

THE INFLUENCE OF THE CHOICE OF THE TAXATION FORM ON THE AMOUNT OF THE BURDEN OF TAXATION

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Abstract

The aim of this article is to show the way to do a calculation necessary when choosing the appropriate form of taxation of a small and medium-size entrepreneur. For a taxpayer making the decision to choose the form of taxation, the fundamental importance has the establishing what determines the profitability of particular taxes and how to conduct tax policy in order to calculate the possibly lowest tax. The amount of tax is determined by declared revenues, costs, tax base deduction and tax deduction, also by the tax rate. When analyzing tax payments, a few issues need to be taken into account: the foreseeable economic situation of an enterprise (income, costs, investments), the possible manner of its tax approach (declaring income and costs), and the tax deductions that can be used. The personal situation of a taxpayer is also of fundamental importance, and especially the scope of duties in rates of insurance, acquiring income outside economic activities, the right to use taxable allowances, including within the vested rights, as well as the right to joint tax settlements with a spouse or children. The amount of tax depends finally on the individual situation of an enterprise and a taxpayer himself. The matter of choosing the appropriate (optimal) form of taxation of economic activities is of fundamental importance since it influences the amount of planned revenues, costs of their acquiring and calculating the tax base deduction or tax. Fitness for information and the costs and nuisance of record-keeping and first of all the amount of tax need to be taken into account as well.

Key words

Burdens, tax, lowest tax, settlement, progressive taxation, selective instruments, VAT, lump sum, tax card.

1. INTRODUCTION

Fiscal burden accompanies all economic activities of enterprises. Regardless of the place, line of business and the scale of economic activities, each entity is obliged to settle amounts due to the state. The resistance on the side of enterprises is only natural.

Although it is impossible to escape the burden of taxation, the peculiarity of every entity separately implies different kinds and scales of this type of solutions. The choice of the proper legal form of performing the activities, the shape of its structure that minimizes the burden of taxation, and the taxpayer using effective tools of managing tax liabilities can limit their amount. The aim of this article is to demonstrate a way of calculating essential when choosing the right form of taxation of a small and medium-size entrepreneur.

2. THE KINDS OF ELEMENTS THAT HAVE AN INFLUENCE ON THE FORMS OF TAXATION.

Because of the fact that entities are obliged to share the effects of pursuing economic activities and to transfer their part to the state budget, mechanisms aiming at limiting the amounts paid by taxpayers have appeared. For the enterprises that pursue economic activities

fairly, the legality of a chosen solution is of fundamental importance. Such solutions include tax optimization in its broad meaning, which involves choosing the lawful solution that allows avoiding tax or lowering its amount. Tax law foresees such optimization, the use of regulations permitted by the law in the scope of taxable allowances, exemptions or the possibility to settle tax losses.

In the tax ruling the following rule has been established: “if the legal order in force makes it possible for a taxpayer to choose a few lawful constructions allowing achieving the intended economic goal, of which each shall be of a different tax dimension, then the choice of the most beneficial tax solution shall not be treated as circumvention of the law.”¹ Thus the tax optimization within the law limits was sanctioned. Using the possibility to minimize the burden of taxation on the grounds of the tax law is accepted by fiscal authorities, though circumvention of the tax law or even tax evasion have nothing to do with lawful tax planning.²

The income drawn from economic activities in Poland is burdened with one income tax: individual income tax or company tax. A Polish entrepreneur who is not a legal person has the possibility to optimize income tax by choosing alternative taxation forms. He is able to select taxation on the grounds of the personal income tax act or flat income tax on selected incomes drawn by natural persons act. Within the first act an entrepreneur chooses between taxation with general rules, i.e. progressive taxation by the tax scale or the uniform rate taxation. Within the other act (after complying with conditions), the choice is made between lump sum on recorded revenues and a tax card.

Tax instruments aim at reducing regular charges and stimulating the development of enterprises. It is connected with taxable allowances defined by the Tax Ordinance as foreseen in the tax law provisions exemptions, deductions, reductions or decreases, using of which causes the tax base reduction or tax reduction. Depending on the conditions of use, the instruments can be divided into general ones, accessible for entrepreneurs without statutory limits, and selective, the use of which requires meeting certain conditions.

The group of general instruments foreseen by the Polish law includes: leasing, accelerated or delayed depreciation, choosing the taxation method by a natural person, an allowance for new technologies, simplified advances for income tax by the tax regulations, and allowances in tax payment on the grounds of the Tax Ordinance. The selective instruments are: tax exemptions resulting from starting activities in the Special Economic Zone (SEZ), tax privileges connected with creating the Tax Group Business (TGB), facilities concerning advance payment dates for those starting their activities, allowances and tax base deductions or tax deductions, joint taxation of spouses according to the tax regulations. A few of them, leasing, amortization, an allowance for new technologies, influence the costs of revenues and thus the tax base. The rest of them result in direct reduction of the amount of tax.³

¹ The decision of the Provincial Administrative Court of 30th March, 2004, syg. III SA 2984/02, “Tax Monitor”, no 6.

² *O nowy ład podatkowy w Polsce*, red. nauk. J. Ostaszewski, Scientific studies from „Entrepreneurship”, the Szkoła Główna in Warsaw publishing house, Warszawa 2007, p. 357.

³ B. Zbroińska, A. Girałka, *Obciążenia podatkowe w Polsce i w Niemczech*, „Ekonomika i Organizacja Przedsiębiorstwa” 2007, no 1, p. 23.

The aim of managing taxes in an enterprise is to limit the tax risk and minimize tax expenditure. It is of a supplementary character, i.e. it is achieved taking into account the main aim of an enterprise (earning money). Accomplishing tax goals should not limit achieving the aims of an enterprise (earning money by means of the market operations – producing and selling products, creating and taking over new markets). For instance aiming at simplifying records and settlements by the flat rate tax can be at variance with other financial targets, e.g. wish to raise outside capital, which requires an appropriate detailed financial report, including the tax report.

When the tax expenditure (the sum of the costs of records and settlements, and the amounts of tax due) and the tax risk are low and the influence of a taxpayer on the burden of taxation is significant, the tax is favourable.

The simplest criterion of choosing the form of taxation is defining the amount of expenditure of its records and settling. The most convenient taxes are respectively: a tax card, a recorded lump sum, and general flat and progressive tax settled on the basis of the tax revenue and cost register.

The nuisance of settlements taken into account, the worst is the general tax on natural and legal persons settled on the basis of account books. The estimation of formal obligations should take into consideration not only the income tax. Fulfilling other possible records and reporting obligations, first and foremost concerning the VAT and connected with settling accounts with employees, takes place alongside with the obligations concerning settling accounts with an entrepreneur. Thus the simplifications in flat rate taxes can be valid if a taxpayer settles VAT anyway and settles accounts with his employed workers. We can risk the statement that most often in such a case low costs of records and settlements concerning the income tax are not of significant importance for a taxpayer. For most taxpayers flat rate tax simplifications are not important. Those simplifications have no meaning for micro entrepreneurs who do not pay VAT and do not employ workers.

The criterion of records costs is of significant importance if a taxpayer is capable of choosing between book records and less expensive and simpler tax revenue and cost register. The consequences of using a certain form of records are not only administrative costs but also the tax risk and the amount of declared income, thus the paid tax. The decision to choose the tax revenue and cost register should in some cases be made for a period longer than a tax year. If a taxpayer expects to exceed the sales by € 800,000 then he should consider whether or not it would be profitable to keep an account books from the beginning of his activities. It would help to avoid future costs when changing from tax records to book records and to maintain content-related continuity.⁴

Among tax constructions we can find both exemptions from tax and allowances reducing tax rate or already stated tax amount. The form of preference close to allowances can also be taken by tax base exemptions of certain kinds of income e.g. those intended for investments. Influencing taxpayers' decisions by means of allowances reducing the rate or amount of tax and also preferences resulting from the configuration of tax base has both advantages and disadvantages. The system of allowances consisting of reducing the tax rate or directly the tax amount is of a simple construction, and when the aspect of the tax psychology is taken into

⁴ M. Ludwiński, *Jak wybrać najkorzystniejszą formę podatku dochodowego?*, A Modern Company, a portal of knowledge for business, //www.nf.pl (17.08.2008).

consideration, the system can be understood as an actual allowance. Lower burdens that result from diversifying the tax base are often treated by taxpayers as satisfaction of social justice.⁵

Using the financial factor that is taxation in shaping the size, structure and spreading over time the costs of pursued activities in financial strategies is a particularly complex concept. An enterprise possesses broad or limited scope of freedom in influencing the level of tax burden owing to costs. It refers particularly to the burden of income tax. Besides, the tendencies to maximise costs and minimise costs can appear simultaneously. In financial strategies one aims at mutual adjustment in time of revenues and costs in order to minimise the burden of taxation in periods included in the time horizon of a financial strategy. The criterion of this adjustment is minimising the burden of taxation with simultaneous ensuring current and long-term financial liquidity as well as the desired level of productivity in all periods included in the time horizon of a financial strategy.⁶

Among the sources of financing enterprises, own sources occupy an important place, among them financial surplus comprising of amortization and a profit after tax playing an important role. The amount of a profit after tax depends on the amount of a profit before tax and income tax. The amount of a profit before tax is influenced by all economic factors occurring in an enterprise, including the capital assets and intangible and legal values structure as well as the methods of their amortization, varied tax benefits, also other regulatory receivables (so called quasitax). A profit before tax is an accounting approach, in the tax approach this amount is the tax base. A thesis can be advanced that in the income tax many phenomena influencing the amount of financial surplus are focused. Influencing taxes has a good effect on the amount of the surplus, including generation of the profit in an enterprise.

The state burdens enterprises with varied charges requiring involving financial resources. Those burdens include taxes as an important factor generating expenditure in those organizations. The increase of the burden of taxation reduces paying capacity of enterprises defined as the ability to meet all obligations. The increase of expenditure on taxes influences the financial liquidity, which is of significant importance because, as is indicated in literature and practice of management, many enterprises that generated profit failed because of the lack of financial liquidity.

The presented picture shows clearly that taxes have a significant influence on the condition of finances in enterprises, and also on achieving goals by those enterprises.⁷

3. SOLUTIONS FOR COMPANIES CONCERNING CHOOSING THE FORM OF TAXATION.

The possibility to choose the form of records and the form of taxation can be made use of only by taxpayers to whom, when pursuing economic activities, the regulations of personal income tax act concern. The group will include: natural persons individually pursuing economic activities and natural persons who are partners in partnerships, registered partnerships, and limited liability partnerships. In the case of partnerships it is partners, not

⁵ J. Sokołowski, *Zarządzanie przez podatki*, PWN Publishing House, Warsaw 1995, p. 40

⁶ *Polski system podatkowy, założenia a praktyka*, edited by A. Pomorska, Uniwersytet M. Curie-Skłodowskiej Publishing House, Lublin 2004, p. 380

⁷ *Finanse małych i średnich przedsiębiorstw*, edited by W. Pluta, Polish Economic Publishing Mouse, Warsaw, 2004, p.49.

companies, that are the income tax payers. For them however the legislator does not allow the possibility to choose the form of recording economic processes, ordering keeping full account books. The company tax payers need to be taxed according to general rules in the form of monthly, simplified or quarterly advance money. They also need to settle on the basis of account books.

It is extremely difficult to state unambiguously which form of taxation and recording is best for a taxpayer. The characteristic feature of units having the possibility to choose is the variety of the kinds of the pursued activities, their scale and size. For that reason there are no unambiguous and permanent criteria that could be used. When a taxpayer can choose among a few form of taxation, deciding on one of them he must take into account both benefits and losses. The most beneficial (optimal) form of taxation will be the form that ensures the highest net income (the amount of money means after taxation that a taxpayer has at his disposal) and satisfying other needs.

Evaluating and estimating one needs to remember that depending on the form of taxation the following are different:

- tax base (general rules – income, lump sum – revenue on activity, a card – tax paid according to the decision of the head of a revenue office),
- tax rate that depends not only on the form of taxation, but also e.g. with lump sum on the kind of pursued activity, and with taxation with general rules on the amount of income (with this form of taxation we deal with an ascending tax scale – the rate rises along with the increase of the tax base, if a taxpayer does not make use of taxation in the form of the flat tax),
- the scope of obligations imposed by regulations

For those reasons when analysing certain form of taxation, the following need to be taken into account:

- the amount of planned revenues and the possibility to determine the amount of costs of revenues, also making tax base or tax deductions,
- fitness for information of the records of economic events,
- costs and nuisance of making use of a certain kind of records,⁸

In order to compare the amount of business tax, taking into account different forms of taxation one needs to decide on such a kind of activity and such corporate status that concerns all three ways of taxation. An example can be pursuing economic activities in the area of retail trade in food products, fruit and vegetables. Let us assume that the activity is pursued in own premises, in a town with 15,000 citizens, one person is employed with an employment contract.

⁸ N. Artienwicz, *Jak wybrać najkorzystniejszą formę opodatkowania i ewidencjonowania*, „An accountant’s Monitor” 2008, no 1, pp. 23-24.

In 2008 revenues of 68,640 PLN will be drawn.

The costs of revenues will include:

- purchase of articles of trade – 22,450 PLN
- an employee's salary + employer's social contributions – 13,500 PLN
- protective clothing for an employee – 90 PLN
- purchase of fuel for a company car – 1,150 PLN
- costs of car repairs – 300 PLN
- automobile liability insurance and comprehensive automobile and property damage insurance – 800 PLN
- fixed assets depreciation – 1,800 PLN
- electricity, water and heating – 1,450 PLN
- phone bills – 720 PLN
- Total: 42,260 PLN

Thus the income will be 26,380 PLN (revenue – costs of revenues).

In 2008 we will pay employer's social contributions of 5,740 PLN that we will be able to deduct from the income. Contributions for health insurance that we will deduct from tax will amount to 2,130 PLN.

Comparing the amount of income tax due taking into account different forms of taxation:

3.1 TAXATION WITH GENERAL RULES

Revenue of 68,640 PLN minus the costs 42,260 PLN = income of 26,380 minus the amount of social contributions of 5,740 PLN = tax base of 20,640 PLN \times tax rate of 19% = 3,921.60 PLN minus the amount reducing the tax of 586.85 PLN = 3,334.75 PLN minus contributions for health insurance of 2,130 PLN = 1,204.75 \approx 1,205 PLN.

The income tax will amount to 1,205 PLN.

3.2 TAXATION WITH GENERAL RULES – 19% FLAT TAX

The income of 26,380 PLN minus the amount of social contributions of 5,740 PLN = the tax base 20,640 PLN \times 19 % tax rate = 3,921.60 PLN minus contributions for health insurance of 2,130 PLN = 1,791.60 PLN \approx 1,792 PLN.

The 19 % income flat tax will amount to 1,792 PLN.

Just like in the case of the flat tax, deciding on the tax scale as the form of settlements, the tax we will pay will be calculated on the income drawn. The tax will not be paid until our activity is profit-yielding, which means when our revenues exceed costs. Deciding on taxation by the scale we are not required to make a declaration about choosing this form.

One of the differences between the tax scale and the flat tax are tax rates. In the case of the flat tax it is 19%, the tax scale is 19%, 30% and 40%.

Unlike in the case of the flat tax, deciding on the tax scale we can exercise different kinds of privileges. Settling in this way we make use of the following possibilities: joint settling with a spouse, preferences for single parents, exemption from tax in connection with investments in the Special Economic Zone and tax allowances. The tax scale is profitable when our income does not exceed significantly the first tax threshold. If our profits exceed significantly the first threshold, then the flat tax as the form of taxation is more beneficial.

Choosing the tax scale as well as the flat tax, we are obliged to keep the revenue and cost register.

Deciding on the flat tax we are devoid of:

- the possibility to settle with a spouse,
- preference for single parents,
- exemption in connection with investments in the Special Economic Zone,
- any kind of tax allowances.

Incomes settled according to the flat rate do not include other incomes taxed by the tax scale or capital incomes. Using the flat rate we have the right to reduce income by our and co-workers' social contributions. Choosing the flat tax is beneficial when company income exceeds significantly the first tax threshold.

3.3 TAXATION IN THE FORM OF LUMP SUM ON RECORDED REVENUES.

Revenue of 68,640 PLN minus the amount of social contributions of 5,740 PLN = 62,900 PLN × the 3% tax rate = 1,887 PLN minus contributions for health insurance of 2,130 PLN = -243 PLN.

Taxation of the shop in the form of lump sum means there is no income tax.

The amount of tax depends on the amount of revenue and not on income like in the case of general rules. Tax must be paid whether our activities generate a profit or a loss. The amount of lump sum depends on the kind of activities. Lump sum is an easy form of settling since it does not require many formalities, only simplified financial documentation that includes employment records, revenues records and capital assets records is required. In this form the tax base is revenue that before taxation is reduced by paid social contributions. The amount of tax depends on the amount of revenue, it is calculated as interest on revenues, joint taxation with a spouse is not possible.

3.4 TAXATION IN THE FORM OF A TAX CARD.

In accordance with Appendix 3, Part II of act passed on 20th November, 1998 on flat income tax on certain revenues drawn by natural persons, Journal of Laws no 144, item 930 as amended, services in retail trade in food, beverages, tobaccos and flowers, in a town with the number of citizens between 5,000 and 50,000, when employing one worker, the monthly tax rate is between 461 PLN and 723 PLN. Thus assuming the lowest rate, annual income tax would amount to:

$461 \text{ PLN} \times 12 \text{ months} = 5,532 \text{ PLN}$ minus contributions for health insurance of 2,130 PLN = 3,402 PLN,

Whereas assuming the highest rate, annual income tax would amount to:

$723 \text{ PLN} \times 12 \text{ months} = 8,748 \text{ PLN}$ minus contributions for health insurance of 2,130 PLN = 6,618 PLN

Choosing a tax card means there is no need to calculate revenues or costs of activities, and tax is paid every month, it is of fixed amount determined by the head of a revenue office, after reducing it only by a paid contribution for health insurance. Other allowances and deductions or preferential settlements with a spouse and for single parents are not possible. An advantage of a card is no need to keep records.

The presented example shows that various forms of taxation for economic activities in retail trade in food products, fruit and vegetables the income tax amounts to:

1. taxation with general rules – 1,205 PLN
2. 19% flat tax – 1,792 PLN
3. lump sum on recorded revenues – does not occur
4. a tax card: minimum 3,402 PLN, maximum 6,618 PLN

In this particular example the best choice is taxation in the form of lump sum on recorded revenues because income tax does not occur for the whole year.

Taxation in the form of a tax card is the least beneficial even if we were obliged to pay the minimal rate.

Taxing activities with general rules, adding accounting costs (keeping documentation by an accountancy bureau) of 3,000 PLN a year to costs of revenues, income tax would be reduced to

Revenue of 68,640 PLN minus the costs of 45,260 PLN (42,260 PLN + 3,000 PLN) = income of 23,380 PLN.

Income of 23,380 PLN minus the rate of social contributions of 5,740 PLN = tax base of 17,640 PLN \times 19% tax rate = 3,351.60 PLN minus amount reducing tax of 586.86 PLN = 2,764.75 PLN minus contributions for health insurance of 2,130 PLN = 634,75 \approx 635 PLN.

The possibility to shape tax by costs exists only in the case of taxation with general rules since with flat rate forms tax is calculated without taking into account costs. Thus if costs are less significant, taxation in simplified forms is more beneficial, since a taxpayer will draw higher net income, whereas the higher costs, the more beneficial it is to tax by the tax scale. These costs reduce taxable income and the amount of paid tax is lower as well.

4. SUMMARY

For a taxpayer deciding on the form of taxation, it is of fundamental importance to establish what defines the profitability of particular taxes and how to conduct their tax policy in order to establish potentially lowest tax. The amount of tax is determined by declared revenues, costs, tax base deductions and tax deductions, as well as tax rates. Analysing tax payments it is necessary to take into account the foreseen economic situation of an enterprise (revenues, costs, investments), possible ways of tax approach (declaring revenues and costs), possible tax deductions. The personal situation of a taxpayer is also essential, first of all the scope of duties in contributions for insurance, income outside economic activities, the right to tax allowances, including within vested rights, as well as the right to settle with a spouse or children. The amount of tax depends finally on an individual situation of an enterprise and a taxpayer himself.

The basic criterion when choosing the form of taxation is the ability to foresee the amount of tax that will need to be paid at the end of the tax year. The lower tax, the more beneficial form has been chosen. It is not possible to state unambiguously which form of taxation is more beneficial, and which should be avoided, as it depends on an individual situation of a given taxpayer.

As it has been showed in this article, the question of choosing the appropriate (optimal) form of taxation of economic activities is of key importance since it influences the amount of planned revenues, the costs of revenues and of tax base or tax deductions. Fitness for information, costs and nuisance of keeping records and most of all the amount of tax that we will need to pay should be taken into account.

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