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## **TAX STRATEGIES AS A MODERN TOOL OF FINANCIAL MANAGEMENT IN COMPANIES**

### **Introduction**

In the market economy there are companies of varied size, i.e. micro-, small, medium-sized and big ones, and of diversified organizational and legal form. They operate within a defined fiscal policy of the state that should be harmonized with adequate EU directives. Taxes, which are the policy's main instrument, constitute a significant burden to the budget of business entities. Thus, business people make attempts to apply tax strategies with the aim to minimize fiscal burden.

The aim of the paper is to present selected tax strategies that are the tool of modern finance management applied in companies. The paper also analyzes current income and VAT taxation methods. The application of a simulation experiment made it possible to point at the optimal solutions regarding the burden on taxation of business entities.

### **1. Concept and classification of selected tax strategies**

Current regulations of tax law make it possible for tax-payers to apply particular tax strategies. It is a common tendency among business people either to pay lower taxes or to avoid doing it<sup>1</sup>. The literature on the subject presents numerous definitions of tax strategies and criteria of their classification.

The concept of tax strategy is perceived as a reaction of business entities to taxation that may consist in <sup>2</sup>:

- adapting to the tax,
- taking measures to transfer the tax,
- taking measures to avoid paying the tax

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<sup>1</sup> J. Ickiewicz, *Obciążenia fiskalne przedsiębiorstw*, PWE, Warszawa 2009, p. 147.

<sup>2</sup> M. Pietrasiewicz, *Polityka fiskalna*, Poltext, Warszawa 1998, pp. 63-64.

- making attempts to make up for the tax, i.e. to decrease unit production costs or increase the sales in order to raise production effectiveness and alleviate tax burdens,
- ceasing business operations that are subject to taxation,
- evading taxes.

S. Zarębski defines tax strategy as *a set of company basic decisions that aim at the reduction of tax burden in order to improve company's market position*<sup>3</sup>. His definition presents the variety of the classification criteria of tax strategies. This involves the moment when the strategy is introduced, the number of taxes it concerns as well as the operating time of the strategies applied.

According to J. Ickiewicz, tax strategy involves operations and decisions made by tax-payers in order to lower the fiscal burden, to prevent double taxation or sometimes to avoid the taxation or to defer it<sup>4</sup>.

When considering the time criterion, tax strategies can be divided into<sup>5</sup>:

- long-term strategies,
- short-term strategies.

The choice of either short- or long-term strategy depends on several factors; the stability of tax regulations is one of them. Practically, short-term strategy is applied by tax-payers whose income comes from employment or civil law contracts, while long-term strategy is used by companies.

When considering the object of taxation, tax strategies can be classified as:

- income strategies,
- cost strategies,
- strategies consisting in the choice of a legal and organizational form of operating,
- strategies related to the choice of taxation method in the income tax,
- strategies including indirect taxes.

Income strategy involves minimization of income that constitutes the taxable base. Legal manifestation of this type of strategy includes the reliefs and exemptions that are offered by the taxation system, e.g. R&D tax relief, effective from 1 January 2016.

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<sup>3</sup> S. Zarębski, *Opodatkowanie przedsiębiorstw usługowych*, [in:] B. Filipiak, A. Panasiuk (ed.), *Przedsiębiorstwo usługowe. Ekonomia*, Wydawnictwo Naukowe PWN, Warszawa 2008, p. 205.

<sup>4</sup> J. Ickiewicz, *Niektóre strategie podatkowe i paropodatkowe jako specyficzne źródło i formy finansowania małych przedsiębiorstw*, [in:] A. Bogus, M. Wypych (ed.), *Harmonizacja rynków finansowych i finansów przedsiębiorstw w skali narodowej i europejskiej*, Difin, Warszawa 2007, pp. 441-449.

<sup>5</sup> J. Ickiewicz, *Obciążenia fiskalne...*, op. cit., p. 148.

According to J. Ickiewicz, the concept of cost strategy consists in generating business costs in the way that should result in the minimization of tax liabilities in a defined period. Thus, tax deducted costs can be either minimized or maximized in particular periods of time. The cost strategy also involves the minimization of costs that are not tax deducted. A crucial element of the strategy is the choice of the depreciation method of fixed assets. Companies may amortize/depreciate fixed assets for tax reasons with the application of linear method, degressive method, by individual rates or – in the case of assets equal or lower than 3 500.00 PLN – a single depreciation charge can be written down in the first month of the use of the asset or in the following month <sup>6</sup>.

The strategy that is related to the choice of the legal and organizational form of operating involves major organizational entities in which dividends are paid. Setting up a limited partnership instead of a share holding company can result in the avoidance of double taxation of the profit on the level of company and then of the dividend.

After reviewing the current literature on the subject, tax strategy will be perceived for the needs of this article as legal and long-term operations and decisions made by tax-payers to optimize tax burden and improve company's competitive position. The decisions should include first of all: the choice of the location and form of business operations, the application of the available tax preferences, the choice of the taxation method or the decision to transfer the operations to other place or to cease the operations.

## **2. The impact of fiscal burden on company's financial situation and its further development opportunities**

In every country fiscal systems are closely linked with the issues of effective tax collection. There are limits in economic practice that cannot be crossed; otherwise business activities will be negatively affected. The negative effects may include the decrease in the entrepreneurship of citizens, the development of gray economy or the transfer of economic activities to regions with less restrictive tax regulations. As regards the state budget, such situation will result in a decrease in revenue<sup>7</sup>. The Laffer curve (Figure 1) shows the relationship between tax rates and tax revenue of the state. Tax revenue grows with the increase in tax rates.

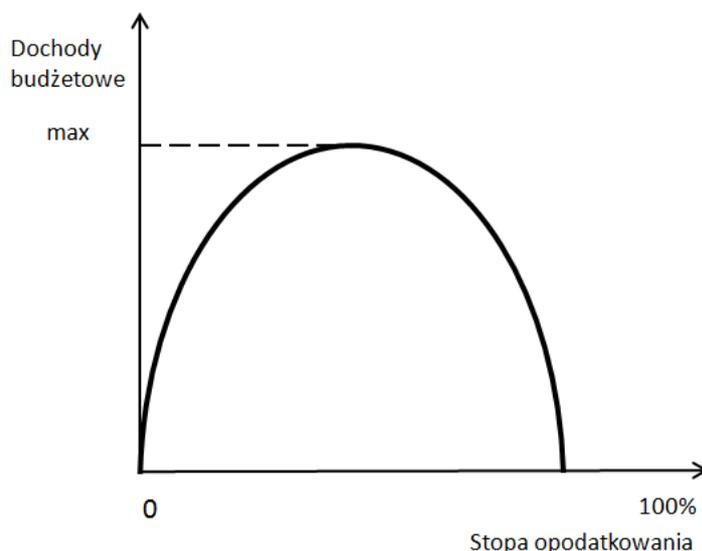
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<sup>6</sup> Act of 15 February 1992 on CIT; consolidated text, Journal of Laws 2015, item 1932, Art. 16f/3

<sup>7</sup> M. Zieliński, *Finanse publiczne*, [in:] H. Zadora (ed.), *Finanse i bankowość w gospodarce rynkowej*, Wydawnictwo Politechniki Śląskiej, Gliwice 2004, p. 94.

However, when the boundary of effective taxation is crossed, entrepreneurship decreases, which results in the fall in budget revenues.

**Figure 1. Laffer curve**



Source: Author's research.

The reaction of private business to the increase in fiscal burden is varied. Companies may make a decision on paying the tax, applying a tax strategy or – in extreme cases – leaving the market or avoiding the taxation. Business entities that decided on paying legally the taxes try to make up for the burden or make attempts to transfer the taxes. In the case of the latter they try to maintain the profitability on a satisfying level. Due to the character of indirect taxes, they are often included in the prices of products and services, which results in the increase in sales prices; consequently, the demand for the products drops and the sales revenue decreases<sup>8</sup>. The transfer of the whole tax burden onto the buyers is not neutral to the profitability. The inclusion of the increasing taxes to prices leads to the decrease in the real income of customers which in turn results in the drop of demand for the goods offered by the company to the level of the price elasticity of the demand for its products<sup>9</sup>. It should be pointed out that the more difficult it is for tax-payers to transfer taxes to customers, the greater the tendency to avoid paying taxes. This can result in tax avoidance, e.g. the use of tax reliefs, or in tax evasion, which involves creative accounting.

<sup>8</sup> B. Kolanowska-Kowalska, *Polityka fiskalna*, [in:] B. Pietrzak, Z. Polański, B. Woźniak (ed.), *System finansowy w Polsce*, Wydawnictwo Naukowe PWN, Warszawa 2004, p. 662.

<sup>9</sup> S. Owsiak, *Finanse publiczne teoria i praktyka*, Wydawnictwo Naukowe PWN, Warszawa 2005, p. 188.

The state fiscal system has a significant impact on company's short- and long-term decisions. Tax burdens determine the amount of net profit which is the difference between the gross profit and income tax with other mandatory taxes. Net profit can be divided into two sections: the dividend, which is a part of the profit to be distributed among capital owners (shareholders) and the retained profit for financing (short-term) operating targets or (long-term) investment targets. The above process is referred to as the self-financing of business. The retained profit increases the value of the business entity and its accessibility to external sources of financing, e.g. credits.

Self-financing of operations with the profit puts the company in a good light. It testifies to its good financial condition, which increases its credibility and attractiveness among investors as they want to minimize the risk and maximize the rate of return of the invested capital.

### 3. Organizational and legal form of an entity and the choice of tax strategy

From the very moment of the decision to start their business activities, entrepreneurs apply tax strategies by choosing their company legal and organization form and the way how the generated revenue will be taxed. Table 1 presents the number of businesses in Poland (with the exception of natural persons that run farms) with a breakdown by organizational and legal form, as of 29.02.2016.

**Table 1. Number of businesses in Poland (without natural persons that run farms) with a breakdown by organizational and legal form, as of 29.02.2016.**

No.	Organizational and legal form	Quantity
1	Natural persons running a business	2 972 411
2	Civil law partnerships	286 795
3	Private limited companies	388 748
4	Joint stock companies	11 399
5	Co-operative	17 539
6	State-owned companies	147
7	<b>Total</b>	<b>3 677 039</b>

Source: Author's research based on the GUS report (Central Statistical Office of Poland).

According to Table 1, the organizational and legal form of a natural person running a business is the most common one. Their generated revenue is taxed in line with the act on PIT. Companies can choose one of the two taxation methods, either by way of general principles or

by the tax on recorded revenue without deductible costs, which also includes a fixed amount tax (*tax card*) (this however depends on the amount of turnover and the type of activity).

In the case of civil law partnerships of natural and legal persons, it is the partners and not the company itself that pay the income tax. Each of the partners pays the tax on his/her share of the profit.

The deed of the private limited company has to be signed at the notary office. The revenues are taxed in line with the Act on CIT. The taxable base is the revenue minus tax deductible expenses. Company shareholders receive dividend for the profits. In the case of private limited companies and joint stock companies there is a problem of double taxation – first, on the level of company revenues and then, at the moment of the dividend payout.

The problem of double taxation can be avoided by founding a limited partnership. One of the partners is the limited partner responsible for partnership's liabilities up to the contribution while the other is the limited partner that takes part in the partnership management and is jointly and severally responsible for the liabilities. Each partner pays taxes in line with the selected taxation method and organizational and legal form.

The above analysis shows that the form of a limited partnership is the most beneficial organizational and legal form for the SME sector. It helps the limited partner optimize the fiscal burden by avoiding double taxation of the profits generated by the company.

#### **4. Choice of income taxation method**

Depending on the organizational and legal form, the revenues of companies are taxed either on the basis of the Act on CIT or the Act on PIT.

The taxation on the basis the Act on CIT concerns tax-payers who run non-agricultural businesses and are<sup>10</sup>:

- a share-holding company (joint-stock, limited liability),
- a commercial bank,
- a tax capital group,
- a co-operative,
- a company wholly owned by the State Treasury,
- a state-owned company.

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<sup>10</sup> Act of 15 February 1992 on CIT; consolidated text, Journal of Laws 2015, item 1993 Art. 1-1a .

Natural persons that have income from, among others, business activities in the territory of the Republic of Poland or a contractual employment in the territory of the Republic of Poland regardless of the place of wage payment are taxed in line with the Act on PIT<sup>11</sup>.

Natural persons who engage in business activities can choose one of the three taxation methods:

- general principles, including progressive taxation,
- linear (proportional) taxation, with a rate of 19%,
- lump-sum taxation, including fixed amount tax (tax card) or taxation of the recorded revenue costs without deductible costs.

The above taxation methods may be related to the status of a small taxable person that entitles it to a simplified payment of income tax advances. General principles are a commonly applied taxation form, which means that every individual that runs a business can be taxed this way. The idea of progressive taxation is that the taxation burden increases with the increase of company's revenue. All business events are registered in the tax revenue and expense ledger. The costs include expenses on the purchase of products and materials, energy, services, payroll, depreciation and amortization of fixed assets, etc. The expenses on, e.g. the purchase of land or fines are not tax-deductible. Moreover, if the net revenue in the previous financial year exceeded the amount of 1 200 000.00 Euro, the tax-payer loses the status of a small taxable person, which involves the loss of the opportunity to pay income tax advances on the quarterly basis.

The advantage of linear taxation is the constancy of the tax rate. This form is beneficial to business entities which exceed the first tax threshold. After having reached 85 582.00 PLN, their tax burden decreases. However, the choice of this method of taxation involves several drawbacks, e.g. there is no tax exempt amount, no joint taxation of spouses and there are fewer tax reliefs.

The taxation of the recorded revenue costs without deductible costs is also available to partners in civil law partnerships, registered partnerships, professional partnerships as well as to freelancers. The lump sum rates depend on the type of business activity. Entrepreneurs who do not employ any staff keep themselves the records of revenue and facilities, including fixed and intangible assets. The application of this taxation forms results in, among other elements, the loss of the right to joint taxation of spouses.

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<sup>11</sup> Act of 26 July 1999 on PIT; consolidated text, Journal of Laws 2015, item 1992

The simplest and also the least frequent method is the fixed amount tax (tax card). In such cases business people are not obliged to keep the accounts (the records of revenue and expenses). If they have employees – up to five people (with the exception of communes with high unemployment rates) – it is necessary to keep records of employment and staff incomes. This taxation form cannot be used by entities that provide educational and gastronomic services, sell fuels and car vehicles. The tax rates depend on the type of business activity, the size of the locality where the activity is conducted and the level of employment. The main disadvantage of this form is the necessity to pay tax also when the company does not generate any revenue.

Table 2 presents a tax analysis of particular taxation methods in a construction service company which generated annual revenue of 580 000 PLN and whose expenses amounted to 398 000 PLN (including social insurance of 14 000 PLN). The entity employs a staff of three.

**Table 2. Tax analysis of particular taxation methods**

Specification (annual values in PLN)	General principles (progressive tax)	General principles (linear tax)	Fixed amount tax (tax card)	Lump sum taxation	CIT
<b>Revenue</b>	580000.00	580000.00	580000.00	580000.00	580000.00
<b>Tax deductible costs</b>	398000.00	398000.00	-	398000.00	398000.00
<b>Tax base</b>	182000.00	182000.00	580000.00	182000.00	182000.00
<b>Tax rate (in %)</b>	14 839.02 PLN + 32% of the excess over 85 528.00 PLN	19	12 months x 1 352 <sup>12</sup>	5.5	19
<b>Total annual tax</b>	45710	34580	16224	10010	34580

Source: Author's research.

It can be concluded from Table 2 that after exceeding the first PIT threshold, the taxation of business activities with a linear tax decreases the tax burden while the values of CIT and proportional tax are equal: 34 580 PLN. The tax burden of a company would be the highest if it was taxed in line with general principles (progressive tax). In the case under investigation, the optimal taxation method is the lump-sum taxation: 10 010 PLN. The additional advantage of this form is that there is no need to keep complicated accounting records.

<sup>12</sup> Proclamation of the Minister of Development and Finance of 24 October 2016 on fixed amount tax rates, amounts to which certain services can be provided with the exception of services for the population, and on quarterly fixed amount tax rates on the income of clergymen, for 2017, Monitor Polski 2016, item 1120.

## 5. Selection of the VAT taxation method

The decision to be taxed with VAT is crucial for every business entity. This method of taxation has both advantages and disadvantages. When starting business activities, entrepreneurs make decisions whether they are going to choose a VAT cash accounting scheme or to take advantage of the VAT-exempt status. The main advantages of the latter are:

- the lack of charges for the VAT registration of the company,
- the lack of the obligation to keep records of sales and purchases
- the lack of the obligation to make VAT declarations,

The main drawback of the VAT-exempt status is the lack of the possibility to deduct VAT from purchases. As a result, VAT is included in the production costs which leads to the increase in the prices of products, commodities or services. This may cause a deterioration of the competitive position on the market in relation to other companies that are VAT-payers.

Companies may renounce the VAT-exempt status by notifying the Head of Tax Office. Such a decision is beneficial for companies which – due to the sales tax of 8% and the purchase tax of 23% - have an excess of input tax over tax due and are planning to increase their investment and cooperate with companies that require VAT invoices as the condition for further cooperation.

The choice of the VAT cash accounting scheme is possible for small tax-payers, i.e. entities whose sales revenue from the previous tax year did not exceed the equivalent of 1.2 million Euro. In the case of this method, tax obligation arises when a part or the full payment due is received but not later than 180 days after the product or service delivery<sup>13</sup>. This strategy consists in choosing VAT accounting between the cash accounting scheme and general principles, which involves different moments when tax obligation arises. The main advantage of the VAT cash accounting scheme is the possibility to improve financial liquidity by deferring (by maximum 180 days) the VAT payment deadline until the receivables are paid. The choice of the cash accounting scheme may result in numerous problems as regards a correct recognition of the tax obligation. Moreover, the necessity for the customers to analyze the VAT-MP (VAT-small tax-payer) invoice with the aim to determine correctly the tax obligation may create additional problems.

Table 3 presents a tax simulation for a company that settles VAT under general principles or takes advantage of the VAT-exempt status.

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<sup>13</sup> Act of 11 March 2004 on VAT; consolidated text, Journal of Laws 2015, item 1649, Art. 21 par 1 (2)

**Table 3. Tax simulation for a company that settles VAT under general principles or takes advantage of the VAT-exempt status.**

Specification	General principles	VAT-exempt status
Product price (PLN)	40.50	40.50
Input VAT 23 % (PLN)	9.32	9.32
Product purchase price (PLN)	40.50	49.82
Margin (%)	30	30
Margin (PLN)	12.15	12.15
Net sales price (PLN)	52.65	61.97
VAT due 23% (PLN)	12.11	-
Gross sales price (PLN)	64.76	61.97

Source: Author's research.

It can be concluded from Table 3 that it is more beneficial for a buyer who is an active VAT payer to purchase the product with the salesman that settles VAT under general principles. The buyer will be entitled to deduct 23% VAT and consequently the net price will be 52.65 zlotys. The company that has the VAT-exempt status offers its products for a higher prices (9.32 zlotys) than it would if it was an active VAT payer.

## Conclusions

Fiscal policy of the state has a significant impact on business activity of its citizens. Severe fiscal policy leads to the decrease in entrepreneurship perceived as the desire to set up new businesses. Newly founded economic entities make decisions as regards the choice of income and VAT taxation, which involves several implications.

The presented above analysis of income tax proves that after exceeding the first PIT threshold it is beneficial to apply the linear method of tax accounting which results in the decrease of tax burden. The use of the VAT cash accounting scheme is advantageous for newly set up companies. Deferring the VAT payment deadline results in the improvement of the financial liquidity of a small taxpayer. VAT-exemption status may frequently lead to the deterioration of the competitive position due to the necessity to include VAT input in purchase costs.

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### ***Abstract***

The aim of the paper is to present selected tax strategies that are the tool of modern finance management applied in companies. The paper also analyzes current income and VAT taxation methods. The application of a simulation experiment made it possible to point at the optimal solutions as regards the fiscal burdens of business entities.