

Fiscal Optimization Through the Acquisition of Intra Group Services

Marius Boita

Gheorghe Pribeanu

”Vasile Goldis” Western University of Arad, Romania

bmarius1963@yahoo.com

pribeanu_g@yahoo.com

Ionela Mihaela Milutin

Western University of Timisoara, Romania

ionelamilutin@yahoo.com

Abstract

This empirical study addresses the fiscal optimization of the profit tax by purchasing intragroup services for planning, respectively preparing the financial statements and adjusting the income and profit tax, with an impact on the deduction of value added tax. The study focuses on the economic relations regarding the procurement of services between a Romanian company and a cross-border one in affiliation relations. The study concludes that by applying fiscal policies and interpreting the legislation in the field of tax-accounting, certain transactions between related parties lead to fiscal optimization of taxes and fees, which have a negative impact on the consolidated state budget and the Romanian economy.

Key words: fiscal result, taxation, accounting, taxes, consolidated budget

J.E.L. classification: M21, M41, E62, E63

1. Introduction

The need to prepare the Transfer Pricing File is when transactions take place between affiliates, to reflect the fair price charged on the market.

It should clarify that the prices charged in intragroup transactions are the same as for transactions with an unaffiliated entity.

In most cases, the prices applied intragroup in transactions with goods or services are below market value, or depending on the situation, they are well above market value.

This empirical study addresses the fiscal optimization of the profit tax by purchasing intragroup services for planning, respectively

The optimization, by underestimating the tax base, consists mainly in intentionally altering the supporting documents or concealing the financial and accounting records, in order to either overestimate the expenses or underestimate the income.

By presenting and avoiding methods by underestimating the tax base, to which people prone to these phenomena have resorted and are resorting to non-payment of taxes or fees to the budget, or to justify the origin of goods from illicit sources, or smuggling, or from clandestine domestic production, fraud has been reported.

2. Literature review

Bayer and Sutter (2004, p. 27) identify two main reasons why people do not avoid paying taxes: loss aversion and moral constraints, and moral constraints can effectively discourage tax avoidance.

Panayi (2017), quoted by Radu, Dumiter and Jimon (2017), highlights the high costs of business succession and explicitly the reduction of profits associated with cross-border transactions.

Perroux Fr. (1969, pp. 49) considers economic growth as an increase in the size of the national economy, expressed in the total goods and services obtained over a period of time, including depreciation.

3. Findings. SSB Group case study

Within the SSB Group, certain management services are provided which include management support, marketing support and services related to the improvement of the production process or quality issues whose costs are allocated between the local entities. These services are billed to the beneficiary companies by the SSB Group headquarters, based on an hourly rate plus a 5% surcharge.

The techniques for optimizing the company's results are presented in the manner and accounting instructions recommended by international accounting standards.

The presence of several - options - acceptable in the accounting field, according to some accounting options, or an estimation independence in the situation of presenting the consolidated financial statements, can mark/distort the result/performance of the company.

We cite as an example one of the accounting/optimization engineering and its influence on the company's results.

3.1. Regarding the services provided by the affiliated entities in the period 2016 - 2020:

Applicable legislation is defined in art. 19 para. (5) of "Law no. 227/2015", which stipulates:

As art. 7 and art. 11 para. (2) of "Law no. 227/2015" on the Fiscal Code, that between the affiliated persons, the costs of administration, management, control, consulting or similar functions are deducted at the central level through the parent company, on behalf of the group as a whole. Expenditure of this kind can be deducted only if it provides additional services to the affiliated persons or if the price of the goods and the value of the services provided are also taken into account for the services or administrative costs.

Article 19 para. (6) of Law no. 227/2015 provides: Transactions between affiliates are carried out according to the principle of market value. When establishing the fiscal result of the affiliated persons, the regulations regarding the transfer prices, provided by the Fiscal Procedure Code, are taken into account.

Following the analysis of the transactions carried out by SSB SRL with the affiliated persons and the analysis of the Transfer Pricing File presented by the Company, as a result, it was concluded that SSB SRL performs functions and risks that exceed the manufacturer's functional profile based on contract or order, as defined in the Transfer Pricing File, regulated by Order no. 442/2016.

Certain expenses with the strategic functions/risks, respectively, strategic development research and marketing expenses fulfilled by the affiliated company, are invoiced based on some allocation keys with a profit margin of 5% to SSB SRL.

Thus, during this period, the functional profile for which it was compensated/remunerated, Societatea SSB SRL, is that of a manufacturer based on contract/order. Comparable companies on the basis of which the comparability analysis was established are companies with the same functional profile.

Consequently, the profit margin, respectively the revenues registered in Romania by the company SSB SRL is related to a manufacturer based on a contract that performs routine functions and risks.

Routine functions are functions of SSB SRL, while strategic functions are functions of SSB Luxembourg.

Each affiliate assigns its profits and operating margin according to the general business model, respectively contract-based manufacturer/entrepreneur.

3.2. Developer research costs

However, SSB Luxembourg charges SSB SRL: Basic research and development costs in the amount of:

- 5,250,999 lei for 2016;
 - 6,885,095 lei for the year 2017;
 - 7,322,850 lei for the year 2018;
 - 7,625,900 lei for 2019;
 - 8,222,888 lei for the year 2020.
- Total: 35,307,732 lei

Expenditure on generic research - basic development research are the expenses of the entrepreneur, of a company with full functions and risks and not the expenses that a manufacturer should incur on the basis of a contract with routine functions, as long as his operating margin, respectively the revenues recorded by the manufacturer on a contract basis, independently, are not revenues to cover these costs, respectively generic research costs.

As we have shown, in fact, these functions are functions of the affiliate company.

These basic development research expenditures do not always materialize as completely new products or innovations resulting from the development research activities and do not include maintenance or improvement of continuous operations.

Concluding the above: the functional profile for which it was compensated/remunerated, SSB SRL is that of a manufacturer on a contract basis.

Comparable companies on the basis of which the comparability analysis was established are companies with the same functional profile.

As a consequence, the profit margin, respectively the revenues registered in Romania by SSB SRL are related to a manufacturer based on a contract that does not fulfill strategic functions and risks.

The OECD Guideline states that in comparing the functions performed, it may be relevant and useful to take into account the risks assumed by those parties. In an open market that is prone to high risks, it will be offset.

In view of the above, in our opinion, it is considered that these basic development research expenses are non-deductible in the calculation of the taxable profit and the profit tax related to each fiscal period.

The legislation is not met the conditions of deductible expenses provided by art. 19 par. (1) and 25 para. (1) of Law 227/2015.

In our opinion, the company unjustifiably diminished its profit tax calculation base, treating as tax deductible a series of expenses representing basic development research expenses, expenses in the total amount of 35,307,732 lei, representing non-deductible expenses for profit calculation taxable income and profit tax for the period 2016-2020, replenishing the taxable base for each fiscal period.

3.3. Marketing expenses

SSB Luxemburg also invoices SSB SRL for marketing expenses for the period 2016 - 2020, as follows:

- 175,160 lei for the year 2016;
 - 220,915 lei for the year 2017;
 - 255,100 lei for the year 2018;
 - 439,795 lei for the year 2019;
 - 515,999 lei for the year 2020.
- Total: 1,606,969

Marketing, advertising and promotion Within the SSB Group, marketing activities include operational advertising activities, as well as market analysis and market development, or strategic decisions on issues such as the introduction of new products or product changes.

Those activities are generally either performed by each local entity individually, or some services may be provided centrally.

In addition, the projects are usually initiated on the basis of a request, so that the marketing activities are not relevant for SSB SRL, which is a manufacturer for the Group's clients.

SSB SRL does not perform marketing, advertising and market promotion functions, as well as risks associated with these functions, given the functional profile of SSB SRL, described in the Transfer Pricing File.

SSB SRL uses the Group's customer base, for which it pays the licenses provided in the concluded License Agreements, and the concluded contracts are in the name of SSB Luxembourg. Marketing costs are not the costs of a contract-based manufacturer whose activities are usually provided to the OEM for use in the production process.

As already mentioned, the functional profile for which it is compensated/remunerated, the society SSB SRL, is that of a manufacturer on a contract basis. Comparable companies on the basis of which the comparability analysis was established are companies with the same functional profile.

As a consequence, the profit margin, respectively the revenues registered in Romania by Societatea SSB SRL are related to a manufacturer based on a contract that does not have strategic functions and risks.

In view of the above, it is considered that these basic development research expenses are non-deductible when calculating the taxable profit and the profit tax for each fiscal period.

The expenses thus registered does not meet the legislation of deductible expenses provided by art. 19 para. (1) and 25 para. (1) of Law no. 227/2015.

In our opinion, the company unjustifiably diminished its profit tax calculation base, treating as tax deductible a series of expenses representing marketing expenses, expenses in the total amount of 1,606,969 lei, representing non-deductible expenses when calculating taxable profit and income tax for the period 2016-2020, replenishing the tax base for each fiscal period.

4. Conclusions

Following this study we will reveal the following conclusions:

In view of those presented in the case study, it is considered that these basic development research expenditures are non-deductible in calculating the taxable profit and the profit tax for each fiscal period.

As a consequence, the profit margin, respectively the revenues registered in Romania by the company SSB SRL are related to a manufacturer based on a contract that does not depend on strategic functions and risks.

In our opinion, the expenses in the total amount of 36,914,701 lei, representing the basic development research and marketing expenses represent non-deductible expenses for the calculation of the taxable profit and the profit tax for the period 2016-2020, reuniting the related taxable base. each fiscal period.

Analyzing these services, it results that they are not clear and determinable, and from a fiscal point of view they diminish the reported profit in Romania of the company SSB SRL, explicitly the profit tax.

Routine functions are functions of SSB SRL, while strategic functions are functions of SSB Luxembourg.

Each affiliate assigns its profits and operating margin according to the general business model, respectively contract-based manufacturer/contractor.

By applying/interpreting the fiscal policies in the fiscal-accounting field, certain transactions carried out between affiliated parties lead to the fiscal optimization regarding the taxes and fees, which has a negative impact on the consolidated state budget, respectively of the Romanian economy.

The independence given by the legislation in force, as an option of the accounting policies by the management of the companies, to an increase or reduction of the fiscal effect, represents in our opinion one of the most important informative thresholds of the profit and loss account.

Usually, the people who process the accounting records, take advantage of this possibility to apply permissive accounting policies, which most of the time are within the limits of the law.

At this time, inaccurate tax legislation, which creates instability between different areas of activity or contains many legislative inaccuracies, is important for authorized decision makers in Romania to develop measures in the future by reducing the effects and uncertainties on the legislation, by clear definitions, leading to an interpretation, respectively, a correct application of the financial accounting legislation by all taxpayers.

5. References

- Panayi, C. 2007. *Double Taxation, Tax Treaties, Treaty Shopping and the European Community*, Eucotax, Kluwer Law International, quoted by Radu, Dumiter and Jimon, 2017, *Study On Budget Revenue Collection, Shadow Economy and Tax Losses Caused By It*
- Perroux, Fr. 1969. *The economy of the twentieth century*. Paris: PUF
- *** Law no. 227/2015 on the Fiscal Code with subsequent amendments and completions
- *** Order no. 442/2016 of January 22, 2016 on the amount of transactions, deadlines for preparation, content and conditions for requesting the transfer pricing file and the procedure for adjustment/estimation of transfer pricing, Published in the Official Gazette no. 74 of February 2, 2016
- *** [Online] Available at: <http://store.ectap.ro/articole/102.pdf> [Accessed in October 2021]
- *** [Online] Available at: <https://edpb.europa.eu/sites/default/files/files> [Accessed in November 2021]