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## Article

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## Application of the CCCTB and Safe Harbours to European SMEs: Can the Decrease in Compliance Costs Support better SME Performance?<sup>1</sup>

Veronika SOLILOVÁ\* – Danuše NERUDOVÁ\* – Marek LITZMAN\*\*

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### Abstract

*Small and medium-sized enterprises (SMEs) are facing internal markets with higher taxation and transfer price compliance costs as well as cross-border loss compensation problems. With respect to the taxation (transfer pricing) compliance costs that are borne by SMEs, the possible solutions for decreasing those costs were suggested to be safe harbours and common (consolidated) corporate tax bases. This paper includes an evaluation of the suggested approaches and their impacts on the SMEs' economic performance. In addition, this evaluation accounts for the selected economic variables that are classified by industry and firm size, assuming decreased compliance costs of taxation and the fulfilment of the long-term goals of the EU2020 agenda, such as smart and inclusive growth in the EU. Based on the results, it can be concluded that safe harbours and the CCCTB system are able to improve SMEs' performance. The most important economic variables supporting the increase in business performance are current assets, value added, enterprise value and, finally, operating revenues. In researched countries, the highest impact on the business performance would result from the created added value.*

**Keywords:** SMEs, transfer pricing rule, safe harbour, CCCTB, Czech Republic, Slovak Republic, business performance

**JEL Classification:** F23, K33, G38

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## Introduction

The European Commission (2016a) stated that Small and medium-sized enterprises (hereinafter SMEs)<sup>2</sup> comprise almost 99% of all firms in the EU, i.e., just under 24 million SMEs in 2017. SMEs, as the economic backbone of the European economy, contribute significantly to national and global economic growth. They generate almost 57% of the total value added and account for a large proportion of the total employment (i.e., they provide 93 mil. jobs), mainly in the service sector (European Commission, 2017). Even though the contributions of SMEs to employment differ by sector, as a whole, SMEs create at least 67% of the jobs in the EU. SMEs are also involved in global value chains as partners, suppliers and distributors of large and multinational companies.

The surveys<sup>3</sup> of the European Commission have revealed that all SMEs face the same obstacles, mainly tax systems that generate excessive compliance costs. Certain features of the tax system may disadvantage SMEs relative to large enterprises, even though many tax requirements may appear to be relatively “neutral” for businesses with respect to size. These tax requirements include higher fixed costs that are associated with tax and compliance regimes. Due to this, governments are taking many measures to reduce these impacts by providing preferential tax policies, special provisions, specific tax rules and simplification measures that are targeted at SMEs. One of them that can be considered is safe harbours<sup>4</sup> with respect to transfer pricing issues. If these measures are

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<sup>2</sup> SMEs are categorized according to the number of employees and their turnover or balance sheet total, as following: micro, small and medium-sized enterprises. Medium-sized enterprises are defined SMEs as “enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million”. Small enterprises are defined as “enterprises having less than 50 employees and turnover or balance sheet total of less than EUR 10 million, and microenterprises as a firm with less than 10 employees and a balance sheet or turnover below EUR 2 million.” For more details see European Commission (2003).

<sup>3</sup> European Commission (2001), *Company Taxation in the Internal Market* (COM(2001)582 final), and also in *Internationalisation of SMEs* (2010) or *Modern SME policy for growth and employment* (COM(2005)551 final), European Commission (2005). Furthermore European Commission in *Annual reports on European SMEs 2011/2012; 2012/2013; 2013/2014; 2014/2015; 2015/2016 and 2016/2017*.

<sup>4</sup> OECD (2013; 2017): *TP Guidelines*, Chapter IV, section E defines a safe harbour as follows. “A safe harbour is a provision that applies to a defined category of taxpayers or transactions and that relieves eligible taxpayers from certain obligations otherwise imposed by a country’s general transfer pricing rules. A safe harbour substitutes simple obligations for those under the general transfer pricing regime. Such a provision could, for example, allow taxpayers to establish transfer prices in a specific way, e.g. by applying a simplified transfer pricing approach provided by the tax administration. Alternatively, a safe harbour could exempt a defined category taxpayers or transactions from the application of all or part of the general transfer pricing rules. Often, eligible taxpayers complying with the safe harbour provision will be relieved from burdensome compliance obligations, including some or all associated transfer pricing documentation requirements.”

carefully designed, i.e., if they do not increase complexity, they can address the disproportionately high tax compliance burdens faced by SMEs. Another one that can be considered is a Common Consolidated Corporate Tax Base (hereinafter CCCTB), which is mainly directed towards large enterprises (hereinafter LEs), but SMEs can voluntarily opt for this corporate taxation system. Moreover, the European Parliament report on the CCCTB suggests a decrease in the consolidation threshold from EUR 750 mil to zero with respect to the mandatory obligation of the CCCTB for all eligible<sup>5</sup> companies; i.e., SMEs would also be eligible for this corporate taxation regime after fulfilling the conditions. Therefore, researchers have addressed whether both suggested approaches (CCCTB and Safe harbours) are able to improve business performance by decreasing the compliance costs of taxation.

The aim of the paper is to research the impacts of the CCCTB system and Safe harbours on both the business performance and economic indicators of SMEs operating in the Czech Republic and Slovak Republic, which are classified via industry, with respect to the decreased compliance costs of taxation under the CCCTB system and the application of Safe harbours. We research whether decreased compliance costs of taxation through the application of CCCTB system or Safe harbours are able to improve the business performance of SMEs and identify the most important economic variables that support improved business performance with the emphasis on the fulfilment of the long-term goals of the EU2020 agenda, such as smart and inclusive growth in the EU.

## 1. Theoretical Background of the Issue

SMEs are strongly heterogeneous, specifically across and within industries and sectors, in their innovation behaviour, profitability and growth potential. They significantly differ from LEs in many aspects, such as their size, activities, needs, resources, labour productivity, employees' qualifications and skills and capital intensity. Thus, they cannot achieve the same economies of scale as LEs. From the international perspective, the most important issues that SMEs face when operating in Internal Markets are the *compliance costs of taxation* which are generated due to the lack of a unified taxation system for SMEs (there are 28 different tax systems in the EU), *transfer prices* and problems with *cross-border loss compensation*. SMEs face specific problems and have specific needs since they do not have comparable resources to LEs to handle the high taxation

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<sup>5</sup> An eligible company is a company fulfilling two-layer cumulative conditions for a group taxation scheme and consolidation based on the Article 3 of the CCCTB proposal, which are as follows: at least 50.01% of ownership rights and more than 75% of voting rights.

compliance costs. In 2007, the European Commission (2007a; 2007b) highlighted that a big company spends *one euro per employee* to comply with regulatory duties, a medium-sized enterprise might have to spend *around four euros* and a small business *up to ten euros*. With respect to the compliance costs of transfer pricing issues, Solilova and Nerudova (2018) determine them to be between EUR 3,090 and 5,564 annually per entity for European SMEs, which represents 1.32% to 2.38% of the overall corporate taxes that are collected.

The measurement of compliance costs is very problematic in the economy since they represent the complexity of the tax system, which is influenced by many factors (Pavel and Vitek, 2015). The European Commission (2007b) highlights some of those factors, such as the number of taxes that must be complied with, the frequency of changes to the tax laws, the complexity of the tax system, the existence of different tax administrations, the difficulty associated with interpreting unclear tax laws, multiple deadlines for tax payments throughout the year, the costs of external tax service providers, the compliance costs for the internal staff or owner, and the tax registration procedures. Moreover, tax compliance costs involve a large fixed component and impose a relatively higher burden on SMEs than on LEs, which can benefit from economies of scale. Generally, when compliance costs are measured as a percentage of turnover or income, then, as Cressy (2000) states, these costs tend to be regressive with regard to firm size. The same conclusion was reached by Sandford (1995) who further states that this regressive effect is cumulative and the excessive burden of these costs can generate a prohibitive effect. Nerudová et al. (2009) further mention that compliance costs are significantly higher in the case of SMEs with foreign branches or subsidiaries in comparison with SMEs that are not internationalized. A European Commission study (2007a; 2007b) found out that, “on average, a company with fewer than ten employees has to face a regulatory burden that is about three times higher than the burden of a company with more than twenty but fewer than fifty employees. For LEs, the burden per employee is only one fifth or one tenth of that of SMEs.” Other research that was performed by Coolidge (2012) proved that compliance costs of taxation are 5% of turnover in case of SMEs, whereas for LEs, they are less than one tenth of 1%. In case of the Czech Republic, the corporate and individual taxation compliance costs were determined by Vitek and Pavel (2008) to be 42.9% and by Pudil et al. (2004) to be 35.9% with respect to the corporate and individual taxes that were collected. In case of the Slovak Republic, as Nemec, Čižmárik and Šagát (2017) stated, the Slovak tax administration is significantly more expensive than the Czech tax administration since the compliance costs are very high in comparison with the other developed countries and Slovakia’s neighbours, according to research on

period from 2004 to 2011. Čižmárik (2013) further adds that the corporate and individual taxation compliance costs are 73.4% with respect to the corporate and individual taxes that were collected. Based on the analysis of Paying taxes 2014/2015, Solilová and Nerudová (2016a) state that total taxation compliance costs of medium sized enterprises in the Czech Republic are 50.4% of profits, which correspond to 24th position out of 29<sup>6</sup> countries. Furthermore, with respect to the time that is needed for preparing, filing and paying the three major taxes,<sup>7</sup> those companies spend 51 working days (28th out of 29 countries). In case of the Slovak Republic, the total taxation compliance costs of medium sized enterprises are 51.2% of profits (25th out of 29 countries) and, with respect to the time that is needed for preparing, filing and paying the three major taxes, they spend 24 working days (18th out of 29 countries). Furthermore, labour taxes and contributions are increasing the compliance costs. In the Slovak Republic, it has reached 39.7% of profits plus 1% of profits for other taxes,<sup>8</sup> and in the Czech Republic, it has reached 38.4% of profits plus 2.5% of profits for other taxes. With respect to all countries for 2014/2015, the Czech Republic ranked 122, and the Slovak Republic ranked 73 among the 189 analysed countries.

However, if we look at the transfer pricing compliance costs issue as a fulfilment of the arm's length principle,<sup>9</sup> the compliance costs are extremely high. In accordance with the research performed by Solilova and Nerudova (2018), transfer pricing usually requires tax consultancy (i.e., primarily in the form of transfer pricing documentation and country-by-country reporting), which increases the compliance costs of taxation and thus the transfer pricing compliance costs. Particularly, these costs range from EUR 4,341 to EUR 7,704, and the time spent ranges from 18 to 35 working days/year in the case of the Czech Republic. In the case of the Slovak Republic, the costs range from EUR 2,121 to EUR 4,857 and the time ranges from 19 to 33 working days/year. The authors further highlight that when taking into account the assumed number of SMEs in the Czech and Slovak Republics and the overall corporate taxes that are collected in these countries, the compliance costs of transfer pricing represent between 26.8% and 98.9% of the corporate taxes that are collected in the Czech Republic and between 16.6% and 43.4% of the corporate taxes that are collected in the Slovak Republic according to the indicators that are used for the determination of the compliance costs (i.e., time or costs indicator).

<sup>6</sup> Analysis covers all EU Members plus Norway.

<sup>7</sup> Corporate Income Tax, VAT and Personal Income Tax.

<sup>8</sup> Property and property transfer taxes, dividend, capital gains and financial transactions taxes, waste collection, vehicle, road and other small taxes or fees.

<sup>9</sup> Under this principle, associated enterprises must set transfer pricing for any intra-group transaction as if they were unrelated entities and all other aspects of the relationship were unchanged.

Based on this research, it is possible to say that the arm's length principle is a resource-intensive process because it imposes a heavy administrative burden on taxpayers and tax administrations. These compliance costs may be disproportionate to the size of the firm, its functions, and the transfer pricing risks that are assumed in its controlled transactions. The TP Guidelines (OECD, 2010; 2017) state that the application of the transfer pricing rules may be more complex for SMEs in several places and therefore too burdensome.

Therefore, simpler tax compliance and transfer pricing are essential, especially for SMEs. Currently, there are available two approaches in the EU, namely, Safe harbours and CCCTB, which should be considered as tools for the improvement of the efficiency and effectiveness of corporate taxation and for the elimination of the size disadvantages of SMEs, mainly with respect to their compliance costs of taxation.

After the relaunching of the safe harbour<sup>10</sup> provision in the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (hereinafter, TP Guidelines), the application of *safe harbours for SMEs* is available and justified. The safe harbours' arm's length ranges are determined by the industry in which the enterprise operates and the size of the enterprise follows the fundamental principle of the arm's-length standard of comparability. Generally, the standard of comparability is based on the theory that the profit rates that are earned by enterprises operating under similar conditions in the same market and industrial sector are equalized in broadly similar product markets. Furthermore, the standard is also based on the general analogy resulting from the generality of a simplified approach. For taxpayers and tax administrators, the application of safe harbours'<sup>11</sup> arm's-length marginal ranges can reduce compliance costs and administration costs, increase certainty for taxpayers and improve the effectiveness of tax administration, mainly by decreasing the number of transfer pricing disputes, audits, and MAP cases for tax administrators. With respect to SMEs, they would not be required to perform time-consuming comparability analysis resulting in the determination of the arm's-length profit margin or mark-up. They could apply for publicly presented safe harbours, thus saving time, financial capital and human resources and reducing the compliance costs of taxation.

<sup>10</sup> Definition of Safe Harbours, see note 3 above.

<sup>11</sup> Safe harbours are also classified by the EU Joint Transfer Pricing Forum (2011a) (hereinafter EU JTPF) as a means of providing a simplified measure for SMEs that saves administrative resources and reduces compliance costs. Moreover, the EU JTPF (2011b) uses a safe harbour approach for the valuation of low value added services, particularly in the range of 3 – 10% and often around 5%. A similar approach is in the new TP Guidelines where the mark-up of 5% is applied in the case of low value added services (OECD, 2017). In addition, it is important to mention that the current UN Transfer Pricing Manual also contains a comprehensive and pragmatic discussion of safe harbour provisions.

With respect to the corporate tax system, as was mentioned above, there are 28 different tax systems in EU, thus resulting in high compliance costs of taxation. Therefore, there have been many attempts to coordinate or harmonize them in the EU. The first concept was the Neumark Report<sup>12</sup> in 1962, which is very similar to the Proposal for a Council Directive on a CCCTB (European Commission, 2011; 2016b; 2016c) that was introduced in 2011 and 2016. However, the last two proposals from 2016 introduced the C(C)CTB as a tool for fighting tax evasion and tax fraud. Initially, the Commission suggests implementing the C(C)CTB system in two steps, aware of the fact that the most discussed and controversial issue is the consolidation regime and mechanism for sharing the tax base. Therefore, only the common rules for the corporate tax base's (hereinafter CCTB) construction should be implemented as a first step and the full CCCTB should be implemented only in the second step. Under the *CCCTB system*, the profits of multinational groups in the EU will be consolidated for corporate tax purposes. Consequently, the profits of multinational groups will be allocated to the EU Member States in which the group is active using a formulary apportionment that replaces the current transfer pricing rules. Both of the proposals are mandatory for all multinational groups with consolidated revenues of at least EUR 750 million. Thus, the micro and SMEs are exempt from the obligatory application of the C(C)CTB system, but they can opt for this system since both proposals include motivations for entering the C(C)CTB system, namely, the enormous deduction for R&D and allowances for growth and investment. Since the most attractive part of the project, as represented by the consolidation scheme, is missing in the first step, the Commission is also suggesting the introduction of cross-border loss offsetting as a possible temporary solution.

Regarding the legal procedure of the proposals, in the European Parliament, both proposals were assigned to the ECON, which released its report on 21 February 2018. The report suggests amending the proposal of the C(C)CTB directive from 2016 by changing the threshold of the mandatory application of the directive from EUR 750 mil. to zero over a maximum period of seven years. Furthermore, it takes into account the digital change in the business environment as the digitalization of the world economy, e-commerce and new business models offer significant opportunities for businesses. As a result, the formula apportionment for the consolidated tax base comprises four equally weighted factors, i.e., sales, assets, payrolls and the new collection and use of the personal data of online platforms and service users (hereinafter, the 'data factor'). Lastly, taking

<sup>12</sup> Report „Tax Harmonization in the European Economic Community“ of the Fiscal and Financial Committee chaired by prof. Fritz Neumark that was established by the European Commission in 1960. Available at the following: <<http://www.steuerrrecht.jku.at/gwk/Dokumentation/Steuerpolitik/Gemeinschaftsdokumente/EN/Neumark.pdf>>.

into account the future international economic environment in the post-Brexit period, adopting both proposals in one step instead of the previously announced two-step approach is suggested. The European Parliament adopted its opinion in its plenary on 15 March 2018 and the proposal is now in the hands of the Council. If approved, the CCCTB would be enacted on January 1, 2020.

## **2. Data and Methodology**

Based on our research (Solilova and Nerudova, 2018) that was performed from 2015 to 2016 on European SMEs, we determined the compliance costs of transfer pricing issues to be between EUR 3,090 and 5,564 annually per entity for European SMEs, which represents 1.32% to 2.38% of overall corporate taxes that are collected for the 2015 tax year. Those compliance costs of transfer pricing issues cover only the management of the transfer pricing documentation, including the consideration of the most appropriate transfer pricing methods and their update. Other issues such as Advance Pricing Agreements, Country-by-Country Reporting and corresponding adjustments are not taken into account.

As a means of decreasing compliance costs, Safe harbours were determined by accounting for the industry and the firm size of the SMEs. The EBIT margin<sup>13</sup> and Mark-up on costs<sup>14</sup> were applied as profitability indicators. Both of them are not influenced by financial losses and are related to the operating activities of an enterprise. Therefore, they are considered to be the appropriate profitability indicators in the transfer pricing area. Generally, as Solilova and Nerudova (2016b) state, in the case of small entities, the proposed safe harbours range between 1 and 11%, and in the case of medium-sized entities they range between 1 and 13%, depending on the profitability indicator that is used (EBIT margin or Mark-up on costs) and the industry in which the SME operates. In addition, with respect to the second approach (i.e., CCCTB), under this system, the transfer pricing issues will be eliminated through the consolidation regime, resulting in decreased compliance costs, which are also due to the unified tax rule for the construction of the tax base in the EU.

To research the impacts of the introduction of safe harbours and the CCCTB on SMEs' performance and other economic variables (see Table 1), with the emphasis on the fulfilment of the long-term goals of the EU2020 agenda, such as smart and inclusive growth in the EU, the elasticities of the selected economic variables with respect to the operating profits or losses (EBIT) were determined and analysed.

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<sup>13</sup> Operating profits or losses/Sales or Operating revenue x 100, which is known as the EBIT margin.

<sup>14</sup> Operating profits or losses / total operating costs x 100, which is known as the Mark-up on costs.

Table 1

**Economic Variables that were used in the Analysis**

Variables	Variables
Fixed assets	Enterprise value
Intangible fixed assets	Number of employees
Tangible fixed assets	Operating rev. Turnover
Current assets	Added value
Stock	Working capital
Total assets	Capital

Source: Amadeus (2015) for 2014.

The elasticities were determined based on the analysis of the median value (see Table 2) of the selected variables of SMEs<sup>15</sup> (micro entities, small entities and medium-sized entities) across industries, which are classified using their NACE codes (NACE A up to NACE S) in the Czech Republic and Slovak Republic in 2014.

Table 2

**Economic Variables and their Median Value in EUR**

Country	Total for Industry					
	Czech Republic			Slovak Republic		
	Micro	Small	Medium	Micro	Small	Medium
Intangible fixed assets	3,180	928	269	3,580	496	111
Tangible fixed assets	68,641	469,323	1,698,654	36,260	269,893	1,770,594
Current assets	64,255	513,188	3,302,492	47,032	577,098	3,710,417
Stock	8,931	57,481	322,319	6,560	56,764	285,621
Total assets	143,006	1,316,303	6,321,429	86,882	1,275,034	7,218,695
Capital	7,214	16,811	724,323	6,553	52,955	262,023
Working capital	7,546	74,617	523,360	2,657	65,324	472,159
Enterprise value	11,402,251	n.a.	51,385,383	183,333	2,135,216	80,294,176
Number of employees	3	15	83	2	16	81
Operating turnover	133,395	1,028,827	5,997,930	99,194	1,136,649	7,493,052
Added value	62,742	351,463	1,940,466	51,783	369,650	2,324,082

Source: Amadeus (2015) for 2014; own processing.

Entities with no data for a particular variable were excluded from the dataset. To determine elasticity of each variable, a regression was applied, and both sides of the equation are in logarithms:

$$\ln(EBIT_i) = \beta_0 + \beta_i \ln(x_{n,i}) + \varepsilon \quad (1)$$

<sup>15</sup> SMEs were classified in accordance with the European Commission (2003) as follows. Medium-sized enterprises are defined as enterprises that employ fewer than 250 persons and have an annual turnover not exceeding EUR 50 million and/or an annual balance sheet total not exceeding EUR 43 million. Small enterprises are defined as enterprises having fewer than 50 employees and turnover or balance sheet totals of less than EUR 10 million. Microenterprises are firms with fewer than 10 employees and a balance sheet or turnover below EUR 2 million.

where  $\beta_0$  is a constant,  $x_n$  is a set of variables of interest (see Table 1) that are counted for every NACE code  $i$ ,  $\beta_i$  are the regression parameters, and  $\varepsilon$  is the error term. The term  $\beta_i$  can be directly considered as the elasticity of variable  $x_n$ .

Through the determined elasticities, it is possible to indicate how much the EBIT (in our case, it represents the business performance of an entity) and the other economic variables will increase/decrease if the compliance costs of transfer pricing/taxation decrease after the introduction of safe harbours and the CCCTB, respectively.

Furthermore, the first and the last centiles of the results were excluded to remove outliers that may affect the quality of the estimation. Altogether, 117,316 SMEs were analysed, including 61,613 from the Czech Republic and 55,703 from the Slovak Republic (see details Table 3).

**Table 3**  
**Number of SMEs**

	SMEs – Czech Republic	SMEs – Slovak Republic
Micro entities	40,450	45,001
Small entities	16,178	8,645
Medium-sized entities	4,985	2,057
Total	61,613	55,703

Source: Amadeus (2015) for 2014.

### 3. Results

Through the below mentioned results, we would like to answer the question of how decreased compliance costs of taxation through the application of the CCCTB system or Safe harbours are able to increase the business performance of SMEs and identify the most important economic variables that support this increase.

As is obvious from the Table 4, the elasticities of all researched variables for both countries are positive and range from 0.21 to 0.92. The highest impacts on the EBIT are changes in the current assets, total assets, enterprise value and added value for Czech SMEs and changes in the value added and number of employees for Slovak SMEs. The smallest impact on the EBIT is the change in intangible fixed assets for both countries since those assets are usually very low in SMEs. An interpretation of the results can be as follows. If the selected variable increases by approximately 1% as a result of decreased taxation or transfer pricing compliance costs, then the EBIT will increase by about X%. For example, if the current assets of a Czech SME increase by approximately 1%, then the EBIT of the Czech SME will increase by approximately 0.92%.

Table 4

**Elasticities of the Variables with Respect to the EBIT for SMEs in the Selected Countries**

Variables/Country	CZ	SK	Variables/Country	CZ	SK
Fixed assets 2014	0.44	0.36	Enterprise value 2014	0.87	0.39
Intangible fixed assets 2014	0.30	0.21	Number of employees 2014	0.69	0.81
Tangible fixed assets 2014	0.43	0.41	Operating rev. Turnover 2014	0.82	0.77
Current assets 2014	0.92	0.69	Added value 2014	0.87	0.86
Stock 2014	0.33	0.27	Working capital 2014	0.45	0.48
Total assets 2014	0.87	0.66	Capital 2014	0.44	0.46

Source: Amadeus (2015); own processing.

However, individual results vary between the Czech Republic and Slovak Republic across industries, as is presented in Tables 5 and 6. Generally, the elasticities of Czech SMEs range between  $-1.49$  and  $1.66$ , which is contrary to the Slovak SMEs that range between  $-3.98$  and  $1.74$ . Furthermore, the highest impact on the EBIT (values higher than 1) would be generated by the following industries in the case of Czech SMEs: A – *Agriculture*; C – *Manufacturing*; D – *Electricity, gas, steam and air conditioning supply*; G – *Wholesale and retail trade; repair of motor vehicles and motorcycles*; K – *Financial and insurance activities*; L – *Real estate activities*; M – *Professional, scientific and technical activities*; O – *Public administration and defence; compulsory social security*; and R – *Arts, entertainment and recreation* (see black highlighted values, Table 5). In case the Slovak SMEs, the highest impact on the EBIT (values higher than 1) would be generated only by the following industries: B – *Mining and quarrying*; D – *Electricity, gas, steam and air conditioning supply*; K – *Financial and insurance activities*; O – *Public administration and defence; compulsory social security*; and Q – *Human health and social work activities* (see black highlighted values, Table 6). Moreover, changes in the number of employees, operating revenues and value added would generate negative impacts on the EBIT in the case of the Czech SMEs operating in industry O – *Public administration and defence; compulsory social security* in comparison with the Slovak SMEs operating in industries<sup>16</sup> L, M, P and S with negative changes to their EBITs when the enterprise value and intangible fixed assets changed. In addition, it is obvious that an emphasis on increasing the value added of SMEs operating in both countries would generate one of the highest positive impacts on the EBIT.

Further, Figure 1 presents a visualization of the results for both countries across industries. It is seen that almost all variables for Czech SMEs have higher elasticities than the Slovak SMEs.

<sup>16</sup> For an explanation of the NACE code, see Table 5.

Table 5

## Elasticities of the Variables with Respect to the EBIT across Industries for the SMEs in the Czech Republic

NACE <sup>1</sup>	Fixed assets 2014	Intan. fixed assets 2014	Tan. fixed asset 2014	Current assets 2014	Stock 2014	Total assets 2014	Enterpr. value 2014	No. of employees 2014	Operating revenue 2014	Added value 2014	Working cap. 2014	Capital 2014
A	0.5873	0.0838	0.5888	<b>1.0178</b>	0.5652	0.9341	0.9341	0.9586	<b>1.0296</b>	<b>1.0768</b>	0.6268	0.4321
B	0.5074	0.0544	0.5357	0.8888	0.3774	0.7914	0.7914	0.9431	<b>1.0462</b>	0.9878	0.5449	0.4624
C	0.5629	0.3602	0.5633	0.9411	0.5146	0.9200	0.9200	<b>1.0410</b>	0.9756	<b>1.0319</b>	0.5637	0.4843
D	0.5144	0.3074	0.5058	0.5784	0.2026	0.9273	0.9273	0.7064	0.7348	<b>1.0505</b>	0.3226	0.1775
E	0.4594	0.3188	0.4878	0.8522	0.3453	0.8377	0.8377	0.7738	0.8410	0.8896	0.4821	0.3723
F	0.4322	0.3128	0.4339	0.8199	0.2780	0.8181	0.8181	0.8876	0.8524	0.9229	0.3548	0.4140
G	0.3968	0.3060	0.3887	0.8717	0.4794	0.8784	0.8784	0.9238	0.8235	<b>1.0270</b>	0.5400	0.5080
H	0.4234	0.2518	0.4269	0.8975	0.2394	0.9080	0.9080	0.8697	0.8862	0.9839	0.4304	0.3841
I	0.3398	0.3412	0.3322	0.8213	0.3856	0.7256	0.7256	0.8198	0.8783	0.8713	0.3890	0.3390
J	0.4229	0.1979	0.3934	0.9211	0.3112	0.9079	0.9079	0.9475	0.9306	0.9093	0.4513	0.4902
K	0.4075	0.4705	0.3663	0.8962	0.4265	0.8049	0.8049	<b>1.4223</b>	0.9618	0.9281	0.6245	0.5974
L	0.4022	0.2849	0.3993	0.8882	0.1332	0.7609	0.7609	0.6225	<b>1.0169</b>	<b>1.0266</b>	0.4373	0.5266
M	0.3452	0.2970	0.3381	0.8558	0.2267	0.8373	0.8373	<b>1.0360</b>	0.8888	0.9458	0.4067	0.4918
N	0.3535	0.2845	0.3310	0.8743	0.1801	0.8382	0.8382	0.3807	0.8045	0.8121	0.3795	0.4246
O	0.6850	0.6850	0.6850	<b>1.6690</b>	0.2977	<b>1.2791</b>	<b>1.2791</b>	<b>-1.4972</b>	<b>-0.8056</b>	<b>-0.8056</b>	0.5412	0.3555
P	0.3090	0.0739	0.2875	0.7472	0.2235	0.7447	0.7447	0.2609	0.7960	0.7808	0.2904	0.5459
Q	0.2812	0.1041	0.2781	0.9841	0.2562	0.8753	0.8753	0.8015	0.9518	0.9658	0.2625	0.3835
R	0.4425	0.4325	0.4133	0.8901	0.3745	0.7913	0.7913	0.7711	0.9227	<b>1.0929</b>	0.4808	0.4815
S	0.4221	0.5968	0.3975	0.9789	0.3958	0.9517	0.9517	0.4923	0.9662	0.9553	0.4836	0.4735

Note: A – Agriculture, forestry and fishing; B – Mining and quarrying; C – Manufacturing; D – Electricity, gas, steam and air conditioning supply; E – Water supply; sewerage, waste management and remediation activities; F – Construction; G – Wholesale and retail trade; repair of motor vehicles and motorcycles; H – Transporting and storage; I – Accommodation and food service activities; J – Information and communication; K – Financial and insurance activities; L – Real estate activities; M – Professional, scientific and technical activities; N – Administrative and support service activities; O – Public administration and defence; compulsory social security; P – Education; Q – Human health and social work activities; R – Arts, entertainment and recreation; and S – Other services activities.

Source: Amadeus (2015); own processing.

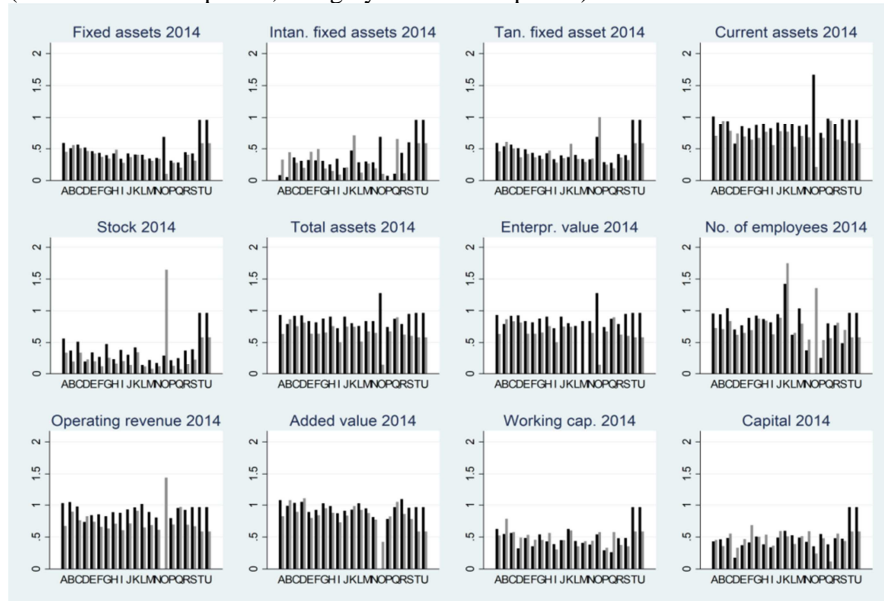
Table 6  
Elasticities of the Variables with Respect to the EBIT across Industries for the SMEs in the Slovak Republic

NACE <sup>1</sup>	Fixed assets 2014	Intan. fixed assets 2014	Tan. fixed asset 2014	Current assets 2014	Stock 2014	Total assets 2014	Enterpr. value 2014	No. of employees 2014	Operating revenue 2014	Added value 2014	Working cap. 2014	Capital 2014
A	0.4507	0.3285	0.4571	0.6993	0.3420	0.6383	0.6383	0.7291	0.6722	0.8240	0.5219	0.4522
B	0.5554	0.4421	0.6063	0.9461	0.2037	0.8677	0.8677	0.7130	0.8968	<b>1.0738</b>	0.7835	0.3577
C	0.5058	0.2766	0.5038	0.7814	0.3420	0.7587	0.8346	0.8369	0.7600	0.8949	0.5755	0.5537
D	0.4625	0.1987	0.3629	0.7363	0.2362	0.8159	0.8159	0.6230	0.8248	<b>1.1042</b>	0.4905	0.3315
E	0.4222	0.4502	0.4154	0.6893	0.2070	0.6398	0.6398	0.6541	0.7381	0.7964	0.5334	0.4680
F	0.3697	0.4935	0.3634	0.6414	0.1150	0.6403	0.6403	0.6967	0.6603	0.8409	0.4568	0.6857
G	0.3447	0.1889	0.3381	0.6690	0.2621	0.6612	0.6612	0.8774	0.6312	0.9496	0.4552	0.5035
H	0.4830	0.1498	0.4711	0.7633	0.1724	0.7594	0.7594	0.8446	0.7091	0.8785	0.5643	0.5351
I	0.2765	0.0938	0.2802	0.5553	0.2102	0.5066	0.5066	0.6310	0.6072	0.7290	0.3051	0.3642
J	0.3682	0.2034	0.3487	0.7748	0.1346	0.7533	0.7533	0.8902	0.7104	0.8356	0.4507	0.5941
K	0.4032	0.7062	0.5759	0.7670	0.3496	0.7491	0.7491	<b>1.7490</b>	0.9088	0.9836	0.6036	0.5094
L	0.3274	0.1217	0.3373	0.5281	0.1114	0.5188	<b>-0.1449</b>	0.6521	0.6507	0.9250	0.3551	0.3919
M	0.3068	0.2647	0.2901	0.6989	0.0767	0.6775	<b>-3.9833</b>	0.7993	0.6868	0.8751	0.4338	0.5145
N	0.3418	0.1931	0.3421	0.6777	0.1140	0.6546	0.6546	0.5464	0.6114	0.7722	0.4394	0.5905
O	0.1018	0.1018	<b>1.0089</b>	0.2101	<b>1.6462</b>	0.1374	0.1374	<b>1.3567</b>	<b>1.4414</b>	0.4245	0.5754	0.2412
P	0.2763	<b>-0.4152</b>	0.2491	0.6689	0.1211	0.6752	0.6752	0.5424	0.6965	0.8203	0.3327	0.4814
Q	0.2006	0.6497	0.1909	0.9504	0.0695	0.8970	0.8970	0.5721	0.9686	<b>1.0485</b>	0.5754	0.1161
R	0.4030	0.1108	0.3599	0.6420	0.1548	0.6258	0.6258	0.8123	0.6930	0.8604	0.3743	0.5545
S	0.3092	<b>-0.6341</b>	0.3196	0.6189	0.2347	0.6061	0.6061	0.6991	0.6697	0.7828	0.3536	0.4364

Note: See Table 5.

Source: Amadeus (2015); own processing.

**Figure 1**  
**Elasticities of the Variables with Respect to the EBIT across Industries<sup>17</sup> for SMEs**  
 (black – Czech Republic, and grey – Slovak Republic)



Source: Amadeus (2015), own processing.

**Figure 2**  
**Elasticities of the Variables with Respect to the EBIT across Industries for Micro Entities**  
 (black – Czech Republic, and grey – Slovak Republic)

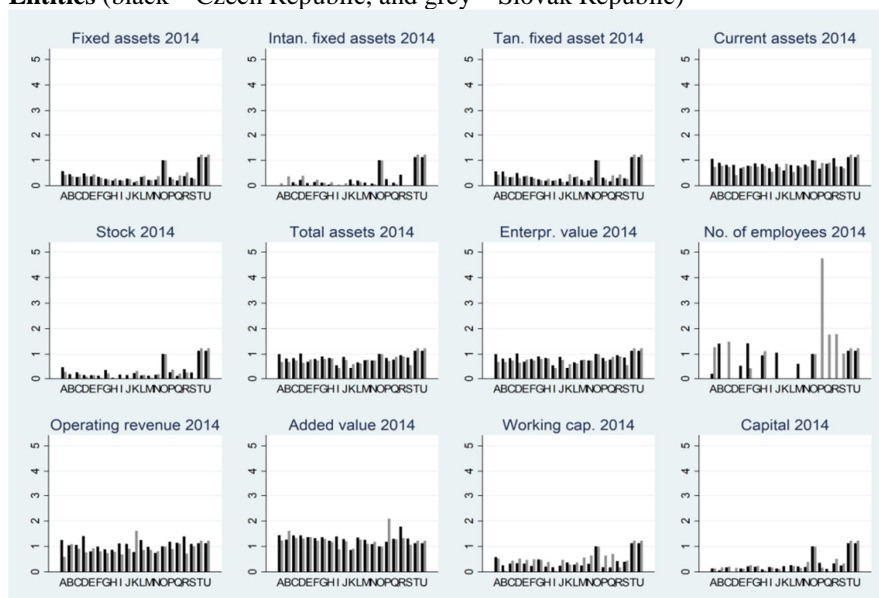


Source: Amadeus (2015), own processing.

<sup>17</sup> See explanation under Table 5.

Figure 3

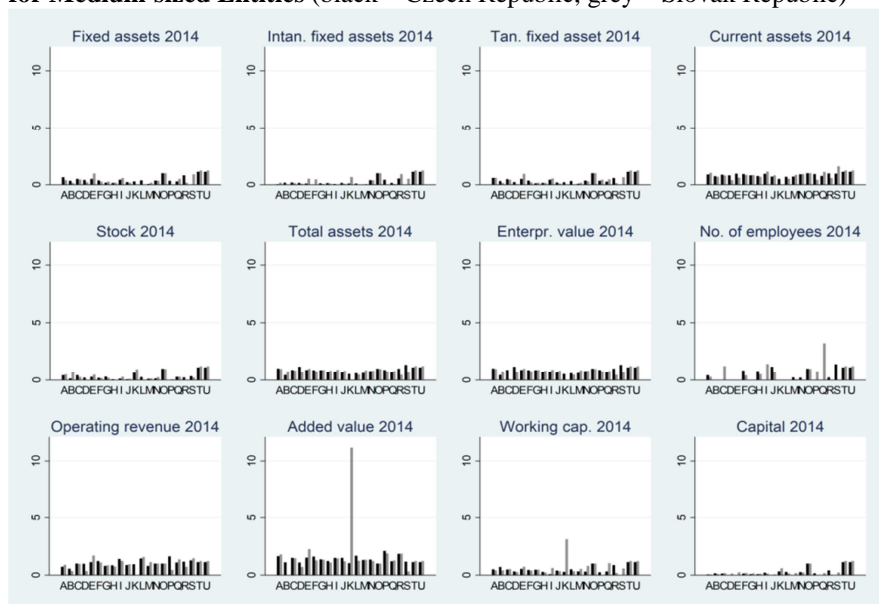
**Elasticities of the Variables with Respect to EBITs across Industries for Small Entities** (black – Czech Republic, and grey – Slovak Republic)



Source: Amadeus (2015), own processing.

Figure 4

**Elasticities of the Variables with Respect to the EBIT across Industries for Medium-sized Entities** (black – Czech Republic, grey – Slovak Republic)



Source: Amadeus (2015), own processing.

The other Figures, 2 – 4, present a visualization of the results of both countries across industries via a classification of the SMEs as micro entities, small entities and medium-sized entities, respectively. Generally, based on the results, is possible to say that the positive impacts of the changes of the variables on the EBIT slowly increases as the firm size increases. Moreover, as was mentioned above, the highest impacts on the EBIT would be generated by the changes in value added, enterprise values, current assets and operating revenues.

#### 4. Discussion

From an international perspective, more than 44% of SMEs (on average in the EU) are active in many forms of international activities, such as exporting, importing, foreign investment, international cooperation, or having international subcontractor relationships, within the EU (European Commission, 2010). The European Commission (2016a) adds that only 1.2 million SMEs are exporters while 1 million of them export within the EU. All those entities face compliance costs of taxation, which are significantly higher in the case of SMEs. Therefore, any suggestion that is able to improve the efficiency of the corporate taxation system and decrease compliance costs of taxation is desired, and the CCCTB and Safe harbours represent such a suggestion.

Both suggested tools are based on simplifications. The CCCTB system includes both a unified tax rule for the construction of tax base in the EU and one-stop-shop approach for tax governance. The safe harbour is a simplified approach that utilizes the arm's length range, and its clear and simplified application can decrease transfer pricing compliance costs in the post-BEPS period.

Our research proved that the business performance of SMEs would be increased under the CCCTB system or in case of the application of Safe harbours. The most important economic variables supporting the increase in business performance are current assets, value added, enterprise value and finally operating revenues. In both countries, the highest impact on the business performance would be the value added.

With respect to the value added, it should be highlighted that the CCCTB system is based on the establishment of fair taxation eliminating tax competition and profit shifting opportunities. The formula apportionment comprises four equally weighted factors (i.e., sales, assets, payrolls and the data factor<sup>18</sup>), which help to split the CCCTB between the individual EU Member States in which the entities of the group operate and where the main factors affecting the creation of

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<sup>18</sup> The data factor was suggested as a new allocation factor by the European Parliament through its report on February 2018.

value are based. Thus, an implementation of the CCCTB is able to support the business performance of entities and can be considered as a suitable approach for the internationalized SMEs. However, the explanatory power of the allocation formula's factors in the prediction of the corporate tax base provides a different view on this issue. Mintz (2008) sees that payrolls are the most easily measured allocation-formula factor that could have different impacts on the allocation of the CCCTB based payroll costs. I.e., countries with generally lower payroll costs could be disadvantaged against those countries with higher payroll costs, as Eberhartinger and Petutschnig (2014) state. Cobham and Loretz (2014) highlight that the allocation formula's factors, such as tangible assets and the number of employees, are beneficial for low-income countries, while sales and payroll represent the more beneficial factors for high-income countries. Roggeman et al. (2012) highlight that hard-valuated intangible property is a critical aspect in the knowledge-based economy resulting in the underestimation of the CCCTB for some entities and consequently some countries if the intangible property would not be added as a factor in the allocation formula. Globally, all three allocation formula factors (sales, payrolls and assets) together are able to explain almost 35% of the variability in profitability of Czech companies (Krchnivá and Nerudová, 2015) and almost 28% of the variability of the corporate tax profits of EU28 (Roggeman et al., 2012), which is in contrast to being able to explain almost 50% of the variability in the profitability of U.S. firms if the same allocation formula factors are used (Hines, 2008). This low explanatory power of the formula apportionment in the prediction of the tax base provides similar results as the research by Domonkos et al. (2013) on the impacts of the CCCTB implementation on the Slovak Republic. Based on the sample of the 11 biggest companies in the Slovak Republic, the authors concluded that the implementation of a CCCTB would lead to a 31.9% decrease in tax revenues for the Slovak Republic in 2009 and a decline of 14.6% in 2010. In case of the Czech Republic, detailed research was undertaken by Nerudová and Solilová (2015a; b), Solilová and Nerudová (2016a) and Nerudová and Solilová (2017a) who predicted that the Czech Republic would gain 3.39% higher corporate tax revenue compared to the current situation with the system's obligatory implementation. However, from the fiscal point of view, if the CCCTB features<sup>19</sup> would be attractive for SMEs and result in them entering the CCCTB system, then the total tax base of SMEs in the EU would decrease by between 46.0 – 58.6% compared to the current situation (i.e., SMEs would pay lower corporate income taxes), as shown by Nerudová and Solilová (2017b).

<sup>19</sup> I.e., a significant reduction in R and D, cross-border loss offsetting, fair tax competition, the elimination of tax obstacles to mergers and acquisitions mainly in the areas of capital profit taxation, and the elimination of transfer pricing issues

## Conclusion

The SMEs' tax preferences or SME-specific tax rules are often justified according to the important role of SMEs in the economy, particularly in terms of their contributions to employment, job creation and innovation. Moreover, with respect to the transfer pricing issue, SMEs performing transfer pricing analysis based on the same principles as LEs encounter disproportionately huge compliance cost of taxation mainly due to their lower human and financial capital.

The aim of the paper was to research the impacts of the application of a CCCTB system and Safe harbours on both the business performance and economic indicators of SMEs in case of decreased compliance costs of taxation with the emphasis on the fulfilment of the long-term goals of the EU2020 agenda, such as smart and inclusive growth in the EU.

Based on the results of our research, we can conclude that both the CCCTB system or Safe harbours can increase business performance (represented by the EBIT) of SMEs and that the most important economic variables that are able to support this increase are current assets, value added, enterprise value, and/or the number of employees since those variables reflect the highest positive impacts on the EBIT. In general, the positive impacts on the EBIT are reflected across industries and further increased as the size of the entity increased; i.e., the highest impact was for medium-sized entities compared to micro entities. In addition, lower elasticities, i.e., the impact on the EBIT, were generally shown in the case of Slovak SMEs in comparison with Czech SMEs. Generally, based on the results, we can conclude that safe harbours and the CCCTB system are able to support SME's performance with an emphasis on smart and inclusive growth in the EU.

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