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TRANSACTIONS WITH RELATED ENTITIES IN THE LIGHT OF TAX SOLUTIONS AND CSR GOALS

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Purpose: The aim of the article is to analyze the impact of transactions with related entities on the company's financial results and the implementation of sustainable development goals. The lack of the tax dimension of corporate social responsibility in the literature encourages research in this area.
Design/methodology/approach: Based on the study of literature and legal regulations, reference was made to the transfer pricing policy as the main instrument of tax optimization in the light of CSR solutions. It also conducted its own survey research to learn more about the relationship between the use of corporate social responsibility in a company's strategy and its approach to taxation.
Findings: The article shows that the proposed changes in the publication of financial statements and non-financial reporting, together with the transfer pricing policy, constitute a new face of tax optimization in the context of corporate social responsibility. Based on the study, it can be concluded that CSR should be extended to include tax issues in the field of transactions with related entities.
Originality/value: Little is known in the literature about tax issues in CSR, although solutions are increasingly being introduced to encourage companies to behave socially responsibly. Recommendations for solutions in the field of disclosing information about transactions with related entities involving CSR in the context of tax avoidance constitute the originality of the article.

Keywords: corporate social responsibility, corporate taxation, tax avoidance, transfer pricing, capital groups.

Category of the paper: Research paper.

1. Introduction

Corporate social responsibility (CSR) is an interdisciplinary issue that is broadly understood and focuses not only on increasing the value of the company, but also on the natural environment, ethical business conduct and openness to the needs of the broadly understood environment. Tax solutions are increasingly being introduced in individual countries to encourage companies to behave socially responsibly. However, in the literature on CSR, little is known about the importance of taxes in this area, especially regarding transactions with related entities.

Transfer prices, i.e. prices established between related entities, are an important element of accounting and business management. In recent years, non-financial reporting, including sustainability (ESG) reporting, has become increasingly important. In this context, transfer pricing can play an important role in providing information on the environmental, social and governance impact of a company's activities.

The aim of the article is to examine the relationship between the use of corporate social responsibility in the financial relations of a capital group and its approach to taxation in the area of transfer pricing. Attention was drawn to the challenges facing non-financial reporting in the field of sustainable development goals.

2. Domestic and international related entities

The organizational structures of capital groups, mainly multinational corporations, are complicated and it is difficult to determine the relationships between individual entities and who may influence their activities. The provisions of tax law relating to prices in controlled transactions and the sanctions contained therein may be applied when it is proven that these prices have been manipulated only between entities that can be called related entities under the law, as specified in the introduction to the OECD Guidelines on transfer valuation in controlled transactions (OECD, 2010). Defining related entities is therefore a very important issue for determining the area of application of the mentioned regulations, as well as the established sanctions. Therefore, tax regulations in most countries strictly define under what circumstances entities can be considered related. Definitions of related entities were also formulated by the OECD and International Accounting Standards (Sojak, Baćkowski, 2003, pp. 29-30).

The international definition of the concept of related entities formulated by the OECD is included in Art. 9 section 1 (a) and (b) of the Model Tax Convention on Income and Capital, hereinafter referred to as the OECD KM (OECD, 1992), as well as in the above-mentioned OECD Guidelines. Two enterprises are linked when one of them participates directly or indirectly in the management, control or capital of the other or the same person participates directly or indirectly in the management, control or capital of both enterprises. In individual OECD countries, related entities may be defined differently, which may result in double taxation in practice. Most of them also differ from the OECD definition contained in Art. 9 OECD KM. In addition, they may be defined differently for different purposes, e.g. accounting, taxation, etc. All definitions contained in national transfer pricing regulations particularly address the issue of control exercised by one entity over the activities of another.

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Relationships between entities according to Polish tax regulations may occur in the following cases:

- a domestic entity participates directly or indirectly in the management or control of a foreign enterprise or has a share in the capital of this enterprise;
- a foreign entity participates directly or indirectly in the management or control of a domestic entity or holds a share in the capital of this entity;
- the same person (natural or legal) or an organizational unit without legal personality directly or indirectly participates in the management or control of a domestic entity and a foreign entity or holds a share in the capital of these enterprises;
- a domestic entity participates directly or indirectly in the management or control of another domestic entity or holds a share in the capital of that entity;
- the same person (natural or legal) or an entity without legal personality directly or indirectly participates in the management or control of domestic entities or holds a share in the capital of these entities (Ustawa…, 1992; Ustawa…, 1991).

The definition of related entities has a significant impact on the scope of application of regulations in connection with the application of transfer pricing, as it lists the entities to which these regulations apply. The concept of control is extremely important, as it is the most important factor determining the effectiveness of all regulations regarding related entities (Krzewski, Michalak, 2000).

3. Taxation of enterprises and CSR goals

Corporate social responsibility is a concept that has no universal and universally accepted definition. For this reason, determining its scope is not an easy task. Due to the lack of unambiguous standards, it is difficult to precisely determine which behaviors of enterprises are a manifestation of social responsibility (Kozłowska-Makóś, 2020).

In accordance with ISO 26000, CSR is an organization's responsibility for the impact of its decisions and activities on society and the environment, which is ensured through transparent and ethical conduct that:

- contributes to sustainable development, including social well-being and health,
- takes into account the expectations of stakeholders,
- is in accordance with applicable law and consistent with international standards of conduct,
- is integrated with the organization's activities and practiced in its relations (ISO 26000, 2010).

Therefore, the concept of corporate social responsibility should be understood as a concept thanks to which companies at the stage of building a strategy voluntarily take into account social, local, environmental protection as well as relations with various groups of stakeholders. Corporate social responsibility means not only meeting all formal and legal requirements as part of business operations, but also increased investment in human resources, environmental protection and relations with the company's environment, i.e. additional voluntary commitment. Therefore, CSR is a process in which enterprises manage their relationships with various stakeholders who can have a real impact on the success of their business.

Pro-social activities are costly and not every company would voluntarily bear this type of burden. Therefore, at least some of the activities, including paying taxes, must be obligatory, i.e. regulated by the state by relevant legal provisions, to ensure a proportionate distribution of these burdens to all enterprises, thus maintaining comparable operating conditions (Brigham, Houston, 2005).

The development of capital groups, as well as their financial results, do not depend only on the efficiency of management, but also on how much of the added value generated is discharged in the form of taxes and para-taxes. Taxes are a source of financing public and social goods, which are also used by business entities.

Corporate income tax plays a special role here, as it is mainly the larger enterprises that demonstrate in their business strategies that they implement socially responsible activities.

However, related entities are reluctant to pay taxes, which results in unethical or even aggressive tax planning. This is related to the phenomenon of tax avoidance, which occurs in varying degrees and in different forms of individual countries. Escaping from taxes can be understood and implemented in various ways. In the context of the problem under consideration, the most important thing is to distinguish these activities according to the legal criterion, i.e. without or in breach of law.

The first of these, known as tax avoidance, is a taxpayer's action that meets all of the following conditions:

- is in line with the letter but is contrary to the spirit of tax law (ratio legis),
- leads to the taxpayer obtaining a tax advantage, in particular reducing or liquidating tax obligations,
- the tax advantage is an important motive for the taxpayer to take the action under consideration.

It is believed that the tax avoidance thus defined leads to total or partial non-payment of tax in the jurisdiction in which the enterprise derives economic benefits (i.e. the place of the source). Unlike avoidance, tax evasion is an illegal phenomenon involving the concealment or misrepresentation of the nature of a transaction (Kozłowska-Makóś, Kluzek, 2018).

4. Taxation avoidance in the related parties

International capital groups are the effect of running economic activities of varied scope in different countries. Regardless of whether the group of related entities was established for business or financial reasons, one of the consequences of its operation is the taxation of direct income from activities in various tax jurisdictions. In this context, income tax becomes one of the risk factors for the operations of an international capital group.

Taxation of international capital groups is associated with such phenomena as: tax optimization or international tax avoidance. These phenomena occur in varying intensity and in different forms in particular countries. All activities of business entities aimed at minimizing tax burdens within the limits of applicable law are referred to as tax optimization (tax planning). Capital groups striving to minimize the tax burden have two options to choose from: tax savings and tax avoidance.

Tax savings involve the use of tax benefits, tax rebates and exemptions offered by the legislator, as well as the selection of the most favorable form of taxation.

Tax avoidance is based on the taxpayer's operation in a legal way, using the legal forms allowed. He will be looking for the most favorable way to minimize tax burdens by using gaps in the law. It is important to distinguish between avoiding taxation from tax evasion. Tax avasion means that the taxpayer violates applicable law. This is punishable.

Noteworthy is the concept of "international tax avoidance" defined as ethical tax planning, which uses legal methods to avoid excessive taxation. Typically, as part of tax optimization in the international market, capital flows through countries offering tax privileges). The activities of international capital groups are based on at least several tax laws of individual countries, EU tax law, as well as international tax law. This diversity and multitude of regulations allow related entities to create such a strategy that will use various instruments to optimize, and thus to avoid taxation. In addition, in their tax strategies, capital groups use a number of financial instruments, which often complicate the real verification of transparency and credibility by the tax administrations of individual Member States.

It is worth noting that in today's era complex capital structures use highly advanced tax technologies, which are mainly based on multi-pass hybrid solutions using complex derivative instruments. The multiplicity and complexity of instruments, which at the same time are subject to dynamic "mutation", contributes to ineffective and helpless tax control in individual countries. Another important element of the lack of effectiveness in the fight against international tax avoidance is the lack of a modern holding tax law. The idea of a modern holding tax law should be based on tax constructions satisfying not only international groups guided by honest intentions, but also protecting the state budget interest. The lack of the concept of a modern holding tax law is one of the key reasons for the ineffective state struggle against international tax avoidance.

Undoubtedly, the situation is also complicated by the phenomenon of international harmful tax competition between countries. In intra-EU relations, tax competition should be considered a phenomenon involving the use of various taxation techniques to develop the national economy and prosperity by increasing the competitiveness of domestic economic activity or attracting foreign investments. Tax competition is a natural consequence of globalization processes, because in the world of growing economic interdependencies taxation has an increasing impact on investment decisions of capital groups. It is an expression of a discrepancy between the interests of a single country (a member state of the European Union) and the interest of all countries (the European Union). More and more often the boundary between harmful and favorable tax competition is difficult to determine. This is particularly noticeable when the Member States (most often neighboring) form their tax policy, basing it on constructions that directly or indirectly influence the decisions of international capital groups regarding the change of their tax residence (Kozłowska-Makóś, 2022a). Bearing in mind the above tendencies, it is worth looking at the instruments used to avoid taxation by international capital groups.

5. Corporate social responsibility and transfer pricing policy

In the valuation of transfers between related entities there is still one very important aspect, namely a differentiated tax system in the countries in which the various responsibility centers of a capital group are located.

Complex capital structures take appropriate policy of price transfer, depending on whether they are an international group, which has subordinate companies located in countries with different tax rates. Tax effect in this case of differentiated prices in the international groups is best demonstrated by the same transfer using so-called high and low transfer price. In the country of the company-supplier, where is a higher rate of income tax it pays to fix the transfer price at a lower level. Lower transfer price means that we pay less corporate income tax. We obtain the lower profit after taxation. However, in the country of the company-recipient, where is a lower tax rate, the low transfer price means that we pay more income tax. In the end we get a higher taxable income (Figure 1).

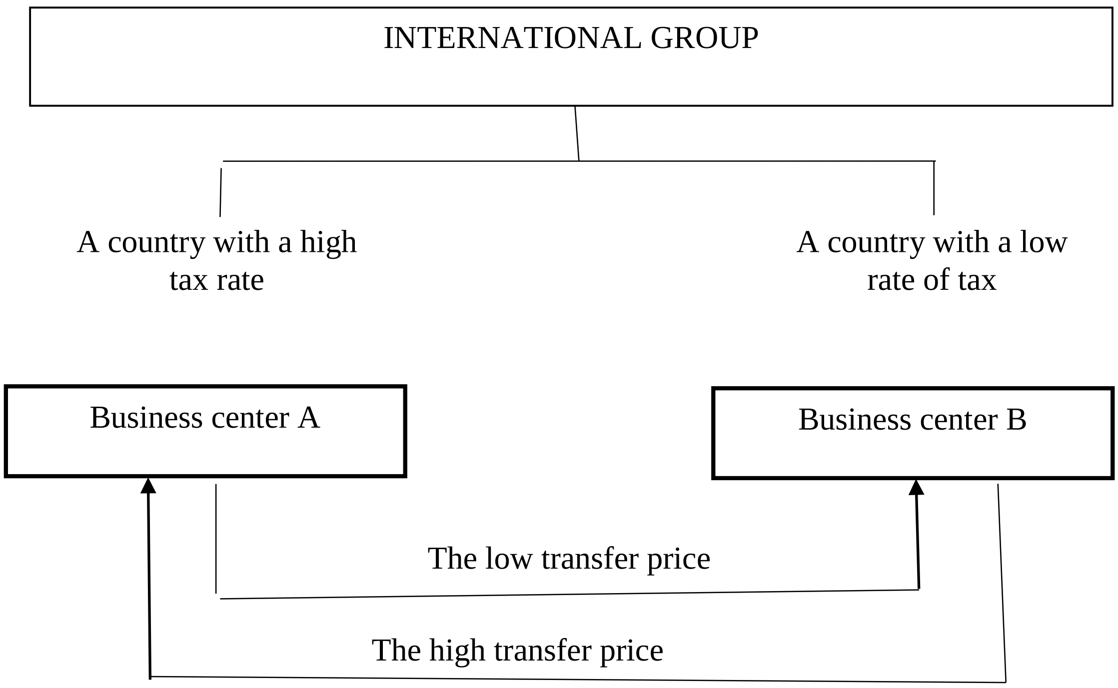

Figure 1. Preferences of transfer.

Source: Kozłowska-Makóś, 2022b.

It can be argued that the phenomena involving the income shifting between companies lying in the different countries of the same capital group to reduce tax liabilities will remain a problem on a global scale. Due to the fact that the unification of tax rates around the world is impossible, in order to minimize this phenomenon, international consensus on tax law concerning related entities is required, which at present is imperfect and raises important issues between the taxpayer and tax administration.

Although the issue of taxation as one of the key elements of CSR is not widely accepted, research in this field is already under way in the world. Our own survey was conducted in order to learn more about the relationship between the use of corporate social responsibility in the strategy of a company and their approach to taxation. The survey covered 300 respondents who were senior and middle managers, as well as owners (Figure 2).

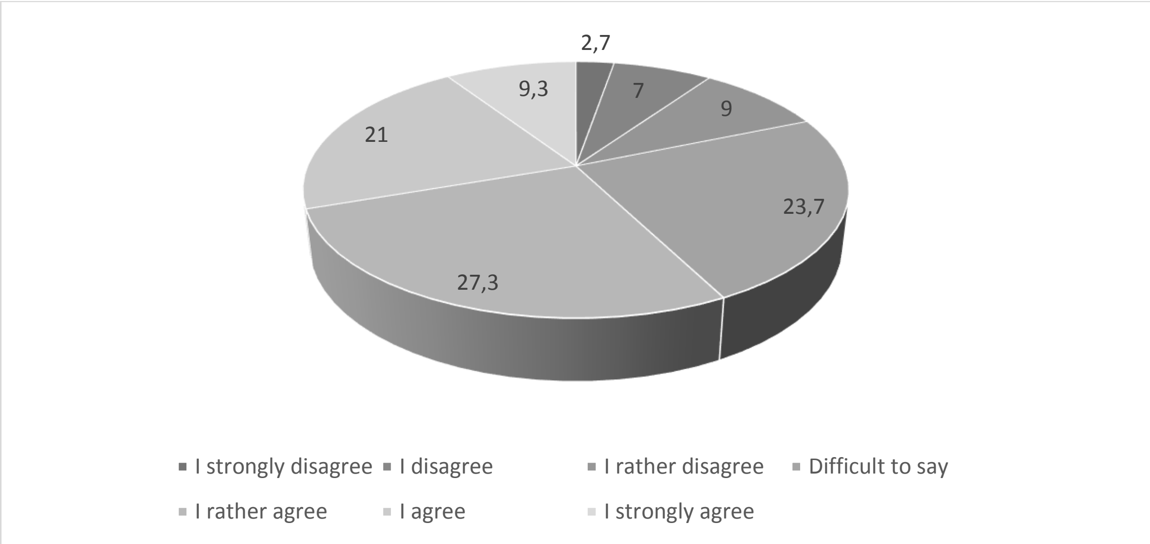

Figure 2. Impact of the CSR concept on corporate taxation.

Source: Own research.

The survey results indicate that tax issues are rather part of the Polish CSR program. The relationship between CSR and tax liabilities was identified in more than half of the surveyed enterprises. Almost a quarter of respondents had no opinion, and for a fifth of respondents the concept of CSR in taxation definitely does not matter.

From a utilitarian perspective, you can conduct a cost-benefit analysis to assess whether specific actions result in maximum well-being for most people. Avoiding taxation in one jurisdiction may result in investment and improvement of conditions in another country, but ethical relativism can be problematic. Ethics is a reflection of local social morality, so there are differences, especially between developed and underdeveloped countries.

6. Challenges in the use of transfer pricing in financial, non-financial and ESG

Accounting and tax compliance has been the subject of a vast amount of research. However, tax compliance is relatively rarely the subject of research in terms of its inclusion in business processes and treatment in a systemic perspective.

The multitude of tax and balance sheet law regulations imposes on enterprises a number of supervisory and reporting obligations. For example, according to Polish accounting regulations, the management board of a commercial law company is responsible for, mong others, the internal control necessary for the correct preparation of financial statements, including the correctness of tax settlements, and the supervisory board is responsible for supervising the financial reporting process. In addition, companies listed on the Warsaw Stock Exchange should annually submit a statement on the company's compliance with the corporate governance principles contained in Best Practice for GPW listed companies. The regulations do not contain guidelines as to how the internal control system in the field of accounting, financial reporting, and taxes, is to be constructed in practice (Sulik-Górecka, 2022).

In recent years, non-financial reporting, including sustainable development (ESG) reporting, has become increasingly important (Emerling et al., 2022). In this context, transfer pricing can play an important role in providing information about the impact of a company's activities on the environment, society and governance. Transfer pricing can have a significant impact on information disclosed in non-financial reporting. For example, high transfer prices set for transactions involving greenhouse gas emissions may indicate that the company is not sufficiently active in environmental protection. In turn, low transfer prices set for salary-related transactions may suggest that the company does not provide employees with appropriate working conditions.

In the following years, the scope of disclosure of non-financial information, including that in terms of sustainability and corporate social responsibility, will evolve and expand. As of 1 January 2021, taxpayers in Poland whose revenue value in the tax year exceeded the equivalent of EUR 50 million (according to the average NBP exchange rate, announced on the last business day of the calendar year preceding the reporting year) and tax capital groups regardless of the amount of revenues achieved are required to publish information on the executed tax strategy on their website or the website of a related entity (Ustawa…, 1992).

Pursuant to the regulations, the minimum scope of information on the implemented tax strategy includes among others:

- information on transactions with related entities, the value of which exceeds 5% of the balance sheet total of assets,
- information on the processes and procedures for managing the performance of obligations under tax law and ensuring their proper performance,
- information on the settlements in countries applying harmful tax competition (transactions with entities based in tax havens).

The variety of reporting obligations in Poland results from the wide scope of various types of taxes functioning in the Polish tax system. It is obvious that the tax authorities are concerned with the greatest possible tax revenues, hence instruments are implemented to capture any irregularities (Sulik-Górecka, 2022). In order to counteract the phenomenon of tax avoidance, also anti-abuse clauses are used, including, in particular, the General Anti-Avoidance Rules

(GAAR). Another exemplary instrument to prevent tax avoidance is the need to report information on tax schemes Mandatory Disclosure Rules (MDR) in a situation where the taxpayer has applied some arrangement, the main purpose of which is to achieve a tax benefit (Ustawa…, 1997). Regulations regarding transfer pricing issues are also included in the OECD Model Convention. Its content includes the basic principle relating to transfer prices, i.e. the arm's length principle, the essence of which consists in recommending the valuation of transfer between related entities, taking into account commercial and financial conditions in force on the free market. A less popular instrument for the prevention of tax avoidance is the provisions relating to the controlled foreign corporation. Their essence consists in adding to the income of a shareholder in the country of his tax residence the income of a subsidiary located in another country and the taxation of the sum of this income in the first country. This taxation also takes place when the income has not been paid in the form of a dividend. Their task is to counteract the phenomenon of income retention in tax havens. Many countries have developed lists of countries that use harmful tax competition and taxed the income of controlled foreign companies when these companies are located in the jurisdictions listed in the list (locational approach).

A novelty in Polish regulations are the provisions of the Tax Ordinance, section IIB, entitled “Cooperation”, introduced by the Act on resolving disputes related to double taxation and concluding advance pricing agreements (Ustawa…, 2019, Ustawa…, 1997), enabling the conclusion of the so-called “cooperation agreements” in the field of taxes. Such a civil law contract will allow for obtaining a number of special privileges, mainly in the form of no tax inspections, no obligations in relation to the so-called “national schemes”, or (under certain conditions) limiting certain sanctions, e.g. in VAT.

The risks associated with failure to pay adequate attention to tax compliance include not only tax risks manifested in the necessity to pay taxes with interest, but also the imposition of penalties or sanctions or consequences provided for in the Fiscal Penal Code. The consequence of violating tax compliance can be the loss of a company’s credibility and reputation, as well as a number of negative consequences for managers who will be held responsible in this regard (Sulik-Gorecka, 2022). Current applicable laws and regulations will not resolve all tax avoidance problems. However, the increasing social pressure and public interest caused that some international enterprises began to perceive the discharge of taxes to the budget as part of the policy related to sustainable development and corporate social responsibility (Wasilewski, Bischoff, 2017).

7. Summary

Currently, many enterprises, especially larger and prosperous ones, indicate that corporate social responsibility is an indispensable element of their business strategy. Corporate social responsibility is relatively rarely associated with transactions between related entities forming a capital group.

Imprecise regulations, lack of case law on complex transfer pricing issues, and limited experience of tax authorities in examining and assessing transactions concluded in capital groups increase the transfer pricing risk for taxpayers. Corporate social responsibility (CSR) is a response to the challenges posed by the concept of sustainable development.

Related entities face challenges in concluding internal transactions, especially in the area of non-financial reporting. ESG reporting is becoming more and more popular among enterprises. This is due to the growing expectations of stakeholders, such as investors, customers and employees, regarding responsible business conduct. Transfer pricing can be used to improve the quality of ESG reporting. For example, companies can use transfer pricing methods that take into account ESG factors such as environmental impact or employee rights. Thanks to this, the information disclosed as part of ESG reporting will be more reliable and transparent.

It therefore follows that the use of transfer pricing in non-financial and ESG reporting poses certain challenges. One of them is the lack of uniform standards for ESG reporting. As a result, companies may use different disclosure methods, which may make comparisons difficult. Another challenge is the lack of access to transfer pricing data. This data is often confidential and not publicly available. As a result, companies may have difficulty estimating the impact of transfer pricing on their financial and ESG performance.

To increase the importance of transfer pricing in non-financial and ESG reporting, it is necessary:

- development of uniform ESG reporting standards that would take into account transfer pricing factors,
- ensuring access to transfer pricing data, including publicly available data,
- development of transfer pricing methods that would take into account ESG factors.

Implementation of these recommendations would improve the quality of ESG reporting and increase its credibility.

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