

Tax Newsletter



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Dear Sirs,

Please get yourself acquainted with the next issue of our Tax Alert bulletin, in which we present major changes in tax regulations and selected examples of decision of administrative courts issued in the recent time. We would like to draw your attention in particular to amendments to OECD Guidelines, which may result in a change in the approach to valuating transactions concluded between related entities and vetting procedure applied by supervision authorities.

In this issue we also continue the discussion on the latest amendments to the Polish Fiscal Audit Act concerning expansion of the authorities' right to obtain information.

We hope you will enjoy it!

Krystyna Szydłowska

EDITORIAL

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Amendments to the Fiscal Audit Act - continuation of elaboration from July 2010 issue

On 30 July 2010 the amendments to the Fiscal Audit Act (Polish Journal of Laws Dz.U. of 2010, no. 127, item 858) came into force. The amendments extend i.a. the group of entities obliged to provide data upon request of the fiscal audit authorities. The scope of the information to be delivered has been expanded as well.

When vetting a taxpayer's settlements with the tax office, fiscal audit authorities have the right to apply to private entities (legal persons, organizational units having no legal personality, natural persons pursuing business activity), e.g. the taxpayer's contracting parties, to submit information (including personal data) concerning events that had a direct influence on the arising or amount of the taxpayer's tax liability.

Announcements and advertisements appearing in the press, on television and on the radio may also serve as sources of information on the taxpayer. Publishers and editors of journals, broadcasters of radio and television programmes as well as providers of services by electronic means have been charged with the obligation to provide information on entrepreneurs' companies and addresses as well as first names, surnames and addresses of natural persons placing advertisements or commercials indicating that they conduct business activity.

Moreover—apart from banks—entities running brokerage houses, savings and credit unions, investment fund companies, insurance fund companies and pension funds are obliged to provide identification data of account holders, if in the opinion of the fiscal audit authority a given account holder uses the account to conduct business activity not registered for taxation or if the holder's account is credited with funds not covered by the sources of income disclosed by the taxpayer or stemming from undisclosed sources. Apart from information on bank accounts, financial institutions will be obliged to provide information on the scope of powers of attorney submitted with the said institutions authorising to dispose of the bank accounts as well as on the turnover on these accounts along with titles of and parties to individual bank transfers. The scope of information concerning loan and credit agreements concluded by the taxpayer that fiscal audit authorities are entitled to request has also been extended. As from 30 July of the current year, upon a written request of fiscal audit authorities banks and other financial institutions will have to provide information on financial obligations arising from such credits or loans, purposes for which they have been granted, collaterals securing their repayment, as well as data on deposit agreements and safe deposit box agreements.

Fiscal audit authorities will have the right to process the acquired information without the consent and knowledge of the entity to which it pertains.

The information requested by fiscal audit inspectors will be granted on the basis of a decision of the head of the fiscal audit office. The entity obliged to provide information will have the right to appeal against the decision to the general inspector of fiscal audit.

Apart from modifications extending the authorization of fiscal audit authorities as regards access to data and the right to demand information, the amendments in question also introduce changes concerning tax audit proceedings and the scope in which authorities are entitled to use means of coercion.

VAT Refund from abroad – extended deadlines for submitting applications

The European Commission has postponed the deadline for submitting applications for refund of VAT paid by entrepreneurs in other EU members states in 2009 from September 2010 until March 2011.

As from 1 January 2010 a new procedure concerning VAT refund to taxpayers on account of expenses incurred within the framework of business activity conducted in an UE member state in which they have no seat and in which they are not registered for VAT purposes was introduced. According to the new procedure, a taxpayer willing to obtain VAT refund must submit an electronic tax refund application in the member state in which it has its seat via the Internet portal established by that state. Subsequently, the application is forwarded to the tax administration authorities of the relevant UE member state.

Delays in the implementation of the new procedure by some EU member states have considerably shortened the time limit for submitting applications (some portals were activated as late as in May 2010). For this reason the European Commission has decided to extend the deadline for submitting applications until March 2011. For Polish entrepreneurs this means that they will be able to submit VAT refund applications via the Internet portal until 31 March 2011, and not until 30 September 2010 as originally planned.

Please note, however, that the indicated time limit is the deadline for submitting VAT refund applications and not for the actual VAT refund, which is 4 months as from the submission date of the application along with all necessary documents or—in the case of applications requiring additional documents or information to be delivered—even 8 months as from receipt of the application.

Transfer Prices: Amendments to OECD Guidelines

Recommendations of OECD formulated in the form of OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration constitute a material part of regulations on transfer prices.

Recently introduced amendments to the Guidelines are certainly worth elaborating upon. It was the first such an extensive modification as from their adoption in 1995. The amendments were adopted on 22 July of the current year and are an effect of many years' work and multilateral consultations, among others with the business milieu.

Most of the changes apply to Chapter I, II and III of the Guidelines concerning the market price principle, transaction comparability analysis and application of transaction profit methods. Additionally, new Chapter IX was introduced, which regulates some aspects of enterprise restructuring from the point of view of transfer prices and contains among others recommendations as to transfer of functions, risks, assets and profit potential within the framework of a group of related entities.

Traditional methods put on a par with transaction profit methods

Most important are restrictions concerning the hierarchy of transaction valuation methods implemented by way of introducing a rule governing selection of the “most appropriate” method in each case. This rule allows to select the appropriate method without the necessity to check the possibility of applying each of the available methods, and to decide mainly on the basis of access to comparable data and its reliability, with the reservation that the comparable uncontrolled price method still remains the preferred one.

Apart from increasing the importance of the transaction net margin method, the amended Guidelines emphasize the importance of selecting the appropriate profitability ratio, providing detailed hints as to the most frequently used indices.

Transaction Comparability Standards

As far as the introduced amendments are concerned, it is also worth to mention practical recommendations contained in the 9-step comparative analysis process, which may turn out to be immensely helpful in preparing a transparent and reliable analysis and valuation of transactions concluded between related entities (in particular from the point of view of presentation to tax authorities).

Further actions to be taken by OECD with regard to transfer prices are supposed to pertain first of all to regulating issues concerning immaterial assets, whose definition and valuation principles are still problematic.

Real estate tax - new rates of local taxes in 2011

In connection with the announcement of the President of the Central Statistical Office (GUS) of 13 June 2010 informing that in the first half of 2010 the consumer price index increased by 2.6% as compared with the first half of 2009 the Minister of Finance has announced upper thresholds of local taxes and fees for the year 2011.

The table below presents examples of maximum rates:

	2010	2011
Real estate tax on land related to conducting business activity	PLN 0.77	PLN 0.80
Real estate tax on buildings related to conducting business activity	PLN 20.51	PLN 21.05
Tax on means of transport related to trucks with admissible total weight of between 3.5 and 5.5 tones	PLN 729.28	PLN 748.25

CIT - Tax qualification of entertainment expenses

Pursuant to the provisions of the Corporate Income Tax Act, entertainment expenses do not constitute tax costs, whereas advertising expenses are recognized as tax deductible costs. Due to the fact that both these terms are not defined, taxpayers frequently find it difficult to establish whether a given expense should be charged to advertising or entertainment expenses.

In this context please note the decision of the Supreme Court of Administration of 2 February 2010, in which the court established that costs of purchasing small gifts bearing names or logos of brands sold by the taxpayer (licensed brands) qualify as entertainment—and not advertising—expenses, as their purpose is to increase the prestige of the seller. The Supreme Court of Administration maintained that “things that promote the logo of a given company are considered advertisement, whereas things that are to build a good image of one’s own company thanks to the use of logos of other companies qualify as entertainment”. Thus, expenses related to purchasing this kind of gifts are not recognized as tax deductible costs.

On the other hand, in its decision of 16 March 2010 the Voivodship Administrative Court in Bydgoszcz expressed its stance concerning lunches with contracting parties outside the company's premises that was very favourable for the taxpayers. Tax authorities presented an opinion pursuant to which costs of refreshments prepared for a contracting party at the company's premises qualify as tax deductible costs, whereas costs of customary food and drinks at a restaurant are to be recognized as entertainment costs, and thus are not treated as tax deductible costs. The court dissented from the opinion of tax authorities claiming that it makes the decision as to whether a given expense classifies as related to conducting business activity or not contingent upon the place of the event, and not its purpose. The court underlined that "for given expenses to be qualified as entertainment costs they must go beyond established norms or customs, be evidently posh and sumptuous, and be incurred solely for the purpose of creating the company's image". At the same time the court maintained that not all expenses related to catering or purchase of food and drinks constitute entertainment.

Alternatively, in its decision of 14 May 2010 on expenses related to integration and training events with participation of employees and contracting parties the Voivodship Court of Administration in Warsaw concurred with the opinion of the Tax Chamber that the taxpayer may charge expenses related to organization of integration events and trainings for its employees towards tax deductible costs, whereas amounts paid in connection with events intended for customers and contracting parties do not qualify as such. In the opinion of the Court the taxpayer may not charge the entire amount towards tax deductible costs only due to the fact that it is not able to distinguish expenses related to events for employees and those related to events for contracting parties. The Court emphasised that the burden of proof that certain expenses may be recognized as costs lies with the taxpayer.

CIT - Moment at which an initial fee provided for in a lease agreement is charged towards costs

Amendments to the Corporate Income Tax Act that came to force as of 1 January 2007 clearly divided tax deductible costs into costs directly and indirectly related to income.

Pursuant to Article 15 sec. 4d of the Corporate Income Tax Act, tax deductible costs other than costs directly related to income (the so-called indirect costs) are deducted on the day on which they are incurred. However, when such costs pertain to a period exceeding the given tax year and it is not possible to establish which part of such costs relates to the current tax year, they constitute tax deductible costs proportionally to the period to which they relate. In the light of the aforementioned provision there frequently arise disputes between taxpayers and tax authorities that question the right to charge the initial fee towards tax deductible costs upon its incurring.

Lease is among entrepreneurs a very popular way of financing economic activity. As far as operating lease is concerned, during the basic term of the agreement the user charges fees provided for in the agreement towards costs. The so-called initial fee is generally settled on a one-off basis upon conclusion of the lease agreement. Its payment is frequently a precondition for releasing the object of lease, which is necessary to initiate performance of the lease agreement. Therefore, the initial fee is not related to lease instalments, but is settled on a one-off basis in connection with the release of the object of lease to the user.

Judicature of administrative courts confirms that in the case of operating lease the initial fee constitutes an indirect cost related to conducting business activity and should be recognized as tax deductible cost for the purposes of calculating income tax on the day on which it was incurred (decision of 29 June 2010 of the Voivodship Court of Administration in Opole no. I/SA/Op110/10 and decision of 23 March 2010 of the Supreme Court of Administration no. II FSK1733/08). Tax authorities have a different view: they consequently order to settle initial lease fees proportionally to the term of the lease agreement. It may not be ruled out that recurring decisions of administrative courts allowing to charge the initial fee towards tax deductible costs in the date of its settlement will force tax authorities to change their stance.

Personal Income Tax - Minister of Finance does not agree to settlement of losses on account of participation in investment funds

In response to a parliamentary question the Ministry of Finance has upheld the stance represented by tax offices pursuant to which taxpayers have no right to reduce income on account of sale of shares by loss incurred in connection with participation in investment funds.

In the justification the Ministry quoted Article 30a sec. 5 of the Personal Income Tax Act according to which it is not admissible to reduce income on account of participation in capital funds by loss on this account as well as other losses on cash funds and property rights.

Tax authorities represent the view that due to the fact that income on account of participation in capital funds is subject to a flat-rate withholding tax collected by the withholding agent at the rate of 19%, it consequently may not be combined with other kinds of income from the same source, e.g. sale of shares.

This stance was undermined in the decision of the Voivodship Court of Administration in Warsaw (file ref. no. III SA/Wa1147/09), where it was established that there are no legal regulations prohibiting to deduct losses on account of participation in capital funds from income on account of sale of shares against payment. In the opinion of the court profit and loss on sale of shares stem from the same source of income, and pursuant to the Personal Income Tax Act it is admissible to settle losses against profit from the same source. The fact that the tax is collected by a withholding agent may not limit the taxpayers' rights. Taxpayers representing this stance risk a dispute with tax authorities which may be favourably resolved only before an administrative court.

Please be informed that this newsletter is of general character and cannot replace specific consulting in individual cases.

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