, which can significantly reduce their tax base. Charitable donations can also be used to offset income tax obligations. A qualified tax Preparation Company or trained accountant can be a lifesaver when it comes to income tax matters.

These days, quotient of Corporate income tax and gross domestic product is used for international comparison of tax burden. According to Eurostat this quotient is in Czech Republic somewhere between 35 and 36%. The average of tax burden in EU is 41, 5%, so in Czech Republic according to this quotient tax burden is below the average. But the important indicator is how much can citizen buy with the money from income after the collection of tax.

In Table 4. – Corporate income tax rates in OECD countries - we can see that tax burden is higher in USA than in Czech Republic. But that is very simplified conclusion.

In my opinion USA tax system offers more various tax credits. But it is very hard to understand all of them and know conditions that must be met in case the tax payer wants to apply for them. From this point of view Czech tax system is more clear and simple, using mainly 3 forms for tax return.

To sum up all, in tax systems of both countries we can find advantages and disadvantage. It depends on the quality and experiences of individual official tax adviser how well he can work for the profit of the company. And it is in responsibility of owners and company managers to choose good official tax advisers, who understands and uses well all advantages and disadvantages of taxation system.

Summary

This work is aimed at comparison of Corporate income tax and taxation of corporations in Czech Republic and USA. In theoretical part, main legal aspects, history and rules of taxation systems in both countries separately are described. In practical part, systems in both countries are compared and interesting basic differences on some practical, fictional examples are showed. This work is an attempt to compare tax burden in Czech Republic and USA. Appendix contains important forms needed for collection of tax in Czech Republic and USA.

Souhrn

Tato práce srovnává daně a systém zdanění právnických osob v České Republice a USA. V teoretické části jsou popsána hlavní pravidla zdanění a právního ošetření daně v každém státě zvlášť. V krátkosti je zmíněna i historie daní z příjmů. V praktické části jsou srovnávány systémy zdanění právnických osob v obou zemích na praktických, fiktivních příkladech a ukázány na nich zajímavé rozdíly. Tato práce je pokusem o srovnání daňové zátěže v České Republice a USA. Přílohy obsahují důležité formuláře pro daňová přiznání jak v České Republice tak v USA.

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Appendix

- **Appendix A – Form 5404** of Ministry of Finance, model 15 **-** Czech Corporate Income Tax Return
- **Appendix B –** The Tax Credit Form for Czech Corporate Income Tax Return
- **Appendix C –** Form for Czech Corporate Income tax collected by Withholding Tax
- **Appendix D – Form 1120 -** U.S. Corporation Income Tax Return
- **Appendix E – Form 1120-A -** U.S. Corporation Short-Form Income Tax Return
- **Appendix F – Form 1065 -** U.S. Return of Partnership Income
- **Appendix G – Form 1040 -** U.S. Individual Tax Return
- **Appendix H – Form 1120-W -** U.S. Estimated Tax for Corporations
- **Appendix I – Form 4466 -** U.S. Corporation Application for Quick Refund of Overpayment of Estimated Tax
- **Appendix J – Form 1120-S -** U.S. Income Tax Return for an S Corporation
- **Appendix K – Form 1120-S (Schedule K1) –** Shareholder's Share of Income, Deduction, Credits, etc.
- **Appendix L – Form 1065 (Schedule K1) -** Partner's Share of Income, Deduction, Credits, etc.