

Does VAT on domestic delivery of goods also have to be paid on the value of related services provided abroad? According to the court, yes

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The Municipal Court in Prague adopted a decision in an important tax dispute regarding a distribution chain in the pharmaceutical sector. In general terms, the conclusions contained in the Court's decision may be relevant to other distribution companies using a similar business model.

A Czech company (the "Distributor") purchased medicinal products from the European pharmaceutical warehouse of a Swiss group company (the "Supplier"). The Distributor subsequently supplied the products to wholesalers and hospitals in the Czech Republic and Slovakia. As part of its business activities, the Distributor also provided marketing services to the Supplier. This ensured the Distributor's reasonable overall profitability from the perspective of transfer prices as, due to price regulation, the profit generated from the sale was insufficient. The Distributor reported marketing services for VAT purposes as the provision of a service with the place of supply outside the country; as a result, the company did not apply Czech VAT.

The tax administrator (and, subsequently, also the Court) assessed the marketing services as a supplementary supply to the main supply, which is the distribution of medicinal products. A supplementary supply is subject to the same tax treatment as the main supply. According to the Court, the Distributor was unable to prove that the marketing services constituted a separate supply, particularly for the following reasons:

- ▶ The Distributor was unable to distinguish between distribution costs and marketing costs, from which both the tax administrator and the Court inferred that the marketing costs were already reflected in the price of the medicinal products.
- ▶ The objective and purpose of the marketing service contract could not be fulfilled (i.e. the development of the Supplier's business on the Czech market; the Supplier did not carry out any business activities here).
- ▶ The Supplier is neither the manufacturer of the promoted medicinal products, nor the holder of an authorization for distribution of the given medicinal products in the Czech Republic and, consequently, cannot be the recipient of marketing services related to the Czech market.
- ▶ The transfer prices documentation submitted during the tax audit showed that it was the Distributor who decided about the scope of promotion on the Czech market.
- ▶ In addition, in the context of the transfer pricing review preceding the VAT review, the Distributor declared that the marketing support was an integral part of the distribution and could not be regarded as a separate activity.

Based on the above, the Court has concluded that the Distributor artificially separated marketing from distribution and divided them into two independent supplies, although the Distributor was obliged to include in the tax base from the sale of medicinal products on the Czech market (the main supply) also the consideration which, in this particular case, was the payment by a third party for the supplementary supply, i.e. the marketing services.

The above decision and the related procedural path again demonstrate that, in the context of a tax audit, specific statements and evidence provided to the tax administrator must always be carefully considered, consistent and subject to a thorough assessment taking into account the bigger picture. Perfect arguments, which are accepted without reservation by the tax administrator for the purposes of income taxes (or transfer prices), may not necessarily work for other taxes (here, VAT); on the contrary, the same arguments may give rise to doubts or increase potential risks.

The decision of the Municipal Court is now the subject of an appeal (cassation complaint) submitted to the Supreme Administrative Court; the SAC will ultimately decide whether the additional tax assessment was justified.



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