

Common Consolidated Corporate Tax Base (Ccctb) In the Theory of Corporate Finance

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Abstract

One of the main objectives to be accomplished by the European Union law is to eliminate barriers to the functioning of domestic market and in particular improve the competitiveness of enterprises. After several years of efforts, on 16 March 2011 the European Commission approved a proposal for the directive on a Common Consolidated Corporate Tax Base which is to remove obstacles to the functioning of internal market and increase tax harmonization in the EU. The article is aimed at presenting the essence of CCCTB in the theory of corporate finance and its importance for enterprises, based on the survey of Polish and EU companies. The paper addresses issues relating to tax in corporate finance. Canons of taxation will be discussed and special emphasis will be placed on principles behind formulating fiscal law provisions (including the EU law). Furthermore, the article presents the results of surveys into the importance of taxation canons for Polish and EU companies. Attention will also be paid to taxable income and deductible expenses with special reference to non-taxable income and non-deductible expenses. The proposal for the directive on CCCTB will be compared with fundamental theories of corporate finance – such as the theory of capital structure

Keywords: income tax, CCCTB, corporate finance

Topics group: Law and business, Organizations and finance

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I. Introduction

Financial crisis faced by the European Union has revealed a problem of tax systems that are in operation in the Member States. Difficulties encountered by enterprises stem from different guidelines on calculating corporate income tax and the impossibility of consolidating financial statements for tax purposes. This problem is faced not only by transnational corporations, but all entities (legal persons) conducting activity in the European Union.

One of the main objectives to be accomplished by the European Union law is to remove barriers to the functioning of domestic market and particularly enhance the competitiveness of enterprises. In this context, the concept of Common Consolidated Corporate Tax Base (CCCTB) has been developed. Its role in a comprehensive reform of tax law is undeniable. The reform is to improve the competitiveness of the EU enterprises. CCCTB concept may become a new quality in tax system.

After several years of efforts, on 16 March 2011 the European Commission approved a proposal for the directive on a Common Consolidated Corporate Tax Base.

The article is aimed at presenting the essence of Common Consolidated Corporate Tax Base (CCCTB) in the theory of corporate finance and its relevance to firms, based on the survey of companies operating in Poland and other Member States. Table 1 presents structural characteristics of Polish enterprises participating in the survey.

Table 1: Structural characteristics of Polish enterprises participating in the survey (percentage share)

Type of organization	joint-stock company	limited liability company	cooperative society	other		total
	3.57	82.15	3.57	10.71		
position	tax manager	chief financial officer	chief accountant	another position		100
	3.57	1.79	60.71	33.93		
number of employees	up to 9 employees	up to 49 employees	up to 100 employees	up to 250 employees	more than 250 employees	100
	37.5	41.07	7.14	8.93	5.36	
period of activity	less than 3 years	between 3 and 5 years	between 5 and 10 years	more than 10 years		100
	12.5	16.07	41.07	30.36		
type of activity	production	trade	construction	service	other	100
	8.9	2	12.	3	1	
	3	3.21	5	5.71	9.65	00

Source: own elaboration based on the questionnaire survey

Limited liability companies constituted the majority of respondents participating in the survey. This is due to the fact that this form of business activity is most popular among entities that have legal personality. Another reason behind such a conclusion is that small enterprises, namely employing up to 49 persons, represented the highest percentage of respondents. Furthermore, questionnaires were mainly filled in by chief financial officers. In small companies they are responsible for tax issues. Nevertheless, this is favourable in the context of the survey and its representativeness. So is the period of activity which, in the case of most respondents, exceeded 5 years, i.e. was rather long.

Table 2 presents structural characteristics of enterprises operating in the Member States that have responded to the survey.

Table 2: Structural characteristics of the EU enterprises participating in the survey (percentage share)

Type of organization	joint-stock company	limited liability company	cooperative society	other		total
	50	35.71	0	14.29		
position	tax manager	chief financial officer	chief accountant	another position		100
	17.86	46.43	10.71	25		
number of employees	up to 9 employees	up to 49 employees	up to 100 employees	up to 250 employees	more than 250 employees	100
	32.14	0	0	0	67.86	
period of activity	less than 3 years	between 3 and 5 years	between 5 and 10 years	more than 10 years		100
	0	35.71	0	64.29		
type of activity	production	trade	construction	service	other	100
	21.43	7.14	21.43	42.86	7.14	

Source: own elaboration based on the questionnaire survey

Unlike Polish companies, the majority of EU entities were joint stock companies. These are large entities and firms employing more than 250 persons represented the highest percentage of respondents. Questionnaires were mainly filled in by chief financial officers, i.e. employees responsible for tax issues. In the companies under discussion, accounting and taxes are separate departments. The latter are managed by chief financial officers since tax payment has a direct effect on firm's liquidity and financial standing.

According to the judgment of the Court of Justice of the European Union, „*Although direct taxation falls within their competence, the Member States must nonetheless exercise that competence consistently with Community law*”². This is a recommendation for Common Consolidated Corporate Tax Base.

Tax in corporate finance theory

Every change in taxation and tax theory has to do with tax relevance and role in corporate finance practice. In this context, taxation has assumed a new significance to corporate finance theory and practice, and a new paradigm has been construed³. Tax always poses certain risk to the life-cycle of the enterprise, which stems from considerable changeability and uncertainty of taxation law. Furthermore, as a category which has an effect on capital value, tax causes disruption to business certainty. **Two things are certain in every enterprise, namely capital and tax**⁴.

Tax is a financial service and hence every payment of the tax depletes resources that a given company has at its disposal, i.e. capital. It changes the balance of cash generated by the firm. After all, financial resources are used to cover tax liabilities. Considered a burden that has assumed special importance in legal terms, tax has a direct effect on capital potential of the enterprise⁵.

The essence and features of tax are the same in every fiscal system. Rules and financial regulations are subject to change. They determine tax effect, rate and importance for enterprises. The proposal for the directive on CCCTB has such relevance.

² Judgment of the Court of 14 February 1995 Finanzamt Köln-Altstadt vs. Roland Schumacker Case C-279/93; and Judgment of the Court of 4 October 1991 the European Commission vs. the United Kingdom, Case C-246/89, See: p. I-4585, section 12

³ J. Iwin-Garzyńska, *Szkice o kapitale i podatkach w istocie nauki finansów przedsiębiorstw*, Difin, Warszawa 2010 pp. 48-49

⁴ *Ibidem*, p. 40

⁵ Until recently the definition of tax has not taken account of corporate finance context. Cf. J. Iwin-Garzyńska, *Opodatkowanie kapitału*, *Economicus*, Szczecin 2010, pp. 14-23

It is worth quoting views held by Adam Smith. He emphasizes the correlation between individual and national as well as taxation policy pursued by the state⁶. He pays attention to a number of discrepancies between individual and state interest, and places an emphasis on seeking a compromise as part of fiscal policy. Summing up the views expressed by Smith, it should be stated that the level of capital in the company, determining its prosperity as an entity, has to do with fiscal policy followed by the European Union.

Attempting to define the essence of tax in corporate finance, an error can be noticed. It consists in ignoring the subjectivity of a company and its organization⁷. Tax is not „only“ a burden for the benefit of the country. The importance of *Common Consolidated Corporate Tax Base* should be highlighted in this context. It is aimed at eliminating barriers to the functioning of internal market as well as to the functioning of companies in the European Community. Problems faced by enterprises stem from different guidelines on calculating corporate income tax and impossibility of consolidating financial statements for taxation purposes.

Cannons of taxation in the financial essence of tax and CCCTB concept

Taxation system, composed by various tax titles, should be based on certain cannons. These are fundamental rules that govern tax issues in the enterprise, the state and the EU. An important aim is to seek effective income tax system and thereby include the tax cannons in the concept of CCCTB.

Cannons of taxation are not a closed catalogue. This is the knowledge that is not subject to change. It represents phenomena emerging in social and economic reality⁸. Therefore, regardless of political and financial situation of the European Union, the concept of CCCTB should be developed in line with fundamental cannons of taxation and implemented in such a fashion in the future.

⁶ Cf. A. Smith, *Badania nad naturą i przyczynami bogactwa narodów*. Wydawnictwo Naukowe PWN, Warszawa 2007, pp. 583-704. Research on the effect of tax policy on economic growth rate has already been referred to in a number of publications. Cf. Marsden K.: *Links Between Taxes and Economics Growth; Same Empirical Evidence*. Washington 1983; A. Rabushka, *Tax Policy and Economic Growth in Advanced Developing Nations* U.S. Agency for International Development 1987.

⁷ Cf. J. Iwin-Garzyńska, *Kapitał i podatki w nauce finansów przedsiębiorstw*. Finanse nr 4, Warszawa PAN INoF 2011, PP. 117-133

⁸ A. Gomułowicz, *Zasady podatkowe wczoraj i dziś*, Dom Wydawniczy ABC, Warszawa 2001, p. 12.

Adam Smith is considered one of the best known authors of taxation principles. It was him who formulated four canons of taxation, namely canon of equality, canon of certainty, canon of convenience and canon of economy⁹. Fundamental in itself, the canon of equality entails the apportionment of tax burdens in line with the assumption that taxes are universal and proportional to one's income. As far as CCCTB is concerned, the aforementioned principle is particularly significant since it calls for equal standards to be met by all enterprises operating in the European Union. To be more specific, the companies should pay their income taxes in line with the same principles (adjusted only to income bracket). Such a recommendation justifies excluding income tax from the list of harmonized tax rates.

Tax certainty consists in determining the maturity date, method of payment and amount of tax based on clearly and explicitly formulated legal regulations. In fact, this is the objective of the concept under discussion. One of its main assumptions is to provide transparent principles of corporate taxation, regardless of the Member State in which a given enterprise has its establishment and the countries with which this enterprise makes transactions.

The canon of convenience is to provide tax payers with the most suitable (for them) method and place of payment and maturity date. On the other hand, the canon of economy entail the minimization of tax collection costs for tax payers, the state and the entire European Union. In the second half of the 19th century, Wagner modified the principles of taxation and divided them into the following four groups: fiscal, economic, equity and technical.

Taxation canons are to guarantee that a proper amount of tax revenues is paid into the state budget. On the other hand, the significance of economic principle (referring to the integrity and protection over tax sources) involves construing taxes in such a way so that entrepreneurs are able to multiply their capital. As for the canon of equity, Wagner calls for the universality of taxation and eliminating excessive financial differences among society members. As for the financial essence of tax and the concept of common consolidated corporate tax base, these principles are particularly relevant. Uniform taxation system should guarantee the effectiveness of tax source as well as the stability of budget revenues both in the country where the company has its establishment as well as in the entire European Union.

⁹ Cf. A. Smith, *Badania nad ...*, op.cit., p. 584 and next pages.

Furthermore, unitary tax system ought to facilitate economic development of enterprises, and tax must not restrict their freedom. The last-mentioned group of taxation cannons presented by Wagner are technical principles (including convenience, certainty, and economy). These are similar to postulates formulated by Smith. Nevertheless, in Wagner's case, these cannon refer both to tax payers and tax authorities¹⁰. The idea behind introducing common consolidated corporate tax base in enterprises operating in the European Union has its origin the cannon of certainty. According to these cannon, all entrepreneurs managing their business in the EU should be sure about the principles that underlie tax imposition. The cannon of certainty, formulated by Smith, is a protest against tax abuse by tax authorities. Abuse cases are possible due to the arbitrariness of tax imposition.

According to Smith, certainty principle is to prevent from imposing taxes in the amount defined by law provisions, and at the same time protect tax payers from arbitrary actions taken by tax authorities. Understood by Wagner, tax certainty is provided if tax regulations are formulated in plain language, which enables tax payers to understand and get to know them in advance, and tax authorities act only on the basis of these regulations. Wagner suggests general and system solutions since tax infringes personal and economic interests. Thereby only a specific amount of tax shall be paid¹¹.

According to Neumark, the more comprehensible, clear and precise the tax act is, the greater the awareness of obligations to be met by tax payers and the less the abuse cases stemming from extremely fiscal interpretation of tax obligations by the respective authorities¹². Undoubtedly, such a postulate has laid foundations for the concept of common consolidated corporate tax base. It is to minimize the risk faced by enterprises, and the EU directive is to protect the tax base and particularly the right that companies have to create this base. If the cannon of certainty is violated, enterprises need to take proper counter-measures and reduce the tax risk¹³.

¹⁰ A. Gomułowicz, J. Małecki, *Podatki i prawo podatkowe*. Wydawnictwo Prawnicze LexisNexis, Warszawa 2002, p. 64.

¹¹ *Ibidem*, p. 24.

¹² *Ibidem*, p. 26.

¹³ See: S. Wrzosek, *Analiza wrażliwości jako warunek praktycznej efektywności inwestycji rzeczowych*, [in:] *Zarządzanie finansami firm – teoria i praktyka*, t. 2, edited by W. Pluty, Prace Naukowe, Nr 1042, Wyd. Akademii Ekonomicznej we Wrocławiu, Wrocław 2004, p. 396.

Identifying the canons of taxation, essential for the development and operation of tax system in line with CCCTB, it should be borne in mind that the main objective of taxation has a fiscal character. In other words, tax enables the Member States to generate budget revenue. For this purpose and for the sake of tax efficiency, tax should not exert any effect on the economy, should not perform any economic or social function¹⁴. This stems from the universality of taxation. If tax is to be a common burden, it ought to be neutral against economic processes since all entities are obliged to pay taxes by virtue of law. This rule is of special importance for the development of unitary (income) tax system for enterprises operating in the European Union. Such a system will be developed through applying the principle of taxation universality.

Summing up, the role of taxation principles is unquestionable. They show what is right, just and rational in social and economic terms while creating effective and efficient¹⁵ tax system as well as introducing changes into this system (due to the changeability of socio-economic conditions). Following the canons of taxation should facilitate the creation of fiscal environment friendly for entrepreneurship and economic development in the European Union.

Therefore, it is relevant to verify if Polish and EU enterprises are familiar with solutions provided in the proposal for the directive and consider them significant from the perspective of fundamental canons of taxation.

¹⁴ P.M Gaudemet., J. Molinier, *Finanse ...*, op. cit., p. 422

¹⁵ According to Wilkinson, tax system is efficient if distortions caused by its operation in economic behaviour displayed by investors, consumers and savers as well as changes in product prices are minimized. If a given type of tax alters economic behaviour displayed by tax payers (i.e. their natural preferences), additional tax burdens are being placed and thereby their prosperity is reduced to less than minimum level. Wilkinson is inclined to believe that effective actions taken by public authorities should be aimed at minimizing such distortions, due to which taxation becomes effective and neutral. M. Wilkinson, *Taxation*, London 1992, pp. 22-23.

Table 3: Cannons of taxation – benefits accruing from implementing CCCTB in the opinion of Polish enterprises (0 – insignificant, 5 – significant).

	0	1	2	3	4	5	absence of answer	Altogether
Eliminating barriers created by different domestic tax systems	5.36%	3.57%	7.14%	10.71%	12.50%	23.21%	37.50%	100%
Administrative simplifications and reducing bureaucratic burdens	3.57%	8.93%	10.71%	5.36%	16.07%	17.86%	37.50%	100%
Providing enterprises with permanent establishment in different Member States with equal treatment	7.14%	7.14%	8.93%	8.93%	10.71%	19.64%	37.50%	100%
Eliminating double taxation and dealing with tax evasion	3.57%	3.57%	8.93%	3.57%	8.93%	33.93%	37.50%	100%
Better utilization of capital, growth of competitiveness, new jobs	1.79%	8.93%	10.71%	12.50%	14.29%	14.29%	37.50%	100%
Formulating a more transparent tax policy	1.79%	3.57%	3.57%	10.71%	17.86%	25.00%	37.50%	100%
Cross-border equalization of profits and losses	7.14%	10.71%	8.93%	7.14%	7.14%	21.43%	37.50%	100%

Source: own elaboration based on the questionnaire survey

Polish enterprises regard solutions proposed in the proposal for the directive as significant for the development of transparent tax policy and eliminating double taxation. This is an important signal that the aforementioned entities expect tax system to be stable and transparent. It is beyond any doubt that such expectations stem from the cannon of generality and equality. Furthermore, entrepreneurs are inclined to believe that introducing such a system will facilitate the elimination of barriers created by particular tax systems. They consider the proposed concept significant for administrative simplifications and reducing bureaucratic burdens, which is in line with the cannon of economy and efficiency. Nearly one-third of enterprises participating in the survey declare that the concept under discussion will enable to deal with double taxation and tax evasion, which entails that the cannons of equality, universality and fairness are the most significant in the opinion of the aforementioned entities.

Table 4 shows answers provided by enterprises operating in the European Union.

Table 4: Cannons of taxation – benefits accruing from implementing CCCTB in the opinion of the EU (except for Poland) enterprises (0 – insignificant, 5 – significant).

	0	1	2	3	4	5	absence of answer	Total
Eliminating barriers created by different domestic tax systems	12.50%	16.60%	16.60%	12.50%	16.60%	8.30%	16.40%	100%
Administrative simplifications and reducing bureaucratic burdens	16.60%	8.33%	16.60%	12.50%	8.33%	12.50%	24.74%	100%
Providing enterprises with permanent establishment in different Member States with equal treatment	12.50%	0.00%	12.50%	4.17%	16.60%	12.50%	41.73%	100%
Eliminating double taxation and dealing with tax evasion	8.33%	8.33%	16.60%	12.50%	12.50%	8.33%	33.50%	100%
Better utilization of capital, growth of competitiveness, new jobs	16.60%	0.00%	16.60%	4.17%	8.33%	12.50%	41.50%	100%
Formulating a more transparent tax policy	12.50%	8.33%	16.60%	8.33%	16.60%	12.50%	25.50%	100%
Cross-border equalization of profits and losses	12.50%	8.33%	16.60%	20.83%	12.50%	12.50%	16.50%	100%

Source: own elaboration based on the questionnaire survey

EU entrepreneurs did not provide answers to all the questions. The majority of respondents expressed their opinions about eliminating barriers created by different domestic tax systems as well as cross-border equalization of profits and losses. Enterprises operating in the EU are inclined to believe that the concept of CCCTB may be useful in the context of the aforementioned two aspects. These two issues are particularly significant for enterprises under discussion.

Furthermore, tax burdens created by twenty-seven different income tax systems are faced particularly by entities that conduct cross-border activity. Another factors important in the opinion of the EU companies were: administrative simplifications, reducing bureaucratic burdens and greater transparency of tax policy. Analyzing the answers provided, it can be noticed that the above issues are of major importance. A new concept of income tax may give rise to administrative simplifications following from the need for simplicity and transparency of tax system. However, EU enterprises' opinions about administrative simplifications reveal they do not believe that the concept of CCCTB will change something in this respect. In fact, they are afraid that administrative and bureaucratic costs may increase. On the contrary, EU entrepreneurs are positive about the possibility of enhancing the transparency of tax policy. In other words, they call for applying the principle of transparency of corporate income tax system.

The neutrality of tax against economic processes should be a reason behind striving for the harmonization of taxation in the European Union. Such neutrality entails that tax does not exert any effect on decisions made by entrepreneurs about the legal form, business location or method of financing¹⁶. Such a system of fiscal law may be referred to as ***economic neutrality of tax law***.

In order to get to know the influence that taxation has on decisions taken by entrepreneurs and their activity, in 2004 the European Commission conducted a survey in which seven hundred entities participated from the then fourteen Member States (except for Luxembourg). The results were published in ***European Tax Survey***¹⁷. The analysis of respondents' declarations enable one to state that taxation is a significant factor determining entrepreneurs' decisions about business location. According to 87.3% of entities responding to the survey, tax-related issues have had an impact on their decisions about the form of business activity conducted abroad. Such a situation is contradictory to the principle of taxation neutrality and, most of all, should not take place on the internal market.

¹⁶ Company Taxation in the Internal Market, SEC (2001) 1681, p. 2

¹⁷ European Tax Survey, SEC (2004) 112/2 quoted after: M. Supera-Markowska, *Wspólna Skonsolidowana Podstawa Opodatkowania jako koncepcja harmonizacji opodatkowania korporacyjnego w UE*, C.H. Beck, Warszawa 2010, p. 32

Common currency area has been created in the European Union relatively recently. Therefore, theoretical discussion and findings of empirical research provide a number of interesting cases of countries with one currency but different tax systems operating in their particular regions. Special attention should be paid to experience shared by the United States of America¹⁸ and Canada¹⁹ (federal states with a single currency, yet different tax jurisdictions) in the case of which tax harmonization was not successful.

It is there that tax competition among different states (provinces) is observed. The U.S. literature on the subject presents a great deal of information concerning the subject matter and results of empirical research conducted in this scope²⁰. The findings of these research (see: Zodrow) are relevant since they provide a foundation for recommendations to be followed by the EU common currency area²¹. Nevertheless, controversy over the harmonization of tax systems as well as advantages and disadvantages of tax competition referred to in such research should not be neglected.

Common Consolidated Corporate Tax Base – fundamental assumptions

In a document entitled "A Common Consolidated EU Corporate Tax Base²²" published on 7th July 2004 includes the assumptions of the concept aimed at reducing the costs and barriers to business activity in the European Union²³. **On 16th March 2011²⁴** the European Commission submitted a proposal for the directive on a Common Consolidated Corporate Tax Base (CCCTB).

¹⁸ Cf. e.g. R. Baldwin, P. Krugman, *Agglomeration, Integration and Tax Harmonization*, European Economic Review 2004, no. 48, pp. 1–23.

¹⁹ Cf. J. Mintz, *Corporate Tax Harmonization in Europe: It's All About Compliance*, International Tax and Public Finance 2004, no. 11, pp. 221–234.

²⁰ W.E. Oates, *Fiscal Competition or Harmonization? Some Reflections*, National Tax Journal 2001, no. 54, pp. 507–512

²¹ G.R. Zodrow, *Tax Competition and Tax Coordination in the European Union*, International Tax and Public Finance 2003, no. 10, pp. 651–671.

²² *A Common Consolidated EU Corporate Tax Base*, Commission Non-Paper to informal Ecofin Council, 10 and 11 September 2004, http://ec.europa.eu/taxation_customs.

²³ *Tax Policy in...*, pp. 19–32

²⁴ *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base* of 16 March 2011{SEC(2011) 315}{SEC(2011) 316}

According to the proposal, the main goal of the concept is to eliminate at least some major tax problems impeding economic growth on the EU single market. Due to the lack of uniform corporate tax regulations, interdependence of domestic tax systems often results in double taxation. Hence, enterprises have to deal with heavy administrative burdens and high costs associated with conforming to tax regulations. Such a state of affairs discourages companies from making investments in the EU and consequently hinders the achievement of priorities included in „*Europe 2020*” - a strategy for smart, sustainable and inclusive growth²⁵.

Common Consolidated Corporate Tax Base is a major initiative designed to eliminate obstacles to the creation of a single market²⁶. It is considered²⁷ an initiative stimulating growth that should be undertaken in the first place in order to facilitate economic development and create new jobs. CCCTB concept would guarantee the coherence of domestic tax systems but not the harmonisation of tax rates.

According to the proposal for the directive, tax rates ought to be subject to fair competition. Different rates enable particular countries to maintain certain level of tax competition on internal market. Furthermore, fair competition based on tax rates provides a greater transparency and allows the Member States to take account of the competitiveness of their markets and budgetary requirements while determining tax rates²⁸.

²⁵ The strategy is aimed at smart, sustainable, and inclusive growth. The Strategy *Europe 2020* has defined the following three inter-related priorities:

- smart growth: development of the economy based on knowledge and innovation;
- sustainable growth: supporting the economy based on a more efficient use of resources, more environmentally friendly and more competitive;
- Inclusive growth: supporting the economy characterized by a high employment rate, providing social and territorial cohesion.

Cf. Communication from the Commission EUROPE 2020 A strategy for smart, sustainable and inclusive growth - COM (2010) 2020 Brussels 3.3.2010.

²⁶ Communication from the Commission Towards a Single Market Act – For a highly competitive social market economy – 50 proposals for improving our work, business and exchanges with one another - COM(2010) 608 Brussels 27.10.2010.

²⁷ Communication from the Commission Annual Growth Survey: advancing the EU's comprehensive response to the crisis, COM(2011) 11 Brussels 12.01.2010.

²⁸ Cf. J. Iwin-Garzyńska, *Opodatkowanie przedsiębiorstw w Unii Europejskiej – założenia koncepcji wspólnej skonsolidowanej korporacyjnej podstawy opodatkowania*. in: *Opodatkowanie przedsiębiorstw. Wybrane zagadnienia*. Edited by J. Iwin-Garzyńska. Difin, Warszawa 2013, p. 208

Supporting research and development is one of fundamental objectives included in the directive under discussion. As part of Common Consolidated Corporate Tax Base, all costs associated with R&D are tax deductible expenses. For enterprises that would decide to adopt the system, such an approach will be an incentive to further investment in research and development. In case of economic losses which are subject to cross-border compensation, consolidation within the framework of CCCTB will contribute significantly to reducing the tax base. Nevertheless, the implementation of CCCTB will expand the average EU tax base mainly due to the option taken as far as the depreciation of assets is concerned.

The introduction of CCCTB would reduce or even eliminate barriers to conducting cross-border activity in the European Union. This is of profound importance for enterprises regardless of their size. In the case of small and medium-sized companies, costs involved in adjusting the activity to regulations imposed in particular countries are a major barrier. Compared to the turnover of such firms, these costs are an important item. As for large enterprises, the possibility of cross-border settlement of tax losses is the main advantage of the new solution²⁹. A system will be chosen voluntarily. Since not all enterprises conduct their activity abroad, CCCTB will not require companies which do not intend to expand their business outside their homelands to cover costs associated with adopting a new tax system.

Only methods for determining tax base will be subject to harmonisation. It will not be the case with financial statements. Therefore, the Member States will still apply domestic principles of financial accounting, and CCCTB will impose autonomous regulations on calculating corporate tax base. These regulations will not exert any effect on producing annual and consolidated financial reports. As for CCCTB, certain enterprises would have to follow uniform tax rules (applicable in the entire European Union) and would deal with single tax administration (one-stop shop). Having decided to apply common consolidated corporate tax base, the company is no longer subject to domestic corporate tax system as far as all the issues regulated by joint regulations are concerned.

²⁹ J. Iwin-Garzyńska, *Wspólna skonsolidowana korporacyjna podstawa opodatkowania dla małych i średnich przedsiębiorstw*. in: Uwarunkowania rynkowe rozwoju mikro, małych i średnich przedsiębiorstw. Edited by A. Bielawska. Zeszyty Naukowe US nr 752, Ekonomiczne problemy usług nr 102, Szczecin 2013, pp. 594-602

Enterprises conducting activity in more than one state will benefit from the possibility of cross-border loss relief and lowering the costs involved in conforming to corporate tax regulations. The possibility of direct consolidation of profits and losses for the purpose of calculating the EU tax base is a major step toward reducing over taxation in a cross-border context. At the same time, it is a step toward improving the existing conditions, namely in the scope of tax neutrality of domestic and cross-border activity. This will lead to a more effective fulfilment of internal market potential³⁰.

The main advantage of implementing CCCTB for enterprises is the reduction of costs associated with observing tax regulations. Data published by the European Commission indicates that the introduction of the aforementioned concept may lower such costs by circa 7%. Actual reduction of the costs under discussion may have a major impact on enterprises' potential and willingness to expand their business and enter foreign markets (especially the companies that have operated only on regional markets so far)³¹.

The directive under consideration provides a complete set of corporate tax regulations. It specifies which entities may select tax system, method of determining tax base, relief scope and methods. Furthermore, it introduces regulations on combating fraud, proposes a method for the apportionment of consolidated base, and specifies how CCCTB system is to be administered by the Member States in line with „one-stop shop” principle³².

³⁰ Calculations made with reference to multinational enterprises operating in the EU indicate that about 50% of multinational financial groups and 17% of multinational non-financial groups may receive direct compensation for cross-border losses. *Prawo podatkowe przedsiębiorców*. Ed. by H. Litwińczuk, LEX a Wolters Kluwer business, Warszawa 2013, pp. 234-235

³¹ Cf. COUNCIL DIRECTIVE on a Common Consolidated Corporate Tax Base (CCCTB); Brussels, COM(2011) 121/4, 2011/0058 (CNS) {SEC(2011) 315}{SEC(2011) 316}. According to the estimates made by the European Commission, a new regulation would enable to save about 700 million Euro annually in the European Union on the costs associated with adjusting to other fiscal systems, circa 1.3 billion Euro as a result of the consolidation of calculation rules, and nearly 1 billion Euro on cross-border activity. Experts are inclined to believe that such a solution would increase the attractiveness of the EU as a location of large-scale investments.

³² J. Iwin-Garzyńska, *Wspólna Skonsolidowana korporacyjna podstawa opodatkowania szansą dla przedsiębiorstw polskich*, Roczniki Naukowe Wyższej Szkoły Bankowej w Toruniu. Edited by Maria Dragun Gertner. Toruń: Wyższa Szkoła Bankowa w Toruniu, 2012, nr 11

Optional implementation of CCCTB entails that it will be the 28th tax system adopted by the twenty-seven Member States. In other words, certain enterprises or individual tax-payers will choose fiscal regime referred to in the directive or follow their domestic tax systems. Therefore, the proposal is a major step toward the harmonisation of corporate income tax which, by improving the internal competitiveness of the EU, is to restrict harmful internal competition.

In the context of following the principles of income tax, and particularly the principle of tax system coherence and transparency, it should be emphasized that the directive under discussion provides a complete regulation on CCCTB. Directive on CCCTB and related issues should be implemented only when all the aspects to determining the tax base and its apportionment are known, and so are the mechanisms that underlie the functioning of administration in such the new system. Needless to say, the system has to be comprehensive and coherent³³.

Income tax base vs. CCCTB

Corporate tax system is based on a general rule according to which tax amount to be paid by the entrepreneur depends on the tax base and tax rate. Tax base shall be subject to harmonisation, i.e. will be determined in line with rules and regulations uniform for all the companies that have adopted CCCTB system in the European Union. In other words, the tax base will be calculated as a difference between taxable income (minus exempt revenue) and tax deductible expenses. Therefore, in order to determine the tax base, one ought to bear in mind such notions as taxable income, exempt revenue and tax deductible expenses. Defining the above categories as part of CCCTB system, one should take account of a set of joint regulations on determining corporate tax base, not violating provisions included in the Council Directives 78/660/EEC³⁴ and 83/349/EEC³⁵ as well as Regulation (EC) No 1606/2002 of the European Parliament and of the Council³⁶.

³³ J. Iwin-Garzyńska, *Wspólna Skonsolidowana Korporacyjna Podstawa Opodatkowania szansą rozwoju regionu* Zeszyty Naukowe Uniwersytetu Szczecińskiego; Ekonomiczne Problemy Usług nr 63, Wydawnictwo Naukowe Uniwersytetu Szczecińskiego, Szczecin 2012

³⁴ Dz.U. L 222 of 14th August 1978, p. 11. (Journal of Laws of the Republic of Poland)

³⁵ Dz.U. L 193 of 18th July 1983, p. 1. (Journal of Laws of the Republic of Poland)

³⁶ 10 Dz.U. L 243 of 11th September 2002, p. 1. (Journal of Laws of the Republic of Poland)

Tax revenue is an excess of revenues over tax deductible expenses in a given fiscal year, with special reference to the principles of determining income (revenue) from profit-sharing by legal persons as well as transactions between related parties and resident tax payers with permanent establishments in tax havens³⁷. If tax deductible expenses exceed revenues, the difference is a loss³⁸. In specific situations, tax base is a revenue itself and deductible expenses are not taken into account³⁹.

As far as the EU concept of common consolidated corporate tax base is concerned, tax base is calculated by subtracting exempt revenues, tax deductible expenses and other deductible items from revenues⁴⁰. Apart from the definition, the concept presents a normative approach to detailed rules on calculating tax base. According to the idea, revenue is calculated in line with the following general principles:

- a) Accrual basis;
- b) Profits and losses are recognized when they are earned or incurred respectively (realization principle);
- c) Transactions and taxable events are evaluated individually (principle of individual evaluation);
- d) Revenues are calculated in line with uniform principles, unless exceptional circumstances justify the change (principle of coherence)⁴¹.

³⁷ Cf. Corporate Income Tax Act, Article 7 (2), Article 10, Article 11

³⁸ Ibidem, Article 7 (2)

³⁹ Ibidem, Article 21 and Article 22

⁴⁰ *Article 10 Elements of the tax base*

⁴¹ Cf. A proposal for the directive *Article 9 General principles*

1. In computing the tax base, profits and losses shall be recognised only when realised .

2. Transactions and taxable events shall be measured individually.

3. The calculation of the tax base shall be carried out in a consistent manner unless exceptional circumstances justify a change.

4. The tax base shall be determined for each tax year unless otherwise provided. A tax year shall be any twelve-month period, unless otherwise provided.

Also WP/066/2008, p. 2, point 5,

The proposal for the directive provides definitions of such notions as revenue, profit and loss. "Revenues" are understood as proceeds of sales and other transactions, except for value added tax and other types of tax and tax receivables on behalf of government bodies, in monetary or non-monetary form, including proceeds from the disposal of assets and rights, interest, dividends and other profits, proceeds of liquidation, royalties, grants and subsidies, gifts received, compensation and ex-gratia payments.

Furthermore, revenues include non-monetary gifts made by the tax payer. On the contrary, revenues are neither equity raised by the tax payer, nor debt repaid to it. According to the authors of the proposal, „profit” is an excess of revenues over tax deductible expenses and other deductible items in a given fiscal year, whereas „loss” is an excess of tax deductible expenses and other deductible items over revenues generated in a given tax year.

Emphasis should be placed on the fact that according to the proposal, not only non-monetary gifts received, but also made by a donee are subject to taxation. In the case of a donor, income is in fact fictional, i.e. object of donation has not been presented (donated) but sold at a market price. So-called hidden reserves (i.e. a difference between market value and book value of the object of donation) are taxed in such a way,⁴².

Corporate Income Tax Act, which is in operation in Poland, does not provide solutions imposing tax on the donor. Therefore, solutions included in the proposal can be considered less favourable for Polish enterprises. Such an approach to the valuation of non-monetary gift received by the donee is presented in Article 22 (*Valuation*) of the proposal according to which:

1. For the purposes of calculating the tax base, transactions shall be measured at:...

- b) The market value where the consideration for the transaction is wholly or partly non-monetary;
- c) The market value in the case of a non-monetary gift received by a taxpayer;

⁴² *Wspólna korporacyjna podstawa opodatkowania w UE a opodatkowanie dochodu spółek w Polsce*, edited by H. Litwińczuk, Oficyna Prawa Polskiego, Wydawnictwo Wiedza i Praktyka, Warszawa 2011, p. 74

The proposal for the directive provides a relatively short list of exempt items. According to Article 11 *exempt revenues*:

The following shall be exempt from corporate tax:

- a) Subsidies directly linked to the acquisition, construction or improvement of fixed assets, subject to depreciation in accordance with Articles 32 to 42;
- b) Proceeds from the disposal of pooled assets referred to in Article 39(2), including the market value of non-monetary gifts;
- c) Received profit distributions;
- d) Proceeds from a disposal of shares;
- e) Income of a permanent establishment in a third country.

Exempt revenues shall also include dividends, proceeds from the disposal of shares in the company outside the group and profits generated by foreign permanent establishments. As for the relief for double taxation, in most Member States it is the case with dividends and proceeds from the disposal of shares. In this way, such countries avoid the need of calculating the tax payer's entitlement to a credit for the tax paid abroad. Particularly if the entitlement is to take account of corporate tax paid by the enterprise which distributes dividends. The exemption of foreign income also meets the simplicity requirement.

In the survey on common consolidated corporate tax base and its importance for companies operating in Poland and other Member States, the aforementioned entities have been asked about the significance of exempt revenues. Table 5 shows answers provided by Polish enterprises to the aforementioned question.

**Table 5: Significance of exempt revenues in the opinion of Polish enterprises
(0 – insignificant; 5 - very significant)**

	0	1	2	3	4	5	absence of answer	total
Proceeds of forestry and farming activity	92.86%	0.00%	0.00%	0.00%	0.00%	3.57%	3.57%	100.00%
Accrued but not received interest on debt, bank deposits, etc.	66.07%	16.07%	7.14%	3.57%	1.79%	1.79%	3.57%	100.00%
Exchange gains calculated on a balance sheet date but unrealised	69.64%	8.92%	5.36%	1.79%	5.36%	5.36%	3.57%	100.00%
Dividends and other proceeds from profit-sharing by legal persons	80.36%	1.79%	3.57%	8.92%	0.00%	1.79%	3.57%	100.00%
Tax refund, fees and other non-deductible expenses	69.64%	17.85%	5.36%	1.79%	1.79%	0.00%	3.57%	100.00%
Received interest on overpaid tax	82.15%	8.92%	5.36%	0.00%	0.00%	0.00%	3.57%	100.00%
Grants and subsidies on the defrayal or reimbursement of expenses	87.50%	7.14%	1.79%	0.00%	0.00%	0.00%	3.57%	100.00%
Proceeds from the government of foreign country in the form of non-repayable assistance	92.85%	1.79%	0.00%	0.00%	1.79%	0.00%	3.57%	100.00%
Proceeds from business activity conducted in Special Economic Zone	94.64%	1.79%	0.00%	0.00%	0.00%	0.00%	3.57%	100.00%
Proceeds from the utilization of real estate free of charge	94.64%	1.79%	0.00%	0.00%	0.00%	0.00%	3.57%	100.00%
Proceeds defined by the Head of tax office	94.64%	1.79%	0.00%	0.00%	0.00%	0.00%	3.57%	100.00%

Source: own calculation based on the questionnaire survey

The analysis of the data presented in Table 5 indicates that exempt revenues are rather insignificant for Polish companies. This may stem from the fact that certain exempts have a special character and are the case with specific companies, e.g. conducting forestry or farming activity, conducting activity in Special Economic Zone. As for the enterprises participating in the survey, this was a relatively low percentage.

According to the proposal of the directive on a CCCTB, *deductible expenses shall include all costs of sales and expenses incurred by the tax payer with a view to obtaining or securing income, including costs of research and development and costs incurred in raising equity or debt for the purposes of the business*⁴³.

What arises from the above is that deductible expenses associated with conducting business activity normally include all the costs involved in sales as well as generating and securing the income. Furthermore, deductible expenses include R&D costs as well as costs incurred in order to generate equity or foreign capital for the sake of business activity⁴⁴.

As for tax deductible expenses in the concept of CCCTB, cause and effect relationship between exempt revenues and tax deductible expenses is of particular relevance. According to the proposal for the directive, deductible expenses include *expenses incurred by the tax payer for the purpose of the business, with the view to obtaining or securing income*. This condition, referred to as „economic purpose test”, is ambiguous⁴⁵ and imprecise. As it has already been mentioned, Corporate Income Tax Act in operation in Poland has imposed individual approach to each and every cost incurred by the company, particularly in the case of so-called indirect costs associated with securing the source of revenue. Nevertheless, even a detailed analysis does not eliminate the tax risk posed by the fact that the assessment made by tax authorities may differ from subjective assessment made by the tax payer. In such a situation it is often the court that resolves the classification of cost, namely whether it is a deductible or non-deductible expense⁴⁶.

The aforementioned Act is not precise in the context under discussion. Hence, the assessment of costs incurred by the company will also be made by the court since it may be difficult and ambiguous to define „economic purpose” of a given expense.

⁴³ Article 12 of the proposal for a Council Directive *Deductible expenses*

⁴⁴ Issues relating to costs associated with raising equity and incurring debt, treated as tax deductible costs, will be addressed in next sections of the present paper.

⁴⁵ Wspólna korporacyjna ..., op. cit. p. 77

⁴⁶ According to the sentence pronounced by the Supreme Administrative Court, if an expense is to be recognized as tax deductible expense, it is not enough to express hope that such a revenue will be earned in the future. Every entrepreneur has to analyse his/her operations, and not only hope that these operations will be successful. The sentence pronounced by the Supreme Administrative Court on 2 December 2004. FSK 1215/04; Rzeczpospolita daily on 3rd December 2004.

However, it should be emphasized that the proposal for the directive considers *all costs incurred by the tax payer for business purposes as deductible expenses*. Nonetheless, Article referring to the aforementioned expenses is flexible.

Article 14 of the proposal lists non-deductible expenses, namely:

- a) profit distributions and repayments of equity or debt;
- b) 50 % of entertainment costs;
- c) the transfer of retained earnings to a reserve which forms part of the equity of the company;
- d) corporate tax;
- e) bribes;
- f) fines and penalties payable to a public authority for breach of any legislation;
- g) costs incurred by a company for the purpose of deriving income which is exempt pursuant to

Article 11; such costs shall be fixed at a flat rate of 5% of that income unless the tax payer is able to demonstrate that it has incurred a lower cost;

In order to analyse deductible expenses in the context of income tax and CCCTB concept, it is essential to get to know entrepreneurs' attitudes toward the burden placed by non-deductible expenses.

**Table 6: Significance of non-deductible expenses in the opinion of Polish enterprises
(0 – insignificant; 5 - very significant)**

	0	1	2	3	4	5	absence of answer	total
Costs incurred for the purpose of land purchase or perpetual usufruct	66.07%	10.71%	8.93%	1.79%	0.00%	8.93%	3.57%	100.00%
Costs incurred for the purpose of using personal car in the amount set, based on the value of the car, exceeding 20 000 Euro	60.72%	12.50%	8.93%	7.14%	3.57%	3.57%	3.57%	100.00%
Costs incurred for the purpose of loan (credit) repayment except for capitalized loan (credit) interest	46.43%	21.42%	8.93%	8.93%	1.79%	7.14%	5.36%	100.00%
Accrued but unpaid or amortized interest on debt including loan	62.50%	16.06%	1.79%	3.57%	8.93%	1.79%	5.36%	100.00%
Interest, commission and exchange difference on loan (credit) increasing the costs of investment during its realization	73.22%	7.14%	3.57%	1.79%	3.57%	7.14%	3.57%	100.00%
Collection costs associated with defaulting on the debt	75.00%	14.29%	3.57%	0.00%	3.57%	0.00%	3.57%	100.00%
Fines and penalties	76.78%	10.71%	5.36%	1.79%	1.79%	0.00%	3.57%	100.00%
Deductible (barred) debt	58.93%	19.64%	3.57%	0.00%	3.57%	1.79%	12.50%	100.00%
Default interest on untimely contributions to the budget and other contributions	55.36%	32.14%	5.36%	3.57%	0.00%	0.00%	3.57%	100.00%
Reserves created in line with Accounting Act	62.50%	7.14%	10.71%	3.57%	5.36%	1.79%	8.93%	100.00%
Entertainment costs	55.36%	32.14%	5.36%	3.57%	0.00%	0.00%	3.57%	100.00%
Capital allowance calculated for tax purposes faster than for accounting purposes	62.50%	7.14%	10.71%	3.57%	5.36%	1.79%	8.93%	100.00%
Interest on loans granted by shareholders	44.64%	25.00%	16.07%	1.79%	3.57%	3.57%	5.36%	100.00%
Revaluation of assets in books of account	71.42%	1.79%	12.50%	5.36%	3.57%	1.79%	3.57%	100.00%

Source: own computation based on the questionnaire survey

Polish companies do not regard non-deductible expenses as particularly significant. Fines and penalties, collection costs and exchange differences (in the case of loans) are considered the least important. On the contrary, interest on loans granted by shareholders seems to be more relevant in the opinion of the tax payers under discussion.

Corporate finance, capital structure vs. CCCTB concept

Issues relating to the effect that income tax has on capital structure are very complex. Attention should be paid to fundamental questions regarding tax solutions suggested in CCCTB concept in the context of corporate finance theory. As far as research on capital structure and its impact on goodwill are concerned, major breakthrough was achieved by Franco Modigliani and Merton H. Miller. In 1958 they published an article entitled *The Cost of Capital, Corporation Finance and the Theory of Investment*⁴⁷. It has initiated a number of publications on the subject and started a discussion that is in fact held up to the present day. The discussion centres on the consequences of the capital structure imposed by the company for its finance and goodwill⁴⁸. According to the theory developed by Modigliani and Miller, in the world without taxes both the goodwill and weighted average costs of capital (WACC) do not depend on capital structure.

In 1963 Modigliani and Miller published an article which was a correction to the capital structure irrelevance proposition⁴⁹. It was then that they addressed the problem hitherto explored by corporate finance. **Major difficulty lay in defining the role of tax in shaping the financial policy to be pursued by the company**⁵⁰. The authors under discussion presented a different view on the effect that the capital structure had on the goodwill. Having in mind corporate income tax, they were inclined to believe that under such circumstances the level of foreign funding to the enterprise was optimum and therefore the capital structure was optimum.

⁴⁷ Cf. F. Modigliani, M.H. Miller: *The Cost of Capital, Corporation Finance and the Theory of Investment*. American Economic Review 1958, nr 48

⁴⁸ Cf. article by F. Modigliani and M.H. Miller: *Corporate Income, Taxes and the Cost of Capital. A Correction*. American Economic Review 1963, nr 53

⁴⁹ Cf. F. Modigliani, M. H. Miller: *Corporate income ...*, *op.cit.*

⁵⁰ Cf. D. J. Ashton: *Corporate Financial Policy: American Analytics and U.K. Taxation*. Journal of Business Finance and Accounting 1991, nr 4

Taking account of tax differentiation (**tax asymmetry**) was a key to the analysis. The asymmetry is between income generated by shareholders and creditors at the company level⁵¹. Costs associated with interest on foreign capital reduce income tax base, unlike retained dividends and profits⁵². Hence, the utilization of outside capital involves interest tax shield. If interest is subtracted from corporate tax base, the goodwill of business entity which utilizes debt financing exceeds the goodwill of the company which does not utilize foreign capital (by the compound value of tax shield)⁵³.

Introducing the tax system allowing to reduce the tax base by expenses such as interest on debt, Modigliani and Miller proved that less expensive foreign capital (due to interest tax shield) increased the goodwill. At the same time, they were the first to stress the importance of tax for financial policy pursued by the company and aimed at increasing its goodwill.

The theory formulated by Modigliani and Miller in 1963 highlighted **the role of tax in corporate finance**. They proved that it was possible to shape the capital structure and goodwill through tax policy. It is worth emphasizing that this aspect to tax has not yet been noticed by employees responsible for tax management in enterprises. Nowadays tax is often treated as a fiscal burden and not a flow that may be managed in order to exert an influence on the goodwill. **With reference to the concept of CCCTB, the aforementioned theory states reasons for introducing one corporate tax system in the entire European Union so that all entities have equal opportunities for developing their goodwill through tax policy.**

As for factors determining the capital structure in a given company, attention was also paid to the role of the other, namely non-debt tax shields, resulting from depreciation and investment allowances that may lessen the effect of interest tax shield⁵⁴. Non-debt tax shields enabled to modify the research conducted by Miller by adding the concepts framed by DeAngelo and Masulis. They highlighted the role of investment tax shield in determining optimum tax structure.

⁵¹ Cf. J.D. Matin, S.H. Cox, R.D. McMinn: *The Theory of Finance. Evidence and Applications*. The Dryden Press, Chicago 1988

⁵² Cf. L.D. Schall, Ch.W. Haley: *Introduction to Financial Management*. McGraw-Hill International Editions, New York 1991, p. 429

⁵³ Cf. F. Modigliani, M. H. Miller: *Corporate ...*, op. cit.

⁵⁴ Cf. A. C. Shapiro, *Modern Corporate Finance*. McMillan Publishing Company, New York 1990, p. 439

Furthermore, they proved that the goodwill of company with high non-debt tax shield may be the same as the goodwill of entity with high debt and thereby high interest tax shield. The higher the depreciation tax shield, the lower the interest shield. Such a conclusion was drawn by Masulis. In other words, the variety of tax shields enables one to create capital structure optimum for every company and the economy⁵⁵. Capital structure is optimum at a certain debt level, when the total value of tax shields (interest and depreciation) is a maximum allowance under certain fiscal conditions⁵⁶.

Based on the theory developed by Modigliani and Miller as well as the research conducted by DeAngelo and Masulis, it can be stated that **taking account of income tax and depreciation costs enables the companies to increase their goodwill through tax benefits**. Therefore, the optimum capital structure of the company does not stem only from the share of equity and outside capital in the aforementioned structure, but is also a consequence of financial system solutions adopted as far as income tax is concerned⁵⁷.

The analysis of the theories referred to in the present paper suggests those debt and interest tax shields are particularly relevant to shaping the optimum structure of capital. So are system solutions for recognizing tax effects of debt financing.

Solutions aimed at determining the level and structure of capital have been included in the proposal for the directive on CCCTB. It would be a simplification to put into practice an assumption that interest lessens the debt cost by recognizing it as a deductible expense.

⁵⁵ Empirical verification has shown that the theory developed by DeAngelo and Masulis is not the case with Polish companies. Polish enterprises with high depreciation tax shield, which is a substitute for interest shield, do not incur debt to a lesser extent. Companies with debt in their capital structure to a greater extent make use of the effect of depreciation tax shield. Cf. J. Iwin-Garzyńska: *Empirical Verification of Depreciation Tax Shield Theory in Conditions of Polish Economy in Transformation*. *Ekonomia*, Wydawnictwo Uniwersytetu Warszawskiego, kwartalnik nr 15/2004, pp. 25-34

⁵⁶ Cf. J. D. Martin, S. H. Cox, R. D. McMinn, *The Theory of Finance. Evidence and Applications*. The Dryden Press, Chicago 1988, p. 347

⁵⁷ Cf. J. Iwin: *Theory of irrelevance of capital structure versus depreciation tax shield*. *Zeszyty Naukowe Uniwersytetu Szczecińskiego nr 305, Folia Oeconomica Stetinensia 7*, Wydawnictwo Naukowe Uniwersytetu Szczecińskiego, Szczecin 2001, pp. 111-116

According to Corporate Income Tax Act, tax deductible expenses do not include loan (credit) repayment, except for capitalized interest on the loan (credit). In other words, interest is recognised as a deductible expense once it has been capitalized. In legal terms, in the case of contract relationship payment is one form of discharging the liabilities by a debtor due to which the debt is amortized⁵⁸.

General principles formulated in the Act enable one to account for interest expenses by recognizing them as deductible costs. Obviously, there are exceptions to the rule (e.g. interest, calculated to date of handing over a fixed asset for use, is capitalized to its original value and effectively recognized as deductible cost through capital allowance)⁵⁹. Therefore, according to the Act under discussion, the term 'tax deductible expenses' does not refer to „*accrued but not paid or amortized interest, including interest on loan (credit)*”⁶⁰.

Another type of expenses associated with incurring a debt by the company are commissions and charges. As to the principle, commission is an expense not directly incurred to accomplish the goal for the sake of which the loan has been taken out, but is a source of funding. As for the moment of recognizing commission as a deductible expense, one should pay attention to the regulation included in the Act according to which tax deductible costs, other than costs directly associated with revenues, are deductible once they have been incurred (on such a date)⁶¹.

In line with the Act under discussion, Polish companies can recognise paid and capitalized interest and costs associated with incurring the debt as tax deductible costs. Therefore, it should be verified if solutions proposed by the legislator are significant to Polish enterprises. Table 7 shows the survey results.

⁵⁸ Cf. J. Iwin-Garzyńska, *Koszt długu, CCCTB a budżetowanie kapitałowe*, in: *Budżetowanie działalności jednostek gospodarczych – teoria i praktyka*, edited by A. Dury, Wydawnictwo AGH, Kraków 2012

⁵⁹ Similar opinion concerning the moment of interest deductibility is held by the Ministry of Finance, for instance in: individual interpretation made by the Director of Tax Chamber in Warsaw on 8 April 2009, sign. IPPB3/423-28/09-2/ER

⁶⁰ Cf. Corporate Income Tax Act..., Article 16 (1) 11

⁶¹ Ibidem, Article 15 (4d), including the definition of incurred (expense) date provided in Article 15(4e) of the Act.

Table 7: Significance of tax deductible expenses associated with debt utilization in the opinion of Polish enterprises (0 – insignificant, 5 – significant)

	0	1	2	3	4	5	absence of answer	Total
Costs associated with repayment of loan (credit) except for capitalized interest on the loan (credit)	46.4%	21.4%	8.9%	8.9%	1.8%	7.2%	5.4%	100%
Accrued but unpaid or amortized interest on debt, including loan (credit)	62.5%	16.1%	1.8%	3.5%	8.9%	1.8%	5.4%	100%
Interest, commission and exchange differences between loans (credits) increasing the cost of investment during its realization	73.2%	7.1%	3.6%	1.8%	3.6%	7.1%	3.6%	100%
Interest on loans granted by shareholders	80.4%	1.8%	5.3%	1.8%	1.8%	5.3%	3.6%	100%

Source: based on the questionnaire survey

Polish companies do not attach considerable significance to tax solutions for recognizing costs associated with debt utilization as deductible costs. Over 45% of enterprises participating in the survey do not pay attention to the fact that costs associated with the repayment of loan (credit) are non-deductible. Only more than 7% of entities consider this a major restriction.

Furthermore, the impossibility of reducing the tax base by accrued (but not paid or capitalized) interest is not a problem for Polish companies. Even a lower percentage of companies place profound importance on interest and commission paid during the realization of real investments and representing their original value. So is the case with interest on loans granted by shareholders? In other words, Polish entrepreneurs do not notice the role of deductible expenses in reducing the effective cost of raising foreign capital in the form of loans and credits. In addition, the entities responding to the survey do not consider it problematic that interest on debt can be recognized as a tax deductible cost only if it is paid or capitalized.

In this context, it can be stated that suggestions put forward by the European Commission could be adopted by Polish enterprises within the scope under discussion⁶². Developing the tax system as part of CCCTB concept, attention was paid to the balance between flexibility and standardization of regulations, particularity and generality, and attractiveness of solutions proposed in the concept compared to domestic solutions. If the companies are free to choose the taxation system, they will be able to shape the structure and rate of the tax base⁶³.

The concept under consideration does not refer precisely to interest expenses as tax deductible costs. According to a general definition⁶⁴, all the costs covered by the company to incur and service the debt are deductible expenses. The debt repayment (e.g. credit principal) will not be a tax deductible expense. This solution is identical to the one proposed in Corporate Income Tax Act. Analyzing deductible expenses in line with CCCTB concept, accrual basis is of particular relevance. According to Corporate Income Tax Act in force in Poland, interest is recognized as tax deductible expense in line with cash basis. Accrual basis is also used in MSR/MSSF. Therefore, it can be concluded that interest expenses would reduce the tax base once the tax has been calculated and not actually paid. Such a solution is favourable for enterprises and makes tax principles similar to accounting solutions.

Final conclusions

Income tax system operating in the European Union requires standardization in order to be competitive compared to China, Russia, the United States of America, etc. Nowadays, the Member States are not a single organism as far as income tax is concerned. In fact, they represent twenty-seven different entities that have to compete with one another inside and outside the EU.

⁶² J. Iwin-Garzyńska, *Opodatkowanie kosztu długu przedsiębiorstw a koncepcja Wspólnej Skonsolidowanej Korporacyjnej Podstawy Opodatkowania* in: *Finanse w niestabilnym otoczeniu - dylematy i wyzwania. Finanse przedsiębiorstw*. Edited by T.Famulska, A.Walasiak, Wydawnictwo Uniwersytetu Ekonomicznego w Katowicach, Katowice 2012, pp. 89-90

⁶³ M. Supera-Markowska, *Wspólna Skonsolidowana podstawa opodatkowania jako koncepcja harmonizacji opodatkowania korporacyjnego w UE*, CH Beck, Warszawa 2010, pp. 204-205

⁶⁴ Cf. *Council Directive on a Common ...* Article 12, p. 23

The main objective is to harmonize corporate income tax system so that all the companies operating in the EU are provided with comparable conditions and represent one body outside the European Union. In line with CCCTB concept, tax base (i.e. principles underlying the formation of taxable income and deductible expenses) will be subject to harmonization.

The survey referred to in the present paper indicates that the proposed concept may be favourable for Polish and EU enterprises. Entrepreneurs notice benefits accruing from the suggested solutions. What may be a major concern is limited knowledge that business entities have and their unwillingness to participate in surveys. Unfortunately, the analysis of tax aspects does not suggest another method. There is a general unwillingness among companies to enter merit-based discussion on taxation issues. This unwillingness may stem from distrust in opening fiscal documentation for people from outside the organization, even for the sake of research. This is to the disadvantage of such fields as finance, corporate finance, law and the quality of civil law. The questionnaire survey has enabled one to get to know general views held by Polish and EU enterprises about the proposed harmonization of income tax.

It seems that the Member States have had enough time to work on the details of the directive. However, political interests also play a crucial role. Some countries consider power to tax absolutely essential. Financial crisis, and particularly recent crisis of public finance, has revealed a number of problems with taxation. Nevertheless, the Member States want to protect their budget revenues and remain entirely autonomous in shaping income tax. It is beyond any doubt that CCCTB is a serious proposal. Hence, enterprises operating in the European Union should be aware of its implementation and take account of its possible financial implications. Nevertheless, it is difficult to define the final legal form of the directive on CCCTB or state whether it will come into force.

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