Transfer pricing in agricultural enterprises

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Abstract: International tax issues already have not been problems of multinational enterprises. The effect of globalization and international business development causes that many small and medium size firms including agricultural entities are now engaged in the cross-border transactions and have to face the international tax issues. One of the important areas of international taxes is transfer pricing. The transactions between these persons should be assessed at their arm's length price according to the arm's length principle (internationally accepted standard) as the price which would have been agreed between the unrelated parties in free market conditions. The aim of the paper is to evaluate the impact of the selection of the form of the subsidiary on the total tax liability of the agricultural entity, including the determination of the transfer price, the application of the arm's length principle and decisions about the most suitable legal form of the subsidiary.

Key words: transfer prices, arm's length principle, tax liability

The Czech Republic as a small open economy has been increasingly involved in the international trade. Many agricultural and food entities are being restructuralized or joined to the multinational entities (hereinafter as MNEs). However, their connection to the MNEs brings new problems in the form of the thin capitalization rules, know-how, royalties, usual prices and especially transfer prices and the compliance with the arm's length principle and its impact on the tax base.

The issue of the transfer pricing is an instrument which MNEs use for tax planning. Properly chosen transfer pricing strategies can distribute the tax risks, so that the largest part of the company profits is generated in low tax jurisdictions. It is necessary to strictly abide the rules laid down in the national laws on income taxes, during the above mentioned tax planning, since the tax authorities may adjust the tax base of the entity, in cases that the taxable profit is not recorded in the source state due to a special relationship between the associated entities. This occurs in cases, where the transfer prices do not fulfill the arm′s length principle and there is a risk of the tax evasion with the elements of the harmful tax competition.

As defined by (Arnold and McIntyre 2002), transfer price is a price set by a taxpayer when selling to, buying from, or sharing resources with a related person. Related persons should be defined as including two or more persons that are owned or controlled, directly or indirectly, by the same interests. A good indicator of such relationships is the ability to set transfer prices that differ from market prices. The market price is a price set in the marketplace for transfers of goods and services between unrelated persons.

The arm's length principle represents the principle used in the international tax field worldwide. Under this principle, associated enterprises must set transfer pricing for any intra-group transaction as if they were unrelated entities and all other aspects of the relationship were unchanged. When transfer pricing does not reflect market forces and the arm's length principle, the tax liabilities of the associated enterprises and the tax revenues of the host countries could be distorted. Therefore, the OECD member countries have agreed that for the tax purposes, the profits of associated enterprises may be adjusted as necessary to correct any such distortions and thereby to ensure that the arm's length principle is satisfied. The OECD member countries consider that an appropriate adjustment is achieved by establishing the conditions of the commercial and financial relations that they would expect to find between independent enterprises in similar transactions under similar circumstances. The authoritative statement of the arm's length principle is found in paragraph 1 of Article 9 of the OECD Model Treaty (Model Tax ... 2008): "when conditions are made or imposed between two enterprises in their commercial or financial relations which differ from those which would be made between

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independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

There are several reasons why the OECD member countries and other countries have adopted the arm's length principle. A major reason is that the arm's length principle provides broad parity of tax treatment for members of the MNEs and independent enterprises, avoids the creation of tax advantages or disadvantages that would otherwise distort the relative competitive positions of either type of entity, so the arm's length principle promotes the growth of international trade and investment.

In order to apply the arm's length principle in practice, the OECD Transfer Pricing Guidelines (Transfer Pricing Guidelines ... 1995) provide guidance on the application of the arm's length principle to the pricing, for tax purposes, of cross-border transactions between the associated enterprises. The OECD has set forth a series of accepted methodologies, namely the comparable uncontrolled price method (hereinafter as the CUP), resale price method (hereinafter as the RPM), cost-plus (hereinafter as the COST+) method, profit split method and transactional net margin method (hereinafter as the TNMM).

As mentioned by (Kratzer 2008), for testing the arm's length principle under the TNMM, the tested party needs to be selected to be the MNE for which the reliable data on the most closely comparable transactions can be identified and should only perform the so-called routine functions for instance, a distributor, a sales agent, a toll or contract manufacturer, or an enterprise responsible for contract research and development. As an example, the parent company (a producer of consumer goods, responsible for the group's strategic planning, research and development, production, worldwide distribution) has subsidiaries responsible for routine functions only (local distribution) in applying the TNMM the respective tested parties would to be the local distributing companies, so it is more likely that the comparable companies can be found.

As suggested by the OECD Transfer pricing Guidelines, it may also be necessary to use the multiple-year data in comparing the net margins of the controlled transactions of the test party with comparable uncontrolled transactions of either the same MNE or an independent enterprise in order to take into consideration the effects resulting from the temporary accounting differences, varying business and product life cycles and discrepancies in the short-term economic conditions, which have an impact on net profitability of the controlled and/or uncontrolled transactions (Transfer Pricing Guidelines 1995, § 3.44. The net margins of more than one year may be looked at on an average basis, however, a number of the OECD member countries have the rule of examining the fiscal years separately.

When the most appropriate method or methods are applied, the profit level indicators determine the arm's length range, which is determined as the difference between the lowest and the highest value of the range. However, the statistical tools, for instance the interquartile range, are more meaningful and should be used in practice (Comparability: Public ... 2006). Currently many tax administrations require a narrowed range of results, so-called interquartile range, to eliminate extreme results.

The proposed revision of the OECD Transfer Pricing Guidelines proposes replacing the status of "the last resort" the transactional profit methods with a standard and furthermore introducing examples that indicate that transactional profit methods are found to be more appropriate than the traditional transaction methods, for instance where it is found that a net profit margin analysis is more reliable than a gross margin analysis because there are material differences in functions between the tested and the uncontrolled transaction e.g. commissionaire agent and distributor (Proposed revision ... 2009).

However, Oosterhoff (2010) mentions that unfortunately the statements of the original OECD Transfer Pricing Guidelines, which provide that transactional profit methods may not be applied automatically simply because there are difficulties in obtaining data, are still included and remain largely unchanged. More guidance around the availability of data and the link with the transactional profit methods would have been helpful.

Currently, the worldwide crisis and recession accelerates the need for reposition of the function, assets and risks in many MNEs. As mentioned by Wittendorff (2009), the tax authorities of some are clamming the loss of the tax revenue due to the business restructurings relocating high-value-added functions, risks and assets as well as the associated profit potentials to low-tax countries. The common fact patterns include the transformation of a full-fledged manufacturer into a contract manufacturer or a toll manufacturer, the conversion of a full-fledged distributor into a limited-risk distributor or a commissionaire, the rationalization or specialization of operations, and the transfer of intangibles to a central entity.

The aim of the paper is to evaluate the impact of different forms of the subsidiary on the total tax liability of the agricultural entity, including the de-

termination of the transfer prices, the application of the arm's length principle and the decisions which of the legal form of the subsidiary is the best.

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MATERIALS AND METHODS

To meet the aims, the research has been divided into five steps. Firstly, the expression of the profit margin has been quantified by using the data in the Amadeus Database[1]. Further, before the determination of the arm's length range itself, it was necessary to identify the form of the subsidiary (distributors, commission agent). Following, the determination of the arm's length range for distributors and commission agents for 3 years at least has been done and the identification of the arm's length range on the average and the profit margin of the distributors and commission agents. Next, the determination of the transfer prices for the individual legal forms of subsidiary and their the tax liability, including the total tax liability for the group. Finally, in the last step the selection of the best option of the legal form of subsidiary was done.

The OECD Transfer Pricing Guidelines recommended for the evaluation of controlled transactions the COST+, the RPM or the TNMM methods in the case of the commission agent and distributors. However, as stated in the Art. 152 of the OECD study "Transfer Pricing Aspects of business restructuring", the COST+ method and the cost-based TNMM method are not appropriate, because the costs on sold products are not arising to the commission agent (Transfer Pricing Aspects ... 2008). Thus there are two methods to use – the RPM[2], under which the transfer price is determined after deducting the gross margin from the sales price, or the sales-base TNMM method, under which the transfer price is equal to the selling price minus the cost of sales and the net profit margin (in the case of the commission agent, zero costs enter into the calculation, for the commission agent never owns the goods, i.e. never purchases it).

There are a number of different profit level indicators available for an arm's length test under the TNMM. The choice of a profit level indicator and the appropriateness of its application depend on, for instance, whether the tested party is a service provider, production facility or sales organization. One of the most frequently used profit level indicators is the operating margin, which is defined as

$$\text{Operating margin}^3 = (\text{Operating profit/Sales or Operating revenue}) \times 100 \quad (1)$$

and measures operating profits as a percentage of sales or operating revenue.

For the identification of the form of the subsidiary, it is necessary to make a deep research of all selected subjects in the Amadeus database. It has been checked that all the selected subjects record the absolute values of indicators for all selected years (3 years at least) in order to guarantee the validity of the indicators. The selection of the indicators of sale and operating revenue according to the state of headquarters, excluding the subjects, which are realizing loss in the long term (2 years and more), has been done as well.

Further, it is necessary to determine the form of the subject – distributor or commission agent. The determination can be done by the application of the following indicators:

$$\text{Cost of goods sold/Operating revenue}^4 = \text{CGS/OPREV} \quad (2)$$

[1]Amadeus contains comprehensive information on over 14 million companies across Europe (45 European countries).

[2]Article 2.14 OECD Transfer Pricing Guidelines states that the resale price method is probably most useful where it is applied to marketing operations however the article 2.15 states, that where the reseller is carrying on a general brokerage business, where we can rank search activity and conducting business on behalf of a principal, the resale price margin may be related to a brokerage fee, which is usually calculated as a percentage of the sales prices of the product sold. The determination of the resale price margin should take into account whether the broker is acting as an agent or a principal. Moreover article 2.22 states that the resale price margin is easiest to determine where the reseller does not add substantially to the value of the product.

[3]It is called "Profit margin" in the Bureau van Dijk's Amadeus database.

[4]In case that the states have defined an indicator of Sales (hereinafter SALES), which is more accurate because it includes only sales of goods sold and sales of own products and services, unlike an Operating revenue, it is necessary to use this indicator. In that case, United Kingdom or Denmark does not specify this indicator, therefore operating revenue, which is more comprehensive, has to be used.

Cost of employees/Operating revenue = CE/OPREV (3)

Other operating expenses/Total costs = OOPEX/TOTC (4)

Total costs = Operating revenue – P/L before taxation (5)

TOTC = OPREV – PLBT (6)

Material cost/Total costs = MC/TOTC[5] (7)

These above calculated ratios have been used to distinguish the subjects on the distributors and commission agent. The relatively higher value of the indicator Cost of Goods Sold/Operating Revenue refers to the distributor. This stems from the fact that the distributor owns his/her goods, thus the ratio of the cost of goods sold and sold own products and services to sales has to be of higher values. Different methods of recording of the transactions in accounting in the case of distributors and commission have an impact on the amount of profit margins, i.e. the distributors perform significantly lower profit margins. This negative correlation indicators CGS/OPREV or SALES with profit margin at distributors has been proved by (Jelínek 2009) with the application of regression analysis. The resulting regression model[6] is below:

$$\eta = \beta_0 + \beta_1 x \quad (8)$$

CGS/SALES = 0.7753 – 0.9187 × profit margin (9)

The lower value of the indicator Cost of Employees/Operating Revenue refers to the distributor. In the case of a negative correlation of the previous indicators, the negative correlation between the CE/OPREV or SALES and CGS/OPREV or SALES has been also proved (Jelínek 2009). The resulting regression model is below:

$$\eta = \beta_0 + \beta_1 x \quad (10)$$

CE/SALES = 0.350 – 0.328 × CGS/SALES (11)

The results of the regression analysis shows the negative correlation between the value of the indicator CGS/OPREV and indicator CE/OPREV. Both above mentioned ratio indicators are considered as suitable indicators for the identification of commission agents and distributors.

As mentioned by Mehta (2006), the limited distributors and commission agent may be interchangeable forms of doing business, the primary difference between these two forms of distribution is the choice of handling of the finished goods (while a distributor would take title to the goods, a commission agent would not do so). The limited distributor's remuneration will basically be a margin on the sales of goods, the limited distributor enjoys a margin that it earns as the difference between purchase and sales cost. Consequently, the margins of a commission agent would be lower than those of a distributor. This fact should be taken into account when the profit margin is calculated. The same procedure has been applied also on the OOPEX/TOTC indicator and the MC/TOTC indicator. In case of lower values it is not possible unambiguously determine whether it is the distributor. Therefore, a further comparison with other relative indicators is needed. The lower values of the ratio CE/OPREV, OOPEX/TOTC and MC/TOTC determine the distributor.

Kratzer (2008) mentions that using the interquartile range is required by many tax administrations and recommended, because it eliminate extreme results. The interquartile range is a range from the 25th to the 75th percentile of the results derived from the uncontrolled transactions – only those 50 percent of observations which are closest to the median are considered as a reliable range of the arm's length results. The median is the mid-point of the interquartile range. If the profit margin of the tested party falls within this interquartile range, even in all three years, we can conclude that the arm's length principle is met.

The transfer price is determined by the sales-base TNMM method, under which the transfer price is equal to the selling price minus the cost of sales and the net profit margin in the case of distributors. In the case of commission agent, the transfer price is determined by the RPM method, under which the transfer price is equal to the commission fee since the commission agent never owns the goods, has no cost on sold goods and records only the commission fee as a profit (Transfer Pricing Guidelines 1995, § 2.14 and 2.15).

The selection of the best option of the legal form of subsidiary is performed by comparing the tax liabilities of the various forms of subsidiaries, since the MNEs want to generate the largest part of profits in low tax jurisdictions.

[5]Material has been defined only by some of the European countries, namely Bosnia, Croatia, Finland, France, Lithuania, Serbia (including the item cost of goods sold) and the Czech Republic, Germany, the Netherlands, Belgium and Italy (not including the item cost of goods sold) and therefore it could not be used in the model.

[6]Results of the regression analysis are available in the article Jelínek (2009).

RESULTS AND DISCUSSION

An organic farm focused on the processing of cow's milk is based in Austria. The company decided to establish a subsidiary in the Czech Republic, the South Moravia region. The reason for the establishment of the company in the Czech Republic represents a lower income tax rate 19%[7], a cheaper workforce, an increased customer interest in bio food[8] and a suitable locality.

The parent company, when establishing a subsidiary company, must consider which functions is the subsidiary going to perform. It is necessary to adopt a contract and an organizational structure, and consequently the method of transfer pricing according to the function and risks of the subjects in the group. The subsidiary organic farm in Austria could be established in the form of a "buy-sell" distributor, agent (commission agent) or "full-fledged" distributor.

"Buy-sell" distributor should be limited in distribution, i.e. it would take over only the lower risk of the short-term transition of ownership, the parent company would provide a standard marketing support. The subsidiary would exercise only sales with the use of its physical assets. In such a case, neither market risk, currency risk, credit risk, risk warranty nor the risk of unsalable stocks is beared. The subsidiary would, however, trade on its own account, as well as it would negotiate the terms of sale for the local customers. For these narrowly defined distribution activities of the company, there would belong also a lower reward.

Another possible form of the subsidiary of the organic farm in Austria, located in the Czech Republic, represents a commission agent. It would be analogical to the limited distribution activities distributor (buy-sell distributor). However, in the case of the commission agent, the ownership rights are never passed, unlike the distributor. The relationship between the parent and subsidiary company would be adjusted by the commission contract, where the subsidiary as an agent concludes by its name on behalf of the principal (mother) sales contracts with customers. Basically, it is providing of services to the commission, when most of the risk is still borne by the principal. In this situation, the commission agent cannot realize a loss. In this case, the commission agent (subsidiary) would actively search for customers, sell products (including the administration – i.e. invoicing and payments), advertises products and leads the payroll, accounting and tax agenda.

The last option represents a "full-fledged" distributor known as a leading strategic distributor. In this case, the subsidiary would own all the tangible assets necessary for selling products and supplies, and intangible assets necessary for the production and marketing. Thus the subsidiary in the role of the full-fledged distributor is receiving all the sale and distribution functions and risks (i.e. market, currency and credit risks, risk warranty and risk of unsalable stocks). The main activities of the full-fledged distributor include sales management and marketing mix. The activities carried out correspond to a higher reward.

The expression of the margin (profit margin) represents the crucial fact for the calculation of the price according to the arm's length principles. The profit margin has been quantified by using the data in the

Table 1. Filtering criteria

No.	Search strategy	Total of selected companies
1.	Legal status – active	12 521 903
2.	Region/country – the European Union	10 154 460
3.	NACE Rev. 2 (primary codes only) – 4611 (agents involved in the sale of agricultural raw materials, live animals, textile raw materials and semi-finished goods. 4617 (agents involved in the sale of food, beverages and tobacco)	30 918
4.	BvD Independence indicator: A+, A, A–	1 107 341
5.	Other operating expenses, Cost of goods sold, Cost of employees – all companies with a known value, last available year	1 973 319
6.	Profit margin (%) – all companies with a known value, 3 years for at least	6 899 493
Boolean search (1 and 2 and 3 and 4 and 5 and 6)		**14**

Source: Amadeus, Bureau Van Dijk

[7]The current income tax rate in Austria is 25%.

[8]In the Czech Republic, bio products can be considered as a new bio market segment.

Table 2. Key financial indicators

Company name	Country	Year	OPREV th EUR	PLBT th EUR	CGS th EUR	OOPEX th. EUR	CGS/ OPREV (%)	OOPEX/ TOTC (%)	CE/OPREV (%)
Median	last available year		41.762	823	37.325	3.027	83.60	13.10	7.26
Average			71.169	1.614	63.138	6.454	80.63	18.53	17.07
International distribution agency APS	DK	2008	213	1	143	71	67.16	33.18	33.04
PBS agency APS	DK	2009	71	–22	37	56	52.65	60.34	79.55
Quarrymoor limited	UK	2007	15.433	135	12.353	2.778	80.04	18.16	8.64
Elsoms spalding limited	UK	2009	20.715	1.619	14.858	4.359	71.73	22.82	14.26
L.S. Smellie & Sons	UK	2008	13.312	540	10.924	2.108	82.06	16.51	8.57
Berry Bros & Rudd	UK	2008	311.167	7.867	264.928	40.137	85.14	13.23	5.95
A.L. Tozer Ltd.	UK	2008	1.769	158	918	821	51.88	50.94	58.47
Dunalastair Philip	UK	2007	37.628	1.109	30.783	4.735	81.81	12.97	5.51
W.N. Lindsay Ltd.	UK	2009	86.903	25.12	81.973	2.290	94.33	2.71	2.79
Fengrain Ltd.	UK	2009	101.768	366	97.144	4.188	95.46	4.13	1.74
WCF Ltd.	UK	2007	215.938	5.282	194.438	17.784	90.04	8.44	4.08
Feed Factors Ltd.	UK	2008	45.895	657	43.866	1.006	95.58	2.22	1.48
Harlow Agricultural	UK	2008	69.210	989	64.009	3.276	92.48	4.80	3.44
The Harbro Group Ltd.	UK	2009	76.351	1.387	67.556	6.747	88.48	9.00	11.50

Source: Amadeus, Bureau Van Dijk

Table 3. Profit margin of distributors (in %) – United Kingdom

Company name	2007	2006	2005
Median	*2.32*	*1.80*	*3.14*
Average	*2.79*	*5.00*	*3.65*
First quartile	*0.98*	*0.84*	*0.66*
Second quartile	*2.32*	*1.80*	*3.14*
Third quartile	*2.91*	*3.79*	*4.69*
Lower limit	*0.22*	*–0.07*	*0.13*
Upper limit	*10.94*	*27.68*	*14.04*
Elsoms spalding limited	10.94	12.29	7.38
L.S. Smellie & Sons	1.08	27.68	14.04
W.N. Lindsay Ltd.	1.31	0.66	0.22
Berry Bros & Rudd	4.86	4.98	3.78
Feed Factors Ltd.	2.86	1.80	0.71
Harlow Agricultural	2.32	1.02	3.14
The Harbro Group Ltd.	0.82	1.36	1.16
Fengrain Ltd.	0.22	–0.07	0.13
WCF Ltd.	2.45	2.40	3.43
Quarrymoor limited	0.87	0.30	0.60
Dunalastair Philip	2.95	2.60	5.61

Source: Amadeus, Bureau Van Dijk

Amadeus Database. Firstly, it is necessary to filter the data according to the selected criteria stated in the Table 1. The companies of a similar size selling agricultural products should be selected. Active companies operating in the EU according to the NACE classification code 4611 and 4617 have been selected as the filtering criteria – i.e. the agents involved in the sale of agricultural products, food, drinks and cigarettes. Other filtering criteria were the independency of subjects and the availability of the necessary financial data. The above described filtering criteria generated 14 similar market subjects from database.

Further, it was necessary to chose financial indicators, which are mentioned in Table 2. They were used for the determination of the form of the subject – either distributor or commission agent – by the methodology, which has already been described in the chapter Materials and methods.

Based on the above mentioned research, the PBS Agency, the International Distribution Agency APS, the AL Tozer Limited were identified as commission agents.

Finally, it is necessary to determine the arm's length range for the distributors and commission agents for 3 years at least. The selected operators were avail-

Table 4. The average arm's length range for distributors

	The average arm's length range (%)
Lower limit	0.093
1st quartile	0.83
Median	2.42
3rd quartile	3.80
Upper limit	17.55

Source: Amadeus, Bureau Van Dijk

able from the years 2007–2009, therefore, the arm's length range is expressed for the period 2007–2005. The results are stated in the Table 3.

The arm's length range for distributors, focusing their activity on the sale of agricultural raw materials, food, drinks and cigarettes, has been identified 0.83–3.80% in average. The results are presented in the Table 4.

The Table 4 shows that the profit margin of the distributor with limited functions should oscillate around the median value – i.e. 2.42%, in comparison with the full-fledged distributor, where the margin oscillates around the value of 3rd quartile – i.e. 3.80%.

With respect to the very small sample of subjects identified as commission agents (it is necessary to have the sample of 5 subjects at least), a new selection was made. Table 5 shows the newly selected filtration criteria. In comparison with the original filtration criteria (Table 1), the NACE code was changed, the location was not specified and the companies without loss were required. The newly selected filtering criteria generated 58 similar market subjects from the database.

For the identification of the commission agents, there was used the methodology which has already been described above (in chapter Materials and Methods) – Table 6.

The Table 7 shows eight commission agents which were identified in the sample.

The arm's length range for commission agents is 7.27–14.48% on average as is shown in Table 8.

The above stated table shows that the current commission agent, who does not exercise any specific service or bears no specific function and risks, should reach the margin of 9.77%, which is the median value.

The observed difference in profit margin for the distributor and commission agent is mainly caused by the differences in recording of the transactions in the accounting. The commission agent does not own the object of the transaction and the cost of sold goods are not arising to him. In comparison, the distributor owns the object of transaction, therefore he/she reaches a higher margin. Specific net profit margins needed for the calculation of the transfer price are 2.42% for the distributor with the limited function and risks, 3.80% for the full-fledged distributor, and 9.77% for the commission agent.

In consideration of the pros and cons of the legal forms of subsidiary, it is also necessary to take into account the tax impact both in the Czech Republic and Austria. Table 9 indicates the tax liability in the Czech Republic and the calculation of transfer prices, for which the parent company transfers the commodity (milk) on the selected type of entity in the group. As can be seen from the table below, the commission agent has no cost on sold goods because he/she does not own the goods, and in the profit and loss account only the commission (commission fee) and other related operational costs are recorded. For that reason, he/she faces the lowest tax liability by the highest margin. The distributors have, according to the calculation of transfer prices, in both cases the gross cost on sold goods in the amount of 10 million CZK and the sales on sold goods 20 million CZK.

Table 5. Filtering criteria

No.	Search strategy	Total of selected companies
1.	Nace Rev. 2 (primary codes only) – 461 (wholesale on a fee or contract basis)	255 023
2.	Costs of employees/Operating revenue (%) – all companies with a known value, last available year	4 367 415
3.	Cost of goods sold/Operating revenue (%) – all companies with a known value, last available year	1 291 525
4.	Other operating expenses/Operating revenue – all companies with a known value, last available year	1 434 103
5.	BvD Independence indicator: A+, A, A–	1 107 341
6.	P/L before tax (th EUR) – last available year, last year –1, last year –2, min = 0, for all selected periods	2 431 909
Boolean search (1 and 2 and 3 and 4 and 5 and 6)		**58**

Source: Amadeus, Bureau Van Dijk

Table 6. Key financial indicators

Company name	Country*	Year	PLBT (th. EUR)	CGS/OPREV (%)	OOPEX/TOTC (%)	CE/OPREV (%)
Median	last available year		441	76.30	22.12	13.76
Average			30.378	74.72	21.77	15.45
Halheck	UA	2008	2	97.77	0.08	2.12
Stemcor holding Ltd.	UK	2008	54.382	96.56	1.93	1.31
Feed factors Ltd.	UK	2008	657	95.58	2.22	1.48
Fengrain Ltd.	UK	2009	366	95.46	4.13	1.74
Atstesvironiuo	UA	2008	2	95.22	2.07	6.54
General product	UK	2008	71	94.88	3.39	1.62
W.N. Lindsay Ltd.	UK	2009	2.512	94.33	2.71	2.79
Krivoozerschina	UA	2008	3	93.12	6.41	0.16
Harlow agricultural	UK	2008	989	92.48	4.80	3.44
Chandlers oil & gas Ltd.	UK	2009	936	90.50	8.34	4.24
WCF. Ltd.	UK	2007	5.282	90.04	8.44	4.08
Norkem holding	UK	2008	1.359	90.04	7.77	5.62
Taylor Maxweill Ltd.	UK	2008	462	89.75	9.24	5.64
The Harbo Group Ltd.	UK	2009	1.387	88.48	9.00	11.50
Thomas sherriff and company	UK	2008	498	85.60	12.33	12.65
Berry bros. & Rudd Ltd.	UK	2008	7.867	85.14	13.23	5.95
Centura Group	UK	2009	320	84.52	14.29	35.32
Elliott brother (bilder)	UK	2008	1.559	84.33	12.70	14.03
Trans Cafema	UA	2008	0	83.33	11.85	33.33
Botusdaske	UA	2008	2	82.12	13.66	26.63
L.S. Smellie & Sons Ltd.	UK	2008	540	82.06	16.51	8.57
Dunalastair Philips	UK	2007	1.109	81.81	12.97	5.51
T. H. White holding Ltd.	UK	2008	3.938	80.14	17.73	14.74
Quarrymoor Ltd.	UK	2007	135	80.04	18.16	8.64
Ernest doe & sons Ltd.	UK	2008	3.276	78.37	20.87	13.50
All type roofing supplies Ltd.	UK	2007	1.412	78.28	16.64	8.44
Hafele Danmark	DK	2009	301	78.27	17.54	14.38
Blue machinery Ltd.	UK	2008	28	77.81	26.34	12.59
Ukrlakoforga	UA	2007	2	76.91	0.00	21.85
Hambleside hold. Ltd.	UK	2008	172	75.69	23.77	12.11
E.P.B. hold. Ltd	UK	2008	209	73.64	24.91	13.43
Ron Lewis hold. Ltd.	UK	2008	73	73.63	25.46	15.13
Seconique hold. Ltd	UK	2009	2.882	72.74	22.77	8.44
Maximes APS	DK	2008	52	72.01	24.17	17.64
Elsoms Ltd.	UK	2009	1.619	71.73	22.82	14.26
Walter tripper Ltd.	UK	2008	706	71.72	26.71	15.45
Wright & offland holding	UK	2009	310	71.05	27.44	22.51
Grant & stone Ltd.	UK	2008	1.347	70.98	24.92	14.23
CRH public Ltd.	IE	2008	1.628	70.56	21.58	19.41
Harris & Bailey Ltd.	UK	2008	1.970	70.43	27.85	14.95
Plyanemca Ltd.	UK	2008	60	69.42	29.54	17.70
John A. Stephens	UK	2008	1.146	68.99	29.23	18.00
Robert price & sons	UK	2009	59	68.84	32.20	19.49

Table 6 to be continued

Company name	Country*	Year	PLBT (th. EUR)	CGS/OPREV (%)	OOPEX/TOTC (%)	CE/OPREV (%)
Median	last available year		441	76.30	22.12	13.76
Average			30.378	74.72	21.77	15.45
IRM Bristol	UK	2009	29	68.75	29.82	14.31
International distribution	DK	2008	1	67.16	33.18	33.04
Bradford & sons Ltd.	UK	2009	3.818	66.56	31.54	19.68
Charles Kendall group Ltd.	UK	2008	9.983	66.48	22.66	15.69
Huws gray Ltd.	UK	2007	8.484	66.11	24.43	12.06
Kniolagrooladna	UA	2008	421	63.33	25.57	7.94
M. Linda	DK	2008	3	63.05	36.51	35.76
Raz – roll international Ltd.	UK	2007	230	61.63	35.46	23.11
Tool & Fastener solutions Ltd.	UK	2008	723	61.55	28.76	14.75
Salco holding Ltd.	UK	2009	71	58.68	40.91	9.58
Max nierich	DK	2008	2	58.21	40.77	36.00
UMS united medical systems	DE	2008	10.127	51.66	25.93	29.28
Sonderbarg skontoktor	DK	2009	48	29.38	72.16	7.79
Aleris aluminum Denmark	DK	2008	12	26.41	72.42	68.44

*UK – United Kingdom, UA – Ukraine, DK – Denmark, DE – Germany, IE – Ireland
Source: Amadeus. Bureau Van Dijk

Table 7. Profit margin (in %) of commission agents

Company name	Country*	2007	2006	2005
Median		*10.50*	*9.77*	*9.04*
Average		*11.79*	*12.02*	*10.07*
First quartile		*7.93*	*6.19*	*7.68*
Second quartile	UK	*10.50*	*9.77*	*9.04*
Third quartile		*14.75*	*16.13*	*12.57*
Lower limit		*0.03*	*1.79*	*3.40*
Upper limit		*27.92*	*30.16*	*18.58*
IRM Bristol Ltd.	UK	0.03	1.79	3.40
John A. Steohens Holdings	UK	6.79	6.10	9.23
CRH Public Ltd.	IE	9.07	8.55	8.85
Tool & Fastener Solutions Ltd.	UK	17.44	17.80	15.29
Harris & Bailey Ltd.	UK	10.24	6.28	7.61
Kniolagrooladna	UA	10.77	14.46	9.85
Charles Kendal Group Ltd.	UK	12.07	10.99	7.75
UMS United medical systems international agency	DE	27.92	30.16	18.58

*UK – United Kingdom, UA – Ukraine, DE – Germany, IE – Ireland

Source: Amadeus, Bureau Van Dijk

However, the full-fledged distributor has, due to the higher number of functions and risks transferred from the parent company, higher other operating costs and therefore a lower tax liability.

Table 10 shows the tax liability in Austria from the perspective of a parent and a separate entity without any expansion in the form of the subsidiary (i.e. the original condition). In the case of the commission agent, the parent company recorded the sale of milk in the statements of revenues. In other cases, the sale is recorded by the subsidiaries in the Czech Republic. The commission fee paid by the commission agent enters into costs. Due to the above mentioned reason, the tax liability is in this case the highest in the group. In the case of distributors, the revenues payments for the intra-group transfers of milk enter into the revenue payments of the parent company. Tax liability of the parent company is higher in the case of the full-fledged

Table 8. The average arm's length range for commission agents

	The arm's length range (%)
Lower limit	1.39
1st quartile	7.27
Median	9.77
3rd quartile	14.48
Upper limit	25.55

Source: Amadeus, Bureau Van Dijk

Table 9. The tax liability of individuals in the group and transfer pricing

Milk	Type of the subject in the group – Czech Republic		
	commission agent	distributor with limited function	full-fledged distributor
Commission fee sales of goods	10% gross margin 1 mil. l × 0.10 × 20 CZK/l = 2 mil. CZK	1 mil. l × 20 CZK/l = 20 mil. CZK	1 mil. l × 20 CZK/l = 20mil. CZK
Costs of goods	0 CZK	10 mil. CZK	10 mil. CZK
Margin	2 mil. CZK. thus 100%	10 mil. CZK. thus 50%	10 mil. CZK. thus 50%
Other operating expenses	1.5 mil. CZK	1.5 mil. CZK	3.5 mil. CZK
Profit	0.5 mil. CZK	8.5 mil. CZK	6.5 mil. CZK
Tax liability (19%)	95 th CZK	1.615 mil. CZK	1.235 mil. CZK
Transfer price (RPM or TNMM method)	commission fee 2 CZK/l = 2 mil. CZK	20 mil. CZK – 10 mil. CZK – 0.0242 × 20 mil. CZK = 9.516 mil. CZK	20 mil. CZK – 10 mil. CZK – 0.038 × 20 mil. CZK = 9.240 mil. CZK

Source: own calculation and processing

distributor in comparison with the distributor with a limited function and risks, due to the lower transfer price of milk and other lower costs, for the parent company has transferred the majority of the functions and risks on him/her. The extension on the distributor with the limited functions and risks seems to be the best option. In this case, the tax liability has reached the lowest value of 1.744 million CZK. If the company had not extended itself, all the income would be taxed in Austria by 25% corporate tax rate, i.e. the tax liability would amount to 2.750 million CZK (i.e. by 57% more).

The Figure 1 summarizes the impact of different variants. It highlights the selected variant of the distributor with the limited function and risks, under which the total tax liability is 1.744 million CZK in case of the sale of 1 mil. litres of milk.

CONCLUSION

To sum up the research and discussion above, various factors need to be taken into account when considering the transfer pricing strategy[9]. During the research, the used model has revealed that the most suitable structure of the group of Austrian agriculture enterprise and its subsidiary in the Czech Republic. The subsidiary should fulfill the role of the distributor with limited functions in the group, for it decreases the risks and the total tax liability of the group. It had been proved that properly selected transfer pricing strategies can achieve the distribution of the tax risks and reduce the total tax liability. The aim of the paper was to evaluate the impact of the selection of the form of the subsidiary on the

Table 10. The tax liability of parent company in the group and transfer pricing

Milk	Parent company – Austria			Original condition
	commission agent	distributor with limited function	full-fledged distributor	
Sales of goods	20 mil. CZK	9.516 mil. CZK	9.240 mil. CZK	20 mil. CZK
Production and other operating expenses	9 mil. CZK	9 mil. CZK	7 mil. CZK	9 mil. CZK
Commission fee	2 mil. CZK	–	–	–
Profit	9 mil. CZK	516 th. CZK	2.240 mil. CZK	11 mil. CZK
Tax liability (25%)	2.250 mil. CZK	129 th. CZK	560 th. CZK	2.750 th. CZK
Total tax liability for the group	0.95 + 2.250 = 3.2 mil. CZK	0.615 + 0.129 = 1.744 mil. CZK	1.235 + 0.560 = 1.795 mil. CZK	2.750 mil. CZK

Source: own calculation and processing

[9]One of the important factors is also the rate of VAT. Its impact has been surveyed by David and Nerudová (2008) and also by Nerudová and David (2008).

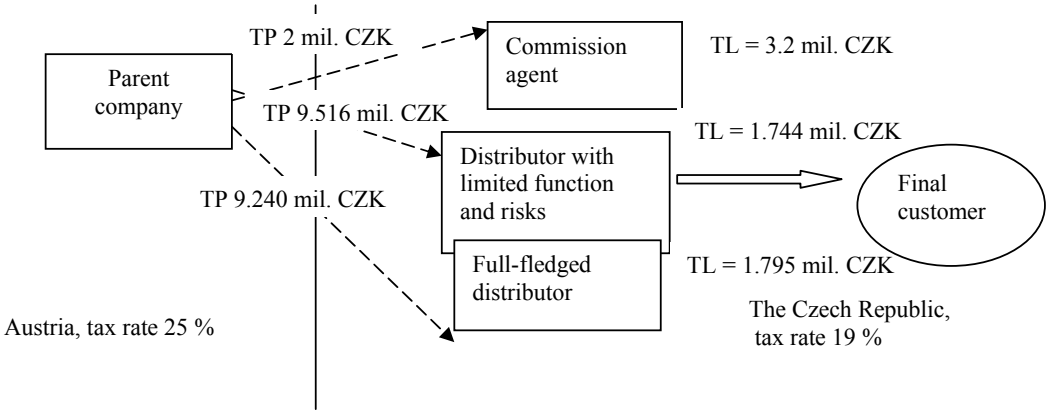

Figure 1. Typology of subjects in the group, their transfer prices and tax liability

TP = transfer pricing, TL = tax liability
Source: own calculation and processing

total tax liability of the selected agricultural entity, including the determination of the transfer price, the application of the arm's length principle and the most suitable legal form of the subsidiary has been fulfilled and summarized in the Figure 1.

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