

Tax Newsletter

Issue 28 – July-August 2012



Dear Sirs,

We present our holiday issue of Tax Newsletter for July-August.

We would like to draw your attention to the planned amendments to Personal Income Tax limiting the current tax credits (for children and Internet) and privileges regarding tax deductible costs. These changes are to be introduced next year.

We also discuss the resolution of seven judges on the controversial issue of tax treatment of non-depreciated initial value of investment in third party assets. This resolution may be of paramount importance, for instance in the case of earlier termination of lease agreement and reporting loss resulting from non-fully depreciated fixed assets. In line with the resolution this loss will be tax deductible.

In addition, we also present interesting tax interpretations and the discussion of major changes in the Double Taxation Avoidance Treaty between Poland and Norway.

Yours sincerely,

Krystyna Szydłowska

SUMMARY

- 1. PIT: Proposed changes in the area of Personal Income Tax**
- 2. CIT: Non-depreciated investment in third-party asset is a tax deductible expense**
- 3. CIT: General interpretation – how to understand the condition of levying Income tax on total income regardless of the place of its generation**
- 4. Transfer pricing: obligation of preparing transfer pricing documentation for transactions comprising several services and re invoicing**
- 5. SEZ: Possibility to classify expenses borne outside the Special Economic Zone as eligible costs**



1 PIT: Proposed changes in the area of Personal Income Tax

On 27 July 2012 a bill amending the Act on Personal Income Tax was examined by parliament and forwarded for further proceeding. It is planned that the amendments will come into effect on 1 January 2013. The proposed amendments include several changes, among others, in the following areas:

a) Child tax credit

The amount of deduction for the first and next child is currently PLN 1,112.04. Following the proposed amendment the tax credit for the third child should be 50% higher. This means that parents having a third child would be entitled to deduct the amount of PLN 1,668.06. The tax credit for the fourth and every next child would be increased by 100% (i.e. the amount of tax credit would equal PLN 2,224.08).

Another amendment would be to make the tax credit depend on the level of income. At present, everyone – regardless of income – is entitled to benefit from tax credit for a child once the required criteria are met. The Minister of Finance proposes that the tax credit is not applicable to:

- Taxpayers being married for the entire tax year and having just one child if total income of the spouses exceed PLN 112,000,
- Non-married taxpayers being single parents in line with the Act on Personal Income Tax having just one child eligible for deduction, if the income of the taxpayer exceeds PLN 112,000,
- Non-married taxpayers having in the tax year just one child eligible for deduction, if

the taxpayer's income exceeds PLN 56,000.

For families bringing up two children regardless of their income – tax credit will remain unchanged.

b) Liquidation of tax credit for Internet

According to the reasons given by the Minister of Finance the aim of introducing the tax credit for Internet (in the amount of PLN 760) in 2005 was the increase of prices of services caused by the increase of VAT rate from 7% to 22%. Currently, according to the Minister of Finance, a strong competition among electronic media providers resulted in a significant decrease of Internet services' prices and hence the increase of Internet users. Therefore, in the Minister's opinion the liquidation of tax credit is justified because it does not affect the number of people using Internet.

c) Restriction on the deduction of 50% of tax deductible costs of the copyright agreements

In line with the planned amendments the restriction on the application of 50% tax deductible costs is expected with regard to:

- Transfer of property right to an invention, topography of integrated circuit, utility model, industrial design and ornamental design, trademark, and royalties concerning the rights obtained in the first year of licence term from the first entity with whom the licence agreement was concluded, and
- Copyrights and related rights obtained by performers.



The deduction of 50% of tax deductible costs will be limited by a cap amounting to the half of the amount representing the upper limit of the first range of tax brackets – i.e. PLN 42,764 per year.

2 CIT: Non-depreciated investment in third-party asset is a tax deductible expense

On 25 June 2012 a Resolution (ref. II FPS 2/12) was adopted by the Supreme Administrative Court in which a panel of 7 judges explained that “a loss corresponding to a non-depreciated initial value of the investment in third-party asset not meeting the criteria of article 16 section 1 item 6 of the CIT Act can be classified as tax deductible expense if it arises because of taxpayer’s actions undertaken in order to achieve the purpose defined in article 15 section 1 of the aforementioned act”.

In the resolution the Court discussed thoroughly the terms “loss” and “liquidation” used in the regulation in order to give its proper interpretation. The Supreme Administrative Court firmly supported the position expressed recently in the judicial decisions according to which “In other words, if a loss arose following the liquidation of a non-fully depreciated asset which lost its economic utility for other reasons than the change of business activity type, this loss is a tax deductible expense.” In reference to the term “liquidation” the Court indicated that “If the liquidation of a non-fully depreciated asset results from the loss of its economic utility within the same type of business activity, the reported loss will always be a tax deductible expense. Obviously a question arises as to when the fixed

asset loses its economic utility. This aspect of the prerequisites laid down in the regulation should be viewed from the perspective of objective economic criteria allowing us to assume that despite consequences in the form of loss, the taxpayer’s action has its economic justification and is linked to the income. For instance, the early termination of lease agreement and conclusion of a new one on different conditions may give rise to higher profits. Similarly, the deliberate conclusion of lease agreement for a period shorter than the depreciation period can be considered to be economically justified if the taxpayer demonstrates that his action is economically justified and is linked to income.”

In line with the above, a loss corresponding to non-depreciated initial value of the investment in third-party asset not related to the change of business activity of the taxpayer can be deemed to be a tax deductible expense on the condition that ceasing to use this fixed asset by the taxpayer was aimed at retaining or securing a source of income.

3 CIT: General interpretation – how to understand the condition of levying income tax on total income regardless of the place of its generation

On 3 July 2012 the Minister of Finance gave a general interpretation no. DD5/033/4/12/RDX/DD-363, according to which “the condition of being subject to CIT on the total income regardless of the place where the income was generated should be understood as the condition of having a so-called tax residence which is not directly connected neither with the question of actually bearing the tax burden by the taxpayer nor granting tax



credits and exemptions by the country of residence.”

The Minister of Finance explained that the condition of taxation on total income should not be synonymous with the fact of bearing the tax burden. The position of the Minister of Finance confirms the common practice according to which the fact of being subject to taxation on the total income is documented by the tax residence certificate.

4 Transfer pricing: obligation of preparing transfer pricing documentation for transactions comprising several services and re invoicing

Documentation limits regarding the total value of services of homogenous nature

The Supreme Administrative Court in its judgment of 10 May 2012 (ref. II FSK 1893/10) dismissed a cassation complaint against the judgement of the Voivodship Administrative Court in Warsaw of 17 May 2010 (ref. IIISAWa 2132/09) resolving the taxpayer's doubts about the application of quantitative limits for transactions for the purpose of preparation of transfer pricing documentation specified in article 9a of the Act on Corporate Income Tax¹.

The Supreme Administrative Court confirmed thereby that the limits mentioned above cannot be applied separately to the fee paid for each service of similar nature provided by the same related entity.

The case subject to discussed judgments concerned the taxpayer's doubts related to the

cooperation agreement concluded with a shareholder in the area of inter alia: administration support, HR support, financial advisory and marketing services. The agreement also comprised accounting support, IT system management and additional marketing and telecommunication services purchased by the shareholder from third parties for related entities.

The fees for each of these actually provided services were fixed separately based on the calculation mechanism taking into account parameters / indicators specific for each service (e.g. the number of employees in the case of HR services). In turn, re invoicing of costs of purchase of external services was based on actual costs of services for a given company without adding margin.

In taxpayer's opinion, due to the fact that each of services provided under cooperation agreement constituted a separate service for which a separate price was fixed, the limit of EUR 30 thousand giving rise to an obligation of preparing transfer pricing documentation should have been applied to each service separately. In turn, in the opinion of tax authorities which was shared by the both courts, in accordance with article 9a of the CIT Act the obligation of preparing tax documentation concerns transactions, the total value (or its equivalent) of which under the agreement, or the total amount of due benefits paid during the tax year exceeds the predefined limits. The above meaning that the prerequisite for documentation obligation is the value of a transaction or a group of transactions carried out with a related entity upon exceeding the specified limits during the tax year (in this case EUR 30 thousand). If the level of prices under the agreement depends on future factors (included in the calculation mechanism) unknown at the moment of agreement conclusion, an important

¹Act on Corporate Income Tax of 15 February 1992 (Journal of Laws of 2011; No. 74; item 397 consolidated act with subsequent amendments)



aspect is the total amount of due benefits actually paid to a given contractor during the tax year.

The above understanding of regulations is backed by the interpretation of intent because separate treatment of each service of similar nature i.e. services supporting the activity of related entities in specific areas could lead to evasion of documentation obligation regulations regarding transactions with related parties by allocation of minor services and determination of separate fee for each of them.

The final resolution of the Supreme Administrative Court confirms that the documentation obligation applies to a service actually consisting of one or more transactions; therefore, homogenous services taken in their totality, provided by the same related provider, should be used for determining the limit.

Reinvoicing of services is subject to documentation

The Supreme Administrative Court confirmed the position of tax authorities and courts on reinvoicing of services purchased from third parties indicating that the reinvoicing is in fact a resale of services purchased previously at the same price (i.e. at the costs of their initial purchase), which can be considered to be tantamount to the provision of the services purchased beforehand. Therefore, related parties conclude a transaction, parties to which are obliged to prepare tax documentation (if total amounts of the transaction exceed the predefined value limits). The Act does not make the documentation obligation vary depending on whether the price fixed between the parties is the same or different than the one applied in settlements with an external party.

5 SEZ: Possibility to classify expenses borne outside the Special Economic Zone as eligible costs

In its judgment of 13 June 2012 (ref. II FSK 2352/10) the Supreme Administrative Court stated that the regulations of the Council of Ministers (on specific Special Economic Zones hereinafter: "SEZ") applicable until 24 February 2007 allowed to include the expenses borne outside SEZ in the calculation of public aid limit, if they were related to the zone activity and arose during the term of permission for conducting activity in SEZ

The case concerned a company carrying out business activity within the Katowice SEZ which was granted the permission for conducting business activity in 2006. During the period when the investment was realized it appeared that, for technical reasons independent of the Company, the construction of part of its structures outside the SEZ area is necessary.

In the rationale of the judgment, the Supreme Administrative Court underlined that in the legal framework applicable until 24 February 2007 (i.e. before the change of regulations of the Council of Ministers on specific SEZ) the eligibility of expenses for regional aid consisting in the exemption from CIT pursuant to the article 17 section 1 item 34 of the CIT Act in conjunction with article 16 section 1 of the Act on special economic zones depended not on the place where the expenses were incurred but on their link with zone activity. It was only following the amendments to the regulations of the Council of Ministers (on specific SEZ) that a provision was



introduced stipulating that expenses borne within the area of SEZ are eligible for regional aid.

International tax law: Amendment to the Polish-Norwegian Treaty on Avoidance of Double Taxation

A protocol amending the Polish-Norwegian Convention for the Avoidance of Double Taxation of 2009 was signed in July this year. Major changes introduced by the protocol include the provisions relating to the method of taxation of remuneration for work aboard sea vessels operated in the international freight in consequence of which the sea men working on the sea vessels used for international freight will pay tax on their income in the place where the company operating the vessel is based.

Moreover, a provision modifying the rule of deduction of tax paid by the Poles working in Norway was added, further to which the deduction of hypothetical tax to be paid in Norway will apply to income declared in Poland in case where the income is exempted from tax in Norway.

How to order Tax Newsletter?

Tax Newsletter is a free-of-charge monthly newsletter concerning tax issues.

In order to subscribe, please send an e-mail to: podatki@mazars.pl with the following data:

First name and surname
Position
Name of the company

*If you do not want to receive the newsletter in the future, please send an e-mail with "NO" in the subject heading at:
podatki@mazars.pl*

Contact:



Krystyna Szydłowska
Head of the Tax Advisory Department
k.szydłowska@mazars.pl

Tax Advisory Department
Mazars in Warsaw
Ul. Piękna 18
00-549 Warszawa
Phone no.: +48 22 25 55 200
E-mail: podatki@mazars.pl
www.mazars.pl

Mazars is a partner company of the Instytut Rachunkowości i Podatków



The aim of this Tax Newsletter is to inform the readers about the current changes related to taxes. The presented information has been prepared with due diligence, but it is presented in an abridged and general form. This publication is therefore solely informative and is no legal or tax advice. Mazars Audyt Sp. z o.o. is not responsible for the use of the presented information. Before taking any decision or steps, we suggest that you ask the consultants of Mazars Audyt Sp. z o.o. for expert advice.