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Base of Corporate Income Tax and the EU Concept

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Additional information is available at the end of the chapter

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Abstract

The chapter discusses the base of the corporate income tax and summarizes the provisions of Polish law on corporate income tax with the draft common consolidated corporate tax base (CCCTB) directive. An analysis of tax revenues and tax costs with particular emphasis on revenue not constituting tax revenue and expenses is not considered tax deductibles. The chapter involved conducting a survey. Surveys were sent to 1000 Polish companies subject to corporate income tax. The companies were selected at random from among all businesses in Poland. Surveys were also sent to 500 companies in the European Union (EU), mainly in Germany, the UK, France, the Netherlands, Italy and the Czech Republic. The survey was answered by a total of 112 Polish companies and 50 foreign companies. Both the Polish and foreign operators who responded to the survey were dominated by limited liability companies and joint stock companies. The basic part of the study was carried out in 2010–2011, but in 2012, the study was repeated, and additional 200 surveys were sent to Polish companies, of which 15 had answered.

Keywords: finance, corporate finance, corporate income tax, tax harmonization in the European Union, CCCTB concept

1. Introduction

The financial and public finance crisis that affected the European Union (EU) countries also highlighted the problem of tax systems in force in 27 EU states. One of the primary purposes of EU law is to eliminate obstacles to the functioning of the internal market, particularly to improve the competitiveness of businesses. Having said that, the concept of a common consolidated corporate tax base (CCCTB) aims to eliminate obstacles to the functioning of the internal market and increases the degree of tax harmonization in the European Union [1].

The chapter discusses the base of the corporate income tax and summarizes the provisions of Polish law on corporate income tax with the draft CCCTB directive. An analysis of tax revenues and tax costs with particular emphasis on revenue not constituting tax revenue and expenses is not considered tax deductibles.

2. Tax revenues

The corporate income tax is based on the universal principle that the value of the tax which the entrepreneur is liable to pay depends on the tax base and tax rates. The tax base is subject to tax harmonization, i.e., the amount will be determined according to uniform rules for all companies covered by the CCCTB in individual EU countries. The tax base will therefore be the difference between taxable income, minus income exempt from taxation and deductible costs. Thus, to determine the tax base, it is important to indicate the notion of tax revenues, income exempt from income tax and deductible costs. Defining these categories in the system of a common consolidated corporate tax base should include a set of common rules for calculating the corporate tax base, without prejudice to the provisions laid down in Council Directives 78/660/EEC and 83/349/EEC and Regulation of the European Parliament and of the Council 1606/2002/EC.

The analysis of the tax base for corporate income tax in the Polish legislation in the context of the CCCTB concept should start with defining the tax base, i.e., taxable income. In the simplest terms, this is defined as a difference between tax revenues and the costs of obtaining them.

In accordance with the provisions of Polish law on corporate income tax, income tax represents the excess of the sum of revenues over costs to obtain them achieved in the fiscal year, subject to the special rules for determining the income (revenue) from participation in profits of legal persons and transactions between related parties and entities residing in tax havens.¹ If the deductible costs exceed the amount of revenue, the difference is a loss. In certain situations, the tax base is the income without taking into account tax-deductible expenses. The income indicated in the act is the basis of income taxation regardless of the type of revenue sources from which it accrues.

The Polish law on corporate income tax does not explicitly specify the definition of “income”. The rules for the generation of income are defined in Art. 12 of the Act on Corporate Income Tax. Art. 12, par. 1, only contains a catalogue of examples of taxable income subject to corporate income tax. This is indicated by the legislator with the phrase “income particularly includes”. This is an open list, and tax revenues particularly include:

1. Received money, cash, including foreign exchange differences
2. Value of goods or rights received free of charge or partially for a fee, as well as the value of other unpaid or partially paid benefits
3. Value (subject to par. 4 item 8 of the Act) of redeemed or expired:

¹Vide Law of 15 February 1992 o podatku dochodowym od osób prawnych [on Corporate Income Tax] (OJ 2000 r. No. 54, pos. 654 with later modifications, Art. 7, par. 2; Art. 10, Art. 11.

- Liabilities, including credits and loans and excluding loans amortized from the labour fund
- Funds in bank accounts (banks)

The literature indicates that, based on the open list contained herein, income can be defined as any enlargement of property resulting in increasing assets or decreasing liabilities [1]. Such definition of tax revenue is also reflected in court decisions. In its judgement of 13 July 2010, the Supreme Administrative Court stated that:

the legislature did not formulate the requirement that income may only cover the benefits mentioned in Art. 12, which are a direct result of achieving the aim of economic activity of a legal person. Therefore any cash deposit may be considered as income of the legal person, provided it meets other requirements set out in section 2 herein. In particular par. 4 of the quoted article contains a list of benefits that cannot be classified as income. It is important to note that the legal norm contained in Art. 12, par. 4 of the act on corporate income tax provides a closed list, the scope of which is not subject to extension or constriction through the use of analogy and extensive interpretation.

Essentially, including a property benefit in the revenues of the legal person is determined by the definitive nature of the benefit in the sense that it definitively actually increases the assets of the legal person. In its judgement dated 27 November 2003, the Supreme Administrative Court in Warsaw stated that “income can include only those values that determine the final increase in the assets of the taxpayer”.

At the same time, recognizing a benefit as income is not determined by the fact that it was not included in the list of tax revenues not recognized by legislature. This was pointed out by the Supreme Administrative Court in its judgement in 14 May 1998, in which it stated that:

the essence of the income tax suggests that it is a public and legal burden on the increase in wealth (income) and, therefore, the revenue - as a source of income - is only the value in entering the property of the taxpayer, may increase their assets. Therefore, the money or monetary values received within the meaning of Art. 12, par. 1 item 1 of the Act in question only include such values that increase the assets of the taxpayer, i.e., those they can dispose of as their own.

Taxation should cover all income, unless expressly exempted. Tax-neutral revenues and therefore those that do not constitute bases for determining the taxable income of the taxpayer are listed in Art. 12, par. 4 act on corporate income tax, where an exhaustive list is included. As a result of this regulation, this provision provides a closed list, the scope of which is not subject to extension or narrowing through the use of analogies or broad interpretation.

Income free of income tax includes payments or accrued receivables on the account of the supply of goods and services. Recognizing received or accrued contributions as deferred revenue requires the ability to allocate these payments to future accounting periods. The company must prove (pointing to the provisions of the contract or the content of the invoice) that the supply of goods or services is to take place in the following accounting periods after the accounting period in which the taxpayer receives payment (advance payment). The provision in question applies in particular to services provided on a continuous basis.

According to Art. 12, paragraph 4, item 2, income not constituting tax revenues includes amounts of accrued but not received interest on debt, including outstanding loans (credits).

This provision shows that interest is neutral for tax purposes until they paid. The taxpayer receives tax revenue from interest income at the time of actual receipt. In this case, cash accounting will apply, which means that the entity, which is owed interest is required to allocate them to their tax revenues only in the accounting period in which the interest is actually received. Any decision of contractors regarding, e.g., changes in interest rates on loans, postponement of payments, etc., shall remain tax neutral until actual payment of interest.

Income exempt from taxation also includes revenue generated by redeemed shares in a company in the part constituting the cost of their purchase or acquisition. The matter also applies to the value of assets received by shareholders in connection with the liquidation of the legal entity. On the other hand, the amounts received for the redeemed shares in excess of expenditure on the acquisition of those shares are taxable income.

In accordance with the provisions of the act, tax-exempt revenues are revenues due to redistributable as well as non-redistributable capital, provided for the Code of Commercial Companies. Such subsidies are a variety of cash benefits brought by shareholders for the company to enlarge its assets. Therefore, subsidies do not affect the size of the share capital. Tax income also does not include amounts and values that are in excess of the nominal value of shares, resulting in their release and transferred to the capital.

Neutral tax cash contributions include funds brought to the capital company and noncash contributions. The provisions of the Law on Corporate Income Tax represent that property values brought to cover equity (capital) are not tax income of businesses, which means that the capital raised through the issue of new ordinary shares shall not constitute taxable income. The consequence of this is the fact that expenses related to the acquisition of capital may not be treated as tax-deductible costs. After all, they do not refer to tax income. They are directly related to the performance of a tax-neutral operation on the share capital [2].

In accordance with the provisions of the Polish Law on Corporate Income Tax, the provisions of the act shall not apply to:

- Income from agricultural activities, with the exception of income from special branches of agricultural production
- Income from forestry within the meaning of the forest act
- Revenues resulting from activities, which may not be legally effective contracts
- Revenue (income) of shipowners taxed under the principles arising from the Law of 24 August 2006 on Tonnage Tax.

The presented provisions show that income derived from these activities is not subject to income tax, i.e., it is free from this tax.

In the EU concept of a common consolidated corporate tax base, it has been determined that the tax base is calculated by decreasing income by income exempt from tax, deductible expenses and other deductible items. Next to the definition, a normative interpretation of specific rules for its determination was proposed. It has been stated that income shall be calculated according to the following general principles:

- The accrual basis.
- Gains and losses are recognized only when they are effective (principle of realization).
- Taxable transactions and events are measured individually (the principle of individual valuation).
- Income calculation is performed according to uniform rules, unless exceptional circumstances justify a change (consistency).²

The introduction of the said rules would favourably distinguish the CCCTB proposals from those used in Polish law on corporate income tax. The Polish solutions reflect the accrual basis in relation to taxable income and costs. The realization principle can be found in relation to interest income and expenses, but it lacks a general reference to taxable profits and losses. The principles of individual valuation and consistency are also slightly emphasized in Polish law.

The draft directive defines the concepts of revenues, profits and losses. The term “revenues” defines income from sales and all other transactions, without the value-added tax and other taxes and duties collected on behalf of government authorities, in cash or noncash form, including proceeds from the disposal of assets and rights, interest, dividends and other distributions and proceeds from liquidation, royalties, subsidies and grants, gifts received, compensation and voluntary payments. Revenues also include in-kind donations made by the taxpayer. Revenues shall not include equity raised by the taxpayer or debt repaid to the taxpayer. According to the authors of the draft directive, “profit” means a surplus of revenues over deductible expenses and other deductible items in a tax year, and “loss” means the excess of deductible expenses and other deductible items over revenues in a tax year.

It is worth emphasizing that, in accordance with the draft directive, taxation applies not only to noncash donations collected by the recipient but also those transferred by the recipient. In the case of the donor it is in fact a fictitious revenue, resulting from the adoption of a fiction that the donated item has not been donated, but was sold according to its market value. In this way, the tax covers the so-called hidden reserves, i.e., income equal to the difference between the market value and the accounted value of a donation [3]. In the Polish law on corporate income tax, there are no solutions requiring the taxation of the donor; hence, the solutions contained in the draft directive may be considered to be less favourable for Polish enterprises. Such an approach to the valuation of monetary donations received by the recipient is based on Article 22 of the draft directive *Valuation*, which states that:

1. For the purposes of calculating the tax base, transactions are evaluated by:(...)
 - (a) Their market value, if all or part of the benefit from the transaction, is nonmonetary.
 - (b) Their market value for monetary donations received by the taxpayer.

²Vide draft directive Article 9 general principles:

When calculating the tax base, only effective gains and losses are taken into account.

Transactions and taxable events are measured individually.

The calculation of the tax base is carried out in a uniform manner, unless exceptional circumstances justify a change in the method of calculation.

Unless otherwise provided, tax base is determined for each tax year. Unless otherwise provided, tax year is any period of twelve months. Also, WP/066/2008, p. 2 item 5.

The list of exemptions from income tax contained in the draft directive is relatively short. Article 11 *Income exempt from taxation* reads:

The following is exempt from corporate tax:

- (a) Grants directly related to the acquisition, manufacture or improvement of fixed assets subject to depreciation in accordance with Arts. 32–42
- (b) Income from the sale of assets referred to in Art. 39, par. 2, including the market value of in-kind donations
- (c) Distributed revenues received
- (d) Proceeds from the disposal of shares
- (e) Income from a facility in a third country

	0	1	2	3	4	5	No answer	Total
Revenues from forestry and agricultural activities	92.86	0.00	0.00	0.00	0.00	3.57	3.57	100.00
Accrued but not received interest on receivables, bank deposits and so on	66.07	16.07	7.14	3.57	1.79	1.79	3.57	100.00
Foreign exchange gains established at the balance sheet date but unrealized	69.64	8.92	5.36	1.79	5.36	5.36	3.57	100.00
Dividends and other revenues from participation in profits of legal persons	80.36	1.79	3.57	8.92	0.00	1.79	3.57	100.00
Returned taxes, charges and expenses not included in KUP	69.64	17.85	5.36	1.79	1.79	0.00	3.57	100.00
Interest received on excess payment of tax	82.15	8.92	5.36	0.00	0.00	0.00	3.57	100.00
Grants, subsidies and payments received to cover the costs or as reimbursement of expenses	87.50	7.14	1.79	0.00	0.00	0.00	3.57	100.00
Income earned from foreign governments derived from non-returnable aid	92.85	1.79	0.00	0.00	1.79	0.00	3.57	100.00
Revenues generated from the economic activity of the SEZ	94.64	1.79	0.00	0.00	0.00	0.00	3.57	100.00
Income from real estate made available free of charge	94.64	1.79	0.00	0.00	0.00	0.00	3.57	100.00
Revenues established by decision of the head of the tax office	94.64	1.79	0.00	0.00	0.00	0.00	3.57	100.00

Source: Author's own calculation based on surveys.

Table 1. The importance of nontax revenues for polish businesses (0, insignificant; 5, very significant) (in %).

Exemption from tax should also apply to income from dividends, proceeds from the disposal of shares in the company outside the group and the profits of foreign establishments. By granting relief for double taxation, the majority of member states exempts the dividends and proceeds from the disposal of shares, thus avoiding the necessity of calculating the amount to be deducted for tax paid abroad, in particular when while calculating the vested deduction, one must take into account the amount of corporate tax paid by the company paying the dividend. The exemption of income earned abroad meets the same requirement of simplifying the system.

While conducting research on a common consolidated tax base and its importance for the Polish and EU companies, questions were asked regarding the significance of revenues other than tax income. The test results are very interesting also from the point of view of simplifying the Polish tax system. Data showing the answers given by Polish companies is included in **Table 1**.

The analysis of the data contained in **Table 1** shows a high insignificance of amounts of income not constituting tax revenues. This may be due to the fact that many of these exemptions are specific and relate to specific companies, e.g., in the agricultural production and forestry activities in the SEZ. These subjects were relatively few in the total group of companies surveyed.

3. Cost of acquiring income

The provisions of the Corporate Income Tax Act do not contain a strict list of expenses that are treated as tax-deductible costs [4]. According to the Act, deductible costs are costs incurred to generate revenue or maintain or secure sources of income, apart from the costs, which are listed numerically in the laws as not deductible.³ A literal interpretation of this provision leads to the conclusion that all incurred expenses, excluding those restricted by law,⁴ are tax-deductible costs as long as they remain in the causal link with revenues, including those aimed at maintaining or securing the functioning of the source of revenue. The provisions of the Act show that it is possible to recognize as deductible costs these expenditures, which—judging rationally—can help to create or increase the company's revenue, provided that the expenditure has not been excluded from such costs. In the jurisprudence of administrative courts and tax authorities, the notion that costs within the meaning of the Corporate Income Tax Act may include those expenses that are in a causal relationship to the economic activity and the revenue obtained in respect thereof has perpetuated.

While defining deductibles for tax purposes, one should not use the definitions contained in other laws, e.g., the Accounting Law. The definitions presented in the theory of economics and

³Expenses that are not deductible for tax purposes are defined by the legislator in Art. 16, par. 1 corporate income tax.

⁴The basic condition for the recognition of the expense as a deductible cost is the absence of this expense in the catalogue of expenditures that are not recognized by the legislature as deductible costs. A list of these expenditures is set out in the law on corporate income tax.

finance and accounting law do not apply to the tax law, and for the purposes of interpretation of the texts of acts of tax law, one should only use the definition of tax expense in Art. 15, par. 1 of the Corporate Income Tax Law.⁵

The wording of the provision on tax-deductible costs gives the company the ability to deduct for tax purposes any cost, provided that there is a direct or indirect connection with the activities and that bearing it has or may have an impact on the amount of income earned. Therefore, tax-deductible costs are all rationally and economically reasonable expenses associated with running a business whose goal is to achieve the protection and preservation of sources of income.

The most important prerequisite that must be met for a certain expense to be recognized as tax deductible is that there should be a causal relationship between the expense and the revenue. This involves such relationship that incurring the cost has an impact on the generation or increase of revenue. In its judgement, the court stated:

undoubtedly the costs of revenues must be related to a specific source of revenue, i.e., the amount of income from that source is affected by the costs incurred in order to obtain revenue, i.e., there must be a causal relationship between the expenses incurred and the actual resulting income or the possibility of obtaining that income.

Tax-deductible costs directly related to revenues should be considered these costs which directly affect the revenue acquired from that source. So these are all costs which are essential for the specified source of revenue to bring specific profits. To recognize the expense as tax deductible, it is not always necessary to demonstrate a direct link between it and the revenue. It should be noted that the deductible costs are all expenses incurred in order to obtain revenue, including in those incurred in order to maintain and secure a source of income, so that this source of revenue brings income in the future as well. Therefore, the costs will also include indirect costs associated with the revenue obtained, if it is shown to have been reasonably incurred in order to obtain revenue (including for ensuring the functioning of the source of revenue), even if the revenue is not achieved due to objective reasons.

Deductibles will therefore include such an expense that meets the following conditions:

- It was incurred by the taxpayer; i.e., in the final analysis, it must be covered with resources of the taxpayer.
- It is definitive (actual); i.e., the value of the expenses incurred has not been reimbursed to the taxpayer in any way.
- It remains in connection with the economic activity of the taxpayer.
- It was incurred in order to obtain revenue or maintain or secure the sources of income.
- It was properly documented.
- It cannot belong in the group of expenses that shall not be deemed tax deductibles in accordance with the provisions of the Act.

⁵The exception is made when the lawmakers refer directly to the provisions of other acts.

It should also be noted that the definition formulated by the legislature is very general. Therefore, every expense incurred by the taxpayer should be subject to individual scrutiny in order to carry out its legal qualification. The exception is when the act clearly shows its affiliation to the category of deductible expenses or disables the ability to include it in such costs. In its judgement, the Supreme Administrative Court stated that:

In determining deductible costs, every expense - other than those expressly set out in the Act - requires individual assessments of the direct relationship with income and the rationality of action to achieve this income. Situations, in which this causal relationship is not clear, should therefore be solved according to the principles of rational reasoning, individually for each case.

Expenses not recognized by the legislature as tax-deductible costs can be divided into three groups:

- Expenses that are not included in the cost of revenues beyond the statutorily defined limits or when no distinct conditions are met
- Expenses which, by their nature, are not deductible for tax purposes but in certain circumstances are recognized as such
- Expenses which are absolutely not deductible

Among the presented groups of costs not considered deductible costs, one can distinguish the following groups:

- (a) Expenditure on the purchase and modernization of fixed assets and intangible assets
- (b) Losses and penalties, including, e.g.:
 - Loss of prepayments, advances and down payments
 - Interest, contractual penalties and damages
 - Enforcement costs, fines and penalties
- (c) Liabilities and reserves, including, e.g.:
 - Overdue receivables
 - Reserves created on the basis of the accounting law
- (d) Taxes
- (e) Expenditure on the operation of cars not included in fixed assets
- (f) Other expenses, including, e.g.:
 - Costs associated with tax-free income
 - Representation expenditure

The definition of deductible included in the draft CCCTB directive (on a common consolidated tax base) differs from that recognized in the corporate income tax. According to the provisions in the draft directive:

deductible costs include any costs incurred by the taxpayer for business purposes related to the achievement, maintaining or securing income, including costs of research and development work and the costs of increasing the capital or debt for commercial purposes.⁶

It follows that the deductible cost of doing business should normally include all costs related to sales and costs associated with achieving, maintaining and securing income. The deductibility also covers the costs of research and development and the costs incurred in raising own or foreign equity for the business purposes. The supplement on deductible costs in the draft directive stipulates that:

tax-deductible costs also include donations to charities specified in Art. 16, established in a Member State or in another country covered by the agreement on the exchange of information on request, comparable to the provisions of Directive 2011/16/EU. The maximum amount of deductible costs related to contributions or monetary donations to charities is 0.5% of revenue in the fiscal year.

In the analysis of deductible cost for income tax and the concept of a CCCTB, the category of cause and effect relationship between the income tax and the cost of its acquisition is extremely important. The draft directive stipulates that deductible costs are the “costs incurred by the taxpayer for commercial purposes related to the achievement, maintenance or protection of revenue”. This condition, referred to as the “economic purpose test”, is ambiguous [5] and imprecise. As indicated earlier, a provision in the Polish law requires an individual approach to every cost incurred by the company, especially when it concerns the so-called indirect costs associated with maintaining sources of income. However, even a thorough analysis does not eliminate tax risks arising from the fact that the assessment made by the tax authority may be different from the subjective assessment of the taxpayer. It is then often the court that decides on the eligibility of cost as a tax cost. In one of its judgements, the Supreme Administrative Court stated:

to include the expense in deductible costs it is not enough to hope that such income would one day be achieved. Each entrepreneur acting professionally must analyse the actions they take, and not just hope that they will prove to be beneficial.

The risk of an erroneous inclusion of a cost into deductibles is also clear from the wording contained in the draft directive. The fact that the wording is imprecise may result in the assessment of the cost incurred by a company also being ultimately carried out by a court, as setting “economic purposefulness” of the expense incurred can be difficult and ambiguous. However, it should be emphasized that the draft directive contains a provision that “deductible costs are considered as such if they are incurred by the taxpayer for business purposes”. This wording is still flexible than that contained in the law on corporate income tax.

The draft directive also allows for pro rata write-downs due to depreciation of fixed assets.

Article 14 of the draft directive lists the costs that are not deductible. These include, e.g.:

- (a) Distributed revenues and repayment of equity or debt
- (b) 50% of representation cost
- (c) The transfer of retained profits to other reserves forming part of the company's equity

⁶Article 12 of the draft directive *Deductible expenses*

- (d) Corporate tax
- (e) Bribes
- (f) Fines and penalties paid to a public authority for breach of any legislation
- (g) Costs incurred by the company in order to generate income exempted from taxation pursuant to Art. 11; the amount of such costs is fixed at a flat rate of 5% of that income, unless the taxpayer is able to demonstrate that he has incurred a lower cost

	0	1	2	3	4	5	No answer	Total
Expenses for the purchase of land or the right of perpetual usufruct of land	66.07	10.71	8.93	1.79	0.00	8.93	3.57	100.00
Costs related to the operation of a car to the extent determined by the value of the car exceeding the equivalent of 20,000 Euro	60.72	12.50	8.93	7.14	3.57	3.57	3.57	100.00
Repayment of loans (credits), excluding capitalized interest on these loans (credits)	46.43	21.42	8.93	8.93	1.79	7.14	5.36	100.00
Interest on liabilities accrued but not paid or written off, including loans	62.50	16.06	1.79	3.57	8.93	1.79	5.36	100.00
Interest, fees and currency exchange differences on loans (credits that increase the cost of investment in development)	73.22	7.14	3.57	1.79	3.57	7.14	3.57	100.00
Enforcement costs related to defaults	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
Debts written off as overdue	58.93	19.64	3.57	0.00	3.57	1.79	12.50	100.00
Interest on late payment of overdue budget payments and others	55.36	32.14	5.36	3.57	0.00	0.00	3.57	100.00
Reserves formed in accordance with the provisions of the accounting act	62.50	7.14	10.71	3.57	5.36	1.79	8.93	100.00
Representation costs	55.36	32.14	5.36	3.57	0.00	0.00	3.57	100.00
Depreciation write-offs calculated for tax purposes more quickly 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 the accounting books	71.42	1.79	12.50	5.36	3.57	1.79	3.57	100.00

Source: Author's own calculation based on surveys.

Table 2. The importance of non-deductible costs for polish businesses in income tax (0, insignificant; 5, very significant) (in %).

While analyzing deductible costs for income tax and the CCCTB concept, it is important to note how businesses perceive the burden of costs that are not deductible for tax purposes. **Table 2** shows the importance of the costs that are not considered deductibles for Polish companies.

The data contained in **Table 2** shows that for Polish company costs that are not considered deductibles in income tax do not have much significance. The least important include fines and penalties, enforcement costs, interest expenses, commissions and foreign exchange differences on loans. In contrast, the cost of interest on loans granted by shareholders has greater importance for tax-payers.

It is important to note the wording states that revenue, expenses and all other deductible items shall be recognized in the tax year in which they were achieved or incurred. It follows that the tax costs are deducted in the tax year in which they are incurred. Incurring a deductible cost occurs when the following conditions are met: firstly, the obligation to make payments; secondly, the ability to determine the amount of liability with reasonable accuracy; and thirdly, in the case of trading goods, transfer of significant risks and rewards of ownership of goods to the taxpayer, while in the case of services, receiving the services by the taxpayer. It should be stressed that the proposed solution is possible to implement in the Polish law on corporate income tax.

4. Common consolidated corporate tax base: fundamental assumptions

A document entitled “A Common Consolidated EU Corporate Tax Base⁷” published on 7 July 2004 includes the assumptions of the concept aimed at reducing the costs and barriers to business activity in the European Union. **On 16 March 2011⁸**, the European Commission submitted a proposal for the directive on a common consolidated corporate tax base (CCCTB). 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 growth.⁹

⁷A common consolidated EU corporate tax base, Commission Non-Paper to Informal Ecofin Council, 10 and 11 September 2004 (http://ec.europa.eu/taxation_customs)

⁸Proposal for a council directive on a common consolidated corporate tax base of 16 March 2011{SEC(2011) 315}{SEC(2011) 316}

⁹The strategy is aimed at smart, sustainable and inclusive growth. The *Europe 2020* strategy has defined the following three interrelated 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 of Europe 2020: A strategy for smart, sustainable and inclusive growth (COM(2010) 2020 Brussels 3.3.2010)

Common consolidated corporate tax base is a major initiative designed to eliminate obstacles to the creation of a single market.¹⁰ It is considered¹¹ 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 no harmonization 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 a 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 into account the competitiveness of their markets and budgetary requirements while determining tax rates [6].

Supporting research and development is one of the 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 solution.

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 harmonization. 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. Enterprises conducting activity in more than one state will benefit from the possibility of cross-border loss relief and lower the costs involved in conforming to

¹⁰Communication 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)

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

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 towards reducing overtaxation in a cross-border context. At the same time, it is a step towards 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 potential.¹²

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).¹³

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" principle.

Optional implementation of CCCTB entails that it will be the 28th tax system adopted by the 27 member states. In other words, certain enterprises or individual taxpayers will choose fiscal regime referred to in the directive or follow their domestic tax systems. Therefore, the proposal is a major step towards the harmonization 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 coherent.

5. Corporate finance and 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

¹²Calculations made with reference to multinational enterprises operating in the EU indicate that about 50% of multinational financial groups and 17% of multinational nonfinancial groups may receive direct compensation for cross-border losses.

¹³Cf. 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.

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* [7]. Publications has been started discussion that is held up to the present day. The discussion centres on the consequences of the capital structure imposed by the company for its finance and goodwill [8]. 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 proposition. It was then that they addressed the problem hitherto explored by corporate finance. **Major difficulty lays in defining the role of tax in shaping the financial policy to be pursued by the company** [9]. 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. Taking into account the tax differentiation (**tax asymmetry**) was a key to the analysis. The asymmetry is between income generated by shareholders and creditors at the company level [10]. Costs associated with interest on foreign capital reduce income tax base, unlike retained dividends and profits [11]. 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).

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 of tax shield. 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. 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 economy. 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 conditions [12].

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 into account 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 concerned.

The analysis of the theories referred to in the present paper suggests that debt and interest tax shield 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.

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 recognized 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 amortized.

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). 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)”.

Other types 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). In line with the Act under discussion, Polish companies can recognize 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 3** shows the survey results.

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 as a major restriction.

	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.

Table 3. Significance of tax-deductible expenses associated with debt utilization in the opinion of Polish enterprises (0, insignificant, 5, significant) (in %).

Furthermore, the impossibility of reducing the tax base on accrued (but not paid or capitalized) interest is not a problem for Polish companies. For the few companies place a meaning on interest and commissions paid in the course of actual implementation investments, representing their original value, this is the case for 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 discussion.

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 base.

The concept under consideration does not refer precisely to interest expenses as tax-deductible costs. According to a general definition, 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.

Analysing 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.

6. Conclusions

The income tax system, both in Poland and in the European Union, is in need of repair. The need to improve the Polish system is due to the large erosion of the tax law and the poor quality of legislation. Inside the Union, it requires uniformity in order to become competitive with China, Russia and the United States. Currently, EU countries do not constitute a single entity in terms of corporate income tax but 27 different players as they compete with one another within the EU and beyond. The aim should be to harmonize the system of corporate income tax for all companies within the EU to have comparable working conditions in terms of income tax and represent a unified entity outside the Union. According to the idea of the CCCTB concept, unification will include the tax base, namely, the principle of shaping revenues and tax costs.

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