Singidunum University International Scientific Conference
Međunarodna naučna konferencija Univerziteta Singidunum

AUDIT
Scientific - original paper

TAX OPTIMIZATION TOOLS AS PART OF ENTERPRISE STRATEGY MANAGEMENT

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Abstract:

This paper presents various tax optimization tools that have a significant impact on the strategic decisions made by business entities. Their significance was highlighted in order to create possible solutions aimed at reducing the tax burden. Attention was paid to the importance of identifying the potential tax risk hauling areas and the ways to reduce them. The validity of proper identification of the potential rights of choice and the analysis of the individual situation of the entity in determining appropriate tax optimization tools were indicated. The paper emphasizes that the choice of tax instruments depends on the company's goals and business conditions.

Keywords:

tax law, risk management, tax optimization.

THE ESSENCE OF TAX OPTIMIZATION IN ECONOMIC ENTITIES

Risk is inherent in every economic activity. Decisions made by entrepreneurs are burdened with uncertainty, which in effect makes economic entities analyze the variants of potential threats thoroughly. The risk component cannot be ignored by the management staff, who are profit-oriented. In order to ensure continuity of an economic entity's activity, it is essential to know how to identify negative events and eliminate them. Every enterprise operating on the market must adapt to the prevailing economic conditions. The entity's activities are affected by internal and external environments, which condition its chances to stay on the market. For the purpose of a correct tax return, entities implement a tax strategy that is suitable for them as it is one of the elements in the functioning of the entity's global strategy.[1] The entity's awareness that a given tax liability and its amount are certain diminishes the probability of losses in the enterprise. The knowledge regarding taxes permits the economic evaluation of the enterprise and a decision on continuing its activity. A properly implemented strategy allows a quick response to the changing environment. Actions taken based on a well-thought tax strategy increase enterprise effectiveness and lead to higher goodwill. The right definition of the strategy requires a thorough analysis of the environment and the knowledge of the expected changes. A critical element present in every enterprise is tax risk, which is an objective phenomenon, yet its scale and results can be influenced through properly taken measures and a certain liberty.[2] Diagram 1 presents the steps for determining a tax strategy in the enterprise.

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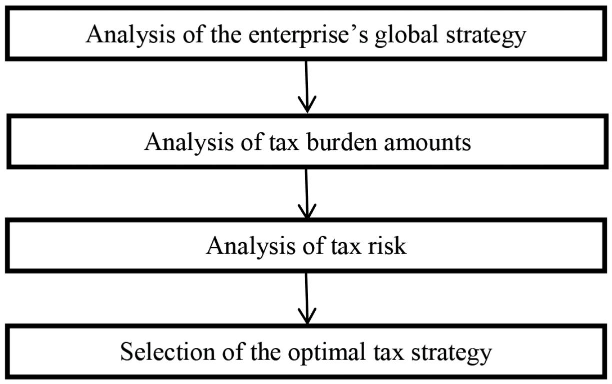
1 Mikrut, A., Poznańska, A. (2009). Strategia podatkowa przedsiębiorstwa, *Zeszyty Naukowe Małopolskiej Wyższej Szkoły Ekonomicznej w Tarnowie No. 2(13)/2009, 2,* 235-236.

2 Poszwa, M. (2007). Zarządzanie podatkami w małej i średniej firmie, *Wydawnictwo C.H.Beck*, 10-15.

DOI: 10.15308/finiz-2017-112-118

Diagram 1. Tax strategy analysis



Source: Own work based on: Poszwa, M. (2007). Zarządzanie podatkami w małej i średniej firmie, Wydawnictwo C.H.Beck, 12-13.

The formulation of a tax strategy begins with defining the company's global strategy and the related functional strategies. The potential development chances of the entity are specified at this stage. The enterprise defines the mission, goals and values, and sets the directions for further development. The awareness of the decisions made is an important risk management aspect for the intended actions not to prove pointless or wrong.[3] What can serve as an example is setting an inappropriate rate for a given product, which could lead to negative financial consequences for the entrepreneur. For the purpose of securing themselves against tax risks effectively, economic entities identify tax risk management areas. The previously agreed assumptions are verified at the next stage. This is when production costs and tax expenses are analyzed and investment plans are determined. The following step is to indicate the possibilities to reduce tax liabilities and to analyze tax risk optimization variants. The entity's awareness that a given tax liability and its amount are certain diminishes the probability of losses in the enterprise. The knowledge regarding taxes permits the economic evaluation of the enterprise and a decision on continuing its activity. Uncertainty is enhanced by the fact that tax law is prone to changes and the economic entity has to adapt to the changing environment. As a result, long-term decisions must be analyzed in depth. Due to numerous aspects which might significantly affect the manner in which enterprises pursue their economic activities, they apply tax risk minimization tools. In effect, tax optimization mechanisms are implemented.

A correct identification of risk factors in the enterprise will enable the application of suitable methods and instruments to eliminate or mitigate the negative tax consequences or permit the use of opportunities in the context of the changing tax law. Tax risk management is first of all identification of a given risk, assessment of its effect on the enterprise, measurement and monitoring of the measures taken to reduce its impact. Optimization actions are implemented in order to secure the economic entity's assets and income against losses. Occasionally, the tax system itself creates chances for neutralization of proceeds from taxes, yet the use of such opportunities depends on the taxpayer's knowledge resources. Certain limitations in applying optimization measures could not only occur in connection with changes to the tax law but also arise from the enterprise's global strategy. At times, tax purposes are not convergent with the entity's intentions. In such a situation, one needs to select a procedure enabling the accomplishment of the main purpose by means of legal methods of tax burden minimization. Tax optimization assumes that the risk of negative consequences of decisions is reduced on the one hand and financial benefits are generated on the other hand.[4] Optimization measures are sometimes perceived as actions contrary to or on the fringes of the law. Their legality and compliance with the law are questioned and taxpayers are accused of the so-called circumvention of the tax law. The selection of the measures taken can depend on the capability to apply specific tax planning methods and tools and taxpayers' awareness of the chances they can use.

SELECTED STRATEGIC TAX OPTIMIZATION TOOLS

Strategic management is a long-term information and decision process which points to the potential resolutions of the situations occurring in the enterprise's operation. Strategic actions determine a given entity's development direction with the influence of internal and external environments taken into account.[5] When pursuing their general strategic goals, enterprises must select tax optimization tools which are suitable for them to permit tax burden minimization.

3 Elkin. P,(1998). Mastering Business. Planning and Strategy, *The Power of Strategic Thinking, 22.*

4 Walicka, M. (2012). Optymalizacja podatkowa w działalności gospodarczej małych przedsiębiorstw, *Zeszyty Naukowe Uniwersytetu Szczecińskiego No. 708 Finanse, Rynki Finansowe, Ubezpieczenia No. 52*, 272-273.

5 Griffin, R.W.(2004). Podstawy zarządzania organizacjami, *Wydawnictwo Naukowe PWN*, 702.

When commencing its economic activity, the entity has certain options for choosing its legal form. It is a long-term decision, the nature of which is definitely strategic. Indicating the organizational and legal form suitable for a given enterprise involves many factors, such as: the purpose and object of the pursued activity, the resources related to assets, the scope of responsibility of other shareholders. This choice arises from the liberty introduced by the legislator for economic entities.[6] The entity needs to specify its activity's taxation method. Entities here analyze the variants of their options by solving certain dilemmas which can consist e.g. in considering a situation where the real taxation of the income generated by a company's shareholder is higher than that of a partnership's partner but on the other hand, the entity is liable up to the financial contribution made rather than with all its assets. Economic entities also need to analyze their situation from the angle of using tax reliefs or exemptions.[7] The lack of an unambiguous approach indicating the taxation of certain transactions on the part of tax authorities generates the sense of uncertainty. An example is the situation of taxing the shares issued to the limited joint-stock partnership's partner, where there is no clear standpoint whether such shares shall be taxed on general principles or be treated as shares in a partnership. The tax consequences of such a situation differ considerably, and the lack of a clear opinion of the tax administration in this matter increases tax risk.

Another tax optimization tool is the selection of the enterprise's registered office. The Double Taxation Act stipulates that an economic entity shall be taxed on its entire income in the location of its registered office. It is usually the same as the location of a given enterprise's management board. The situation where an entity has a facility in another country is an exception. As a result, proper organization of the activity permits a selection of the right tax jurisdiction. One of the methods for using this tax instrument for optimization purposes is the establishment of the income generation center in a country with a low income tax rate.[8] The economic entity, as the center, provides services to entities from other countries. A proper employment of the provisions in the double taxation treaty enables the use of tax preferences, e.g. the tax on the income generated in Poland will be lower in Cyprus.[9] Tax risk with this respect will occur when the tax authority questions the location of the enterprise's registered office and identifies a different jurisdiction. It is an extremely long procedure that is a financial burden to the taxpayer. Another significant problem could be the approach to the interpretation of the laws applicable in the country where the enterprise's registered office is located. The entity can face a completely new tax reality. An example can be the situation where a Polish entrepreneur decides to move its registered office to Cyprus, where the tax system is based on the Anglo-Saxon tradition, while in Poland it relies on the norms of the continental system.

A yet another tax optimization instrument is the employment of the contractual benefits provided for in the double taxation treaty. One of the goals is to exclude third-country residents from receiving benefits arising from the concluded agreements.[10] Such regulations used in this manner are treated as optimization tools but are also regarded as a certain abuse. In order to apply specific laws, economic entities establish separate entities which are supposed to ensure contractual benefits. An example of such a procedure is treaty-shopping, which consists in an unauthorized entity using another entity's capabilities to apply the regulations arising from the double taxation treaty. Contractual benefits occur when a given country's resident, who is not a party to the double taxation treaty, takes measures to have the provisions stipulated there applied by a shell enterprise, while its goal is only to carry out a mock transaction to be able to benefit from the preferential provisions of the treaty. The benefits arise from the fact that treaty-shopping results in tax limitation in the country where the source of the obtained income is situated or a low income tax rate is employed in the country of the income-generating entity. According to the OECD, such a tax practice might lead to negative consequences, i.e. the phenomenon of disturbing the tax balance between the countries which have signed the double taxation treaty is indicated. Yet more phenomena suggesting contractual benefits have been identified on the basis of treaty-shopping. One of them is a direct conduit method, which consists in the conclusion of transactions between the entity being a resident and an entity from another country. No double taxation treaties have been concluded between these countries or the tax regulations are not satisfying to a party. In such a situation, a daughter company is established in a country which has signed the double taxation treaty with both countries and the transactions carried out will bring tax benefits due to that. The establishment of an intermediary company, the so-called conduit company, results in the transferred income being taxed in compliance with the preferential conditions agreed between the countries. Another way is the stepping stone method, which is also based on establishing a company intermediating in transactions to use the preferential terms and conditions provided for in the treaty. It is a similar method to direct conduit, but in this case the aim is to limit the tax liability of the intermediary company through mutual balance of tax expenses. Another mechanism is the back to back loan, which is based on using the preferential provisions of the double taxation treaty when taxing the transferred interest. The indicated situations

6 Kosikowski,C.(1995). Wolność gospodarcza w prawie polskim, *PWE*, 177.
7 Kruczalak, K.(2008). Prawo handlowe. Zarys wykładu, *Lexis Nexis*, 148.
8 Lai Lan Mo, P. (2003). Tax avoidance and anti-avoidance measures in major developing economies, *Praeger*, 15.
9 Mckee, D. L., Garner, D. E.(2000). Offshore financial centers, accounting services. and the global economy, *Westport* , 15.
10 Głuchowski, J.(1996). Oazy podatkowe, *Dom Wydawniczy ABC*, 106.

might cause tax risk increase since tax authorities could accuse the taxpayer of circumventing the laws and applying prohibited transfer pricing.[11]

One more tax optimization tool could be the technique of changing tax residence, also called the double residence technique, which consists in a given entity having tax residence and a significant share in the enterprise in the country being a party to the double taxation treaty. When selling shares, in order to prevent taxation of the sales profit, the entity decides to move to the country where the income is exempt from taxes or the tax rate is low. Such a situation can be treated as maneuvering the tax domicile. The employment of this technique could also lead to a change in the amount of the dividend disbursed between two entities having tax residence in one country. Tax risk with this respect will involve the possibility of an accusation on the part of tax administration which could point to the fact that the taxpayer has improperly declared the location of full tax liability.

TAX OPTIMIZATION INSTRUMENTS BEING AN ELEMENT OF THE ENTERPRISE'S STRATEGY

Year by year, tax tools have gained in significance when analyzing the strategic solutions applied by enterprises. In order to use the individual tax instruments, a questionnaire survey was conducted from June to August 2017. The questionnaire was sent to 50 foreign enterprises operating in the segment of medium and large enterprises on various markets for at least 10 years.

The questionnaire contained the following questions:

1. Does your enterprise apply tax optimization measures? YES / NO
2. Are the measures aimed at reducing tax risk strategic, long-term? YES / NO
3. Does the choice of the legal form of your enterprise influence long-term tax decisions? YES / NO
4. Is the choice of the legal form of your enterprise significant when applying for tax reliefs? YES / NO
5. Is the enterprise's registered office one of the elements of your enterprise management strategy? YES / NO
6. Does the geographic location of your enterprise's registered office influence the tax liability amount? YES / NO
7. Does your enterprise use tax preferences arising from the double taxation treaty? YES / NO
8. Can you see the necessity to carry out tax risk analysis in the context of selecting tax optimization tools in your enterprise? YES / NO

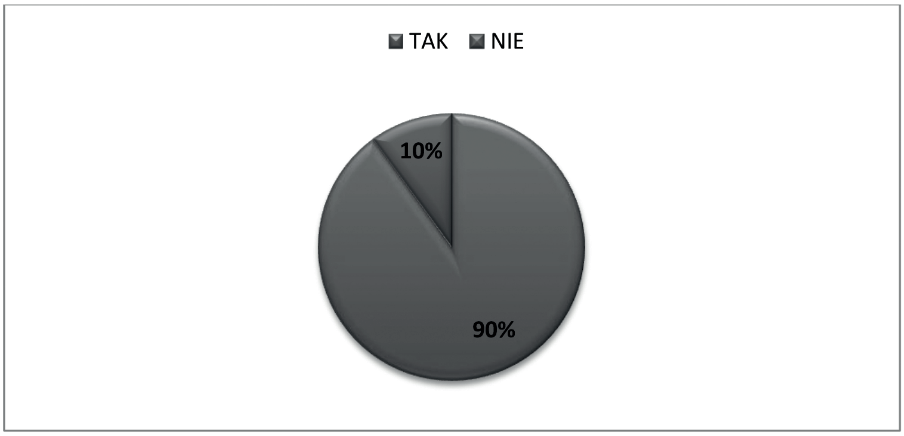
As a result of the conducted questionnaire survey, the influence of individual tax instruments on strategic actions taken by the entities was indicated. The questionnaires were responded to by 48%of the selected enterprises. The responses imply that a vast majority of them apply optimization measures aimed at reducing tax liabilities (Chart 1). As an outcome of the conducted survey, it was also determined that 60% of the examined enterprises implement long-term strategic actions aimed at reducing tax risk (Chart 2). The successive questions, related to the use of specific tax optimization tools, showed that 58% of the surveyed enterprises declared that the choice of a legal form had an influence on long-term tax decisions (Chart 3). 67% of the analyzed economic entities indicated that the decision on the organizational and legal form influenced the possibilities to use tax reliefs (Chart 4). The survey shows that the selection of the location of the enterprise's registered office was a component of the enterprise's strategy for 75% of the studied enterprises (Chart 5) and had an influence on the tax liability amount in 70% (Chart 6). The results of the questionnaire survey show that 90% of foreign enterprises apply the provisions of the double taxation treaty in order to enable the use of tax preferences (Chart 7). A majority of the analyzed entities emphasized that tax risk assessment was significant in the context of adapting selected tax optimization tools in the enterprises (Chart 8).

CONCLUSION

A proper selection of tax optimization tools is an appropriate solution aimed at minimizing tax burden and reducing the phenomenon of tax risk. When determining strategic measures, the entity cannot ignore the tax aspect as long-term decisions might influence the tax liability amount. The decision on selecting a given tax optimization tool should be preceded with an in-depth analysis of the economic conditions in which the entity operates. The conducted survey confirmed that adopting an appropriate tax strategy and making decisions on implementing individual tax optimization tools influence enterprises' strategic actions.

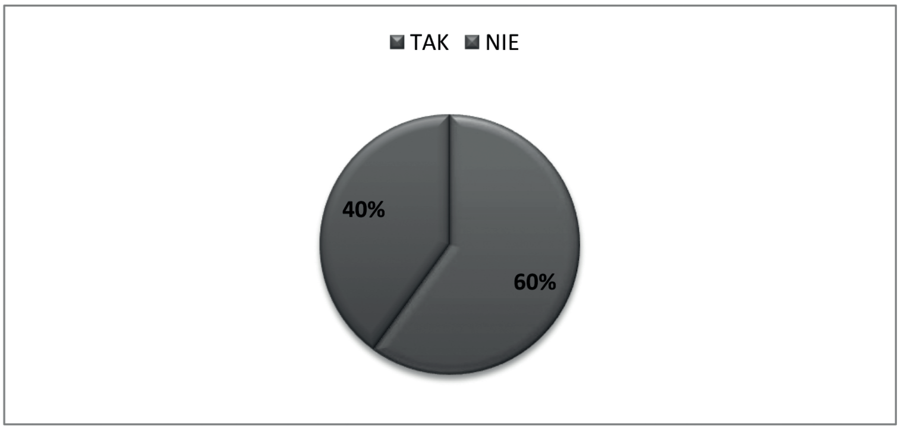
11 Hamaekers, H., Holmes, K. J., Głuchowski, J., (2006). Wprowadzenie do międzynarodowego prawa podatkowego, LexisNexis, 247.

Chart 1. The quantity of the enterprises applying tax optimization measures



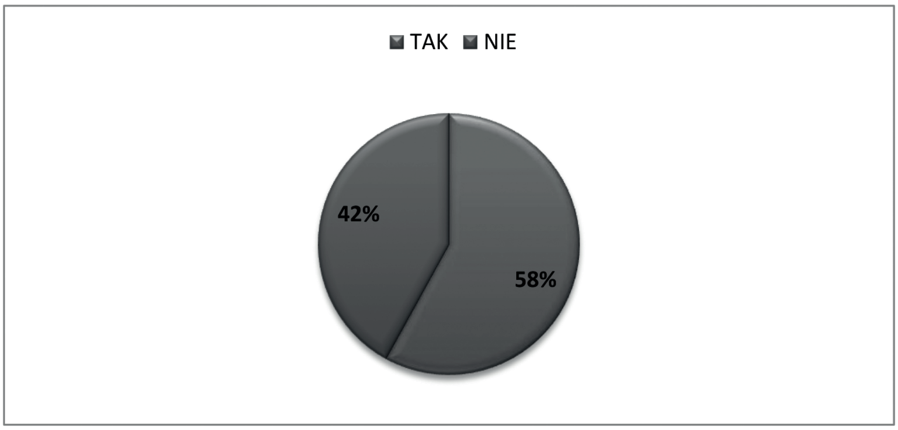
Source: Own work based on the conducted questionnaire survey.

Chart 2. Strategic, long-term measures reducing tax risk



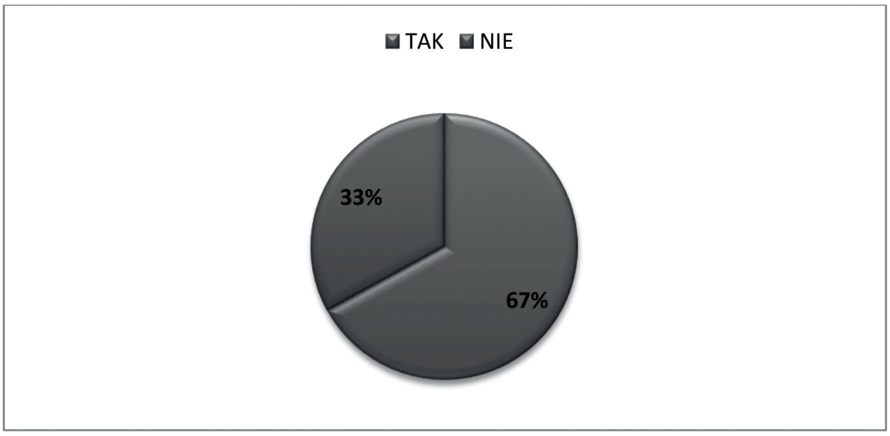
Source: Own work based on the conducted questionnaire survey.

Chart 3. The influence of the selection of the legal form on long-term tax decisions



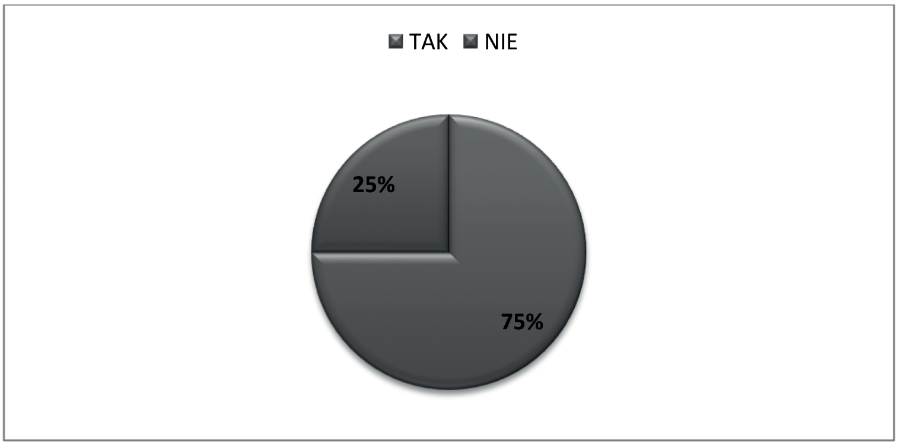
Source: Own work based on the conducted questionnaire survey.

Chart 4. The influence of the selection of the legal form on the obtainment of tax reliefs



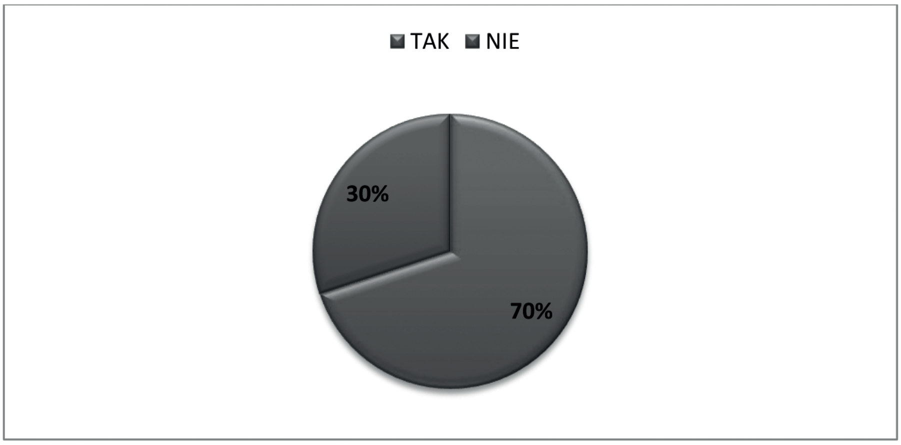
Source: Own work based on the conducted questionnaire survey.

Chart 5. The selection of the enterprise's registered office as component of the enterprise management strategy



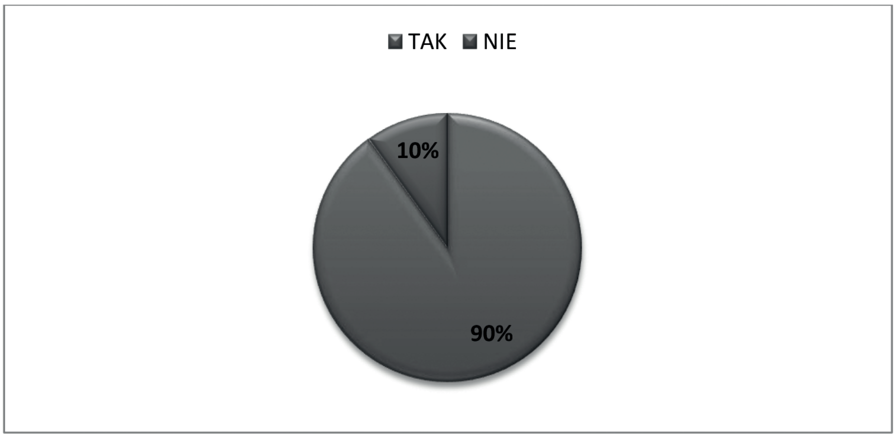
Source: Own work based on the conducted questionnaire survey.

Chart 6. The influence of the enterprise's geographic location on the tax liability amount



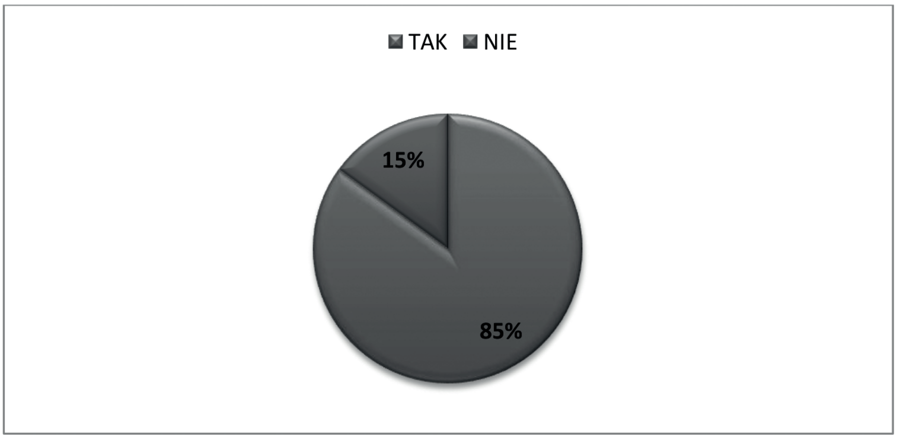
Source: Own work based on the conducted questionnaire survey.

Chart 7. The application of tax preferences based on the double taxation treaty



Source: Own work based on the conducted questionnaire survey.

Chart 8. The necessity to analyze tax risk in the context of selecting tax optimization tools



Source: Own work based on the conducted questionnaire survey.

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